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Developing Countries and the WTO

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When the World Trade Organization (WTO) was founded ten years ago on January 1, 1995, commentators hailed it as a major transformation of the world trading system. The new, more juristic and permanent World Trade Organization replaced the previous, more pragmatic and ad hoc General Agreement on Tariffs and Trade (GATT). The industrial countries, led by the United States, the EU, and Japan, brought about this change to consolidate and deepen their own and the world's commitment to an open trading system. Their support for the change was crucial because they dominated the GATT, and they continue to dominate the WTO.

The world of trade is changing, however, in another way. Developing countries, led by China, India, and Brazil, are playing an increasingly important role and are having a dramatic impact on the WTO's agenda. The earliest signs of this second transformation were visible in the Uruguay Round negotiations that led up to the WTO's founding. In another context I have referred to this shift as a transition from a "Trade as Aid" to a "Trade as Trade" regime for developing countries—a transition that is still unfolding.

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The Pre-Uruguay Round, Two-Tier GATT

During the lifespan of GATT, from 1947 to 1995, developing countries were largely on the sidelines of the world trade system. They were the recipients of largesse, but not serious participants in the functioning or governance of the regime. Theories of trade and development prevalent in the early part of this period presumed that development required shelter from the rigors of the competitive world market. The developing countries' need to protect "infant industries" and shelter local producers was highly touted. This can be seen in Article XVIII of GATT. Under its provisions developing countries have wide-ranging authority to protect select industries with quotas that would otherwise run afoul of Article XI's prohibition on quantitative restrictions.

In 1979, the GATT contracting parties expanded this exceptionalism for developing countries by adopting the Enabling Clause, a clause which allows industrial countries to grant the third world non-reciprocal, preferential access to their markets. The industrial countries did not allow similar access to other GATT countries, and they got nothing in return. This violated two cardinal principles of the trade regime: (i) non-discrimination, and (ii) reciprocity. Non-discriminatory, most-favored-nation treatment (MFN) is enshrined in GATT Article I. Though regional arrangements compromise the MFN principle, it is still the touchstone of the world trading system. Reciprocity is also central. It normally takes the form of mutually exchanged trade concessions agreed upon at periodic negotiating rounds, such as the current Doha Round.

The 1979 Enabling Clause regime is known as the Generalized System of Preferences (GSP). Most of the OECD countries, including the European Union and the United States, have enacted such a regime, in each case for a select group of developing countries and a select group of products. These GSP programs allow duty-free or reduced-duty access for eligible developing-country goods, with no reciprocal concession in return.

During this pre-WTO period, another aspect of two-tier GATT emerged. In a series of GATT negotiating rounds, the industrial members negotiated and adopted various "side-agreements" amending, expanding, and tightening the original GATT rules. Examples are the Kennedy Round Antidumping Code (1968), the Tokyo Round Antidumping Code (1979), and the Tokyo Round Subsidies and Countervailing Duty Code (1979). A good many developing countries failed to adhere to these side agreements, and hence were not bound by their disciplines. Thus, again, one set of rules applied for the industrial world, and a different set for the developing world.

The Uruguay Round and Developing Countries

This two-tier GATT system began to change during the Uruguay Round negotiations from 1988 to 1995. For the first time, the GATT membership tried to bring the developing countries into the trade regime as fully functioning partners. For example, the WTO came into being on the basis of what was called the "single undertaking." All previous GATT members withdrew from the GATT and its many side agreements, and simultaneously became contracting parties to the new WTO and all of its sub-agreements—one of which includes the original GATT '47 rules. Developing countries did the same.

This arrangement reflected a basic bargain. The developing countries accepted once again the core GATT rules, but also all of what had previously been side-agreements. The bargain also required them to accept the new agreement on protecting intellectual property (Trade Related Aspects of Intellectual Property Rights, or TRIPS). On the other side of the ledger, they gained advantages in agriculture and textiles. Though these rights were limited, they were still real. A new Agreement on Agriculture initiated reforms that have the potential to liberalize agricultural trade in the long term, and an amendment to the Agreement on Textiles and Clothing (ATC) set a deadline of January 1, 2005, for elimination of industrial country textile quotas. The amendment did not, however, reduce the high tariff levels on textiles.

Although the Uruguay Round made progress on the third world's behalf, it did not address the fundamental paradox of the two-tier system. It left the GSP exceptionism in place, thus continuing the system of reverse discrimination in favor of developing countries. At the same time, it failed to deal effectively with agricultural subsidies and tariff peaks on a range of developing country exports not included in GSP. Thus, there exists side-by-side in the current WTO regime both positive discrimination in favor of developing countries, and negative de facto discrimination against them. Both of these results stem, in a sense, from the two-tier GATT, from treating developing countries as only marginal, not-fully-participating members.

Perverse Positive Discrimination

Although certainly well-intentioned, the GSP nonreciprocal, preferential regime for developing countries has disappointed many observers. Some pitfalls in the GSP regime are easy to grasp. As a form of unilaterally granted largesse or benevolence (hence the concept "Trade as Aid"), GSP access is unreliable and constrained. If a developing country exporter makes any real headway in capturing a substantial part of an industrial country's market, a backlash from competing local producers is quick to develop and hard to resist. Trade officials would be pilloried were they to favor developing-country entrepreneurs over homegrown firms and workers—especially since the latter go to the polls. Since preferential access is a "gift" in the first place, the gift can be legally withdrawn; and when necessary, it is.

Moreover, attaching political conditions ("conditionality") to the "gift" has been irresistible. Thus, to be eligible for GSP treatment under the U.S. plan, a developing country must afford adequate protection for intellectual property, not expropriate the property of U.S. citizens, guarantee adequate worker rights, enjoy a clean bill of health on enforcing arbitral awards in favor of U.S. citizens, support the U.S. efforts to combat terrorism, and so on.[1] Also, various "rules of origin" conditions limit the benefits that might otherwise flow to non-eligible countries that produce components for a final product assembled in an eligible country.

But the greatest drawback to the GSP regime is its potential for perverse effects on development itself. Both theoretical analysis and empirical studies [2] tend to confirm that development rates are more favorable for countries not participating in the preferential regimes. This seems to be largely—if not exclusively—because of political-economic effects within the developing country itself. Recall that the GSP regime gives exporters market access without asking for reciprocity. Thus, the exporter constituency—normally the most vigorous in advocating for free trade—is absent from the lobbying hallways of GSP-beneficiary capitals. In consequence, the import-competing constituency finds itself in the happy position of calling all the shots on trade policy. The result is an isolated (and inefficient) home market protected behind high tariff and non-tariff walls. Thus, the GSP system tends to produce high import barriers at home and unstable, politically conditioned access abroad—a bargain of Faustian proportions. The high import barriers cause misallocation of resources and inefficiencies that actually retard development.

Paradoxical Negative Discrimination

The negative discrimination against developing country exports is perhaps even more pernicious, and also derives from two-tier GATT—in particular, from the non-participation of developing countries in the bargaining give-and-take of the periodic negotiating rounds. The dominant GATT players have been the U.S., Europe, and Japan, each of which significantly subsidizes and protects agriculture. Similarly, the U.S. and Europe have traditionally blocked open trade in textiles and clothing. Many developing countries have natural comparative advantages in these sectors and would reap benefits from their liberalization. Prior to the Uruguay Round, however, agriculture and textiles were more or less off-limits because the major industrial countries had no interest in liberalizing, and the developing countries were not even in the game. Two-tier GATT was the culprit.

A seamstress works at a sewing machine at a factory in Ho Chi Minh City, Vietnam. The factory exports clothing and toys all over the world.

The winds of change first stirred in the early stages of the Uruguay Round. By then, considerable rethinking had occurred in the field of development economics. By the early 1980s, economists increasingly recognized that closed markets were inefficient and counterproductive, even for developing countries, and that outward-looking, export-led growth was particularly promising. Both sides of that equation (opening up at home and pursuing comparative advantage abroad) called for more normal and fuller participation of developing countries in the reciprocal give-and-take of the world trade system. The Uruguay Round thus saw the beginning of the transformation away from two-tier GATT—a transformation still in progress. With developing countries participating more fully than ever before, agricultural liberalization gained a foothold in the Uruguay Round Agreement on Agriculture. The round also liberalized textile trade.

The Doha (Development) Round Challenges

Despite this progress, the challenges facing the negotiators in the current Doha Round are formidable. The round began in 2001, and will perhaps be completed in 2007. It is known as the Development Round because of its emphasis on aligning the WTO with development goals. Some commentators have criticized the "Development" theme, because they believe—correctly, I think—that development depends fundamentally on internal conditions within developing countries, and not so much on the prevailing trade regime. But, of course, as we have seen, the trade regime can have important effects on an internal market, and can facilitate, if not directly guarantee, development. So what choices do the Doha Round negotiators face?

A new role for developing countries would effectively convert the WTO from a two-tier, "Trade as Aid" system to a single-tier, "Trade as Trade" regime.

Despite the Uruguay Round progress, agricultural barriers and subsidies remain high. The textile trade, though denuded of quotas, still faces high tariffs. And even though on-average industrial country tariffs are low, they often peak on a range of goods of interest to the third world. Thus, developing countries have clear negotiating objectives.

A strong argument can also be made for dropping the non-reciprocal preferential access regime of GSP—or at least limiting it. This could go hand-in-hand with reciprocal market-opening commitments on the part of developing countries. In other words, developing countries would begin to assume normal membership in a single-tier WTO—effectively converting the world trade body from a two-tier, "Trade as Aid" system to a single-tier, "Trade as Trade" regime.

The very existence of the current preferential regime feeds opposition to such change. Even if preferential market access is insecure, limited, and politically conditioned, some producers benefit, and can be expected to lobby against change. They will want to hold on to what they have. At the same time, another trend may undercut their influence and even their incentive to lobby forcefully. Influential voices in the trade community are urging industrial countries to pursue a "zero tariff" target for MFN trade. [3] The closer the negotiators come to this goal, the less important trade preferences will be. So if preference margins are certain to shrink, lobbying for continued preferential access may not be worth the candle.

Again, on the other side of the bargaining ledger, developing countries are pressing hard within the Doha Round negotiations for a substantial reduction and eventual end to agricultural subsidies, and for further liberalization of tariff peaks on third world exports. This is as it should be under a single-tier, "Trade as Trade" approach.

It is true that some countries in the least developed group would be harmed both by the elimination of preferential access and—as net food importers—by the phasing out of food subsidies. For these countries, some have proposed a special compensatory fund, perhaps administered by the World Bank or other international organization, that could be used to ease the burden of transition.[4]

Increasingly, of course, the bloc of countries once treated simply as "developing countries" will experience differentiation. It will be easier for countries like China, India, and Brazil, with larger, more important markets, to make the transition from "Trade as Aid" to "Trade as Trade" than it will be for the poorest and least developed countries. Some have even suggested that the more successful developing countries—whose tariff levels are higher than those of industrial countries and less likely to move to zero on the same timetable—should consider preferential access to their markets for the poorest countries. This would perpetuate, however, the perverse effects associated with non-reciprocal preferences mentioned above.

Will the WTO continue its transition to a one-tier, "Trade as Trade" regime for developing countries? Will the negotiators succeed in eliminating agricultural subsidies, and in truly liberalizing trade in textiles and other products of interest to the Third World? Will industrial tariffs move dramatically toward zero? These are some of the challenges facing the negotiators as they seek a successful conclusion of the Doha "Development" Round over the next year and a half. We should wish them well and, if it continues to emerge, hail the transition to a one-tier WTO.

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1. *See* 19 U.S.C. sec 2462.

2. *See* Caglar Ozden and Eric Reinhardt, "The Perversity of Preferences: GSP and Developing Country Trade Policies, 1976-2000," February 15, 2002 (pdf version at http://userwww.service.emory.edu/~erein/research/gsp2.pdf; video presentation available following links at www.worldbank.org); Arvind Panagariya, "EU Preferential Trade Policies and Developing Countries," 25 *World Economy* 1415 (2002).

3. *See* Peter Sutherland and Jagdish Bhagwati, et al., "The Future of the WTO" at 26 (2004), available at http://www.wto.org.

4. *See* Bernard Hoekman, "Overcoming Discrimination Against Developing Countries," at 32-34 (2004) (paper presented at a Cornell-Cordell Hull Institute joint conference on the "WTO and the World Economy" held in Paris, in July, 2004. The paper will be included in a conference volume, *Rethinking the WTO,* edited by John Barceló and Hugh Corbet, scheduled to appear in 2005.