

## GVCs, inclusiveness, WTO and poor developing countries A brainstorming exercise<sup>1</sup>

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- I. **Introduction**
- II. **Global institutional framework to enhance GVCs' efficiency**
- III. **The effects of such an evolution on WTO and its poorer members**
- IV. **What is the role of WTO in the GVCs?**
- V. **Can WTO address these issues?**
  - 1) WTO's dilemma
  - 2) Possible roles of WTO in a world of mega-deals
- VI. **WTO has to change some of its principles and its functioning to remain relevant in a world where the production is based on GVCs**
  - 1) Its principles have to be adapted to the new system
  - 2) WTO's functioning would have to change fundamentally
- VII. **Some thoughts about concrete steps WTO might consider to adapt itself to the new economic and negotiating environment created by GVCs**
  - 1) Bali Ministerial
  - 2) The functioning of WTO
- VIII. **Implications for poorer developing countries**
  - 1) Implications for the negotiating position of LDCs in the Doha Round
  - 2) Implications for internal trade policies of LDCs

### Short Bibliography of think pieces submitted to the E-15 process

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<sup>1</sup> The paper takes full advantage of the think pieces prepared for the E-15 group organized by ICTSD (see references at the end of the paper).

## I. Introduction

Global Value Chains (GVCs) are the product of businesses rearranging their production processes taking advantage of new possibilities provided by technology, communication, transport and liberalization so as to reduce the costs of production by minimizing the costs of inputs (capital, labor, technology) through the efficient combination of comparative advantages in the execution of tasks all over the world.

GVCs are not trade in intermediate goods, but trade in tasks. They are not really a “de-verticalization” of business, but the integration of tasks distributed all over the world into one production process.

The business relationship in a GVC is fundamentally different from a trade relationship. A trade transaction is relatively simple: it is the transfer of a product for a given price. The information required for the transaction is limited to the price, the characteristics of the product and maybe the time of delivery. The relationship between vendor and buyer is basically a one-shot affair. In such a relationship, trade-related measures are the main determinant to allow the transaction to take place efficiently.

In a value chain, the relationship is fundamentally different:

- The vendor executes a task for somebody else which is fully integrated into the buyer's business process. This is as often a service as it is a product. It is not a one-shot affair but a longer term business arrangement.
- Each task producer is a partner in a chain who has a relationship in which he gets the support (technology, training, information, models) which allows him to produce goods and services that fits the firm's particular needs.

The concepts and the needs of such a relationship are fundamentally different than the ones that govern free trade. In such a relationship, trade related transaction costs are only one element: other elements such as rules and institutional arrangements that protect the partnership; the ability to communicate; and entrepreneurial innovation with other links in the chain become preponderant. The costs of conventional barriers to trade are low compared to other transaction costs. For an efficient functioning of a value chain both “hardware” (transportation, communication, infrastructure) and “software” (institutional arrangements) have to be competitive i.e. all behind-the-borders measures. An integration into global value chains requires access to factors of production (capital, talent and innovation/information), i.e. a much broader focus than traditional trade policy.

Thus a mercantilist approach to trade policy (as the one largely followed in WTO) is, as Grant Aldonas expresses it self-defeating, as a means to help poor developing countries to integrate into the world economy.<sup>2</sup> Such an approach largely limits them to a static view of their comparative advantage, as a producer of commodities and cheap labor, disconnected from the global transfer of information, technology and innovation.

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<sup>2</sup> Grant Aldonas in his think piece gives a powerful analysis of the drivers of GVCs which go beyond the traditional subject within WTO

## II. Global institutional framework to enhance GVCs' efficiency

Global Value Chains are created and develop outside institutional frameworks: they are the result of entrepreneurial innovation taking advantage of new opportunities created by technological innovations, communication facilities, and the integration of national economies into a global economy in view of maximizing efficiency and global welfare.

Global value chains are not global: they have developed around major economic hubs with other regional economic centers for which the conditions to integrate various tasks into an efficient production framework existed.

Institutional frameworks conducive to GVCs have developed around consumption hubs (USA, EU, Japan) with "production hubs" which had similar institutional and policy frameworks through either regional integration agreements (EU, NAFTA, etc.) or through bilateral trade agreements among important trading partners, which are in the process of expansion to create larger and larger units, developing into so called mega-deals (TPP, TTIP) and sectorial agreements such as the plurilateral services agreement.

At the same time such agreements evolved from preferential trade agreements into deeper integration models. As trade related measures such as tariffs became less and less important in the total transaction costs, integration agreements ventured more and more into behind-the-border measures, and thus are becoming more and more rule-making.

RTAs, plurilaterals and mega-deals have a clear comparative advantage in rule-making for GVCs and integration efforts:

- They are exclusive and not inclusive: only countries and regions fully dedicated to integrate their economies are participating. The participants' willingness to make concessions thus may be bigger than this is the case in an inclusive, larger setting. Moreover, those who are not willing or able to take on the commitments cannot block the exercise, but simply leave the integration process.
- The benefits of participation (and the costs of exclusion) are much more visible, and the political acceptance of "concessions", may be much bigger. If a majority of participants accepts an integration measure, a country not willing to do so excludes itself from an important market. Under such sanctions, it is politically much easier to agree to a concession than when you can simply block an agreement.

Integration measures concern behind-the-border measures which are by definition much more constraining and politically sensitive than border measures. Proposed measures in that field can go much deeper in the framework of a self-elected, like-minded group than is possible in an inclusive system, which has to take into account institutional and developmental differences. Much of the reduction of transaction costs concern common standards and the mutual recognition of certificates and procedures. Establishing a consensus among the EU and the USA on those issues should be easy (although not given) compared to agreeing on such a system with some 160 members with important institutional and capacity differences.

It is therefore unavoidable and efficient to work out favorable conditions for GVCs within RTAs, mega-deals, and plurilaterals rather than within WTO.

RTAs, mega-deals, and plurilaterals are very adaptive and evolving instruments. Provided the mega-deals and the plurilaterals do deliver what they are expected to deliver (which seems likely, but certainly not assured), the “global trading system” will evolve pragmatically and naturally through an expansion and harmonization among mega-deals and through plurilaterals:

- The principles agreed upon in the major mega-deals (TPP, TTIP, etc.) will have to be adopted by countries which have free trade agreements with important members of those mega-deals. The efforts of Turkey (through the EU), and of Canada and Mexico (through NAFTA) to be included in the US-EU deal is an example. Countries participating in more than one mega deal will be a powerful force to ensure harmonization between the mega-deals:
- If the mega-deals are successful other important trading nations (such as the BRICS) may have to join the mega-deals. The recent announcement of China that it is seriously analyzing whether it should join the TPP justifies this hypothesis.
- Once the mega-deals (and plurilaterals) cover a large part of the international trade and distribution of tasks, the principles adopted by the mega-deals will become best international practices that any country that does not want to be excluded from the international distribution of tasks will have to adopt (whether they are a member of the mega-deals or not). Bigger economies (such as the BRICS) may have the possibility to negotiate their entry; poorer and smaller countries will have no choice but adopt those standards or to be excluded from the international development.

The result of this process will be a multilateral system which has been defined by the bigger economies and that is imposed either *de facto* or *de jure* on the great majority of today’s WTO members i.e. the poorer developing countries.<sup>3</sup>

### III. The effects of such an evolution on WTO and its poorer members

- 1) RTAs, mega-deals and plurilaterals, are efficient instruments to diminish the transaction costs for GVCs thereby maximizing the global welfare. They seem clearly the preferred instruments to promote economic integration. Fears that they are trade-diverting rather than trade-creating have proven to be exaggerated: (i) those deals cover behind-the-border measures which most often cannot be applied in a discriminatory way, (ii) tariff preferences are only a minor obstacle, and (iii) they now cover many countries and most of the bilateral trade, so that their trade-distorting effect is indeed minimal. It would therefore be irrational to try to undermine those efforts to increase global welfare by diminishing the transaction costs through deeper integration.
- 2) For poorer developing countries (and in particular LDCs) a new global trade system based on an expansion of mega-deals would have important consequences:

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<sup>3</sup> It took GATT almost 40 years to transform itself into an inclusive WTO. It seems that it took only some 10 years for the bigger economies to free themselves of the constraints of an inclusive system.

- All special and differential treatment measures negotiated within WTO become irrelevant either *de jure* or *de facto*. Indeed, the proliferation of free trade agreements will annul the benefits of trade preferences given to developing countries. Exemptions from rules will exclude developing countries from global value chains as other countries will provide more attractive conditions for the global distribution of tasks;
- Rules will be made by a limited number of “interested and interesting countries”. Poorer countries (who are unable or unwilling to participate in such integration instruments) will be excluded from the rule-making process. The rules thus will be responding to the needs of the countries which participate in the mega-deals and will not necessarily be adapted to the needs and capacities of the poorer countries;
- The issues addressed (and the subjects covered) by the deeper integration agreements will be tailored to the interests of the bigger trading powers and will ignore the needs and interests of the outsiders. The development objectives of WTO will, by definition, have a tendency to be ignored;
- Poorer countries lose their negotiating power even if they decide to join into the negotiation of mega-deals. Bigger countries might be willing to take into account the interests of developing countries such as the BRICs to have them in an integration agreement. However, they have no incentive to make concessions to get a poorer developing country that is neither important as a task provider nor as a market to enter into a mega deal.

A multilateral trading system based on harmonization and extension of mega-deals therefore marginalizes the poorer and smaller developing countries and deprives them from a place on the negotiating table they have worked so hard to get in the WTO.

- 3) Successful mega-deals and plurilaterals in line with requirements of the GVCs will make negotiations in the WTO irrelevant unless WTO reviews its role and functioning fundamentally. It is indeed illusionary to believe that the major trading powers will negotiate multilaterally issues at the WTO if and when their interests are satisfied in mega-deals which cover a very large part of their economic interests. The parallel progress of liberalization by mega-deals and within WTO seems a very unlikely outcome, unless WTO reforms its role and functioning fundamentally. For this reason, it seems also illusionary to believe that a breakthrough in the Doha negotiations would reestablish WTO to its past glory.

#### **IV. What is the role of WTO in the GVCs?<sup>4</sup>**

- 1) Global Value Chains should have global rules and these rules should ideally be made by an inclusive organization such as WTO where all interests and differences are taken into account to ensure a fair and level playing field for international transactions. Since a

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<sup>4</sup> Andrew L. Stoler proposes that WTO should accept that real market access is affected through RTAs and not through multilateral agreements. He considers that it is high time that WTO reforms itself. He very much encourages plurilateral agreements for such rule based issues and proposes that WTO leaves liberalization to others.

global and inclusive regulating system is by definition not an efficient instrument to promote deeper integration among countries, WTO should define, multilaterally and in an inclusive manner, the principles or minimum standards that should be observed when negotiating such integration agreements, and leave the liberalization and harmonization function to other more efficient fora for that (RTAs, mega-deals, plurilaterals).<sup>5</sup> Integration deals negotiated under those principles would be integrated (under Annex IV) into the multilateral regulating framework and would be monitored, managed and disciplined in a multilateral framework (including the application of DSU).

Unfortunately such an approach is idealistic and not realistic. A global inclusive system is too slow and static, and will always be overtaken by the rapidly evolving real economy. Experience shows that GVCs develop on their own and big economies which have an interest in them will not submit to a cumbersome and constraining rule-making system that they do not control. A second best solution will have to be found.

- 2) If WTO is not the primary actor in liberalization for GVCs, if the rules and regulations under which GVC function are not made in WTO, if the management of agreements is no longer made in WTO and if the future of the DSU for GVC rules is questioned, the various functions of the WTO are no longer relevant to the global economy of tomorrow. This, however, does not mean that WTO has become or is becoming irrelevant in the new global distribution of tasks.

To redesign the WTO so as for the institution to be relevant to the global market place of today, the following elements have to be addressed:

- a. The WTO has to abandon its ambition of supremacy in defining and policing the global trading system, in its advanced form of integration. It is not its function and it cannot have that function.
- b. The WTO cannot continuously expand its field of intervention by addressing more and more behind-the-border measures which affect the distribution of the tasks globally. It is not the right forum for that nor does it have the necessary negotiating capacity or the right people to do that.
- c. The WTO has to define its comparative advantage and only fulfills those functions for which it is better equipped than other more efficient fora.
- d. It has to refocus its activities on a smaller number of issues and provide a real service to the global economy.

- 3) To define the future role of the WTO in the global trade system, it is useful to concentrate again on its objectives.

- a. Two essential objectives of WTO cannot be achieved by the other fora: RTAs and mega-deals are, by definition, exclusive and not inclusive. This is true – even if they benefit all countries – as they define the rules in an exclusive setting among those who are willing and able to participate;
- b. GVCs, mega-deals and RTAs are by definition not putting development issues of countries which are not part of the agreement as an objective. GVCs are certainly extremely efficient and

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<sup>5</sup> Peter Draper proposes the elaboration of a code of conduct to be defined within WTO, and leaves the operationalization of the integration measures to RTAs/mega-deals. He, however, does not address the issue whether WTO members are able or willing to work on such a code of conduct.

maximize the global wealth. They are, however, not addressing distributional issues neither between countries nor within countries.

## V. Can WTO address these issues?

### 1) WTO's dilemma

The advantage of the WTO system of inclusiveness and development concerns are at the same time its disadvantages in the search for a system establishing rules for GVCs.

The RTAs, mega-deals and plurilaterals advantage in determining concrete and effective rules favoring GVCs are due to the fact that they do not have the constraints imposed by inclusiveness and distributional issues among all WTO members.

Therefore, WTO, by trying to “correct” the exclusive character of the RTAs, will reintroduce the constraints of WTO into the RTAs thereby annulling the comparative advantage of those fora for GVC rules.

Therefore it seems unrealistic and not desirable for WTO to determine rules which have to be followed by the RTAs negotiators in the pursuit of rules for GVCs. Proposals for WTO to define rules to be followed in RTAs' negotiations are not realistic:

- Countries excluded from RTAs, mega-deals and plurilaterals do not want to “legitimize” exclusive systems unless they would abide by the rules of non-discrimination and inclusiveness of WTO;
- WTO members who want to follow a deeper integration will not allow outsiders who are not willing to take such commitments to set restrictive rules on them.

A systemic approach is therefore probably excluded and one has to look at the specific issues the mega-deals create and see how the negative impact on others can be mitigated. GVCs are, economically speaking, very efficient and maximize the global welfare.<sup>6</sup> However they have a distributional issue by encouraging a “race to the bottom”. Given the finite demand for the products and the limited number of lead companies (which may have oligopolistic brand or marketing powers) and the unlimited supply of labor in developing countries and the existence of entry barriers for lead companies (while there are no entry barriers at the bottom), it is economically unavoidable that the efficiency gains of GVCs will be captured either by the lead company (usually in the North or the emerging markets) or the consumer (also in the North and/or in the richer emerging markets.). This “race to the bottom” will have the following consequences:

- Labor costs will be minimized and labor conditions may be exploitive (see for instance Bangladesh textile factory issue);
- Subsidizing GVC operations by allowing them to extract special tax deals and forcing Governments to limit their taxation policy to remain competitive.

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<sup>6</sup> Kati Suominen expresses similar ideas on the new function of WTO (transparency, etc.) but is more optimistic about a parallel development of WTO and mega-deals.

A market without rules has a clear tendency to be exploitive. For a market to be functioning in the interest of everybody, it needs rules. At the national level this is the role of Governments. International competition limits the possibilities of the Governments to do their job of protecting the vulnerable. It is the function of a multilateral system to ensure that free trade is not turning into a “Wild West” and to put limits to this “race to the bottom”.<sup>7</sup>

## 2) Possible roles of WTO in a world of mega-deals

Clearly the WTO has a role as a clearing house and for transparency purposes. Moreover WTO should also analyze those agreements, compare them and define both best practices and harmonization (most used concepts). This way the WTO could advance both the knowledge of the issues of such agreements as well as ways to promote convergence between different agreements.

WTO studies should also analyze the shortcomings of the new system and identify means to minimize them. By defining best practices and vulgarize them, WTO would contribute to the adoption of best practices and would inform outsiders of the evolution of the system brought about by those agreements.

The role as clearing house is, however, not enough. The specificity of the WTO is the elaboration of rules and the management of those rules including dispute settlement. As some of these functions will be taken over by other fora, WTO has to reinvent itself.

If WTO limits its function to analysis and information dissemination, it will not distinguish itself from UNCTAD and OECD. It needs to have a more normative function and some means to enforce its norms.

The following functions could be given to WTO so as to mitigate potential negative impacts of GVC arrangements on the excluded countries:

- A clearing house function for information on GVC arrangements;
- The analysis of the effects of those agreements both on members and non-members;
- The elaboration of best practices and minimum requirements to ensure that their negative effects on outsiders are minimized through the inclusion of instruments such as aid for trade; S&D; and etc.;
- The elaboration of principles to avoid the “race to the bottom”.

On the basis of this information, WTO would be the body where those issues can be discussed inclusively and where best practices can be elaborated. Those best practices could be adhered to by various Governments on a plurilaterals basis. Countries who have voluntarily agreed to adhere to these best practices would take commitments under WTO which could be submitted to the Dispute Settlement Mechanism (DSM). GVC arrangements in conformity with the best practices would be actionable under the WTO DSM, which might be an incentive to adhere to those best practices.

Such an approach would have the following advantages:

- WTO would contribute to transparency, knowledge and diffusion of regulations and principles which are similar and thus reduce the costs of multiple systems;
- WTO would be the only forum where non-members and members analyze together the benefits and costs of those agreements;

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<sup>7</sup> This statement is controversial: Frederik Mayer and William Milberg make a strong argument in this direction. Bernard Hoekman and Ben Sheperd show that trade facilitation gains are beneficial to small enterprises also in the poorer countries and concludes that there is no evidence that the benefits are reaped by the lead companies and/or consumers in the more affluent countries.

- WTO could assist in identifying the needs for technical and financial assistance of its poorer countries which do not have the capacity of joining such agreements, but would want to (aid for trade);
- Subsidies and dumping measures could be redefined to include elements of undue advantages granted to lead companies or to define minimal standards that private firms have to follow in their distribution of tasks among different countries;
- Sanctions against companies which do not follow the minimum standards could be elaborated thereby creating a level playing field where companies that do not adhere to minimum standards could be “punished” through anti-dumping and countervailing measures. This would ensure that firms which are willing to follow minimum standards are not undercut by “free riders”.

The Trade Policy Review Mechanism (TPRM) could become a powerful instrument to analyze the impact of GVC on economies at different levels of development:

For countries at the lower end of the GVCs, the TPRM could identify the measures they should take to avoid the exclusion from the GVCs and how to climb up the ladder of production. An analysis of the support needed might lead to a roadmap of reforms including the support required whereby the provision of aid for trade could work as an additional incentive to integrate their economies into the worldwide distribution of tasks;

For countries which are at the top of the GVCs, the analysis could make recommendations on how to avoid the “race to the bottom” and how to minimize the potential negative impacts of the GVCs on the outsiders or the countries at the bottom of the supply chain. Such an analysis would also have a big impact on the behavior of multinationals which are dependent on the good will of the consumers. For this purpose, advocacy NGOs and foundations may usefully be associated, as organizations like the WWF have great experience in negotiating voluntary norms of behavior with multinationals.

## **VI. WTO has to change some of its principles as well as its functioning to remain relevant in a world where the production is based on GVCs**

Global Value Chains are a game-changer: they affect fundamentally the way countries trade with each other. It is the WTO that has to adapt to these changes not the reverse. Principles based on the trade in goods and services are not necessarily adapted to the world of trade in tasks. They have to be adapted. WTO has a unique advantage to monitor, analyze and propose ways and means to address potential adverse effects of this new organization of the international production process.

To be able to play this role WTO will have to change:

### **3) Its principles have to be adapted to the new system**

- a. The distinction between developing and developed countries will have to take into account the new situation. This does not mean that WTO should ignore the difference in the development of its members, but the way this distinction is taken into account will have to be reviewed. This means the following:

- Exemptions may no longer be a useful instrument to take into account institutional and development differences. Indeed, lead companies do not care whether a country has an exemption of an obligation or not, when they decide to outsource one of their tasks and thus create value chains.
  - Aid for trade will clearly have to be a major concern to ensure that the latecomers can get into the GVC;
  - Protection of those who have no negotiating power – through minimum standards – will have to be a concern of the system;
  - Special and differential treatment clearly continues to be of relevance. However, it will have to be redefined. Indeed, a system where nearly all economic transactions are made on a preferential basis (the mega-deals), traditional preferences for LDCs will not provide them with any special advantage but will only put them on an equal footing with those who are part of the mega-deals.
- b. WTO has established rules to ensure that trade relations between countries are based on rules rather than on the relative power of the negotiating countries. This was and is a very important element of an efficient and fair multilateral trading system. In a world based on the distribution of tasks, these rules are no longer relevant to achieve the objective: GVCs are, by definition discriminatory, but actors in the GVCs, not Governments, are responsible for discrimination. The distribution of tasks is done on an efficiency basis through market forces. This is fair as far as we consider that market forces are fair (which they are in an economic sense, but not in a social one). While the distribution of tasks is economically efficient and maximizing global welfare, the distribution of the remuneration among the different tasks is based on power not on rules. Limited demand and excess capacity as well as unlimited supply of labor will necessarily lead to the distribution of the benefits of the GVC to the top (either the parent company or its clients). The remuneration of the different tasks therefore is not based on rules, but on the negotiating power of the actors in the GVC. A fair basis for these negotiations (which are driven by the private sector, not the Governments) could be re-established by defining minimum standards for labor conditions and/or minimum remunerations of various tasks. This is not easy, but the only way to ensure that economic relations are based on some rules rather than on the power of negotiating entities. This would also allow the lead companies to remunerate factors of production at a reasonable level, without being undercut by other firms which do not follow these principles. The adoption of these standards by the Governments on a multilateral level would also open the way to sanction multilaterally the non-observation of these standards. Existing rules on dumping and subsidies could include such unfair competition measures.
- c. WTO's objective of ensuring that trade and development are inclusive would also require a rethinking of the TPR exercise which could become a major instrument to assess the impact of GVCs at the country level:
- Measures needed to ensure that the GVC production process is regulated so as to avoid any blatant exploitation of the weak;
  - Measures the country should take to ensure that it participates in the global value chain and/or on how to climb up the ladder of the value chain.

As such an exercise would go way beyond the traditional trade centered analysis of TPRs, their functioning would have to be reviewed and it would have to include other economic agencies such as the World Bank and regional development banks. As aid for trade will play an important role in enabling countries to accede the GVCs, the Enhanced Integrated Framework (EIF) should be associated to define the required aid for trade.

#### 4) WTO's functioning would have to change fundamentally

- a. The analytical capacity of the Secretariat would have to be strengthened and it would have to use outside neutral researchers for their work including the capacities of institutions like the World Bank, UNCTAD and OECD;
- b. The function and composition of the committees would have to be reviewed: they would have to look into the minimum standards as well as into the effect of rules in RTAs and mega-deals on the functioning of the world trading system. Committees therefore would have to be able to have access to expert advice from research institutes, think tanks, the private sector and NGOs.
- c. As the WTO cannot impose rules of behavior on the fora which negotiate the rules and regulations of the GVCs, the negotiating function of the WTO would have to be based on persuasion on the basis of best practices (worked out on the experience with measures used in RTAs) rather than fix multilaterally enforceable rules;<sup>8</sup>
- d. Best practices would have to be adopted through the system of plurilaterals so as to avoid that they are imposed on countries which do not want to adopt them.

As minimum standards and behavioral rules for negotiating such deep integration agreements are highly political, Ministers would have to be much more involved. The creation of some governing structure would probably be unavoidable to ensure that the Ministerial Conferences provide inputs in a form and of substance which are relevant to them. Meetings would have to be much more focused on issues which are political and require Ministerial involvement and on a more recurrent basis.

## **VII. Some thoughts about concrete steps WTO might consider to adapt itself to the new economic and negotiating environment created by GVCs**

### 1) Bali Ministerial

The Bali Ministerial Conference's objective is to revive the WTO by:

- Showing that the WTO members are able to agree and to come to a consensus on some concrete issues (the so called small package);
- Defining a new approach to the negotiations that provides again some credibility that the system will be able to deliver (the way forward).

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<sup>8</sup> Robert Z. Lawrence also expresses the need of a complementary role of WTO: he sees the integration of plurilaterals and WTO by including deep plurilateral agreements as part of a WTO that has a variable geometry. He says that while this is not possible at this point in time, such agreements may be easier once more and more members become part of deep regional agreements.

a. The small package

It seems that the small package has to include at least three elements:

- A Trade Facilitation agreement;
- Some decision of food security and agriculture;
- Some development-related elements including cotton.

Concerning the first point, it seems possible and necessary that the Ministerial Conference adopts the Trade Facilitation agreement. This is clearly fully in line with the requirements of GVCs and it is the field in which WTO can make a contribution to a more efficient distribution of tasks at the global level. The agreement – the way it shapes up – seems to be complementary and in line with the evolving international system:

- It defines principles and minimum standards;
- It will not have by itself a major impact on the reduction of transaction costs, but it does provide a solid framework which then can be further operationalized in various RTAs and mega-deals. It thus corresponds to a rational approach to further deepen integration by (i) having WTO define the principles and basic standards for trade facilitation and (ii) the RTAs and mega-deals applying and deepening them within an internationally agreed framework and according to multilateral principles.

Concerning food security and agriculture it seems unlikely that those who want a change in the rules and commitments and those who object to revise the rules and commitments outside a broader approach to the multilateral negotiations will come to an agreement. This is also valid for cotton.

A solution might consist in:

- Adopting some temporary and/or intermediary measures to address the concerns of the G-33, as well as some improvements in the management of Tariff Rate Quota Administration (TRQ) and in the disciplines for export subsidies;
- A decision to address the issue in a broader framework on a priority basis with a concrete timeframe;
- The cotton issue might be addressed specifically and ambitiously in such an approach.

To give some credibility that the negotiations on agriculture, food security and cotton have a chance to come to results, the following decision might be taken by the Ministers in Bali:

- Agriculture, food security and cotton, which are major issues within the global system, will be addressed on the basis of the concept of an agrifood value chain covering agricultural subsidies (both internally and externally), industrial commodities (such as fertilizers, pesticides, agricultural machinery), services (logistics, marketing, financing, etc.) as well as research and development (IP) and aid for trade. Such an approach would (i) allow to address the issues of G-33 countries and of the cotton producers in an expedite manner and (ii) provide a more conducive approach to the negotiation by integrating the three negotiating fields (agriculture, NAMA and services) on a sectorial

basis (food security), thereby ensuring that Members' interests in all three fields of negotiation are addressed simultaneously.<sup>9</sup>

- Negotiators are instructed to prepare such a package for adoption by the Ministers in December 2014, at the next Ministerial Conference, a conference which should take place every year (see below). Cotton will be treated specifically and ambitiously in such a package.

b. The way forward

To give credibility that the current negotiations can deliver agreements, WTO will have to change *its modus operandi* in the negotiation process. The major issues in the present negotiations concern:

- The maintenance of what has been, in principle, already accepted during the ten-year-old negotiations versus starting on a new basis;
- The principle of consensus of all members versus the advancement through the process of multilaterals which can be joined freely by members;
- The principle of "nothing is agreed until everything is agreed" versus an attempt to advance step by step and to agree and conclude any topic where there is an agreement.

As these issues presently block all negotiations and as there is no hope to reach an agreement to solve them, a new approach has to be found which skirts those issues.

The change in the organization of the production system globally and the emergence of mega-deals provide the justification to change the approach to the negotiations.

It is proposed that the Bali Ministerial decides the following:

- Ministers decide to explore ways and means to adapt the negotiating process to the changes which have occurred in the global production process;
- Ministers are aware that the global system of production and the rule-making have changed and that the WTO has to adapt its principles, functioning and processes to take into account these developments so as to attain its overall objectives. These objectives are to facilitate the integration of the world economy by establishing, managing and policing a multilateral rules system which is inclusive and which ensures that all its members and its population have a conducive international environment for their sustainable development. Ministers therefore instruct their negotiators to establish a negotiating group on agriculture and food security on this basis and to report within one year on progress made, issues encountered and a timetable to come to an agreement on agriculture and food security on this basis.
- Ministers recognize that the evolution in the global environment, especially the requirements of the Global Value Chains and the proliferation of RTAs, mega-deals and plurilaterals, require a fundamental rethinking of the role and the functioning of WTO. For this purpose Ministers instruct the WTO to create a working group including representatives of all regions and groups as well as representatives of the private sector and the civil society to propose the changes in WTO to adapt to the new situation and to allow it to continue to fulfill its objective of creating and managing a multilateral trade

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<sup>9</sup> Grant Aldonas proposes agreement in Bali on a value chain approach to the Doha negotiations with a goal of winding up the Doha business within one year so as to turn attention to the challenges of new patterns of trade.

framework that is inclusive and development oriented. Ministers will consider their proposals during a special Ministerial meeting to be held in one year.

- The work of the negotiating group should follow the following principles:
  - (i) It is recognized that RTAs, mega-deals and plurilaterals are better equipped and more efficient in furthering integration measures and in defining common operational standards. They can go faster and deeper than is possible within WTO. WTO cannot and should not limit any measures which are contributing to the global welfare through further integration of the economies.
  - (ii) However, just as WTO has inherent shortcomings, these deals cannot achieve all the objectives of WTO. The role of WTO is to ensure that these deals are contributing as much as possible to WTO's objectives rather than to put restrictions on such deals. Those instruments of integration have the following issues:
    - They are, by definition, not inclusive, but exclusive;
    - The distribution of the negotiating power is largely defined by the economic power of the participants: smaller and developing countries have only the choice of accepting what the bigger economic powers have decided or to be left out of the deal. WTO which has as its mandate to ensure that economic relations and their rules are based on rules rather than on economic power has a role to play there;
    - GVCs are a very efficient instrument to maximize global welfare. However they do not address distributional issues: the reduction of the transaction costs and efficiency gains have a tendency to be captured by the top of the value chain at the expense of the bottom of the value chain. They may lead to unfair practices in the production chain as the unlimited supply of labor and the finite demand at the top of the ladder lead to a skewed negotiating power. WTO may have a role to play there;
    - RTAs and GVCs have a tendency to address the issues faced by the bigger trading powers (i.e. those of the interested and interesting partners) at the expense of the issues faced by poorer developing countries. WTO may have a role to re-equilibrate the interests of various countries taking into account the differences in their negotiating power and given their specific needs for entering the GVC to further their sustainable development.
  - (iii) WTO cannot impose principles to be followed by mega-deals, plurilaterals and RTAs: a top down approach is simply not working as various economic interests which have the means to assert themselves will always find ways to ensure that their requirements in terms of the regulatory framework are met. Moreover, value chains require concrete and "behind the border" measures for which WTO is badly equipped. WTO will have to redefine its role away from negotiating deeper integration deals (which cannot be done at a global level and inclusively, towards a role of ensuring transparency,

inclusive scrutiny and analysis of the deals made outside WTO in terms of their effect on inclusiveness, transparency and harmonization among them.

## 2) The functioning of WTO

Such a new approach to the role of the multilateral system would require a fundamental change in the functioning of the WTO and in its organization. The following functions of WTO would have to be strengthened:

a. WTO's role for transparency in the rules governing the international distribution of tasks would become extremely important;

b. WTO's role as the place to define best practices and minimum standards would become a preponderant task. Best practices and minimum standards would have to be based on what is being done outside WTO. To assist the elaboration and the spread of best practices and minimum standards, WTO will have to reorganize itself:

- It will require a stronger secretariat with a strengthened analytical ability;
- It will require mechanisms to include the private sector and the civil society in this work;
- It will require a change in the decision making procedures: indeed to be sufficiently fast and relevant to the deals made outside of WTO, best practices will have to be adopted on the basis of some qualified majority and instead of consensus;
- The role and functioning of the DSU will have to be reviewed so as to ensure that the various rules made outside the WTO are interpreted and policed by WTO's dispute settlement mechanism thereby following the same basic principles.

c. The role of the TPRM would have to be strengthened and reoriented. The analytical framework to analyze the countries' policies could be the requirements and effects of the GVCs:

- For countries at the bottom of the value chain, the TPRM should put the emphasis on what the country can and should do to ensure that it is part of the global value chain and so that it can climb up the latter in the value chain. Its emphasis would therefore to be put on providing policy recommendations on how the country can better integrate into the world economy through participation in the value chain;
- For countries at the top of the value chain, the analysis should cover the impact of its policies on the fair distribution of the benefits of the distribution of the tasks (and their remuneration) among the different countries in and outside the value chains and what they can do to limit as much as possible conditions which might hinder the integration of latecomers and poorer developing countries into the value chains.

Such a TPRM approach would require a new way of elaborating them: they would have to include the World Bank and the regional banks as well as the major actors of the private sector both in the country and outside.

d. The role of WTO would become much more political. Indeed the WTO will have to convince its Members that following minimum standards of inclusiveness and fairness in a system that is largely defined by efficiency concerns and economic power is in the interest of all and ultimately a condition to ensure that globalization is politically sustainable. This is largely a political role which can only be

assured by the Ministers. The role of the Ministers in WTO will therefore have to be strengthened. The interests of Ministers will only be assured if they are called to make well-prepared political decisions. To ensure the political guidance of the organization it probably will be necessary to:

- Establish a Governing Council at a ministerial level which is consulted, meets more frequently and prepares the agenda for the Ministerial meetings;
- Yearly meetings of the Ministers with an agenda that requires their presence and which allows them to take decisions;
- Some system of qualified majority decisions.

## VIII. Implications for poorer developing countries

### 1) Implications for the negotiating position of LDCs in the Doha Round

#### a. For the Bali Ministerial

The impressive and rapid development of mega-deals and plurilaterals (which might be used to harmonize conflicting FTAs) shows that LDCs have to do anything in their power to save the WTO – the only forum in which they are represented and have some negotiating power. Small and poor countries are the major beneficiaries of an inclusive multilateral trading system. They are the only ones which have no real alternative to defend their legitimate interests. This means that they have to be the driving force of multilateralism by being pro-active and consensus-oriented. Contributing to the success of Bali therefore might well be the first priority for LDCs.

This might well mean the following for the specific items under discussion:

- **The Trade Facilitation Agreement is of major importance to LDCs:** (i) it fits into the requirements of the Global Value Chains; (ii) it defines rules inclusively and does not exclude anybody; (iii) it takes into account the differences in institutional and economic development by allowing each country to define its own priority, while maintaining that all countries will move towards the same basic standard; (iv) it combines obligations with aid for trade and last but not least (v) it provides a multilaterally agreed framework for trade facilitation which will be a guide for other fora when they decide to go further;
- **LDCs need a decision on DFQF in Bali at a 100 %** so as to at least partially compensate the preference erosion they will experience through the mega-deals. It therefore seems essential that LDCs make a proposal that is supported by all of them and that is not actively opposed by the African countries which benefit of the AGOA preferences. Time seems to be of the essence. Bali might well be the last chance for them to obtain DFQF;
- **LDCs may want to reconsider their total opposition to the plurilateral agreement on services** and propose principles that would need to be taken into account when negotiating such agreements. This might be a very opportune moment to propose the principles that need to be followed when operationalizing their services waiver in any future agreement. Indeed - while the BRICS which are interesting markets – can afford to boycott an agreement on services, LDCs have no blocking power and have to admit that such a

plurilateral agreement will exist with or without them<sup>10</sup>. Moreover, all studies show that efficient services are an essential element to be able to integrate the value added part of the value chains;

- **LDCs may need to show flexibility and willingness to engage in the negotiations** so as to force the others to come out of their reserves. This can only be achieved by tabling pro-actively proposals which have a chance of being adopted and which are consensus-oriented.

b. In the longer term

LDCs might be well-advised to start a fundamental rethinking of their position in the WTO and how they can minimize the fact that much of the multilateral framework of economic relations will be developed outside WTO. This could include:

- **A redefinition of the content of special and differential treatment.** LDCs need rules that are providing conducive international environment for their development, not exceptions to rules which are not adapted to their needs and situation. Latecomers, like the LDCs, in the international trading system have special needs and constraints, which the multilateral system has to address and not to “avoid” by giving exemptions and by including hortatory language which is of very little use in the multilateral legal framework. While preferences may well be a useful element to give LDCs a head start in preparing themselves to compete internationally, they need to fulfill two conditions: (i) they should be legal commitments to incite investments and not voluntary and revocable “favors”; (ii) they should not distort the comparative advantage and thus favor the creation of industries which are not sustainable in the long term.
- **Negotiations on new issues such as competition, investments, environmental and labor issues,** which have been refused by the LDCs in the past as they were afraid (not without reasons) that these measures might be used for protectionist purposes, might become useful instruments for the LDCs to define minimum standards to avoid the race to the bottom that GVCs might encourage. LDCs have to take into account the fact that rules on those issues will be created – either within the mega-deals outside the WTO or within WTO where they have a voice. They also have to be aware that those issues will only be treated within WTO if the smaller countries show flexibility and expeditious work within WTO.
- **LDCs might want to consider on how they can transform their group from what is essentially a lobby group into an operational negotiating group** taking fully into account that their negotiating power is only political and therefore very limited in presence of powerful economic interests. Unless the group is able to negotiate among itself positions which have a chance of being accepted by all members, they will not be in a position to contribute to the search for compromises, which are always required in a negotiation.

## 2) Implications for internal trade policies of LDCs

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<sup>10</sup> According to recent declarations from Chinese officials, China will join talks on trade in services in the near future (see *China Daily-US Edition*, 27 September 2013). This will reinforce the isolation of LDCs and poorer countries on this issue.

Any country in the world has an interest to be part of the GVCs to ensure a sustainable longer-term development of its economy:

- a. The first priority is therefore to ensure that their economies are part of the value chains. As discussed earlier, the behind-the-border measures are much more important in the decisions of the private sector than are border measures, when the economic actors decide to include a country into their distribution of tasks. Great emphasis should therefore be given to ensure that the framework conditions for doing business in the countries are competitive. This includes both soft and hardware.
  
- b. The second priority is to move up on the value chain so as to increase the part of value of a product that is captured by the country. Many LDCs are integrated in the GVCs through the provision of natural resources. Without any transformation of the natural resources in the country, LDCs are basically exporting their development opportunities. Global Value Chains have the advantage for LDCs that a country does not need to be competitive in all aspects of the product, but that it can concentrate its efforts to become competitive in just a few tasks. There are clearly some basic elements that have to be taken into account:
  - The services sectors, which are embedded in nearly any task, are extremely important to ensure the competitiveness of an economy. These sectors deserve much more attention than they do get in most of the countries;
  - Some clustering of activities – through an industrial policy based on exports rather than imports – may well be required. Present rules provide much more space than most LDCs realize or utilize. Regional integration might be a very useful tool in this direction. LDCs may want to make proposals on framework conditions which they consider necessary to be able to implement industrial/services policies to catch up technologically, that might not be available today. Investments and technology policies will certainly be essential as well as the establishment of a ruled-based (and enforceable) contract framework.

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