



Car trailer-trucks in Brazil

# Making the **WTO** More Supportive of Development

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**How to help developing countries integrate into the global trading system**

**I**N WORLD trade negotiations there is a constant tension between attempting to establish a set of universally applicable rules and allowing certain opt-outs or exceptions, particularly for developing countries. The World Trade Organization (WTO) attempts to manage this tension through what is known as *special and differential treatment* (SDT). SDT spans promises by high-income countries to provide preferential access to their markets, the right to limit reciprocity in trade negotiating rounds to levels “consistent with development needs,” and greater freedom to use otherwise

restricted trade policies. The underlying premise is that industries in developing countries need assistance for some time in both their home market (protection) and in export markets (preferences).

But SDT is controversial. Many economists argue that the existing SDT “package” has not been very beneficial: preferences have been of limited value for most developing countries as a result of exceptions, non-trade conditionality, and supply capacity limits, while nonreciprocity and weaker disciplines on trade barriers have impeded more rapid integration into the world econ-



omy (as continued protection biases incentives against exporting and improving productivity). Others argue that preferences are needed because industrialized countries have consistently thwarted the development potential of the trading system by maintaining high barriers to developing country exports and that rich countries have historically intervened in trade in ways that the WTO now constrains. Thus, SDT is necessary to give developing countries the same opportunities.

Restrictive trade policies may help support the development of domestic industry. For such industries to become efficient, however, they need to be able to source inputs from the most competitive suppliers and confront competition in the markets for their products. Whatever one's views on the effectiveness of trade policy to support domestic industry, both theory and experience suggest that over time trade barriers should be lowered to ensure this. By establishing a mechanism through which countries negotiate the reduction of trade barriers, the WTO can be regarded as pro-development.

What then is the problem from a development perspective? First, the WTO is driven by mercantilism: the desire of members to improve their terms of trade through better access to the markets of other members. ***The focus is not on the welfare or growth prospects of members, or on the identification of "good" policy, but on ways that national policies impose costs on other countries.*** It may be the case, for example, that there is a rationale for subsidies (to offset a market failure), even if this is to the detriment of other countries.

Second, ***the ambit of the WTO increasingly extends beyond trade policy.*** Domestic regulatory policies (or their absence) may have a strong economic efficiency rationale even if they entail some negative spillovers on others. Intellectual property protection is an example—limited enforcement may well be the best option for poor countries (see Box 1). Regulatory disciplines may also give rise to high and asymmetric implementation costs, with the burden falling disproportionately on poorer countries. Longer transition periods—the basic instrument adopted in the Uruguay Round—are an inadequate response.

Third, ***little effort is made to identify what the preconditions are for benefiting from specific WTO agreements or whether they have been satisfied.*** Nor is there a mechanism to monitor the effectiveness of policies justified under SDT provisions or to identify alternative policies (including development assistance) that might be more efficient in attaining the objectives of a poor country. To return to the subsidy example, assuming there is a case for intervention, subsidies or taxes are generally more efficient than trade barriers in addressing market failures, but governments may not have the capacity to use them, resulting in the use of more distorting (costlier) trade policies.

Finally, ***traditional SDT has resulted in significant discrimination among developing countries,*** incentives by recipients of preferences to oppose liberalization, and less certainty and predictability of trade policy.

The current approach to SDT in the WTO places the primary focus on detailed negotiation of opt-outs, rules, and

exemptions from specific agreements. An example is the Doha Round proposal that developing countries be permitted to designate special products and use special safeguard procedures for agricultural products. This approach requires poor countries to determine on an issue-by-issue basis the specific provisions that would be beneficial. What these are may not be clear, and the ability to get agreement from developed countries on such proposals is constrained by mercantilist calculus: the perceived cost to them of a proposal, not whether it makes sense from a developmental point of view. This article proposes a new approach that would imply major changes for *both* developed and developing countries. It would make the WTO more supportive of development and enable developing countries to better integrate into the global trading system by having all WTO members accept a set of core commitments while allowing latitude in other areas.

### **A development-friendly WTO**

How can WTO trade agreements become more supportive of development? Arguably, such agreements should

- remove foreign barriers to trade for products that poor countries produce;
- lower domestic barriers that raise the prices and reduce the variety of goods and services that firms and households consume; and
- support the adoption of complementary regulations and institutions that enhance development.

#### **Box 1**

#### **Cambodia: tripping up over TRIPS?**

Recent case studies illustrate the potential payoffs of greater flexibility in the WTO's regulatory enforcement. One example is Cambodia, which has made significant efforts to adopt legislation consistent with the Trade-Related Aspects of Intellectual Property Rights (TRIPS) agreement and has trained government officials and the private sector in enforcement. The government drafted laws on trademarks, patents, copyright, protection of trade secrets, unfair competition, and plant variety protection. It set up training courses for lawyers, judges, law enforcement, and customs officers. And it expedited the drafting of laws and implementing regulations, publishing Khmer books on the subject.

While most of this was paid for by donors, it is questionable whether the benefits offset these costs, given that Cambodia is unlikely to be a producer of high-tech or pharmaceutical products for many years to come. Indeed, the economic price tag of strong enforcement of intellectual property rights may be a multiple of the direct administrative costs and the opportunity costs in human resource terms of devoting so much attention to this area. It is an open question whether these laws constituted priorities from a development perspective and whether the costs incurred would have passed a cost-benefit analysis. This was not undertaken, because complete adoption of TRIPS was seen as a requirement for accession to the WTO.

Political economy forces constrain realization of the first objective. Small, poor countries have little to offer in the mercantilist WTO exchange to induce large countries to remove policies that harm them. The preferential access dimension of SDT was motivated in part by this observation. Many of the poorest countries today have not been able to use SDT to expand and diversify their exports. Moreover, preferences are not an enforceable commitment under the WTO. Instead, they are “best endeavor” promises that, in practice, have been subject to many restrictions and conditions. The second objective requires domestic reforms—here the question is how to mobilize political support for such reform, given fiscal constraints, industrial policy objectives, and the fact that nonreciprocal preference programs may imply that exporters already have free access to major markets. The third objective may be impeded by the fact that the rules adopted have often been developed in high-income countries. WTO rules on intellectual property protection are a good example.

**The challenge is to introduce flexibility when it is desirable, while at the same time strengthening the trading system.** An important role of the system should be the adoption of good policies—in part by increasing transparency and reducing uncertainty regarding the policies confronting traders. This function of the trading system is of great value to developing as well as developed economies.

### Proposed new approach

Making the WTO more supportive of development could involve three basic elements:

- First, unconditional acceptance by developing countries of a core set of disciplines relating to market access—including the most-favored-nation (MFN) principle, binding of tariffs and commitments to reduce tariffs in the future—as well as acceptance, in principle, of the WTO *as a whole*.
- Second, permitting countries not to implement “non-core” WTO rules on development grounds, in the context of multilateral consultations with representatives of the trade and development communities (donors, financial institutions) on the effectiveness and impact of the policies concerned. Assessments of these policies should consider negative spillovers and should be published in the relevant countries to increase the accountability of governments.
- Third, a shift away from discriminatory trade preferences as a form of “trade aid,” coupled with strengthened grant-based financing targeted predominantly at the poorest countries to improve trade supply capacity and the competitiveness of local firms, and to redistribute some of the gains from trade liberalization.

The intention should *not* be to make the WTO a development organization. This is not desirable, even if it were feasible. Instead, the objective is to put in place an enabling mechanism to foster greater integration of developing countries into the WTO.

WTO is a binding contract: commitments are enforceable. This gives the WTO its value—traders have greater certainty

regarding policy, and governments know what they are “buying” when they make commitments. Allowing for “policy space”—or leeway for countries to pursue policies that would otherwise be subject to multilateral discipline—will increase uncertainty and could reduce the willingness of major trading countries to make commitments in the first place. Agreement that a core set of WTO disciplines would constitute binding obligations on *all* members would help

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address this concern. Thus, violations of core rules would be enforced through existing dispute settlement mechanisms.

Negotiations would need to define what this core comprises. Arguably, it includes transparency, MFN treatment, the non-use of quotas, the binding of all tariffs, and the willingness to make commitments to lower such tariffs over time in the context of trade rounds. Why these? Because they constitute the fundamental principles on which the trading system is based, and are beneficial to all countries regardless of their level of development. If this were accepted, it would imply stronger multilateral commitments in the core areas than exist now. In particular it would imply the end of non-reciprocal trade preferences by developed countries. There are both systemic (the MFN principle) and developmental rationales for this. The evidence suggests that those countries that can benefit from trade preferences have already done so, while those that have not confront domestic constraints that impede them from fully exploiting these opportunities. The primary need is to address those constraints and to remove trade-distorting policies that affect developing countries disproportionately on a nondiscriminatory basis. Thus, a trade-off for acceptance of the core principles by developing countries is that higher income countries augment and gradually replace preferences with expanded development assistance to bolster trade capacity. Another trade-off is that non-core disciplines become eligible for the policy flexibility mechanism.

### How policy flexibility would work

Differentiation among developing countries in the application of SDT has been a sensitive topic in the WTO. Many more advanced developing countries oppose suggestions that SDT be limited to a subset of poorer and more vulnerable countries. A major advantage of a development framework that is explicitly designed as an enabling mechanism is that assumptions about who is eligible can be avoided. One way to allow this would be for any (self-designated) develop-



ing country to be able to invoke the process, but to accept as well explicit consideration of a “spillover test” as part of the consultations—the extent to which a specific policy has negative effects on other countries. This would introduce differentiation on a de facto basis, and is discussed further below.

**Judging non-core policies.** Consultations would assess the impact and effectiveness of nonconforming policies (non-core). This first requires identification of such policies. Traditionally, this is left to dispute settlement and, in the case of small and poor countries, the dispute settlement procedure is unlikely to be invoked. (This is, in fact, a weakness of the status quo, in that poor countries are ignored.) Currently, there are only two WTO mechanisms that identify inconsistent policies of smaller countries: the Trade Policy Review and committees that oversee the operation of specific agreements. The former constitutes a valuable transparency exercise that arguably is underutilized because the secretariat is not permitted to form judgments regarding WTO consistency of observed policies, and impacts within and across countries are not considered. The process is infrequent (every 6+ years). Agreement-specific WTO committees focus mostly on (changes in) implementing legislation and its application—the focus is not on the economic rationale or effectiveness of policies. Moreover, attention centers predominantly on the larger markets.

An explicit link between a new development framework and an augmented Trade Policy Review could generate more information on the effects of developing country policies. Assessing whether instruments are achieving development objectives and whether less trade-distorting ones can be identified inherently require judgments regarding appropriate sequencing and the need for complementary reforms and investment. These must be made by the concerned government but can be informed by inputs from other members and from development and financing institutions. The involvement of the latter would be necessary and desirable for a number of reasons. First, they have the mandate, experience, local presence, and capacity to provide policy advice. Second, these organizations generally take the lead in developing and financing projects and programs in developing countries. The WTO should not move into project design and financing.

A major advantage of the proposed mechanism could be improved communication between the development and trade communities—identifying where development organizations should help and where WTO disciplines may not be optimal for a country. In any such process, development organizations must have a seat at the table. The launch of the first version of the Integrated Framework for Trade-Related Technical Assistance to Least Developed Countries (IF) at the WTO’s 1996 ministerial meeting in Singapore shows that initiatives by trade ministers are doomed to fail if they are not coordinated with (owned by) the development institutions that will be asked to provide assistance and the countries that will use it.

That said, if the membership of a monitoring mechanism were to span all WTO signatories as well as relevant interna-

tional development institutions, it would probably not be effective. One option would be to build on the revamped Integrated Framework—which has now become a unique example of international collaboration in the trade area, following a major rethinking and redesign in 2000 (see Box 2). If extended beyond the least developed countries, the IF agencies and donors would overlap to a very great extent with the set of players one would expect to engage in any trade-related policy dialogue.

**Recognizing spillovers.** Whether a policy imposes significant negative financial costs on other countries should be part of the terms of reference of the consultation process, as is the identification of possible policies that are less trade distorting. For example, as mentioned, basic economics suggests that subsidies are more efficient instruments to address market failures than trade policies. If binding budget constraints in a developing country preclude the use of (temporary) subsidies, development assistance may be used to overcome them if there is agreement that it would help address a market failure. Linkage to aid may also help establish a credible exit mechanism, a key condition to prevent capture and control rent seeking.

**Settling disputes.** Although the process of determining the impact and effectiveness of a particular policy that is inconsistent with a non-core WTO discipline should enhance both transparency and accountability of governments, such policies may inflict substantial harm on other WTO members. If they are also developing countries, policy space may imply robbing Peter to pay Paul. This again points to the importance of identifying less trade-distorting policies to pursue the government’s objective. If these do not exist or are not adopted, countries ultimately have recourse to the standard WTO remedy: dispute settlement.

#### Box 2

##### IF as a model

The Integrated Framework for Trade-Related Technical Assistance to Least Developed Countries (IF) is an unlikely name for a model of future cooperation. But it is a good basis on which to develop a policy dialogue on trade. It brings together key multilateral agencies working on trade development issues with donors and recipient countries. More than 40 of the least developed countries (LDCs) have applied for assistance under the scheme.

The basic purpose is to embed a trade agenda into a country’s overall development strategy and ensure that trade-related adjustment and capacity building are in line with the trade policy aims of the country concerned *and* prioritized with other development assistance needs. Although the IF has raised awareness of trade issues within the LDCs, many countries need additional resources to implement the recommendations of their trade integration strategies.

The IF has a steering committee with rotating membership—spanning six multilateral agencies, contributing donors, and recipient countries, as well as an interagency working group that handles diagnostics and follow-up.

Larger developing countries are more likely to impose relatively larger spillovers on trading partners, whether developed or developing. This suggests that the spillover assessment proposed above may be an effective way to differentiate between countries in terms of the extent to which they can invoke “policy space” for development purposes. While spillovers imposed by a small country on large WTO members will be small by definition, they may be relatively large for another small country. Thus, a development mechanism should complement dispute settlement and not replace it. In effect, developing countries would be granted immunity as long as policies do not create significant negative spillovers, with a higher threshold for the impact on higher-income countries.

**Building capacity.** The proposed mechanism should also help address supply capacity constraints in poor countries by going beyond their identification to include an expansion of aid funds for this purpose. In particular, consideration could

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be given to a binding commitment by richer countries to transfer a share of the gains realized from multilateral trade reforms (under the Doha Round) to developing countries. Such gains are potentially large, depending on the extent of liberalization commitments made. For example, part of the tariff revenue collected on goods that are due to be liberalized over time or part of the budgetary allocation for agricultural subsidies that is to be eliminated under a Doha agreement could be made available to fund trade capacity improvements in developing countries. Especially in small low-income

countries that already have relatively free access to major markets, using aid to address constraints that reduce their competitiveness can have high payoffs. That said, a major lesson of World Bank experience with projects and programs in this area (and most others) is that country ownership and leadership at the highest levels are critical factors in ensuring concrete and sustained follow-up in removing constraints to trade expansion. As noted, the proposed mechanism could help mobilize such engagement within the context of overall poverty reduction strategies.

### **Worth the attempt**

Would the establishment of a mechanism to allow greater flexibility on a country-specific basis, with all its complications, be of value? The potential upsides from the approach sketched out above are significant. Small developing countries are rarely subjected to litigation by developed economies due to their size. While that suggests a policy flexibility mechanism is not really needed, this fact in itself illustrates the need for change: greater engagement with poor countries on their trade policies would be beneficial. Acceptance of core principles by all developing countries, including MFN, and thus the (gradual) demise of trade preferences, and the explicit agreement by high-income countries to put greater weight on the policy objectives of developing countries by taking the supply-side capacity agenda seriously through an augmented IF-type mechanism would be other significant changes.

A major advantage of the WTO is that it is a single-issue organization: the focus is always on trade. This is not the case at other international organizations. Creating a focal point for a *constructive*, as opposed to adversarial, interaction among governments could do much to raise the domestic profile of the trade agenda in developing countries. It would also add to information on the effects of existing policy instruments—a necessary condition for adopting better policies—and ensure that trade-related policy actions and investments are considered by decision makers. Although there will certainly be greater human resource costs, much of the required work could be undertaken in the context of the activities and diagnostics of the Integrated Framework.

In a nutshell, there is a fundamental choice to be made regarding the development dimension of trade agreements. It is a choice that goes beyond the WTO, extending to North-South regional trade agreements as well. The same tension arises there, with asymmetries in both power and size that are often much greater than in the WTO. The type of mechanism proposed above could also be considered in the context of regional trade arrangements such as the Economic Partnership Agreements the EU is negotiating with the African, Caribbean, and Pacific countries. ■

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