Knowledge Sharing Program

Korea KNOWLEDGE SHARING PROGRAM

Follow-up Issues in Accession and Implementation of the WTO System for Azerbaijan

May 2009

MINISTRY OF STRATEGY AND FINANCE

KDI Korea Development Institute

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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) of the Republic of Korea and the Korea Development Institute (KDI). The KSP is designed to contribute to the socio-economic development of the targeted development partnership country by sharing Korea's development experience and knowledge. The most distinguishing characteristic of the 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.

The first one-year Knowledge Sharing Program for Azerbaijan was successfully completed in 2008, and in response to the Azerbaijani Government's request for its continued participation in the program, the MOSF and the KDI have decided to extend it for another year in order to help the Azerbaijani Government take the initial step forward in implementing the policy recommendations from the first KSP project. Through an extensive survey of the Azerbaijani Government and agencies, the KDI and the Ministry of Economic Development of the Republic of Azerbaijan, the counterpart organization, decided to tackle the issues of post- Azerbaijan's WTO accession. These are: 1) Current Issues in Services and Negotiation Strategy, 2) Import Policy and Development of Tariff Mechanism in the WTO System, 3) Strategies in Agricultural Negotiation of Azerbaijan for WTO Accession, and 4) Analysis of Azerbaijan's Export

Structure and its Implications for Diversification Strategy. These subtopics focus on the issues of negotiation techniques and potential problems, with their possible solutions, arising from WTO accession by Azerbaijan.

I would like to take this opportunity to express my gratitude to the project manager Dr. Keukje Sung and the project consultants including Dr. Dukgeuk Ahn, Dr. Jeong-bin Im and Dr. Siwook Lee for all their work in successfully completing the KSP for Azerbaijan. My sincere thanks also goes to Mr. Mikayil Jabbaorv, Deputy Minister of Economic Development and all Azerbaijan 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 personals could benefit from the Korea's 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.

Oh-Seok Hyun
President
Korea Development Institute

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CURRENT ISSUES IN SERVICES AND NEGOTIATION STRATEGY

Chapter 01

CURRENT ISSUES IN SERVICES AND NEGOTIATION STRATEGY

Keukje Sung

1. Current Issues in Services

1.1. Jackson-Vanik Amendment

Background

In 1974, US reacted to severe restriction by the Soviet Union in 1972 on the emigration of the (Jewish) people, imposing 'diploma tax'. The Soviet Union contended that they have invested huge amount of resources for the education of highly educated immigrants, and they have imposed, in some cases, as high as $40,000 immigration tax. This was called 'diploma tax'. The reaction by the US was the denial of trade benefits, especially the MFN status, to the country which restricts free emigration. This reaction aimed at the USSR at the time, but later was expanded to all communist countries (non-market economies). This reaction was named after the proponents, Jackson and Vanik, and was an amendment to the 1974 Trade Act of the US.

Denial of benefits

According to the Amendment, a country which restricts free emigration would be denied

1) MFN tariff status
2) Access to US financial facilities (export credits, export credit guarantees, and investment guarantees)
3) Ability to conclude a trade agreement with the US

Criteria

The criteria whether a country denies free emigration are;

1) Denies its citizens the right or opportunity to emigrate
2) Imposes a more than nominal tax on emigration or on documents required for emigration; or
3) Imposes a more than nominal tax, fee, or any other charge on any citizen because of his/her desire to emigrate to the country of his/her choice

Restoration of benefits

Such denial benefits, however, can be restored in the following way. In each case, the restoration of benefits is in full; that is, all benefits resume in any of the three ways. The only difference is the frequency of determination and report of the status.

'Waiver' procedure

As an initial step, US president may 'waive' some of the criteria for an initial period of 18 months, and extend for additional 12 month periods, expiring on July 3 each year, if he determined;

- that such waiver will substantially promote the objectives of the Jackson-Vanik amendment, and
- has received assurances that the emigration practices of that country will henceforth lead substantially to the achievement of the objectives of the Jackson-Vanik amendment

This extension may be subject to Congressional disapproval by joint resolution.

'No violation' (or full compliance) procedure

Usually after several years of 'waiver' status, US president may determine 'no violation' by a country any time. However, this determination must be renewed semi-annually (June 30 and December 31). Initial and subsequent determination may be subject to Congressional disapproval at the year-end.

'Termination' by the Congress

If another several years of 'no violation' pass, then as part of the legislation by the Congress, the extension of PNTR (permanent normal trade relations) treatment may be granted.

Actual Implementation

In practice, MFN status is gradually extended following the track of denial, waiver, no violation and finally termination. There are still two countries which are denied MFN status, and even waivers are not given; they are Cuba and North Korea. Until 2008, waivers were given to 24 countries, and denial has been terminated by legislation for most of those 24 countries. However, two countries, Belarus and Turkmenistan are under the early stage of 'waiver', and 6 countries including Azerbaijan, Kazakhstan, Moldova, Russia, Tajikistan and Uzbekistan are under the stage of 'no violation'.

Relation to WTO Accession

US may deny MFN status to a country depending upon their policy objectives. However, such denial of MFN benefits to a WTO member would be a violation of the WTO agreements. Thus, if a country which was denied MFN status due to the Jackson-Vanik Amendment accedes to the WTO, then US can face a dilemma. In this respect, US has sought invocation of Article 13 of Marrakesh agreement in order to maintain Jackson-Vanik restriction. This is a rather awkward situation where a newly acceding member to the WTO is denied the MFN status by a major trading partner. In practice, US has withdrawn such invocation after a couple of years.

Table 1-1 | WTO Members and Jackson-Vanik Amendment

	Accession to WTO	Invocation	Withdrawal
Armenia	2003. 02.05	2002. 12.09	2005. 02.02
Georgia	2000. 06.14	1999. 09.30	2001. 01.08
Kyrgyzstan	1998. 12.20	1998. 10.09	2000. 09.18
Moldova	2001. 07.26	2001. 05.02	Not yet
Mongolia	1997. 01.29	1996. 07.11	1999. 07.07
Vietnam	2007. 01.11	2006. 11.03	2007. 01.07
Romania	1995. 01.01	1994. 12.30	1997. 02.20

(Table 1-1) lists WTO members but has been denied MFN status for a certain period by the Jackson-Vanik Amendment. The dates for Article 13 invocation and withdrawal are also included. As can be seen from the table, it took a year or two for the invocation to be withdrawn for most cases, however, it took about three years for Armenia and Romania. In the case of Moldova, the invocation is still effective from the year 2001.

There are also non-WTO member countries which are still subject to the restriction. Those countries are listed in (Table 1-2). As mentioned before, Belarus and Turkmenistan are still under the waiver status. 5 non-WTO members, including Azerbaijan and Russia, are under the waiver status.[1] Some countries were given ‘termination’ status, even before they acceded to the WTO. They include Albania, Bulgaria, Cambodia, Estonia, Latvia, Lithuania, and Ukraine. In the case of Azerbaijan, if it follows through similar paths as the other CIS countries, then US may invoke Article 13 for a short period of time, and then withdraw such invocation. However, depending upon the political relationship between the two countries, US may terminate such restriction before the entry of Azerbaijan to the WTO.

1) Moldova is under the stage of ‘no-violation’, but it is a member of the WTO.

Table 1-2 | Non-WTO Members and Jackson-Vanik Amendment

	Waiver	No violation	Termination
Azerbaijan	1992. 04.06	1997. 06.03	Not yet
Belarus	2001. 07.02	Not yet	Not yet
Kazakhstan	1992. 06.03	1997. 12.05	Not yet
Russia	1992. 04.16	1994. 09.21	Not yet
Tajikistan	1992. 06.24	1997. 12.05	Not yet
Turkmenistan	2003. 08.08	Not yet	Not yet
Uzbekistan	1992. 04.16	1997. 06.03	Not yet

1.2. Lessons from Telecommunication Dispute Settlement

Does 'interconnection' in Reference Paper only apply to domestic connection?

It is true that Annex in telecommunication was mainly for the value-added services, and Reference Paper for domestic competition safeguard. However, in the final agreement, there has not been any mention on such intent or history of negotiation. Thus, the panel ruled that the Annex also applies to basic service providers, and the Reference Paper applies to international interconnections.

Does the he Reference Paper not apply to accounting rates?

It is true that accounting rates[2] are agreed not to be subject to dispute settlement. However, "what is not to be subjected" is the different accounting rates, not the accounting rate itself. The following is quoted from the Report of the Group on Basic Telecommunications[3] on 15 February 1997;

In the light of the fact that the accounting rate system established under the International Telecommunications Regulations is the usual method of terminating international traffic and by its nature involves differential rates, and in order to avoid the submission of further such exemptions, it is the understanding of the Group that:

2) When an international call is made, telecommunication facilities in both countries are used. Thus, both carriers negotiate and charge certain rates for such usage. This usage charge is called accounting rate, and usually this charge is divided equally to the carriers, being called the settlement rates. Each carrier can charge different rates for the customers, and this rate is called collection charges. If a carrier charges lower collection rates, then usually there will be more outgoing calls, and this carrier usually ends up paying more as settlement rates. In 1995, it is said that US carriers have paid out USD 5 billion as settlement rates.

3) S/GBT/4, Report of the Group on Basic Telecommunications, WTO

- *the application of such accounting rates would not give rise to action by Members under dispute settlement under the WTO*
- *that this understanding will be reviewed not later than the commencement of the further Round of negotiations on Services Commitments due to begin not later than 1 January 2000.*

Does 'cost-oriented' take into consideration the general state of the industry?

Pricing should be based on the costs incurred in supplying the service. It does not have to be the same as cost. But, the general state of the industry, or the coverage and quality of the network are not taken into consideration in calculating the cost.

Is the list of anti-competitive behavior in the Reference Paper exhaustive?

Reference Paper: The anti-competitive practices referred to above shall include in particular:

(a) engaging in anti-competitive cross-subsidization;

(b) using information obtained from competitors with anti-competitive results; and

(c) not making available to other services suppliers on a timely basis technical information about essential facilities and commercially relevant information which are necessary for them to provide services.

In the US-Mexico case, the major supplier, TELMEX, has negotiated the accounting rates and the same rates have been applied to all carriers, and revenues for international incoming calls were distributed in accordance with the outgoing calls, not incoming calls. These are considered as price-fixing and market-sharing. These practices were ruled as anti-competitive.

Should a developing country be given differential treatment?

The following provision in the Telecommunication Annex stipulates preferential treatment to a developing country in telecommunications;

Annex 5(g) Notwithstanding the preceding paragraphs of this section, a developing country Member, consistent with its level of development, may place reasonable conditions on access to and the use of public telecommunications transport networks and services necessary to strengthen its domestic telecommunications infrastructure and service capacity and to increase its participation in international trade in telecommunications services. Such conditions shall be specified in the Member's Schedule.

However, as noted in the text, such consideration should be given during negotiation and the results of such negotiations should be inscribed in the schedule.

What has been offered by Mexico for mode (1)?

The following is what Mexico has inscribed in its schedule.

None, except the following: International traffic must be routed through the facilities of an enterprise that has a concession granted by the SCT.

Panel ruled that first, 'None, except...' has no meaning. Also, routing requirement does not have a MA restriction in Article 16. Thus, Mexico's offer has no contents.

Can business activities in accordance with the domestic laws be challenged as violations of the Reference Paper?

Yes, they can be considered as violations. Domestic laws should be amended.

As can be seen from the major issues in the US-Mexico case, the observance of the Telecommunication Annex and Reference Paper may not be straightforward as they look, for members with less regulatory experiences. In this regard, it is important that Azerbaijan accumulate experience in regulation and encourage regulators to gain necessary training in countries which have histories of regulation under the competitive situation. Also, the entries in the schedule should be drafted with great care. Unnecessary entries such as "none, except" or insertion of certain domestic regulations such as routing requirement carry no substantive meaning, and make the schedule less streamlined.

1.3. Entries in the Services Offer

The following are the comments on Azerbaijan's offer in Services (as of 13 March 2007). These comments do not represent views of any WTO members or interested parties, but simply comments based on the GATS and guidelines for scheduling. Azerbaijan's services offer is not a public document at the moment, but only a part of the services offer were cited for comments. This offer in services was submitted approximately two years ago, and Azerbaijan has submitted a revised offer since then.

1) Real Estate Purchase: unbound, with regard to purchase of land
   - Comma after unbound should be removed
   - If purchase is not bound, that means, you cannot commit any measures. This can be translated as to mean that any measures can be introduced. Then, 'the permission to acquire right to use land for no more than 99 years' is not necessary. The right to use land no more than 99 years may or may not be included. You might want to provide information to the other members, but this may be cited by the other members as a part of your commitment.

- If Azerbaijan wants to commit this ‘right of use’, then the entry should read ‘Real estate: unbound except foreigners may acquire right of use over land for no more than 99 years’.

2) If there are limitations which fall under Articles 16 and 17, then it should be entered only once under the Market Access column. But, the ‘right of use’ is listed under many sectors.

3) Definition of sectors with ‘*’
   - It is mentioned in several incidences that ‘*’ indicates that the specified service in the list of classification is the constituting part of more entire CPC paragraph specified in the other space’. This is rather obscure. The service can be either 1) part of the CPC or 2) covers the whole CPC. If the service covers more than one CPC, then it should be written as ‘XXX** + YYY**’
   - In other members’ offers, when ‘*’ is inscribed, this means that the service is ‘technically infeasible’ to be provided under certain modes. When ‘**’ is inscribed, it means that the service is ‘part of the CPC description.
   - If this is what Azerbaijan meant, then it should read ‘** indicates that the specified service constitutes only a part of the general aspects of the operations covered by the CPC (for instance voice mail (CPC 7523**) is only a constituting part of the CPC 7523 paragraph).’

4) Professional services for Mode (4)
   - ‘unbound, except for the indicated in the Horizontal section’ is usually inscribed by other WTO members as ‘unbound except as indicated in the horizontal section’.
   - This is a rather inappropriate practice in the GATS. In the GATS, all the entries should be written in a negative approach; that is, only limitations are to be inscribed. If there are no entries, then there are no limitations. But by inscribing as ‘unbound except’, members are inscribing only measures that are allowed, while all other measures are not allowed. This is a positive approach, which goes against the GATS.

5) Legal documentation and certification services, Mode (1)
   - It reads ‘None, except for the drafting’. All entries in the National Schedule are to follow negative approach; that is, only the limitations are to be included. If you write ‘none, except XXX’, this means that there is only the restriction XXX. In this case, you simply write ‘XXX’ without ‘none, except’. This was the case for Mexico during the US-Mexico telecommunication dispute. Mexico wrote ‘none except’, but the panel concluded that such ‘none except’ has no legal meaning at all.
   - Azerbaijan excluded the ‘drafting work’ from Mode (1), but not in Mode (3). Does this mean that drafting by foreigners are allowed in Mode (3)?

6) Auditing service, Mode (1)

- It reads 'none, except for the requirement on carrying out of the final audit by the audit company not registered in the Republic of Azerbaijan together with a local audit company. A foreign audit company must be entitled to render audit services in home country.' Strictly speaking, this entry is a little contradictory, since it said 'none' at first, and after the sentence, another limitation was also introduced
- It seems that what Azerbaijan wanted was 'A foreign audit company which is entitled to render audit services in the home country can provide final audit service only together with a local audit company.'

7) Auditing service, Mode (3)

- The entry should not start with 'none'.
- Can foreign auditors become 100% owners, by hiring just one Azerbaijan auditor?

8) Architectural services and Urban planning and landscape architectural services, Modes (3) and (4)

- The entry should not start with 'none' as stated above.
- Does Horizontal limitation on Mode (4) not apply to these two services?
- Here is a rather important question for all professional services. Azerbaijan mentioned on the certificates of architectures, but not of other services, including legal services, accounting and bookkeeping, taxation, engineering and medical and veterinary services. Do you need certificates or licenses to provide these services? Then why not inscribe all those certificating requirements, not only for the architectural service? Do you have nationality requirement only for the architectural services?
- The entry can read 'Foreigners, stateless persons and foreign legal entities must provide architectural services jointly with a citizen or legal entity of the Republic of Azerbaijan having special permission for carrying out architectural services. Only citizens of the Azerbaijan Republic are eligible for architectural licenses.'

9) Technical testing and analysis, Mode (1)

- Do you have an internal definition of 'International Accreditation institutions'?

10) Services incidental to manufacturing, Mode (3)

- 'None, except' is not necessary.
- You may consider the exclusion of these activities from the sub-sector description, rather than inscribing as limitations in the Market Access column.

11) Telecommunications

- More detailed comments would follow in the next section. However, entries by other WTO members show diverse limitations such as; interconnection to Intelsat or Inmarsat is reserved to XXX, foreign governments cannot own shares of facility based service providers, radio licenses are not given to foreigners, discretion (may be exercised) during licensing procedure, etc. Doesn't Azerbaijan have these limitations?

- In Modes (1) and (3), when you wrote 'unbound', then you do not need to list any limitations, because nothing is being committed. If you inscribe "none, Aztelecom Industrial association has exclusive rights...', then in a sense you are binding yourself for the measures listed thereafter. When you 'unbound', you are not binding anything. Then why do you bind yourself again?
- As a technical matter, if the entries in the MA and NT are the same for consecutive subsectors, you would better inscribe those subsectors together, instead of repeating all entries for each subsector.

12) Audiovisual services, Modes (1) and (3)

- 'None, a contract with a local legal entity must be signed' should read 'A contract with a local entity must be signed'.
- Moreover, the first entry, and the next entry 'Parties signing a contract determines the terms and conditions of contract' does not have any legal meaning, because service suppliers, of course, sign contracts and determine terms and conditions. Also, these are not limitations under Article 16.

13) Construction and related engineering services, Mode (3)

- 'None' should be eliminated in 'None. The number of foreign engineers...', as it has no meaning.

14) Education services, Mode (3)

- What is the meaning of 'except for natural persons and associations'? Do you mean that natural persons and associations cannot provide education services in Mode 3? Then it should read 'Natural persons and associations are not allowed.' Of course, once again, without 'none'.

15) Financial services, Mode (3)

- The entry in the NT column is a duplication of 'horizontal limitations' in the heading.
- This is the same for (a) life insurance, and (b) non-life insurance. But, in (c) reinsurance and retrocession, only horizontal limitations were mentioned, while in (d) insurance broking and agency and (e) services auxiliary to insurance, there is no mention on the horizontal limitations. Don't you have limitations on the directors in (d) and (e)? As they are written now, limitations on the directors (in the heading) are to be applied to all financial services including insurance services, but the entries in the NT column are very different. Indeed, even if you inscribe 'none', all limitations on the directors would still apply.

16) Life insurance, and non-life insurance, Mode (4)

- 'Only permanent residents of the Republic of Azerbaijan are entitled to be insurance agents'. What can an insurance agent do? Can life and non-life insurance services be provided only by insurance agents? As an individual or hired by an insurance company? Can insurance service be provided by a natural person or only by a legal entity? Is the establishment of legal entity only be made insurance agents?

17) Non-life insurance, Modes (2) and (3)

- If you are going to exclude these services, it is better to exclude these services from the sectors, not from the MA column.
- In the MA column, you did not inscribe the limitation on directors, while you did for the NT column. What is the difference?

18) Banking sector

- Here, all the entries in the MA and NT are the same for all subsectors. Thus, it is clearer and simpler if all the subsectors are listed together in the first column, and the MA and NT limitations are inscribed just once.

19) Hospital services, Mode (3)

- As mentioned before, 'none' is not necessary. Here, do you mean 'one of the owners, directors or deputy directors must be a medical doctor.'? Which doctor? Including dentists? Should the doctors be licensed in Azerbaijan or any other countries?

20) Tourist guide services, Modes (3) and (4)

- Who can establish a legal entity to provide tourist guide service? Can an individual tourist guide provide the service without establishing a legal entity?
- Can foreigners establish a company, and hire tourist guides? According to your inscription, foreigners can do so.
- Entry in Mode (4) can be written as 'Unbound except as indicated in the horizontal section, and that the tourist guides should know Azerbaijani language.' But, I do not think this additional requirement is needed, because you do not allow service providers (tourist guides in this sector) in Mode (4).
- If you keep this limitation, then when a foreign company establishes a tourist guide company in Azerbaijan, and sends a manager to Azerbaijan, that manager should speak Azerbaijani language, which can be very burdensome and not necessary.

21) Passenger transportation and freight transportation, Modes (3) and (4)

- What is meant by 'Does not apply to the vehicles registered abroad.'? Do you mean that foreign registered vehicles cannot be used for the services? If so, you also mentioned below that 'foreign vehicles are not entitled to carry out internal passenger transportation.' You may change this into 'Foreign registered vehicles are not entitled to carry out internal passenger transportation.'

- You have inserted the same limitations under the MA and NT. You only have to insert them under MA.

22) Freight transport agency services, Mode (4)

- If you require natural persons to be Azerbaijani national, then this is zero quota for foreigners. That is foreigners are not allowed for any occasions. Then you can simply write 'unbound', instead of 'unbound except...'
- Also here is a duplicate entry under the MA and NT.

23) MFN exemption, Road transportation

- It should read 'Passenger and freight transportation by passing through the territory of Azerbaijan to the countries which signed bilateral or multilateral agreements with Azerbaijan, by vehicles registered in the countries which signed aforementioned agreements is tax exempted.' If they pass through, they are providing the service within the territory of Azerbaijan.
- According to the offer, foreign registered vehicles cannot be used for transportation. Here, you just mentioned the tax exemption for foreign registered vehicles. If you allow, for example, Turkish registered vehicles to be used for transportation, while you do not allow Georgian registered vehicles, then you are violating your commitment of MFN. Of course, you may give tax exemption to Turkish vehicles, but not to Georgian vehicles, because you asked for MFN exemption for tax measures.

24) Detailed comments on telecommunications offer

Basic Services

The word "long-term" should be clarified with specification, and also whether non-facilities based supplier can have any transmission capacity. There can be cases when equipment has both exchange and transmission capability.

In order to get a license in Azerbaijan, it is presumed that the company should be established in Azerbaijan. If that is the case, you do not need to insert 'established'.

Here only mentioned is 'licensed in Azerbaijan', instead of 'established and licensed'. Then who licenses the satellite-earth stations? Do you have the licensing procedure in place for satellite-earth stations? What are the requirements? Is discretion exercised during licensing? Also, who should have licenses should be clarified: Customers? Institutions? Or all those? If all need licenses, you should write more clearly; for example, " ... development parks. Licenses are needed to use satellite-earth stations."

What do you mean by 'joining WTO'? The date of accession? The date when you submit the protocol? or the date when your government ratifies the agreement and the agreement was put into force?

It should be clarified what is meant by 'on choice of partner'. The entry said '... joint ventures with telecommunications service suppliers duly licensed in Azerbaijan...' Then, are you going to allow non duly-licensed suppliers to form joint ventures? Also, 'foreign capital contribution' is not clear in its meaning. Do you mean foreign equity? How do you distinguish 'legal capital' from 'paid-in-capital' or 'authorized capital'?

If the entries are the same for 'facilities-based' and 'non facilities-based' suppliers, then you do not have to insert the same entries twice.

Value-added Services

Regarding value-added services, there were few WTO members which restrict value-added services. You are maintaining almost the same restrictions in basic services except shorter restrictive periods. It is quite improbable, as an example, that business customers obtain satellite-earth station licenses only to provide, for example, voice mail service.

2. Negotiation Strategy

An intensive two-day workshop for negotiation strategy for general application has been conducted in Baku, Azerbaijan in October, 2008. The workshop consisted of simulation and debriefing, and lectures. Originally 3 simulations were planned, but due to the time constraints and interpretation difficulties, only two simulations were conducted. The first one was a case where ZOPA (zone of possible agreement) was quite wide so that agreement was rather easy. But, most participants were simply eager to narrow down the positions of each party, instead of pursuing a win-win strategy. After this simulation, negotiation principles, mostly based on the book "Getting to Yes"[4], were introduced. Also introduced was the communication psychology, based on the book "Influence".[5] After the introduction of negotiation principles and communication skills, another simulation to test the acquaintances was conducted, where ZOPA does not exist at all. Surprisingly, most participants were able to come to mutually satisfactory results. After the second simulation, memos from the personal experience in negotiation by the lecturer were introduced, followed by the wrap-up. In general, participants seemed not to be familiar with this type of interactive workshop, but they showed great interest in later stages.

4) "Getting to Yes" by Roger Fisher and William Ury, Penguin Book, 1991
5) "Influence" by Robert B. Cialdini, Collins, 2007

Due to the intellectual property rights, simulation cases are not reproduced here. Regarding the two books on which the lectures were given, summaries and some comments by the lecturer are presented. Most of these materials were presented in Microsoft PowerPoint format, but they were formatted here for Microsoft Word presentation. Since these workshop materials are not based on research, they are relegated as attachment to this chapter.

3. Concluding Remarks

The second year KSP for Azerbaijan in services was agreed to focus on negotiation skills, however, it was also agreed that comments be made on the Azerbaijan' s services offer, and some other issues. In this context, the current status of Jackon-Vanik Amendment and specific issues in telecommunications were also covered.

Regarding the Jackson-Vanik Amendment, it seems unlikely that the US would seek Article 13 invocation for a long period of time, and it might be even possible that Azerbaijan could be off the list even before Azerbaijan accedes to the WTO, depending upon the political relationship between the two countries. The telecommunications sector still remains as a concern in that Azerbaijan plans to completely liberalize the sector without intermediate stages. Viewing from the experiences of liberalization in this rather important sector in Korea, gradual liberalization seems to be better suited to a country like Azerbaijan since the telecommunication sector may involve huge stakes among parties involved, and regulatory environment is quite complicated and technical due to the advancement in technology and imbalanced competition stemming from the existence of incumbent giant operators. In this regard, it is advised that Azerbaijan set up cooperation arrangement with countries which accumulated experience in regulation and dispatch their staffs for training in advance of de-regulation, and also that it introduces competition gradually, even before the committed schedule in the WTO. Azerbaijan' s offer in services cover a wide range of sectors, and well structured, but improvement in technical terms was needed in several incidences. A good example would be entries such as 'unbound except' , 'unbound except none for xxx' , 'none. xxx' , or 'none except xxx' which can be quite confusing and ambiguous. Especially, 'unbound except' should be inserted with care since this kind of entry goes against Articles 16 and 17 of the GATS and scheduling guidelines.

[Attachment] Workshop Material for Negotiation Strategy

1. Negotiation Principle
2. Psychology of Persuasion
3. Negotiation Tactics
4. Personal Experience

A1. Negotiation Principle

DO NOT BARGAIN OVER POSITIONS

Positional bargaining leads to Unwise, Inefficient, Non-amicable solutions
Arguing over positions produces unwise agreements: locks yourself in, inviting face-saving problems
Arguing over positions is inefficient; takes more time than you think
Arguing over positions endangers an ongoing relationship; you get hurt
When there are many parties, positional bargaining is even worse; you get stuck
Being nice is no answer; if you focus on relationship too much, you get sloppy agreement.

- soft: soft nego. leads to efficient but unwise agreement
- soft: hard nego. leads to efficient but unwise, nor amicable relationship

Substance and Relationship: You do not take one of the two.

There is an alternative. Substance and Procedure. Change the procedure to create a new game.
Thus goes Principled Negotiation:
People: Separate the people from the problem
Interests: Focus on interests, not positions
Options: Generate a variety of possibilities before deciding what to do
Criteria: Insist that the result be based on some objective criteria

SEPARATE THE PEOPLE FROM THE PROBLEM

Negotiators are people first. *They do not understand you the way you intended.*
Every negotiator has two kinds of interests: in the substance and in the relationship.

Separate the relationship from the substance; deal directly with the people problem. *"Kitchen is a mess!"* is a very neutral statement, but still, it is not understood that way.

They fail to interpret what you say in the way you intend and *do not mean what you understand them to say; counter-reactions in a vicious circle...*

The relationship tends to become entangled with the problem.

Giving in to relationship is not the best or only strategy; chasing wolves in Arctic... Do not solve people problems *with substantive concessions*.

How? Change Perception, Emotion, and Communication: All these are basically communication problems; psychology steps in...

Perception:

Conflict lies not in reality, but in your head!

1. *Put yourself in their shoes (Two equally valid explanations. Understanding is not agreeing*. Two examples: picture of a woman, and real life experience)
2. Don' t deduce their intentions from your fears.
3. Don' t blame them for your problem. *You do a lousy job. They become defensive*.
4. Discuss each other' s perceptions.
5. Look for opportunities to act inconsistently with their perceptions.
6. Give them a stake in the outcome by making sure they participate in the process. Psychology of devaluating the merits of the proposal, simply because it was proposed by the other. *BH experience for World Summit*.
7. Face-saving: Make your proposals consistent with their values.

Emotion:

1. First recognize and understand emotions, theirs and yours.
2. Make emotions explicit and acknowledge them as legitimate.
3. Allow the other side to let off steam. *Silence is best at times*.
4. Don' t react to emotional outbursts.
5. Use symbolic gestures.

Communications:

1. Talk to each other.
2. Talk to them, not to the gallery.
3. Avoid misunderstanding.
4. Listen actively and acknowledge what is being said. *Can you rephrase what the others have said?*
5. Speak to be understood. Important decisions are made when only two persons are in the room!
6. Speak about yourself, not about them. Talk about what you feel. *I feel discriminated*.
7. Speak for a purpose. *Some thoughts are best left unsaid*.

Prevention works best.

Build working relationship. *Have dinner together; no business. Arrive early!*

Face the problem, not the people: side-by-side, not face-to-face!

FOCUS ON INTERESTS, NOT POSITIONS

GENERAL
Leave the door open; no keep it closed in a library
For every interest, there usually exist several possible positions that could satisfy it.

For a wise solution, reconcile Interests, not Positions.: Interests define the problem: distinguish interests from positions.
Your interests are what caused you to so decide; Arab-Israeli confrontation
There usually exist several possible positions that could satisfy it
Many more interests lie behind opposed positions

Behind opposed positions lie shared and compatible interests, as well as conflicting ones: there are many more interests that are shared or compatible than ones that are opposed; agreement is possible because interests differ.

HOW TO FIND OUT
Then, how do you identify interests?
Ask Why?

Ask also Why not? Think about their choice: try to figure out where their minds are now.
In doing so, 1) ask "Whose decision do I want to affect?" And 2) "What decision people on the other side now see you asking them to make?"

Realize that each side has multiple interests. Also, worry interests not only in affecting, but also effecting agreement: You are dealing with many people!
(DOS was friendly, DOC was next, but USTR was hostile!)

The most powerful interests are basic human needs: baseball player; the owner does not want to let the public know he is in financial trouble; the Mexican government felt being bullied by the US; not 'their problems' but make it a legitimate concern to be satisfied.
(Sometimes it is quite personal, like his/her for his/her promotion)

Make a list: at all times!
HOW TO TALK: Talking about Interests

You negotiate to satisfy your interests. Same is true of the other side: So, **talk them out to the other.**

Make your interests come alive: it is your job; be specific, it will make your interests credible and impact the other; You can afford to take a strong stance in setting forth the seriousness of your concerns; Good technique: say ‘Correct me, if I am wrong.’ ; You have to convince them that they might feel the same way if they were in your shoes!

Acknowledge their interests as part of the problem: “Do on to others as you would have them do on to you”; especially easy if you have shared interests.

Put your problem before your answer: positions later! (Nice tactic!) They will listen only to figure out where you will end up.

Look forward, not back: people usually argue on the past things. Talk about where you would go, instead of where you came from.

Be concrete but flexible: don’ t stick to just one position. Go to negotiation with more than one option, and with an open mind.

Be hard on the problem, soft on the people: combination of support for interest and attack on the problem. Let the other feel that he is *respected*, but not the problem; *cognitive dissonance*-create inconsistency so that he is propelled to solve it.

INVENST OPTIONS FOR MUTUAL GAIN

Best negotiator is the one who knows best how to expand the pie! But people too often ‘leave money on the table.’

Answers do not lie along a straight line.

How can we avoid that?
First, DIAGNOSIS, and then PRESCRIPTION.

DIAGNOSIS

Four major obstacles are present.
premature judgment
searching for the single answer
the assumption of a fixed pie
thinking that ‘solving their problem is their problem’

Premature Judgment: do not criticize first; you may worry that your proposal may be considered as your offer; you may be disclosing your bargaining position. *What if he considers my suggestion as an offer? You may avoid it by making two or more options or making it clear that they are illustrative options. What if I disclose some piece of information that will jeopardize my bargaining position? Same is true. But you are there to* *satisfy your needs…*

Searching for the single answer: you tend to think that you should narrow the gap between positions, not broadening the options available; avoid premature criticism and premature closure; the more options, the better.

The assumption of a fixed pie: no zero-sum game! No negotiations are either-or type!

Thinking that 'solving their problem is their problem' : you are not negotiation alone

PRESCRIPTION

Accordingly, the following four are needed.

1) Separate the act of inventing options from the act of judging them
2) Broaden the options on the table rather than look for a single answer
3) Search for mutual gains
4) Invent new ways of making their decision easy

Separate Inventing from Deciding

Within your group, you do not have to worry about disclosing information.

Prepare a brainstorming: postpone all criticism and evaluation of ideas; ideas stimulate another

Brainstorming: define your purpose, choose a few participants, change the environment, design an informal atmosphere, choose a facilitator

During the brainstorming: seat the participants side by side, clarify the ground rules, including the no-criticism rule (off the record), make a long list of ideas, record the ideas in full view (to see them all)

Look for mutual gains

Not a zero-sum game, rarely if ever; first of all, both are worse off if negotiation breaks down. *At least, there is a relationship problem.*

HOW? *Identify shared interests:* in price negotiation, price is not the only thing! You want the money for some other thing; he may cut down charity, if he pays more taxes. Townsend Oil Refinery story.

NOTE that

1) Shared interests lie latent in every negotiation (what if it broke?)
2) shared interests are opportunities, not godsends (make it concrete and future oriented)

3) stressing shared interests can make the negotiation smoother and more amicable.

And also dovetail differing interests: an agreement is possible because each side wants different things! Think of stock trading; HOW?

Different beliefs? (an impartial arbitrator will make both of you winners!)

Different values placed on time? (installment works)

Different forecasts? (contingent contract)

Difference in aversion to risk? (step-wise agreement! Pay low now, but pay high if succeed! Or even insurance company!)

Also Ask for their preferences: by creating several options equally acceptable to you; change the procedure! Remember dividing a cake between brothers! Vive la difference!

Make their decision easy

Make their, not your, decision easy: people usually pay too little attention to this problem.

NOW, *Who's shoes?:* rather focus on one person who you are dealing with. Give her arguments that she will need to persuade others to go along.

What decision?: requesting the other side to be 'more forthcoming' will probably not produce a decision you want. *How would you respond? Why don't you do first?* Even if they do, you will definitely ask more! Drafting earlier sometimes helps; Find a solution which the other side *feel that it is the right thing to do;* PRECEDENT is a good facilitator.

Draft agreement as early as possible.

It is easier to do nothing than stop doing something; it is easier to stop doing something than something new. Nothing>stop doing>doing something new!

Summary

Making threats is not enough: what would the other side most fear? How they might be criticized? Be creative! *Offers work better than threats.*

INSIST ON USING OBJECTIVE CRITERIA

Deciding on the basis of will is costly

You are not on the islands with no history, no customs and no moral standards

Negotiate on some basis independent of will.

The case for using objective criteria

Principled negotiation produces wise agreements amicably and efficiently: precedent, community practice; spend more time in talking about possible standards and solutions, not defending and attacking other' s positions; if a negotiator has to clear a position with a higher authority, the task of adopting positions is very time-consuming; MIT model in the deep-sea mining;

Developing objective criteria

How can you develop it?
How do you use them in negotiating?
Develop some alternative standards in advance!

Fair standards: examples; market value, precedent, scientific judgment, professional standards, efficiency, costs, what a court would decide, moral standards, equal treatment, tradition, reciprocity, etc; should apply to both sides, not only to you!

Fair procedures: let one side offer equally acceptable proposals; *let them offer equally satisfactory options. Or make them offer what they think is a fair arrangement before they go on to decide their respective roles in it*. Or negotiate what they think is a fair arrangement; or '*last-best-offer arbitration*' ---parties will try to make more acceptable proposals!

Negotiating with objective criteria

Frame each issue as a joint search for objective criteria: suggest your own criteria or invite his own, and try to use his criteria. Ask what' s your theory? Agree first on principles!

Reason and be open to reason: do not use standards to justify your position, nor escalate it to principles; IT DOES NOT MEAN THAT THE AGREEMENT BE BASED SOLELY ON THE CRITERION YOU ADVANCE; if you cannot agree on a standard, try another; if there are two standards, *try the difference;* if still not, try a third party for advice on what standard to use; OPENNESS TO REASON + INSISTENCE ON A SOLUTION BASED ON OBJECTIVE CRITERIA

Never yield to pressure: invite them to state their reasoning, suggest objective criteria you think will apply and refuse to budge except on this basis; refusal to a threat is easier to defend (publicly or privately) than is a refusal to advance sound reasons; if they refuse to advance sound reasons for their positions, then no further negotiations!

"Trust is an entirely separate matter."
Invite them to state their reasoning, suggest objective criteria you think will apply, and refuse to budge except on this basis.

Ask them "How should I persuade my constituents with this agreement? Under pressure?" Unless you can state objectively why that amount is what I'm entitled to, then I think I'll do better in court!

WHAT IF THEY ARE MORE POWERFUL - BATNA

First PROTECT yourself against an agreement you should reject, and make the MOST of your assets.

Protecting yourself
You may easily go along, worrying your investment until now. That's because you were not prepared.

The cost of using a bottom line: it is better than nothing. Negotiators usually prepare bottom-lines; but this LIMITS your ability, *INHIBITS imagination, and usually* TOO HIGH *if you talk about your members;* rather find BATNA. Every negotiation involves more than one variable.

Know your BATNA: in almost any case, any arbitrary bottom line would not reflect true interests; the results you can obtain *WITHOUT NEGOTIATING;* compare results of negotiation with this, since you are negotiating to become better off!; ADVANTAGE = flexibility (permits exploration)
Insecurity of an unknown BATNA: do not negotiate without knowing what would happen if it breaks down; do not be too OPTIMISTIC, it is *not the SUM* of alternatives, but just one of them; in reality, they are *too PESSIMISTIC,* since they do not have BATNA.

Formulate a trip wire: for early warning; another test; as an early warning, identify one that is better than BATNA but worse than perfect agreement; like, talk to me if this fails;

Making the most of your assets

Protecting yourself from bad agreement is one thing, but making the most of your asset is quite another.

The better your BATNA, the greater your power: real power depends how attractive to each is the option of not reaching agreement; best alternative is the power!

Develop your BATNA: Thus make best BATNA; you have to develop it; how?
1) *Invent a list, improve some of them,* select the best one tentatively; do not think there is only one option, the end;
2) if you find some other options, try *to develop them, more workable, more attractive, substantiate them;*

3) and choose the best

SHALL I DISCLOSE BATNA? Depends; if BATNA is very attractive, yes; if they think you don’t have a good BATNA, then yes; otherwise, no.

Consider the other side’s BATNA: think about the other’s BATNA, too; try to lower their BATNA; if BATNAs are so good, better not have any agreement!

BATNA = POWER!
Apply knowledge, time, money, people, connections, and wits into devising a BATNA.

WHAT IF THEY WON’T PLAY (use negotiation Jujitsu)

THREE steps: *first, do what you can do;* it can be contagious.
Second, focus on what they can do; this is negotiation Jujitsu; go around.
Third, ask a third party to help.

Negotiation Jujitsu

Do not push back; if they assert their position, do not reject their position; if they attack your ideas, don’t defend your ideas; if they attack, don’t counter attack; side-step!
They can do three things: asserting positions, attack your ideas, or attacking you. Now, how to deal with each:

Don’t attack their position, look behind it: treat their position as an option; think about it, what is the interest, *why they are asserting it; assume that their position is a genuine attempt; ask them* WHY; induce them to find out the consequences themselves;
Don’t defend your ideas, invite criticism and advice: do not spend time in criticizing; improve your ideas from THEIR point of view; *ASK their ADVICE* what they would do if they were in your position; in doing so, *they may be able to invent a solution that meets your concern.*

Recast an attack on you as an attack on the problem: allow them to let steam off; reshape the attack on you to attack on the problem;

Ask questions and pause: ASK questions, do not make statements which generate resistance; questions pose no target to attack; and sometimes *KEEP SILENCE;* if the answer is insufficient, then wait; they will feel impelled to break by answering your question.

Consider the one-text procedure
When nothing works, try this one-text procedure; let a third party listen to your requests, and

let him make an offer; hard to make concessions, but easy to criticize; essential for multi-party negotiation; you can just start even without the consent from the other side.

A2. Psychology of Persuasion

The Psychology of Persuasion: trigger

A story of an Indian jewelry store in Arizona: mistake by the clerk to increase price twofold instead of cutting it in half

May I use the Xerox machine [because I have to make some copies]? 60% versus 93%!
- You learn 'you get what you paid for' and develop a stereotype that 'expensive=good': does this enhance 'civilization'?
- Contrast principle
  - Expensive suits and sweaters, real estate, car sales…
  - Overbooking tickets and awards ($10,000; $200, $300, $500)

Weapons of Influence
1) Reciprocation: give and take
2) Commitment and Consistency: hobgoblins of mind
3) Social Proof: truths are us
4) Liking: the friendly thief
5) Authority: directed deference
6) Scarcity: the rule of the few

1) Reciprocation: give-and-take
- Feel obliged to pay back: web of indebtedness
- Let them owe you, or give something first
  - Brilliant examples of Hare Krishna
  - Gum or candy by waiters
  - Different attitude by Congress to Johnson and Carter
  - Power of free sample: 2-3 day free trial from Amway
  - Benevolent boss who cares all birthdays in his team
- Contrast Principle and Reciprocity
  - 12 year-old boy scout: $5 ticket or $1 chocolate (where was the concession?)
  - Chaperon of juvenile delinquents [or one day to a zoo or 2 hours for 2 years?] 17% versus 50%!
- Ask high, then reduce! That's a concession, already!
- How to neutralize?
  - Perceive and define his action not as a favor, but a tactic

2) Commitment and Consistency

- Very powerful: inconsistency is an undesirable personality trait
  - Would you watch my things? 4 vs. 19 out of 20
  - Tim did not return to normal life, but Sara says…
  - Cabbage Patch doll? During season, always sold out; after the season, produced and sold again!
- Commitment is the KEY; get them committed!
  - Would you vote on the Election Day?
  - How are you doing today? May I visit you? 18% : 90%
  - Don' t you want to save money?
  - Sticker "Be a Safe Driver" and then larger billboard "DRIVE CAREFULLY" rejection by 24% : 83%
  - Compliment others! Then you made them committed...
  - Why I like… testimonial contest by P&G
  - Would you call me if cancelled? 30% : 10%
- Extra effort goes into commitment and then into consistency
  - Initiation ceremony? First year in law/medicine
- Throwing a lowball
  - Experiment at 7? Volunteer? Then come by 7? 24% : 56%
- Go back to the original source. Forget foolish consistency!

3) Social Proof

- You just do what others do without much thinking…
  - Canned laughter, salting collection basket, long waiting list to an empty night club?
- Uncertainty…I am not sure that…
  - Stabbed 3 times in 35 minutes, 38 witnesses?
  - Was it surely a homicide?
  - Help! I' m having a stroke! 1 and 5 pedestrian--85% : 31%
  - What' s your name? John, please help me!
- Combination of similarity and social proof
  - Your neighbor is on TV commercial?
  - In People' s Temple in Guyana, 910 people died in orderly, willful fashion
  - Herding behavior
- Rethink the validity of social proof.
  - Attention! This is a bad social proof!
  - Isn' t it manipulated?

4) Liking

- We tend to say yes to someone we know and like!
- Strategy of Tupperware Party
  - Games and prizes for everybody: reciprocity

- Ask users to speak about it: consistency
- Others bought already!: social proof
- +your neighbor makes profit! : the friend, liking!

• The Guinness Book of Records Car Salesman
  - 13,000 messages a month, saying, "I like you…"
• Sources of liking
  - Physical attractiveness: getting help, persuasion.
  - Similarity: asked by persons in similar dress.
  - Compliments: tend to believe praise and like them!
• We like things that are familiar
  - Contact and Cooperation: off to the camp!
  - Cooperation, but conflict, too: how? Work together
  - Change your name into Brown to be elected!
• Association
  - Phone calls to the weatherman
  - Cars with good-looking models…
  - Any good images will do: stars on CF
  - Luncheon technique: meal = good feeling!
  - We won! But also they lost.
• Conscious effort to concentrate EXCLUSIVELY on merits…

5) Authority: follow an expert!
• Blind compliance
  - Simple phone calls to nurses…
• Symbols of authority
  - Titles: professors are taller by 5cm
  - Clothes: uniforms?give him coins!
  - Not much honking to luxury cars
• Think again the authority
  - Is he really an expert? Is this a tactic?
  - Waiter recommends you to a cheaper menu…

6) Scarcity
• 'I just sold the last item. If I can get one from somewhere, would you buy it?
  - Only 5 left! Last day for sale!
• Fear to lose what you have.
  - You don' t let things you already own
  - Romeo and Juliet: if prohibited, then do more!
  - 'This is only for adults' sells more
  - Invite competitors at the same time
• Why do I need this? What are the cost and benefit?

Conclusion

Why triggers, or auto pilot?

- Why triggers?
  - Compare benefits and costs: opportunity cost, again?
  - Triggers are quite efficient, and rational
- If the stake is high, these properties do not hold
  - Do we pay lots of time and energy?
  - If trigger brings large cost, then the trigger will change too

A3. Negotiation Tactics

Tactics are used when…

- Follow negotiation principles
- If the other party uses tactics, do not become a victim
- If the stakes are high and relationship does not matter much, it is likely that tactics are used

	High stakes	Low stakes
Relationship matters	Balanced Concerns	Relationships
Relationship does not matter much	*Transactions*	Tacit Coordination

1. Do not become a victim to these tactics…
2. Tactics you should know…
3. Tactics you may use…

1. Do not become a victim to these tactics

- Ignore it if the other party uses these tactics
- If they continue using these tactics, explicitly raise them, but do not respond in kind

Uncomfortable environment

1. They suggest to meet at lobbies or meet someone else during negotiation
2. Meeting place is too small, or overwhelmingly too big
3. Meeting place is too cold or too warm
4. Meeting place is very noisy and it is hard to concentrate
5. The chair is uncomfortable or your seat is lower than theirs
6. The sun is right in your eyes
7. You are on time, but they make you wait
8. They frequently look at watch during negotiation

9. Negotiation is interrupted by telephone calls, or the secretary frequently comes in with memos

Psychological tactics

1. They do not make eye contacts intentionally
2. They do not listen to you carefully
3. They make you repeat
4. They refer to you or your company with wrong names intentionally
5. They look tired or bored
6. They do not take a look at the materials you handed or put them aside
7. They mention your appearance or physical shortcomings
8. They make you feel socially inferior
9. They ask you difficult questions or quote economic statistics to make you feel ignorant
10. They tell you to meet someone else at the next meeting
11. They make mistakes intentionally and see how you react
12. They pass out memos among themselves with wrong information, but let you see them as if they did not intend to do so

Pressure tactics

1. Luxurious offices, impressive overseas network, and corporate jets, helicopters, yachts, and limousines
2. They wear very expensive suits or accessories
3. Secretary runs in even at a dry cough
4. They name social celebrities as friends
5. They have many, long impressive titles
6. They boast of frequent overseas travel or large business operation

2. Tactics you should know…

- You should know these tactics, but it is not recommended to use them first
- If they use these, just ignore them

1. They highly appraise your appearance (cognitive dissonance?)
2. They sometimes keep silence or ask blunt questions (silence, punt)
3. They appear crazy
4. They outnumber your team
5. Good guy-bad guy routine (beware of secretaries, committees…), or I wanted, but have no authority… (hard hearted partner)
6. Death by a thousand exceptions
7. They frequently mention competitors, or ‘this is the last item!’ (Noah’s Ark, bandwagon)

8. They plant the seeds for discord in your team (Trojan Horse)
9. They flinch, or look not interested in your proposal
10. They let you make the first offer (especially if they think about 'split the difference' later)
11. They ask concessions one by one
12. They ask you more after the negotiation is over (maybe the following morning right before you leave…)
13. They ask your concession for their small concessions (straw man, decoy, red herring,…)
14. Concede now, and become famous later (contingent contract)
15. Just one dollar a day! (funny money)
16. Puppy dog close (can you return it?)
17. Do not trust printed materials blindly
18. This is not for negotiation; it is a precondition, or refuse to negotiate
19. Delay tactics
20. Hot potato, fait accompli!, Lock-in, ultimatum, take-it-or-leave-it!

3. Tactics you may use…

- Following tactics are rather reasonable…
  1. Negotiate in your turf
  2. Place important issues at the start
  3. Focus on problems, and put up with emotions
  4. Invoke law or justice
  5. Discuss alternatives, not complaints
  6. Price is not the only issue in negotiations
  7. Do not show signs of concessions from the start ($100 or near offer: ONO)
  8. Don' t accept the first proposal
  9. Concession is not the best strategy for a successful negotiation, and they expect even more
  10. After a concession, ask for a concession however small
  11. Ask for concession right away
  12. When you concede, reduce the amount of concession in the next move
  13. Threats are to be used very carefully, do not be firm too much
  14. If negotiation stalls, change places or negotiators
  15. If resolution appears impossible, call in third parties
  16. Draft contract first
  17. Read the contract to the end
  18. Pay attention to the details (avoid one truck contract)
  19. Make a small concession at the end
  20. Appraise your partners, but don' t gloat

A4. Personal Experience

1. HOW TO NEGOTIATE? (ESPECIALLY WITH THE AMERICANS)

Lessons from Personal Experience (written in 1994)

2. CONTENTS

- PREPARATION
- BEFORE STARTING NEGOTIATION
- INTERPRETER?
- DURING NEGOTIATION
- NEGOTIATION ATTITUDE
- KEY TO A SUCCESSFUL NEGOTIATION
- HEAD OF DELEGATION
- HOW TO CONCLUDE?

2.1. PREPARATION

Collect all available information

- information can add up like jigsaw puzzles
- easier to understand their position

Try counter-lobbying

- Government is not the only one to deal with
- Consider seminars, press conferences

2.2. BEFORE STARTING NEGOTIATION

Agree on agenda first

- Prevent additional requests

Agree when to close negotiation

- You' re not physically as strong
- The longer the session, the more requests asked

Do not agree on deadline

- Last minute pressure

2.3. INTERPRETER?

No Interpreter?

- Positive: speedy; safe
- Negative: talkative; dragging

English or Expertise?

- Expertise is much preferred
- Too good an interpreter? Talkative again!

2.4. DURING NEGOTIATION

Spare your words

- Unnecessary words call for mistakes
- Mistakes call for mistakes

Do not raise expectations

- Make clear what you mean
- You are not understood as you want to be

2.5. NEGOTIATION ATTITUDE

Always calm down

- Hot temper invites mistakes

Find logical flaw

- Defense invites another mistakes

Call for a break

- Stop making mistakes; cool down
- Better not be too frequent

Distinguish between formal & personal matters

- Business is business
- Do not be personal during negotiation
- After negotiation, become friends

2.6. KEY TO A SUCCESSFUL NEGOTIATION

Negotiation is compromise

- Nothing is black or white; everything is gray
- No win-lose; pursue win-win

Be constructive and creative

- Find win-win compromises
- Don' t indulge in defending and/or attacking

2.7. HEAD OF DELEGATION

Full trust to the Head

- Do not cut in
- It is not as easy as it looks

Do not distract attention

- Whisper (into ear); use memos
- Do not giggle

3. HOW TO CONCLUDE?

No written agreement

- You will get caught later
- You won' t be there to interpret

If not, propose first

- Negotiation proceeds in your frame

Consult lawyers

- Do ask time for review by lawyers

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Chapter 02

Import Policy and Development of Tariff Mechanism in the WTO System

Chapter 02

IMPORT POLICY AND DEVELOPMENT OF TARIFF MECHANISM IN THE WTO SYSTEM

Dukgeun Ahn

1. General Principles of Tariff Systems in the WTO

1.1. Legal Principles on Tariff Systems

A. GATT Article II and Tariff Binding

GATT Article II provides that products from one Member, upon importation into the market of another Member shall "...be exempt from ordinary customs duties in excess of those set forth and provided therein [in the Schedule of the importing Member]", thus establishing a ceiling on the level of customs duties that can be applied on a product whose tariff is bound. These products have to be exempt also from all other duties and charges on or in connection with importation in excess of those imposed on the date "of this Agreement" or those directly and mandatorily required to be imposed thereafter by legislation in force in the importing Member on that date. An Understanding on this Article was negotiated in the Uruguay Round and is legally incorporated into GATT 1994. It provides, for the purposes of transparency, that the level, as of 15 April 1994, of these "other duties and charges" on tariff items included in the Schedules be also registered therein and thus be subject to binding.

B. GATT Article XXVIII and Tariff Modification and Withdrawal

(1) Modification and Withdrawal - GATT Article XXVIII

Article XXVIII provides a means for a Member to modify or withdraw a concession in a Schedule either by agreement with the affected countries, or in the last resort unilaterally. The procedures were well developed under GATT 1947, but are now also subject to an Understanding on the Interpretation of Article XXVIII of GATT 1994 concluded in the Uruguay Round. The corresponding procedures under GATS are similar, but include an arbitration procedure.

Agreements concluded under Article XXVIII are not “covered agreements” within the meaning of the DSU, nor are they part of the “decisions, procedures and customary practices” of the GATT CONTRACTING PARTIES. However, they may constitute a supplementary means of interpreting the resulting Schedules (Article 32 of the Vienna Convention) as part of the historical background of the concessions.

Members affected by the modification or withdrawal have certain rights of renegotiation and compensation. For this purpose they are divided into three categories:

(a) Members with which a concession was initially negotiated, which thereby possess an initial negotiation right (INR).

Because successive Schedules are normally cumulative in their effect, countries retain INRs arising from earlier concessions. For example, country A might have bound its tariff on widgets at 15 per cent in the Kennedy Round Schedules following negotiations with country B, and bound the same tariff at 10 per cent in the Tokyo Round following negotiations with the same country. Country B would then have two INRs, which would come into play if country A wanted to raise the tariff to 20 per cent. INRs are listed in a Member’ s Schedule, and more than one country may have an INR on a particular product.

Under GATT 1947 a concept of “floating” INRs was developed for Schedules adopted in connection with the introduction of the Harmonized System in 1987. A country was deemed to have an INR if for a representative time prior to the time the question was raised had a principal supplying interest (below) in the product concerned. INRs could continue to arise from bilateral negotiations.[6]

The same principle had been used in the Kennedy and Tokyo Rounds when, because of the use of formulae in calculating tariff reductions, many tariff concessions could not be said to have been negotiated with any particular country. It was therefore decided that in these cases any country which had a principal supplying interest during a representative period prior to the time when the question arose should be regarded as having an INR.[7]

6) Decision of 24 June 1998, BISD 35S/336 (1989).
7) BISD 26S/202 (1980).

Any Member with a principal supplying interest in a concession that is modified or withdrawn gets an INR in the compensatory concessions, unless another form of compensation is agreed by the Members concerned.[8]

(b) Any other Member determined by the Ministerial Conference to have a "principal supplying interest."

Such a country should normally have had a larger share of the market in question than at least one country with an INR (unless it has been deprived of such a share by discriminatory quantitative restrictions). There should only be one country in this category, unless, in exceptional cases, there is near equality.

Furthermore, a country may exceptionally be designated if the concession affects a major part of its exports. This may be the only way in which a developing country could secure a qualifying interest under Article XXVIII. Under the 1994 Understanding, the Member which has the highest ratio of exports affected by the concession to its total exports is deemed to have a principal supplying interest (if it does not already have an INR). (In accordance with the Understanding, this rule has been reviewed, and the Market Access Committee has reported that there is no basis for changing it.

Although a principal supplying interest carries the same rights as an INR, it suffers the disadvantage that it may be lost as a result of a decline in exports, whereas an INR is secure against such changes.

(c) Members determined to have a "substantial interest."

This term is not capable of precise definition, but is intended to cover only those Members which have a significant share in the market (or would have in the absence of discriminatory quantitative restrictions),[9] and that is usually taken to be at least 10 per cent of imports.

The volume of trade is based on the most recent three-year period for which statistics are available. Only MFN-based trade is taken into consideration. However, exports benefiting from non-contractual preferences (e.g., GSP) will be included if the trade has (or will) become MFN-based before the conclusion of Article XXVIII negotiations.[10]

In the case of a new product, where such statistics are not available, a Member possessing INRs on the tariff line where it is or was formerly classified is deemed to have an INR. The

8) 1994 Understanding, par. 7.
9) Note 7 ad Art. XXVIII:1
10) 1994 Understanding, par. 3.

determination of principal supplying and substantial interests and the calculation of compensation will take into account, inter alia, production capacity and investment in the affected product in the exporting Member and estimates of export growth, as well as demand forecasts in the importing Member. For these purposes, "new product" is understood to include a tariff item created by a breakout from an existing tariff line.[11]

(2) Procedures

Three procedures are specified by Article XXVIII, although only one of them is used with any frequency. They have been supplemented by the Guidelines adopted in 1980.[12]

Paragraph 1 provides a three-yearly cycle of negotiations and modifications (the current one is based on 1 January 1994), although this may be changed by the Ministerial Conference.[13] Notice must be given between six and three months before the implementation of the modifications, upon which the Ministerial Conference will designate the interested countries,[14] and negotiations and consultations will commence. If the country taking the action recognizes another country's claim to have an interest, that recognition constitutes a determination by the Ministerial Conference. In other cases the claim must be referred to the Council for a decision.[15]

The Member wishing to modify or withdraw a concession must attempt to secure the agreement of countries in Categories (a) and (b), above. As regards Category (c) countries the duty is merely to consult, but because such countries have in the last resort the same rights to unilateral compensatory action (below) as those with the higher levels of interest, this consultation may be little different from an attempt to secure an agreement. Negotiations should be completed before the new period commences.

If agreement is achieved, the concession may be modified or withdrawn on the first day of a designated three-year period (implementation may be deferred, in which case so may compensation).[16]

Although the time for negotiations has sometimes been extended, the constraints of Paragraph 1 procedure have made it unpopular and increasing reliance has been placed on the alternative provided by Paragraph 5.

11) 1994 Understanding, par. 4
12) Guidelines on Procedures for negotiations under Article XXVIII, BISD 27S/26 (1981).
13) Note 1 ad Art. XXVIII:1.
14) Note 3 ad Art. XXVIII:1.
15) Guidelines, par. 4.
16) Note 2 ad Art. XXVIII:1.

Under the Paragraph 5 procedure, a Member may reserve the right to modify its Schedule, following the same procedures, at any time during the ensuing three-year period. The modifications may be implemented as soon as the conclusion of negotiations is notified (and not before). The drawback is that other Members then have the right to use the same procedures to modify or withdraw concessions initially negotiated with the Member making the reservation. Furthermore, the reservation applies to the whole Schedule and cannot be confined to selected items.[17] In other respects, the procedure is similar to that of Paragraph 1.

Finally, under Paragraph 4, the Ministerial Conference may authorize renegotiations outside the three-year cycles, and in this instance (alone) it has the power to veto unilateral action by an applicant, if that Member is determined to have unreasonably failed to offer adequate compensation.

This procedure is now very rarely used. It was invoked by Korea in 1986 and by EC in 1992 regarding oilseeds following the panel findings that the EC had nullified or impaired its zero tariff bindings. It has never proved necessary to resort to the veto.

Whichever procedure is used, if no agreement is reached during the negotiations, the concession may nevertheless be modified or withdrawn (subject to the veto under Paragraph 4), but countries in any of the three categories are then free, within six months of such action, to withdraw substantially equivalent concessions initially negotiated with the modifying Member. Likewise, if the agreement reached is one with which a country having a substantial interest is not satisfied, it may withdraw such concessions. This right of retaliation is very rarely used. The deadlines may be extended to allow completion of Article XXIV: 6 negotiations.

Agreements conclude on the basis of Article XXVIII usually provided for compensatory adjustment with respect to other products. The Member must endeavor to maintain a general level of reciprocal and mutually advantageous concessions not less favorable to trade than that previously applicable.[18] In general, this should be assessed on the basis of a three-year period, and imports of the product in question from all sources should be considered.

There is no WTO provision that allows departure from the non-discrimination principles of GATT Articles I and XIII in the case of compensation negotiated in the framework of Article XXVIII.[19]

The participation of Categories (b) and (c) countries should not result in compensation or retaliation greater than the withdrawal or modification sought, judged in the light of the

17) Report of working party on schedules and customs administration, BSID 3S/205 (1995), par. 31.
18) Art. XXVIII:2
19) Appellate Body report EC - Poultry, pars. 96 et seq.

conditions of trade at the time of the proposed withdrawal or modification, making allowance for any discriminatory quantitative restrictions maintained by the applicant Member.[20]

There may be circumstances in which no compensation is required. Thus, in 1984 a panel concluded that the EC could reduce the size of a bound tariff quota when several of its previous beneficiaries became entitled to duty-free treatment as part of a free-trade agreement (but the Article XXVIII negotiations had nevertheless to be held).

A means of assessing "substantially equivalent" concessions was suggested in 1963 following the unbinding by Germany of its tariff on chickens in connection with the creation of the EC. Article XXVIII came into play because of Article XXIV: 6, and a GATT panel was asked to give an advisory opinion on the value to be ascribed to US exports of chicken to Germany. The method adopted was, apparently, to estimate the value of the exports which would have occurred had the binding been maintained and had certain improper trade barriers (discriminatory quantitative restrictions) not been in effect, and approach somewhat similar to the "trade coverage" formula. The events became known as the "Chicken War."

When an unlimited tariff concession is replaced by a tariff rate quota, the amount of compensation provided should exceed the amount of the trade actually affected by the modification. The basis for the calculation of compensation should be the amount by which future trade prospects exceed the level of the quota. The calculation of future trade prospects should be based on the greater of:

(a) the average annual trade in the most recent representative three-year period, increased by the average annual growth rate of imports in that same period, or by 10 per cent, whichever is the grater; or

(b) trade in the most recent year increased by 10 per cent.

In no case will a Member's liability for compensation exceed that which would be entailed by complete withdrawal of the concession.[21]

Guidelines on the procedures for Article XXVIII negotiations were adopted in 1980.[22] An agreement may be recognized as made within the context of Article XXVIII even if the formal certification procedure is not followed.[23]

A Note to Article XXVIII states that negotiations and consultations should be conducted with the greatest possible secrecy in order to avoid premature disclosure of details of

20) Note 6 ad Art. XXVIII:1.
21) 1994 Understanding, par. 6.
22) BISD 27S/26 (1981).
23) Panel report EC-Poultry, par. 204.

prospective tariff changes. The Ministerial Conference must be informed immediately of all resulting changes in national tariffs.

As an alternative to Article XXVIII renegotiations a Member may seek a waiver in order to permit modifications of its Schedules, but in such cases conditions imposed may be similar to those required by Article XXVIII.[24]

(3) Rectifications and Certifications

In 1955 and amendment to GATT was proposed that would have introduced a procedure for the certification of those alterations to the Schedules which recorded rectifications of a purely formal character or modifications resulting from action under Article Ⅱ:6, Article XVIII, Article XXIV Article XXVII and Article XXVIII. Until that time, such alterations had been authorized by protocols of rectifications and modifications, with all their attendant delays. The amendment never came into force and was eventually abandoned, but the certification procedure was nevertheless put into effect and, in 1968, approved by a decision of the CONTRACTING PARTIES.[25] A modified procedure was adopted in 1980 in parallel with the development of a loose-leaf system for recording the Schedules.[26] Changes in Schedules are now required whenever national customs tariffs are amended or rearranged in ways that affect bound items.

This procedure is used, inter alia for the introduction of Schedules based on the HS by Members that did not participate in the original protocols and the implementation of some sectoral agreements on tariff reductions that have been concluded outside of negotiating rounds.

A draft certification circulated by the Director-General "becomes a Certification" unless within three months an objection is made claiming that the draft does not correctly represent the modification, or that the proposed rectification is something other than a mere amendment or rearrangement which does not alter the scope of a concession.[27] Certifications are published in batches.

Annex. Legal Meaning of Terms in GATT Articles

(1) Initial Negotiating Rights (INRs)

(a) Definition of INRs

Although there is nothing like an explicit definition of the term Initial Negotiating Rights

24) See, e.g., Brazil - Renegotiations of Schedule III, BISD 22S/10 (1976).
25) BISD 19S/16 (1969)
26) Decision of 26 March 1980, BISD 27S/25 (1981).
27) BISD 27S/25 (1981).

in the WTO Agreement, there are references to concession(s) having been "initially negotiated" in Articles II, XVIII, XXVII and XXVIII of GATT 1994. It stems from those references that a WTO Member should be understood to be an INR-holder, for the purposes of the GATT, any time it has originally negotiated with another WTO Member a specific concession.

A distinction can be made between two types of INRs: namely "fixed" and "floating" INRs. "Fixed" INRs have been granted in bilateral negotiations under Article XXVIII; in the context of rounds of tariff negotiations which have adopted the request/offer negotiating modality; and in accession negotiations[28]. Such INRs, in turn, may be sub-divided into (a) INRs on present concessions referred to as "current" INRs, and (b) INRs granted on earlier concessions referred to as "historical" INRs. Historical INRs remain legal rights which in certain situations may be invoked, for example if the proposed modification of the concession exceeds the rate at which the historical INR was granted.

On the other hand, the expression "floating" INRs under the decisions adopted at the end of the Kennedy and Tokyo Rounds and in the context of the introduction of the Harmonized System nomenclature[29] is based on the same principle as principal supplying interests which can be enjoyed by different contracting parties at different points of time. In other words, these "… negotiating rights would remain floating until they become activated in a concrete case…"[30].

(b) Negotiating Rights Conferred

INRs become important when a concession on which the INR exists is being modified or withdrawn. Under these circumstances, an INR-holder has the right to negotiate and seek compensation from the Member seeking to withdraw or modify that concession. Small countries, in particular, have considered INRs important as it gives them a negotiating right, which they otherwise might not have under the criteria of principal supplying or substantial supplier rights, even though trade in that item may be of considerable significance to them.

28) There is a presumption that INRs are "...inherent in bilaterally-agreed lists...". However, a practice has developed in the latter years of GATT 1947, and now in the WTO where some bilateral lists specify the INRs which were granted as part of Article XXVIII or accession negotiations. The implication of such action is that on the remaining concessions there are no INR-holders. Moreover, an additional practice which has evolved in accession negotiations is for some Members to secure commitments from the applicant country that the level at which the INR is accorded to them on a concession will not be higher than the rate at it which it is granted to other Members.

29) BISD35S/336.

30) C/M/222. Interesting to note that the Secretariat has discovered at least one case where the bilateral lists reflecting the final results of Article XXVIII negotiations contain the same language on INRs as that contained in the Decision on "Floating" INRs. In other words INRs were not automatically accorded to the contracting party with which the bilateral agreement had been signed but rather to the contracting party which would be a principal supplier at the time the concessions were renegotiated.

(c) Determination of INR-holders

As a concession may involve INRs at different rates for different Members, the identification of INR-holders can be complex.[31] This situation has been rendered even more difficult by the fact that the legal instruments which contain the results of tariff negotiations or renegotiations such as Protocols or Certifications do not reflect this information. INRholders are mostly identified in the bilateral agreements deposited with the Secretariat and in informal working documents.

The situation is more complicated with respect to historical INRs as they concern INRs which were granted and which were not necessarily incorporated into successive schedules of concessions. There was an attempt to clarify the situation in 1980 at the time of the aforementioned exercise to introduce loose-leaf system of schedules of tariff concessions. In the relevant decision, it was agreed that: "…all these previous INRs must, in order to maintain a legal value, be indicated in the loose-leaf schedules…". Because of the complicated nature of the exercise it was also agreed that "earlier schedules and negotiating records will remain proper sources for interpreting concessions until 1?January 1987." However, on 6 November 1986, the GATT Council upon request by the Committee on Tariff Concessions agreed to change the wording of "until 1 January 1987" to "until a date to be established by the Council". No such date has been subsequently established.

In late 1985, issues relating to historical INRs were raised again in the Committee on Tariff Concessions at the time of the transposition exercise of schedules into the Harmonized System nomenclature. The discussion revolved around the need to transpose historical INRs into the new schedules. While some contracting parties were of the view that historical INRs could be eliminated, for others this was not an option. The approach adopted by those contracting parties that had difficulties showing historical INRs in their new schedules was to discuss with any contracting party the question of retaining such INRs during the course of Article XXVIII negotiations conducted in connection with this exercise.

In 1995-1996, the question on historical INRs was raised again in the WTO Market Access Committee. The Council agreed that: "Each Member shall include in its schedule all INRs at the current bound rate. Other Members may request the inclusion of any INR that had been granted to them. Historical INRs different from the current bound rate not specifically identified shall remain valid where a Member modifies its concession at a rate different from the rate at which the INR was granted." The decision also specifically states that the "Consolidated Loose-Leaf Schedules of Goods replaces all previous schedules for all purposes relating to Member's rights and obligations with the exception of historical INRs".

31) In 1982, the Secretariat in its paper noted "Submission of Loose-leaf Schedules - Initial Negotiating Rights regarding Earlier Bindings" (TAR/W/30) noted that: "In the course of the preparation of loose-leaf schedules, it was found that a complete listing of previous INRs in respect of concessions given in different nomenclatures and at different rates could be very complicated and in some cases could amount to several pages of INRs in respect of one tariff line…"

The current situation has improved with the finalization of the Consolidated Tariff Schedules (CTS) Database which provides, as its name suggests, consolidated information on the schedules of concessions of Members. As a result and to the extent possible, information on INRs has been furnished. However, it is to be noted that the CTS database does not have a legal basis.

(2) Principal Supplying Interest

(a) Definition of Principal Supplying Interest

There are two definitions of principal supplying interest provided in Article XXVIII and its interpretative note.

The first one incorporates a criterion which is based on import shares. According to Interpretative Note 4 to Paragraph 1 of Article XXVIII, a Member may be considered to have a principal supplying interest in a concession "if that Member has had, over a reasonable period of time prior to the negotiations, a larger share in the market of the applicant contracting party than a contracting party with which the concession was initially negotiated or would, in the judgment of the CONTRACTING PARTIES, have had such a share in the absence of discriminatory quantitative restrictions maintained by the applicant contracting party."

The second definition in Interpretative Note 5 to Paragraph 1 contains a criterion which is based on export shares. More specifically, Note 5 states that "the CONTRACTING PARTIES may exceptionally determine that a contracting party has a principal supplying interest if the concession in question affects trade which constitutes a major part of the total exports of such contracting party."

(b) Negotiating Rights Conferred

A WTO Member having a principal supplying interest in a concession has the right to negotiate and seek compensation[32] from the Member seeking to withdraw or modify that concession. The overall objective being to "maintain a general level of reciprocal and mutually advantageous concessions not less favorable to trade than that provided for in this Agreement prior to such negotiations."

32) Paragraph 7 of the Understanding addresses the question of compensation for a principal supplier. It specifies that any Member having a principal supplying interest in a concession which is modified or withdrawn is to be accorded an INR in compensatory concessions, unless another form of compensation is agreed to by the Members concerned. This paragraph came into being because it had been found that on occasions a principal supplier had been compensated on the basis of trade coverage only but not in respect of equivalency of negotiating rights, i.e compensation would be given on a relatively large number of items in which the affected party was not a principal or substantial supplier. This meant that the party would not have the right to negotiate if those compensatory concessions were modified or withdrawn at a later stage. In order to redress this imbalance it was agreed to accord negotiating rights on compensatory concessions, unless mutually otherwise agreed.

(c) Determination of Principal Supplying Interest

Unlike the case of substantial interest, no rule has evolved regarding a percentage import share that a Member would be required to have in order for it to acquire the status of a principal supplier under Paragraph 1 of Article XXVIII. This is also true of the concept of principal supplying interest contained in Interpretative Note 5 to the same paragraph. In fact, the procedures for negotiations under Article XXVIII adopted by the GATT Council on 10?November?1980, requires a contracting party which considers that it has a principal supplying interest in the concession to communicate its claim in writing. This has to be done within 90-days of the circulation by the Member proposing the change, of import statistics of the products involved by country of origin, for the last three years for which statistics are available. A recognition of such a claim by the Member proposing the modification or withdrawal of that concession would constitute "a determination by the CONTRACTING PARTIES of interest in the sense of Article XXVIII:1."

The import statistics are provided to assist in determining the supplier status of a Member.[33] There have been few instances where claims of interest have not been recognized, and one particular case concerned a principal supplying interest claimed on the basis of the criteria set out in Interpretative Note 5 to Paragraph 1 of Article XXVIII.

(3) Substantial Interest

(a) Definition

Interpretative Note 7 to Paragraph 1 of Article XXVIII states that "The expression "substantial interest" is not capable of precise definition and accordingly may present difficulties for the CONTRACTING PARTIES. It is, however, intended to be construed to cover only those contracting parties which have, or in the absence of discriminatory quantitative restrictions affecting their exports could reasonably be expected to have, a significant share in the market of the contracting party seeking to modify or withdraw the concession."

In practice, Members having 10 per cent of market share have been considered as having substantial interest in a concession. This was mentioned on July 1985 in a meeting of the Committee on Tariff Concessions, where it was stated that the "10 per cent share" rule had been generally applied for the definition of "substantial supplier."[34]

33) Paragraph 3 of the Understanding on the Interpretation of Article XXVIII of GATT 1994 resulting from the Uruguay Round clarified that in determining which Members have a principal supplying interest or substantial interest, only MFN trade relating to the affected product should be taken into account. Paragraph 4 also specifies that in the case of a new product (i.e. for which three years' trade statistics are not available, the determination of principal supplying and substantial interest should take into account inter alia "production capacity and investment in the affected product in the exporting Member and estimates of export growth, as well as forecasts of demand for the product in the importing Member"

(b) Negotiating Rights Conferred

A WTO Member having a substantial interest in a concession has the right to consult with the Member wishing to modify or withdraw that concession. It is to be noted that under this criterion the Member concerned has the right to consultation, and not negotiation as in the case of holders of INRs and principal supplying interest rights.

(c) Determination of Substantial Interest

Under the procedures for negotiations under Article XXVIII determination of substantial interest is based on the notification of a claim of interest by a Member which considers that it has a substantial interest in the concession, and recognition of that claim by the Member proposing to modify or withdraw the concession. The claim of interest has to be made within 90-days of the circulation by the Member proposing the change, of the import statistics of the products involved by country of origin, for the last three years for which statistics are available. A recognition of such a claim by the Member proposing the modification or withdrawal of that concession would "constitute a determination by the CONTRACTING PARTIES of interest in the sense of Article XXVIII:1". The import statistics are provided to assist in determining the supplier status of a Member.

(4) Redistribution of Negotiating Rights: Discussion in the Uruguay Round

In Uruguay Round Negotiating Group on GATT Articles, the question of redistribution of negotiating or suppliers' rights in connection with Article XXVIII was addressed. This issue was raised by those delegations which were of the view that the existing criteria for the attribution of rights to negotiate or to be consulted in Article XXVIII negotiations should be changed in order to give greater weight to the significance of the trade concerned for exporting countries. It was felt that reliance on import market shares as a basis for determining negotiating rights had resulted in an increased concentration of those rights in the hands of a limited number of larger contracting parties. In short, there had to be a wider and more equitable distribution of suppliers' rights among contracting parties. Discussion had begun in the Committee on Tariff Concessions on a Swiss proposal in early 1986 that a test be carried out in the context of the negotiations linked to the introduction of the Harmonized System, by offering a negotiating right to "the exporter for which trade in a specific product has the most importance." This discussion was subsequently subsumed into the Uruguay Round Negotiating Group on GATT Articles.

Several proposals were made in that Negotiating Group to the effect that an additional negotiating right as principal supplier should be given to the contracting party for which trade in the affected product had the greatest importance. The contracting party in question would be determined by the ratio of its exports of the product in question to a chosen criterion. The

34) TAR/M/16.

criteria proposed included: (i) the GNP of the exporting country; (ii) the total exports of the exporting country; (iii) the population of the exporting country; (iv) the exports of the affected product by the exporting country to all destinations; and (v) the total exports of the exporting country in the trade sector in question; this criterion was to be used only in the case of a developing country. Another proposal was to upgrade the definition of principal supplying interest which appeared by way of exception in interpretative Note 5 to Paragraph 1 and place it on the same level as the other criteria established in Article XXVIII.

It was also proposed that one or more additional contracting parties might be granted consultation rights as substantial suppliers. According to the different criteria proposed countries would acquire such rights: (i) if the value of their exports of the affected product to the market in question was greater than 10 per cent of the value of their total exports of the product to all destinations; (ii) if the ratio of imports from the country in question into the affected market exceeded 5 per cent of the total imports from all sources; and (iii) if the CONTRACTING PARTIES determined that the country in question had a substantial interest in terms of its potential trade in the product affected, based on such considerations as its production and export capacity and level of international competitiveness. One participant proposed a formula to determine additional substantial interest. A formula which would take account of two factors: (1) the affected exports in relation to total exports, and (2) the importance of exports for the domestic economy.

Another proposal suggested an entirely new approach to negotiating rights. It envisaged that on a date to be decided, all current initial negotiating, principal supplier and substantial supplier rights, determined in accordance with the current rules, would be inscribed in schedules of concessions as negotiating rights. As a result of which there would no longer be a distinction between initial negotiating, principal and substantial supplier rights; the acquisition of new negotiating rights would not be on the basis of trade shares but of a negotiated exchange of reciprocal rights; and there was to be a threshold (i.e. import value) below which it would not be necessary to negotiate compensation.

Discussions on this subject in the Negotiating Group led to the Understanding on the Interpretation of Article XXVIII of GATT 1994. The Understanding has strengthened the criteria set out in Interpretative Note 5 to Paragraph 1 of Article XXVIII and accords a principal supplier right to the Member which has the highest ratio of exports affected by the concession, (i.e. exports of the product to the market of the Member modifying or withdrawing the concession) to its total exports. It was also agreed that this criterion “would be reviewed by the Council for Trade in Goods five years from the date of entry into force of the WTO Agreement with a view to deciding whether this criterion has worked satisfactorily in securing a redistribution of negotiating rights in favor of small and medium-sized exporting Members.

If this is not the case, consideration will be given to possible improvements, including, in the light of the availability of adequate data, the adoption of a criterion based on the ratio of exports affected by the concession to exports to all markets of the product in question."

In early 2000, the Council for Trade in Goods requested the Committee on Market Access to undertake the review pursuant to this Understanding. The Committee' s report to the CTG on the review states that "··· at this stage, there was no basis to change the criterion contained in Paragraph 1 of the aforementioned Understanding. The Committee was of the view that any Member that so wished, could bring up the matter of a further review in the Council in the future."[35] Since then no further discussion has taken place on this subject.

C. Tariffs Not Bound by MFN Principle

There are several tariffs not bound by the MFN principle. First of all, tariffs - normally zero, except for a few items - agreed between FTA parties are not applicable to other WTO Members. As of February 2009, about 180 regional trading arrangements including FTAs are notified to the WTO. Georgia-Azerbaijan FTA that entered into force on July 10, 1996 is an example.

Secondly, MFN does not apply to preferential tariffs under Generalized System of Preference (GSP). But, the WTO Members still need to respect non-discrimination principle as ruled in European Communities - Conditions for the Granting of Tariff Preferences to Developing Countries.[36] The Appellate Body of the WTO ruled that a GSP granting Member should render identical treatment to all similarly-situated GSP beneficiaries, that is, to all GSP beneficiaries that have the 'development, financial and trade needs' to which the treatment in question is intended to respond.

Thirdly, tariffs imposed under trade remedy system are also applied selectively pursuant to requirements of pertinent regulations. Most frequently used trade remedy tariffs are antidumping duties. During the period of 1995 ? June 2008, India used antidumping duties most frequently by imposing 372 cases. It is followed by the United States (245), European Communities (252), Argentina (165), South Africa (124), Turkey (113), and China (108). Countervailing duties are typically used by developed country Members such as the US (50), EU (23), and Canada (12). Safeguard duties are mostly used by developing country Members. During the period of 1995 - November 2008, it was Turkey (11) that used safeguard tariffs most then followed by India (9), Chile (7), Jordan (6), US (6), Philippines (5), and Czech Republic (5).

35) WTO, G/MA/111.
36) WTO, WT/DS246/AB/R

1.2. Developments and Practices in the GATT/WTO

A. Main Trends of Tariff Renegotiations (1958-1994)

During the period 1958 to 1994, the relative flexibility in the use of Article XXVIII:5 as compared to Article XXVIII:1 (where renegotiations could be done only in a slot of about six months before the commencement of successive three-year periods) and Article XXVIII:4 (where authorization had to be obtained and renegotiation had to be completed within defined time limits) induced a gradual shift to Article XXVIII:5. This is evident from the table given below[37]:

Time Period	Invocation of		
	Para.1	Para. 4	Para. 5
1958-59	0	11	1
1960-69	27	21	11
1970-79	9	5	43
1980-89	2	2	54
1990-94	3	1	8

The slide into desuetude of Article XXVIII:4 took place notwithstanding the fact that the authorization of renegotiations under this provision became progressively easier. In the early 1950s, when special authorization had to be given, the discussions among contracting parties were spread over two or three days. Even as early as in 1958, however, approval of requests for authorization under Article XXVIII:4 had become a routine matter and there was no detailed examination of “special circumstance” in the Inter-sessional Committee. Requests were granted even when the documents had not been circulated in advance in accordance with the rules of procedure. Again, the limitation of time in respect of Article XXVIII:1 renegotiations was not a big impediment and extension of time was easily given.

B. Reservation Made for Tariff Renegotiations

The relative freedom of Article XXVIII:5, under which negotiations could begin at any time and could be carried on over any period, made this paragraph very attractive to contracting parties. All that they had to do in order to be able to invoke Article XXVIII:5 at any time during

37) A. Hoda, Tariff Negotiations and Renegotiations under the GATT and the WTO: Procedures and Practices, 88 (2001).

	Year												
	1958-60	61-63	64-66	67-69	70-72	73-75	76-78	79-81	82-84	85-87	88-90	91-93	94-96
No. of Contracting Parties	4	9	2	6	9	12	11	18	19	23	28	35	37

a three-year period was to make a reservation to this effect at the beginning. Such a reservation was made by an increasing number of contracting parties during the period 1958-94, as will be seen from the following table[38]:

These reservations were made even if there was no intention at the time of the reservation to hold such negotiations, with a view to retaining the flexibility to invoke Article XXVIII:5 if the need arose to renegotiate a tariff concession.

C. Tariff Renegotiations under the WTO System

There have been 34 requests to enter into renegotiations under GATT Article XXVIII since the establishment of the WTO in 1995, 4 of which have been withdrawn, 8 have been concluded and formally certified, and 5 have been concluded but have not been certified for various reasons. Although the remaining 17 are in principle still ongoing, it should be noted that 2 of them relate to schedules which were withdrawn in the context of an enlargement of the European Communities (i.e. Hungary and Bulgaria).[39] Table 2-1 summarizes the GATT Article XXVIII renegotiation for newly acceded WTO Members after the WTO accession.

Table 2-1 | Renegotiation of Schedules of Concessions by Acceded WTO Members

WTO Member	Renegotiations under GATT Article XXVIII
Bulgaria	G/SECRET/13 is currently underway withdrawn for the enlargement to EC-27
Croatia	G/SECRET/24 is currently underway
Estonia	withdrawn for the enlargement to EC-25
Latvia	withdrawn for the enlargement to EC-25
Lithuania	withdrawn for the enlargement to EC-25
Moldova	G/SECRET/31 is underway

37) A. Hoda, Ibid, 89.
39) WTO, G/MA/W/23/R.5.

The frequency of recourse to Article XXVIII to modify or withdraw tariff concessions for protective purposes has considerably decreased as compared to the period under GATT 1947. In most cases, the renegotiations relate to concessions on specific agricultural products. Also, WTO Members have typically had recourse to Paragraph 5 of Article XXVIII, thus continuing the pattern established during the previous two decades under GATT 1947.

In terms of Article XXIV:6 renegotiation, the case concerning EEC to expand the membership is worthwhile to be mentioned. On 15 December 1994, the EEC had circulated for the information of the contracting parties to GATT 1947 the "Treaty concerning the accession of Austria, Finland, Sweden and Norway to the European Union", indicating that some further adjustment of the instruments concerning the accession of new Member States would be required to reflect Norway's decision not to accede and that the treaty would enter into force on 1 January 1995. It was also indicated that the EEC intended to withdraw the tariff schedules of Austria, Finland, Sweden and the EEC 12 and would be ready (from 1 January 1995) to enter into tariff negotiations provided for in Article XXIV:6. Pending completion of the Article XXIV procedures and the creation of a new schedule for the EEC 15, the communication stated that the tariff commitments of the EEC 12 would be fully respected. The acceding countries were, however, to align their duties with the Common Customs Tariff on 1 January 1995 except where a separate time-table was laid down in the Act of Accession.

On 19 January 1995, the EEC informed the General Council that the ratification procedures for the accession of Austria, Finland and Sweden to the European Union had been completed and the Accession Treaty had entered into force on 1 January 1995. On 27 January 1995, the EEC furnished the basic data for discussion under Article XXIV:5 and negotiations under Article XXIV:6. They consisted of concordance tables of tariff concessions made by the newly-acceding Members along with that of the EEC 12 and trade data showing the value and quantity of total trade for three years with other GATT contracting parties for each tariff line together with a breakdown by country of origin.

Following the commencement of the process under Article XXIV:6, 15 WTO Members expressed an interest in joining the negotiations, but the process followed thereafter was entirely bilateral. An important point was raised even before 1 January 1995 that the renegotiations under Article XXIV:6 should have been commenced and concluded before the establishment of the Common External Tariff.

Following an agreement with the US, the EEC adopted a decision on 29 December 1994, opening tariff quotas in the newly-acceding member States during the period 1 January to 30 June 1995, "to provide temporary relief to its trading partners for the most serious cases in which there is an increase in import duties". Not satisfied with this action, Canada invoked Article XXVIII:3 and on 1 March 1995 gave a 30-day notice for the withdrawal of certain concessions initially negotiated with the EEC. Canada requested the EEC to provide interim compensation by reinstating the 1995 tariff rate that would have been in effect in Austria, Finland and Sweden had they not joined the EEC during the period 1 April to 1 July 1995, in respect of certain products of interest to it. The EEC stated in response that it had acted in the same manner on that occasion as in the case of earlier expansions of the Community and contested that Canada was in a situation which justified the exercise of rights under Article XXVIII:3. However, an agreement was reached and the EEC provided interim compensation to Canada by accelerating the tariff reduction on newsprint already committed in the Uruguay Round. The above agreements with the US and Canada on interim compensation on account of the establishment of the Common Customs Tariff even before the commencement and conclusion of Article XXIV:6 renegotiations were not notified to the WTO Members.

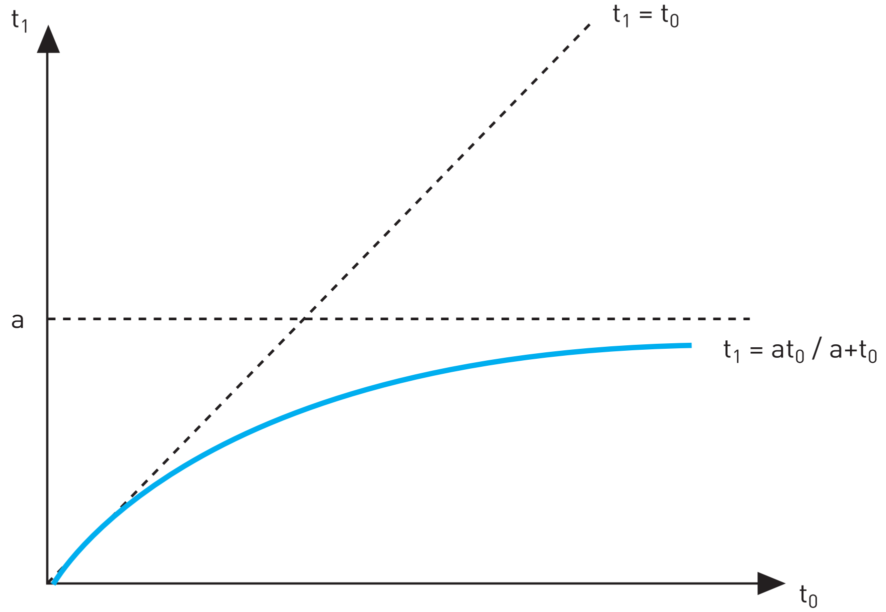
On 28 February 1996, the EEC notified its new Schedule CXL, containing the tariff and other commitments "in the light of the Article XXIV:6 negotiations which have now been concluded with most of the EC partners. The notification mentioned that, as all current negotiations under Article XXIV:6 had not been completed till then, the EEC reserved the right to modify the concessions. The US and Canada objected to this notification on the ground that the bilateral agreements with the EEC, although initialed, had not been formally signed. A number of agricultural exporting countries made the point that, even if agreement had been reached on the netting out of export commitments and aggregation of domestic subsidy commitments, the Article XXIV:6 procedures could not be applied with respect to the commitments on domestic support and export subsidy commitments for the modification of which appropriate legal modalities of implementation had to be discussed and agreed. Argentina made the point that the notification was not in order when the negotiations and consultations under Article XXVIII had not been concluded.

The bilateral agreements with the US and Canada were notified to the Secretariat by the end of July 1996, but other agreements were not notified. The EEC has continued to notify amendments in the schedule originally notified on 28 February 1996 in the light of further agreements and comments.

C. Tariff Negotiations in Doha Round Based on Formula Approach

Tariff reductions for industrial products would be made using a "simple Swiss" formula with separate coefficients for developed or for developing country members. But, whereas the coefficient for developed members will be the same applicable to all of them, there will be a menu of options for developing members that will apply according to the scale of the flexibilities they choose to use. The lower the coefficient the higher the flexibilities and vice versa. A Swiss formula produces deeper cuts on higher tariffs.

Figure 2-1 | Tariff Negotiation Formula for Doha Negotiation



t_1 = final bound rate of duty
t_0 = base rate of duty
a = 8 for developed Members
= 20, 22, or 25 for developing Members

The Chair' s draft modalities contain these coefficients: 8 for developed members and 20, 22 and 25 for developing[40]. Therefore, not all developing countries applying the formula would apply the same coefficient. The use of the different coefficients would depend on three new options:

* A member choosing to apply the lowest coefficient, 20, would be entitled to make smaller or no cuts in 14 percent of its most sensitive industrial tariff lines, provided that these tariff lines do not exceed 16 percent, the total value of its NAMA imports. These tariffs would be subject to cuts equal to half of the agreed formula reduction. As an alternative, the member can keep 6.5 percent of its tariff lines unbound or exclude them from tariff cuts, provided they do not exceed 7.5 percent of the total value of its NAMA imports.

40) WTO, TN/MA/W/103/Rev.3 (Dec. 6, 2008).

* A member choosing to apply a coefficient of 22 would be entitled to make smaller or no cuts in a smaller number of products: up to 10 percent of its most sensitive industrial tariff lines from the full effect of the formula, provided that these tariff lines do not exceed 10 percent of the total value of its NAMA imports. These tariffs would be subject to cuts equal to half of the agreed formula reduction. As an alternative, the member can keep 5 percent of its tariff lines unbound or exclude them from tariff cuts, provided they do not exceed 5 percent of the total value of its NAMA imports.

* A member choosing to apply the highest coefficient, 25, will have to apply it on all its products without exceptions.

The proposed coefficients would mean that the maximum tariff in developed countries would be bellow 8 per cent. This would mean that developed countries would have bound tariffs at an average of well below 3 per cent, and tariff peaks below 8 per cent even on their most sensitive products.

The majority of tariff lines for developing country members applying the formula would be less than 12-14 percent, depending on the coefficient and the flexibilities used. In the developing countries applying the formula, bound tariffs would be at an average of between 11 to 12 per cent, and only a limited number of tariff lines would have levels above 15 per cent. The difference between bound rates and those actually applied would be substantially reduced.

The Recently Acceded Members (RAMs) shall apply the modality provided for developing countries or small and vulnerable economies whose NAMA trade share for the reference period of 1999 to 2001 is less than 0.1 percent. In addition, the RAMs applying the formula shall be granted an extended implementation period of 3 equal rate reductions. The first reduction shall be implemented on 1 January of the year following the entry into force of the DDA results. Each successive reduction shall be made effective on 1 January of each of the following years. Moreover, Albania, Armenia, Cape Verde, Former Yugoslav Republic of Macedonia, Kyrgyz Republic, Moldova, Mongolia, Saudi Arabia, Tonga, Viet Nam and Ukraine shall not be required to undertake tariff reductions beyond their accession commitments.

The tariff reductions will be implemented gradually over a period of five years for developed members and ten years for developing members, starting 1 January of the year following the entry into force of the Doha results.

The so-called anti-concentration clause, to avoid excluding entire sectors from tariff cuts, is also agreed to require the full formula tariff reduction for a minimum of 20% tariff lines or 9% of the value of imports in each tariff chapter.

2. Development of Import and Tariff Policies of Korea

2.1. Evolution of Import Policy in Korea

A. Import Liberalization

The Korean government maintained restrictive import systems when it implemented export-driven industrial policy until 1980. Korea invoked GATT Article XVIII:B - the so-called, balance of payment exception clause - to limit importation when it joined GATT in 1967. This balance of payment exception was dis-invoked only in 1990 after it lost the disputes with the US, Australia and New Zealand.[41] Although Korea began import liberalization since the late 1970s, it was reversed due to the second oil crisis. Major events during the export-driven development period are as follows:

(1) Export Driven Development Period (1967-80)

1967: Accession to GATT, Import based on the negative list system (luxury product prohibited)
1969: Comprehensive import restriction due to balance of payment problem
1978: Import liberalization
1979: Import restriction due to the 2nd Oil Crisis

The open economy period began since 1981 by resuming import liberalization policies. The Early Announcement Program in which the items to be liberalized for importation are announced in advance was introduced in 1984 to alleviate adjustment costs of market liberalization. The import monitoring system was also repealed in 1989.

(2) The Open Economy Period (1981-94)

1981: Import liberalization resumed
1984: Early Announcement Program for import liberalization
1988: Completion of Early Announcement Program
1989: Repealing Import Monitoring System

The WTO system provided another important opportunity to deepen import liberalization not only in conventional market access areas but also completely new areas such as agriculture and services markets. Korea also joined the OCED in 1996, which substantially improved financial market liberalization. In 2000, even mere notification systems for trade business were completely repealed.

41) For more detail, see Dukgeun Ahn, "Korea in the GATT/WTO Dispute Settlement System: Legal Battle for Economic Development", Journal of International Economic Law, Vol.6, No.3, 597-633, 2003.

(3) The WTO Period (1995-00)

1995: WTO
1996: OECD
1996: Negative list system for trade approval
1999: Repealing import diversification problem
2000: Repealing notification system for trade business

Korea has engaged in the FTA negotiations since 2000, starting from the Korea-Chile FTA. Import liberalization using FTAs is unprecedented for Korea. As of February 2009, Korea already ratified FTAs with Singapore, EFTA and ASEAN (excluding Thailand) in addition to Chile. Moreover, Korea concluded an FTA with the United States in June 2007. The Korea-US FTA worked as a catalyst to invoke FTA negotiations with other countries, most notably the European Union. The Korean market is expected to become much more open with increasing FTA arrangements with Canada, India, Australia, Japan and eventually China.

(4) The FTA Period (2000- present)

2000: Korea-Chile FTA began
2004: Korea-Chile FTA entered into force
2006: FTA with EFTA, Singapore
2007: Korea-US FTA concluded

B. Import Diversification Program[42]

Despite the accession to the GATT in 1967, the Korean government maintained various import restraints primarily due to its balance-of-payment problems. The chronic foreign debt problems aggravated by the heavy chemical industry promotion policy starting from 1973 and the first oil shock in 1974, in fact, strengthened import restrictions. It was only in 1977 when the total value of exportation exceeded $10 billion that a serious effort to liberalize importation was undertaken.[43] In 1978, three major import liberalization measures were implemented in May, July and September.

In May 1978, as a safeguard mechanism for major import liberalization, the Korean government effectively applied the Import Diversification Program that was first introduced concerning 7 product items in 1977.[44] Subsequently, the Executive Order of the Trade

42) This part is mainly based on Dukgeun Ahn, "WTO Disciplines under the IMF Program: Conflict or Congruence: From the Korean Experience" in WTO and East Asia: New Perspectives, 29-33 (eds. by Mitsuo Matsushita and Dukgeun Ahn, 2004, Cameron May).
43) The overall trade balance in 1977 was still in deficit at some $764 million.
44) Public Notice by the Ministry of Commerce and Industry, No. 78-8.

Transaction Act was amended to include Article 21:3 that stipulated discretionary import restriction of products from countries with which Korea had trade deficits.[45] The legal foundation for the Import Diversification Program was later replaced with Article 19.2 of the Foreign Trade Act.[46] Article 35.5 of the Executive Order of the Foreign Trade Act provided a more specific legal support for the Programme that was employed to address country specific trade imbalance.[47]

Table 2-2 | Number of Items Subject to the Import Diversification Program

Year	Number of Items			Liberalization Rate
	CCCN 4 level	CCCN 8 level	CCCN 10 level	
1980	195			69.3
1982	209	913		76.6
1984	168	590		84.9
1986	159	414		91.5
1988			344	94.8
1990			268	96.3
1991			258	97.2
1992			258	97.7
1993			258	98.1
1994			230	98.6
1995			204	99.0
1996			162	99.3
1997			127	99.9
1998			88	99.9

Source: Ministry of Commerce and Industry
Note: 1. The increase of the number of the items subject to the Import Diversification Program is due to the amendment of HS code on January 1, 1990.
2. CCCN (Customs Cooperation Council Nomenclature) is the pre-1989 version of harmonized systems of tariff classification.
3. "Liberalization Rate" shows the percentage of the tariff lines that are not constrained by any formal restrictions for importation.

45) Executive Order of the Trade Transaction Act (Presidential Decree No.10057, Nov. 1, 1980), Art.21:3, para.2.4.
46) Public Law No. 3895 (Enacted on Dec. 31, 1986; entered into force on July 1, 1987).
47) Executive Order of the Foreign Trade Act (Presidential Decree No.12191, June 30, 1987).

The Import Diversification Program basically targeted the imports from Japan. After the liberation from colonial governance in 1945, Korea resumed economic relationship with Japan since 1965. Bilateral trade with Japan, however, caused huge trade deficits for Korea that often intensified political tension rooted on a former colonial history. The Import Diversification Program was, therefore, devised from the inception to address potentially too dependent trade structure on Japanese imports. When Korea experienced the largest trade deficit with Saudi Arabia in 1982, the Import Diversification Program was modified in 1983 to apply to the country with the largest trade deficit "in the past five years." This amendment was solely to single out Japan as the potential target for the system. As a result, products from countries other than Japan had never been subject to the Import Diversification Program.

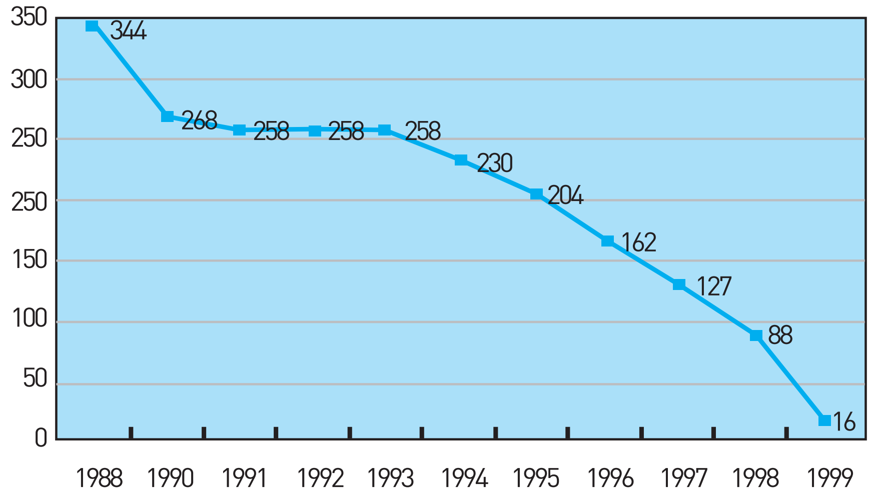
Although the Import Diversification Program began with 7 product items in 1977, it soon included 100 additional items by May 1978 and 107 more items by the end of 1978. But, the problem of the Import Diversification Program was already raised when the application to intermediary products and machinery harmed competitiveness of domestic production. Accordingly, the product coverage under the Import Diversification Program was focused on final consumer products, rather than intermediary products that were used in subsequent manufacturing process. The Korean Government allowed various exceptions to the Import Diversification Program. These have been granted for production facilities, parts and components in connection with the Foreign Investors Industrial Parks; sample products for domestic production; and materials for producing exports. In addition, the Import Diversification Program also covered divergent products for which import substitution policies were undertaken. This function of the Import Diversification Program, however, was not as crucial as the role to address unbalanced trade deficits.

The product coverage was continuously increased until 1981[48] and then gradually reduced to phase out by June 1999. The Import Diversification Program was formally terminated when the last 16 product items including VCR, mobile phones, colour televisions, automobiles, and camera were removed from the list.

The Japanese government had requested repeatedly to repeal the Import Diversification Program, alleging the violation of GATT obligation particularly, under Articles I, XI and XIII. Since the Korean government dis-invoked Article XVIII:B for its import restrictive measures in 1990[49], the legitimacy of the Import Diversification Program under GATT obligations was indeed questionable. But, the Japanese government never brought a formal complaint on the Program to the GATT dispute settlement system. Instead, the Japanese government relied on a more political and diplomatic channel, for example, by raising the issue at the ministerial level.

48) The product coverage in 1981 on the basis of the CCCN 8-digit reached about 924 items.
49) Ahn, supra note 36, 603-606.

Figure 2-2 | Number of Product Items under Import Diversification Program



As an effort to improve bilateral economic relations and also to cope with a new trading system established by the Uruguay Round negotiation, the Korean government decided to reduce the product coverage of 258 items by half during the five year period beginning in 1994[50]. The long term plan for the Import Diversification Program prepared in December 1993 left the reform plan open for future works.

But, with the accession to the OECD in 1996, Korea agreed to eliminate the Import Diversification Program by the end of 1999. The OECD accession negotiation which took place between November 1995 and July 1996 had seven evaluation sectors and four policy review areas. As one of the policy review areas, trade issue was discussed and the Import Diversification Program was scheduled to phase out by the end of 1999.

In addition, at the end of 1997 when the Korean government reached an agreement with the IMF on economic reform programs to receive financial support, it committed to repeal the Import Diversification Program by the end of June 1999. After the Korean government reached a stand-by arrangement with the IMF in an effort to overcome a financial crisis on December 3, 1997, 11 "Letters of Intents" were exchanged to elaborate the structural reform programs in the course of restructuring and recovery process. By the Letter of Intent dated December 18, 1997, the Korean government committed to accelerate the phase-out of the Import Diversification Program by June 1999, six months earlier than the due date committed to the WTO. Pursuant to this agreement, the Korean government removed 25 items by the end of 1997, 40 items by the end of July 1998, 32 items by the end of 1998, and finally the remaining 16 items - primarily in

50) MITI, 1999 Report on the WTO Consistency of Trade Policies by Major Trading Partners 55 (1999).

industrial machinery, electrical and electronic equipment, and automotive sectors ? by the end of June 1999. As part of a restructuring program committed to the IMF, the Korean government successfully implemented the scheduled liberalization, as indicated in Table 2-2, or the complete phase-out of the Import Diversification Program

2.2. Development of Tariff Policy of Korea

A. Evolution of Tariff Policy in Korea

Table 2-3 | Principle of Reforming Tariff Rate Structure in Korea

		1988	1989	1990/91	1992	1993	1994-
Raw Materials	Non-Competitive	5	1~2	1~2	1~2	1~2	1~2
	Competitive	10	5	5	5	4	3
Parts and Finished Products	Base Rate (Manufacturing Products)	20	15	13	11	9	8
	Products without Domestic Competitiveness or Domestic Substitutes	10~20	10	10	10	9	8
	Luxury Products	30~50	20	16	13	10	8

Source: S. Park, Evolution and Evaluation of Tariff Policy (Korea Institute of Public Finance, 1997).

Until the mid-1950s, the Korean government used tariff systems mainly for fiscal revenue purposes. Tariffs had constantly increased to protect domestic industrialization up to the late 1960s. Then, the tariff system was modified to adopt tariff escalation system in which tariffs tend to increase as manufacturing process is further undertaken. Also, flexible tariff systems to accommodate antidumping, countervailing and safeguard duties were adopted in 1967. The Korean government adopted the uniform tariff system since 1984 to simplify and reduce the base tariff rate, which is now 8%.

As shown in Table 2-3, the Korean government used to favor import of non-competitive raw materials and parts without domestic competitiveness to assist domestic industrialization. The tariff escalation system was transformed into uniform tariff system in 1994.

The notable developments in critical periods in terms of tariff policy evolution are as follows:

(1) Tariff System for Fiscal Revenue (1949-56)

Primary purpose for government revenue source

(2) Tariff Escalation System (1957-83)

Until 1967: Constant tariff increase to protect domestic industrialization

1967: Import liberalization with flexible tariff system (safeguard duty, countervailing duty, tariff rate quota, etc.)

1979: Average tariff reduction from 35.7% to 24.9%

(3) Uniform Tariff System (1984-Present)

1984: Adjustment duty for import liberalization, base rate of 20%

1988: Tariff reduction for raw materials to improve competitiveness

1994: Due to UR negotiation, average tariff rate reduced from 19.7% to 7.9%

Table 2-4 | Trend in Change of Average Tariff Rates in Korea

		1st Tariff Rate Reduction Announcement		2nd Tariff Rate Reduction Announcement							
	1983	1984	1988	1989	1990/91	1992	1993	1994	1997	1999	2000
Average Tariff	23.7	21.9	18.1	12.7	11.4	10.1	8.9	7.9	8.6	8.6	8.6
Agricultural Products	31.4	29.6	25.2	20.6	19.9	18.5	17.8	16.6	18.7	18.6	18.6
Manufacturing Products	22.6	20.6	16.9	11.2	9.7	8.4	7.1	6.2	6.3	6.4	6.4
Raw Materials	11.9	10.6	9.5	3.9	3.9	3.3	3.2	2.8	2.6	2.5	2.5
Parts and Components	21.5	18.7	17.1	17.1	10.7	9.3	7.8	7.0	6.9	6.8	6.8
Finished Products	26.4	24.7	18.9	13.3	11.2	9.4	7.9	7.1	6.8	7.0	7.0

Source: Korea's Import Policy (Ministry of Commerce, Industry and Energy, 2003).

B. Tariff System of Korea

The customs tariff is Korea's main trade policy instrument as well as a major, albeit declining, source of tax revenue (4.6% of total tax revenue in 2007). The 2008 tariff consists of 11,729 ten-digit lines. The 2008 customs tariff remains relatively complex, involving a multiplicity of rates (83 *ad valorem*, 41 alternate duties) often having small rate differences and involving decimal points.

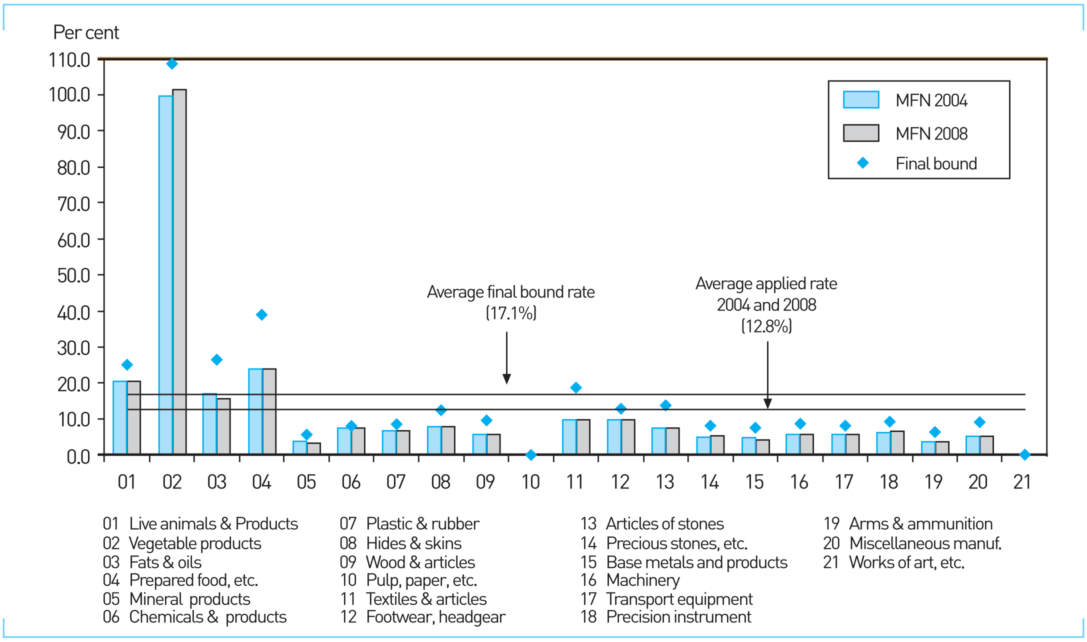
Tariff rate quotas apply under Korea' s multilateral agricultural market-access commitments, with in-quota rates ranging from zero to 50% (2007) compared with outofquota rates up to 800.3%, and with average fill rate of 68.3%. Other measures (e.g. "autonomous" tariff quotas, usage tariffs, and duty concessions) selectively reduce tariffs on inputs.

Requests to modify tariff rates are submitted by the relevant ministries and interested parties to the Ministry of Strategy and Finance (MOSF), which presents the case to the Customs and Tariff Deliberation Committee.[51] If accepted by the Committee, any modification is submitted to the State Council. After approval by the State Council, the modification is enacted as part of the Customs Act, by the National Assembly, in the form of an Annex to the Act.

(1) Applied MFN Rate

The applied MFN rate averaged 12.6% in 2008. This is high by OECD country standards, thereby requiring tariff concessions or drawbacks (to ensure that tariffs levied on intermediate inputs do not feed through as taxes on exports), adding to the complexity of border taxation. Peak ad valorem rates have concentrated in agricultural items; applied MFN tariff rates range from zero to 887.4% (manioc); some 86.6% of rates were 10% or below in 2008.

Figure 2-3 | Average applied MFN and bound tariff rates, by HS section, 2004 and 2008



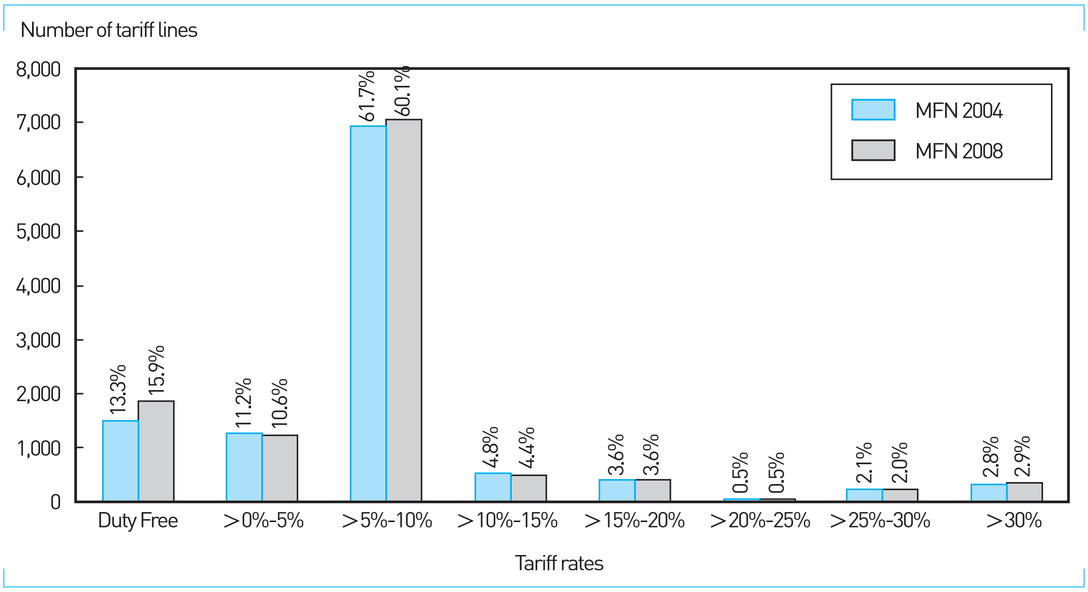
Note: Calculations include out-of-quota rates (thereby excluding lower in-quota rates) and the ad valorem part of alternate rates. Averages for 2004 are based on HS02 nomenclature, and for 2008 on HS07. Only HS sections 03, 12, 14, 19 and 21 are fully bound. Final bound rates are based on the 2008 tariff schedule.
Source: WTO Secretariat calculations, based on data provided by the Korean authorities.

51) This consists of academics, customs officials, journalists, and representatives from non-governmental groups, including consumer and business organizations, and from relevant ministries.

The average applied customs duty on agricultural products (WTO definition), at 53.5%, remains more than eight times higher than the average for non-agricultural goods (6.5%). Average tariffs are highest for vegetable products (HS Section 2), at 101.6%. Manufacturing tariffs are highest for footwear and headgear (HS Section 12) at 10.1%, and for textiles and articles (HS Section 11) at 9.8%. Korea has bound 90.8% of its tariff lines: 98.7% of agricultural lines (excluding mainly rice) and 89.5% of its non-agricultural lines. The average gap of 4.3 percentage points between the average bound and applied MFN tariff rates still imparts a degree of unpredictability to the tariff regime and provides scope for the authorities to raise applied rates within the bindings. Korea has continued to use this gap to apply higher MFN duties (e.g. adjustment duties) termed as "flexible tariffs," which the authorities maintain are within WTO bindings.

Over 99% of tariffs are ad valorem duties. This simplifies the tariff structure and improves transparency. However, there are some 124 different rate bands (83 ad valorem, 41 alternate duties), mainly associated with agricultural tariffs, of which about 44 have decimal duties; alternate duties apply to 0.7% of total tariff lines (about 81). Tariff rates range from free to 887.4%. Some 87% of rates are 10% or below (in 2008); 60.1% of rates are between 5% and 10%; the modal rate is 8%. Rates of over 30% apply to 2.9% of tariff items (2.8% in 2004); "nuisance" applied MFN rates (2% or less) apply to 1.9% of tariff lines, and 2.6% of lines have domestic tariff "peaks" (rates over 38.3%).

Figure 2-4 | Distribution of MFN tariff rates, 2004 and 2008



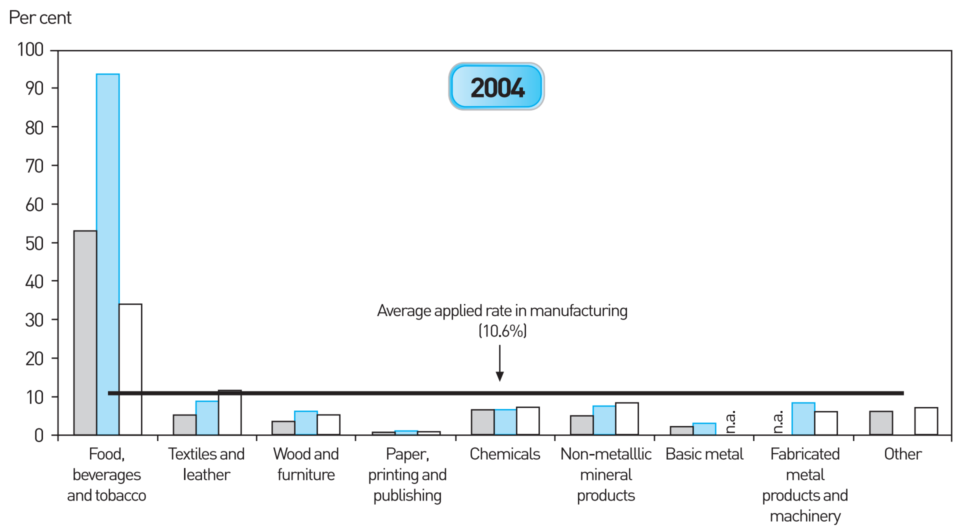
Note: Includes out-of-quota rates for tariff quotas (excludes lower in-quota rates) and the ad valorem part of alternate duties. Percentages denote the share of total lines. Totals do not add to 100% as no tariff rates were provided for 16 lines (import restriction, representing 0.1% of total lines). The 2004 estimates are based on HS02 nomenclature and 2008 on HS07.
Source : WTO Secretariat calculations, based on data provided by the Korean authorities.

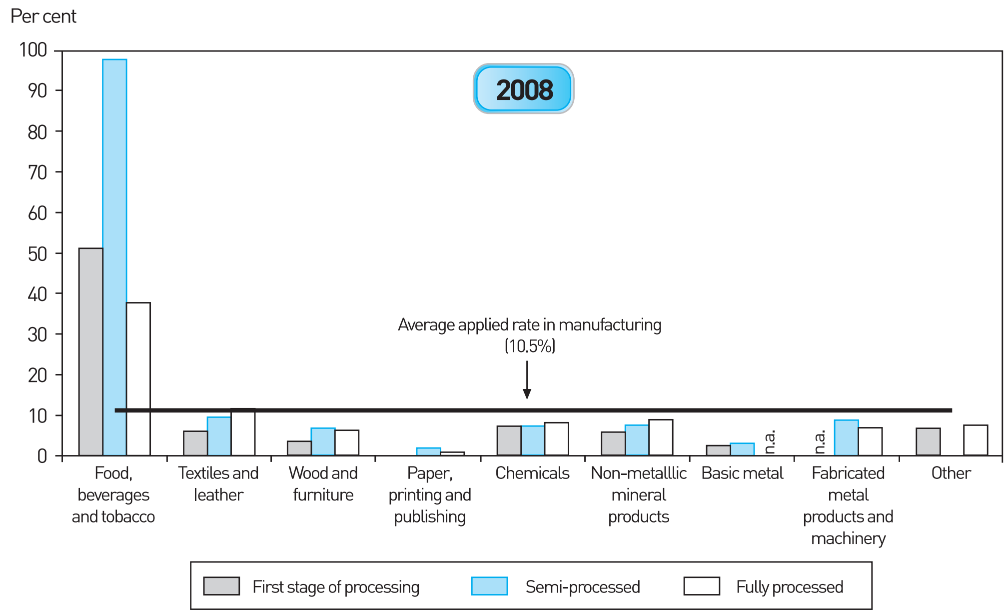
Non-ad valorem tariffs consist of alternate duties on several manufacturing tariff items, mainly cinematographic film, diagnostic or laboratory reagents, raw silk, and recorded video tapes. These generally apply the greater of an ad valorem or a specific duty, whereby the ad valorem alternate rate sets a floor on the import duty rate. Alternate duties also apply to a number of agricultural tariff items as out-of-quota duties, which also provide very high minimum ad valorem rates, generally of well over 100% (exceeding 500% on sesame seeds and oil, jujubes and pine nuts).

(2) MFN Tariff Dispersion and Escalation

Summary indicators of overall tariff dispersion show relatively wide dispersion in applied MFN tariff rates (ranging from zero to 887.4%). Tariff escalation is minimal within the Korean Tariff Schedule as a whole. As indicated in Table A.3, the tariff average actually declines between the first and second stage of processing before increasing slightly on the third stage. Escalation remains most pronounced in semi-processed food, beverages and tobacco and throughout all production stages of textiles and leather, basic metal products, and non-metallic mineral products (Figure 2-5). However, de-escalation has persisted for semimanufactures compared with finished items mainly for food, beverages and tobacco, and fabricated metal products and machinery

Figure 2-5 | MFN tariff escalation by 2-digit ISIC industry, 2004 and 2008





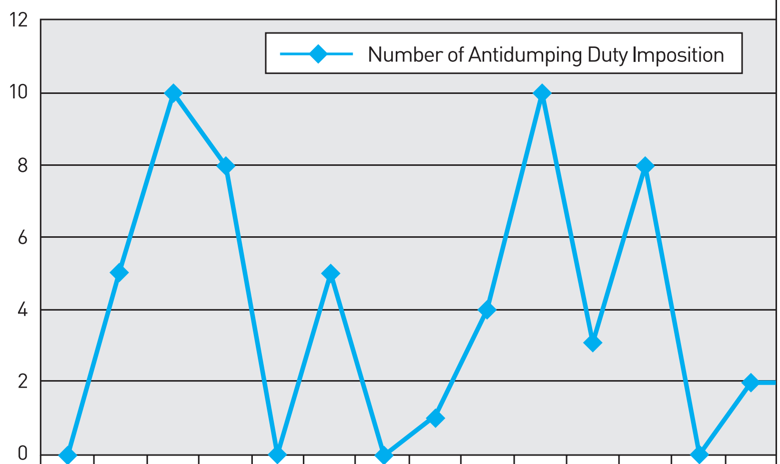
Note: Includes out-of-quota rates for tariff quotas (excludes lower in-quota rates) and the ad valorem part of alternate duties. 2004 averages are based on HS02 nomenclature and 2007 on HS07.
Source: WTO Secretariat calculations, based on data provided by the Korean authorities.

(3) "Flexible" Tariffs

Korea applies temporary higher MFN duties (termed as flexible tariffs) than those set at the customs tariff schedule; the flexible tariffs mechanism includes adjustment, safeguard, special safeguard, and seasonal duties. Through a number of different mechanisms and rationales, the system allows the authorities to increase or decrease certain tariffs at their discretion, with differentials of as much as 40% above or below a fixed tariff rate. This provides considerable scope to encourage or discourage imports of particular items, for inflation-control and industrial policy purposes.

The number of items covered by the broad "flexible tariff" description has been cut in recent years from 203 (HS ten digits) in 2004 to 101 in 2007. The authorities intend to gradually reduce or remove these tariffs in line with the reduction of tariff rates resulting from the DDA and FTA negotiations.

Figure 2-6 | Use of Antidumping Duties in Korea



	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	Jan.-Jun. 2008
Number of Antidumping Duty Imposition	0	5	10	8	0	5	0	1	4	10	3	8	0	2

Source: WTO Webpage 〈http://www.wto.org/english/tratop_e/adp_e/adp_e.htm〉.

A. Adjustment duties

Adjustment duties protect domestic industries from import surges and lighten the shock from trade liberalization. They are set annually by the MOSF. The Customs and Tariff Deliberation Committee considers the MOSF' s proposals, and if approved by the State Council, adjustment duties are implemented by Presidential Decree.

In 2007, they applied to 21 six-digit tariff items covering mainly certain fish, rice preparations, sauces, and plywood. Duties currently range from 11% on plywood to 57% on croakers. Alternate duties where duties are the higher of an ad valorem or a specific duty are applied to six of the six-digit tariff lines. Several products that were subject to adjustment duties in 2007, such as several fish and plywood items remained unbound.

B. Special safeguard and safeguard tariffs

Korea reserved the right to take special safeguard action (SSG) on crop and related products (e.g. grains, potatoes, ginseng, and soybean) under the WTO Agreement on Agriculture.

Safeguard, including provisional, tariffs may also apply to imports that have surged and caused or threaten to cause material injury to domestic producers, where deemed necessary to protect domestic industries (Customs Act).

C. Seasonal duties

Seasonal duties may be levied on goods with fluctuating seasonal prices, to protect domestic industries against competing imports that threaten to "disrupt" production. Seasonal duties were put in place in 2004 on grapes imported from Chile under the KCFTA: preferential duties are applied only to grapes imported during the Korean off-season.

D. Antidumping duties

Antidumping duties are also actively utilized to protect domestic industries, although countervailing duties have never been used in Korea. Targets of antidumping duties become more diverse. As contested in Korea - Paper Industry, antidumping practices of the Korea Trade Commission have seen remarkably improved, particularly compared to those during the the GATT period.

(4) Bound Tariff

Korea bound 90.8% of all tariff lines in the Uruguay Round. Some 98.7% of agricultural tariff lines (excluding mainly rice) and 89.5% of industrial tariff lines (WTO definitions) are bound. On a tariff classification basis, 84.4% of agricultural tariff lines (HS Chapters 01-24) and 91.9% of industrial lines (HS Chapters 25-97) are bound.

The simple average bound tariff rate fell slightly from 17.2% in 2004 to 17.1% in 2008; a further decrease should take place in 2009 when all Uruguay Round commitments are to be fully implemented.[52] Following "tariffication" of non-tariff measures, except on rice, very high bound (and applied) tariffs, often seemingly prohibitive, apply to many commodities, such as cereals and dairy products. Korea's average bound rates on agricultural and industrial products (WTO definitions) are 62.5% and 9.4%, respectively (in 2008). Korea uses this scope mainly to raise MFN tariffs annually by applying higher adjustment duties on a number of products to temporarily protect domestic producers.

Korea has been included in several collective waivers that suspend the application of the provisions of Article II of GATT 1994 in order to allow it to reflect the changes resulting from the HS (2002) nomenclature in its Schedule of concessions. The current waiver is valid until the end of 2008.[53] Since 1 January 2007, Korea has also benefited from similar collective waivers for the introduction of Harmonized System 2007 changes in its Schedule of concessions; this is also valid until end 2008.[54]

52) When all commitments are fully implemented, the average bound tariff on industrial products will fall only marginally to 9.3% (WTO definition).
53) WTO, WT/L/712, 21 December 2007.
54) WTO, WT/L/713, 21 December 2007.

(5) Duty Concessions/Exemptions

The MOSF may grant reductions or exemptions of import duties for various purposes, such as industrial development (Articles 88-109, Customs Act). The MOSF determines tariff concessions in consultation with relevant ministries. The authorities indicate that revenue forgone from import duty relief was US$915 million (equivalent to 7.5% of total tariff revenue) in 2007 (US$424 million or about 5% of tariff revenue in 2003).

Tariff concessions also apply under other legislation. For example, capital goods imported for foreign investment projects located in special zones (e.g. foreign investment zones), are exempt from customs duties, generally for up to three years. Customs duties on certain imported goods and for certain importers can be paid in installments over five-years. The Promotion Act for the Development of Aircraft and Space Industries also allows dutyfree imports of parts (revenue forgone of W 44.6 billion in 2007, up from W 25.9 billion in 2004).[55]

(6) “Usage” Tariff Rates

Imported inputs for specified end-uses under “usage” tariff rates may be exempt from tariffs under “usage” tariff rates (Article 83, Customs Act). Autonomous tariff quotas also provide lower in-quota duties for certain imported inputs, including those used in specified end-uses. Korea Customs Service is responsible for post-audit monitoring to ensure that the inputs meet the end-use criteria; full duty is collected on inputs used for other purposes. Usage tariff rates, autonomous tariff quotas and, to a lesser extent, duty concessions on inputs seem to be an important component of Korea’ s industrial policy, whereby the Government encourages certain manufacturing activities.

(7) Tariff Preferences

Korea grants limited reciprocal tariff preferences to developing countries under the Global System of Trade Preferences among Developing Countries (GSTP) and the GATT Protocol relating to Trade Negotiations among Developing Countries (TNDC). It also provides unilateral (non-reciprocal) duty-free and quota-free tariff preferences to LDCs; as of January 2008, their scope was expanded to cover 75% of the national tariff schedule. The MOSF may withdraw or modify unilateral trade preferences if considered inappropriate taking into account the country’ s income level, volume of imports, and international competitiveness of the product and country concerned.

55) WTO, G/SCM/N/71/KOR, 2 August 2001 and G/SCM/N/123/KOR, 24 January 2006.

At present, Korea' s reciprocal concessions under the Asia-Pacific Trade Agreement (APTA) are mostly at either 50% or 30% of the MFN tariff rate. Special concessions apply to Bangladesh and to Lao PDR, at mainly 100%, 50% or 30% of the MFN duty (on 300 tariff items).

Korea' s simple average tariff rate remains at the MFN average of 12.8% (the same as in 2004) for imports from countries receiving preference under the GSTP, and TNDC; it falls slightly to 12.3% (12.5% in 2004) and 9.2% (according to the authorities) for imports from APTA countries and LDCs, respectively. However, this is changing rapidly in line with Korea' s move to expand its bilateral and regional free-trade agreements, concluded with ASEAN (in effect from 2007), Chile[56], Singapore, and EFTA, and the United States. It is in the process of talks with Japan, Canada, Mexico, and India, and is looking to open discussions with China, GCC, MERCOSUR, Turkey, Russia and possibly Israel.

Table 2-5 | Preferential trading arrangements, 2008

Agreement	Participants	Coverage[a] (no. of lines)	Preferential Margin
Asia Pacific Trade Agreement			
APTA I	China, India,Sri Lanka	1,282	5% to 98% of MFN rate
APTA II	Bangladesh, Laos	1,505	5% to 100% of MFN rate
Global System of Trade Preferences (GSTP)	43 countries	12	10% to 73% of MFN rate
Least Developed Countries (LDCs)	50 countries	5,522	100% of MFN rate
TNDC	12 countries	6	10% of MFN rate
Korea-Chile FTA (KCFTA)	Chile	9,407	8% to 100% of MFN rate
Korea-Singapore FTA (KSFTA)	Singapore	..	..
Korea-EFTA FTA	Iceland, Liechtenstein, Norway, Switzerland,	..	..
Korea-United States (KORUS FTA) (ratification pending)	United States	..	..
Korea-ASEAN FTA	ASEAN countries	..	..

a. Based on 10-digit tariff lines. Only rates that are lower than the corresponding MFN rate are taken into account.
Source: WTO calculations based on data provided by the Korean authorities.

56) The average tariff rate for imports covered by the Korea-Chile FTA is 6.3% (in 2008).

Table 2-6 | Structure of Korean MFN tariffs, 2004 and 2008[57]

(Per cent)

		2004	2008	Final Bound[a]
	Bound tariff			
1.	Bound tariff lines (% of all tariff lines)	91.5	90.8	90.8
2.	Simple average bound rate	17.2	17.1	17.1
	Agricultural products (HS01-24)	61.1	61.7	61.7
	Industrial products (HS25-97)	10.0	9.8	9.7
	WTO agricultural products	61.1	62.5	62.5
	WTO non-agricultural products	9.7	9.4	9.3
	Textiles and clothing	18.5	18.4	18.4
3.	Duty-free tariff lines (% of lines)	14.2	15.4	15.5
4.	Non-ad valorem tariffs (% of lines)	1.0	1.0	1.0
5.	Non-ad valorem tariffs with no AVEs (% of lines)	1.0	1.0	1.0
6.	Nuisance bound rates (% of lines)b	2.1	2.0	2.0
	Applied tariff			
7.	Simple average applied rate	12.8	12.8	..
	Agricultural products (HS01-24)	47.9	47.8	..
	Industrial products (HS25-97)	6.6	6.5	..
	WTO agricultural products	52.2	53.5	..
	WTO non-agricultural products	6.7	6.5	..
	Textiles and clothing	9.8	9.7	..
8.	Tariff quotas (% of all lines)	1.7	1.7	..
9.	Domestic tariff "peaks" (% of all lines)[c]	2.5	2.6	..
10.	International tariff "peaks" (% of all lines)[d]	8.9	8.9	..
11.	Overall standard deviation of tariff rates	52.0	52.1	..
12.	Coefficient of variation	4.1	4.1	
13.	Duty-free tariff lines (% of all lines)	13.3	15.9	..
14.	Non-ad valorem tariffs (% of all lines)	0.6	0.7	..
15.	Non-ad valorem tariffs with no AVEs (% of all lines)	0.6	0.7	..
16.	Nuisance applied rates (% of all lines)[b]	2.7	1.9	..

.. Not available.
a. Based on 2008 tariff schedule. Implementation of final bound rates to be reached in 2009. Currently all but 266 tariff lines have reached the U.R. implementation rates.
b. Nuisance rates are those greater than zero, but less than or equal to 2%.
c. Domestic tariff peaks are defined as those exceeding three times the overall simple average applied rate (indicator 7).
d. International tariff peaks are defined as those exceeding 15%.
Note: The 2004 tariff, based on HS02 nomenclature, consisted of 11,261 tariff lines; the 2008 tariff is based on HS07 nomenclature and consists of 11,729 tariff lines.
Source: WTO Secretariat calculations, based on data provided by the Korean authorities.

57) WTO, WT/TPR/S/204, 44-45 (2008)

C. Exemption from Tariffication Obligation: Rice

During the Uruguay Round, rice in Korea was exempted from tariffication obligation until 2004, along with rice in Japan and the Philippines. Taiwan was also granted the same exception for rice when it joined the WTO. Instead, Korea was required to import 4% of domestic consumption as the minimum market access (MMA), based on 1986-1988. Thus, in 2004 when tariffication exemption expired, Korea must import 205,000 ton of rice under the MMA requirement.

Unlike Korea that was treated as a developing country, Japan and Taiwan were regarded as developed countries. As a result, they must import 8% of domestic consumption as an MMA. Both countries accepted tariffication requirements earlier than permitted due dates.

In 2004, this exemption for Korea was further extended to 2014 after negotiation with 9 Members. The MMA arrangement under the extended tariffication exemption is shown in Table 2-7. Under the new arrangements, the import quotas were allocated to China, US, Thailand, and Australia. Australia abandoned the quota allocation when it suffered from the shortage of rice production in recent years

Table 2-7 | Yearly Import Requirement under Tariffication Exemption

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
MMA(A)	225,575	245,922	266,270	286,617	306,964	327,311	347,658	368,006	388,353	408,700
Rice for cooking(B)	22,557	34,429	47,928	63,055	79,810	98,193	104,297	110,401	116,505	122,610
B/A	10	14	18	22	26	30	30	30	30	30

Source: Ministry of Food, Agriculture, Forestry and Fisheries.

Recent increase of rice price, however, considerably increases burden to comply with MMA requirements. Despite constantly decreasing domestic demands, the MMA amount must be imported regardless of price or market demand. It is estimated that the MMA amount will reach up to 12% of the total demand in 2014.[58] Moreover, the MMA requirement must be satisfied even at the time tariffication is accepted. This may be a significant burden in the future because the market demand for rice in Korea continues to decline.

Another problem is that shadow reduction of tariffs makes impact of tariffication bigger as tariffication is delayed. Tariffs applicable at the time tariffication obligation is applied is

58) D. Park et al., "Evaluation of 3 Years after Tariffication Exemption of Rice in Korea", Korea Rural Economic Institute, p.3 (2008.10).

pursuant to the tariff reduction schedule that would have worked if the tariffication was implemented. Therefore, a lower tariff will be applied when tariffication is more delayed. The impact of tariffication to the market will be bigger by adopting a lower tariff when tariff systems are introduced later.

3. Tariff Policy of Azerbaijan

3.1. General Feature of Azerbaijan Tariff Policy

The average tariff rate of Azerbaijan is generally very low, particularly considering the fact that Azerbaijan rarely participated in tariff negotiations so far. Based on 2007 tariff data, the simple average MFN applied rate of total tariffs is merely 9.2%. The tariffs for manufacturing or non-agricultural products are almost equally divided between 0~5% and 10~15% ranges. In an agricultural sector, 10~15% range accounts for almost 80% of tariffs.

Table 2-8 | **Tariffs and Imports: Summary and Duty Ranges**

Summary		Total	Ag	Non-Ag	Non-WTO member	
Simple average final bound					Binding coverage:	Total
Simple average MFN applied	2007	9.2	14.2	8.4		Non-Ag
Trade weighted average	2006	5.6	9.3	5.2	Ag: Tariff quotas(in %)	
Imports in billion US$	2006	4.8	0.6	4.3	Ag: Special safeguards(in %)	

Frequency distribution		Duty-free	0<=5	5<=10	10<=15	15<=25	25<=50	50<=100	>100	NAV in %
		Tariff lines and import values (in %)								
Agricultural products										
Final bound										
MFN applied	2007	0.7	15.0	1.4	79.0	0.8	1.7	1.0	0.3	5.6
Imports	2006	27.1	27.4	1.1	40.7	0.4	0.9	2.3	0.1	19.8
Non-agricultural products										
Final bound										
MFN applied	2007	1.4	46.5	6.3	45.5	0.0	0.0	0.0	0.1	0.4
Imports	2006	14.4	51.0	14.1	20.4	0.0	0.0	0.0	0.0	3.6

Source: WTO, World Tariff Profiles 2008.

Table 2-9 | Overall Tariff Situations

Country/ Territory	Binding coverage	Simple average		Duty-free		Non ad valorem duties		Duties > 15%		Number of MFN applied tariff lines
		Bound	MFN applied	Bound	MFN applied	Bound	MFN applied	Bound	MFN applied	
	In %			Share of HS 6 digit subheadings in per cent						
Afghanistan			5.7		0.5		0.8		32	5,376
Albania	100	7.0	5.4	28.2	28.1	0	0.1	15.8	0	10,177
Algeria			18.6		1.4		0		40.7	5,902
Argentina	100	31.9	12.0	0.0	13.1	0	12.1	97.8	36.7	9,803
Armenia	100	8.5	2.9	36.3	71.4	0	0.4	0	0	5,909
Australia	97.0	9.9	3.5	20.9	48.8	0.3	0.2	13.4	4.1	6,002
Azerbaijan			9.2		1.3		1.1		0.7	10,671
Bahrain	73.6	73.6	5.0	2.8	8.7	0	0.6	70.8	0.5	7,103
Bangladesh	15.5	15.5	14.6	0.0	7.4	0	0.1	15.1	40.0	6,652

Source: WTO, World Tariff Profiles 2008.

Table 2-10 | Tariffs and Imports by Product Groups

Product groups	MFN applied duties			Imports	
	AVG	Duty-free in%	Max	Share in %	Duty-free in %
Animal products	14.2	0	15	0.5	0
Dairy products	15.0	0	15	0.4	0
Fruit, vegetables, plants	13.8	0.3	40	0.5	0.2
Coffee, tea	14.6	0	15	0.8	0
Cereals & preparations	13.1	3.8	15	3.9	78.8
Oilseeds, fats & oils	8.4	0	15	1.0	0
Sugars and confectionery	13.2	0	15	1.7	0
Beverages & tobacco	34.8	0	181	2.6	0
Cotton	13.0	0	15	0.0	0
Other agricultural products	12.0	0.8	15	0.1	30.3
Fish & fish products	11.3	0	15	0.1	0
Minerals & metals	8.3	0.1	15	27.1	33.1
Petroleum	10.7	20.0	15	0.6	0
Chemicals	4.4	3.2	31	6.2	15.9
Wood, paper, etc.	11.0	0	15	3.2	0
Textiles	12.8	0	295	0.9	0
Clothing	15.0	0	15	0.5	0
Leather, footwear, etc.	12.4	0	73	1.3	0
Non-electrical machinery	3.4	0.1	15	22.9	0.0
Electrical machinery	9.0	0	15	8.8	0
Transport equipment	4.0	5.0	15	11.9	9.6
Manufactures, n.e.s.	9.9	6.0	15	5.0	23.9

Source: WTO, World Tariff Profiles 2008.

Table 2-9 shows that Azerbaijan has 10,671 MFN applied tariff lines, indicating that it has a very elaborated tariff system. Among them, tariffs higher than 15% accounts for less than 1%. MFN applied non ad-valorem tariffs are only 1.1%. Thus, the tariff structure shows the typical features of developed country Members.

3.2. Issues and Policy Suggestions for Azerbaijan Tariff Policy

A. More Sectoral Flexibility

Despite the arguments in favor of relatively uniform protection, the actual experience with tariffs worldwide suggests that most countries differentiate their tariffs substantially. Typically, the protection pattern involves low tariffs for unprocessed commodities and raw materials as well as capital goods, and much higher tariffs for processed final goods. The basic reason for this is the influence of vested interests in maintaining protection on the final goods produced in the country, but who also lobby for tariff free access to their inputs. When there is no domestic intermediate goods industry, or the intermediate industry is small, there is no effective opposing lobbying influence for tariffs on these intermediates; the result is low tariffs on intermediates and high tariffs on selected final goods--a situation known as tariff escalation.

However, the tariff escalation that characterizes many countries' trade regimes, both developed and developing, causes problems in inefficient resource allocation: This "escalating" tariff structure tends to favor final goods production at the expense of intermediates, and in the long run encourages assembling type activities. That is, intermediate goods production is discouraged because it is disfavored relative to final goods and assembling activities. Thus, because an intermediate goods industry doesn't exist today to lobby for equal protection, incentives are established which hinder its eventual creation.

Although it is well known that Chile has a uniform tariff, there are quite a few countries with tariff structures that are uniform or at least close to uniform. Bolivia and the Kyrghyz Republic have virtually uniform tariff schedules of 10 percent, respectively. Singapore has a simple tariff average of 0.5% and a standard deviation of less than 3%. Azerbaijan has a 15 percent maximum tariff and Bosnia-Herzogovia is reported to be about to move towards a uniform tariff. A number of other countries, including Brunei Darussalam, Ecuador, Honduras and Mexico, have tariff averages (under 13%) with small variances (under 6 percent).

To reduce the added anti-export bias that raising tariffs on intermediate and capital goods imposes, many countries employ mechanisms that allow exporters duty free access to imported intermediates. This includes duty drawback procedures and export processing zones. Coupled with effective duty free access to imported intermediates for exporters, the welfare tradeoff from raising tariffs on intermediate and capital goods is much more likely to be positive.

Very importantly, duty drawback systems are WTO consistent if not excessive even under the rigorous subsidy discipline of the WTO.[59] The Korean experience shows significant contribution of duty drawbacks to promote industry development.[60]

The principal problem with duty drawback schemes is that the administration of these schemes can be very costly, and lead to cumbersome procedures and delays when tariffs are high. Exporters complain of delays and lack of payment in many countries. When tariffs are high there is also the risk of fraudulent claims. The empirical evidence suggests in countries without well functioning bureaucracies, duty drawback becomes ineffective and very difficult to administer at high tariff rates (in excess of 15 or 20 percent) because of leakage, delays in payment and fraudulent claims.[61] For example, in China, duty drawback systems were not effective mainly due to monitoring problems regarding false reporting.

Low uniform tariffs, in general, are the best policy, and would be best combined with duty drawback depending on administrative competence and the level of the tariff. In many countries it will also be important to obtain technical assistance for institutional development of duty drawback and temporary admission mechanisms.

B. Temporary Protective Tariff System

In low value industries including agricultural sectors and light industries, specific tariffs are more effective than ad valorem tariffs. Because the base value itself is low, the proportional protection level is inevitably low unless the ad valorem tariff rates are unusually high. Such protective nature of specific duties explains the reason why, after the WTO accession, tariffs are generally converted into ad valorem tariffs. Moreover, Azerbaijan maintains only a very few specific tariffs in tariff lines. Therefore, it is very difficult for Azerbaijan to adopt or resort to specific duties for certain industry sectors at the current stage of the WTO accession.

The only legitimate temporary protective measures in terms of tariffs are thus duties permitted under the trade remedy system. But, in cases of antidumping and countervailing duties, certain wrongful conducts by exporters or exporting governments must exist. Therefore, under the current tariff structure of Azerbaijan, a safeguard system may be the only effective measure in addressing domestic industry injury caused by import surge.

As explained in Section 1.1, safeguard measures are recently used very heavily by developing countries or WTO Members that have little experience of managing the trade

59) WTO SCM Agreement, Annex I (i)

60) Mah, J, "The effect of duty drawback on export promotion: The case of Korea", Journal of Asian Economics, 18 (2007), 967-973.

61) Mitra, P. (1992), "The Coordinated Reform of Tariffs and Indirect Taxes," World Bank Research Observer, Vol. 7, pp. 195-218.

remedy systems. In fact, relying mostly on safeguard systems for industry protection from import surge at the initial stage of the GATT/WTO system appears quite common for most developing countries. After Korea established the Korea Trade Commission in 1987, it also relied mostly on safeguard actions during the early years.

In this regard, a trade remedy system should be strengthened and more articulated so that Azerbaijan can confidently use the system if necessary. The institutions and procedural rules need to be improved promptly.

C. Coherent System with Domestic Tax Policies

With globalization, governments need to deal with more frequent cases of transfer pricing by multinational enterprises (MNEs). From the perspective of companies, they have decisions to make between lower transfer prices to reduce tariff burden or higher transfer prices to reduce tax burden. MNEs induced by investment incentives typically including tax exemption often try to use lower transfer prices to reduce tariff burden.

In many countries, tariff systems and tax systems related to transfer prices of multinational enterprises show discrepancy, quite often inconsistent with each other. For example, the criteria to determine “affiliated companies” in tax laws and tariff systems are often different; in Korea, 50% versus 5%, respectively. In practice, there are controversies regarding how much of transfer prices represent legitimate transactions between headquarters and subsidiaries and how much of transfer prices are merely under-reporting to circumvent import duties. Although some transfer prices may be accepted as legitimate market prices for the purpose of domestic tax matters, they may still not be permitted as appropriate import prices. If the above question is not timely and transparently explained, the burden to MNEs or any domestic companies in a global supply chain, in general, may face huge uncertainty in their business. It can also have a direct implication for foreign direct investment to the extent that ex post tariff burden appears arbitrary or discretionary by a customs authority.

National Tax Service and Korea Customs Service in Korea agreed to conduct the investigation on transfer price together on January 13, 2009.

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Table A.1 | MFN Tariff Averages by HS Chapter, 2004 and 2008

HS 2-digit	Description	No. of lines[a]	2004		2008		Final Bound		
			Average (%)	Range (%)	Average (%)	Range (%)	%age bound	Average[b] (%)	Range[b] (%)
	Total	11,729 (11,261)	12.8	0-887.4	12.8	0-887.4	90.8	17.1	0-887.4
01-24	Agriculture	1,787 (1,709)	47.9	0-887.4	47.8	0-887.4	84.4	61.7	0-887.4
25-97	Industry	9,942 (9,552)	6.6	0-754.3	6.5	0-754.3	91.9	9.7 (9.8)	0-754.3
01	Live animals	56 (50)	15.2	0-89.1	13.4	0-89.1	100.0	18.3	0-89.1
02	Meat & edible meat offal	95 (96)	22.5	3-40	22.6	3-40	100.0	22.7	6.6-40
03	Fish & crustaceans, mollusks & other aquatic invertebrates	300 (265)	16.1	5-20	15.7	0-20	24.0	12.9	10-20
04	Dairy produce; birds' eggs; natural honey; edible prod. n.e.s.	68 (51)	61.8	8-243	57.7	8-243	100.0	59.1	19.7-243
05	Products of animal origin, n.e.s.	68 (69)	8.9	0-27	9.0	0-27	98.5	13.8	0-36
06	Live trees & other plants; bulbs, roots & the like; cut flowers etc.	76 (74)	11.0	8-25	11.3	4-25	100.0	21.3	13.1-36
07	Edible vegetables, certain roots, tubers	133 (131)	116.7	8-887.4	115.2	0-887.4	100.0	122.3	18-887.4
08	Edible fruit & nuts; peel of citrus fruit/melons	78	72.7	8-611.5	72.5	8-611.5	100.0	81.8	18-611.5
09	Coffee, tea, maté & spices	39 (36)	62.7	2-513.6	77.4	2-513.6	100.0	90.9	13.1-513.6
10	Cereals	32	215.3	1.8-800.3	215.3	0-800.3	81.3	218.0	1.8-800.3
11	Prod. of the milling industry; malt; starches; inulin; wheat gluten	47 (45)	311.8	4.2-800.3	313.1	4.2-800.3	91.5	316.0	4.2-800.3
12	Oil seeds & oleaginous fruits; misc grains, seeds & fruit; etc.	138 (131)	88.1	0-754.3	90.8	0-754.3	97.8	96.1	0-754.3
13	Lac; gums, resins & other vegetable saps & extracts	27 (28)	89.6	3-754.3	92.6	3-754.3	100.0	99.3	11-754.3
14	Veg. plaiting materials; vegetable prod. n.e.s.	21	5.0	3-8	5.0	3-8	100.0	9.1	6.6-18
15	Animal/veg. fats & oils, waxes, etc.	100 (98)	16.6	2-630	15.6	2-630	100.0	26.5	4-630
16	Preparations. of meat/fish/mollusks, etc.	91 (90)	23.7	18-72	23.7	18-72	69.2	34.0	18-72
17	Sugars & sugar confectionery	33	19.7	3-243	19.1	3-243	100.0	31.2	9-243
18	Cocoa & cocoa preparations	33	10.9	2-40	10.9	2-40	93.9	27.4	5.4-54
19	Preparations of cereals, flour, starch or milk; pastry cooks' products	52 (50)	10.9	5.4-45	11.4	5-45	92.3	34.1	5.4-54
20	Prep. of vegetable./ fruit / nuts / other parts of plants	109 (108)	33.9	5-63.9	34.0	5-63.9	100.0	42.7	15-90
21	Misc. edible preparations	71 (67)	32.7	8-754.3	32.2	8-754.3	97.2	62.3	13.1-754.3

HS 2-digit	Description	No. of lines[a]	2004		2008		Final Bound		
			Average (%)	Range (%)	Average (%)	Range (%)	%age bound	Average[b] (%)	Range[b] (%)
22	Beverages, spirits & vinegar	52	21.1	8-270	21.1	8-270	100.0	32.8	8-270
23	Residues & waste from the food industries; prepared animal fodder	46	12.2	0-71	11.9	0-71	100.0	17.5	0-90
24	Tobacco & manuf. tobacco substitutes	25	30.9	20-40	30.9	20-40	100.0	59.1	32.8-65.5
25	Salt; sulfur; earths & stone; plastering materials, lime & cement	145	3.3	1-8	3.3	0-8	95.2	5.6	1-13
26	Ores, slag & ash	56	1.3	1-2	0.6	0-2	98.2	1.3	1-2
27	Mineral fuels & oils bituminous substance; mineral waxes	144	5.3	1-8	5.0	0-8	72.9	7.9	1-13
28	Inorganic chemicals; organic or inorganic compounds of precious metals, etc.	392 (412)	5.2	0-8	5.2	0-8	99.2	5.3	0-13
29	Organic chemicals	921 (882)	5.7	0-8	5.5	0-8	100.0	5.8	0-22.5
30	Pharmaceutical products	154 (148)	5.0	0-8	5.0	0-8	41.6	1.1	0-30
31	Fertilizers	38 (40)	5.8	1-6.5	5.8	0-6.5	100.0	6.5	6.5-6.5
32	Tanning/dyeing extracts; coloring matter, etc.	140 (141)	6.9	6.5-8	6.9	4-8	100.0	7.4 (7.7)	6.5-13
33	Essential oils; perfumes, cosmetic/toilet articles	68 (73)	18.5	5-754.3	20.2	5-754.3	98.5	22.3 (24.7)	6.5-754.3
34	Soap, organic surface-active agents, washing preparations, etc.	53 (52)	6.7	6.5-8	6.6	2-8	90.6	6.6 (6.7)	6.5-9.6
35	Albuminoidal substances; modified starches; glues; enzymes	58 (52)	48.2	6.5-385.7	63.8	6.5-385.7	100.0	66.2	6.5-385.7
36	Explosives; pyrotechnic products; matches; etc.	22	7.5	6.5-8	7.5	6.5-8	100.0	6.6 (8.5)	6.5-9.6
37	Photographic or cinematographic goods	222 (221)	7.1	0-8	6.6	0-8	100.0	6.2 (8.4)	0-6.5
38	Miscellaneous chemical products	230 (213)	6.4	0-50	6.6	0-50	99.1	7.3	0-50
39	Plastics & articles thereof	233 (228)	6.8	5-8	6.7	4-8	97.9	6.5 (7.0)	6.5-13
40	Rubber & articles thereof	146	7.1	0-8	7.1	0-8	100.0	11.6	0-13
41	Raw hides & skins (no furskins) & leather	67	3.8	2-8	3.3	1-8	100.0	7.9	5-13
42	Articles of leather; saddlery & harness; etc.	117 (118)	10.0	8-13	10.0	8-13	76.1	15.8	13-16
43	Furskins & artificial fur; manuf. thereof	58 (59)	9.0	3-16	9.1	3-16	56.9	12.1	5-36
44	Wood and articles of wood; wood charcoal	285 (209)	5.5	1-8	5.3	0-8	64.9	9.0	2-13
45	Cork and articles of cork	7	8.0	8-8	8.0	8-8	100.0	13.0	13-13
46	Manuf. of straw/esparto, etc.; basket-ware and wickerwork	20 (14)	8.0	8-8	8.0	8-8	100.0	12.7	10-13

HS 2-digit	Description	No. of lines[a]	2004		2008		Final Bound		
			Average (%)	Range (%)	Average (%)	Range (%)	%age bound	Average[b] (%)	Range[b] (%)
47	Pulp of wood/other fibrous cellulosic material; recovered paper and paperboard	29 (26)	0.1	0-2	0.0	0-0	96.6	0.0	0-0
48	Paper and paperboard; articles of paper pulp, of paper or of paperboard	190 (186)	0.0	0-0	0.0	0-0	100.0	0.0	0-0
49	Printed books, newspapers, pictures & other prod. of the printing industry; etc.	35	1.4	0-8	0.7	0-4.7	100.0	0.0 (0.7)	0-0
50	Silk	37	14.1	2-51.7	13.9	2-51.7	97.3	22.9	9-51.7
51	Wool, fine or coarse animal hair; horsehair yarn and woven fabric	58	6.8	1-13	6.4	0-13	100.0	13.1	2-30
52	Cotton	181 (182)	8.5	1-10	8.3	0-10	100.0	12.4	2-13
53	Other vegetable textile fibers; paper yarn and woven fabrics of paper yarn	47 (51)	4.8	2-8	4.6	2-8	100.0	7.6	2-13
54	Man-made filaments	127 (124)	8.0	8-8	7.7	2-8	100.0	13.6	13-30
55	Man-made staple fibers	247 (256)	9.0	2-10	8.9	2-10	100.0	12.8	2-13
56	Wadding, felt & non-woven; special yarns; twine, cordage, etc. and articles thereof	50	8.5	8-10	8.5	8-10	100.0	19.8	13-30
57	Carpets and other textile floor coverings	21 (23)	10.0	10-10	10.0	10-10	100.0	30.0	30-30
58	Special woven fabrics; tufted textile fabrics; lace; tapestries; trimmings; embroidery	60 (62)	10.3	8-13	10.3	8-13	100.0	17.5	13-30
59	Impregnated/coated/covered/laminated textile fabrics; etc.	30	8.2	8-10	8.2	8-10	100.0	13.0	13-13
60	Knitted or crocheted fabrics	45 (46)	10.0	10-10	10.0	10-10	100.0	30.0	30-30
61	Articles of apparel and clothing accessories, knitted or crocheted	152 (162)	12.8	8-13	12.8	8-13	100.0	31.0	16-35
62	Articles of apparel and clothing accessories, not knitted or crocheted	169 (171)	12.6	8-13	12.6	8-13	100.0	25.6	16-35
63	Other made up textile articles; sets; worn clothing and worn textile articles; rags	59 (66)	11.8	8-13	11.7	8-13	100.0	23.1	13-30
64	Footwear, gaiters etc.; parts of such articles	52 (55)	11.5	8-13	11.4	8-13	100.0	13.0	13-13
65	Headgear and parts thereof	16 (18)	8.0	8-8	8.0	8-8	100.0	13.0	13-13
66	Umbrellas, sun umbrellas, walking-sticks, seat-sticks, etc. and parts thereof	11 (12)	11.3	8-13	11.2	8-13	100.0	13.0	13-13
67	Prep. feathers & down &; artificial flowers; articles of human hair	21	8.0	8-8	8.0	8-8	100.0	13.0	13-13

HS 2-digit	Description	No. of lines[a]	2004		2008		Final Bound		
			Average (%)	Range (%)	Average (%)	Range (%)	%age bound	Average[b] (%)	Range[b] (%)
68	Articles of stone, plaster, cement, asbestos, mica or similar materials	89 (72)	8.0	8-8	8.0	8-8	88.8	13.0	13-13
69	Ceramic products	86	7.9	3-8	7.9	3-8	81.4	14.2	13-16
70	Glass and glassware	137 (124)	7.8	0-8	7.5	0-8	80.3	13.6	0-35
71	Natural /cultured pearls, precious or semi-precious stones, metals, coins, etc.	118	5.2	0-8	5.2	0-8	100.0	8.2	0-13
72	Iron and steel	277 (211)	0.6	0-8	0.3	0-5	100.0	0.7	0-10
73	Articles of iron or steel	209 (196)	4.3	0-8	4.1	0-8	99.0	6.8	0-16
74	Copper and articles thereof	87 (90)	6.6	0-8	6.5	0-8	100.0	9.9	0-16
75	Nickel and articles thereof	25	4.6	1-8	4.4	0-8	100.0	7.4	2-13
76	Aluminum and articles thereof	60	7.5	1-8	7.4	0-8	100.0	11.8	3-16
78	Lead and articles thereof	20	6.6	1-8	6.0	0-8	100.0	10.3	3-13
79	Zinc and articles thereof	19	6.8	1-8	6.3	0-8	100.0	11.1	3-13
80	Tin and articles thereof	14	6.8	1-8	6.7	0-8	100.0	10.4	3-13
81	Other base metals; cermets; articles thereof	78 (76)	5.1	0-8	4.1	0-8	100.0	6.6	3-10
82	Tools, implements, cutlery, spoons & forks, of base metal; parts thereof	146	8.0	8-8	8.0	8-8	97.9	15.5	13-30
83	Miscellaneous articles of base metal	53 (52)	8.0	8-8	8.0	8-8	100.0	13.0	10-16
84	Nuclear reactors, boilers, machinery and mechanical appliances; parts thereof	1,231 (1,158)	6.0	0-13	5.9	0-13	92.4	9.2	0-20
85	Electrical machinery and equipment and parts thereof; etc.	787 (721)	5.5	0-13	5.3	0-13	71.3	7.3	0-20
86	Railway or tramway locomotives, rolling-stock and parts thereof; etc.	48	3.7	0-8	3.7	0-8	100.0	5.7	0-13
87	Vehicles other than railway or tramway rolling-stock, & parts & accessories thereof	192 (207)	7.9	0-10	8.0	0-10	71.9	11.8	0-20
88	Aircraft, spacecraft, and parts thereof	49	0.9	0-8	0.9	0-8	100.0	1.0	0-13
89	Ships, boats and floating structures	44	3.7	0-8	3.6	0-8	36.4	4.3	0-5
90	Optical, photographic, cinematographic, measuring, checking, precision, etc.	440 (443)	5.9	0-8	6.2	0-8	93.4	7.7	0-16
91	Clocks and watches and parts thereof	89	7.8	5-8	7.8	5-8	96.6	13.7	13-16
92	Musical instruments; parts & access. thereof	58 (59)	8.0	8-8	8.0	8-8	100.0	13.4	13-16
93	Arms & ammunition; parts thereof	87 (26)	3.7	0-8	3.7	0-8	100.0	6.4	0-16

HS 2-digit	Description	No. of lines[a]	2004		2008		Final Bound		
			Average (%)	Range (%)	Average (%)	Range (%)	%age bound	Average[b] (%)	Range[b] (%)
94	Furniture; bedding, mattresses, mattress supports, cushions, etc.	88 (86)	3.7	0-8	3.6	0-8	98.9	5.8	0-13
95	Toys, games and sports requisites; parts and accessories thereof	94	4.7	0-8	4.7	0-8	100.0	8.5	0-16
96	Miscellaneous manufactured articles	88 (86)	8.0	8-8	7.8	0-8	95.5	13.1	13-16
97	Works of art, collectors' pieces and antiques	15 (13)	0.0	0-0	0.0	0-0	100.0	0.0	0-0

a. Numbers in brackets refer to 2004 tariff schedule.
b. Numbers in brackets refer to the 2008 bound rate. Final implementation to be reached in 2009.
Note: The 2004 tariff is based on HS02 nomenclature and the 2008 tariff is based on HS07. Calculations include out-of-quota rates for tariff quotas (thereby excluding lower in-quota rates) and the ad valorem part of alternate duties. Calculations for bound rates are based on the 2008 tariff schedule.
Source: WTO Secretariat calculations, based on data provided by the Korean authorities.

Table A.2 | Non-ad valorem (alternate) MFN Applied Tariffs, 2008

HS Code	Description	Non-ad valorem Rate
0409000000	Natural honey	243% or W 1,864/kg[a]
0703101000	Onions	135% or W 180/kg[a]
0703201000	Fresh peeled garlic	360% or W 1,800/kg[a]
0703209000	Fresh garlic other than peeled	360% or W 1,800/kg[a]
0706101000	Carrots	30% or W 134/kg[a]
0709601000	Sweet peppers (bell type)	270% or W 6,210/kg[a]
0709609000	Fruit of the genus capsicum/pimenta other than sweet peppers	270% or W 6,210/kg[a]
0711901000	Garlic	360% or W 1,800/kg[a]
0711905091	Fruits of the genus capsicum or of the genus pimenta	270% or W 6,210/kg[a]
0712200000	Onions	135% or W 180/kg[a]
0712319000	Mushrooms other than cultivated	30% or W 1,218/kg[a]
0712320000	Wood ears (Auricularia spp.)	30% or W 1,218/kg[a]
0712330000	Jelly fungi (Tremella spp.)	30% or W 1,218/kg[a]
0712391020	Oak mushrooms	30% or W 1,625/kg[a]
0712391030	Ling chiu mushrooms	30% or W 842/kg[a]
0712391090	Other mushrooms	30% or W 1,218/kg[a]
0712901000	Garlic	360% or W 1,800/kg[a]
0712902010	Bracken	30% or W 1,807/kg[a]
0712902030	Welsh onions	30% or W 1,159/kg[a]
0712902040	Carrots	30% or W 864/kg[a]
0712902094	Flowering ferns	30% or W 1,446/kg[a]
0714201000	Fresh sweet potatoes	385% or W 338/kg[a]
0802401000	Chestnuts in shell	219.4% or W 1,470/kg[a]
0802402000	Chestnuts shelled	219.4% or W 1,470/kg[a]
0802901010	Pine-nuts in shell	566.8% or W 2,664/kg[a]
0802901020	Pine-nuts shelled	566.8% or W 2,664/kg[a]
0802902010	Ging ko-nuts in shell	27.0% or W 803/kg[a]
0802902020	Ging ko-nuts shelled	27.0% or W 803/kg[a]
0810903000	Jujubes, fresh	611.5% or W 5,800/kg[a]
0813402000	Jujubes, dried	611.5% or W 5,800/kg[a]
0904201000	Fruit of the genus capsicum/pimenta, neither crushed not ground	270% or W 6,210/kg[a]
0904202000	Fruit of the genus cappsicum/pimenta, crushed or ground	270% or W 6,210/kg[a]
0910101000	Ginger: fresh or chilled	377.3% or W 931/kg[a]
0910102000	Ginger: dried	377.3% or W 931/kg[a]
0910103000	Ginger: other than fresh, chilled or dried	377.3% or W 931/kg[a]
1003009010	Unhulled barley	324% or W 326/kg[a]
1003009020	Naked barley	299.7% or W 361/kg[a]
1201001010	Soya beans for soya bean oil and oil cake	487% or W 956/kg[a]
1201001020	Soya beans for feeding	487% or W 956/kg[a]
1201009010	Soya beans for bean sprouts	487% or W 956/kg[a]
1201009090	Other soya beans	487% or W 956/kg[a]
1207400000	Sesamum seeds	630% or W 6,660/kg[a]
1207991000	Perilla seeds	40% or W 410/kg[a]
1515500000	Sesame oil and its fractions	630% or W 12,060/kg[a]
2306901000	Of sesamum seeds	63% or W 72/kg[a]
3706101000	Cinematographic film	6.5% or W 195/metre
3706102000	Cinematographic film	6.5% or W 4/metre
3706103010	Cinematographic film	6.5% or W 26/metre

HS Code	Description	Non-ad valorem Rate
3706103020	Cinematographic film	6.5% or W 468/metre
3706103030	Cinematographic film	6.5% or W 78/metre
3706104000	Cinematographic film	6.5% or W 26/metre
3706105010	Cinematographic film	6.5% or W 1,092/metre
3706105020	Cinematographic film	6.5% or W 182/metre
3706106010	Cinematographic film	6.5% or W 1,560/metre
3706106020	Cinematographic film	6.5% or W 260/metre
3706901000	Cinematographic film	6.5% or W 9/metre
3706902000	Cinematographic film	6.5% or W 5/metre
3706903010	Cinematographic film	6.5% or W 26/metre
3706903020	Cinematographic film	6.5% or W 468/metre
3706903030	Cinematographic film	6.5% or W 78/metre
3706904000	Cinematographic film	6.5% or W 26/metre
3706905010	Cinematographic film	6.5% or W 25/metre
3706905020	Cinematographic film	6.5% or W 8/metre
3706906010	Cinematographic film	6.5% or W 1,092/metre
3706906020	Cinematographic film	6.5% or W 182/metre
3822003058	Diagnostic or laboratory reagents	6.5% or W 182/metre
3822003059	Diagnostic or laboratory reagents	6.5% or W 4/metre
3822003060	Diagnostic or laboratory reagents	6.5% or W 26
3822003061	Diagnostic or laboratory reagents	6.5% or W 468/metre
3822003062	Diagnostic or laboratory reagents	6.5% or W 78/metre
3822003063	Diagnostic or laboratory reagents	6.5% or W 1,092/metre
3822003064	Diagnostic or laboratory reagents	6.5% or W 1,560/metre
3822003065	Diagnostic or laboratory reagents	6.5% or W 260/metre
3822003066	Diagnostic or laboratory reagents	6.5% or W 8/metre
3822003067	Diagnostic or laboratory reagents	6.5% or W 25/metre
5001000000	Silk-worm cocoons suitable for reeling	51% or W 5,276/kg[a]
5002001020	Raw silk (not thrown)	51.7% or W 17,215/kg[a]
5002001030	Raw silk (not thrown)	51.7% or W 17,215/kg[a]
5002001040	Raw silk (not thrown)	51.7% or W 17,215/kg[a]
5002001050	Raw silk (not thrown)	51.7% or W 17,215/kg[a]
8523292231	Recorded video tape	13% or W 20/min

a. Whichever is the greater.
Source: Data provided by the Korean authorities.

Table A.3 | MFN Applied Tariff Escalation, 2004 and 2008

ISIC	Product and Processing	Tariff 2004				Tariff 2008			
		Number of lines	Average	Range	S.D.[a]	Number of lines	Average	Range	S.D.[a]
	Total	11,261	12.8	887.4	52.0	11,729	12.8	0-887.4	52.1
	-1st stage of processing	1,403	34.4	0-887.4	114.9	1,460	34.4	0-887.4	114.7
	-semi-processed	3,488	9.2	0-800.3	41.5	3,654	8.8	0-800.3	40.6
	-fully processed	6,370	10.1	0-800.3	28.7	6,615	10.2	0-800.3	30.0
1	Agriculturerw materials	706	48.1	0-800.3	132.1	743	48.1	0-800.3	132.2
2	Mining and quarrying-raw materials	199	2.7	1-8	1.5	199	2.4	0-8	1.6
311	Food products								
	-1st stage of processing	202	55.6	2-887.4	163.0	223	51.7	0-887.4	155.4
	-semi-processed	111	101.9	3-800.3	203.7	110	102.4	3-800.3	204.6
	-fully processed	586	27.9	0-630	44.6	607	28.0	0-630	44.0
312	Food manufacturing								
	-1st stage of processing	34	36.2	0-513.6	93.0	38	32.8	0-513.6	88.4
	-semi-processed	13	26.1	8-243	65.2	13	26.1	8-243	65.2
	-fully processed	97	73.0	0-800.3	178.2	106	85.0	0-800.3	182.8
313	Beverages								
	-fully processed	54	30.6	5-270	58.8	54	30.6	5-270	58.8
314	Tobacco manufactures								
	-fully processed	14	39.5	32.8-40	1.9	14	39.5	32.8-40	1.9
321	Textiles								
	-1st stage of processing	64	5.4	0-51.7	12.2	53	5.5	0-51.7	13.5
	-semi-processed	673	9.1	8-13	1.4	660	9.0	2-13	1.7
	-fully processed	357	11.2	0-13	2.6	339	11.1	0-13	2.6
322	Clothing								
	-fully processed	257	12.7	8-16	1.9	253	12.7	8-16	1.8
323	Leather products								
	-1st stage of processing	1	3.0	3	0.0	1	3.0	3	0.0
	-semi-processed	51	5.1	5-8	0.4	51	5.1	5-8	0.4
	-fully processed	72	8.1	8-16	0.9	71	8.1	8-16	0.9
324	Footwear								
	-fully processed	32	11.9	8-13	2.1	31	11.9	8-13	2.1
331	Wood products								
	-1st stage of processing	4	3.5	2-8	3.0	5	2.8	0-8	3.0
	-semi-processed	116	6.1	5-8	1.4	175	5.9	3-8	1.9
	-fully processed	53	8.0	8-8	0.0	65	8.0	8-8	0.0
332	Furniture except metal								
	-fully processed	44	2.2	0-8	3.6	47	2.0	0-8	3.5
341	Paper products								
	-1st stage of processing	25	0.1	0-2	0.4	28	0.0	0-0	0.0
	-semi-processed	129	0.9	0-8	2.5	142	1.3	0-8	2.9
	-fully processed	46	0.2	0-8	1.2	46	0.2	0-8	1.2
342	Printing								
	-fully processed	42	1.1	0-8	2.8	42	0.6	0-4.7	1.4
351	Industrial chemicals								
	-1st stage of processing	86	7.0	1-8	1.5	89	6.9	1-8	1.8
	-semi-processed	1,527	5.9	0-50	2.2	1,549	5.8	0-54	2.8
	-fully processed	32	6.6	5-8	1.0	37	6.1	2-8	1.7

ISIC	Product and Processing	Tariff 2004				Tariff 2008			
		Number of lines	Average	Range	S.D.[a]	Number of lines	Average	Range	S.D.[a]
352	Other chemicals								
	-1st stage of processing	6	8.0	8-8	0.0	6	8.0	8-8	0.0
	-semi-processed	177	10.9	5-754.3	56.2	183	10.6	2-754.3	55.3
	-fully processed	648	7.1	0-201.2	13.6	651	7.0	0-201.2	13.5
353	Petroleum refineries								
	-1st stage of processing	3	5.0	5-5	0.0	3	4.3	3-5	1.2
	-semi-processed	6	5.5	5-6.5	0.8	6	5.5	5-6.5	0.8
	-fully processed	87	6.2	1-8	1.6	87	6.2	0-8	1.8
354	Petroleum and coal products								
	-1st stage of processing	12	3.7	1-5	2.0	12	3.0	1-5	1.7
	-semi-processed	12	4.2	0-5	1.9	12	4.2	0-5	1.9
	-fully processed	8	6.9	6.5-8	0.7	8	6.9	6.5-8	0.7
355	Rubber products								
	-1st stage of processing	2	5.5	3-8	3.5	2	5.5	3-8	3.5
	-semi-processed	34	8.0	8-8	0.0	34	8.0	8-8	0.0
	-fully processed	97	8.1	0-13	1.9	95	8.0	0-13	1.8
356	Plastic products								
	-semi-processed	4	6.5	6.5-6.5	0.0	4	6.5	6.5-6.5	0.0
	-fully processed	36	8.0	6.5-8	0.3	37	8.0	6.5-8	0.2
361	Pottery and china								
	-fully processed	38	8.0	8-8	0.0	42	7.8	0-8	1.2
362	Glass and products								
	-semi-processed	61	7.9	3-8	0.7	72	7.2	3-8	1.7
	-fully processed	64	7.8	0-8	1.2	66	7.7	0-8	1.3
369	Non-metallic mineral products								
	-1st stage of processing	7	5.0	5-5	0.0	7	5.0	5-5	0.0
	-semi-processed	18	5.6	3-8	1.4	19	5.5	3-8	1.4
	-fully processed	126	8.0	3-8	0.4	143	8.0	3-8	0.4
371	Iron and steel products								
	-1st stage of processing	6	2.0	2-2	0.0	6	2.0	2-2	0.0
	-semi-processed	268	0.6	0-8	1.7	347	0.3	0-8	1.3
372	Non-ferrous metal								
	-1st stage of processing	9	2.0	2-2	0.0	9	2.0	2-2	0.0
	-semi-processed	275	5.4	0-8	2.5	266	4.9	0-8	2.7
381	Metal products								
	-semi-processed	5	8.0	8-8	0.0	4	8.0	8-8	0.0
	-fully processed	381	7.0	0-8	2.6	391	7.1	0-8	2.5
382	Non-electrical machinery								
	-fully processed	1,152	5.9	0-13	3.5	1,286	5.7	0-13	3.5
383	Electrical machinery								
	-fully processed	735	5.7	0-13	3.6	799	5.4	0-13	3.7
384	Transport equipment								
	-fully processed	387	6.1	0-10	3.2	371	6.1	0-10	3.3
385	Professional and scientific equipment								
	-fully processed	538	5.8	0-8	3.5	538	6.0	0-8	3.4

ISIC	Product and Processing	Tariff 2004				Tariff 2008			
		Number of lines	Average	Range	S.D.[a]	Number of lines	Average	Range	S.D.[a]
390	Other manufactured products								
	-1st stage of processing	37	6.0	3-25.6	4.9	36	6.1	3-25.6	5.0
	-semi-processed	8	0.0	0-0	0.0	7	0.0	0-0	0.0
	-fully processed	386	6.8	0-13	3.2	388	6.7	0-13	3.2
410	Electrical energy								
	-fully processed	1	5.0	5	0.0	1	5.0	5	0.0

a. Standard deviation.

Note: The 2004 tariff is based on HS02 nomenclature and the 2008 tariff on HS07. Calculations exclude in-quota rates and include the ad valorem part of alternate rates.

Source: WTO Secretariat calculations, based on data provided by the Korean authorities.

Table A.4 | Adjustment Tariff, 2007

HS	Description	General(%)	2007
0301.92	Eels (excluding glass eel (for aquaculture))	10	30% or W 1,908/kg whichever is greater
0301.99	Sea-bream (excluding fry (for aquaculture))	10	40% or W 2,781/kg whichever is greater
0301.99	Sea bass (excluding fry (for aquaculture))	10	38
0301.99	Croakers (excluding redlip croaker and yellow croaker)	10	36
0303.79	Alaska pollack	10	30
0303.79	Saury (excluding horn fish)	10	34
0303.79	Croakers (excluding redlip croaker and yellow croaker)	10	57
0306.23	Shrimps and prawns, salted or in brine	20	50% or W 363/kg whichever is greater
0307.49	Squid (frozen, excluding fish meat)	10	22
0709.59	Oak mushrooms	30	45% or W 1,625/kg whichever is greater
0712.39			
1902.19	Chinese vermicelli	8	45% or W 355/kg whichever is greater
1904.90	Rice, steamed or boiled	8	50
2103.20	RiSauces, preparations therefore and mixed seasonings of the following: 1. Capsicum paste 2. Containing 20% or above of Capsicum or garlic or onion or ginger, or containing 40% o above of any mixture of these	8	45
2103.90	Mae joo	8	16% or W 64/kg whichever is greater
4412.31	Plywood, veneered panels and similar laminated wood, of a	8	11
4412.32	whole thickness not less than 6 mm, with each ply not		
4412.39	exceeding 6 mm thickness		
4412.99			
8479.89	Surface mount machines for electronic parts of gantry type, having equal capacity to or less than the maximum placement speed of 55,000 cph, excluding machines whose placement accuracy is higher than +/- 5 micrometers (3 sigma) or machines whose placement capacity is equal to or less than a ball pitch of 50 micrometers.	8	16

Source: The Korean authorities.

Chapter 03

STRATEGIES IN AGRICULTURAL NEGOTIATION OF AZERBAIJAN FOR WTO ACCESSION

Chapter 03

Strategies in Agricultural Negotiation of Azerbaijan for WTO Accession

Jeong-Bin Im

1. Review of WTO Agreement on Agriculture and Korea's Experience

1.1. Review and Evaluation of the WTO Agreement on Agriculture

Agriculture was included into the GATT system, for the first time, in the UR negotiations. In earlier rounds, agriculture was a notable exception to the GATT trading system and was left undisciplined by multilateral trade rules. The goal of the UR negotiation on agriculture was to

Table 3-1 | Main Provisions of the Uruguay Round AoA

(Unit: Percent)

Negotiated Reduction	Mplementation Period	
	Developed Countries (1995-2000)	Developing Countries (1995-2004)
Market access		
Average tariff cuts for all ag. products	36	24
Minimum tariff cuts per product	15	10
Domestic support		
Total cuts in AMS	20	13
Export subsidies		
Value cut	36	24
Volume cut	21	14

Source: WTO, Agreement on Agriculture, http://www.wto.org/

improve agricultural trade opportunities by eliminating non-tariff measures and reducing tariffs and subsidies. To achieve this goal, the negotiation proceeded by focusing on three major areas: market access, domestic support, and export subsidies. The structure of the WTO Agreement on Agriculture (hereafter "AoA") is best understood by looking at these three areas. <Table 3-1> summarizes the main provisions of the Uruguay Round AoA.

1.1.1 Market Access

The Uruguay Round resulted in a systemic change in the market access for agricultural products by converting all non-tariff barriers into tariff equivalents and binding all tariffs. Members agreed to eliminate all non-tariff measures such as import bans or quantitative restrictions and transit to a tariff-only regime through a process called "tariffication" for all agricultural products.[62]

Under the tariffication mechanism, Members converted non-tariff measures into a tariff level which afforded an equivalent level of protection. Members also agreed to reduce tariffs for all agricultural products by 36% (minimum 15%) over 6 years on the average. As for developing countries, reduction rates were two-thirds of those applied for developed countries and implementation period was 10 years.

The experience to date from the URAA implementation period shows that agricultural tariffs remain high. The global unweighted average bound tariff rate for agricultural commodities is around 36% for OECD members, and 63% for non-OECD countries. Also tariffs among countries and commodities exhibit substantial disparities. Particularly, disparities across commodities that tariffs escalate from bulk to processed agricultural products can increase the distortion effects of tariffs on agricultural trade. It is known as tariff escalation.

As shown in Table 3-2, the average tariff level on agricultural products are much higher than those on industrial goods in most countries. Based on these facts, agricultural exporting countries are now arguing that agricultural tariffs should be further reduced substantially with consideration of current tariff structures by product and country.

62) http://www.wto.org/english/tratop_e/agric_e/ag_intro02_access_e.htm
"The Agreement on Agriculture contains a "special treatment" clause (Annex 5), under which four countries were permitted, subject to strictly circumscribed conditions, to maintain non-tariff border measures on certain products during the period of tariff reductions (with the possibility of extending the special treatment, subject to further negotiations). As one of the conditions, market access in the form of progressively increasing import quotas has to be provided for the products concerned. The products and countries concerned are: rice in the case of Japan, Korea and the Philippines; and cheese and sheep meat in the case of Israel. As of 1 April 1999, Japan has ceased to apply special treatment."

Table 3-2 | Current Tariff Levels of Major Countries

(Unit: Percent)

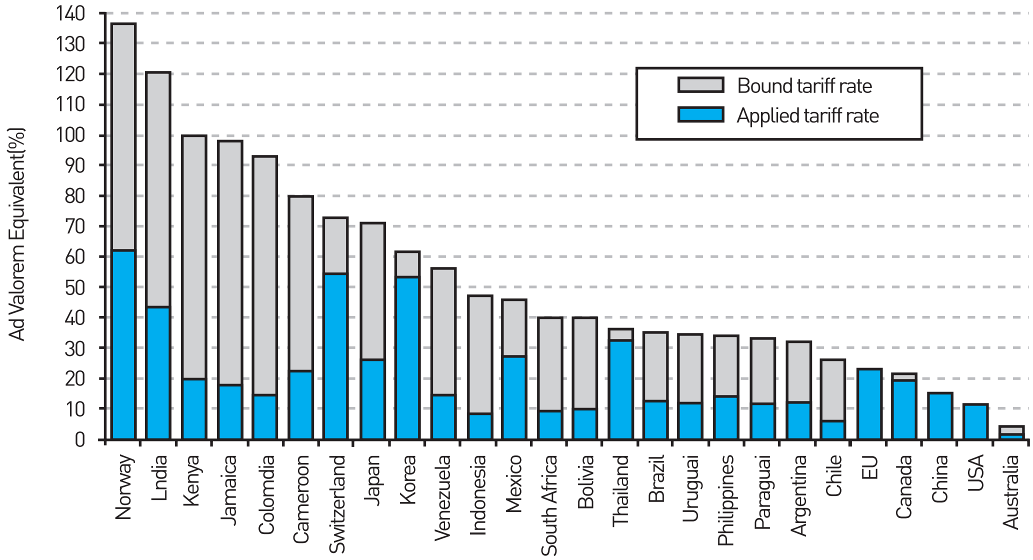
Countries	Agricultural Product Simple Average		Non-Agricultural Product Simple Average	
	Bound Tariff	Applied Tariff	Bound Tariff	Applied Tarif
Australia	3.3	1.3	11.0	3.8
Brazil	35.5	10.3	30.8	12.5
China	15.8	15.8	9.1	9.0
EU	15.1	15.1	3.9	3.8
Iceland	109.3	40.8	9.6	2.3
India	114.2	34.4	36.2	11.5
Japan	22.7	21.8	2.4	2.6
Korea	62.5	49.0	10.2	6.6
Mexico	44.1	22.1	11.2	0.3
New Zealand	5.7	1.7	10.6	3.2
Norway	135.8	57.8	3.1	0.6
Switzerland	54.3	43.5	2.5	2.1
USA	5.0	5.0	3.3	3.2
Azerbaijan	-	14.2	-	8.4
Armenia	14.7	6.9	7.5	2.3
Georgia	13.9	8.8	6.5	0.3
Turkey	60.1	46.7	16.9	4.8
Russia	-	14.6	-	10.3

Source: WTO (2008). World Tariff Profiles

Also, Figure 3-1 shows the difference in bound tariffs and applied tariff rates among major countries. Applied tariff rates on agricultural products are much lower than bound tariff rates in most countries except the EU, China, the United States, and Canada. As seen, there exists watering on agricultural tariffs in terms of much lower bound tariffs than applied tariffs.

Figure 3-1 | Average Bound and Applied Tariff Levels of Major Countries

(Unit: Percent)



Source: WTO (2004). Calculation of Ad valorem Equivalent: Data Requirements and Availability, TN/AG/S/11, and WTO (2008). World Tariff Profiles and

As another part of the tariffication package, WTO Members were required to establish current and minimum access Tariff Rate Quotas (TRQs) as another way of improving market access. If the share of the import quantity of an item had been lower than 3% of its total domestic consumption during the 1986-88 base period, the minimum market access (import of 3% of the domestic consumption) had to be allowed for that item at a low tariff rate, and the percentage would be expanded to 5% by the end of the implementation period. If the share of the import quantity of an item had been over 3% during the base period, members were required to guarantee import access opportunities at levels corresponding to those existing during the base period. For the minimum and current market access quantities, tariff levels were low or minimal in relation to the "normal" ordinary customs duty applied to any imports outside the tariff quota.

As a third element of the tariffication package, members have the right to invoke the special safeguard according to Article 5 of the AoA. The special safeguard provisions allow the imposition of an additional tariff up to 1/3 of bound tariff when certain criteria are met. The criteria involve either a specified import surge (volume trigger), or a fall of the import price below a specified reference price (price trigger).

Box 3-1. Summary of Uruguay Round Agreement on Agriculture: Market Access Provisions

Tariffication, tariff bindings, and reductions
- Non-tariffs barriers to be converted to tariff equivalents (tariffication) equal to the difference between internal and external prices existing during the base period.
- All tariffs to be bound (i. e. cannot be increased without notification and compensation).
- Reduce tariffs by 36%, on a simple average basis, in equal installments over six years.
- Reduce tariffs for each item by a minimum of 15%.

Minimum and current market access(TRQs)
- Minimum market access import opportunities to be provided for products subject to tarifficaion with imports below 3% of domestic consumption during the base period.
- Increase minimum access quotas from 3% to 5% over the implementation period.
- Current access opportunities equivalent to those existing during the base period where imports exceeding 3% of domestic consumption had occurred during the base period.
- Access amounts subject to low level of tariffs and imports above that amount subject to the high tariffs established through tariffication.

Safeguards, exceptions, and special and differential treatment
- Special agricultural safeguard mechanism put in place for products subject to tariffication Imposed if the increase in the volume of imports or the drop in price of imports exceeds certain trigger levels.
- Developing countries allowed the flexibility of ceiling bindings, longer implementation periods(10 years) and lower reduction commitments on tariffs(24% average reduction with a 10% minimum). Least developed countries subject to tariffication and binding but exempt from reduction commitments.

1.1.2 Domestic Supports[63]

Unlike the previous GATT rounds which focused mainly on reforming border measures or reducing tariff, the Uruguay Round includes the reform of trade-distorting domestic policies for the first time. This can be evaluated as an innovative change differentiating the Uruguay Round from the previous GATT rounds.

63) http://www.ers.usda.gov/Briefing/wto/domsupport.htm
http://www.wto.org/english/docs_e/legal_e/ursum_e.htm#aAgreement

The GATT had traditionally not much disciplined purely domestic production policies, except where these had a trade impact. In the UR, however, domestic support policies were recognized as a source of market distortions. Countries, therefore, agreed to limit domestic policies presumed to be the most trade distorting and to exempt no or minimally trade-distorting policies from reduction commitments.

Policies were categorized by color according to the degree of trade distorting effects. Policies that directly influence production decisions, such as price support policies (amber box policies), were capped and subject to cuts. Support levels from amber box policies are quantified by calculation of an aggregate measure of support (AMS), which combines estimated support levels for all commodities into one overall measure. The Total AMS covers all support provided on either a product-specific or non-product-specific basis and is to be reduced by 20% (13.3% for developing countries with no reduction for least-developed countries) during the implementation period.

The AoA exempted three types of domestic programs from reduction commitments. The first type of is amber box policies deemed to be de minimis-defined as support that is less than 5% of the value of production (10% for developing countries). The second type is blue box policies which refer to direct payments under production-limiting programs. The third type is green box policies that are entirely government funded and deemed to have little or no effect on production or trade. Green Box measures include decoupled direct payments which do not depend on current production decisions or prices and government expenditure on natural disaster and general government supports toward agricultural research, extension, and pest and disease control.

Developing countries were allowed additional flexibility in the form of input and investment subsidies to agriculture which are generally available to low-income or resource-poor producers. According to Article 6.2 of the AoA, developing countries are exempt from reduction commitment for these subsidies.

According to the implementation of domestic support reduction, many countries have changed their agricultural policies and have moved from market price support that tends to encourage excess production towards direct income payments and other measures that are less trade distorting. However, the Total AMS approach was adopted in order to reduce agricultural support which has inherent limitations in a sense that WTO members can increase subsidization of certain commodities while reducing subsidization of other commodities. For example, there may be flexibility among support to the items so that when a large reduction is made for one item, less reduction can be made on another item while non-exempt support to any specific item may even be increased within the bound AMS limit.

Furthermore, total agricultural support tends to be increased in some countries through shifting of amber box policies into green box policies. Particularly, there is a very important factor limiting the effectiveness of the URAA in reduction commitment on domestic support distorting production and trade. The base period (1986-88 year) for domestic support reduction through AMS is not representative of average support during the implementation periods. The base period adopted in the URAA is the period of extremely high support for many commodities and countries. In other words, the URAA allows many countries to fulfill reduction commitment without actually reducing domestic support distorting production and trade. This is shown in Table 3-3 that presents the actual use of Bound Total AMS commitments. In most countries, only small shares of the domestic support commitments were actually utilized during the implementation periods except Argentina, Iceland, Korea, Norway, and Slovenia. That is, with the implementation of reduction commitment in agricultural tariffs, there are still watering on domestic support area in terms of much higher bound total AMS than actually used AMS level.

Table 3-3 | Actual Use of Bound Total AMS Commitment Levels (1995-2000)

(Unit: Percent)

Commitment levels	Countries
0 to 19%	Brazil, Canada, Colombia, Costa Rica, Czech Republic, Mexico, New Zealand, Poland,
20 to 39%	Australia, Morocco, Venezuela,
40 to 59%	Cyprus, Japan, South Africa, United States
60 to 79%	European Union, Israel, Slovak Republic, Switzerland, Thailand, Tunisia
80 to 100%	Argentina, Iceland, Korea, Norway, Slovenia,

Source: WTO (2005), Total Aggregate Measurement of Support, Committee on Agriculture. TN/AG/S/13.

Also, there is a disparity in agricultural support levels across countries, even though the URAA placed limits on total AMS support that composed of the sum of non-exempt domestic support expenditures. For instance, the EU, Japan and USA account for about 90% of the total world agricultural support, which shows that agricultural domestic support is concentrated in these three countries.

Based on these facts, exporting countries currently claim that such possibilities of reallocating support among the items must be ruled out by binding and reducing AMS on an item-by-item basis rather than allowing AMS to remain as a total sum.

1.1.3 Export Subsidies

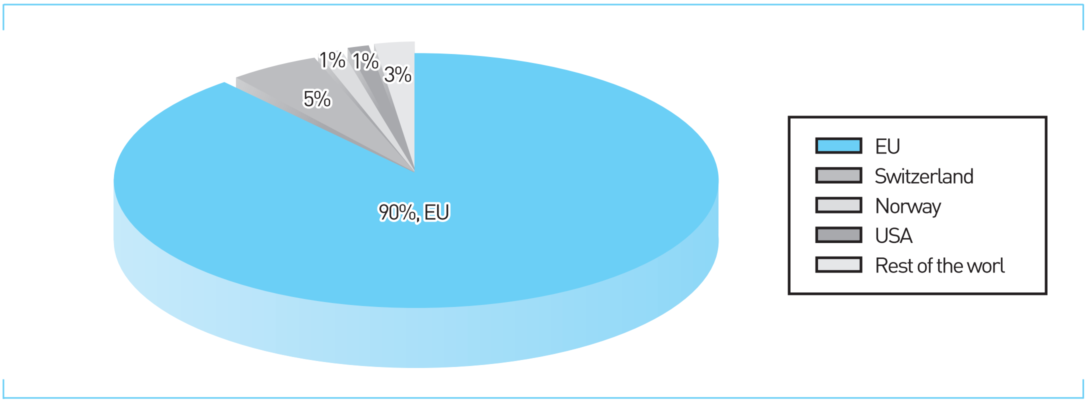
Since export subsidy is the most trade distorting, stricter rules and reduction commitments were applied to export subsidies. Therefore, Members that employed export subsidies were required to reduce the volume as well as the value of their export subsidies. Export subsidy commitments in each Member were determined based on export subsidies provided during the base period. New subsidies cannot be introduced and a Member that has no export subsidy commitment in the Schedule is not allowed to introduce them in the future. Members are required to reduce the value of export subsidies to a level 36% below the 1986-90 base period level over the six-year implementation period, and the quantity of subsidized exports by 21% over the same period. As for developing countries, the reductions are two-thirds those of developed countries over a ten-year period (with no reductions applying to the least-developed countries) and there are no commitments to reduce the costs of marketing exports of agricultural products or internal transport charges on export shipments.

The export subsidy regulations of the URAA considered the strictest binding among three pillars. The total expenditure and amount of subsidized exports have been reduced during the implementation. However it is important to bear in mind that the level of export subsidy is influenced by commodity prices. Based on the available data, high world prices kept countries' use of export subsidy well below their reduction commitment whereas low world prices induced the increase in export subsidy within commitment. Of course, there are very important factors limiting the effectiveness of the URAA in reduction commitment on export subsidies. Firstly, export subsidies are allowed to continue under the URAA and a number of policies with the potential to affect export competition such as export credit, state trading enterprise, abuse of food aid, export restriction and price pooling systems were excluded from the URAA discipline. Also, flexibility provisions were made to carry-over unused export subsidy in some cases in which a country exceeds its limits of export subsidy. Thus very few countries have changed their trade policies substantially to conform their export subsidy commitment, and the rate of export subsidy remained high. Particularly export subsidy concentrated on grain and dairy products. Therefore, the potential impacts of export subsidy on the trade of grain and dairy products are still significant.

Export subsidy is generally considered to have the greatest and most direct market distortion effects rather than domestic support. Export subsidy is also concentrated in only few countries. For example, the EU accounted for nearly 90% of world export subsidies during the year of 1995-2001. Other significant users of export subsidies include Switzerland, Norway and the USA. In this regard, most WTO members without export subsidy have argued that it should be eliminated altogether instead of being further reduced.

Figure 3-2 | **Export subsidy in 1995-2001**

(Unit: Percent)



Note: Countries'export subsidy outlays as a % share of global export subsidy expenditure
Source: WTO (2005), Export Subsidy Commitments based WTO Notifications

1.2. Korea' s Implementation Experience under the WTO System

After the conclusion of UR negotiations, Korea has implemented the WTO commitments accordingly, which brought about liberalization of imports of all agricultural products except rice and rice products as well as reduction of trade-distorting domestic subsidies. Such a commitment inevitably necessitated the reform of domestic agricultural market in a way that enhanced market-orientation.

1.2.1 Market Access

As a result of the UR, non-tariff measures on all agricultural products except rice and rice products have been converted to tariff. Since Korea was recognized as a developing country in the UR, its average tariff was reduced by 24% with a minimum of 10% per tariff line. As shown in Table 3-2 and Figure 3-1, Korea maintains relatively high mean tariff rates around 62%. Also, Korea maintains the highest mean tariff rate (366%) for out of quota, but average tariff level of in-quota is set at relatively low levels (20%) for 67 product groups under tariff rate quotas (TRQs). High tariffs above 100% are mainly levied on grains, starches and vegetables which were subject to tariffication as shown in Table 3-4. Korea maintains alternative tariffs a selection between ad valorem tariff and specific tariff - for about 5% of tariff lines.

As for rice, the staple crop in Korea, a grace period of ten years was allowed to be exempted from tariffication. Instead, market access in the form of progressively increasing import quotas was provided for rice whose in-quota tariff rate for rice import was set at 5% (Minimum Market Access). Import quota quantity increased gradually from 51 thousand tons, which is 1 % of the base period domestic consumption beginning in 1995, up to 2 % by 2000, and 4 % by 2004.

According to Annex 5 Section B of the UR AoA, a negotiation as to whether to continue this special treatment beyond 2005 shall be initiated and completed within 2004 and Korea shall provide additional and acceptable concessions to rice exporting countries in order to continue such special treatment. As such, in 2004, Korea negotiated and finally signed agreements with nine rice-exporting countries including the United States and China to continue the quota system in the rice market until 2014 on the stipulation that the Minimum Market Access quota be increased gradually from 4% as of 2004 to 7.96% of the total consumption of rice by 2014 and to permit up to 30 % of imported rice to be sold directly to consumer by 2010.

Table 3-4 | Korea's Commitment of Market Access of Major Products

(Unit: Percent or won/kg)

Commodity	Year	Tariff Equivalent (% or won/kg)	Market Access (MT)	Tariff on Quota (%)
Rice	1995	(no tariffication)	51,307	5
	2004	-	205,228	5
Barley	1995	333% or 410 won/kg	14,150	20
	2004	229.7% or 361 won/kg	23,582	20
Soybeans	1995	541% or 1,062 won/kg	1,032,152	5
	2004	487% or 956 won/kg	1,032,152	5
Corn	1995	365%	6,102,100	3
	2004	328%	6,102,100	3
Potato	1995	338%	11,286	30
	2004	304%	18,810	30
Sweet potato	1995	428% or 375 won/kg	11,121	20
	2004	385% or 338 won/kg	18,535	20
Oranges	1995	99%	15,000	50
	2004	50%	57,017	50
Beef	1995	44.5%	123,000	20
	2004	40%	225,000	20
Pork	1995	37%	21,930	25
	2004	25%	-	-
Poultry	1995	35%	7,700	20
	2004	20%	-	-
Pepper	1995	300% or 6,900 won/kg	4,311	50
	2004	270% or 6,210 won/kg	7,185	50
Garlic	1995	400% or 2,000 won/kg	8,680	50
	2004	360% or 1,800 won/kg	14,467	50
Onion	1995	150% or 200 won/kg	12,369	50
	2004	135% or 180 won/kg	20,645	50
Sesame	1995	700% or 7,400 won/kg	6,731	40
	2004	630% or 6,660 won/kg	6,731	40
Skimmed	1995	220%	621	20
Milk powder	2004	176%	1,034	20

Source: Country Schedule of Republic of Korea (1994)

Korea maintains tariff rate quotas (TRQs) for 67 product groups (190 items HS 10 Digits). Importers who have licenses to import TRQ volume may grasp all the economic rents resulting from the gap between in-quota tariffs and out of quota tariffs. This is the background that the Korean government operates various tariff quota administration methods for the TRQ products. Particularly, the economic rents which are collected from auctioning system and state trading agencies are reinvested into the agricultural sector. All tariff quotas are allocated on a global Most Favored Nation (MFN) basis. There is no county quota except rice importation.

1.2.2 Domestic Support[64]

The largest share in total support is green box, accounting for 68% in average over the period 1995-2000. Green box measures have been largely devoted to infrastructure and structural adjustment. Over 90% of annual bound AMS was used for rice, and therefore AMS reduction commitment has been a binding constraint for Korea. Until 2004, Korea maintained government purchase for rice at a favorable price, and the proportion of rice purchased by the government to total production dropped from 29% in 1995 to 16% in 2004 as the annual Bound AMS level decreased. The government purchase price for rice was held constant or remained minimal increase in the period of 1995-2004. Therefore, policy adjustment to meet the required AMS reduction commitment was to reduce the government purchase quantities for rice.

In order to prepare for further AMS reduction in the DDA negotiations, Korea ended the annual government purchase of rice in 2005. Instead, Korea established two kinds of direct payment to rice farmers. The first pays 600,000 won per hectare each year for farmers growing rice, as compensation for the benefits coming from maintaining rice paddies. The second payment is related to the market price of rice that farmers receive. If the price falls below a target price that is fixed in advance, the government pays farmers 85% of the difference between the target price and market price for the quantity of rice that farmers sell.

Table 3-5 | Summary of the WTO Notifications for Domestic Support

(Unit: 100 million won)

	Bound AMS	Current AMS	de- minimis	Green Box	S&DT	Total
1995	21,826	20,755	2,822	39,902	204	63,683
2000	17,978	16,909	5,247	50,541	506	73,203
2004	14,900	14,584	5,388	48,669	541	69,182

Source: Ministry of Food, Agriculture, Forestry and Fisheries (MIFAFF), annual notification to WTO

64) Jooho Song, 2008, "Perspectives on Korean Agricultural Development: Lessons and Challenges"

1.2.3 Export Subsidies

Korea has no export subsidy commitment in the UR Country Schedule. However, it provides the kind of export subsidies allowed to developing countries under Article 9.4 of AoA: export subsidies which reduce the costs of marketing exports of agricultural products or subsidies for internal transport and freight charges on export shipments.[65]

Table 3-6 | Summary of the WTO Notifications for Export Subsidies

(Unit: 100 million won)

Year	Total export subsidies	Products
2001	25.95	Fruits, Flowers, Kimchi, Vegetables, Livestock, Ginseng
2002	26.61	
2003	24.67	
2004	25.59	

Source: Ministry of Food, Agriculture, Forestry and Fisheries (MIFAFF), annual notification to WTO

1.2.4 Agricultural Trade and Food Self-sufficiency

Trade liberalization in Korean agricultural sector since 1995 has resulted in increase of agricultural import. The value of import of agricultural products based on CIF price has increased from 3.75 billion US dollars in 1990 to 16.54 billion US dollars in 2008. Compared with the pre-UR period, agricultural import has increased at a faster pace and consequently the agricultural trade deficit has also increased from 2.96 billion US dollars in 1990 to 13.9 billion US dollars in 2008. Fruit and vegetable farmers have been most adversely affected by trade liberalization in Korea. Ranchers raising livestock are also heavily affected by implementation of UR agreement.

Table 3-7 | Agricultural trade in Korea

(Unit: 100 million US dollars, %)

	year			
	1990	2000	2007	2008(P)
Ag. Exports (Share of total exports)	7.9 (1.2)	12.8 (0.7)	24.0 (0.6)	26. (0.6)
Ag. Imports (Share of total imports)	37.5 (5.4)	67.8 (4.2)	133.2 (3.7)	165.4 (3.9)

Note: trade values in 2008 are based on http://www.kati.net/

Source: Ministry of Food, Agriculture, Forestry and Fisheries (MIFAFF), Statistical Yearbook of Agriculture and Forestry, 2008

65) WTO, Notification of Korea on the export subsidy commitments, G/AG/N/KOR/36 (27 February 2007)

The self-sufficiency rate of grain has fallen from 43.1% in 1990 to 27.2% in 2007. In 2007, self-sufficiency rate for barley was 58.3%, 0.2 % for wheat, 0.7% for maize, and 11.1% for soybean. Rice, the main staple food grain in Korea, is produced almost at a self-sufficient level. Self-sufficiency rate for rice was 95.8 % in 2007. Considerable amounts of most of food grains except rice are imported. As of 2007, food self sufficiency rate excluding feed-grain is 51.6%.

2. Current State of Play in the DDA Agricultural negotiations

The Uruguay Round Agreement on Agriculture is the first agreement on agriculture under the GATT, and resulted in multilateral rules established for agricultural trade and domestic agricultural policies. It also provided the basis for the next step toward further agricultural reform: DDA agricultural negotiation is now on-going on the basis of WTO AoA for all of the three pillars. DDA is adopting a more reformative approach for agriculture than the UR, such as harmonization of tariffs and domestic supports across products and countries, and elimination of export subsidies.

Table 3-8 | Basic Structure of DDA Agriculture Negotiations

Market Access	Domestic Support	Export Competition
Substantial improvements in market access for all products -Tariff reduction: Tiered formula -Expansion of tariff rate quota(TRQ) -Special safeguard(SSG	*Substantial reductions in trade-distorting domestic support* -Capping overall trade-distorting domestic support level -Capping product-specific support level -Strengthened disciplines on green box measures	*Reductions of, with a view to phasing out, all forms of export subsidies* -Elimination of export subsidies -Strengthened disciplines on other types of export competition measures

2.1. Market Access[66]

Under the aim of substantial improvements in market access for all products, WTO members have agreed to reduce tariffs through a tiered formula, whose overall objective is to achieve harmonization of tariff structures across countries and products. Higher tariffs will be subject to deeper cuts, but flexibilities will be allowed for members to designate a limited number of Sensitive Products. Sensitive Products will be subject to lower reduction commitments, but with some additional TRQ commitments required to assure that substantial improvements in market

66) http://www.ers.usda.gov/Briefing/wto/tariffsmktac.htm

access will be achieved for all products. Concerning "special and differential treatment for developing countries," developing countries' tariffs will be subject to lesser cuts than developed countries' tariffs over longer time frame. Developing countries will be able to designate a limited number of products as Special Products, which would be subject to no or lesser tariff cuts.

Table 3-9 | Tiered Formula for Tariff Reduction

	Developed Countries		Developing Countries	
	Current tariff	Reduction rate	Current tariff	Reduction rate
1st tier	0~20%	50%	0~30%	33.3%
2nd tier	20~50%	57%	30~80%	38%
3rd tier	50~75%	64%	80~130%	42.7%
4th tier	Over 75%	70%	Over 130%	46.7%
Implementation Period	5 Years		10 Years	

Source: WTO, Revised Draft Modalities for Agriculture (TN/AG/W/4/Rev.4), 6 December 2008

2.2. Domestic Support[67]

Under the aim of substantial reductions in trade-distorting domestic support, WTO members agreed that higher levels of trade-distorting domestic support will be subject to deeper cuts. Blue box and de minimis support will be capped and reduced. Amber box, blue box, and de minimis policies will be aggregated into overall trade-distorting domestic supports (OTDS) and be reduced. As for special and differential treatment, developing countries will be subject to longer implementation periods and lower reduction coefficients for all types of trade-distorting domestic support.

Table 3-10 | Summary of Domestic Support Reductions

Countries	OTDS	AMS	De *minimis*[68]	Implementation Period
EU	80%	70%	50%	5 years
US and JAPAN	70%	60%		
Other Developed countries	55%	45%		
Developing countries	36.7%	30%	33.3%	8 years

Source: WTO, Revised Draft Modalities for Agriculture (TN/AG/W/4/Rev.4), 6 December 2008
* OTDS (Overall Trade Distorting Supports) = AMS + De *minimis* + Blue box

67) http://www.ers.usda.gov/Briefing/wto/domsupport.htm
68) In the UR, de-minimis subsidy was allow up to 5% of total value of agricultural production for developed countries, and 10% for developing countries.

Table 3-11 | Tiered Formula for Domestic Support Reductions

	OTDS		Total AMS	
	Thresholds	Range of cuts	Thresholds	Range of cuts
Band 1	0~10	55%	0~15	45%
Band 2	10~60	70%	15~40	60%
Band 3	〉60	80%	〉40	70%

Source: WTO, Revised Draft Modalities for Agriculture (TN/AG/W/4/Rev.4), 6 December 2008

2.3. Export Subsidies[69]

Under the aim of phasing out all forms of export subsidies, members will eliminate their remaining export subsidies by the end of 2013 on the basis of both budgetary outlays and quantities. As for special and differential treatment for, developing countries are allowed to reduce export subsidy budgetary outlays and quantities by the end of 2016. Furthermore, developing countries continue to benefit from the provisions of Article 9.4 of the AoA until the end of 2021.

DDA negotiations have expanded the definition of export subsidies to include other export competition policies including export credits, food aid, and export state trading enterprises (STEs), and members have agreed to ensure the parallel elimination of direct export subsidies and imposition of disciplines on export credits, food aid policies, and STEs.

2.4. Special and Differential treatments for Developing Countries

DDA negotiations have strengthened special and differential treatment for developing countries, which are not just confined to lower reduction rates and longer implementation. Developing countries can designate Special Products (hereafter "SP") up to 12% of all tariff lines. SP will be subject to no or minimal tariff cuts, and will be self-designated by each member based on criteria such as food security, livelihood security and rural development. Special safeguard mechanism (hereafter "SSM") will allow developing countries to impose additional duty in case of sudden import surge or reduced import price in order to protect local farmers.[70]

69) http://www.ers.usda.gov/Briefing/wto/exptsubs.htm

70) However, there is considerable opposition from exporting countries. In particular, the level of additional duty and specific condition under which developing countries can impose SSM are the main issues to be resolved.:

2.5. Recently Acceded Members

There are also special provisions for recently acceded members (hereafter "RAMs") in the current DDA agriculture chairman's text[71]. Very recently-acceded Members (hereafter "VRAMs")[72] and small low-income RAMs with economies in transition (hereafter "SRAMs") shall not be required to undertake reduction commitments in their OTDS, AMS, de minimis, and tariffs. For other RAMs, lower reduction rates and longer implementation periods than those applied for developing countries are allowed for OTDS, AMS, de minimis, and tariffs. Moreover, in the case of RAMs, the maximum tariff line entitlements to SP shall be 13% and the overall average cut to be achieved for the designated tariff lines may be further reduced to 10%.[73]

Table 3-12 | Special Provisions for RAMs

	Market Access	Domestic Support
VRAMs SRAMs	Exempted from reductions	Exempted from reductions
Other RAMs	- Moderate cuts under the tiered formula for developing countries up to 8 ad valorem percentage points in each ban - Exempt final bound tariffs at or below 10 per cent from tariff reductions - In case of overlap between WTO accession commitments and DDA commitments, begin one year after the end of implementation of the accession commitment - Implementation period for RAMs prolonged by up to two years after the end of the developing countries' implementation period - Designate SP up to 13 per cent and average cut for SP is 10 per cent	- OTDS, AMS: 2/3 of cuts applied for developing countries - RAMs with 5% de minimis: 1/3 of cuts applied for developing countries and 5 years longer implementation period - Blue Box: the maximum permitted value is 5 per cent of the average total value of agricultural production during 1995-2000 or 1995-2004.[74][75]

Source: WTO, Revised Draft Modalities for Agriculture (TN/AG/W/4/Rev.4), 6 December 2008

71) WTO, Revised Draft Modalities for Agriculture (TN/AG/W/4/Rev.4), 6 December 2008

72) Saudi Arabia, the Former Yugoslav Republic of Macedonia, Viet Nam and Ukraine are included in this category.

73) According to agriculture chairman's text, developing countries shall be entitled to self-designate Special Products up to 12% of tariff lines. Up to 5% of lines may have no cut. The overall average cut shall, in any case, be 11%.

74) Provisions on Blue Box are also applied to VRAMs and SRAMs.

75) In cases where there is a movement from AMS to Blue Box after the conclusion of DDA negotiation, the Member concerned shall have the option of selecting as its base period the most recent five-year period for which data are at that time available.

3. Changes in the Korean Agricultural Structure and Policy Direction

3.1. Changes in the Korean Agricultural Structure

3.1.1 Share of Agriculture in GDP

In Korea, an unprecedented rate of industrialization resulted in wide growth-rate gap between agricultural sector and non-agricultural sector. Such a trend was accelerated in the course of the implementation of the UR commitments on agricultural market liberalization. As a result, the share of agriculture in national GDP showed a sharp decline from 23.7% in 1970 to 7.0% in 1990 to 2.4% in 2007. Korea went through a rapid economic growth, with annual GDP growth of 16.9% percent per year during 1970-2007. Average GDP growth rate of agricultural sector per year during the same periods was 9.9%, which is comparatively lower than those of industrial and service sectors.

Table 3-13 | **Share of agriculture in GDP**

(Unit: billion won)

	1970	1980	1990	2000	2007	Annual average growth rate during 1970-2007(%)
National GDP (A)	2,764	38,775	186,691	578,665	901,189	16.9%
Agricultural GDP (B)	644	4,774	13,018	18,646	21,352	9.9%
%(B/A)	23.3%	12.3%	7.0%	3.2%	2.4%	

Source: Ministry of Food, Agriculture, Forestry and Fisheries (MIFAFF), Statistical Yearbook of Agriculture and Forestry, 2008

3.1.2 Changes in agricultural population

As the share of agriculture in national economy had been reduced, the agricultural population in Korea fell drastically from 14.4 million or 44.7% of the total population in 1970 to 6.7 million or 15.6% in 1990, and 3.3 million or 6.8% in 2007. Considering that the agricultural population in developed countries is about 2 to 3% of the total population, the share of the agricultural population in Korea is still relatively high.

Another important point to note is the increasing average age of the agricultural population in Korea. The share of agricultural population over 60s (elderly farmers) in Korea has increased from 7.9% in 1970 to 41.8% in 2007. Indeed, the aging issue of the agricultural population in Korea is very serious.

Table 3-14 | Share of agricultural population

(Unit: million, %)

	1970	1980	1990	2000	2007
Total population (A)	32.2	38.1	42.9	47.0	48.5
Agricultural population (B)	14.4	10.8	6.7	4.1	3.3
%(B/A)	44.7%	28.4%	15.6%	8.6%	6.8%
Total agricultural population (C)	14.4	10.8	6.7	4.1	3.3
Over 60 years (D)	1.14	1.14	1.19	1.33	1.38
%(D/C)	7.9%	10.6%	17.8%	32.4%	41.8%

Source: MIFAFF, Statistical Yearbook of Agriculture and Forestry, 2008

Such phenomenon is due to the fact that the older generation is generally difficult to find another job opportunity and tends to continue farming activity, while younger generation leaves rural villages for higher income and better social standard in the city. The trend has continued throughout the industrialization, and the average age of the agricultural population has increased rapidly.

3.1.3 Changes in farmland size

The Korean agriculture is characterized as small-sized family farming. Based on the principle that only farmers should be allowed to own farmland, the Korean government limited the maximum size of farmland that can be owned to 3ha per farm household until the early 1990s.

Total farmland size was 2.3 million ha in 1970 but it decreased to 1.8 million ha in 2007, since about 20,000 ha to 30,000 ha of farmland was converted into industrial or housing land annually. Meantime the agricultural population declined faster than the farmland reduction. As a result, the average land size per farm is gradually increasing from 0.93 ha in 1970 to 1.45 ha in 2007.

Table 3-15 | Change in farm size

	1970	1980	1990	2000	2007
Total planted land (million ha)	2.3	2.2	2.1	1.9	1.8
Average farm size per farmhouse (ha)	0.93	1.02	1.19	1.36	1.45
Number of farm over 3ha (thousand)	37	31	44	85	86

Source: MIFAFF, Statistical Yearbook of Agriculture and Forestry, 2008

Recently, the Korean government has started easing the farmland possession ceiling recognizing that the ceiling does not help to enhance international competitiveness. As a result, the number of farm owning farmland bigger than 3ha has gradually increased from 447 thousands in 1990 to 86 thousands in 2007.

3.1.4 Changes in planted area by Commodity and number of head by Livestock

As of the end of 2007, the planted area for agricultural production is about 1.78 million ha, accounting 18% of the total national land. The arable land area per capita is only 0.04ha and 1.45ha per farm household, significantly smaller than those of major countries. Approximately 19,000ha of farmland are being annually transformed into non-agricultural uses during 1990~2007. Of the arable land in 2007, the planted area for rice is 0.95 million ha, taking 53.3% of the total planted land. However the portion of land used for rice in the total farming land has dropped from 59% in 1990 to 53%in 2007 while the share of planted area for horticulture such as fruits, flowers and vegetables in greenhouse has shown the increasing trends during the same periods.

Grain farming including rice and barley has been losing its importance in the Korean agriculture. The value of grain production in relation to the total value of agricultural production accounted for 42% in 1990, but dropped to 36% in 2000, and 26% in 2007. This is because farmland has been converted for non-agricultural use in line with economic growth, and converted for crops such as fruits, vegetables, and special crops such as Ginseng which are creating higher income in the process of market liberalization.

Table 3-16 | Planted area by Commodity and number of head by Livestock

(Unit: thousand ha, thousand head)

	1990	1995	2000	2005	2007
Total planted area(thousand ha)	2,109	1,985	1,889	1,824	1,782
Rice	1,244(58.9)	1,056(53.2)	1,072(56.7)	980(53.7)	950(53.3)
Barley	160(7.6)	90(4.5)	68(3.6)	61(3.3)	56(3.1)
Vegetables	277(13.1)	322(16.2)	296(15.7)	240(13.1)	222(12.5)
Vegetables in greenhouse	36(1.7)	82(4.1)	91(4.8)	78(4.3)	73(4.1)
Fruits	132(6.3)	172(8.7)	169(8.9)	150(8.2)	148(8.3)
Flowers	3.5(0.2)	5.2(0.3)	5.9(0.3)	7.9(0.4)	7,5(0.4)
Number of head by livestock					
Cows	1,622	2,594	1,590	1,819	2,201
Dairy cows	504	553	544	479	453
Pigs	4,528	6,461	8,214	8,962	9,606
Chickins	74,463	85,800	102,547	109,628	119,365

Along with rising national income and changing in food consumption pattern, particularly the consumption of livestock products is increasing at a fast pace. Accordingly, the domestic livestock production is continuously increasing except for dairy cows which has been negatively impacted from trade liberalization since 1995, thus its share in the total agricultural production is about 35% in 2007, exceeding the share of rice in the total agricultural production since the year of 2003.

Table 3-17 | Share of Product Values for Major Commodities

(Unit: Percent)

	1990	1995	2000	2007
Rice	36.9	26.1	33.0	22.7
Other Grain	4.9	4.2	2.9	3.0
Livestock	22.3	23.0	25.4	32.5
Fruit	7.4	11.7	8.1	8.1
Vegetable	18.7	25.2	21.1	21.6
Agriculture Total	100.0	100.0	100.0	100.0

Source: MIFAFF, Statistical Yearbook of Agriculture and Forestry, each year

3.1.5 Agricultural Trade and Food Self-sufficiency

Korea has long been a large net food importing country. Imports of agricultural products grew 27 times from 0.5 billion US dollars in 1970 to 13.3 billion US dollars in 2007. During the same period, export of agricultural products increased 24 times from 0.1 billion US dollars to 2.4 billion US dollars . Therefore the agricultural trade deficit has also increased from 0.4 billion US dollars in 1970 to 10.9 billion US dollars in 2007.

Table 3-18 | Agricultural Trade and Food Self-sufficiency

(Unit: billions US dollars, %)

		1970	1980	1990	2000	2007
Import	Nationwide(A)	1.8	21.6	69.8	160.4	356.8
	Agriculture (B)	0.5	3.1	5.4	6.8	13.3
	B/A(%)	27.8	14.4	7.7	4.2	3.7
Export	Nationwide(A)	0.9	17.2	65.4	172.3	371.5
	Agriculture (B)	0.1	1.1	1.1	1.3	2.4
	B/A(%)	11.1%	6.4%	1.7%	0.8%	0.6%
Balance of payment	Nationwide(A)	-0.9	-4.4	-4.4	11.9	14.7
	Agriculture (B)	-0.4	-2	-4.3	-5.5	-10.9
Food self-sufficiency (%)		80.5	56.0	43.1	29.7	27.2

Source: MIFAFF, Statistical Yearbook of Agriculture and Forestry, 2008

Even though import of agricultural products rose sizably in terms of absolute value, its share in the total national imports has dropped sharply. The share of agricultural products in the total national imports fell to 3.7% in 2007 from 27.8% in 1970. During the same period, the share of agricultural products in Korea' s exports decreased significantly from 11.1% to 0.6%. It is mainly because of development strategy of Industrialization and export-orientation which has been employed by the Korean government since the 1960s.

The self-sufficiency rate of grain has fallen from 80.5% in 1970 to 27.2% in 2007. In 2007, self-sufficiency rate for barley was 58.3%, 0.2% for wheat, 0.7% for corn, and 11.1% for soybean. Rice, the main staple food grain in Korea, is at almost self-sufficient level. Self-sufficiency rate for rice was 95.8% in 2007. Considerable amounts of most of food grains except rice are imported from overseas market.

3.1.6 Farm Household Incomes

Average income per farm household has increased from 256 thousand won in 1970 to 31,967 thousand won. Income sources for farm households have shown the changes since the 1970s. Farm household incomes are broadly categorized into agricultural income and non-agricultural income. Major sources of non-agricultural income are divided into income from off-farming activities and transfer income from government and family.

Agricultural income accounted for over 75% of total farm household income in the 1970s but fell to 33% in 2007 whereas the share of non-agricultural income sharply increased from 24% in 1970 to 66% in 2007. The proportion of non-agricultural income to total farm household income is continuously increasing, contributing to the stabilization of farm household income. Actually, off-farm income has played a vital role in stabilizing the farm household income because agricultural income is inherently unstable.

Recently, the growth of agricultural income has been stagnant or declined in Korea. It is mainly due to the increasing agricultural imports since 1995 which have led to falling prices of agricultural products. Also high fuel and material prices as well as rising interest burdens have increased the operational costs of farms. Thus, it has been suggested that non-farm income should be increased so as to increase farm household income. In this regard, the Korean government has long tried to create new income sources for farm households. Although various policy efforts are under way to provide non-farm income sources for Korean farmers through establishment of rural industrialization, promotion of agro-food industry, green tourism, etc. there are still no visible achievements so far.

The percentage of transfer income has continuously increased, accounting for 33% of total household income in 2007. Some of the transfer income comes from the government' s direct subsidy to farmers. For example, the increased public subsidies like rice income compensation program that began in 2005. According to governmental statistics, the proportion of public subsidies was about 8~9% of total farming household income in 2006/2007. Smaller farms received more benefits from other types of public subsidies such as pensions, health insurance, and other social transfer payments, while larger farms received more public subsidies related to farming activity.

Table 3-19 | Farm Household Income and Composition of Income Sources

(Unit: thousand won)

Year	Farm Household Income (A)	Agricultural Income (B)	Income from off-farming (C)	Transferred Income (D)	Ratio (%)		
					B/A	C/A	D/A
1970	256	194	62	0	76%	24%	0%
1980	2,693	1,755	938	0	65%	35%	0%
1990	11,026	6,264	2,841	1,921	57%	26%	17%
2000	23,072	10,897	7,432	4,743	47%	32%	21%
2005	30,503	11,815	9,884	8,803	39%	32%	29%
2007	31,967	10,406	11,097	10,465	33%	34%	33%

Source: MIFAFF, Statistical Yearbook of Agriculture and Forestry, 2008

Until the mid-1990' s, the proportion of farm household income to urban household income was over 95%. However, the income gap between urban and rural households has widened since 1995. In other words, the income gap between urban and rural households is increasing due to the market liberalization following the UR as well as the difference in the productivity growths. In 2007, the average income of farm household was only 73% of that of the residents in cities.

Table 3-20 | Farm household income relative to urban household income

(Unit: thousand won)

Year	Farm household (A)	Urban household (B)	Ratio (A/B)
1990	11,026	11,319	0.97
1995	21,803	22,933	0.95
2000	23,072	28,643	0.81
2007	31,967	44,105	0.73

Source: MIFAFF, Statistical Yearbook of Agriculture and Forestry, 2008

3.2 Changes in the Korean Agricultural Policy

The Korean agricultural policy has undergone a number of significant changes since the 1950s. At the time of independence, the most urgent issues of the newly established government was land reform, which could provide stability to the nation' s largest demographic group and enhance the productivity in the grain sector to address food shortages. Although the aid from the United States helped to solve the severe food shortage during that time, this aid also had the negative effect of depressing grain prices and reducing farm income, and is sometimes considered to have damaged the long-term grain production of Korea.

During the industrialization period, the main goal of agricultural policy was to increase food self-sufficiency through the expansion of agricultural production and "Green Revolution." Specific plans included land reclamation projects, improvement of irrigation system, and research and training programs for increasing productivity. However, uneven development focusing on industrialization left deep gaps between agriculture and other industries, and rural and urban regions.

Table 3-21 | Transition of the Korean Agriculture and Policy Direction

Period	Main Issues and Policy Direction
Before Industrialization	- Creation of owner farming through "Land Reform" - Food shortage and food aid
Industrialization Period ('60~)	- Expansion of grain production - Increased productivity through "Green revolution" - 1980's: entering the era of commercial agriculture
Restructuring Policies ('90~)	- 1990's: React sensitively to the market demand after conclusion of the UR - Structural Reform Measures in Agricultural Sector - 2000's: Clear growth and declines by item(rice vs. livestock products), farm income problem, rural development and welfare - Decreased rice consumption and increased consumption of fruits and meat - Expanding market opening through FTAs
Paradigm shift in the newly established government ('08~)	- Policy coverage: primary industry → primary, secondary, service industry - Policy customer: producer → producer, consumer, food processing enterprises - Agricultural market: domestic market(defensive) → export market(offensive) - Support method: average → selection and concentration

The period after the conclusion of the UR negotiation is characterized by globalization. A series of agricultural policies implemented after the launch of WTO in 1995 demonstrate the transition of the Korean agricultural policies toward more market-oriented system. The focus of agricultural policies has been enhancing competitiveness and the capacity of the Korean agriculture to react sensitively to the market demand while coping with emerging challenges, including, in particular, promotion of environmentally friendly farming for sustainable agriculture, maintaining rural vitality, and establishing social safety net in rural areas.

The current government established in 2008 is pursuing a more offensive approach in agricultural policy. It started to put emphasis not only on production of primary agricultural products but also on processing of primary products and service industry in rural areas. It also expanded policy customers from producers to producers, consumers, and food processing enterprises. Escaping from a defensive approach focusing on protection of domestic agricultural market from imported products, it set an ambitious goal for expanding export of its agricultural products, and is working on selecting agricultural entities having greater chance of success and concentrating government support to them.

Hereafter is the more detailed explanation of recent changes in the Korean agricultural policies under the WTO system.

3.2.1 Reforming agricultural structure to enhance competitiveness

To enhance competitiveness, the Korean government has implemented a number of agricultural programs that reduce production cost through farm consolidation, foster competitive farm entities, and encourage farmers to specialize, as well as promote the development of agricultural technology.

The Korean government has recently eased strict regulations on farmland ownership and transactions. Long-lasted principle that only farmers should be allowed to own farmland is now being eased. Since 2003, the government has permitted agricultural corporations to acquire farmland and prepared conditions for large-scale commercial agriculture to start operation.

To encourage new entrants, the Korean government has selected new farmers and supported them with loans. To promote specialized farmers, it provided special loans to rice, livestock, fruit and vegetable farmers to support expansion of farm size, purchase of new machines, and renovation of orchard facilities. To promote R&D in the agricultural sector, the Agricultural Research and Development Promotion Center (ARPC) was established in 1995. Through 2002-2006, the government budget for R&D increased at an average rate of 6.4%, which is higher than the national budget increase rate of 4.1%.

Although a series of policies aimed at enhancing competitiveness resulted in intended results, they also faced setbacks during the financial crisis in 1997, which caused the price of oil and feedstuffs to skyrocket. Korea is highly dependent on the imports of these products and with higher prices, the overall management cost of agriculture increased sharply. In addition, the terms of trade deteriorated as prices of agricultural products fell, following the drop in demand. As a result, many farm households went bankrupt or suffered from increased debts. Such damage had been even more severe for large-scale farms.

3.2.2 Promotion of environmentally friendly farming[76]

Until the end of 1980s, the main policy focus in agriculture was increase in production and productivity of grain. However, with growing public awareness on environmental issues, consumers' interests in food quality and organic food have increased. In this regard, the Korean government set the promotion of environmentally friendly farming as a major policy goal since the mid-1990s. The ultimate goal is to maintain sustainable agricultural production through coexistence of agriculture and environment, preserve the environment, and ensure food safety. Currently, environment-friendly farming is recognized as a key element to enhancing competitiveness of the Korean agricultural products under the more open market.

Since 2001, the Korean government has carried out 5-year plan for the promotion of environment-friendly farming. It designated environmentally friendly farming zones and has provided support to farmers who produce environment-friendly agricultural products through a direct payment scheme. The beneficiaries of this scheme are required to take training on environment-friendly farming and record the amount of chemicals they use.

Stores that handle only the organic agricultural products are being operated in metropolitan areas to give consumers better access. Department stores are also encouraged to expand the corners allotted for these products. The growing prevalence of e-commerce also gave rise to the door-to-door delivery services and allowed producer to sell their products to consumers directly. Although certified environment-friendly agricultural products accounts for only 3% of the total agricultural products distributed in the market, the government intends to increase the rate up to 10% by 2013. The Korean government also plans to establish a large-scale wholesale distribution center for environment-friendly produced agricultural products in 2009.

3.2.3 Maintaining rural vitality and establishing social safety net

Despite heavy investment in agriculture since the 1990s, it has been very difficult to avoid decrease in rural viability due to continuous migration of rural population into urban areas.[77] Expanded market liberalization by DDA and FTA negotiations has also rendered rural areas more vulnerable to external elements and thus made it necessary to design comprehensive policy for enhancing viability of rural areas. Against this background, in 2005, the Korean

76) www.mifaff.go.kr

77) If current trend continues, the share of rural population is expected to decrease from 19% in 2000, to 19.9% in 2009, and to17.2% in 2013.

government designed "comprehensive policy for enhancing standard of living in rural areas and rural viability." Under the objective of attaining balanced development between rural and urban areas and making rural areas into residential areas for at least 20% of the population, the Korean government has implemented a series of policies in upgrading infrastructure, welfare, education in the rural areas on par with the level of urban areas. The Korean government is working to guarantee the basic standard of living for all farmers including the less competitive ones who quit farming. In this regard, subsidies for pension, medical insurance, and tuitions are being expanded to farmers. It also plans to set rural service standards, which set minimum service standards in rural areas, and reflect such standards into all relevant policy areas.

Due to very vulnerable agricultural income structure reflected in a lower off-farm income of 33%, the Korean government is also focusing on increasing the source of off-farm income by promoting rural village tours and establishing industrial complexes in rural areas. To prevent income fluctuations and secure stable income for farmers, it is increasing disaster insurance in terms of product coverage and recipient farmers.

3.2.4 Expansion of direct payment programs

The conclusion of the Uruguay Round (UR) in 1993 resulted in rapid structural changes in Korean agriculture and imposed binding constraints on available policy options to be consistent with UR commitments. To cope with the challenge of policy environments, market price support has been replaced by decoupled income support.

A number of different direct payments have been introduced since the late 1990s, with a variety of objectives. The first of these was introduced in 1997 in the form of early retirement payments. Farmers over 65 years of age who were willing to sell or rent their land to full time farmers for a period of more than five years were eligible to receive a lump-sum payment per m^2 of the farmland, calculated as the difference between annual farming income and rent during three years. A direct payment to support rural areas with less favorable production and living conditions was introduced on a pilot basis in 2004, then became a national program in 2006.

Following the 2004 rice negotiation, a direct income support mechanism for paddy field was introduced. As AMS for rice accounted for 90% of total AMS in Korea' s UR AMS reduction commitment, rice farmers have been heavily affected by implementing the AMS reduction commitment. As a result, income support for rice farmers through the government purchase program has been significantly restricted. Therefore, rice farmers in Korea have been asking the government to introduce direct payment program stipulated on the AoA. Direct payment for paddy field includes both fixed and variable payment systems from the 2005/06 crop year. To be eligible for the fixed payment, paddy fields had to be in production during the period 1998-2000. The variable payment is given only to farmers who are currently producing rice on registered farmland. The amount of the variable payment is determined according to the difference between a target price and each year's post-harvest price. If the post-harvest price is lower than the target price, farmers receive 85% of the difference, after deduction of the fixed payment, which is multiplied by a fixed national reference yield to calculate the payment per hectare.

In the long-term perspective, in order to overcome instability of farm income and to establish comprehensive income safety-net for farm household, the Korean government is working on designing "income stabilization scheme for farm household" by putting together most of the existing direct payment programs. Under such scheme, each year farm households registered for the programs are paid certain percentage of the difference between target income and annual agricultural income. The Korean government plans to introduce a pilot program during 2010-2011, and then implement the program from 2012.

4. Overview of the Azerbaijan Agriculture and Agricultural Policies

4.1 Overview of the Azerbaijan Agriculture

With abundant fertile land and suitable climatic zones for agricultural production, agriculture has long been a strong point of Azerbaijan. During the Soviet era, Azerbaijan was famous for its rich and abundant agricultural goods. Following independence, agriculture's role in the overall economy has declined from 30% in 1989 to 5.5% in 2007[78] while the share of industry has increased. Azerbaijan's agriculture has undergone a dramatic transition since the breakup of the collective state farm and the privatization of agricultural land starting in 1996. Agriculture is the third biggest sphere in the Azerbaijani economy after oil and construction. Agriculture possesses the biggest share in employment (in 2007, 39% of total employed population was working in agriculture, and only 1% in the oil sector), and has also huge influence on poverty reduction in rural areas. In 2007, 4.14 million of rural population takes 48% of total Azerbaijan's population.

In this regard, the agricultural and rural sector is still of fundamental importance in Azerbaijan, like in the former Soviet states. It is not only a crucial sector to the national economies, but is also important in providing employment, basic livelihood and social security. Deterioration of this sector can lead to social instability and endanger sustainable economic development.

78) In Korea, the share of agriculture in GDP is 2.4% in 2006.

Table 3-22 | Selected Economic Indicators of Azerbaijan

	2001	2002	2003	2004	2005	2006	2007
Population(million)	8.08	8.14	8.20	8.27	8.35	8.44	8.53
Rural population(million)	3.97	4.01	4.05	4.01	4.05	4.08	4.14
Share of Rural population(percent)	49%	49%	49%	49%	49%	48%	48%
Employed Population (thousand)	3,715	3,727	3,747	3,809	3,850	3,973	4,014
Employed population in agriculture (thousand)	1,482	1,495	1,497	1,503	1,510	1,548	1,556
Share of agriculture in employment (per cent)	40%	40%	40%	40%	39%	39%	39%
National GDP (millions of manats)	5,316	6,063	7,147	8,530	12,523	18,746	26,815
Agricultural GDP (millions of manats)	780	835	876	924	1,072	1,263	1,487
Share of agriculture in GDP (in per cent)	14.7%	13.8%	12.3%	10.8%	8.6%	6.7%	5.5%

Source: The State Statistical Committee of Republic of Azerbaijan http://www.azstat.org/indexen.php

The average share of plant growing industry in agricultural production for 2005-2007 is 58 .9% and the share of livestock industry is 41.1%.

Table 3-23 | Gross output of agriculture (by actually current prices)

(Unit: million mantas, %)

Years	Total	Annual growth(%)	of which	
			plant-growing products	livestock products
1995	713.4		418.1(58.6%)	295.3(41.4%)
1996	903.7	26.7%	529.7(58.6%)	374(41.4%)
1997	824.5	-8.8%	486.5(59.0%)	338(41.0%)
1998	884.3	7.3%	538.6(60.9%)	345.7(39.1%)
1999	946.2	7.0%	541.7(57.3%)	404.5(42.7%)
2000	1060.7	12.1%	617.7(58.2%)	443(41.8%)
2001	1179.9	11.2%	718.6(60.9%)	461.3(39.1%)
2002	1270.5	7.7%	774.1(60.9%)	496.4(39.1%)
2003	1366.5	7.6%	807(59.1%)	559.5(40.9%)
2004	1476.6	8.1%	874.8(59.3%)	601.8(40.7%)
2005	1732.1	17.3%	988.2(57.1%)	743.9(42.9%)
2006	1969.7	13.7%	1124.3(57.1%)	845.4(42.9%)
2007	2765.0	40.4%	1726.4(62.4%)	1038.6(37.6%)

Note: value in parenthesis denotes the share of plant and livestock in total value of agricultural production
Source: The State Statistical Committee of Republic of Azerbaijan http://www.azstat.org/indexen.php

Cereals take the highest share in terms of crop production as well as sown area. There are signs of a shift to more profitable crops such as vegetables, potatoes, and melons while the sown area of cotton and tobacco has continued to decrease. Azerbaijan' s largest crop wheat, which is Azerbaijan' s staple crop, takes the highest share in terms of crop production as well as sown area. In 2007, wheat accounted for 66% of Azerbaijan' s grain production.

Table 3-24 | Sown area, production and yield by commodity (2007)

(Unit: 1000 ha, 1000 ton)

	Cereals (wheat)	Potatoes	Vegetables	Sugar beets	Sunflower for seed	Cotton	Tobacco
Sown area (1000ha)	739.6 (487.3)	67.1	85	6.5	9.2	75.6	1.3
Production (1000 ton)	2004.4 (1328.6)	1037.3	1227.3	141.9	13.4	100.1	2.9

Source: The State Statistical Committee of Republic of Azerbaijan http://www.azstat.org/indexen.php

Animals raised in Azerbaijan include poultry, sheep, cows, goats, and pigs (in descending order of numbers). Meat production in tons was highest in beef and veal, poultry meat, mutton and goat meat, and pork (in descending order of production).

Table 3-25 | Meat production (carcass weight)

(Unit: 1000 ton)

Years	Meat total	of which:			
		beef and veal	mutton and goat meat	pork	poultry meat
1985	168	76	30	11.1	50.7
1990	175.5	73.9	35.4	12.6	53.6
1995	82	41.2	24.4	2.1	14.3
2000	108.7	55.5	35	1	17.2
2005	149.6	71.5	41.9	1.5	34.7
2006	155.5	73.4	44.4	1.4	36.3
2007	170.6	75.4	45	1	49.2

Source: The State Statistical Committee of Republic of Azerbaijan http://www.azstat.org/indexen.php

Sales prices of agricultural products have sharply increased in most of agricultural products except for a few of commodities such as cotton, tobacco, and eggs. There are higher increase rate in vegetables, fruits, and livestock products compared to that of grain.

Table 3-26 | Sale price indices of agricultural products (1995=100)

	2000	2001	2002	2003	2004	2005	2007
Grain	134	126	120	155	168	161	231
Cotton	65	82	78	86	107	107	113
Tobacco	177	210	220	131	273	362	114
Potatoes	95	92	72	94	123	75	266
Vegetable	182	164	199	170	232	164	471
Watermelons and melons	171	161	168	193	333	277	322
Fruits and berries	416	330	397	323	298	713	913
Grapes	203	140	167	219	282	375	405
Tea leaves	53	74	96	110	117	136	166
Cattle	213	222	275	332	347	461	620
Sheep and goats	187	196	213	287	335	464	623
Pigs	100	101	120	134	145	178	273
Poultry	147	144	153	160	189	196	227
Milk and dairy products	214	168	186	189	208	229	270
Eggs	60	66	71	63	70	81	121
Wool	176	179	178	207	255	435	652
Cocoons	102	134	148	124	222	183	263

Source: The State Statistical Committee of Republic of Azerbaijan http://www.azstat.org/indexen.php

The structure of Azerbaijan agriculture is mostly small-scale. Over 95% of farms are operated by private owners, family peasant farms and households, and only 4.3% of farms are operated by agricultural enterprises. Each of agricultural producers has 1.92 hectare of land area on average. Rural population is maintained stably at about 50% of the total population.

Table 3-27 | Structure of agricultural products by categories of farms

(by actually current prices, per cent to the total)

	2000	2002	2003	2004	2005	2006	2007
All categories of farms	100	100	100	100	100	100	100
including:							
Agricultural enterprises	2.3	1.8	3.0	4.3	4.0	3.2	4.3
Private owners, family peasant farms and households	97.7	98.2	97.0	95.7	96.0	96.8	95.7

Source: The State Statistical Committee of Republic of Azerbaijan http://www.azstat.org/indexen.php

Table 3-28 | Number of population

(Unit: thousand, %)

Years	Total	of which		Specific weight (%)	
		urban	rural	urban	rural
1980	6114.3	3247.5	2866.8	53	47
1990	7131.9	3847.3	3284.6	54	46
2000	8016.2	4086.4	3929.8	51	49
2007	8532.7	4397.6	4135.1	52	48

Source: The State Statistical Committee of Republic of Azerbaijan http://www.azstat.org/indexen.php

Azerbaijan' s agriculture suffers from low productivity in most types of agricultural products. For example, the cereal yield of Azerbaijan was at 2,735 kilograms per hectare in 2005, it was well below the yield in New Zealand with 7,665, USA with 6,454, and Canada with 3,031. Low productivity in agriculture is to a great extent a result of the lack of agricultural input supply such as fertilizer, pesticide, machinery, etc.

Table 3-29 | Cereal Yield by Country in 2005

(Unit: kg/hectare)

Country	Azerbaijan	New Zealand	USA	Canada	Korea	Japan	China
Yield	2,735	7,665	6,454	3,031	6,283	6,028	5,105

Source: www.nationmaster.com/graph/agr_cer_yie_kg_per_hec-cereal-yield-kg-per-hectare

Azerbaijan' s export is highly dependent on mineral (mainly, oil and gas) trade, accounting for 97.1% of national total exports. According to the drastic increase in international price of oil, trade surplus reached at 40.6 billion US dollars in 2008. However if we exclude the oil trade, Azerbaijan would have a huge trade deficit amounting to 5.4 billion US dollars in 2008.

Azerbaijan is a large net food importing country. Imports of agricultural products were 1.13 billion US dollars and exports of agricultural products were 0.53 billion US dollars in 2008. Therefore, the agricultural trade deficit was about 0.6 billion US dollars . Agricultural imports are diverse and take about 16% of Azerbaijan' s total imports. Imports are diverse and include mainly grains such as wheat, corn, rice, and barley. Also high value-added products such as sugar products and drinks are imported as well as animal products such as chicken, beef, butter, etc., while exports are mostly vegetables and fruits. Azerbaijan remains an important exporter of fresh fruits, juices and concentrates, and vegetables to Russia and other CIS countries. Fruit ranks near the top of the list of Azerbaijani exports. Azerbaijan produces 400,000 to 450,000 tons of fruit a year. However the share of agricultural products in Azerbaijan' s exports was only 1.1% in 2008.

Table 3-30 | **Azerbaijan's agricultural trade in 2008**

(Unit: 1000 US dollars)

Names of groups	Imports	Share of National imports(%)	Exports	Share of National exports(%)	Balance of payment
National Total	7,163,470.3	100	47,756,229.4	100	40,592,759.1
Agricultural Trade	1,130,545.3	15.8	532,971.8	1.1	-597573.5
Alive animals	51,518.5	0.7	1,223	0	-50,295.5
Vegetables	519,545.8	7.3	252,089.9	0.5	-267,456.1
Fruits	3,551.8	0.05	72,893.7	0.2	69,341.9
Animals and vegetable fats and oils	73519.5	1	123422.2	0.3	49,902.7
Food products, beverages, spirits and vinegar, tobacco	485961.5	6.8	156236.7	0.3	-329,725.2
Mineral products	336431.2	4.7	46369752.4	97.1	46,033,321.2

Note: Trade in fruits represents the import and export value in 2007 from Azerbaijan' ministry of agriculture.
Source: The State Statistical Committee of Republic of Azerbaijan http://www.azstat.org/indexen.php

Considering a wide variety of crops and excellent climatic conditions and extended growing seasons, Azerbaijan has a great potential for development of the food processing industry as well as expansion of export of processed agricultural products. However, this will be possible only through procurement of new or refurbished equipment, and the production and processing of agricultural products should be increased. In this regard, further growth of the agricultural sector is dependent on improvements of primary production and processing and development of the full supply chain including logistics and retail.

Agricultural goods are subject to ordinary customs duties, and no other specific border measures are applied to these products. Applied tariff rates on most agriculture products are relatively low ranging between zero and 15% - mostly 0%, 5%, or 15%. Tariff escalation, where the importing party protects its processing sector by setting lower tariffs on raw materials and higher tariffs on valued-added processed products, is not found in Azerbaijan agricultural products, which means the Azerbaijan tariff structure for its agricultural products is not sophisticated enough to protect its domestic market.[79] Alcohol and tobacco products seem to be relatively sensitive as tariffs on these products are in the form of specific duty and there are import quotas for these products. Azerbaijan does not have any export subsidy, export credit guarantee or insurance programs. Additionally, agricultural goods are not subject to export prohibitions or restrictions.

79) State Customs Committee of Azerbaijan Republic http://www.az-customs.net/en/zakon.htm

Table 3-31 | Azerbaijan's agricultural tariff rates compared to WTO member groups

(Unit: Percent)

	Final Bound	Applied
Developed Countries	38	34
Developing Countries	61	25
Azerbaijan	N.A	14.2

Source: UNCTAD and WTO

Table 3-32 | Azerbaijan's tariff structure on agricultural products: share in tariff lines

(Unit: Percent)

Tariff rate	Duty free	$0<x\leq 5\%$	$5<x\leq 10$	$10<x\leq 15$	$15<x\leq 25$	$25<x\leq 50$	$50<x\leq 100$	$x>100\%$
Share in tariff lines(%)	0.7	15.0	1.4	79.0	0.8	1.7	1.0	0.3

Source: WTO

Although Azerbaijan agriculture has developed positively in general, there are many problems, such as weak material and technical base; ineffective land and water resources management; low levels of irrigation and drainage systems; lack of coordination between raw materials production and processing; insufficient provision of scientific and methodological instructions to the agrarian sector and staff training. Problems in the sphere of plant growing include lack of highly productive seeds, chemical preparations, water, soil salinization, productivity reduction and erosion, and underdeveloped processing industry, harvesting, storage, packing, and transportation methods. In the sphere of cattle-breeding, there are problems such as the low level of the fodder base, insufficient stock of grass, increasing diseases, lack of medical preparations, veterinary services and low levels of selection work. Tackling these problems will result in dynamic growth of the production rate in the sector.[80]

4.2. Overview of the Azerbaijan Agricultural Policy

Following the energy sector, agriculture is transforming into the most dynamic, market-oriented sector of the economy. The Azerbaijan government has continuously undertaken structural reform of its agricultural sector in order to improve productivity. Directions of development of this sector includes assurance of effective use of land and water resources; restoration of irrigation; strengthening the logistics of the agrarian sector; supporting coordinated development of raw material production and processing; stimulating growth of

80) ADB, 2008, Development of Agriculture in Azerbaijan
http://www.adb.org/Documents/Events/2008/Trade-Development/AZE-Agriculture-Trade-Policy.pdf8

production of competitive product; improving the financial state of the agrarian sector; improving the scientific-methodical and personnel training system of the agrarian sector.[81]

Agricultural policies mainly consist of tax relief, insurance subsidies, subsidies for irrigated water, seeds, fuel, fertilizers, and construction and maintenance of infrastructure such as irrigation systems, water and electricity supply facilities, drainage works. The share of agricultural subsidies in the total government budget expenditure is estimated to be 8% in 2007 (Table 3-33). Raising the self-sufficiency rate of wheat is one of the major concern of its government, which reflects the fact that more than 40% of wheat demand is met by imports and that international price of wheat is increasing. Wheat is the key staple crop in Azerbaijan, and its consumption and import volume is on the increase. Self-sufficiency rate of wheat in 2007 was 54.8% in Azerbaijan.[82]

Table 3-33 | Wheat in Azerbaijan: Consumption, Production, Imports, and Area harvested

Year	Domestic Consumption		Production		Area Harvested		Imports		Self-Sufficiency(%)
	Quantity 1000MT	△(%)	Quantity 1000MT	△(%)	Area 1000HA	△(%)	Quantity 1000MT	△(%)	
1987	1605	NA	649	NA	268	NA	945	NA	40.4
1988	1655	3.12	782	20.49	306	14.18	900	-4.76	47.3
1989	1463	-11.60	542	-30.69	240	-21.57	900	0.00	37.0
1990	1672	14.29	880	62.36	369	53.75	800	-11.11	52.6
1991	1572	-5.98	889	1.02	406	10.03	700	-12.50	56.6
1992	1442	-8.27	906	1.91	435	7.14	518	-26.00	62.8
1993	1367	-5.20	806	-11.04	499	14.71	600	15.83	59.0
1994	1224	-10.46	739	-8.31	453	-9.22	406	-32.33	60.4
1995	1117	-8.74	598	-19.08	419	-7.51	457	12.56	53.5
1996	1107	-0.90	759	26.92	454	8.35	348	-23.85	68.6
1997	1648	48.87	935	23.19	538	18.50	713	104.89	56.7
1998	1597	-3.09	819	-12.41	515	-4.28	778	9.12	51.3
1999	1616	1.19	866	5.74	423	-17.86	850	9.25	53.6
2000	1898	17.45	1300	50.12	493	16.55	748	-12.00	68.5
2001	2361	24.39	1600	23.08	600	21.70	711	-4.95	67.8
2002	2300	-2.58	1690	5.63	650	8.33	664	-6.61	73.5
2003	2300	0.00	1550	-8.28	600	-7.69	721	8.58	67.4
2004	2500	8.70	1575	1.61	610	1.67	1000	38.70	63.0
2005	2520	0.80	1575	0.00	590	-3.28	1020	2.00	62.5
2006	2500	-0.79	1540	-2.22	560	-5.08	1201	17.75	61.6
2007	2600	4.00	1425	-7.47	500	-10.71	1000	-16.74	54.8

Source: United States Department of Agriculture

81) Priority Directions on the Agrarian Sector, http://www.azerbaijan.az/_Economy/_Agriculture/_agriculture_e.html
82) In case of Korea, self sufficiency rate of rice, its key staple crop, is 95.8% in 2007.

According to Azerbaijan' s notification to the WTO[83], its domestic support for agriculture consists of green box subsidies and non-product specific AMS, both of which are on the rapid increase. Green box subsidy accounts for 30% of total agricultural support of Azerbaijan and non-product specific AMS takes 70% during the 2005-2007 on average.

Table 3-34 | Azerbaijan's WTO notification of agricultural subsidies

(Million manat, %)

Year	2005	2006	2007	Average 2005-2007
Green Box	56.11	76.23	153.17	95.17
Non-product specific AMS	151.74	197.68	330.28	226.57
Sum(A)	207.85	273.91	483.45	321.74
(Annual increase, %)		(31.8)	(76.5)	
Total State Budget Expenditure[84](B)	2,140.7	3,790.1	6,059.5	3,996.767
A/B (%)	(9.7)	(7.2)	(8.0)	(8.1)

In green box subsidies, expenditure for infrastructure accounts for around 90%, and the amount has increased 38% in 2006 from the previous year and 110% in 2007.

Table 3-35 | Azerbaijan's WTO notification of Green Box subsidies

(Million manat, %)

Measure type	Name and description of measure	2005	2006	2007	Average2005-2007
2 (a) Agricultural research	Budget expenditures for running Agricultural research system	2.4	3.5	5.4	3.8
2 (b) (e) pest and disease control, inspection services	Budgetary expenditures in activities related to plant and animal health protection; sanitary and phytosanitary defense; pest and disease control and prevention, including eradication, vaccination and other protective measures, etc.	3.4	3.6	3.7	3.57
2 (c) Training services	Expenditures to set up, maintain and develop agricultural training institutions	1.21	1.53	2.27	1.68
2 (g) Infrastructural services	Expenditures to construct, maintain and develop farm irrigation systems, water and electricity supply facilities, drainage works, etc. for agricultural sector	49.1	67.6	141.8	86.2
Total "Green Box" measures:		56.11	76.23	153.17	95.17

83) WTO, Accession of Azerbaijan, Domestic Support and Export Subsidies in the Agricultural Sector (Revision), WT/ACC/SPEC/AZE/1/Rev.3(13 November 2008)

84) http://www.azstat.org/publications/azfigures/2008/en/020.shtml

In addition to green box subsidies, Azerbaijan maintains a number of nonproduct-specific support programs whose amount accounts for over 2/3 of total agricultural subsidies of Azerbaijan, and is rapidly increasing. All of Azerbaijan' s AMS consists of nonproduct-specific supports. In 2007, its total amount of AMS is 27.1% of its total value of agricultural production, which is far above the current de minimis level of 10% allowed to developing countries under the AoA. Most of its non-product specific AMS is used for tax relief expenditure, supply of irrigation water at reduced costs. Water subsidy is increasing rapidly: 30% from the previous year in 2006 and 67% in 2007. Given the current policy direction and situation of Azerbaijan agriculture, it seems quite difficult to reduce the amount of either subsidy, in particular, subsidy for the supply of irrigation water at reduced costs.

Table 3-36 | Azerbaijan's WTO notification of Non-product specific AMS

(Million manat)

Measure type(s)	Calendar years	Total non-product-specific support
Aid in the amount of MAN 40 for each hectare through the state budget to producers of agricultural products for their use of fuel and motor lubricants in cultivation of plowing areas in accordance with Decision No. 32 dated 15 February 2007 of the Cabinet of Ministers of the Republic of Azerbaijan	2005	-
	2006	-
	2007	56.0
	Average 2005-2007	18.67
Selling with 50% discount of fertilizers to producers of agricultural products by "Agroleasing" OJSC and other legal and physical persons in accordance with Decision 32 dated 15 February 2007 by the Cabinet of Ministers of the Republic of Azerbaijan	2005	-
	2006	-
	2007	24.0
	Average 2005-2007	8.0
Payment of 50% of insurance fee through the state budget paid by agricultural producers in accordance with Decision No. 32 dated 15 February 2007 by the Cabinet of Ministers of the Republic of Azerbaijan	2005	-
	2006	-
	2007	11
	Average 2005-2007	3.67
Expenditure in the form of tax relief	2005	102.6
	2006	119.02
	2007	123.78
	Average 2005-2007	115.13
Payment of subsidies to farms through the state budget for 1st and 2nd reproduction seeds sold from seed farms	2005	0.14
	2006	0.16
	2007	1.5
	Average 2005-2007	0.6
Supply of irrigation water at reduced cost	2005	49.0
	2006	78.5
	2007	114.0
	Average 2005-2007	80.5
Total Non-Product-Specific AMS	2005	151.74
	2006	197.68
	2007	330.28
	Average 2005-2007	226.57

5. Strategies for Azerbaijan's WTO Accession Negotiations in Agricultural Sector

5.1. Overall Strategy

According to the DDA Agricultural Chairman's most recent text, very recently-acceded Members and small low-income RAMs with economies in transition are exempt from reduction commitment of domestic supports and tariffs. In the case of domestic support, such countries are exempt from reduction of OTDS, AMS, and de minimis. In the case of tariffs, they are exempt from the reduction of final bound tariffs and in-quota tariffs.

As a very recently-acceded Member, Azerbaijan is expected to be exempt from DDA reduction commitments. Therefore, it is important to minimize reduction of tariffs and domestic support in the WTO Accession negotiation. Given the importance of agriculture in Azerbaijan's economy and society as a means to maintain food security and as a promising export industry, the Azerbaijan government needs to maintain certain level of tariffs and government support to agriculture in order to have policy flexibility.

Azerbaijan's recognition as a developing country is critical in minimizing reduction. However, the situation is not favorable enough as the World Bank categorizes Azerbaijan as a low-middle income economy based on GNI per capita. Also Azerbaijan's GDP per capita was 3,511 US dollars in 2007. In this regard, Azerbaijan needs to emphasize that it is "a developing and landlocked country" and "a small economy in transition" and that its government needs to continue support on the development of the non-oil sectors, for which flexibility of policy allowed to developing countries is critical. It needs to work on developing more sophisticated logic to support its status as a developing country. In the WTO, there are no specific criteria to determine developing countries and the status as a developing country is determined by self-declaration with no Member objecting to such declaration. Therefore, in order to prevent objections from other Members during its accession negotiations regarding its developing country status, Azerbaijan needs to prepare for some carrots that it can use strategically in the bilateral negotiations with countries having substantial interests in trades with Azerbaijan.

Box 3-2. World Bank Categorization of countries according to GNI per capita

Income criterion:
low income, 935 US dollars or less; lower middle income, 936 US dollars - 3,705 US dollars ; upper middle income, 706 US dollars - 11,455US dollars ; and high income, 11,456 US dollars or more.

Low-income economies (49):
Afghanistan, Haiti, Rwanda, Bangladesh, Kenya, Sao Tome and Principe, Benin, Korea, Dem Rep., Senegal, Burkina Faso, Kyrgyz Republic, Sierra Leone , Burundi, Lao PDR, Solomon Islands, Cambodia, Liberia, Somalia, Central African Republic, Madagascar, Tajikistan, Chad, Malawi, Tanzania, Comoros, Mali, Togo, Congo Dem. Rep, Mauritania, Uganda, Cote d'Ivoire, Mozambique, Uzbekistan, Eritrea, Myanmar, Vietnam, Ethiopia, Nepal, Yemen Rep., Gambia, Niger, Zambia, Ghana, Nigeria, Zimbabwe, Guinea, Pakistan, Guinea-Bissau, Papua New Guinea

Lower-middle-income economies (54):
Albania, Georgia, Namibia, Algeria, Guatemala, Nicaragua, Angola, Guyana, Paraguay, Armenia, Honduras, Peru, Azerbaijan, India, Philippines, Bhutan, Indonesia, Samoa, Bolivia, Iran, Sri Lanka, Bosnia and Herzegovina, Iraq, Sudan, Cameroon, Jordan, Swaziland, Cape Verde, Kiribati, Syrian Arab Republic, China, Lesotho, Thailand, Colombia, Macedonia, FYR Timor-Leste, Congo Rep., Maldives, Tonga, Djibouti, Marshall Islands, Tunisia, Dominican Republic, Micronesia, Fed. Sts., Turkmenistan, Ecuador, Moldova, Ukraine, Egypt, Mongolia, Vanuatu, El Salvador, Morocco, West Bank and Gaza

5.2. Market Access

The first thing that the Azerbaijan government should do is to restructure its tariff rates so that it suits best for Azerbaijan farmers, processors, and the agriculture sector at large. For example, it could organize its tariff structure based on three criteria: tariff escalation, sensitive products, and non-negotiable. In order to protect sensitive products through border measures, including tariffs, it would be wise on the part of the Azerbaijan government to break down tariff lines as much as possible. A closer look at Tariff Schedules of the US or EU might help understand this point. These countries have extremely sub-divided tariff lines for their sensitive products such as dairy and sugar products. On the contrary, developing countries usually have tariff structures which are very simple and less divided.

Second, the Azerbaijan government should carefully settle to a reasonable bound rate by maintaining a good gap from the applied rate especially for sensitive products, which is important in terms of allowing policy space and flexibility for future negotiations. Azerbaijan needs to use tariffs to protect agriculture and therefore should seek a reasonably high bound tariff levels especially on sensitive products.

Third, Azerbaijan can consider ceiling binding which was allowed for developing countries in the UR negotiations as an S&D. In the UR, most of the developing countries have not undertaken tariffication. Instead they used ceiling binding at levels higher than the applied rates. Korea also applied ceiling binding for products such as red pepper, garlic, onion, sesame seeds, milk powder, and butter at tariff levels equivalent to the difference between domestic price and international price. Instead, it allowed TRQs at applied rate levels.[85] However, the general trend in the WTO accession negotiations is comprehensive tariff binding at levels that do not deviate dramatically from applied rates. Azerbaijan will have to be prepared for demands asking to bind its tariffs at much lower rates, although it depends much upon the negotiation capacity and preparedness of the negotiating team. Azerbaijan' s problem is very severe, as the existing tariffs on most agriculture products range between zero and 15%. It is important to note that many WTO members demand higher level of commitments from acceding countries than that had been set for its founding members.

Table 3-37 | Examples of Korea's Ceiling Binding Commitment in the UR

Commodity	Year	Tariff Equivalent(% or won/kg)	TRQ Volume (MT)	Tariff on TRQ (%)
Pepper	1995	300% or 6,900 won/kg	4,311	50
	2004	270% or 6,210 won/kg	7,185	50
Garlic	1995	400% or 2,000 won/kg	8,680	50
	2004	360% or 1,800 won/kg	14,467	50
Onion	1995	150% or 200 won/kg	12,369	50
	2004	135% or 180 won/kg	20,645	50
Sesame	1995	700% or 7,400 won/kg	6,731	40
	2004	630% or 6,660 won/kg	6,731	40

Source: Country Schedule of Republic of Korea (1994)

Finally, referring to the commitments of other new WTO members (Table 3-38), Azerbaijan could insist on long implementation periods for tariff reduction, hopefully 10 years, and the right to make use of Special Safeguard (SSG) to help manage import surge into the domestic market. Given low tariffs of its agricultural products, TRQs may not be necessary. However, Azerbaijan may consider providing TRQs for sensitive products, as a compensation for ceiling binding.

85) * UR Modalites: 13. In case of products subject to unbound ordinary customs duties, developing countries shall have the flexibility to offer ceiling bindings on these products.

Table 3-38 | Market Access commitments of new WTO members

Member	Accession Year	Average Bound Tariff (%)	Staging (years)	TRQ	Special Safeguard
Ecuador	1996	25.8	5	Yes	-
Bulgaria	1996	34.9	5-6	Yes	21(HS 6; 8)
Mongolia	1997	18.4	0		-
Panama	1997	26.1	14	Yes	6(HS 8)
Kyrgyz Republic	1998	11.7	0		-
Latvia	1999	33.6	8	Yes	-
Estonia	1999	17.7	4		-
Jordan	1999	25	10		-
Georgia	2000	12.1	5		-
Albania	2000	10.6	7		-
Croatia	2000	10.4	5	Yes	-
Oman	2000	30.5	4		-
Lithuania	2001	15.6	7	Yes	-
Moldova	2001	12.4	4		-
China	2001	15.7	9	Yes	-
China Taipei	2002	13.1	5	Yes	32(HS 8)
Armenia	2003	14.8	0		-
Macedonia	2003	15	4	Yes	-
Cambodia	2004	41.4	2		-
Nepal	2004	28.1	7		-
Saudi Arabia	2005	12.1	5		?
Vietnam	2007	20.9	7	Yes	?
Tonga	2007	19.2	0		?
Ukraine	2008	10.6	5	Yes	?
Cape Verde	2008	19.3	5		?

Source: Brink (2003)[86] and WTO on-line database

5.3. Domestic Support

First, Azerbaijan should carefully settle high bound AMS levels and low reduction commitments over a long period as far as possible. According to Azerbaijan' s WTO notification of its domestic support, its share of AMS in the total value of agricultural production is high, which is 27.1% in 2007. Considering the trend of its increasing share, using the most recent year, i.e. 2007, as base year would allow Azerbaijan more room for AMS.

86) Lars Brink, 2003, New Members of the WTO: Their Commitments in Agriculture and Provisions Proposed in the Doha Negotiations

Table 3-39 | Azerbaijan's AMS Share of Total Value of Agricultural Production[87]

	AMS (Million MAN)	Value of production (Million MAN)	AMS share of value of production (%)
2005	151.74	1,072.0	14.2
2006	197.68	1,170.9	16.9
2007	330.28	1,217.7	27.1
Average 2005-2007	226.57	1,153.5	19.6

Second, Azerbaijan should secure additional room for domestic support other than AMS. In this light, Azerbaijan needs to target de minimis level at 10% of total value of agricultural production. Most newly acceded countries secured de minimis level at 5% or 10%. Exceptionally, China secured 8.5%. During the accession negotiation, China maintained that it was a developing country, and argued that therefore it had a right for 10% of de minimis. However, the US did not agree with such argument and maintained 5% de minimis level for China. Finally, they compromised at 8.5%. Although China' s domestic support at the time of accession negotiation was only 2% of total value of agricultural production, China secured high level of de minimis to support its agriculture and rural areas expecting increase in imports of grains and further deterioration of rural situation after WTO accession.

Finally, Azerbaijan should review the possibility of utilization on AoA Article 6.2 exemptions on inputs and investment subsidies for low-income and resource-poor (LIRP) farmers, which could provide more room for domestic support. If AoA Article 6.2 exemptions are allowed, Azerbaijan may reclassify some input subsidies that it originally classified into non-product specific AMS, thereby having additional room for AMS.

5.4. Export Subsidies

With no previous export subsidies, it will be impossible for Azerbaijan to have the right to use exports subsidies. However, it could expect to be allowed for the right on AoA Article 9.4 export subsidies until 2021. Developing countries are allowed to provide two kinds of export subsidies without reduction commitment: 1) marketing cost subsidies and 2) internal transport subsidies. Although such privileges will be allowed only until the end of 2021, it would temporarily help Azerbaijan' s agricultural exports into neighboring countries such as CIS, EU, and Turkey.

87) WTO, Accession of Azerbaijan, Domestic Support and Export Subsidies in the Agricultural Sector (Revision)

Table 3-40 | Domestic Support and Export Subsidy Commitments of New WTO Members

Member	Accession Year	AMS reduction (%)	Staging (years)	*de minimis* (%)	Article 6.2 Support	Export Subsidies
Ecuador	1996			10	Yes	
Bulgaria	1996	79	2	5	-	Yes
Mongolia	1997			10	Yes	
Panama	1997			10	Yes	Yes
Kyrgyz Republic	1998			5	-	
Latvia	1999			5	-	
Estonia	1999			5	-	
Jordan	1999	13	7	10	Yes	
Georgia	2000			5	-	
Albania	2000			5	-	
Oman	2000			10	Yes	
Croatia	2000	20	5	5	-	
Lithuania	2001	15	5	5	In de minimis	
Moldova	2001	20	4	5	-	
China	2001			8.5	In AMS	
China Taipei	2002	20	4	5	-	
Armenia	2003			5	-	
Macedonia	2003	20	4	5	-	
Cambodia	2003			10	Yes	
Nepal	2003			10	Yes	
Saudi Arabia	2005	13	10	10	-	
Vietnam	2007	Yes, no cut		10	-	
Tonga	2007			10	-	
Ukraine	2008	Yes, no cut		5	-	
Cape Verde	2008			10	-	

Source: Brink (2003) and WTO on-line database

6. Strategies after the WTO Accession

6.1. Following up on DDA negotiation on agriculture

Once Azerbaijan becomes a WTO Member, first thing to do is foster knowledge of the DDA negotiations, the result of which would replace the UR Agreement and be the new governing rule for international trade. In this regard, Azerbaijan needs to keep analyzing the DDA text on agricultural negotiation and find out its implication on Azerbaijan agriculture and agricultural policies. The DDA agriculture text is very long and complicated and it will take a very long time to study as well as conduct analyses by experts to fully understand the current DDA text.[88]

In the DDA negotiation, recognition as a very recently-acceded Members or small low-income RAMs with economies in transition is important to be exempt from further reduction. According to recent DDA modalities drafts, very recently-acceded Members (VRAMs) or small low-income RAMs with economies in transition are exempt from reduction commitment of domestic support and tariffs. As a very recently-acceded Member in the near future, Azerbaijan is expected to be exempt from DDA reduction commitment.

6.2. Adjustment into the WTO regime

In order to meet WTO accession commitments, it is inevitable for the Azerbaijan government to strengthen the capacity of its government officials. Since the implementation of WTO accession commitments often involve changes in domestic policy, clear understanding of the accession agreement as well as its implication on domestic policy is required. Training of government officials on WTO issues and capacity building for trade policy under the WTO would help Azerbaijan to implement the accession commitments. Azerbaijan government officials also need to improve basic knowledge of the individual WTO agreement, in particular GATT, AoA, SPS agreements, etc. Having a thick layer of WTO experts is something that the Azerbaijan government should aim at to face the challenges from the global trade regime under the WTO.

To capitalize on the opportunities as a potential food exporter, Azerbaijan should upgrade its SPS standards and enhance capacity and expertise of government officials. The SPS Agreement sets out basic rules for food safety and animal and plant health standards. If Azerbaijan wishes to be an integral part of the multilateral trading system, there is little alternative for it but to upgrade its SPS standards. However, if standards are to be upgraded for imported goods, Azerbaijan will also have to upgrade its standards for domestic products as the core WTO principle of national treatment will need to be adhere to also in the SPS area. This will entail

88) UR modalities were 23 pages in A4 size. However, the most recent Agriculture group chairman's text in the DDA negotiation is 122 pages.

large investments in infrastructure as well as development of adequate expertise. If Azerbaijan does not raise its standards, there is a possibility that developed countries might dump sub-standard products on the Azerbaijan market. With limited scientific capacity and expertise, finding the required evidence to deny imports of such products may be difficult.

Moreover, in order to be able to export agricultural products to advanced countries where standard requirements are higher, Azerbaijan should strengthen its capabilities for SPS facilities and certification capabilities. Azerbaijan is exporting fruits and vegetables. However, developed countries are using stringent SPS measures, and often conditions which are difficult to be met by Azerbaijan will be imposed. Azerbaijan also needs to have a better knowledge of the role of institutions such as Codex, OIE and IPPC as SPS agreement stipulates that SPS measures should be based on international standards, guidelines and recommendations developed by such organizations.[89]

6.3. Developing "After WTO Action Plan for Agricultural Sector"

In the agricultural sector, the Azerbaijan government might need to develop after the WTO action plan, drawing on best international practices adjusted to the Azerbaijan environment. It needs to identify the areas which require domestic reforms, formulate tariff policy, and design domestic agricultural policy in the long-term perspective. Drawing upon research on the impact of trade liberalization as well as SWOT analysis of the Azerbaijan agriculture, the Azerbaijan government should work on the action plan for the sustainable development of its agriculture as follows: 1) Enhancing the capacity to produce its staple crop, 2) Promotion of value-added production and export, and 3) Enhancing the viability of rural areas. These seem to be three main goals that the Azerbaijan government should focus on in the agricultural sector.

Table 3-41 | SWOT Analysis of Azerbaijan Agriculture

Strength	Weakness
- Abundant fertile land for agricultural production - Favorable climate conditions(abundant warmth, light, duration of the vegetation period) and a wide variety of crops - Fruits and vegetables well-known for their quality throughout Russian and NIS markets - Comparatively low labor and land cost	- Small-scale farm size(1.92 ha per capita) - Ineffective land and water resources management - Low level of irrigation and drainage system - Outdated food processing equipment and packaging - Underdeveloped food supply chain, including logistics and retail - Low tariff level (maximum 15%) - Lack of productive seeds, chemical preparations, outdated machinery - Increasing animal diseases and lack of veterinary services

89) Sonam Tobgay, 2006, Bhutan and the WTO: A Study on the Impact of Agriculture and Agriculture-Related Issues in WTO Agreements on the Bhutanese Agriculture Sector

Table 3-41 | SWOT Analysis of Azerbaijan Agriculture

Opportunity	Threat
- Government's initiative to supports on the development of the non-oil sectors to reduce overdependence on the oil sector - Strong export potential of value added goods to Russia, Turkey, Central Asia and Europe - WTO accession: Better and more secure market access to major export markets	- WTO accession: Constraint on government flexibility for policy - Tariff binding & commitments for domestic and export subsidies - Developed countries dumping of sub-standard products into Azerbaijan market due to its low SPS capacity and facilities - Intense rural-urban migration and income gap between rural area and urban region

For the goals of enhancing the production capacity and promotion of value-added production and export, it is important to have an improved agricultural infrastructure including irrigation, competitive domestic industry for basic agricultural inputs, such as machinery, highly productive seeds, chemical preparations, and advanced technology on production and food processing. Azerbaijan' s agricultural machinery and input industries are outdated and heavily import-dependent. In order to produce high-quality livestock, fruit, and vegetable products, advanced marketing skills and up-to-date food processing equipment are required in addition to technologies on production, harvest, and quality control. As was emphasized before, in order to be able to export high-quality agricultural products to other countries where standard requirements are higher, Azerbaijan should strengthen its capabilities for SPS facilities, certification systems, and the capacity of its officials to manage SPS matters.

For the purpose of enhancing the viability of rural areas and rural development, there should be parallel development of rural welfare policy and rural industrialization policy. Income gaps and differences in living conditions between rural and urban areas have been widened. Without government measure to stop or reduce these trends, the existing income gap between rural and urban areas and intense rural-urban migration could lead to serious social unrest. Balanced development between rural and urban areas is very important in terms of social stability, in particular, in a rapidly changing society like Azerbaijan. Recognizing this, the Azerbaijan government should work on developing diverse welfare policies for low-income families in rural areas. Subsidies for the cost of bringing up of infants and children, old-age pensions, and subsidies for tuition are the examples of welfare policies that the Korean government implements for its rural areas. As for rural industrial policy, the Azerbaijan government could consider green tourism to rural areas which make use of its favorable climate and geographical advantages such as beautiful landscape.

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Chapter 04

ANALYSIS OF AZERBAIJAN'S EXPORT STRUCTURE AND ITS IMPLICATIONS FOR DIVERSIFICATION STRATEGY

Chapter 04

ANALYSIS OF AZERBAIJAN'S EXPORT STRUCTURE AND ITS IMPLICATIONS FOR DIVERSIFICATION STRATEGY

Siwook Lee

1. Motivation

Recently, globalization has proceeded at an unprecedented speed. It has brought rapid expansion of international trade and movement of capital and labor across borders. Nowadays, integration into the world economy is generally recognized as an inevitable as well as effective means for countries to promote economic growth, development, and poverty reduction. In such circumstances, many countries are actively pursuing openness policy in order to exploit the benefits from globalization.

Meantime, patterns of international trade have been drastically changed. The importance of inter-industry trade, an exchange of products of different industries, has declined whereas the recent growth in international trade is mainly attributable to intra-industry and intra-firm trade. Global operation of MNEs and upstream-downstream fragmentation across different locations are a major driving force for such change. Hence, countries' export structure becomes more similar over time in terms of their sectoral composition, due to the expansion of global outsourcing.

Appropriate integration and specialization into global production value chains is indeed a key factor in economic growth, nowadays. As a matter of fact, such global production sharing has helped developing countries to expand export-oriented activity. The fragmentation of production offers a unique opportunity for producers in developing countries to move from serving relatively small local markets into supplying large firms abroad and thus indirectly serving customers all around the world.

After a painful process of economic and social transformation following the collapse of the Soviet Union, Azerbaijan has recently experienced fast and strong economic growth, which helped to reduce macro-economic imbalances and better integrate into a global economy. Even though the world economy is greatly suffering from the crisis originating from financial sectors in developed economies, the Azerbaijan economy has managed to maintained a healthy outlook, with its GDP growth rate at around 10.8% last year.

As Lee (2008a) observes, the recent economic growth of Azerbaijan has been largely attributable to oil/gas production and construction booms, while the other sectors remain stagnant. The industrial structure of the Azerbaijan economy is highly concentrated around the energy industry and, more recently, construction sectors. Due to high concentration on oil exports, Azerbaijan exposes typical symptoms that many resource-dependent economies face. Unstable prices for these primary commodities may subject a developing country exporter to serious terms of trade shocks.

Natural resource abundance may have a positive effect on economic growth, but export concentration hampers growth. In addition, Agosin (2006) compares experiences of fast-growing Asian countries with those of Latin American economies and concludes that diversified export growth is one of the keys to explain different growth performance between two regions.

The strongest positive effects are normally associated with diversification into manufactured goods, and its benefits include higher and more stable export earnings, job creation and learning effects, and the development of new skills and infrastructure that would facilitate the development of even newer export products.

On the other hand, however, in order to achieve the long-run sustainable export growth under a fairly stable macro-economic environment, enhancing competitiveness of the existing exported goods should be accompanied with efforts for diversifying the export structure. That is, great efforts must be placed in order to encourage new sectors where comparative advantage can be acquired, without ignoring the benefits of continuing to strengthen those sectors that have been subjected to growing international competition.

Many developing countries recently have liberalized trade, undertaken macro reforms and diversified their exports but such efforts do not automatically lead to higher level of economic growth. For example, during the 1960~90s most Latin American economies revealed a substantial extent of export diversification, but their overall growth figures were somewhat disappointing.

The success of export diversification highly depends on the appropriate policy design and its implementation, a country' s structural comparative advantage, factor endowments, and the international market conditions. In this respect, this paper extensively investigates the current export structure of Azerbaijan and extracts policy implications from this exercise.

The rest of the paper proceeds as follows: Section 4-2 introduces some basic concepts and empirical evidence on export diversification. Then Section 4-3 presents the recent trends in international trade. Specifically, by dividing trade flows into three different types, i.e. inter-industry trade, intra-industry trade and intra-firm trade, we investigate recent structural changes in pattern of international trade. Analytic results on Azerbaijan' s export structure are illustrated in Section 4-4. Analytic focus here is on the extent of export diversification, patterns of external trade, and the source of recent export growth. Finally, Section 4-5 summarizes the findings in this paper and introduces some policy suggestions. In particular, policies for Export Processing Zones, as an effective policy tool for developing vertical diversification, and some lessons from the Korean experience on this area are also discussed.

2. Export Diversification and Growth: Concepts and Evidence

2.1. Economic Effects of Export Diversification

Export diversification is a dynamic process of modifying an economy' s pattern of specialization to expand the variety of exportable goods. Apparently, export diversification seems to contradict the traditional trade theory. According to the theory of comparative advantage, the gains from trade follow from allowing an economy to specialize in sectors in which its productive capabilities in comparison to those of its trading partners are relatively better than those of the other sectors. Hence, more specialization in these sectors leads to a greater extent of efficiency.

While the theory of comparative advantage explains well the static pattern of international trade and its welfare implications, it provides little indication as to how a country achieves sustainable growth in the long-run. Furthermore, it does not deal with some potential macro-economic impacts from specialization. For example, exporting a narrow range of commodities may make an economy vulnerable to world price changes of those commodities, and thus lead to instability in export earnings. Such vulnerability hampers appropriate long-term economic planning and undermines productive investment.

As a matter of fact, countries can benefit from diversifying their export portfolio. First of all, export diversification contributes in stabilizing the economy and stimulates private investments. Analogous to the portfolio diversification in finance, export diversification reduces the impacts from specific turbulence such as terms of trade shock. The greater degree of diversification leads to less volatile export earnings. Less volatile export growth is likely to be associated with lower variance of GDP growth (Agosin, 2007).

Countries whose exports are highly dependent on a few products tend to have more volatile real exchange rates than other counterparts, and such real exchange rate volatility discourages investment in tradable goods or services. Hence, economic stabilization through export diversification could encourage risk-averse private firms to invest more, by reducing uncertainties around business environment.

Second, export diversification brings externalities into the domestic economy such as technological spillovers, which is an important determinant for long-run sustainable growth. New endogenous growth literature suggests that every new export variety represents an innovation which is preceded by creative effort and requires knowledge in its production. Agosin (2007) emphasizes the importance of export diversification as the key source of technological learning for countries that are far from the world technological frontier.

Vertical diversification, in particular, can play an important role not only for economic stability but also for the long-term viability for the economy. For developing countries to move toward producing higher value-added products, they can benefit from greater potential for sustained technological learning and more spillover benefits to other activities. A diversification policy aiming to enhance vertical diversification may require more advanced technology, skills and initial capital investment than the horizontal counterpart. Vertical diversification is usually linked with higher learning possibilities that, in turn, may produce greater dynamic externalities than that for horizontal diversification.

Third, export diversification into new industries provides a stimulus for the creation of other new industries and/or expansion of existing sectors, through industrial backward and forward linkages. This is particularly the case if diversification takes place through adding new exports to the existing export basket. The extent to which these linkages of export sectors with the other sectors through export diversification largely depend upon specific patterns of export diversification, input-output coefficients of the production under given production technology as well as the domestic utilization of the commodity. Export diversification among raw primary products and that among processed manufacturing goods would produce quite different impacts on the domestic economy.

Backward linkages exist when increased production by downstream firms provides positive pecuniary externalities to upstream firms. An increase in production by downstream firms generates an increase in demand for upstream firms. In our context, backward linkages from export diversification occur when export-oriented companies try to produce new commodity and purchase their intermediate inputs and/or capital goods from the domestic economy. This may not only help the other sectors in the domestic economy to expand, but also act as an important stimulus to create new upstream sectors.

On the other hand, forward linkages exist when increased production by upstream firms provides positive pecuniary externalities to downstream firms. These are "forward" linkages because the effect of a change is transmitted to firms further along in the sequence of production. Since exports are by definition to serve foreign markets, there may be little scope for forward linkages from export diversification to the other sectors in an economy. In reality, however, commodities are usually sold in both international and domestic markets. Thus depending on the demand structure of these commodities, forward linkages from diversification could take place. In turn, if export diversification brings income growth into the domestic economy, it will increase domestic demand for a wider variety of products.

As discussed so far, export diversification contributes to economic growth in various channels. Most of the empirical studies thus far also indicate the positive correlation between diversification and economic growth. For example, Lederman and Maloney (2007) find that concentration of export revenues reduces economic growth by hampering productivity enhancement. Similarly, De Ferranti et al. (2002) show that 1 percent increase in export concentration is associated with a 0.5 per cent decline in GDP per capita growth. Al-Marhubi (2000), de Pineres and Ferrantino (2000) and Herzer and Nowak-Lehman (2006) also find support for a diversification-led growth hypothesis.

Finally, as Hausman and Klinger (2006) argue, economic growth may be generally not driven by comparative advantage, but by countries' diversification of their investments into new activities. Recent endogenous growth models postulate that technological knowledge increases as a country produces a wider variety of commodities. In addition, according to the theoretical frameworks suggested by Young (1991) and Stokey (1988), free trade may lead less developed countries to specialize in products in which the possibilities for learning-by-doing have been already exhausted. This implies that trade specialization may result in persistent technological divergence between developing and developed countries over time.

Regarding economic growth in resource-abundant countries, many economists claim that resource abundance per se hampers economic growth. This is often referred as "the Paradox of Impoverishing Abundance." Oft-cited growth-impeding factors caused by resource abundance include economic instability, due to volatile commodity prices; risk of "Dutch disease"; Exchange rate appreciation and rising inflation; relatively weak forward and backward linkages with the rest of the economy; under-employment issues; and risk of institutional weakness, etc. Sachs and Warner (2001) and Gylfason (2001), among many others, suggest a negative nexus between resource intensity and growth.

However, there are also various evidences against such resource curse view. First of all, there exists some historical evidence of diversification-led growth from natural resource-based OECD countries, such as Canada, Australia and Scandinavian countries. For example, Blomstrom and Kokko (2003) document the Nordic development history. For the cases of

Sweden and Finland, economic growth was fuelled by the expansion of industries based on domestic raw materials, such as timber and iron ore. These countries, initially one of the poorest countries in Western Europe, were able to upgrade the technological level of their raw material based industries, and establish a foundation for a more diversified economic structure. One interesting characteristics of these countries is that each of them is now posited as one of the richest countries in the world, although industries based on domestic raw materials still account for a significant share of manufacturing activity.

In addition, we have recently witnessed some evidence that resource-based developing countries achieved strong economic growth by nurturing non-traditional industries. Andersson et al. (2005) present such evidence from the cases of agro-food in Chile, of seafood in Thailand, of the cut flower industry in Kenya, etc.

For example, Chile has successfully managed to exploit its natural resource endowment to achieve vertical and horizontal diversification. Besides copper, the agro-food sector has played an important role in this transformation, with success stories such as fresh fruits, wine, and salmon. The Chilean agro-food industry now accounts for around 11 per cent of GDP and 43 per cent of total exports. As Andersson et al. (2005), the agro-food industry led to spread the benefits of growth and create employment opportunities through backward and forward linkages. Backward linkages help to nurture some input-supplying sectors, including those of pesticides and machinery. On the other hand, industries benefiting from forward linkages include food-processing, distribution, and the service industry, including hotels.

Using a dynamic cross-country panel model, Lederman and Maloney (2007) recently find that natural resource abundance appears to be positively correlated with economic growth, and this effect plausibly arises from a greater potential for productivity growth. They convincingly argue that what is detrimental to growth is not the dependence on natural resources per se, but rather the high concentration of exports subject to large price swings.

Lee (2008a) also argues that 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.

2.2. Dynamics of Export Diversification

Export diversification can take a form either of market diversification or of product diversification. Market diversification refers to geographical expansion for export destination.

On the other hand, product diversification takes place by changing the shares of commodities in the existing export mix, or by adding new commodities in the export mix. Product diversification can be further classified into horizontal and vertical ones; the former is to increase the variety of export sectors/products with similar levels of technological sophistication; and the latter is to expand exports by adding higher value-added exports.

Table 4-1 | The Goals and Types of Export Diversification

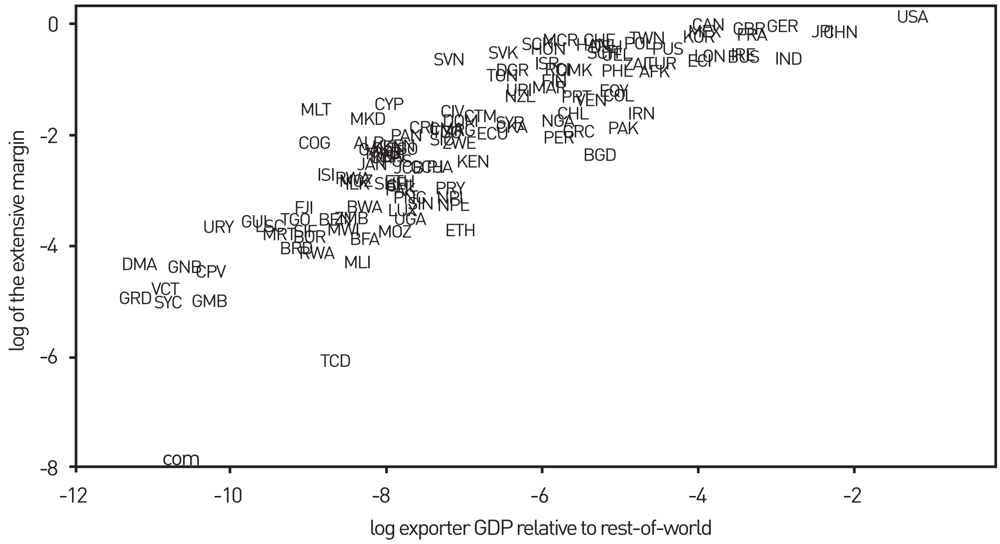
	Stability-oriented		Growth-oriented		
	Based on Existing Commodities	Add New Commodities	Based on Existing Commodities	Add New Commodities	
Horizontal Diversification	Adjust export shares based on covariation of export earnings from individual commodities	Add new commodities based on covariation of export earnings from individual commodities	Adjust export shares based on growth rates of export earnings from individual commodities	Add new commodities based on growth rates of world prices	Add new commodities based on market niche
Vertical Diversification	Adjust export shares based on a commodity's ability to be marketed in raw or processed forms in both international and domestic markets.	Add new commodities based on their flexibility to be marketed in raw or processed forms in both international and domestic markets.	Introduce or expand value-added activities and import substitution	Choose new commodities based on value-added and import substitution potential	

Source: Ali et al. (1991)

Evenett and Venables (2002) empirically investigate the source of export growth, using export data for 23 developing countries for the periods of 1970~97. They find that around 40% of annual export growth was due to the diversification; specifically, one-third of total export growth made by developing countries was attributable to the export of the existing export goods to new markets, while around 10 percent of total export growth was due to the introduction of new products. This finding implies that market diversification is a more important source of annual export growth than product diversification.

On the other hand, Hummels and Klenow (2005) focus on cross-country difference in trade patterns in terms of product composition. Using detailed trade data to decompose trade flows into an extensive component (i.e. growth of exports by adding new commodities) and an intensive component (i.e. growth of exports in goods that are already being exported), they find that the extensive margin is important in explaining why big countries trade more than small countries (See Figure 4-1). Specifically, the extensive margin accounts for 60% of the greater exports of larger economies.

Figure 4-1 | GDP level vs Extensive Margin



Source: Hummels and Klenow (2005)

Kehoe and Ruhl (2003) examine the effect of trade liberalization on the bilateral trade patterns. They find that the set of goods that accounted for only ten percent of trade before the liberalization may account for as much as 40 percent of trade following the liberalization. This indicates that trade liberalization leads to the acceleration of product diversification among tradable goods.

Recently, Carrére et al. (2007) and Amurgo-Pachero and Pierola (2008) find that patterns of export diversification differ, depending on the specific stage of economic development. Low- and middle-income countries diversify mostly along the extensive margin whereas high-income countries diversify along the intensive margin and ultimately re-concentrate their exports towards fewer products. The turn point is around 20,000~22,000 dollars per capita at purchasing power parity. Hesse (2008) interprets such stylized empirical fact in a way that the positive effect of export diversification on economic growth usually takes place in the case of developing countries, in contrast to the most developed countries that perform better with export specialization.

Finally, Shepherd (2008) recently shows that export costs, tariff, and transport costs are detrimental to market diversification for exports, while the market size and development level for the exporting country impact market diversification positively. Specifically, he suggests that a 10% reduction in export-related costs increases the number of export destination by around 5~6%. Shepherd (2008) also finds that the negative impacts of export costs on geographical diversification are bigger in poorer countries than their counterparts. In addition, export costs and transport costs have stronger impacts in more differentiated sectors. Similarly Amurgo-Pachero and Pierola (2008) find that reducing trade costs has a significant impact in the determination of the intensive margin and the changes in the extensive margin.

3. Recent Trends in International Trade

3.1. Globalization and Trade

Globalization recently has proceeded at an unprecedented speed. While globalization has various important facets, comprising economic, socio-cultural, political and technological ones, it is mostly referred to economic globalization. There were two major waves of globalization; one from the second half of 19th century to the early 20th century and another from the second half of 20th century to now. One of the common characteristics of these waves is the fact that international trade as well as movement of capital and labor across borders exponentially expanded over time (see Table 4-2).

Table 4-2 | Globalization Waves in the 19th and 20th Centuries

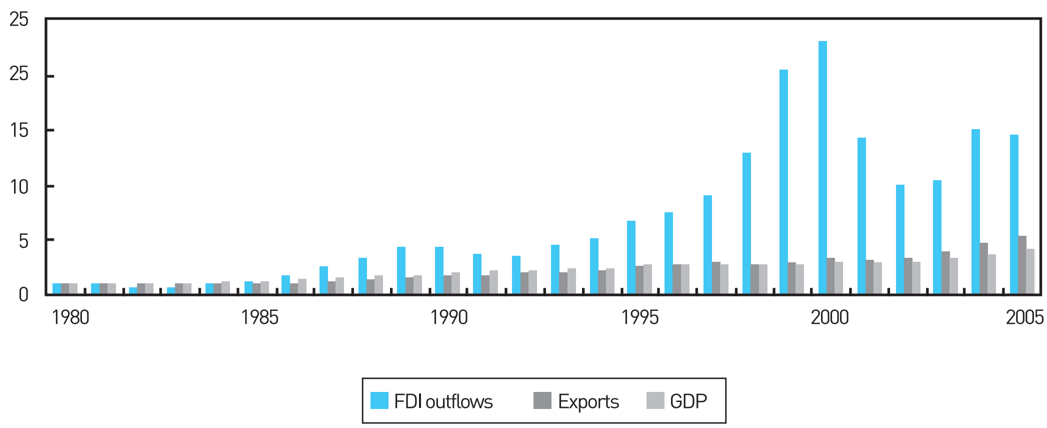
World	1850~1913	1950~2007		
			1950~1973	1974~2007
Population Growth	0.8%	1.7%		
GDP growth (real)	2.1%	3.8%		
Trade Growth (real)	3.8%	6.2%		
Migration (net, million, cumulative) - US, Canada, Australia, NZ	17.9	51.1	12.7	37.4
FDI outward stock (as % of GDP)			5.2 (1982)	25.3 (2006)

Source: WTO (2008)

A distinct feature of the second wave of globalization, compared to the first wave, is that foreign direct investments (FDI hereafter) have been substantially increased and even more accelerated in recent years, largely spurred by the accelerated worldwide liberalization and the expansion of global production network. For example, worldwide FDI outflows have grown about fourteen-and-a half-fold between 1980-2005, while trade flows and GDP have increased only by around 5.3 and 4.1 times, respectively (See Figure 4-2).

As borders are becoming ever more meaningless in economic terms, FDIs 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.

Figure 4-2 | World GDP, Exports and FDI Growth (1980=1)



Source: Lee (2008a)

With a remarkable proliferation of FDI outflows across countries, international trade pattern has been also substantially modified. As multinational enterprises (MNEs hereafter) have played a central role in globalization by expanding their production and distributional network beyond national territories, intra-firm trade, a cross-border transaction between parent companies at home and their subsidiaries abroad, becomes more and more prevalent. Nowadays, one-third of the world trade is estimated to be intra-firm trade via FDI activities of these multinationals (UNCTAD, 2008).

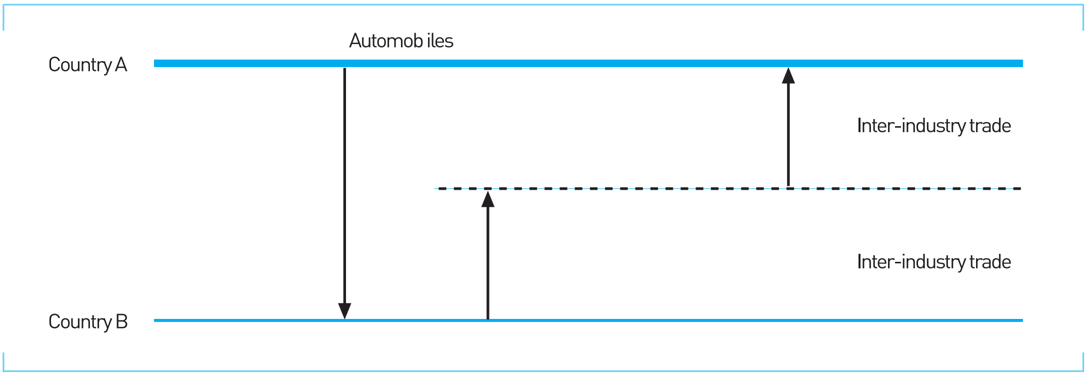
3.2. Recent Patterns of International Trade

There are three different types of international trade. The first one is "Inter-industry Trade," which is an exchange of products of different industries. For example, one country specializes in the production and exports of automobiles where as the other country specializes in those of food. Inter-industry is mostly driven by differences in factor endowments or in technologies, leading to specification (See Figure 4-3). Tradition trade models, such as the Heckscher-Ohlin model and the Ricardian model, serve as analytic workhorses for this type of trade. Thus, gains from inter-industry trade reflect comparative advantage.

The second one is "Intra-industry Trade (IIT)," the exchange of products belonging to the same industry. Unlike inter-industry trade, trade occurs even between countries with similar factor endowments or technology level. For example, Germany exports BMW to the U.S., while the latter exports Ford into Germany. Economies would specialize to take advantage of increasing returns and thus lower costs, not following differences in resource endowments. In this case, it is more efficient if individual countries specialize in a limited variety of production and then trades them with each other. This leads to a wider variety of goods available for consumption.

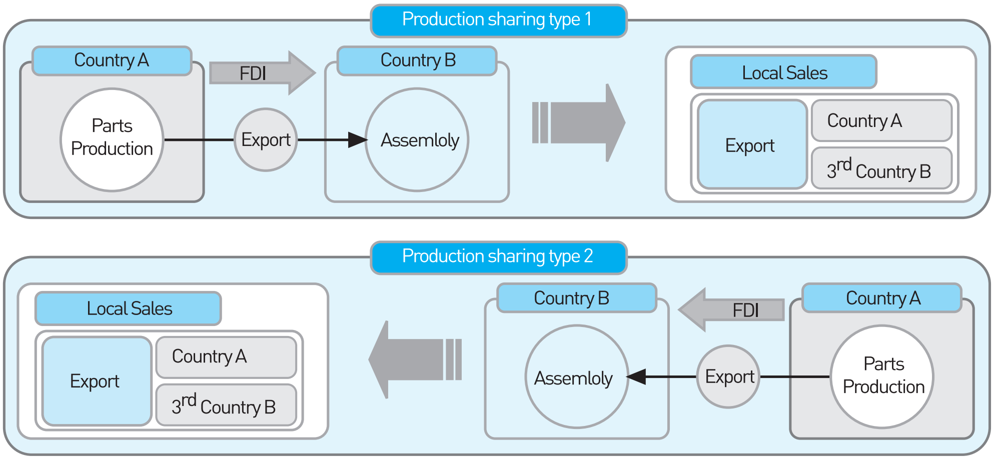
Intra-industry trade can be further classified into horizontal IIT and vertical IIT. Whilst horizontal IIT is related with trade of products of similar qualities but different varieties, vertical IIT is concerned with the two-way trade of products of different qualities but similar usage. Such distinction is important because the determinants of each type of IIT differ. Horizontal IIT is determined by industry-specific factors such as the extent of production differentiation and scale economies, whereas vertical one is by country-specific factors such as differences in factor endowments. Thus the main drivers of vertical IIT are similar with those of inter-industry trade.

Figure 4-3 | Patterns of Inter- and Intra-industry Trade: An Illustrative Example



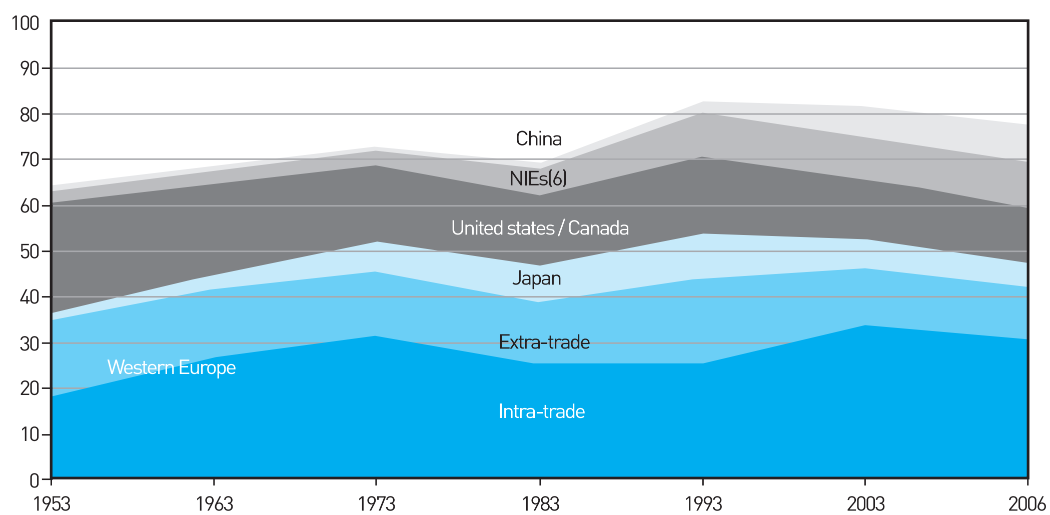
The third type is "intra-firm trade," the exchange of products between parent firms at home and their subsidiaries abroad. This type of trade is in contrast with trade among unrelated parties, or say, arm' s-length trade. Intra-firm trade is motivated by global operation of MNEs and upstream-downstream fragmentation across different locations. For example, as illustrated in Figure 4-4, a parent company at home sends parts and components to its subsidiary abroad, and the latter facilitates assembly process to produce final products. These final products then are sold locally or re-exported to the home country or 3rd countries in the world.

Figure 4-4 | Mechanism of Global Production Network



World merchandise exports continued to expand rapidly since the second half of the 20th century. According to WTO (2008), the average growth rate of world trade reached at 6.2 per cent for the periods of 1950~2007. As for geographical composition for world trade, high-income countries plus China accounts for around 80% of the world trade. As depicted in Figure 4-5, Western Europe accounts for the lions' share of the world trade, of which a substantial portion belongs to intra-European trade. The share of the U.S. in world trade has gradually declined in recent years, while China and other Asian newly industrialized economies have expanded their shares.

Figure 4-5 | Share of Major Exporters in World Trade

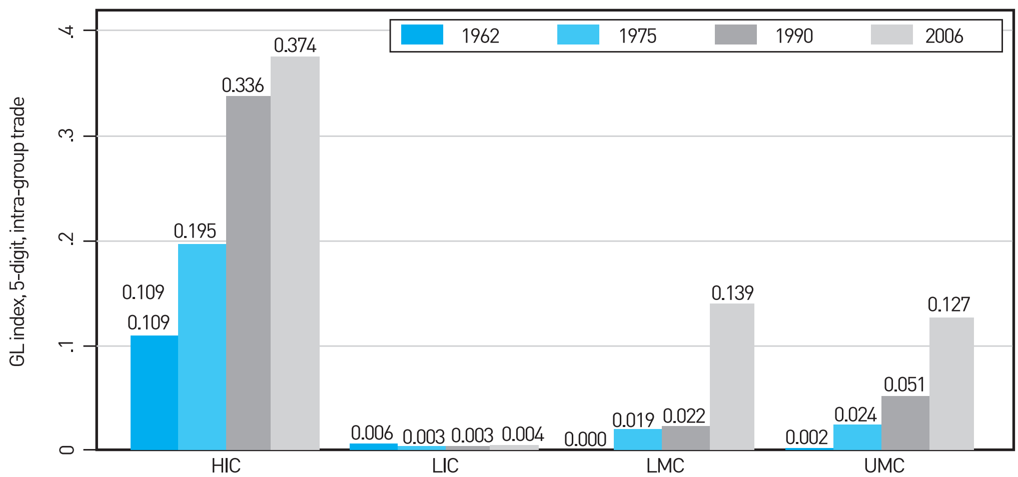


Source: WTO

The dominance of trade among high- and middle-income countries is largely attributable to intra-industry trade. Recently, intra-industry trade has been growing more rapidly than the international flow of goods among different industry groups. According to Brülhart (2008)' s estimation based on the Grulbel-Lloyd index, global IIT accounts for only 7% of world trade in 1962 but, as of 2006, it has grown up to 27% of world trade.90

Figure 4-6 illustrates trends in intra-group IIT by income group. In the case of high-income countries, the importance of intra-group IIT has been gradually increased, reaching at 37.4% of their total trade in 2006. Intra-group IIT among middle-income countries is also expanding, especially since the early 1990s. This is largely due to the emergence of the Chinese economy and the collapse of the Soviet Union. Finally, the intra-group IIT among low-income countries has remained stagnant, being below 1% of their total trade. This implies that intra-industry trade is clearly a high income and middle income country phenomenon.

Figure 4-6 | Trends in Intra-group IIT by Income Group



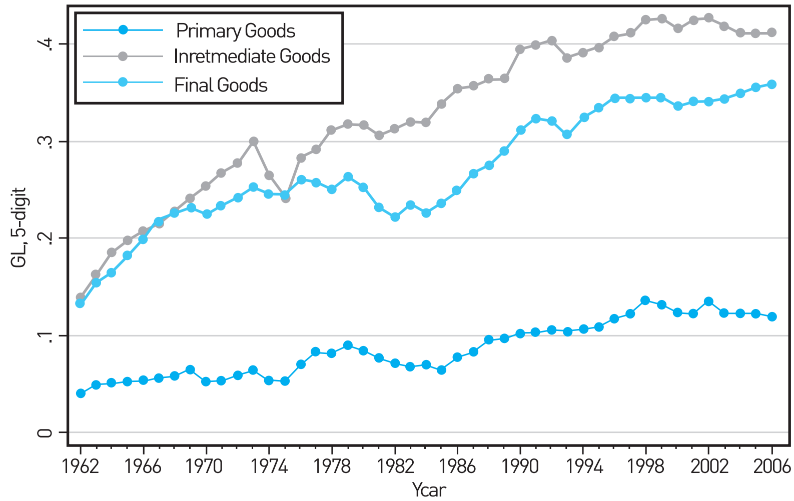
Note: HIC , LIC, LMC, UMC stands for high-income, low-income, lower middle-income and upper income countries, respectively country. Country grouping follows the World Bank categorization.
Source: Brülhart (2008)

Figure 4-7 depicts the evolution of global IIT for different product groups. While the rising importance of IIT is a general phenomenon, regardless of product classifications, intra-industry trade of intermediate goods has been consistently exceeding that of final goods or of primary goods since the late 1970s. This indicates that, as Brülhart (2008) suggests, outward processing under global production network is the dominant driver of recent rises in intra-industry trade.

The increasing importance of outward processing has been also accompanied with the rapid growth of intra-firm trade. Information revolution and new technologies have made it possible to divide the industry' s value chain into smaller functions that can be relocated offshore. Thus Materials and components produced in one country may pass through a sequence of other countries that each adds vale through assembly or other processing before a final product is delivered to customers.

Nowadays, a total of over 79,000 MNEs have established 790,000 foreign affiliates somewhere in the world and, as aforementioned, one-third of the world trade is estimated to be intra-firm trade via FDI activities of these multinationals. MNEs relocate a part of production process offshore, keeping the core value-added activities in headquarters.

Figure 4-7 | Trends in Global IIT by Product Group



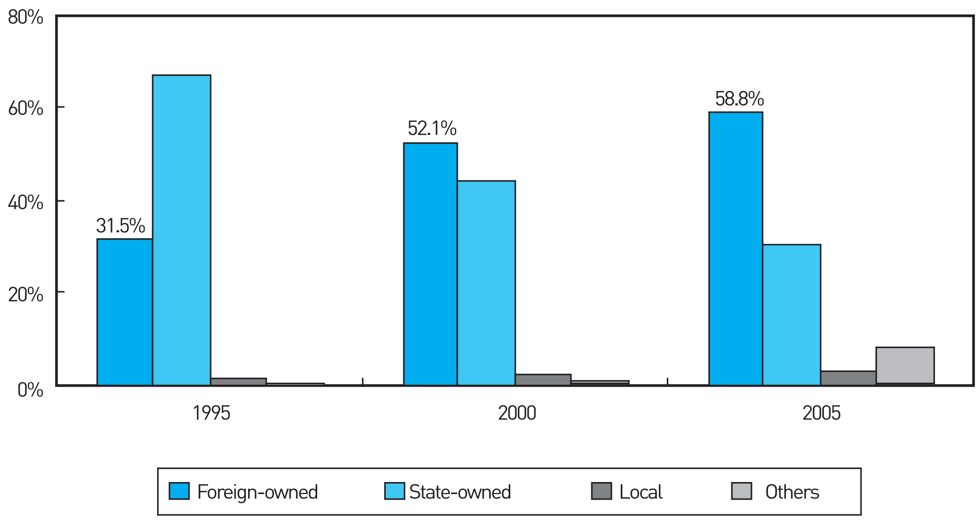
Source: Brulhart (2008)

Appropriate integration and specialization into global production value chains is now a key dynamic driving force of economic growth. As a matter of fact, such global production sharing has helped developing countries to expand export-oriented activity. The fragmentation of production offers a unique opportunity for producers in developing countries to move from serving relatively small local markets into supplying large firms abroad and thus indirectly customers all around the world.

One notable successful case is the growth of the Chinese exports. Relatively low labor costs as well as large local markets enabled China to emerge as the world' s leading manufacturer. Gaulier et al. (2005) among many others argue that foreign affiliates are responsible for a major and ever-growing part of Chinese economic growth. As shown in Figure 4-8, the share of FDI firms in the Chinese exports has been increasing from 32% in 1995 to 59% in 2005.

In sum, the rapid growth of international trade in recent years is mostly attributable to increases of intra-industry and of intra-firm trade. Consequently, countries' exports become more similar over time in terms of their sectoral composition, due to the expansion of global production network.

Figure 4-8 | Composition of the Chinese exports by type of ownership



Source: Chinese Custom database

4. Current Export Structure of Azerbaijan

4.1. Extent of Export Concentration

For the last half of 2000s, the CIS countries have revealed high GDP growth, largely thanks to the rising prices of oil as well as soaring other raw material prices until recently. As illustrated in Table 4-3, the average GDP growth rate of the CIS countries is the highest at 8.4% in 2007 among regions. For example, the Asian countries recorded only 4.7% for GDP growth, whereas the world average is around 3.4%.

Thanks to GDP growth from favourable terms-of-trade movements, the CIS countries recorded a double-digit rise in their imports, while exports tended to increase less than the global average (WTO, 2008). Import growth for the CIS countries reached at 21.5% in 2006, much above than the world average. On the other hand, export grew at a rate of 6%, slightly higher than the world average but much lower than the Asian countries.

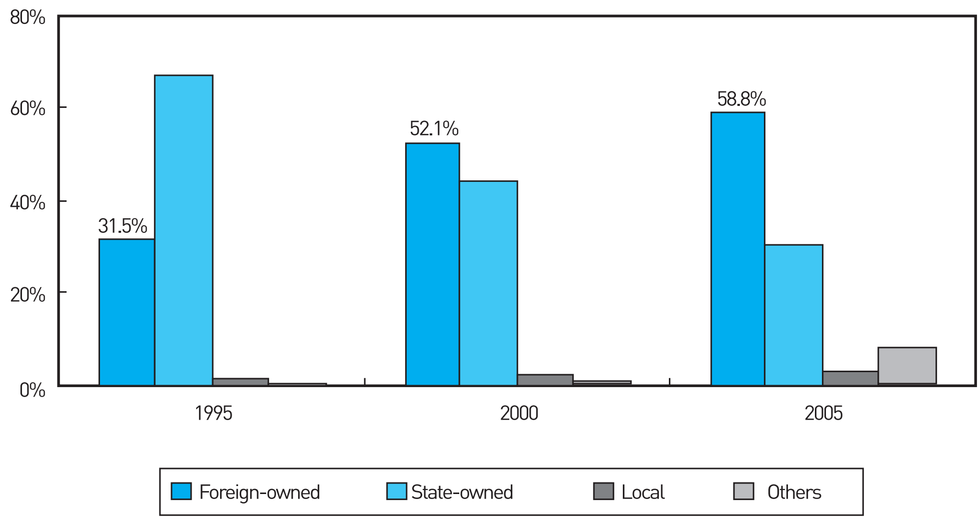
Table 4-3 | GDP and Trade by region (% change)

	GDP			Exports			Imports		
	2005	2006	2007	2005	2006	2007	2005	2006	2007
World	3.3	3.7	3.4	6.5	8.5	5.5	6.5	8	5.5
CIS	6.7	7.5	8.4	3.5	6	6	18	21.5	18
Asia	4.2	4.7	4.7	11	13	11.5	8	8.5	8.5
North America	3.1	3	2.3	6	8.5	5.5	6.5	6	2.5
South/Central America	5.6	6	6.3	8	4	5	14	15	20
Europe	1.9	2.9	2.8	4	7.5	3.5	4.5	7.5	3.5
Africa and Middle East	5.6	5.5	5.5	4.5	1.5	0.5	14.5	6.5	12.5

Source: Lee (2008a)

Figure 4-9 illustrates the recent evolution of export concentration by country groups. As we may expect, the export structure of developed countries is the most diversified. Developing countries have maintained a more concentrated structure than developed counterparts, and the extent of export concentration for developing countries have increased since the late 1990s. Among developing countries, economies in transition reveal relatively higher degree of export concentration. For the periods of 1996~2006, the index of export concentration was almost doubled.

Figure 4-9 | Degree of Export Concentration by Country Group[91]



Source: UNCTAD Database

Table 4-4 reports recent changes in export concentration of the major CIS countries. As shown in the Table, Azerbaijan has the second highest concentrated export structure in 2006, after Tajikistan. On the other hand, Georgia and Ukraine remained fairly diversified export structure for the periods of 1996~2006.

As far the export structure of Azerbaijan is concerned, the energy sector accounts for about 54 per cent of its GDP and 85 per cent of total exports in 2006 (Lee, 2008a). Furthermore, more than a half of public expenditures are mostly spent on the development of infrastructure. On the other hand, the energy sector accounts for merely 2 per cent of total employment.

Table 4-4 | Export Concentration of the CIS countries

	1996	2001	2006
Azerbaijan	0.61	0.75	0.63
Georgia	0.17	0.19	0.17
Kazakhstan	0.23	0.48	0.60
Kyrgyzstan	0.18	0.46	0.28
Russia	0.26	0.32	0.38
Tajikistan	0.48	0.54	0.77
Turkmenistan	0.45	0.53	0.61
Ukraine	0.11	0.12	0.15
Uzbekistan	0.54	0.33	0.29

Source: UNCTAD database

Lee (2008a) further notices that the recent high growth of exports is mostly due to oil production boom. In addition, the export share of crude oil within the oil sector has been expanded (See Table 4-5). Crude oil 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.

In Table 1A - 3A in the Appendix, we report top five exported products (HS 6-digit level) of Azerbaijan, destined to the U.S., EU and Russia. Exports to the U.S. and EU are more concentrated than those to Russia. For example, Petroleum oils (HS 270900 and HS 271000) exports are predominant in the U.S. market, accounting for around 98% of Azerbaijan' s total

91) The degree of export concentration is calculated using the shares of each product (three-digit SITC, Revision 3 level) in a country's exports according the following formula:

$$H_j = \frac{\sqrt{\sum_{i=1}^{n} (x_i / X)^2} - \sqrt{(1/n)}}{1 - \sqrt{(1/n)}}$$

where n is the number of products, x_i is the export value of product i and X the total value of exports for country j.

Table 4-5 | **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-processed	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 Components	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: Lee (2008a)

exports to the U.S. on the other hand, Azerbaijan exports are relatively diversified in the Russian market.

Lee (2008a) also suggests that not only Azerbaijani exports are quite concentrated in terms of product composition, but also this is true for export destination as well. The destinations of the top 10 exports are mostly 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.

Table 4-6 reports the factor intensity of CIS exports as of 2003. Among CIS countries, capital-intensive exports are especially significant for Belarus, Ukraine, Georgia, and Russia, whereas skilled-labor intensive products are predominantly exported by Ukraine. Again, we observe that Azerbaijan' s exports are predominantly resource-intensive accounting for more than 90% of exports.

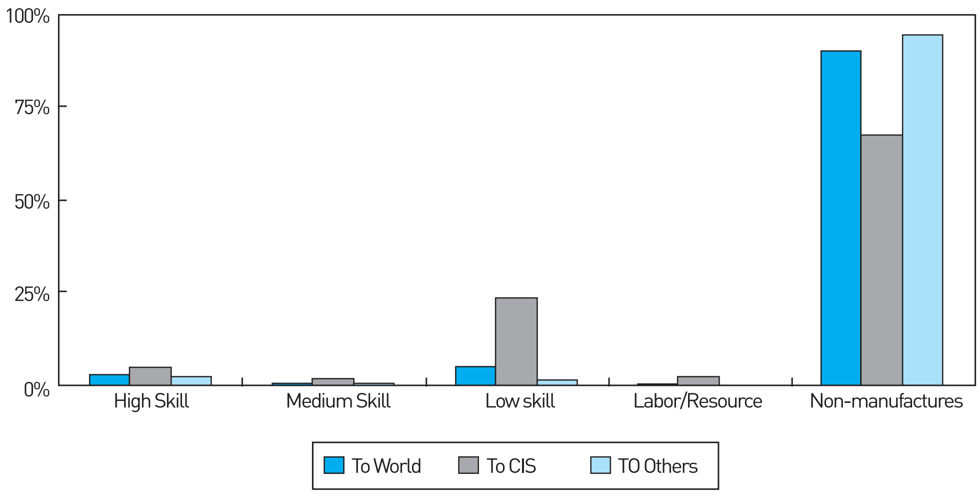
Table 4-6 | **Factor Intensity of CIS Exports (2003)**

	Resource	Unskilled labor	Capital	Skilled labor	Other
Azerbaijan	93.4%	0.5%	4.4%	1.5%	0.1%
Belarus	18.2%	12.8%	22.1%	23.4%	23.5%
Georgia	74.9%	1.3%	19.1%	4.4%	0.2%
Kazakhstan	86.0%	0.3%	4.8%	8.8%	0.1%
Russia	66.5%	1.1%	10.0%	8.7%	13.8%
Ukraine	36.0%	6.0%	19.2%	37.6%	1.1%
Average (CIS)	66.6%	6.6%	11.1%	10.9%	4.9%

Source: Shelburne and Pidufala (2006)

Finally, Figure 4-10 illustrates factor intensity of Azerbaijan's exports by its destination. Exports to non-CIS countries are predominantly non-manufactures, mostly crude oil. Interestingly, around 25% of exports to CIS countries are low skill-intensive exports.

Figure 4-10 | Export Composition by Factor Intensity and destination (2004)



4.2. Patterns of External Trade

Given the fact that the recent growth of international trade is mainly attributable to intra-industry and intra-firm trade, we investigate here the extent of these types of trade in the case of Azerbaijan.

Foremost, Table 4-7 compares the degree of intra-industry trade for a number of countries in the world. Here the extent of intra-industry trade is measured by the Grubel-Lloyd index, which is illustrated in Box1 below.

The second column contains the share of each country's exports in total world exports, and the third column reports the percentage of the 5-digit SITC sectors traded. For example, Korea's share in world trade as of 2006 is around 3.2%, and 99.6% of the sectors is actually being traded. The fourth and fifth columns report the extent of intra-industry trade for each country. As shown in the Table, IIT at the 3-digit level tends to be higher than IIT at the 5-digit level, which is an inherent property of IIT index.

Box 1. The Grubel and Lloyd Index

This index is a standard indicator of measuring the extent of intra-industry trade in terms of its share in total trade. The GL index is defined as

$$GL_{ci} = 1 - \frac{\sum_i |X_{ci} - M_{ci}|}{\sum_i (X_{ci} + M_{ci})}$$

where X_{ci} and M_{ci} refer to country c's exports and imports for an industry i respectively. The index is equal to zero in the absence of intra-industry trade, but to one in the absence of inter-industry trade.

At the 5-digit level, only 1.1% of total trade for Azerbaijan can be identified as intra-industry trade. This is much lower than other countries in the table as well as the world average. As of 2006, the IIT average (unweighted) for the world total is about 0.07 (i.e. 7% of total trade) at the 5-digit level.

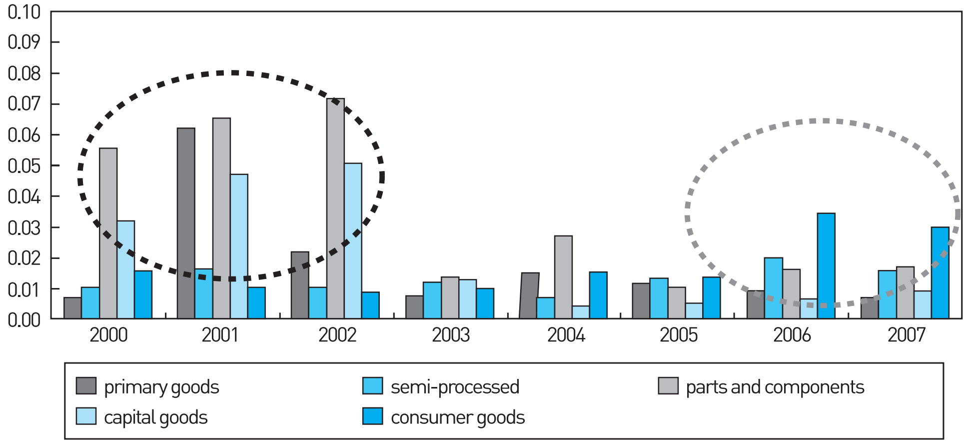
Table 4-7 | Extent of Intra-industry Trade by country (2006)

	% of World trade	% of 5 digit sectors traded	IIT, 5 digit	IIT, 3 digit	Income Group (World Bank)
United States	13.2%	100.0%	0.317	0.503	High
China	9.7%	99.8%	0.182	0.305	Lower Middle
Korea	3.2%	99.6%	0.240	0.412	High
Russia	1.0%	99.0%	0.047	0.146	Upper Middle
Turkey	0.7%	99.1%	0.130	0.217	Upper Middle
Ukraine	0.3%	98.5%	0.115	0.274	Lower Middle
Kazakhstan	0.1%	95.9%	0.042	0.081	Upper Middle
Azerbaijan	0.0%	88.6%	0.011	0.041	Lower Middle
Uzbekistan	0.0%	82.3%	0.000	0.062	Low
World	-	83.3%	0.073	0.138	-

Source: Brulhart (2008)

Figure 4-11 reports the evolution of intra-industry trade for Azerbaijan by product type. Tradable goods are classified into 5 categories based on the United Nations' BEC codes; primary goods, semi-processed goods, parts and components, capital goods and consumer goods. As shown in Figure 4-11, the extent of intra-industry trade recently has declined, especially for part and components as well as capital goods.

Figure 4-11 | Extent of Intra-industry Trade by product type (2006)



Source: Author's calculation based on the U.N. Comtrade database

For example, the share of intra-industry trade in total trade for parts and components has reduced from 5.6% in 2000 to 1.7% in 2006. As for capital goods, the IIT share in 2000 was about 3.2% but declined to 0.1% during the period. Only consumer goods recently revealed a rising importance of intra-industry trade; the IIT share has increased from around 1.6% in 2000 to 3.0% in 2006. However, even in the case of consumer goods, the extent of IIT is still much below the world average.

In sum, most of the Azerbaijan trade is inter-industry trade in nature. The importance of intra-industry trade for Azerbaijan remains stagnant, while countries' exports become more similar over time, due to the expansion of intra-industry trade.

As aforementioned, the emergence of intra-firm trade also characterizes the recent growth of international transaction. Unfortunately, data for intra-firm trade are largely unavailable, except for a few developed countries, notably the U.S. In this paper, we examine Azerbaijani intra-firm exports into the U.S, using the U.S. data, in order to indirectly figure out the recent trend of intra-firm trade of Azerbaijan. Here intra-firm exports mean within-firm transaction between parent firms in Azerbaijan and their foreign subsidiaries in the U.S.

As illustrated in Table 4-8, the share of Azerbaijani intra-firm exports in total exports into the U.S. reached at 61.5%. In particular, the share of manufacturing is impressively high, 91.5% of the total manufacturing exports. Overall, the importance of intra-firm exports rapidly increased since 2004.

We find that oil-related products record the highest level of intra-firm exports. Among manufacturing products, a majority of petroleum and chemicals exports are characterized as intra-firm exports.[92] On the other hand, however, intra-firm exports for the other manufacturing exports are quite rare; only 0.9% of these exports are intra-firm exports.

Table 4-8 | Extent of Azerbaijani Intra-firm Exports to the U.S.

	2001	2002	2003	2004	2005	2006	2007
Agriculture and Livestock	0.0%	16.8%	0.0%	0.0%	0.0%	0.0%	0.0%
Oil, Gas, Minerals and Ores	0.0%	15.8%	0.0%	0.0%	0.0%	58.0%	24.5%
Manufacturing	0.1%	9.5%	0.6%	55.5%	8.3%	91.8%	91.5%
Petroleum products/Chemicals	0.0%	11.2%	0.4%	59.6%	8.7%	92.3%	92.0%
Other Manufacturing	0.4%	0.6%	2.3%	25.3%	3.9%	5.6%	0.9%
Others	2.4%	8.1%	9.1%	18.5%	40.0%	13.3%	2.9%
Total	0.2%	11.6%	0.9%	48.8%	10.3%	78.6%	61.5%

Source: U.S. Census Bureau

4.3. Export Growth: Intensive Margin vs. Extensive Margin

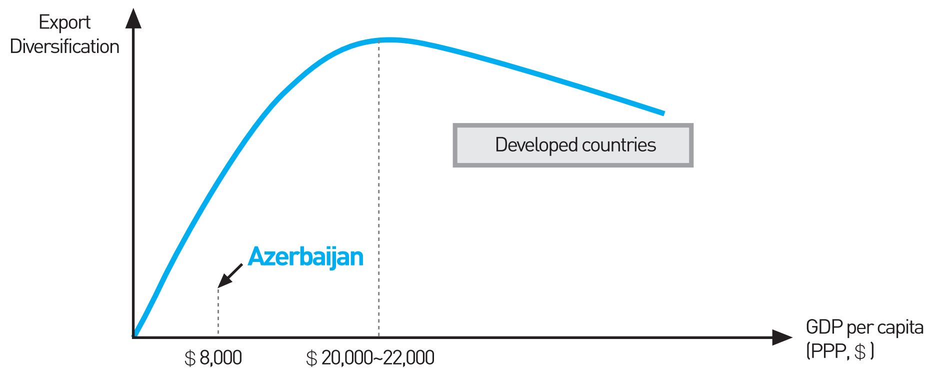
In Section 4.2, we discuss that patterns of export diversification differ, depending on the specific stage of economic development. For example, Carrére et al. (2007) find that low- and middle-income countries diversify mostly along the extensive margin whereas high-income countries diversify along the intensive margin and ultimately re-concentrate their exports towards fewer products. Figure 4-12 graphically illustrates the path of export diversification along development stage.

As depicted in the Figure, the turn point is estimated to be around 20,000~22,000 dollars per capita at purchasing power parity. Given that per capita GDP (PPP) of Azerbaijan is around $8,000 in 2006, the figure shows that the degree of Azerbaijani export diversification is quite low, compared with other countries with similar income levels.

Another important issue to be addressed here is the pattern of export growth. Export diversification is known to be an effective policy for enhancing economic stability. It is a quite relevant policy issue for Azerbaijan, considering its high dependence on oil exports.

92) As shown in the table, the intra-firm export share of total exports drastically declined from 48.8% in 2004 to 10.3% in 2005, and then rebound to 78.6% in 2006. This is mostly due to a sudden decrease of the intra-export share in petroleum refinery products (NAICS 324110) in the year of 2005, while the importance of these products in total exports remained fairly high. We are not sure whether the importance of the arm's length exports for these products increased in 2005 or this is merely due to data error.

Figure 4-12 | Path of Export Diversification



On the other hand, however, as far as the long-term sustainable export growth is concerned, the way of diversifying exports is very important. Amurgo-Pachero and Pierola (2008) recently investigate the differences in export growth performance at a highly disaggregated level of commodities. They find that the intensive margin, the growth of exports in goods that are already being exported, accounts for the most important share of overall export growth.

In a similar vein, Besedés and Prusa (2007) decompose export growth into three components: establishing new partners and markets, having relationships survive or persist, and deepening existing relationships. They find support for the intensive margin-led export growth hypothesis. They argue that, although both developing and developed countries have a large number of new exporting relationships, differences along the extensive margin have very little impact on long-run export growth.

Furthermore, in reality, although many developing countries have tried to diversify their exports over the past couple of decades, not all of them have benefited from a more diversified export basket. During the 1960~90s most Latin American economies achieved a substantial extent of export diversification, but their overall growth figures were somewhat disappointing.

All of these findings suggest that, in order to achieve the long-run stainable export growth under a fairly stable macro-economic environment, enhancing competitiveness of the existing exported goods should be accompanied with efforts for diversifying the export structure.

To examine the sources of recent export growth in Azerbaijan, we adopt an analytic approach proposed by Hummels and Klenow (2005). Economic growth may stem either from an extensive margin (i.e. growth of exports by adding new commodities) and an intensive margin (i.e. growth of exports in goods that are already being exported). Hummels and Klenow (2005) decompose growth of trade flows into these two components and examine on cross-country difference in trade patterns.

In this paper, extensive margin is defined as a weighted count of Azerbaijani export categories relative to the rest of world' s export categories to a specific country or region. On the other hand, intensive margin refers to Azerbaijani exports relative to the rest of the world' s exports in those categories in which Azerbaijani exports to a specific country or region. Detailed definition and methodology for these two margins are illustrated in Box 2.

Box 2. Intensive Margin vs Extensive Margin[93]

Let's first define the market share of country k relative to a set of other exporting countries r in a specific importing market. That is,

$$MS_t = \frac{M_{kt}}{M_{rt}} = \frac{\sum_{c \in N_{kt}} M_{kct}}{\sum_{c \in N_{rt}} M_{rct}}$$

where $M_{kt}(M_{rt})$ refers to the value of exports of country k (a set of the other exporting countries in the world) destined to a reference market. $N_{kt}(N_{rt})$ is the set of observable categories in which country k (a set of the other exporting countries in the world) has positive export value. We can re-write this formula as;

$$MS_t = \frac{\sum_{c \in N_{kt}} M_{rct}}{\sum_{c \in N_{rt}} M_{rct}} \frac{\sum_{c \in N_{kt}} M_{kct}}{\sum_{c \in N_{kt}} M_{rct}} = EM_t \cdot IM_t$$

where EM_t and IM_t refers to extensive margin and Intensive margin, respectively.

Therefore, EM_t is defined as a weighted count of observable export categories in which country k (a set of the other exporting countries in the world) has positive export value, relative to the rest of world's export categories. If export quantity of all products is assumed to be equal, then EM_t is simplified into N_{kt} / N_{rt}. Hence, if EM_t is increasing, other things being equal, it implies that the set of export categories for country is larger.

On the other hand, IM_t is defined as to country k's total exports relative to the other exporting countries' exports in those categories in which country k has positive export value. If IM_t rises, that implies that country k's competitiveness increases in the categories in which country k actually exports.

93) The key reference for the contents of this box is Lee (2008b).

Table 4-9 reports extensive and intensive margins of Azerbaijan' s exports by major export destination as of 2006. As for extensive margin, exports destined for Georgia contains the widest set of export product categories, followed by the European Union and Kazakhstan. Other than Georgia and EU, the extensive margins are fairly low, which indicates that export composition is largely concentrated in a limited number of products.

Table 4-9 | Extensive Margin vs. Intensive Margin of Azeri Exports by region (2006)

Exports destination	Extensive Margin	Intensive Margin	Market Share
EU	45.5%	0.9%	0.4%
United States	21.2%	0.2%	0.1%
Russia	14.1%	1.3%	0.2%
Turkey	16.3%	1.0%	0.1%
Iran (2005)	24.7%	1.6%	0.4%
Kazakhstan	30.6%	1.0%	0.3%
Georgia	72.6%	13.5%	8.9%

Source: Author's calculation based on the U.N. Comtrade database

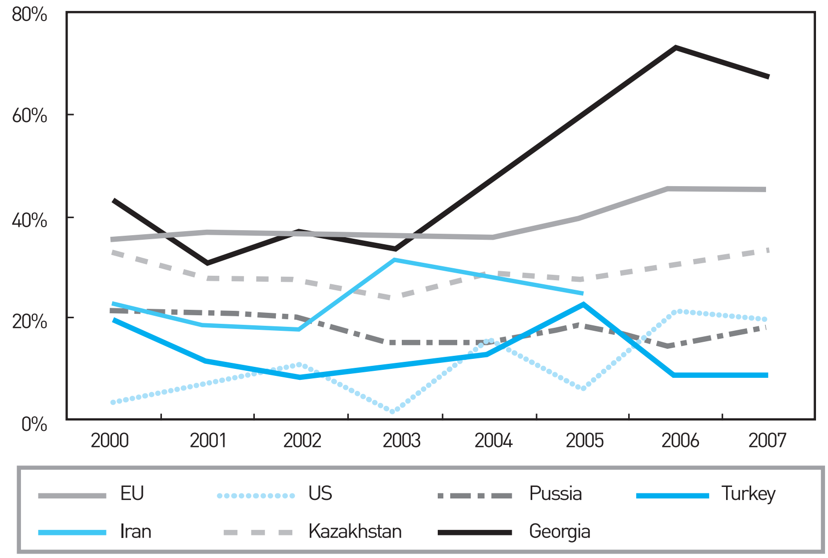
As aforementioned, intensive margin indicates Azerbaijan' s total exports relative to the other exporting countries' exports in the categories in which Azerbaijan actually exports. In turn this means that the Azerbaijan' s market share is relative to the other exporting countries' exports in these product categories. As shown in Table 8, other than Georgia, intensive margins are very low, ranging from 0 to 2%. This implies that current export competitiveness of Azerbaijan is relatively weak.

Employing a similar approach adopted in this paper, Lee (2008b) estimates extensive and intensive margins for Korean exports into China. According to the estimation results, extensive margin reaches at 92.7% in 2007 whereas intensive margin is around 13.2%. This means that Korea exports most of the product categories in which other competing exporters actually export to China. In addition, Korea' s competitiveness for the product categories that it currently exports is also strong and thus its relative market share in China is fairly high.

Figures 4-13 and 4-14 depict the evolution of these margins for Azerbaijan by export destination for the periods of 2000-2006. As shown in Figure 4-13, extensive margin for Azerbaijani exports has been recently rising, especially in Georgian market and, to less extent, in EU and the U.S. On the other hand, extensive margins for Russia, Turkey and Iran, three of the top 5 destinations for exports, remain stagnant.

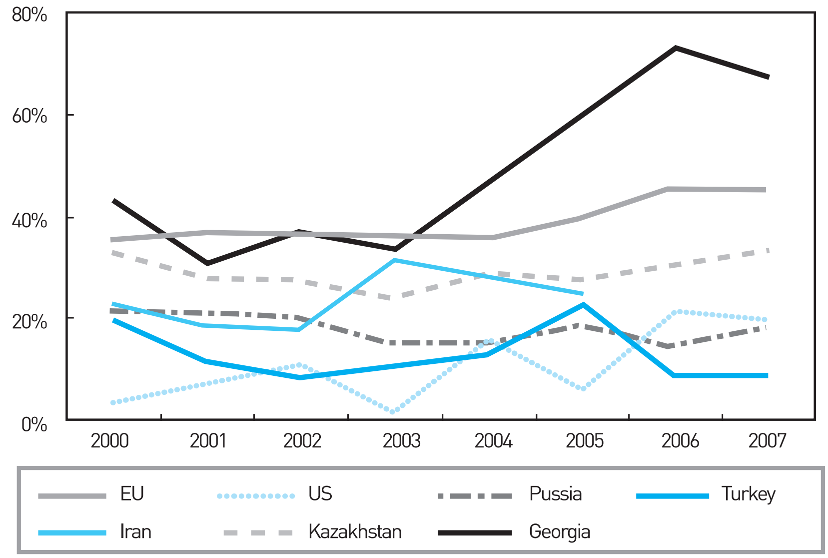
Intensive margins for exports to EU and the U.S. have also improved since 2004, largely due to export growth of oil-related products. For example, Azerbaijan' s relative market share has increased from 0.4% in 2004 to 1.2% in 2007 in the EU market. Similarly, the share in the U.S. market has improved by 0.6% point for the same period. Intensive margin in Georgian market, on the other hand, continued to decline; from 39.2% in 2001 to 12.4% in 2007. Finally, Similar to extensive margins, intensive margins for Russia, Turkey and Iran continued to be stagnant.

Figure 4-13 | Extensive Margin by Export Destination (%)



Source: Author's calculation based on the U.N. Comtrade database

Figure 4-14 | Intensive Margin by Export Destination (%)



Source: Author's calculation based on the U.N. Comtrade database

In Table 4A in the Appendix, we report extensive and intensive margins for the U.S., EU and Russia by types of product. There exist some differences in extensive margin across these countries. For the U.S. extensive margin for primary goods is high at 82.5% because of the large share of crude oil exports. On the other hand, extensive margin for primary goods destined to Russia is relatively lower than those for the U.S. and EU. Interestingly extensive margin for parts and components as well as that for capital goods destined towards EU is relatively high at 58.5% and 56.0%, respectively. Finally, Intensive margins for exports to these countries are very low, regardless of product types. This indicates generally weak competitiveness of Azerbaijan' s exports in these markets.

4.4. Export Competitiveness

As mentioned in Lee (2008a), the Center of Economic Reform (2004, hereafter CER) at the Ministry of Economic Development of Azerbaijan recently examines comparative advantage of Azerbaijani exports, using an extensive set of trade measures. They find that Azerbaijan currently has the comparative advantage in Agriculture, Agro-processing, Oil industry, and Chemical and Petrochemical industry.

However Lee (2008a) argues that, for the sectors that CER (2004) identify as those of comparative advantage, most of the Azerbaijani exports are destined for CIS countries or the neighboring countries (See Table 4-10). This implies that comparative advantage for these sectors is in fact local, instead of global.

Then, using the Commodity Complementarity Indices (CCIs hereafter), Lee (2008a) investigates the correlation between Azerbaijani export specialization and other countries' import specialization.[94] He finds that Russia, CIS and, presumably, some of the neighboring countries (Turkey and Iran) show a greater complementarity between their import structure and Azerbaijani exports. 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.

94) Please refer to Lee (2008a) for detailed illustrations for CCIs.

Table 4-10 | 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%)** Israel (12.7%) France (6.4%)	4,777
28	Inorganic chemicals, precious metal compound, isotopes	157	2.5%	**Tajikistan (82.1%)** Hong Kong (16.6%) Georgia (0.9%)	127
39	Plastics and articles thereof	100	1.6%	Turkey (33.0%) Russia (16.3%) Netherlands (9.9%)	12
08	Edible fruit, nuts, peel of citrus fruit, melons	99	1.5%	**Russia (72.5%)** Italy (11.0%) Germany (6.5%)	91
89	Ships, boats and Other floating structures	73	1.1%	**Kazakhstan (98.6%)** Turkmenistan (1.3%) U.K. (0.1%)	-311
76	Aluminum and articles thereof	71	1.1%	Iran (40.2%) Hong Kong (34.5%) Turkey (11.3%)	54
15	Animal, vegetable fats and oils, cleavage products, etc	63	1.0%	**Russia (91.1%)** Georgia (4.2%) Tajikistan (2.3%)	23
52	Cotton	43	0.7%	**Russia (62.3%)** Turkey (15.4%) Latvia (10.6%)	42
73	Articles of iron or steel	36	0.6%	Kazakhstan (28.6%) Russia (23.5%) Turkmenistan (12.8%)	-388
07	Edible vegetables and certain roots and tubers	33	0.5%	**Russia (98.0%)** Ukraine (1.2%) Georgia (0.8%)	22

Source: Lee (2008a)

This paper further extends Lee (2008a)' s analysis to examine CCIs at sectoral level. CCIs is an interesting measure to analyze in order to examine how much Azerbaijan' s export specialization pattern matches with its trading partner' s import pattern. Estimation results are reported in Table 4-11. We report only countries that reveal CCIs that are higher than 1. If CCI is greater than 1, it means that a greater complementarity between Azerbaijani exports and an importing country' s imports exist than an average pair of countries.

In the case of mineral fuels, oils, etc. (HS 27), the U.S. market shows a relatively high degree of complementarity with Azerbaijan' s exports than other major importers. Similarly, Azerbaijan' s export specialization pattern for Chemicals/metal (HS28) matches fairly well with Russia' s import pattern. Among other sectors, Animal, vegetable fats and oils, etc. (HS 15), Cotton HS (52) and Edible vegetables, etc. (HS 07) are showing great complementarity with a number of major trading partners.

Table 4-11 | International Competitiveness by Sector (2006)

	Industry	Country list for CCI 〉1
27	Mineral fuels, oils, etc	**US(1.2)**
28	Chemicals/Metal	**Russia (3.9)**
8	Edible fruit, nuts, etc	Kyrgyztan (1.5)/ Moldova(1.0)
15	Animal, vegetable fats and oils, etc	Georgia(3.1)/ Kyrgyztan (3.0)/ Kazakhstan(2.8)/ Belarus(2.5)/ Moldova(2.3)/ Russia(1.2)/ Turkey(1.1)
17	Sugars & sugar confectionery	Georgia(1.5)/ Kyrgyztan (1.5)/ Kazakhstan(1.4)/ Belarus(1.4)/ Ukraine(1.3)/ **Iran(1.3)/ Russia(1.2)**
52	Cotton	Kazakhstan(4.1)/ **Turkey(3.7)/ Russia(3.2)/ Iran(2.6)/** Kyrgyztan (2.3)/ Belarus(2.2))/ Ukraine(1.1)
7	Edible vegetables, etc	Kazakhstan(2.9)/ Moldova(2.7)/ Kyrgyztan(2.2)/ Ukraine(2.2)/ Georgia(2.0)/ Belarus(1.3)/ **Russia(1.7)/ EU(1.1) / US(1.1)**
89	Boats and floating structures	**Turkey(10.7)** / Moldova(4.2)/ **Iran(2.5)** / Kazakhstan(2.0)/ **Russia(1.1)**
9	Coffee, tea, mate and spices	Kazakhstan(6.4)/ Kyrgyztan (6.4)/ **Iran(5.1)/ Russia(4.8)/** Moldova(4.5)/ Belarus(4.0)/ Ukraine(3.5)/Georgia(1.0)
24	Tobacco	Kyrgyztan (1.1)/ Moldova(1.0)/ EU(1.0)

Source: Author's calculation based on the U.N. Comtrade database

5. Policy Suggestions

5.1. Summary and Policy Implications

As we discussed above, Azerbaijan' s exports are predominantly resource-intensive accounting for more than 90% of exports. Furthermore, not only Azerbaijan' s exports concentrated in terms of product composition, but also this is true for export destination. The extents of Azerbaijani export diversification remain fairly low, even compared with other countries having similar income levels.

While the recent growth of international trade is mainly attributable to intra-industry and intra-firm trade, most of the Azerbaijan' s trade is inter-industry trade. At the 5-digit level, only 1.1% of total trade for Azerbaijan can be identified as intra-industry trade as of 2006, which is much lower than the world average (7%). The extent of intra-industry trade recently has declined further, especially for parts and components as well as capital goods. In addition, intra-firm trade for manufacturing goods other than petroleum and chemicals are quite rare.

Decomposing trade flows into extensive margin (i.e. growth of exports by adding new commodities) and an intensive margin (i.e. growth of exports in goods that are already being exported), we also find the following; first, other than Georgia and EU, the extensive margins for major export destinations are fairly low. This implies that export composition is largely concentrated in a limited number of products for these destinations. Second, intensive margins are also very low, which indicates weak international competitiveness of Azerbaijan in the categories in which Azerbaijan currently exports.

All of these findings suggest that, in order to achieve the long-run stainable export growth under a fairly stable macro-economic environment, enhancing competitiveness of the existing exported goods should be accompanied with efforts for diversifying the export structure. That is, great efforts must be placed in order to encourage new sectors where comparative advantage can be acquired, without ignoring the benefits of continuing to strengthen those sectors that have been subjected to growing international competition.

As Lee (2008a) argues, at this point and time, it is not clear yet which non-oil products have comparative advantage in the world market and/or have greater potential for export expansion in the future. However, as shown in Table 4-11, petrochemical products, agro-processing and cotton could be good candidates.

Azerbaijan is currently facing the lack of cost competitiveness, infra-structural 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.

Given these observations, we suggest the following; First of all, Azerbaijan should pay great attention to vertical diversification towards producing higher value-added products, which are somehow capital-intensive. Good candidates are again Agriculture, Agro-processing, and Chemical and Petrochemical industry. A diversification policy aiming to enhance vertical diversification may require more advanced technology, skills and initial capital investment than the horizontal counterpart. Vertical diversification is usually linked with higher learning possibilities that, in turn, may produce greater dynamic externalities than that for horizontal diversification.

Lee (2008a) suggests that Export Processing Zones (EPZs) could be a viable and effective option for such export 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). In recent years, a remarkable proliferation of Export Processing Zones (EPZs hereafter) has been witnessed all round the world. According to the International Labor Office (ILO, 2007), the number of EPZs has increased drastically from 79 in 25 countries in 1975 to around 3,500 zones in 130 countries in 2006.[95]

Second, it should be kept in mind that export costs, tariff, and transport costs are detrimental to market diversification for exports. As aforementioned, Shepherd (2008) finds that a 10% reduction in export-related costs increases the number of export destination by around 5~6%. He also finds that the negative impacts of export costs on geographical diversification are bigger in poorer countries than their counterparts.

Third, various activities for identifying foreign demand is also important. It is often the case that domestic producers are unable to export due to lack of foreign market information while foreign consumers become more aware of the products only after producers start to export. Agosin and Bravo-Ortega (2007) illustrate the case of Chilean wines. Domestic production of Chilean wines goes back to the 17th century but only from the mid-1980s did some entrepreneurs produce wines to the tastes of foreign consumers by introducing better foreign production techniques. The discovery of this new export opportunity made wines one of the main export products in Chile (Hesse, 2008).

Last but not least, a key factor for successful diversification in Azerbaijan is the pro-active role of the government in establishing an enabling economic and policy environment that allows local firms to operate on a level-playing field and strengthen their competitive edge in international markets.

95) Free Export Zones (FEZ), Free Trade Zones (FTZ), Special Economic Zones (SEZ) and Industrial Free Zones (IFZ) refer to similar concepts with EPZs although there is some variation for policy prescriptions and objectives. Given the fact that EPZ is the most common term, this paper uses EPZ interchangeably with others.

Private firms often confront substantial investment uncertainties when they try to develop a new commodity. If they succeed in producing it, the gains could be socialized through informational externalities. On the other hand, if they fail, the whole burden would fall on them. This is a typical case of market failure, which leads to under-provision of investments into new activities. Therefore, the government should play an active role in promoting favorable business conditions and in providing the proper incentives for firms to invest in new activities

5.2. Caveat: Policies for Export Processing Zones

EPZs have been often introduced as part of the policy instruments to promote exports and ultimately to contribute to sustainable economic growth. Indeed, these zones could be an efficient way of generating employment, earning foreign exchange to finance domestic investment, and adopting technology developed elsewhere. At the same time, however, EPZs involve large investments in publicly supplied infrastructure and various tax concessions, and thus this raises the question of whether such investments are worthwhile.

Nonetheless, EPZs could be a useful policy tool for industrialization takeoff, especially for a country where institutional backbone is weak and incomplete, or where resources to finance domestic investment are relatively scarce. In the former case, particularly, EPZs could be an interim solution for countries where poor business environment prevails at a national level. More importantly, EPZs could serve as an important channel through which foreign technology is transferred into the domestic economy.

Table 4-12 classifies different types of EPZs and presents their characteristics (ILO, 2003). The most traditional EPZs are Industrial Free Zones or Exporting Processing Zones, of which the main objective is to nurture export sectors, mostly those of light industries such as textiles, goods and electronics. However, recently some other types of EPZs like high tech and science parks, finance zones and warehouse centers emerged.

Motivations for implementing EPZ policies differ across countries. Some countries establish EPZs to ease financial and technological constraints by attracting foreign investors, especially at the early stage of development. Resource-abundant economies often use EPZs as a policy tool for diversifying industrial structure and creating new employment opportunities. Resource sectors such as oil-extracting industry usually account for a large share in exports and/or government revenues in these countries, but they tend to offer little employment opportunity. Finally, for most of the developing countries, EPZs are an efficient way to bypass poor business environment by creating an enclave immune to the weak institutional system and administrative capacity prevailed elsewhere in the economy.

Engman et al. (2007) recently classify different roles of EPZs in economic development as follows. First, EPZs can serve as an enclave to achieve specific policy objectives, such as raising foreign exchange earnings, adopting advanced technology, creating new employment opportunity, etc. Nowadays many developing countries make a great effort to attract FDI, but they often confront difficulties in doing so, mainly due to weakness in administrative and infrastructural capacity. In this case, EPZs allow these countries to focus their resources on a limited area, to achieve certain policy objectives.

Table 4-12 Types of zones: ILO's evolutionary typology

	Trade	Manufacturing			Service		
	Free port	Special economic zone	Industrial free zone / Exporting processing zone	Enterprise zone	Information processing zone	Financial service zone	processing zone
Physical Characteristics	Entire city or jurisdiction	Entire province regionor municipality	Enclave or industrial park	Entire or part of city	Part of city or zone	Entire city or "zone within zone"	Warehouse area often near port or airport
Economic Objectives	Development of trading centre and diversified economic base	Deregulation; private sector investment in restricted area	Development of export industry	Development of SMEs in depressed areas	Development of information processing center	Development of off-shore banking, insur-ance, securities hub	Facilitation of trade and imports
Duty free goods allowed	All goods for use in trade, industry, consumption	Selective basis	Capital equipment an production inputs	No	Capital equipment	Varies	All goods for storage and re-export of imports
Typical activities	Trade, service, industry, banking, etc.	All types of industry and services	Light industry and Manufacturing	All	Data processing, software dev, Etc	Financial services	Warehousing, packaging, distribution, trans-shipment
Incentives - taxation - customs' duties - labour laws - other	Simple business start-up: min. tax & regulatory restraints; waivers to termination of employment & overtime; free repatriation of capital, profits & dividends; preferential interest rates.	Reduced business taxes; liberalized labour codes; reduced foreign exchange controls. no specific advantages; trade unions discouraged	Profits tax abatement and regulatory relief; exemption from for. Exchange controls; free repatriation of profits; Trade union freedom restricted despite the EPZs are required to respect national employment regulations; max 15 years exemptions on all taxes	Zoning relief; simplified business registration; local tax abatement; reduction of licensing requirements; prohibited trade unions; government mandated liberal on hiring and firing	Zoning relief; simplified business registration; local tax abatement; reduction of licensing requirements; prohibited trade unions; government mandated liberal on hiring and firing	Tax relief; strict confidentiality; deregulation of currency exchange & capital movements; free repatriation of profits	Exemption from import quotas; reinvested profits wholly tax-free
Domestic sales	Shipment outside possible with payment of full duty	Highly restricted	Limited to small portion of production			Limited to small portion of production	Unlimited, upon payment of full duty
Other features	Additional incentives & streamlined procedures	Developed by socialist countries	May be extended to single-factory sites				
Typical examples	Hong-Kong, Macao, Singapore, Bahamas, Bataan, Labuan	China (southern provinces, incl. Hainan, Shenzhen)	Ireland, Ch. Taipei, Malaysia, Dom. Rep., Mauritius, Kenya, Hungary	Indonesia, Senegal	Bangalore, Caribbean	Bahrain, Dubai, Caribbean, Turkey, Cayman	Jebel ali, Colon, Mauritius, Iran

Source: ILO (2003) edited by Secretariat

Second, EPZs can be a steppingstone on the path to nationwide trade liberalization. Even though integrating local economies into world economic system is an ultimate goal, it may require time and adequate planning to maximize benefits from such move. Therefore, EPZs can be used as a test bed for countrywide trade liberalization.

Third, Engman et al. (2007) argue that EPZ policy can be a regional development tool to promote investment in disadvantaged areas, although it usually comes from political and social considerations rather than economic and technical ones.

While there exists currently more than 3,500 zones in 130 countries, not all EPZs are successful. There are a number of important guidelines in implementing EPZ policies. First, the EPZ administration should actively promote inter-linkage between local industries and sub-contractors in the EPZ. For example, EPZ firms in Korea had successfully linked with the local economy through subcontracting and domestic purchases and have performed positively in generating net exports and spillover effects (See Box 3).

Table 4-13 | Share of Local Raw Materials in Total Raw Materials for Production in EPZs

Country	EPZ	Local Sourcing of Inputs				Subcontracting
		Year	Share	Year	Share	
Malaysia	Penang	1976	0.2%	1987	17.7%	Very limited
Korea	Masan	1971	3.3%	1985	32.3%	Very active
Taiwan	Total	1967	2.1%	1979	28.3%	
SriLank	Total	1979	0.0%	1991	3.8%	Non-existent

Source: Kusago and Tzannatos (1998)

The close linkage between EPZs and the domestic economy provides a great opportunity for domestic firms to learn advanced managerial and technological skills from foreign firms in the EPZs. Attracting FDI through cost competitiveness from low labor costs tend to be easily eroded, since international competition becomes more and more competitive. Consequently, in order to utilize EPA as a policy tool for enhancing the long-term sustainable growth, EPAs should be linked to the rest of the economy.

Second, a feature of the EPZ of great importance is the existence of a centralized administrative office with various autonomous decision powers. At the same time, the local authority must keep a close relationship with the central government in implementing EPZ policy.

In some countries, a right to issue licenses and permissions to business entities within the EPZs is often granted to the regional government. In this case, there may be a great possibility that the regional interest may be involved in the process of EPZ implementation. Things are getting worse if multiple EPZS co-exist within an economy and if each one is managed by different regional governments, because that may result in the redundant FDI promotion and the wasteful competition among these EPZs.

Third, geographic factors as well as infrastructure played an important role for successful implementation of the EPZ policy. For example, in Masan EPZ of Korea, proximity to Japanese ports substantially reduced transport costs. Furthermore, the existence of a highway directly to Busan and the harbor facilities prior to the establishment also reduced initial investment for EPZ.

Last but not the least, it is widely recognized that policy effectiveness as well as consistency are one of the most important factors for successful EPZ policy. The government should function efficiently enough to ensure that the incentives and the systems ensuring access to them could be adjusted through continuing evaluation by the government in response to the changing environment at home and abroad.

Box 3. Export Processing Zones: the Korea case

Korea had been traditionally a government-led export-oriented economy with little emphasis on foreign direct investment until the Asian financial crisis in the late 1990s. One noticeable exception, however, from this policy stance was the Export Processing Zone (EPZ hereafter) policy. The Korean government recognized EPZs as outlets for attracting foreign investment firms that could bring in the capital as well as technology.

The Korean government established its first EPZ at Masan in 1970, shortly followed by the second EPZ in Iksan in 1973. The government enacted the Free Export Zone Establishment Act, which enabled designation of these two EPZs. The government provided very favorable incentives and business environments to foreign investors within the EPZs.

The Masan EPZ was quite successful, contributed not only to the development and employment creation of the region but also to those of the rest of the economy through backward linkages. The Masan EPZ reached its peak in the early 1980s however, thereafter remained stagnant, due to saturation in space and rising labor costs (Engman et al., 2007).

Following its designation as a Free Export Zone in 1970, Masan has enjoyed phenomenal success. Masan accounts for only 0.2 percent of the total area dedicated to all Korean industrial complexes, but it successfully posited itself as a center of processing trade.

When we compare economic effects anticipated at the planning stage and those realized in 10 and 30 years later from its establishment. As shown in the table below, the Masan EPZ over-performed in terms of FDI inflows and export growth, while employment creation was somewhat lower than expected.other things being equal, it implies that the set of export categories for country is larger.

	Expected effect at planning stage (A)	Ex post effect (B)			
	1970	1980	(B/A)	2000	(B/A)
Foreign Investment (mil. $)	25.0	93.1	3.7	193.7	7.7
Exports (mil. $)	132.5	628.1	4.7	4,442.1	33.5
Employment Creation (1000)	32.3	28.5	0.9	14.4	0.4

When the zone started operations in 1971, domestic firms supplied only 3 percent of materials and intermediate goods to firms in the zone. Four years later, that percentage had increased to 25 percent and eventually reached 44 percent. Consequently, the domestic value added steadily increased from 28 percent in 1971 to 52 percent in 1979 (Engman et al., 2007). This is quite in contrast with some EPZs in other countries.

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Table 1A. | **Top 5 exports to United States (2006)**

	Order	Commodity	HS code	Share
All Products	1	Petroleum oils & oils obt. from bituminous mins., crude	270900	96.74%
	2	Petroleum oils, other than crude	271000	1.73%
	3	Aromatic hydrocarbon mixts. of which 65%/more by volume, incl. losses, dist ...	270750	1.06%
	5	Juice of any single fruit/veg. (excl. of 2009.11-2009.79), unfermented & no ...	200980	0.12%
Raw Materials	1	Petroleum oils & oils obt. from bituminous mins., crude	270900	99.79%
	2	Liquorice roots	121110	0.21%
	3	Live plants, n.e.s., incl. their roots; mushroom spawn	060290	0.00%
	4	Seeds, n.e.s., of a kind used for sowing	120999	0.00%
	5	Raw hides and skins of bovine (including buffalo) or equine animals	410110	0.00%
Partly manufactured products	1	Aromatic hydrocarbon mixts. of which 65%/more by volume, incl. losses, dist ...	270750	99.11%
	2	Sheets for veneering, incl. those obt. by slicing laminated wood, for plywo ...	440890	0.53%
	3	Naphthenic acids, their water-insoluble salts & their esters	382420	0.36%
	4			0.00%
	5			0.00%
Parts and accessories	1	Parts of the turbo-jets/turbo-propellers	841191	67.04%
	2	Parts & accessories (excl. covers, carrying cases and the like) suit. for u ...	847330	12.86%
	3	Boards, panels, consoles, desks, cabinets & oth. bases, equipped with 2/mor ...	853710	12.55%
	4	Parts suit. for use solely/princ. with the boring/sinking mach.	843143	7.56%
	5			0.00%
Capital Goods	1	Electrical app. for line telephony/line telegraphy, n.e.s. in 85.17	851780	59.97%
	2	Automatic regulating/controlling instr. & app., n.e.s.	903289	24.17%
	3	Apparatus for carrier-current line systems/digital line systems	851750	15.86%
	4			0.00%
	5			0.00%
Consumer goods	1	Juice of any single fruit/veg. (excl. of 2009.11-2009.79), unfermented & no ...	200980	50.47%
	2	Carpets & oth. textile floor coverings, knotted, whether or not made up, of ...	570110	18.31%
	3	Caviar & caviar substitutes prepd. from fish eggs	160430	8.07%
	4	Jerseys, pullovers, cardigans, waist-coats & sim. arts., knitted or crochet ...	611020	7.74%
	5	Worked veg./min. carving mat. & arts. of these mats.; moulded/carved arts. ...	960200	5.06%

Source: Author's calculation based on the U.N. Comtrade database

Table 2A. | **S Top 5 exports to EU (2006)**

	Order	Commodity	HS code	Share
All Products	1	Petroleum oils & oils obt. from bituminous mins., crude	270900	86.60%
	2	Petroleum oils, other than crude	271000	6.53%
	3	Articles of jewellery & parts thereof , of oth. precious metal (excl. silve ...	711319	4.87%
	4	Hazelnuts/filberts (Corylus spp.), shelled	080222	0.48%
	5	Parts & accessories of the instr. & appls. of 90.15	901590	0.20%
Raw Materials	1	Petroleum oils & oils obt. from bituminous mins., crude	270900	99.91%
	2	Cotton, not carded/combed	520100	0.06%
	3	Waste & scrap of stainless steel	720421	0.02%
	4	Iron ores & concs. (excl. roasted iron pyrites), non-agglom.	260111	0.00%
	5	Bentonite	250810	0.00%
Partly manufactured products	1	Propan-1-ol (propyl alcohol) & propan-2-ol (isopropyl alcohol)	290512	24.47%
	2	Aromatic hydrocarbon mixts. of which 65%/more by volume, incl. losses, dist ...	270750	16.95%
	3	Polyethylene having a sp.gr. of < 0.94, in primary forms	390110	9.55%
	4	Aluminum, not alloyed, unwrought	760110	5.65%
	5	Petroleum gases other than nat. gas/propane/butanes/ ethylene, propylene, bu ...	271119	5.27%
Parts and accessories	1	Parts & accessories of the instr. & appls. of 90.15	901590	37.40%
	2	Parts suit. for use solely/princ. with the boring/sinking mach. of 8430.41/ ...	843143	18.74%
	3	Sets/assortments of gaskets & sim. joints, dissim. in composition, put up i ...	848490	5.64%
	4	Parts of the mach. & mech. appls. of 84.79	847990	4.55%
	5	Anchors, grapnels & parts thereof , of iron/steel	731600	3.67%
Capital Goods	1	Winches (excl. of 8425.20 & 8425.31); capstans (excl. of 8425..31)	842539	12.75%
	2	Surveying/hydrographic/oceanographic/hydrological/ meteorological/geophysica ...	901580	11.73%
	3	Pumps n.e.s. in 84.13	841381	8.47%
	4	Machines & appls. for testing the hardness/strength/ compressibility/elastic ...	902480	5.70%
	5	Hydraulic power engines & motors other than linear acting (cyls.)	841229	5.58%
Consumer goods	1	Articles of jewellery & parts thereof , of oth. precious metal (excl. silve ...	711319	88.30%
	2	Hazelnuts/filberts (Corylus spp.), shelled	080222	8.66%
	3	Clocks (excl. alarm clocks, wall clocks), other than electrically operated	910599	0.69%
	4	Wrist-watches, electrically operated, whether or not incorp. a stop-watch f ...	910111	0.54%
	5	Nuts (excl. ground-nuts), incl. mixts., prepd./presvd., whether or not cont ...	200819	0.29%

Source: Author's calculation based on the U.N. Comtrade database

Table 3A. | **Top 5 exports to Russia (2006)**

	Order	Commodity	HS code	Share
All Products	1	Fresh fruit, n.e.s.	081090	12.62%
	2	Cotton, not carded/combed	520100	9.97%
	3	Apples, fresh	080810	8.79%
	4	Tomatoes, fresh/chilled	070200	6.61%
	5	Spirits obt. by distilling grape wine/grape marc	220820	6.13%
Raw Materials	1	Cotton, not carded/combed	520100	83.51%
	2	Tobacco, not stemmed/stripped	240110	10.28%
	3	Bentonite	250810	5.39%
	4	Plants & parts of plants, incl. seeds & fruits, of a kind used primarily in ...	121190	0.30%
	5	Guts, bladders & stomachs of animals (other than fish), whole & pieces ther ...	050400	0.12%
Partly manufactured products	1	Polyesters other than polyacetals, in primary forms	390720	14.90%
	2	Sacks & bags, of a kind used for the packing of gds., of polyethylene/polyp ...	630533	13.44%
	3	Casing & tubing, seamless, of iron (excl. cast iron)/steel, of a kind used ...	730429	9.82%
	4	Woven fabrics obt. from strip or the like	540720	9.65%
	5	Buta-1,3-diene & isoprene	290124	7.83%
Parts and accessories	1	Parts suit. for use solely/princ. with the boring/sinking mach. of 8430.41/ ...	843143	31.21%
	2	Taps, cocks, valves & sim. appls. for pipes/boiler shells/tanks/ vats or the ...	848180	20.81%
	3	Cylindrical roller bearings (excl. of 8482.20-8482.40)	848250	12.92%
	4	Spherical roller bearings	848230	9.22%
	5	Electric accumulators, incl. separators therefore, whether or not rect. (inc ...	850710	7.66%
Capital Goods	1	Insulated/refrigerated vans & wagons, railway/tramway, other than tank wago ...	860620	23.27%
	2	Machinery for preparing animal feeding stuffs	843610	17.05%
	3	Vessels for the tpt. of gds. & for the tpt. of both persons & gds. (excl. o ...	890190	14.58%
	4	Reciprocating positive displacement pumps (excl. of 8413.11-8413.40)	841350	6.56%
	5	Boring/sinking mach. (excl. of 8430.10-8430.40), other than self-propelled	843049	5.93%
Consumer goods	1	Fresh fruit, n.e.s.	081090	22.75%
	2	Apples, fresh	080810	15.85%
	3	Tomatoes, fresh/chilled	070200	11.91%
	4	Spirits obt. by distilling grape wine/grape marc	220820	11.04%
	5	Potatoes other than seed potatoes, fresh/chilled	070190	9.49%

Source: Author's calculation based on the U.N. Comtrade database

Table 4A. | **Extensive and Intensive Margins by Export Destination (2006)**

Country	Commodity	Extensive margin	Intensive margin
United State	Primary goods	82.5%	0.3%
	Semi-Processed products	0.4%	0.7%
	Parts and components	16.7%	0.0%
	Capital goods	4.1%	0.0%
	Consumer goods	3.6%	0.0%
EU	Primary goods	67.6%	2.2%
	Semi-Processed products	10.2%	0.1%
	Parts and components	58.5%	0.0%
	Capital goods	56.0%	0.0%
	Consumer goods	30.3%	0.4%
Russia	Primary goods	23.9%	2.7%
	Semi-Processed products	83.9%	1.8%
	Parts and components	17.5%	0.1%
	Capital goods	13.9%	0.1%
	Consumer goods	12.9%	2.2%