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WTO DG floats new approach on agri-subsidies

WTO Director-General Roberto Azevedo has reportedly mooted a fresh approach to tackling the divisive issue of domestic farm subsidies that has become a major stumbling block to concluding the Doha Round trade talks. The proposal however does not fall in line with the structure of reforms negotiated over the years by WTO member states in the course of the Round.

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Azevedo's new efforts on agri-subsidies to conclude Doha Round

In a bid to achieve agreement at the Doha Round trade talks on the divisive issue of domestic farm subsidies, WTO Director-General Roberto Azevedo has reportedly floated a proposal in this area that departs markedly from the reform framework thrashed out in negotiations over the years.

by D. Ravi Kanth and Chakravarthi Raghavan

GENEVA: The World Trade Organization Director-General (DG), Roberto Azevedo, in his current drive to conclude the Doha Development Round at the WTO's Nairobi Ministerial Conference in December, appears to have floated a concept on domestic agriculture support which upends all the collective efforts hitherto on further reforms in agriculture mandated by the Agreement on Agriculture of the Marrakesh treaty of 1994.

Azevedo discussed with the trade envoys of seven major developed and developing countries on 11 June a new concept entailing common reduction commitments on domestic support, as opposed to the tiered formula cuts under the 2008 revised draft modalities on agriculture, sources familiar with the meeting told the *South-North Development Monitor (SUNS)*.

On 10 June, Azevedo had asserted at the Geneva Press Club that he was "working with [a] scenario where we are going to come to a conclusion on what needs to be done to finalize the Doha [Development Agenda trade negotiations]".

At his 11 June meeting with the seven trade envoys, Azevedo reportedly unveiled the scenario he had in mind on the domestic support pillar of the agriculture negotiations.

The seven envoys who took part in the discussion included Ambassador Michael Punke of the United States, Ambassador Angelos Pangratis of the European Union, Ambassador Yu Jianhua of China, Ambassador Anjali Prasad of India, Ambassador Hamish McCormick of Australia, and Ambassador Yoichi Otabe of Japan.

Also present at the meeting were the chair of the WTO General Council Ambassador Fernando de Mateo of Mexico, the chair of the Doha Round agriculture negotiations Ambassador John Adank of New Zealand, and the chair of the Doha Round market access negotiations in industrial goods Ambassador Remigi Winzap of Switzerland.

Unravelling mandates

The DG's approach towards a "common" framework in which all the seven countries would undertake almost the same commitments regardless of their current and historical subsidy outlays and commitments, particularly the trade-distorting domestic support payments, would be tantamount to unravelling all the agreed Doha Round mandates such as the Doha Ministerial Declaration of 2001, the July 2004 framework agreement, and the 2005 Hong Kong Ministerial Declaration.

These three mandates were adequately reflected in the unsettled 2008 revised draft modalities (Rev. 4 text) which clearly showed the landing zones.

Azevedo, when he was the trade envoy of Brazil, had said in 2011: "The December 2008 draft modalities are the basis for negotiations and represent the endgame in terms of the landing zones of ambition. Any marginal adjustments in the level of ambition of those texts may be assessed only in the context of the overall balance of trade-offs, bearing in mind that agriculture is the engine of the Round...

"The draft modalities embody a delicate balance achieved after 10 years of negotiations. This equilibrium cannot be ignored or upset, or we will need readjustments of the entire package with horizontal repercussions. Such adjustments cannot entail additional unilateral concessions from developing countries."

At the Geneva Press Club on 10 June, Azevedo said that "I don't feel the sense that we are coming to an agreement, even conceptually."

Clearly, this statement from the DG

is factually misleading. The architecture for domestic support reduction commitments had evolved after the collapse of the fourth WTO Ministerial Conference in Cancun in 2003.

On the eve of that meeting, when the US and the EU sought to reach a modus vivendi among themselves that they wanted to force on the others, a developing-country farm coalition came into being – the G20, led by Brazil, India, China and South Africa among others – and this group stood together at Cancun in opposition to the US-EU front on agriculture.

The 2004 July framework, evolved at the WTO General Council after the spectacular collapse of the Cancun conference, provided the foundational architecture for the domestic support reduction commitments.

The framework says, "… The Doha Ministerial Declaration calls for 'substantial reductions in trade-distorting domestic support.' With a view to achieving these substantial reductions, the negotiations in this pillar will ensure the following:

- Special and differential treatment remains an integral component of domestic support. Modalities to be developed will include longer implementation periods and lower reduction coefficients for all types of trade-distorting domestic support and continued access to the provisions under Article 6.2 [of the Agreement on Agriculture].
- There will be a strong element of harmonization in the reductions made by developed Members. Specifically, higher levels of permitted trade-distorting domestic support will be subject to deeper cuts.
- Each such Member will make a substantial reduction in the overall level of its trade-distorting support from bound levels.
- As well as this overall commitment, Final Bound Total AMS and permitted *de minimis* levels will be subject to substantial reductions and, in the case of the Blue Box, will be capped as specified in paragraph 15 in order to ensure results that are coherent with the long-term reform objective. Any clarification or development of rules and conditions to govern trade-distorting support will take this into account….

"The overall base level of all trade-distorting domestic support, as measured by the Final Bound Total AMS plus permitted *de minimis* level and the level agreed in paragraph 8 below for Blue Box payments, will be reduced according to a tiered formula. Under this formula, Members having higher levels of trade-distorting domestic support will make greater overall reductions in order to achieve a harmonizing result. As the first instalment of the overall cut, in the first year and throughout the implementation period, the sum of all trade-distorting support will not exceed 80 per cent of the sum of Final Bound Total AMS plus permitted *de minimis* plus the Blue Box at the level determined in paragraph 15.

"The following parameters will guide the further negotiation of this tiered formula:

- This commitment will apply as a minimum overall commitment. It will not be applied as a ceiling on reductions of overall trade-distorting domestic support, should the separate and complementary formulae to be developed for Total AMS, *de minimis* and Blue Box payments imply, when taken together, a deeper cut in overall trade-distorting domestic support for an individual Member.
- The base for measuring the Blue Box component will be the higher of existing Blue Box payments during a recent representative period to be agreed and the cap established in paragraph 15 below…."

The 2005 Hong Kong Ministerial Declaration went a step further by declaring: "On domestic support, there will be three bands for reductions in Final Bound Total AMS and in the overall cut in trade-distorting domestic support, with higher linear cuts in higher bands. In both cases, the Member with the highest level of permitted support will be in the top band, the two Members with the second and third highest levels of support will be in the middle band and all other Members, including all developing country Members, will be in the bottom band. In addition, developed country Members in the lower bands with high relative levels of Final Bound Total AMS will make an additional effort in AMS reduction. We also note that there has been some convergence concerning the reductions in Final Bound Total AMS, the overall cut in trade-distorting domestic support and in both product-specific and non product-specific *de minimis* limits. Disciplines will be developed to achieve effective cuts in trade-distorting domestic support consistent with the Framework. The overall reduction in trade-distorting domestic support will still need to be made even if the sum of the reductions in Final Bound Total AMS, *de minimis* and Blue Box payments would otherwise be less than that overall reduction. Developing country Members with no AMS commitments will be exempt from reductions in *de minimis* and the overall cut in trade-distorting domestic support. Green Box criteria will be reviewed in line with paragraph 16 of the Framework, inter alia, to ensure that programmes of developing country Members that cause not more than minimal trade distortion are effectively covered."

The unsettled 2008 revised draft modalities gave shape to these two foundational structures of the Doha Round negotiations in the agriculture domestic support reduction commitments. The author of the revised draft modalities, Ambassador Crawford Falconer of New Zealand, had provided figures for reduction commitments even though "certain things are manifestly not yet agreed."

But it is known to Azevedo, who took part in each and every small and big meeting in the run-up to the 2008 revised draft modalities, that reduction commitments are clearly laid out in those revised modalities, and many of them including the commitments in *de minimis* were well stabilized.

But in his current zeal to satisfy the demands of one major developed country (the US) which today has specific problems with reduction commitments in domestic support because of its farm legislation, the DG is turning all the previous mandates upside down to propose a common reduction commitment even though the developing countries are not required to undertake such a commitment. Effectively, such a prescriptive approach goes diametrically opposite to the last 14 years of negotiations, which he wants to conclude by hook or by crook.

"Outrageous proposal"

The developing countries, at the consultations, rejected the latest Azevedo concept as it changed the entire architecture of the Doha Round mandates, including the unsettled Rev.4 modalities with specific reduction commitments and flexibilities.

"This is an outrageous proposal which will never fly," said a former trade envoy of an industrialized country who is familiar with the negotiations that resulted in preparing the 2008 revised draft modalities. "It is amateurish on the part

of the DG to suggest such a proposal."

The developing countries, the envoy said, "will not accept such an approach because it not only changes the balance but ties them to an unacceptable framework."

China and India understandably refused, at the 11 June consultations, to accept the DG's approach, which stood the special and differential flexibilities and the less-than-full-reciprocity principles on their head.

Significantly, Brazil, which is the founder of the G20 developing-country farm coalition, seemed to be ready to work with any approach that brings progress in the negotiations regardless of what was decided in the past.

During a meeting of G20 heads of delegation a few days before the DG's consultations, Brazil merely raised questions on what members were expecting in the domestic support, market access, and export competition pillars of the agriculture negotiations. Several member countries of the G20, particularly Venezuela, expressed sharp concern that instead of preparing position papers on domestic support, there was a silence on this issue, said a trade envoy who was present at the meeting.

China maintained at the G20 meeting that under no circumstances would it agree to any commitment to reduce its *de minimis* support from 8.5% as set out in its accession commitments. Peru asked probing questions at the meeting on what was being done in the name of "recalibration".

In a nutshell, the coming few days and weeks are going to test the resolve of the developing countries, particularly China and India, in the face of Azevedo's blatant attempts to create an "iniquitous" structure of agriculture commitments just to satisfy the interests of major developed countries, particularly the United States. *(SUNS8041)* ❐

Azevedo ideas in agriculture surface as Australia-Canada non-paper

The WTO Director-General's proposal on domestic agricultural support is mirrored in a new document put forward by Australia and Canada.

by D. Ravi Kanth

GENEVA: A proposal floated by the WTO Director-General Roberto Azevedo during his meetings with seven major developed and developing countries to bring about convergence on the domestic support pillar of the Doha Round agriculture negotiations has now surfaced in a non-paper issued by Australia and Canada, several trade envoys told the *South-North Development Monitor (SUNS)*.

During his meetings with the trade envoys of the United States, the European Union, China, India, Brazil, Australia and Japan on 11 and 15 June, Azevedo made a strong pitch for a common concept that all the seven countries agree on a cut in the overall trade-distorting domestic support (OTDS), said trade envoys familiar with the development.

Regardless of the existing Doha Round ministerial mandates on domestic support, Azevedo pressed hard for China and India to accept his proposal for undertaking commitments to reduce OTDS. The DG did not suggest any figures for the OTDS cuts.

China and India spurned the Azevedo pitch, fiercely opposing his proposal, saying they will never agree to any change of the OTDS concept as mandated in the July 2004 framework agreement, the 2005 Hong Kong Ministerial Declaration and the 2008 revised draft modalities, said a trade envoy familiar with the development.

But the US, the EU, Australia and Japan supported the DG's proposal for a cut in the OTDS by all. Brazil, which is the coordinator for the G20 developing-country farm coalition, remained silent at the two meetings of the seven countries.

The DG's proposal on OTDS is now echoed in an unofficial "non-paper" issued by Australia and Canada on 18 June, said a trade official.

Australia and Canada argued that it is "feasible" to find a landing zone on the OTDS by reducing the space between the current levels of expenditure and the existing limits in the WTO's Agreement on Agriculture (AoA) of total trade-distorting support of the United States, the European Union, China, India and Brazil.

The AoA was concluded during the previous Uruguay Round of trade negotiations, particularly after the Blair House Agreement between the US and the EU in November 1992. The compromises struck between the US and the EU in the AoA caused "inequities" in global farm trade. The AoA, however, committed the agriculture subsidizers, mostly in the developed countries, to continuing the reform process for gradually reducing/eliminating these subsidies.

The Doha Round trade negotiations were launched in 2001 to create a "level playing field" in global farm trade through substantial reduction commitments in trade-distorting domestic support. But in an attempt to protect one major developed country (the US) which is not in a position to undertake substantial reduction commitments in domestic support because of its farm law, the DG is making a Herculean effort to change the templates in such a way that that country is let off the hook in the Doha Round, several trade envoys maintained.

Non-paper

To bolster the DG's attempts to arrive at a framework on domestic support, Australia and Canada have circulated a non-paper, trade envoys said.

"At a technical level," according to Australia and Canada, the space between existing entitlements of major members in the AoA and their recent reported levels of total trade-distorting support can be reduced to find a landing zone on OTDS "that accommodates Members' existing policies over the short to medium term whilst improving disciplines on domestic support over the Uruguay Round."

The TDS (trade-distorting support), according to Australia and Canada, refers to the sum of members' current total AMS (Aggregate Measurement of Support) and *de minimis* support.

The TDS, however, doesn't cover the reduction commitments in both old and new Blue Box support that are addressed in the July 2004 framework agreement, the 2005 Hong Kong Ministerial Declaration and the 2008 revised draft modalities.

Australia and Canada argued that the figure for TDS is "intended to provide an estimate of the hypothetical maximum amount of trade-distorting support that a Member could provide in

a given year."

"In 2012, the gap between the United States AoA limit on total trade-distorting domestic and the reported current total trade-distorting support is $46 billion," according to the non-paper. "This means that the United States could increase its trade-distorting support under the Farm Bill [of 2014] by over four times what was reported in 2012 while still respecting the limit," the paper maintained.

The US had undertaken commitments in the AMS, Blue Box and *de minimis* during the previous Uruguay Round. Under the 2008 revised draft modalities, the US is required to reduce its OTDS to $14.5 billion.

In their non-paper, Australia and Canada did not refer to the Doha Ministerial Declaration of 2001, the July 2004 framework agreement, the 2005 Hong Kong Ministerial Declaration and the 2008 revised draft modalities.

On China, the non-paper stated, "the gap between China's limit on total trade-distorting domestic support and reported current total trade-distorting support is $142 billion." Therefore, "China could increase its reported current trade-distorting support by over eight times while still respecting its WTO accession commitments."

China did not undertake any AMS or Blue Box commitments because it joined the WTO only in 2001. In its accession commitments, China had agreed for only *de minimis* support of 8.5% of its total production.

Under the July 2004 framework agreement, the 2005 Hong Kong Ministerial Declaration and the 2008 revised draft modalities for recently acceded members, China is exempted from any reduction commitments in its *de minimis*.

The non-paper, however, conceded that OTDS was an innovation compared to existing AoA disciplines because it would impose a fixed ceiling on the sum of the Final Bound Total AMS, *de minimis* and Blue Box support.

"OTDS levels the playing field by making it harder to shift support between boxes as well as creating an upper limit on unrestricted increases in support," Australia and Canada argued.

"The large binding overhang between AoA limits and reported levels of trade-distorting domestic support should allow both parties [the US and China] sufficient scope to comfortably accept OTDS bindings without needing to modify existing policies in the short or medium term," the non-paper argued.

As a "way forward," Australia and Canada maintained, "major WTO Members including the United States, the European Union, China, India and Brazil have a lot of space between their most recent reported total trade-distorting support and current limits under the AoA."

Besides, "there are consistently large gaps, or binding overhang, between China and the United States' reported levels of total trade-distorting domestic support and their current limits ... These gaps are projected to grow in the future."

In conclusion, "this large and consistent binding overhang means that it is feasible and doable to find a landing zone on OTDS that accommodates existing policies over the short to medium term while also improving the disciplines on domestic support over the Uruguay Round," Australia and Canada argued.

Shifting the goalposts

"The non-paper by Australia and Canada is a mischievous attempt to change the goalposts in the domestic support pillar, and the deafening silence [of the paper] on what was negotiated over the last 14 years eroded its credibility in one go," a developing-country trade official told *SUNS*.

"The paper is dead on arrival as everybody knows that it is the US that needs to be protected because of its Farm Bill and the only way to address the problem is allowing some insignificant cuts from the Uruguay Round," the official added.

The non-paper is an attempt to bolster the DG's concerted initiatives to force China and India to undertake some minimum cuts even though they are not required to do so under the Doha Round mandates, another trade official said.

"It could well be that the DG has given his consent for the non-paper," the official added.

Recently, the DG had praised Canada at its trade policy review meeting, saying that "WTO Members can count on Canada to support a pragmatic and successful outcome at the Tenth Ministerial Conference in Nairobi this December."

"We agree with the many Members who have warned that a failure to succeed in Nairobi will have dire consequences for the WTO's reputation as a forum to negotiate modern global trade rules," the DG said.

Australia is also well known for its efforts to push the DG's initiatives time and again, including the hosting of meetings of seven trade envoys as well as the informal ministerial meeting in Paris in early June.

In short, by joining together to circulate the non-paper, Australia and Canada have only vindicated popular perception about their collective effort to push the DG's initiatives. *(SUNS8048)* ❐

DG report to HOD raises more questions than answers

The WTO Director-General updated heads of delegation of member states on 17 June concerning his recent consultations with select trade envoys on the Doha Round, but his report appears to have left quite a few questions unanswered.

by D. Ravi Kanth

GENEVA: A report presented by the WTO Director-General Roberto Azevedo on 17 June about his consultations with select trade envoys in different configurations raised more questions than answers over the continued attempts to rescue one major developed country which remains opposed to a developmental outcome in the domestic support pillar of the agriculture package for concluding the Doha Round trade negotiations by the end of the year.

In giving this assessment, several trade envoys told the *South-North Development Monitor (SUNS)* that at a meeting of heads of delegation (HOD), Azevedo delivered an oral report on his consultations in Paris and with the trade envoys of seven major industrialized and developing countries as well as select trade envoys on fisheries subsidies.

The DG presented a downbeat assessment, stating that a clearly defined post-Bali work programme with precise modalities by end-July is "difficult" as key members are unable to converge on the reduction commitments in the domestic support and market access pillars of the Doha agriculture package, said a South American trade envoy who was present at the meeting.

The DG said that during his consultations with seven trade envoys in two separate rounds of meetings there was

no progress on the most difficult issues – the overall trade-distorting domestic support (OTDS), the Aggregate Measurement of Support (AMS), the old and new Blue Box, and the *de minimis* support.

The seven countries are the United States, the European Union, China, India, Brazil, Australia and Japan.

The two sessions of consultations, on 11 and 15 June, were also attended by the chair of the General Council Ambassador Fernando de Mateo of Mexico, the chair of the agriculture negotiations Ambassador John Adank of New Zealand, and the chair for market access in industrial goods Ambassador Remigi Winzap of Switzerland.

Azevedo said he took part in the two rounds of meetings with the seven trade envoys in Geneva without revealing the name of the host among the seven who invited him for the consultations.

No consensus

The DG told the trade envoys that there is no consensus on the domestic support commitments as set out in the 2008 revised draft modalities.

Back in 2011, when he was Brazil's ambassador to the WTO, Azevedo had said, "The December 2008 draft modalities are the basis for negotiations and represent the endgame in terms of the landing zones of ambition. Any marginal adjustments in the level of ambition of those texts may be assessed only in the context of the overall balance of trade-offs, bearing in mind that agriculture is the engine of the Round...

"The draft modalities embody a delicate balance achieved after 10 years of negotiations. This equilibrium cannot be ignored or upset, or we will need readjustments of the entire package with horizontal repercussions. Such adjustments cannot entail additional unilateral concessions from developing countries."

However, at the HOD meeting, he ought to have but did not explain why there is no convergence on the 2008 revised draft modalities and whether he made any attempt to bring about convergence. Otherwise, his earlier statements regardless of his status would continue to stalk him in the coming days, said a trade diplomat who attended the meeting.

Without suggesting that he floated new concepts during those two meetings with the seven trade envoys, Azevedo spoke about a moving target for reducing domestic support. The DG did not elaborate what this moving target was and whose idea it was at the meeting. Azevedo added that there was no support for the moving target to reduce domestic support but did not indicate who opposed it and who supported it.

In the 2008 revised draft modalities, the then chair of the agriculture negotiations, Crawford Falconer, had suggested a comprehensive framework for reduction commitments in the domestic support pillar. There was no moving target for reducing domestic support and if anything, it was based on historical and current spending levels in the domestic support of major industrialized countries.

The DG maintained that the idea of numerical cuts from an absolute number in the OTDS was not acceptable to some of the seven participants.

The United States has a clear problem here because of its farm bill, a South American trade envoy told *SUNS*.

The US had agreed to bring its domestic support to a level around $14.5 billion in 2008 but later backtracked on that figure.

Another idea of a percentage cut in the OTDS also failed to gain consensus among the seven countries, the DG said.

Here again he ought to have indicated whose idea a percentage cut was and who opposed it, said an Asian trade official who attended the meeting.

The DG said there was also no convergence on transparency and best-endeavour commitments to create adequate mechanisms to address trade concerns arising from the OTDS.

In a similar vein, the cuts in the AMS were impossible for some members, the DG said, without indicating the names of the countries that rejected the idea.

Some countries among the seven maintained that the reduction commitments in the AMS cannot be considered in isolation, the DG said.

It is an open secret that the US is not ready to reduce its AMS because of the farm bill, the Asian envoy argued.

As regards the Blue Box commitments, some members of the seven pressed for adhering to the 2008 revised draft modalities. There was also a discussion on maintaining or eliminating the Blue Box. There is no need for the new Blue Box which was specifically created for the US in the 2004 July modalities, according to the DG, said an African trade envoy.

Azevedo said a cut in the *de minimis* is one of the biggest red lines for some countries among the seven nations.

The US wants China and India to undertake reduction commitments in their *de minimis* support.

On average tariff cut proposals and new approaches in the market access pillar, there are continued differences as some members want the 2008 revised draft modalities while some others are ready to lower the level of ambition through the average cut formula.

At present, there is no consensus on tariff rate quotas, special products and special safeguard mechanism if the average formula framework is adopted, Azevedo pointed out.

The DG also spoke about the larger "green room" meetings on fisheries subsidies and the package for least developed countries (LDCs) such as rules of origin, market access for LDC services providers, duty-free and quota-free market access, and cotton.

On fisheries subsidies, some countries want an important standing discipline as well as prohibition of most harmful subsidies, Azevedo said.

Countries also remained divided on extending special and differential treatment flexibilities, according to the DG.

Azevedo said he is going to convene dedicated meetings on cotton, rules of origin, and duty-free and quota-free market access in July.

Azevedo said the time has come for hard political decisions for finding solutions, failing which it would be difficult to make progress by the WTO's tenth Ministerial Conference in Nairobi, according to trade envoys present at the meeting. *(SUNS8045)* ❒

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Rev. 4 text must be basis, insist majority of South nations

At a recent negotiating session on agricultural market access, most developing-country WTO members maintained that the Rev. 4 draft text on reform modalities should remain the basis for the agriculture talks.

by Kanaga Raja

GENEVA: A majority of developing countries, at an informal meeting of the Special Session of the WTO Agriculture Committee on 16 June, underlined that the Rev. 4 draft agriculture modalities text should remain the basis for moving forward the negotiations in agriculture.

At the session dedicated to the issue of market access, the developing countries also called on those members who are in favour of alternative approaches to come forward and present concrete proposals.

According to trade officials, the Chair of the Committee in Special Session, Ambassador John Adank of New Zealand, welcomed the "encouraging" exchanges among members on the issue of agricultural market access. He however reported that members were "still a long way from where we should be" with regard to finalizing a work programme for the agriculture negotiations.

According to trade officials, most of the interventions at the session focused on the proposed formulae for tariff reduction.

Members especially voiced their views on an earlier communication circulated by the chair in late May in which he cited a growing willingness among members to explore alternative approaches to the tariff negotiations than those set out in the Rev. 4 text.

According to trade officials, Adank said in the communication that, in addition to proposals and ideas put forward by Argentina, Paraguay and Norway, a range of potential alternatives have been brought to his attention (he did not name the proponents of these proposals), including:

- a modified version of the tiered formula set out in the 2008 draft text (option A);
- a combination of the tiered formula plus, using the outcome of this as the starting point, a cut in the overall tariff average (option B); and
- the tiered formula plus, using the outcome of this as the starting point, an average cut of tariff lines (option C).

Need to move towards convergence

In his opening remarks at the informal meeting, the chair said the discussions he has held on these alternative approaches over the past weeks "have not revealed any clear collective preferences."

"At the risk of stating the obvious, we are at the stage where members will need to make choices in order to achieve the objectives set out for us by Ministers" of securing a work programme by the end of July for advancing the Doha Round talks, the chair said.

"Discussions now need to move to a more decisive phase," he said, noting that members have consistently drawn attention to the linkages between the market access pillars in agriculture and non-agricultural market access (NAMA) as well as to linkages among the three main agriculture pillars (market access, domestic support and export competition).

Adank said it was "clear that it won't be possible for any of these issues to be resolved in complete isolation from the others."

According to trade officials, the chair told delegations, "We urgently need to move towards convergence. We've got to know what's possible and what's impossible."

Some 40 delegations took the floor at the informal meeting, voicing their views on the state of play in the market access negotiations and on the alternative formulae cited by the chair in his communication, trade officials said.

Brazil, on behalf of the G20 grouping, Indonesia, on behalf of the G33, Egypt, for the African Group, and others said that the 2008 Rev. 4 draft text should remain the basis for further discussions.

Chile, Colombia, South Africa, Mexico, the Philippines, Pakistan, Thailand and Nigeria said they were not in a position to take a stance on the alternative formula approaches, because they either needed to carry out their own simulations first or needed a better clarification/understanding of what the alternative formulae mean.

According to trade officials, India pointed out that all the three options use the tiered formula. Hence it was difficult to digest why the tiered formula is considered not good by some but is then used in these different approaches. There is a need for clarity, India said, on whether "we want to use the tiered formula or not."

All ministerial decisions have to be respected, and the tiered formula is part of the ministerial decisions. If the formula is being dumped, the reasons for doing this have to be clear, India said.

There is also a need to clarify what the problems are with the Rev. 4 text, said India. For almost a year, it has been hearing about low ambition, but till today there are no proposals on the table. It pointed out that in fact Argentina's proposal is the only one that has been circulated formally.

India said that the opponents of the tiered formula need to come forward and state why they cannot accept this approach.

According to trade officials, India asked how special and differential treatment will be available for developing countries if the ambition is lowered. What are we lowering it against, it asked. For India, all three pillars of the agriculture negotiations have to move together; stabilizing only one pillar may not succeed. Domestic support is important for levelling the playing field, it added.

South Africa had concerns over the uneven application of the recalibration approach. On the specific proposals, it said that it is too early to make a determination and there is a need to run simulations. It is open to exploring alternative tiered formulae along the lines of average cut targets but can only decide when there is clarity on domestic support.

Clarity is needed on how provisions on special and differential treatment will be applied, it said. The proponents of the alternative approaches should put forward proposals with rationale and motivation to allow for interactive engagement. While ambition is being reduced in agriculture, ideas are being advanced in NAMA that suggest a high level of ambition in this area.

Brazil noted that many members have said that they are still considering their options, including option A. It said that there is a need for technical analysis.

On behalf of the G20, Brazil said that

an outcome in all three pillars of the agriculture negotiations is essential for an outcome to the Doha Round. The Rev. 4 text remains the basis for conversations, it added.

Indonesia, on behalf of the G33, another developing-country grouping on agriculture, said it is concerned that the approaches members are now looking at won't lead in the direction that many developing countries were looking for in the Doha Round. The promise of doable outcomes continues to be elusive, it added.

There cannot be a revisiting of virtually all aspects of the Rev. 4 text, including the stabilized parts of that text, only to find the negotiations in a more complicated position, it said. It urged members who favour alternative approaches to come forward and present concrete proposals and avoid putting members in perplexity.

Barbados, speaking for the Africa, Caribbean and Pacific (ACP) Group, said results are needed on all three pillars, and "we can't harvest market access only." Special Products (SP) and Special Safeguard Mechanism (SSM) and treatment of cotton must be integral elements. It called upon members with ideas to circulate their proposals so that they can be discussed and evaluated. The development dimension must be preserved, it said.

Benin, for the Cotton 4 grouping, said that it wants duty-free, quota-free (DFQF) market access. It called for predictable rules of origin. The difficult situation of the least developed countries (LDCs) and their constraints should guide the members. It also wants the benefits of the DFQF regime for cotton and cotton products.

Egypt, on behalf of the African Group, called for balanced and equitable outcomes on all three pillars. Subsidized exports are distorting African markets and high levels of domestic support are a concern. While it welcomed new approaches, any new approach should ensure substantial improvement in market access for developing countries and protect small-scale farmers from import surges. Flexible treatment should also be included for SP and the SSM.

New approaches on market access should address tariff escalation and tariff peaks, and whatever approach is taken should not reduce the margin of preferences that some countries currently enjoy, said Egypt. It said that it cannot accept any dilution of special and differential treatment. It encouraged the proponents of alternative approaches to table their proposals. The Rev. 4 text should remain the basis for moving the negotiations forward.

Speaking on behalf of the LDCs, Rwanda, supporting the African Group, said it is unacceptable that the agricultural reforms promised long ago are not forthcoming. It called on members to eliminate trade-distorting subsidies without conditioning this on any other element of the negotiations.

According to trade officials, China associated itself with the statements of the G20, G33 and recently acceded members (RAMs). Negotiations are at a critical juncture, it said, adding that it is fully committed to concluding the negotiations but the fundamental principles have to be preserved. Market access in particular should be fully in line with the existing mandate.

China underscored that SP and SSM shall be integral parts of the negotiations, as mandated in the 2005 Hong Kong Ministerial Conference of the WTO. Under no circumstances should these be abandoned simply because the level of ambition has been lowered. Any recalibration of the level of ambition should be based on the Rev. 4 text, which is the benchmark. China said it took note of the alternative approaches mentioned by the chair.

Argentina said that the issues of tariff peaks, tariff caps and tariff escalation, amongst others, need to be addressed as part of the market access discussions.

Against the tiered formula

According to trade officials, some members said that they cannot accept the tiered formula in the Rev. 4 text.

Australia and New Zealand said that because the alternatives being suggested would lower the ambition on market access, the flexibilities should be limited or simplified.

Australia, the US, Norway and the EU said that the LDCs and small and vulnerable economies would not be expected to make any market access commitments as part of a final Doha Round outcome.

According to trade officials, Norway, Canada and the EU said they did not believe option A would work, with Canada saying that discussions on the tiered approach had "basically been exhausted" and that consensus remained elusive.

Australia said that it favoured option B because it was more ambitious. However, it said that members it engaged with seemed more supportive of option C, a view also shared by Canada. On flexibilities for developing countries, it is prepared to consider what it can do but that conversation needs to recognize and respect the fact that these options will result in a much lower level of ambition.

According to trade officials, both the EU and the US said that recalibration of expectations is necessary to reach a deal. The EU called for recalibration because of low expectations for the outcomes in NAMA, services and the domestic support pillar of the agriculture negotiations. The US advocated recalibration due to the substantial downward revision in the level of market access ambition for the agriculture talks.

According to trade officials, the EU said that it preferred the "well-known" approach of option C, which Norway also endorsed as the simple and preferable alternative.

The EU said that it wants to deliver three messages: it will consider recalibration and the level of ambition necessary to reach a deal; it favours the average tariff cut approach; and there is a need to limit as much as possible the number of additional elements (on top of the average tariff cuts).

Recalibration is necessary if a deal is to be secured, it said. The level of market access must be calibrated with NAMA and services. In view of the state of negotiations, it has low expectations on what others can do on NAMA and services. Domestic support and market access are linked, and ambition levels need to move in parallel.

The difficulties some members have in accepting reductions augur badly for the outcome in the domestic support negotiations, the EU said, and this will have an impact on the level of ambition in market access. There cannot be a refusal to cut subsidies while expecting more to be delivered on market access, it said.

Among the three alternative approaches, option A, the EU said, is not viable for it. It supports a simpler formula and not going into the more complicated Rev. 4 text formula. It prefers option C.

According to trade officials, the US said that it "probably preferred" a simple average cut but was open to all options.

The US said that it considers the ideas by the chair in his report as a sampling of possibilities. It has considered the ideas of others including Argentina,

Paraguay and Norway. For the US, and many others, it is increasingly coming to the conclusion that the ambitions in agriculture are being substantially revised downward. That is not its hope and its past expectations have taken a hit.

The simple average cut as opposed to the cut in average was probably preferable at this point but it is evaluating the ideas, said the US. It will continue to be open to ideas as presented but consensus on meaningful cuts is elusive. Those members that continue to say that they have high expectations must do two things quickly: articulate what their high expectations are and what will be their own contributions to achieving this.

Japan said it wants a simple and realistic formula with enough flexibility, adding that there is little time left to find a compromise by the July deadline. It said that the Nairobi Ministerial Conference is the last opportunity to conclude the Doha Round.

More interactive stage

In his closing remarks, the chair said: "It's fair to say that discussions are entering a more interactive stage than in past exchanges."

"What we are seeing in some of the comments [is] that countries are moving away from maximalist positions to say that they are able to consider something that, although it might not be in their ideal interest, they could consider in order to move forward to get an agreement.

"We saw today that in a number of exchanges countries with completely different views on market access are prepared to have that discussion. And I am very encouraged by that. But we can't come to any conclusions on the overall approach."

According to the chair, many members expressed a preference for the 2008 draft text but at the same time a number of statements were made saying that unless things changed significantly, it was unlikely consensus would be reached on that text.

Members were also clear in saying they wanted to know more about what the alternatives being proposed might involve and that, if it were not possible to get consensus on the 2008 draft text, it was worth exploring what the possibilities are.

The situation regarding tariff peaks, tariff caps, tariff escalation, tariff rate quotas, safeguards and other flexibilities will impact the outcome on market access, and it was understandable members wanted to talk more about that, the chair said.

Adank said he also heard from members on the need for greater clarity on the alternative formula approaches being proposed, and said he had suggested to the WTO secretariat to prepare a background paper on tariff reduction modalities.

According to trade officials, he also suggested organizing a technical workshop after the secretariat paper is issued to discuss the issue in more detail.

The chair said he would continue working intensively with members and would convene another open-ended meeting at a date to be determined. *(SUNS8044)* ❒

Developing countries denounce recalibration approach for Doha Round

A 4 June meeting in Paris of trade ministers from 29 countries saw several developing-country ministers criticize moves to "recalibrate" the level of ambition for the Doha Round talks. *D. Ravi Kanth* reports.

GENEVA: Trade ministers of leading developing countries denounced at Paris on 4 June attempts by major developed countries to force a decision on the so-called "recalibration" approach to lower the level of ambition of the post-Bali work programme to conclude the Doha Development Agenda (DDA) negotiations later this year, several officials said.

The developing-country ministers at the meeting said the recalibration approach is aimed at pushing the most difficult issues (for developed nations), such as trade-distorting farm subsidies and other developmental issues like cotton subsidies and duty-free, quota-free market access for the poorest countries, into cold storage, a developing-country trade minister told the *South-North Development Monitor (SUNS)*.

At the informal trade ministerial meeting convened on the margins of the annual Organization for Economic Cooperation and Development (OECD) meeting in Paris, the trade ministers from India, Brazil, South Africa and Indonesia, among others, demanded a comprehensive post-Bali work programme for concluding the DDA negotiations.

In sharp opposition, major developed countries – the United States, the European Union, Japan, Australia, Canada, Switzerland and New Zealand – and some developing countries reiterated their position that the level of ambition must be recalibrated on the basis of the so-called "doability" and "realism" criterion.

The US deputy trade representative, Ambassador Michael Punke, told the 4 June meeting that Washington is pursuing the recalibration approach to bolster the efforts of the WTO Director-General Roberto Azevedo who had suggested the idea.

India's trade minister Nirmala Sitharaman delivered a strong statement at the meeting by emphasizing that the "development dimension with enhanced special and differential flexibilities" must remain at the centre of the post-Bali work programme.

"To conclude the Round on the basis of market access is unacceptable," Sitharaman told trade ministers present at the meeting.

Ambition in agriculture depends on the reform of the trade-distorting domestic subsidies based on the revised 2008 modalities, the Indian minister said. She criticized some industrialized countries for diverting attention from their trade-distorting domestic subsidy reduction commitments by raising issues that are not part of the Doha mandate.

For India, she said, issues such as "the special safeguard mechanism (SSM), the special products, the permanent solution for public stockholding programmes for food security, and the LDC package are 'must haves' in the post-Bali work programme," according to a trade official who was present at the meeting.

South Africa's trade minister Rob Davies lamented that efforts to bring about recalibration were carried out on an uneven basis in which the level of ambition in agriculture was drastically reduced while the reverse was sought to be done in market access for industrial goods. Davies said African countries need policy space for carrying out industrial policies, which will become difficult with the increase in the ambition in market access for industrial goods.

Brazil said while services and industrial goods are getting special treatment,

laggards like agriculture are left behind.

China, Brazil, South Africa and Argentina among others supported India by demanding a comprehensive post-Bali work programme for delivering the results promised in the DDA.

The United States' Punke sharply disagreed with the demands made by the developing-country trade ministers for a robust post-Bali work programme to address all issues in the three pillars of the agriculture package. He said there is little evidence of any convergence on any issue at this juncture, said an official familiar with the meeting.

The US official suggested that "red lines" of India, China and the US do not overlap. He said there are only two options open to members, said a participant who asked not to be quoted: either accept a recalibration or face failure at the tenth Ministerial Conference in Nairobi.

The EU trade commissioner Cecilia Malmstrom suggested that there is no need for extending tariff rate quotas in agriculture with the average formula approach.

"There is no realistic assessment on issues among ministers at this juncture," an EU official said.

No common ground

Kenya's foreign minister Amina C. Mohammed, who will chair the Ministerial Conference in her capital Nairobi this December, expressed sharp concern that there is no common ground among members at this juncture. She chaired the Paris meeting in the absence of the Australian trade minister Andrew Robb (who had convened the meeting).

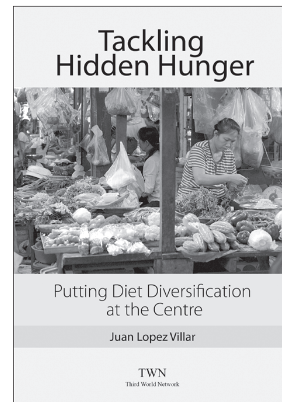
Trade ministers and senior officials from 29 countries such as Argentina, Bangladesh (LDC Group), Barbados (ACP Group), Brazil, Canada, Chile, China, Colombia, Costa Rica, Egypt, European Commission, Hong Kong-China, Iceland, India, Indonesia, Israel, Japan, Korea, Lesotho (African Group), Mexico, New Zealand, Nigeria, Norway, Senegal, South Africa, Switzerland, Chinese Taipei, Tanzania, Turkey and the United States took part in the meeting.

WTO Director-General Azevedo gave his assessment on the state of play in the negotiations following his recent consultations with trade envoys in different configurations. He said that, faced with unbridgeable differences on

(continued on page 20)

TACKLING HIDDEN HUNGER
Putting Diet Diversification at the Centre

By Juan Lopez Villar



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The scourge of "hidden hunger" or micronutrient deficiency affects around two billion people worldwide who lack adequate intake of vitamins and minerals in their diet. While several international and regional initiatives are underway to combat malnutrition, and specifically micronutrient deficiency, these have largely focused on the approaches of nutrient supplementation and food fortification at the expense of dietary diversification, considered the most durable solution to hidden hunger. The development of nutritionally enhanced genetically engineered crops, such as "Golden Rice", has further attracted controversy and raises serious biosafety concerns.

For a global strategy on nutrition to be successful, this book argues, it must place central emphasis on diversifying diets. Towards this end, sustainable farming practices based on agricultural biodiversity, such as agroecology, are key to providing the rich variety of foods that will keep hidden hunger at bay.

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US, Big Pharma pushing to end NV dispute moratorium on TRIPS

WTO member states differ over whether to allow so-called "non-violation" disputes to be raised under the ambit of the WTO's TRIPS Agreement on intellectual property rights.

by Kanaga Raja

GENEVA: The issue of the relevance and applicability of "non-violation" (NV) or "situation" claims in disputes regarding "nullification or impairment" of rights under the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) is continuing to divide the US, Switzerland and some of their supporters on one side, and on the other, the large majority of the membership at the WTO.

This became evident at a 9-10 June meeting of the WTO's TRIPS Council when it discussed the proposal by a group of developing countries that the forthcoming Nairobi Ministerial Conference declare the inapplicability of such claims and disputes in respect of the dispute settlement provisions of the TRIPS Agreement.

According to informed trade sources, differences of view persisted among members on whether non-violation complaints should be applicable under the TRIPS Agreement.

Unlike with other WTO agreements, there is currently a moratorium on bringing disputes pertaining to nullification or impairment of benefits under the TRIPS Agreement as a result of "the application by another Member of any measure, whether or not it conflicts with the provisions of this Agreement", or as a result of "the existence of any other situation". During the period of the moratorium, the TRIPS Council is mandated to examine the scope and modalities for such complaints and submit its recommendations to the Ministerial Conference, which may either accept the recommendations or extend the moratorium.

In promoting non-violation and situation claims to advance the interests of Big Pharma (and its monopoly rentier incomes) against the interests of public health and access to affordable medicines, the efforts of the US and its supporters are striking one more blow at the future of the multilateral trading system itself, according to Chakravarthi Raghavan, Editor Emeritus of the *South-North Development Monitor (SUNS)* and veteran analyst of the trading system.

History of negotiations

The non-violation and situation provisions, Raghavan notes, were smuggled into the Draft Final Act (DFA) of the Uruguay Round talks that was tabled by then GATT Director-General Arthur Dunkel in December 1991, as an outcome of negotiations in Geneva after the spectacular collapse of the Brussels Ministerial Conference to end the Uruguay Round.

The post-Brussels talks in Geneva involved small groups of interested countries; depending on the subject, the talks took place in informal groups among officials from the relevant capital-based government departments. Those who drew up detailed provisions on intellectual property (IP) had full knowledge of these issues (which till then had been dealt with by the World Intellectual Property Organization and its Paris Union and other conventions). (In bringing IP issues onto the Uruguay Round agenda, the proponents' contention was never "market access" – unlike in the areas of trade in goods and trade in services – but rather assuring global minimum standards for IP protection.)

Where agreement could not be reached in this area of negotiations, as in other subjects on the Uruguay Round agenda, Dunkel and his staff supplied "compromises" that were collated and went into the DFA text of December 1991.

It was in this process that the dispute settlement provisions in Articles XXII and XXIII of the General Agreement on Tariffs and Trade (GATT) became the dispute settlement provisions in the TRIPS part of the Dunkel DFA, and that too by reference.

The GATT's own dispute settlement provisions, including the non-violation and situation provisions, date back to the postwar talks on the Havana Charter, with its chapter on commercial policy. The commercial policy chapter, which would become the GATT, had clear provisions on the Most Favoured Nation (MFN) principle and on market access through exchange of bilateral tariff concessions that are multilateralized. All other provisions were aimed at ensuring fidelity to these principles of market access and trade liberalization, with many of the details and disciplines subsequently sketched out in the Tokyo Round and then later made part of the Uruguay Round accords.

[The Uruguay Round negotiations on services in effect were for market liberalization in the services sector, but given the variations in supply of services and competition via four modes of delivery, the application of the non-violation and situation provisions under the General Agreement on Trade in Services (GATS) differed from that in the GATT and trade in goods.]

Progress on the DFA text in the area of trade in goods was held up for a long while over US-Europe differences in agriculture. It was only in 1993, when Peter Sutherland took over from Dunkel as GATT Director-General and renewed intensive talks to conclude the Uruguay Round, that the issue of dispute settlement in TRIPS received the attention of envoys familiar with the GATT and trade dispute processes.

During scrutiny of the TRIPS section of the Dunkel text, the inapplicability to TRIPS of the original GATT non-violation and situation provisions came to the fore, raised by India and others. When the US resisted any change, India made known that it would withhold consensus on the entire Uruguay Round accord. It was only then that the moratorium on non-violation and situation complaints (in Article 64.2 of the TRIPS Agreement) was agreed.

Even in terms of the history of dispute settlement under the old GATT, the non-violation and situation concepts have been sought to be invoked only in disputes where one party felt that its expectations of market access in another party through binding tariff concessions were frustrated by other actions such as subsidization by the other party.

There has been only one GATT dispute and panel report not involving tariff concessions, but even this was not adopted, and thus has no legal status as GATT acquis, Raghavan pointed out.

Developing-country proposal

At the 9-10 June TRIPS Council meeting, Brazil, on behalf of a group of

developing countries, presented a revision of a 2002 document on non-violation and situation nullification or impairment under the TRIPS Agreement.

The paper was co-sponsored by Argentina, Bolivia, China, Colombia, Cuba, Ecuador, Egypt, India, Indonesia, Kenya, Malaysia, Pakistan, Peru, Russia, Sri Lanka and Venezuela.

The proponents of the paper said that like many WTO members, they believe that the application of non-violation and situation complaints to the TRIPS Agreement raises fundamental concerns, which they summarized in detail in their paper.

They proposed that "the Council for TRIPS recommend to the Ministerial Conference that complaints of the type provided for under subparagraphs 1(b) and 1(c) of Article XXIII of GATT 1994 [i.e., non-violation and situation complaints] shall not apply to the settlement of disputes under the TRIPS Agreement."

According to one participant who attended the TRIPS Council meeting, the paper got a lot of support from all the developing countries, while most of the developed countries reiterated their existing positions, with most of them taking shelter under the plea that their governments were yet to reach a conclusion on this.

The US and Switzerland, other sources said, were opposed to the continuance of the moratorium.

According to some sources, the US stand is related to its advocacy of the interests of its big pharmaceutical corporations and its grievance with India and a few others who do not agree to what is called "evergreening". Evergreening refers to the practice of seeking a new patent on a slight variation of an existing patented drug (even if the variation has no proven additional efficacy), thereby effectively extending the patent term. Allowing non-violation complaints could enable challenges against, for example, Indian legislation preventing evergreening.

According to trade sources, Brazil told the TRIPS Council that the paper represented the common understanding among its co-sponsors that non-violation complaints are not necessary and are inconsistent with the balance of rights and obligations under the TRIPS Agreement, and as a whole in the WTO system itself.

The co-sponsors proposed that the Council recommend to the upcoming Ministerial Conference in Nairobi that these complaints shall not apply to the settlement of disputes under the TRIPS Agreement.

A number of developing countries, including the group of least developed countries, the Africa, Caribbean and Pacific (ACP) Group and the African Group, as well as Norway and Canada among the developed countries spoke in support, said the trade sources.

The US and Switzerland continued to argue that consensus was needed to extend the period for non-application of non-violation complaints, these trade sources added.

The TRIPS Council chair was asked to consult on this matter.

Serious concerns

Speaking under this agenda item, India, one of the co-sponsors of the paper, said that serious concerns on the ambiguity, incoherence and limit on flexibilities of members due to the applicability of non-violation complaints (NVCs) in the TRIPS context continue. Neither does past GATT/WTO jurisprudence nor do explanations to the contrary allay its fears. This has reaffirmed its belief on the detrimental consequences non-violation complaints would have in the TRIPS context.

According to India, it is clear that when negotiating the TRIPS Agreement,

Strong support for LDC pharmaceuticals exemption request

Also at the TRIPS Council meeting on 9-10 June, a large majority of member states, mainly developing countries, voiced strong support for a request by the least developed countries (LDCs) for an extension of the transitional period for LDCs with regard to the intellectual property protection of pharmaceutical products, which is set to expire on 1 January 2016.

On behalf of the LDCs, Bangladesh had, at a previous TRIPS Council meeting in February, submitted the request, which calls for an extension of the transitional period "for as long as the WTO Member remains a least developed country" (see *TWE* No. 587).

The request for the extension of the transitional period also covers test data protection under Article 30.3 of the TRIPS Agreement, as well as seeking exemption from the "mailbox" (Article 70.8) and exclusive marketing rights (Article 70.9) provisions of the TRIPS Agreement.

The LDC request received wide support from health experts and civil society organizations. It has also obtained backing from UN agencies such as UNITAID, UNDP and UNAIDS as well as members of the European Parliament and generic-drug suppliers such as the IDA Foundation, a non-profit provider of generic drugs to low- and middle-income countries.

At the June TRIPS Council meeting itself, Uganda, the focal point for the LDC Group on this issue, took the floor and provided a detailed explanation of the LDC request and the need for the exemption.

According to one participant who attended the meeting, most of the developing countries supported the LDC request, while Norway, a developed country, also voiced support. On the other hand, other countries said that they are still looking at the issue, and that they need more clarity with regard to the general waiver and the specific waiver, said the trade source.

According to other informed trade sources, the LDC request received support from South Africa, Nepal, Lesotho (on behalf of the African Group), Myanmar, Cambodia, Barbados (on behalf of the Africa, Caribbean and Pacific group of countries), Tanzania, India, Mali, Cuba, Brazil, Yemen, Togo, Argentina, Sierra Leone, China, Haiti, Democratic Republic of Congo, Uruguay, Rwanda, Chile, the Holy See and the World Health Organization (WHO), as well as Norway.

The developed countries said that they are in the process of studying the request. The European Union called for a more holistic approach, saying that some issues also need to be further clarified, such as the need for a sector-specific extension when there was already a general extension, said these sources.

The TRIPS Council chair was requested to hold consultations on this matter, with the next Council meeting scheduled to take place in October. *(Kanaga Raja/SUNS8041)* ❐

non-violation complaints were made inapplicable to TRIPS under Article 64.2. This is in stark contrast to the GATT and GATS where NVCs were made applicable without any discussion on scope and modalities. This, by itself, clearly indicates the serious concern the membership had in applying NVCs in the special context of the TRIPS Agreement.

Further, said India, Article 64.3 clearly mandated that there had to be an agreement on the scope and modalities of NVCs in the TRIPS context. This, again, is not present in the context of the GATT and GATS. The entire thrust of Article 64 and the intention of the negotiators clearly shows that members viewed TRIPS in a very different way in the context of applicability of NVCs.

If this was not the case, there would have been no issue in applying NVCs like in the case of the GATT without any debate or consensus on scope and modalities. It would also not be the case of proponents of NVCs in TRIPS that the TRIPS does not envisage a consensus on scope and modalities. If NVCs were to automatically apply after a timeframe, there would be no need for Article 64.3. The fact that scope and modalities need to be discussed and agreed upon recognizes the unique nature of the applicability of NVCs to TRIPS.

The negotiators recognized this and "we must not interpret it otherwise," said India. The fears that many delegations, especially developing-country members, have expressed on the ambiguities that NVCs bring cannot be underestimated. Those fears have not been allayed by the discussion but have only strengthened, it added.

It strikes at the very ability of governments to function as well as the ability to deal with challenges to that ability. What are the circumstances in which they will be used to suppress members' sovereign policy space? What are the limits? What are the various policy measures that will come under its scanner?

India said that it is afraid that there are no satisfactory answers to it and neither will there be any.

The TRIPS Agreement lays down a delicate balance between rights and obligations of members. NVCs tilt that balance. The very nature of NVCs makes it impossible to lay down various practical scenarios on how they would impact a member's sovereign space. A new cause of action arises even when there is no textual violation of the TRIPS Agreement. Article 3.2 of the WTO's Dispute Settlement Understanding states, inter alia, that the Dispute Settlement Body's recommendations cannot diminish the rights and obligations provided in the covered agreements. The applicability of NVCs to TRIPS will widen the rights and obligations of the members under the TRIPS Agreement beyond the express terms of the agreement. This is how the delicate balance that now exists will inevitably be affected, said India.

The ambiguity and lack of clarity that NVCs will usher in the TRIPS context will especially affect developing and least developed countries severely. Lack of legal capacity to handle such cases will be a serious issue. It would inevitably lead to addition of litigation cost. The vast array of measures that will suddenly be open to potential challenge will be insurmountable.

India believes that this is an unnecessary burden that was not intended by the TRIPS Agreement. India requested members to seriously reflect on the concerns expressed by an overwhelming number of delegations in the TRIPS Council meeting and earlier. They should join the consensus that complaints on the grounds of nullification or impairment of the type identified in Article XXIII:1(b) and (c) of the GATT 1994 be determined inapplicable to the TRIPS Agreement, in the interest of the stability and certainty of the multilateral system.

Inappropriate application

Also speaking under this agenda item, Nepal said that in its understanding, the application of NVCs, originally a GATT provision, fits only in trade in goods and services but not in any *sui-generis*-type system like TRIPS. As NVCs are basically related to the market access issue, it has less possibility and less relevance of application with regard to the TRIPS Agreement, which basically intends to provide minimum protection to IP-related instruments.

Application of NVCs in the TRIPS regime is inappropriate and will reduce flexibility and policy space of many developing countries in general and least developed coutnries in particular, and prevent them from pursuing developmental goals through legitimate exercise of policy choices in the field of IP, Nepal added.

Nepal said it cannot support any idea to bring the non-violation and situation complaints issue within the ambit of TRIPS as has been argued by some members. It expressed deep concern over the views expressed by some delegations that the Nairobi Ministerial Conference should end the moratorium given so far in this regard, which in its understanding "does not reflect the sentiment of majority of developing and [least developed country] members."

In supporting the paper put forth by the developing-country members, Nepal called upon the TRIPS Council to recommend to the Nairobi Ministerial Conference that complaints of the type provided for under sub-paragraphs 1(b) and 1(c) of Article XXIII of the GATT 1994 shall not apply to the settlement of disputes under the TRIPS Agreement. *(SUNS8042)* ❐

Rights experts voice concerns over BITs and FTAs

A group of UN rights monitors have drawn attention to the potential adverse effects of trade and investment treaties on human rights protection.

by Kanaga Raja

GENEVA: A group of United Nations experts has voiced concerns over the potential detrimental impact that free trade and investment agreements such as the Trans-Pacific Partnership (TPP) and the Transatlantic Trade and Investment Partnership (TTIP) may have on the enjoyment of human rights.

In a statement issued on 2 June, the Independent Experts and Special Rapporteurs of the UN Human Rights Council stressed that ex ante and ex post human rights impact assessments should be conducted with regard to existing and proposed bilateral investment treaties (BITs) and free trade agreements (FTAs).

The experts further expressed concern about the secret nature of drawing up and negotiating many of these agreements and the potential adverse impact of these agreements on human rights.

The human rights experts include Alfred de Zayas, Independent Expert on the promotion of a democratic and equitable international order; Catalina Devandas Aguilar, Special Rapporteur

on the rights of persons with disabilities; Dainus Puras, Special Rapporteur on the right of everyone to the enjoyment of the highest attainable standard of physical and mental health; Farida Shaheed, Special Rapporteur in the field of cultural rights; Gabriella Knaul, Special Rapporteur on the independence of judges and lawyers; and Hilal Helver, Special Rapporteur on the right to food.

Also included in the group issuing the statement are: Juan Bohoslavsky, Independent Expert on the effects of foreign debts and other related international financial obligations of states on the full enjoyment of all human rights, particularly economic, social and cultural rights; Leo Heller, Special Rapporteur on the human right to safe drinking water and sanitation; Victoria Lucia Tauli-Corpuz, Special Rapporteur on the rights of indigenous peoples; and Virginia Dandan, Independent Expert on human rights and international solidarity.

Potential detrimental impact

In their statement, the rights experts said: "While trade and investment agreements can create new economic opportunities, we draw attention to the potential detrimental impact these treaties and agreements may have on the enjoyment of human rights as enshrined in legally binding instruments, whether civil, cultural, economic, political or social."

Their concerns relate to the rights to life, food, water and sanitation, health, housing, education, science and culture, improved labour standards, an independent judiciary, a clean environment and the right not to be subjected to forced resettlement.

The statement said that as also underlined in the UN Guiding Principles on Business and Human Rights, states must ensure that trade and investment agreements do not constrain their ability to meet their human rights obligations (Guiding Principle 9).

"Observers are concerned that these treaties and agreements are likely to have a number of retrogressive effects on the protection and promotion of human rights, including by lowering the threshold of health protection, food safety, and labour standards, by catering to the business interests of pharmaceutical monopolies and extending intellectual property protection."

According to the rights experts, there is a legitimate concern that both bilateral and multilateral investment treaties might aggravate the problem of extreme poverty, jeopardize fair and efficient foreign debt renegotiation, and affect the rights of indigenous peoples, minorities, persons with disabilities, older persons and other persons living in vulnerable situations.

"Undoubtedly, globalization and the many Bilateral Investment Treaties (BITs) and Free Trade Agreements (FTAs) can have positive but also negative impacts on the promotion of a democratic and equitable international order, which entails practical international solidarity," they said.

Investor-state disputes

The UN experts further noted that investor-state dispute settlement (ISDS) chapters in BITs and FTAs are also increasingly problematic, given the experience of arbitrations conducted before ISDS tribunals. "The experience demonstrates that the regulatory function of many States and their ability to legislate in the public interest have been put at risk," the rights experts underlined.

The experts believe the problem has been aggravated by the "chilling effect" that intrusive ISDS awards have had, when states have been penalized for adopting regulations, for example, to protect the environment, food security, access to generic and essential medicines, and reduction of smoking, as required under the WHO Framework Convention on Tobacco Control, or raising the minimum wage.

"ISDS chapters are anomalous in that they provide protection for investors but not for States or for the population. They allow investors to sue States but not vice-versa," said the statement.

The adoption in 2014 of the UN Convention on Transparency in Treaty-based Investor-State Arbitration is an important step to address the problem of the typically confidential and non-participatory nature of investor-state agreements. "Greater transparency should serve to remedy incoherence between current modes of investment with human rights considerations."

The experts invited states to revisit the treaties under negotiation and ensure that they foster and do not hinder human rights.

"If the treaties in question include a chapter on investor-State dispute settlement, the terms of reference of the arbitrators must be so drafted that interference in the domestic regulation of budgetary, fiscal, health and environmental and other public policies [is] not allowed."

Moreover, arbitration tribunals should allow public review and their awards must be appealable before the International Court of Justice or a yet-to-be-created International Investment Court working transparently and with accountability.

There must be a just balance between the protection afforded to investors and the states' responsibility to protect all persons under their jurisdiction, said the experts.

The experts recommended that all current negotiations of bilateral and multilateral trade and investment agreements should be conducted transparently with consultation and participation of all relevant stakeholders including labour unions, consumer unions, environmental protection groups and health professionals.

In addition, all draft treaty texts should be published so that parliamentarians and civil society have sufficient time to review them and to weigh the pros and cons in a democratic manner.

"The Parties should detail how they will uphold their human rights obligations if they ratify the BITs and FTAs under negotiation."

Given the breadth and scope of the agreements currently under negotiation, robust safeguards must be embedded to ensure full protection and enjoyment of human rights, the experts said. *(SUNS8034)* ❐

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FSB financial reform monitoring reports lack focus on EMDE problems

Assessments by the international Financial Stability Board of the impact of global financial reforms have accorded less attention to problems of design and implementation in developing than in developed countries.

by Andrew Cornford

The monitoring reports of the Financial Stability Board (FSB) on the impact of the implementation of the global reform agenda on emerging market and developing economies (EMDEs), while indicating both progress and concerns about future problems and some preliminary conclusions, have several shortcomings, with less attention given to design and implementation in developing countries, illustrated here with the issue of exposure to currency risk in EMDEs.

Since June 2012 [in a report prepared in collaboration with the International Monetary Fund (IMF) and the World Bank] and in two subsequent reports, the FSB has monitored the consequences for EMDEs of the reforms agreed as part of the international reform agenda (FSB, 2012; FSB, 2013; FSB, 2014a). Parallel monitoring of Basel III is described in a report of the Basel Committee on Banking Supervision (BCBS) (BCBS, 2014a). An important objective of this monitoring is to check whether the consequences have been those intended by the agenda's framers.

These reports indicate that implementation of the reform agenda has so far progressed without major hitches. However, their conclusions are still preliminary and the progress observed has been accompanied by concerns as to eventual future problems. Moreover the FSB reports are subject to the shortcoming that the countries to which the conclusions refer are not specified. Similarly the lack of identification of the banks included means that there is no way of being sure how far the reports' conclusions apply to both domestic banks in EMDEs and cross-border banks.

As is common in reports of this kind, less attention is given to typical problems of design and implementation in developing than in developed countries. A problem of this kind of considerable importance to many EMDEs is exposure to currency risk, an issue treated at length here.

Reports of 2014

The FSB report of November 2014 (FSB, 2014a) was followed shortly afterwards by a BCBS report on the implementation of Basel II and Basel III in EMDEs (BCBS, 2014a). The latter contains both findings and recommendations of the Basel Consultative Group (BCG), the main outreach group of the BCBS. The BCG membership consists of selected national regulators and supervisory bodies, regional groups of supervisors, and international financial institutions.

The November 2014 report of the FSB is upbeat about progress with the reform agenda in both EMDE member countries of the G20/FSB (Argentina, Brazil, China, India, Indonesia, Republic of Korea, Mexico, Russia, Saudi Arabia, South Africa and Turkey) and a number of other unspecified EMDEs.

On Basel III the concerns of EMDEs raised in the FSB report relate principally to three areas. Firstly, there is a fear that differences in the risk weights applied to the same exposure to EMDEs by different units of a cross-border bank may be the source of inconsistent and possibly higher capital requirements or lending to such countries. In the case of global systemically important banks (G-SIBs), attention is drawn to the possibility that changes in banks' capital requirements will be accompanied by withdrawal from certain banking activities owing to the capital surcharge for G-SIBs. Moreover there is concern that limits in some EMDEs on the supply of the high-quality liquid assets (HQLA) required for meeting Basel III's liquidity rules may mean that these rules have adverse effects on the liquidity of local financial markets and on their continuing development. Finally misgivings are expressed by EMDEs concerning the impact of Basel III on the provision of long-term investment finance.

Uncertainty amongst EMDEs as to the way in which the reforms will pan out for large cross-border banks is not limited to Basel III. There is also concern as to the effects of group-wide resolution plans for G-SIBs and of the rules for total loss-absorbing capacity (TLAC), which belong to the agenda of the FSB. The first covers the distribution of losses attributed in resolution after insolvency to different categories of G-SIBs' liabilities. The second specifies the level and character of loss-absorbing liabilities prescribed for G-SIBs (including but also over and above the capital requirements of Basel III). With the exception of China, there are no banks designated as G-SIBs in EMDEs, but both of these reforms will inevitably affect the lending and other exposures of these institutions to EMDEs.

EMDEs which are members of the FSB and are implementing the G20 commitments on reforms of over-the-counter (OTC) derivatives markets stress the need for adequate cross-border regulatory coordination if the reforms are to be successful – a point which equally applies to members of the FSB which are advanced economies. EMDEs outside of the FSB which are not implementing these reforms in their local markets believe that they may nonetheless be affected by spillover effects of reforms in advanced economies and may have difficulty in designing appropriate policy responses owing to their lack of relevant technical sophistication.

Concerns in these areas reflect unease among EMDEs – apparently inside as well as outside the G20/FSB – as to the degree to which they are adequately involved in both the design of the resolution plans and the implementation of the reform agenda.

The reform process in advanced economies has already led to initiatives regarding the structural reform of banks in advanced economies involving separation of core commercial banking activities – such as payments and retail banking – on the one hand, and participation in investment banking and other capital-market activities on the other. The separation is being, or is to be, achieved through outright prohibition of certain activities or subsidiarization in legally separate entities. The initiatives in this direction are still ongoing.

Although EMDEs acknowledge the contribution to greater financial stability which structural reforms are intended to make, they are also concerned about possible effects in the form of decreased liquidity in certain markets (such as those for sovereign debt), regulatory arbitrage and leakage to the shadow-banking system. Moreover the structural reforms may complicate the supervision of the local units in EMDEs of banks affected.

As might be expected in an impact assessment of this kind, EMDEs draw attention to shortages of qualified staff for bank supervision. These result both from absolute scarcities of people with the required skills and from the frequently greater financial incentives for such people in the private sector. Such shortages have been a recurring concern of EMDEs since the early stages of the design and implementation of Basel II.

Reports of 2012 and 2013

Many of the points in the FSB report of November 2014 had already been raised in September 2013 and at greater length in June 2012. In these two earlier reports (FSB, 2012; FSB, 2013), several points raised by EMDEs (as in that of 2014) were related to possible future effects rather than impacts which had actually been observed. In the case of Basel III, replies focused on the possible unfavourable effects on lending of higher capital requirements, the need for coordination of risk management practices between entities in the parent and host countries of cross-border banks, and shortages of the HQLA required for meeting Basel III's liquidity rules. There was also criticism of the reliance on the index of the credit-to-GDP ratio for the activation of Basel III's countercyclical capital buffer owing to the widespread experience in EMDEs of larger swings in the cycles of credit and growth than in advanced economies.

The FSB reports of both June 2012 and September 2013 noted that the level and composition of capital in many EMDEs left them well placed to meet the capital requirements of Basel III. The maintenance by banks in EMDEs of capital levels in excess of internationally agreed minima was viewed as reflecting the higher degree of macroeconomic volatility and overall risk in these jurisdictions.

The relatively high capital levels are evident in figures for financial soundness indicators for 213 countries at the end of 2009 in a report of the FSB, IMF and World Bank for the finance ministers and central bank governors of the G20 in October 2011 (FSB, IMF and World Bank, 2011: 45). The average ratio of regulatory capital to risk-weighted assets was 17% for EMDEs compared to 14% for advanced economies. Data published annually for the *Banker 1000* banks in more than 100 countries are consistent with this picture.

Implementation of Basel II and Basel III according to the BCBS/BCG

The report of the BCBS/BCG on the impact and implementation challenges of Basel II and Basel III for EMDEs and small economies (BCBS, 2014a) is less an account of impacts than a listing of problems which have arisen under headings of the Basel framework and a set of recommendations for solving them.

The coverage of this report is organized under the following headings: Basel capital framework, Basel liquidity framework, OTC derivative market reforms, sovereign exposures, domestic systemically important banks, and cross-border supervisory colleges. Underlying the findings and recommendations of the report is the view that countries should move towards a version of the Basel framework incorporating most of the framework's rules. Although there are references to the need in some countries to take account of local conditions, these references are mostly not fleshed out and limited attention is given to problems likely to prove of greater importance in many EMDEs than in advanced economies.

Some examples of the report's findings and recommendations are the following:

- Basel 2.5 (the revised version of the capital framework targeting weaknesses identified at an early stage of the implementation of Basel II regarding the rules for market risk and securitization) has led to increases in risk-weighted assets for exposures to market risk in the financial markets of EMDEs but estimation of the scale of these exposures is decided solely by parent banks and their home-country supervisors. The key recommendation of the BCG is the need for further guidance from the BCBS concerning the treatment of consolidated exposures.
- When adopting Basel II and Basel III banks may conceal some of the risks in their balance sheets or pressure supervisors to approve internal ratings-based (i.e., model-based) approaches to estimating exposures when neither the bank nor the supervisor is ready. The BCG recommends that EMDEs should themselves set priorities for ensuring robustness, reliability and transparency in the adoption of Basel standards.
- A mechanistic implementation of the countercyclical capital buffer of the capital requirements of Basel III (reflected in a trigger based purely on the country's credit-to-GDP ratio) could have negative consequences owing to the lack of the necessary supervisory tools in some EMDEs and to inadequate experience dealing with fluctuations in aggregate credit. Here the BCG also recommends that examples of other macroprudential tools for controlling excessive fluctuations in credit should be explicitly set out in the text of the Basel capital framework.
- Attention is drawn to countries whose banking sectors combine large cross-border and smaller, less sophisticated institutions. The BCG acknowledges that Basel II and Basel III were designed primarily for the former. It recommends that regulatory and supervisory problems involving the former should be resolved on the basis of relationships with their parent authorities. However, there is no reference to experience which has indicated that effective relationships of this kind may be difficult to develop. Corresponding recommendations for the smaller, less sophisticated institutions are not provided.
- The challenges of implementing the Basel III liquidity framework (a concern of the FSB reports mentioned earlier) lead the BCG to recommend a quantitative impact study for EMDEs specifically designed to facilitate their implementation of the liquidity framework.
- The BCG acknowledges that attempts by banks in EMDEs to meet the levels of HQLA required by Basel III's liquidity coverage ratio may lead to concentration of risk in the form of excessive exposure to sovereign debt and to increased currency risk due to resulting imbalances between assets and liabilities denominated in foreign and domestic currencies (the latter an issue treated at length below). The BCG's principal recommendations are full use of the flexibility provided by the rules of the liquidity coverage ratio and careful supervisory monitoring.

● The BCG also acknowledges that the liquidity rules of Basel III are currently encouraging the holding of liquid reserves in cross-border banking groups at the level of the parent institution, causing uncertainty as to how the reserves would be made available to foreign branches and subsidiaries when they are needed. The BCG recommends the development of understandings on the subject between home and host supervisors as well as encouragement by the BCBS of a wider sense of responsibility within groups for group-wide banking operations. Perhaps more trenchantly, the BCG notes that, absent supervisory coordination, acceptance may be necessary of requirements by host supervisors that branches and subsidiaries maintain minimum levels of liquidity in their jurisdictions at all times.

Further revisions of Basel III

Basel III is continuing to be subject to revisions. In a report to the G20, the BCBS acknowledges that its studies have shown that there are material variations in banks' risk-weighting of assets for the purpose of estimating capital requirements for credit, market and operational risks. An analysis in *The Banker* shows that for four United States universal banking groups (JPMorgan, Bank of America, Citigroup and Wells Fargo) risk-weighted assets were equivalent to 58% of total assets unadjusted for risk in 2012, whereas for the top five European banks by size of assets (HSBC, Deutsche Bank, Credit Agricole, BNP Paribas and Barclays) the same ratio was 27.5% (Alexander, 2013).

Such variations can be ascribed only partly to variations in the riskiness of these banks' portfolios. These may also reflect to a significant extent variation in supervisory standards and banks' own risk management. They nonetheless undermine confidence in the rules for regulatory capital, and are in contradiction with the Basel framework's objective of enhancing the equality of the conditions in which banks compete.

In response the BCBS is undertaking a review of not only the different approaches in Basel III to credit, market and operational risk but also the models used in the more sophisticated approaches to risk estimation. The effect of these changes is to be reinforced by improved guidelines which target in particular the lack of consistency (and thus comparability across different banks) regarding both the form and the granularity of information which banks disclose.

Some other recent revisions of Basel III are in the direction of restraining national discretion (BIS, 2015). As the BCBS puts it, "National discretion allows countries to adapt the Basel standards to reflect differences in local financial systems. However, the use of national discretion can also impair comparability across jurisdictions and increase variability in risk-weighted assets."

Amongst the changes are the following: shortening the transition period for the application of flexibility in the recognition of collateral for past-due loans; less flexibility in the definition of retail exposures; abolition of the transitional period during which more flexible arrangements for data and rating systems used in the internal ratings-based approach are permitted for corporate, sovereign, bank and retail exposures; tightening the rules concerning standards for ratings used in the internal ratings-based approach for exposures to corporates, sovereigns and banks; and removal of the mention of a supervisory requirement for external audits of a bank's rating assignment process and estimation of losses.

As already mentioned, while the recommendations of the 2014 report of the BCBS/BCG recognize the importance of local conditions for the way in which the framework is implemented, their thrust nonetheless emphasizes steps for moving towards as full as possible an implementation. This is a trait shared by the future programme of the BCBS. Acknowledgement of the problems which countries with less developed banking sectors will have in applying rules of a framework designed principally with the risks of more sophisticated banks in mind now seems less than in the original text of Basel II which, for example, devoted Annex 11 to the Simplified Standardized Approach. This annex assembled in one place the simplest options for calculating risk-weighted assets (BCBS, 2006).

Exposure to currency risk in developing countries

The Basel capital framework is often charged with taking insufficient account of conditions and problems in EMDEs and other developing economies which are less salient in advanced economies. The relevance of such conditions and problems is acknowledged in the commentary of international financial institutions but discussion has tended to be summary.

One such issue is exposure to foreign-exchange or currency risk in such countries. The issue did figure in a report on financial stability in EMDEs in 2011 (FSB, IMF, World Bank, 2011). Here were listed not only administrative and prudential measures for dealing with currency risks but also examples of their use by EMDEs. Nonetheless the subject is only briefly mentioned but not given extended treatment in the reports on the impact of the reform agenda on EMDEs.

Currency risk manifests itself in the balance sheets and payments obligations associated with the liabilities not only of banks but also of the borrowers to which banks are exposed through their lending. Depreciation of a country's currency – due, for example, to capital outflows – exposes both its banks and its non-banks to currency risk through its effects on liabilities in relation to assets, when there is no matching of assets and liabilities denominated in foreign exchange, and on the domestic-currency value of payments obligations due on debts denominated in foreign currency. Appreciation of the country's currency can also be a problem but will not be considered in this article owing to its more remote connection to banking risks in EMDEs.

For banks the impact of currency depreciation is reflected in both its banking book and its trading book. The banking book contains assets and liabilities associated with commercial banking operations or intended to be held to maturity as a source of income. Balance-sheet items in the trading book, on the other hand, are held with the intention of reselling them in the short term to take advantage of changes in asset prices and interest rates.

The distinction between trading and banking books underlies the approach of the Basel capital framework to currency risk. The exposure to currency risk associated with positions in the trading book attracts capital requirements set in accordance with the separate rules for market risk (BCBS, 2006: 179-182 and 191-202). Exposures to currency risk (or its absence) associated with standard commercial banking operations, especially their funding, which would normally be classified as belonging to the banking book, are not the subject of

special treatment in the Basel capital framework analogous to that of the currency risk in the trading book. Exposures in the banking book affected by fluctuations in exchange rates are translated into their equivalents in domestic currency on the basis of applicable accounting rules (which may of course vary between jurisdictions). Capital requirements corresponding to these exposures are then calculated in the standard way for credit and operational risk.

More detailed attention to short-term currency risk is provided in the liquidity framework of Basel III (BCBS, 2010: paras. 172-176). The inclusion of a metric on this subject "is meant to allow the bank and supervisor to track potential currency mismatch issues that could arise in a time of stress". The Foreign Currency Liquidity Coverage Ratio (LCR) – the metric specified – is the ratio of the stock of high-quality liquid assets in each significant currency to the total net cash outflows over a 30-day time period in each significant currency. This is simply the same metric used for measurement and control of a bank's overall liquidity position but here applied serially to the different currencies on its balance sheet. According to the metric the amount of estimated total net foreign-exchange outflows should be net of foreign-exchange hedges.

The metric is not a standard with an internationally defined minimum threshold. Setting standards is to be the task of different jurisdictions' supervisors based on their views as to what constitutes stress. These views should follow from an evaluation of "banks' ability to raise funds in foreign currency markets and the ability to transfer a liquidity surplus from one currency to another and across jurisdictions and legal entities". The ratio should be higher for currencies for which these abilities are assessed as limited.

How do such rules fit into what is known about actual bank practices regarding exposure to currency risk?

Large cross-border banks typically act as dealers in foreign exchange and have units which run this part of a bank's operations. The individuals who run these units may take speculative positions in different currencies within limits set by the bank. The risk of these positions will presumably be treated as part of management of market risk in accordance with Basel III (BCBS, 2006: 179-182 and 191-202).

Funding for the commercial banking operations of such banks, on the other hand, will be conducted in accordance with internal rules designed to avoid large open currency positions and to ensure close matching of positions in different currencies. With the implementation of Basel III these rules can be expected to include application of the metric of its Foreign Currency Liquidity Coverage Ratio as set by national supervisors.

Various arrangements are used by the banks of advanced economies as part of minimization of exposure to short-term currency risk. The best known of the arrangements for controlling short-term currency risk is the Continuous Linked Settlement (CLS) Bank. However, less is known about the use of these or other similar arrangements by EMDE banks.

Surveys of foreign-exchange settlement have been periodically conducted by central banks for the Committee on Payment and Settlement Systems (since renamed the Committee on Payments and Market Infrastructures) of the Bank for International Settlements. In the surveys banks are not classified by the country of the parent institution but it is reasonable to assume that the great majority are located in advanced economies.

Settlement through the CLS Bank is payment-versus-payment (PVP), i.e., the bought currency is paid out only when the sold currency is received, an arrangement which virtually eliminates principal risk. The CLS Bank holds accounts at the central banks of the countries whose currencies are eligible for its operations. At the time of the 2006 survey 69% of the total value of foreign-exchange obligations of the institutions included in the survey (obligations between CLS institutions and between CLS institutions and third parties) were settled by this method (Committee on Payment and Settlement Systems, 2008: 4-5). The importance of the CLS Bank, which is owned by 69 large financial groups with about 170 financial entities as participants in its settlement system, has increased since 2006 (Scott and Gelpern, 2012: 700-702).

The most widely used alternative settlement method is traditional correspondent banking. Under this method each counterparty to a foreign-exchange transaction transfers to the other the currency it is selling, generally using their respective correspondent banks in the currencies concerned. Since the currency transfers take place independently of one another, the method exposes the counterparties to principal and liquidity risk. Other arrangements with lesser coverage by jurisdictions and institutions are also used to control short-term exchange settlement risk.

The currency risk associated with foreign-exchange settlement is the short-term exposure associated with the settlement transaction itself. Longer-term currency exposures are not covered.

While those responsible for funding strategies in the banks of advanced economies do take open positions which expose them to currency risk, these positions are mostly accompanied by hedging strategies which reduce or control the risk. Such strategies are facilitated by the availability of hedging instruments in the financial markets to which they have straightforward access (and which would reduce exposure according to the metric of the Basel liquidity framework). But the strategies are not covered by reporting systems like those for exchange settlement.

The proportion of short-term foreign-exchange transactions of EMDE banks settled through the arrangements described above is not known. It is reasonable to assume that cross-border banks with a presence in EMDEs and the correspondent banks of local EMDE banks use both the CLS Bank and traditional correspondent banking. Moreover several EMDEs have domestic payments systems through which resident banks, foreign as well as domestic, can settle mutual transactions denominated in foreign currency. But the absence of data impedes a comprehensive picture.

Nevertheless, the taking of open currency positions as part of the funding of banks in EMDEs and other developing countries appears to be fairly common, especially in countries where domestic rates of inflation higher than the rates of depreciation of the currency favour the value of assets in relation to that of liabilities. Attention is drawn to such cases by two analysts of bank credit with extensive experience of Asia (Golin and Delhaise, 2013: 672-674 and 713). While such positions will be brought under tighter control when supervisors introduce as part of their monitoring the Foreign Currency Liquidity Coverage Ratio of the Basel III liquidity framework, they are still likely to feature in banking operations in many EMDEs.

Such open currency positions help to explain the continuing concern with exposure to currency risk in EMDEs and other developing countries in conditions of large capital movements and unstable exchange rates such as those occasioned by actual or expected changes in monetary policy in major advanced economies, especially the United States. Even after the introduction by supervisors of the metric of the Basel III liquidity framework, greater vulnerability to currency risk in EMDEs than in advanced economies is likely to prove a problem which merits more attention and monitoring in reports on the imple-

mentation of the international reform agenda.

The reasons for the persistence of greater vulnerability in EMDEs are implicit in the remarks in the Basel III liquidity framework about the variation in the levels of the Foreign Currency Liquidity Coverage Ratio appropriate for different jurisdictions. Such variation will reflect differences in banks' access to foreign-currency financing and their ability to transfer liquidity surpluses between currencies and jurisdictions. Banks in EMDEs will generally be less well placed to manage their exposure to currency risk under both of these headings. Moreover the capacity of their central banks to provide foreign currencies to their countries' banks in periods of stress as an alternative to financial markets is also likely to be limited since during such periods the central banks may experience pressure on their foreign-exchange reserves and their own access to borrowing foreign currencies.

Policy guidelines on exposure to currency risk in the banking book could prescribe more comprehensive analysis of mismatches of currency exposures than that of the Foreign Currency Liquidity Coverage Ratio of the Basel III liquidity framework as currently drafted. This could take the form of a more comprehensive currency gap analysis, combining maturity mismatches of assets and liabilities with their currency denomination, extending beyond the short period of the Basel III liquidity framework. The difficulty of such analysis in practice should not be underestimated, especially in the case of banks with multiple cross-border operations. However, such an analysis by a bank should itself serve as a vehicle for improving its risk management.

Exposure to currency risk in the banking book could also be given more explicit treatment in the text of the Basel capital framework. Controlling such exposure (with a cross-reference to the liquidity framework) could be explicitly included in Pillar 2 of Basel III (the Supervisory Review Process) under comprehensive assessment of risks for the purpose of sound capital assessment, whose elements are specified as including the following: policies and procedures designed to ensure that the bank identifies, measures and reports all material risks; a process that specifies capital adequacy goals with respect to risk; and a process of internal controls, reviews and audit to ensure the integrity of the overall risk management process (BCBS, 2006: paras. 731-742). Currently the comprehensive assessment of risk has headings for credit risk, operational risk, market risk, interest rate risk in the banking book, liquidity risk and other risks. The last of these headings could be expanded to include full, explicit coverage of currency risk not covered as part of market risk.

Indirect currency exposure and credit risk

How would a more fully developed approach to currency risk accommodate that to which a bank is exposed via the currency-risk exposure of borrowers from it with loans in a foreign currency which has appreciated, thus making repayment obligations more onerous if the borrowers' revenues or incomes are in domestic currency?

The risk to the bank in such cases should be classified as credit rather than as currency risk since the risk to the bank is of borrowers' non-payment of their increased loan obligations. Non-payment of the obligations specified in the original loan contract may result from government action to lower them by fiat through, for example, redenomination in domestic currency on the basis of an exchange rate more favourable to borrowers than the appreciated market rate. Instances of such redenomination have accompanied depreciations of the local currency in some countries.

One way of handling the indirect exposure of a bank to credit risk stemming from the currency risks incurred by its counterparties could be through a supervisors' advisory which could also be part of the comprehensive assessment of risks prescribed in Pillar 2 of Basel III. Such an advisory would be consistent with the statement of the BCBS that "While the Committee recognizes that not all risks can be measured precisely, a process should be developed to estimate risks" (BCBS, 2006: para. 732), which would now include not only different categories of currency risk to the bank but also credit risk resulting from the currency denomination of the liabilities of a bank's borrowers – and not just to its own balance sheet.

The study of the FSB, IMF and Word Bank cited earlier (FSB, IMF and World Bank, 2011: 30) draws attention to the useful role which can be played by stress testing in alerting banks in EMDEs and other developing countries under the heading of indirect currency risk. This recommendation presupposes a certain level of technical capacity of both banks and their supervisors.

Broadening the approach to banking and other financial reforms

As mentioned above, the recommendations of the report of the BCBS/BCG on Basel II and Basel III presuppose pretty complete implementation of these frameworks. But such recommendations raise questions as to universal appropriateness of the rules of this framework.

In 2006 the BCBS expressed the belief that "the revised Framework [at that date Basel II] will promote the adoption of stronger risk management practices by the banking industry, and views this as one of its major benefits" (BCBS, 2006: para. 4). This belief was to be belied by revelations concerning banks' conduct before the current financial crisis and their role in triggering it.

There is now a widespread view that – as expressed by a senior credit risk officer at the Northern Trust in London – "Although Basel II cannot be blamed for the current crisis, the view of risk management that it represents was a contributing factor" (Lumley, 2013: 691-695). What is being targeted in this observation is overreliance on statistical methods and methodologies, an overreliance which critics feel has been encouraged by Basel II and Basel III.

The reaction to the crisis of the BCBS has in fact included not only more stringent quantitative rules but also a new edition of its recommendations for the corporate governance of banks as well as an updating and extension of the BCBS's *Core Principles of Effective Banking Supervision.* Nevertheless, the primary focus of the Basel capital framework remains the quantitative rules.

This focus would appear to be connected to the decision of the BCBS since the 1996 Market Risk Amendment of Basel I progressively to elaborate the rules of the Basel capital framework to cover banking risks posed by innovations and other changes in banking practice as they come to be widespread amongst major banks. Such an approach has been itself a considerable challenge to regulators and has arguably been responsible for much of the complexity targeted by critics of the Basel capital framework.

The approach has had the consequence that the elaboration of the Basel capital framework continues to be driven primarily by the weaknesses in the global financial system highlighted by the current crisis – as well as by longstanding problems of risk management and capital requirements of the banks in advanced economies. Reticence on the part of the BCBS regarding an extension of the Basel capital framework in direc-

tions not currently covered probably also reflects one of the framework's original objectives, namely "maintaining sufficient consistency that capital adequacy regulation will not be a significant source of competitive inequality among internationally active banks" (BCBS, 2006: para. 4). The appropriateness of such reticence is now questionable since the Basel capital framework is no longer intended only for a small group of internationally active banks with parent institutions located in the advanced economies but for more global application.

The agenda of the FSB transcends that of the BCBS but is vulnerable to the same criticism that it reflects primarily responses to flaws highlighted by a financial crisis originating in advanced economies. The FSB has recently shown sensitivity to criticism concerning the lopsidedness of its agenda and its work.

An indication of such sensitivity is the FSB's brief report to the G20 Brisbane Summit in November 2014 on the structure of its representation (FSB, 2014b). The report proposes enhanced representation of EMDEs in plenary meetings of the FSB, greater use of the existing flexibility in the FSB's charter to enable non-member authorities to be involved in the work of the FSB's committees and working groups, better integration of the Regional Consultative Groups into the work of the FSB, and sharpening the FSB's focus on EMDE issues.

The last of these proposals bears most clearly on the issues discussed in this article. As the report puts it, "The FSB should continue to seek to identify policy and implementation issues of most relevance to EMDEs and ensure that they are addressed as part of the FSB's global work" (FSB, 2014b: 3). This goal is to be the subject of an Emerging Market Forum in early 2015. Past experience nonetheless suggests that the required shift in the focus of the FSB's work towards more inclusiveness regarding the concerns of EMDEs will require not only good intentions but also in some respects a change in mindset. The shift in the FSB's focus is thus likely to be gradual. ❒

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the elements to be pursued in the post-Bali work programme, there is no deal as of today.

In her statement, the Kenyan minister Mohammed gave her assessment both on the process-related issues and on the substantive items that must be included in the work programme.

She urged the trade ministers to provide the "focus and direction" to ensure that there is no slippage in the process.

Mohammed said "we must get the business of the WTO done by working in workable, different, but complementary formats and configurations linked to transparency exercises in plenary meetings at appropriate moments."

On substance, she said, the post-Bali work programme must be "realistic, balanced, and which modernizes and updates the WTO negotiating agenda and puts the WTO back in centre field."

The Kenyan minister said "the work programme should be substantively robust, reflect the fundamentals in the Doha agenda and issues that will ensure that the WTO is relevant and adaptable."

It must not be a wish list and divide the membership, she cautioned. "Doha never died," she said, arguing that "the work programme should facilitate closure on Doha."

The work programme "must include agriculture, including an outcome on cotton and an understanding on food security, services, NAMA, trade and environment, fishery subsidies, and an expanded information and technology agreement," the Kenyan minister argued. *(SUNS8036)* ❒