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Special Treatment for Developing Countries
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Trade

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Special Treatment for Developing Countries



There is considerable dissatisfaction with the treatment given by the World Trade Organization to its poorest members. The development of an appropriate framework which maintains the 'rules-based' trading system but differentiates between rich and poor countries is one of the most important issues facing the Doha Round.

WTO members include 32 of the 50 least developed countries (LDCs) recognized by the UN.¹ The economic and social development of these countries, in particular the eradication of extreme poverty, is a major challenge for LDCs themselves, as well as for the international community. Least developed countries are characterized by their exposure to a series of vulnerabilities and constraints, such as limited human capital and productive capacity; weak institutions; geographical handicaps including poor soils, vulnerability to natural disasters, and communicable diseases; poorly diversified industries and underdeveloped markets for many goods and services; limited access to education, health, and other social services; poor infrastructure; and lack of access to information and communication technologies.

¹ These are Angola, Bangladesh, Benin, Burkina Faso, Burundi, Cambodia, Central African Republic, Chad, Democratic Republic of the Congo, Djibouti, Gambia, Guinea, Guinea Bissau, Haiti, Lesotho, Madagascar, Malawi, Maldives, Mali, Mauritania, Mozambique, Myanmar, Nepal, Niger, Rwanda, Senegal, Sierra Leone, Solomon Islands, Tanzania, Togo, Uganda, and Zambia. Eight additional LDCs are in the process of accession to the WTO: Bhutan, Cape Verde, Ethiopia, Laos, Samoa, Sudan, Vanuatu, and Yemen. Furthermore, Equatorial Guinea and Sao Tome and Principe are WTO Observers.

The WTO recognizes that the trade policies which maximize welfare in the rich industrialized countries may not be the same as those which do the most to promote development in the poorest countries. The WTO recognizes the particular needs of developing countries² via 'special and differential treatment' (SDT)—special provisions which give developing countries special rights and which allow developed countries to treat developing countries more favorably than other WTO members. Common SDT provisions include support to help developing countries pay the costs of effectively participating in the WTO, as well as aid to increase their capacity to take advantage of new trading opportunities; exemptions from agreements, which allow developing countries to choose whether or not to implement agreements requiring regulatory or administrative reform; and provisions allowing developed countries to give preferential market access to developing country members. In market access, SDT gives developing countries greater freedom to use industrial policies, including subsidies, and more latitude in tariff reduction (either higher bound tariffs or longer transition periods).

SDT is controversial. Proponents argue that the special circumstances of developing countries demand that they be given the freedom to pursue industrial development through trade policies, even if these policies involve some negative externalities for other countries. Opponents express hostility to SDT because they see it as an abrogation of the principle of reciprocity, and others believe that SDT leads to protectionist trade policies which are inefficient tools for industrial development and are likely to create vested interests and misallocate resources. They argue that by granting exemptions to WTO disciplines, members are doing developing countries a disservice by encouraging protection, prolonging their exclusion from the global economy, and denying access to the benefits of openness.³ The neo-liberal view, embodied in the

² There are no WTO definitions of 'developed' or 'developing' countries. Developing countries in the WTO are designated on the basis of self-selection, although this is not necessarily automatically accepted in all WTO bodies.

³ It should be noted that the benefits of openness are controversial. In particular, the relationship between openness and growth is contentious. Rodriguez and Rodrik (2000) analyse the seminal paper by Sachs and Warner (1995) which linked openness and growth. Rodriguez and Rodrik disaggregate the Sachs–Warner openness measure and find that only the component relating to the black-market premium is significant in growth regressions. They conclude that this indicates that macroeconomic stability, rather

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Washington Consensus, is that most WTO rules, which commit members to liberalize their trade policies, are good rules and should be followed by poor countries as well as rich ones, i.e. the best strategy for all countries and in all situations is to liberalize. The neo-liberal approach relies on strong theoretical assumptions about the efficiency and completeness of markets which, as we discussed in Chapter 2, are unlikely to hold in developed countries, let alone developing countries.

The alternative view places less confidence in markets and recognizes a stronger role for government in economic development. Markets are certainly powerful forces but where they are imperfect, especially in developing countries, government intervention may be required to correct their failures and make them work efficiently. This view has been greatly influenced by the success of the East Asian Tiger economies,⁴ whose reliance on market forces did not preclude an active role for the government, including interventionist policies in trade, FDI, technology transfer, and domestic resource allocation (Lall 1992).

As noted earlier, neo-liberals responded to the East Asian success by arguing that it was due to free trade and other non-interventionist policies. To the extent that East Asian governments had been interventionist, they argued that this was a redundant and unnecessary policy approach that coincided with the liberalization policies which were in fact the true cause of their success (see World Bank 1993a and Noland and Pack 2003). Given that the issue remains undecided, developing countries themselves should decide whether they wish to use industrial policies which, it should be pointed out, almost all of the successful industrialized countries used at similar stages of development (Chang 2002).

At the same time, it is increasingly recognized that laissez-faire policies may not be optimal in developing countries which suffer from various types of market failures (see Chapter 2). Many developed countries currently have comparative advantage in agricultural commodities and natural resources. However, reliance on production

than trade protection, matters for growth. Further analysis (e.g. Warner 2002) has revisited the issue, and the relationship remains controversial.

⁴ See e.g. Stiglitz (1996).

of these goods can be problematic because historically, their prices have been extremely volatile. In addition the production of these goods may not embody the management and organizational skills necessary to build an industrial economy. If this is true, then by concentrating production in the goods in which they have static comparative advantage, developing countries may be preventing themselves from establishing the foundations of an industrial economy.

However, the existence of justifications for government action does not necessarily suggest that trade policy is the appropriate instrument for intervention. Hoekman, Michalopoulos, and Winters (2003) argue that the use of traditional trade policy instruments are likely to impose more costs than benefits on developing countries. These authors are right to claim that the case for various trade instruments of industrial policy is controversial, but it is wrong to conclude that there is a strong case for restricting the policy options of developing countries on these grounds. It requires us to believe that developed countries in the WTO are better informed (and persistently so) than developing countries. In reality SDT provides developing countries with additional freedom to use a range of industrial policies, which are in some cases used efficiently, and in some cases are not. However, the *ex post* identification of failed industrial policy experiments is not necessarily evidence of bad policies. Rodrik (2004) points out that in the case of subsidies for entrepreneurship, even under the optimal incentive program, some of the investments will turn out to be failures. Failed industrial policy experiments are examples of the 'self-discovery' of comparative advantage. The costs associated with these failures may be more than offset by the gains from the successes. All that is required to justify industrial policies is that their expected value be positive. Indeed if there are too few failures, this might be a sign that the industrial policy is not aggressive enough.

In addition there is a difference between openness and liberalization. Developing countries with large populations working in protected industries must be mindful of the costs of adjustment. Trade liberalization creates adjustment costs as resources are moved from one sector to another in the process of reform. When tariffs are reduced, import-competing firms may reduce their production in

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the face of new competition, causing some of their workers and capital to lie idle for a period. The firm's laid-off workers will incur costs while searching for new jobs and may need to invest in retraining. Governments will be called upon to provide assistance to the unemployed while also incurring costs associated with implementing the new systems to manage reform. In developing countries which are already characterized by high unemployment, weak insurance markets, and low levels of social protection, adjustment costs may have a particularly severe effect.

Discomfort with the consequences of the neo-liberal view of special and differential treatment led the Zedillo Commission, in its 'Report of the High-Level Panel on Financing for Development' to the Monterrey Conference on Financing for Development in 2002, to assert the following on infant industry protection: 'However misguided the old model of blanket protection intended to nurture import substitute industries, it would be a mistake to go to the other extreme and deny developing countries the opportunity of actively nurturing the development of an industrial sector' (Zedillo 2001).

Similar support for SDT was expressed in article 44 of the Doha Declaration, which affirmed 'that provisions for special and differential treatment are an integral part of the WTO Agreements'. The article provides that special and differential treatment provisions shall be reviewed in the Doha Round 'with a view to strengthening them and making them more precise, effective and operational'.

SDT in the Doha Round: Exemption, not exclusion

At the WTO's Fourth Ministerial Conference in Cancún, in September 2003, the negotiations collapsed and the meeting ended in failure. One reason for the deadlock was that developing countries were worried about being forced into accepting obligations which would hurt their industries or impose large implementation costs on them. Many developing countries had felt disadvantaged by the

last round, the Uruguay Round, and they came to the view that no agreement was better than another bad agreement. After Cancún, developing countries stepped up their demands for special and differential treatment as a prerequisite for progress in the round. For wary developing countries, SDT was an insurance policy—it would give them the flexibility to opt out of any agreement which proved to be too onerous for them. A group of developing countries, the G33,⁵ united behind the issue of SDT. As the round began to regain momentum in 2004, they renewed their calls for SDT to be given a higher degree of clarity and specificity. In particular they wanted the right to identify special products of interest to developing countries on which there would be no tariff reduction commitment and no new tariff-rate quota commitments.⁶

In May of 2004, EU Trade Commissioner Pascal Lamy attempted to placate the developing countries and salvage the round by offering a significant compromise on SDT. In a letter to trade ministers he wrote: ‘on agriculture and [industrial goods], we propose that the least developed countries and other weak or vulnerable developing countries . . . should not have to open their markets beyond their existing commitments, and should be able to benefit from increased market access offered by both developed and advanced developing countries. So in effect these countries should have the “Round for Free”.’⁷

The danger of the blanket approach to SDT embodied in the ‘Round for Free’ approach is that it may act as a disincentive to the participation of developing countries in the Round. If the least developed countries are required to do nothing, they may be pushed to the periphery of the negotiations. It would be unfortunate if the ‘Round for Free’ rhetoric came to imply an agreement between developed

⁵ For a list of the membership of the G33, see the Glossary.

⁶ See the statement issued by Indonesia on behalf of the G33 member countries in Geneva, 28 July 2004.

⁷ See the letter of 9 May 2004 by Pascal Lamy and EU Agriculture Commissioner Franz Fischler. After attracting criticism from other developed countries for his ‘capitulation’, Lamy quickly backed away from this grandiose offer. In June he noted that the ‘Round for Free’ slogan was perhaps a misnomer since developing countries would be required to make commitments on binding their tariffs in some areas, and participating in negotiations in trade facilitation. He coined the somewhat less catchy slogan ‘Round at a Modest Price’. See his speech ‘Where Next for EU Trade Policy?’ to the Deutsche Gesellschaft für Auswärtige Politik, Berlin, 11 June 2004.

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countries with only a peripheral role for developing countries. Then the Development Round would bear a striking resemblance to the early rounds of trade negotiations, in which the GATT operated as a club for the advancement of rich-country interests. In those early rounds, developing countries were burdened with few obligations, but they had only a weak voice in the negotiations and little power with which to assert their interests. Developing countries benefited from industrial country liberalization, thanks to the Most Favored Nation (MFN) principle,⁸ but their peripheral role meant that they could exert little pressure on the way that industrialized countries liberalized. Thus liberalization of goods of interest to developed countries proceeded swiftly, but goods of interest to developing countries, especially labor-intensive goods, lagged behind and developing countries ultimately suffered. Some developed countries were happy with this system because the small poor countries did not have sufficiently attractive markets to bother with: the benefits of market access were smaller than the costs of liberalizing their own labor-intensive import-competing sectors. The 'Round for Free' approach smacks of the same two-tiered system which exempted developing countries from commitments but excluded them from the negotiations. However, as Keck and Low (2004) argue, 'where new policy areas or new rules are under negotiation, or consideration for negotiation, the best interests of developing countries would be served through engagement with respect to the substance of core proposals'. Another problem with the 'Round for Free' approach, which concerns many negotiators from developed countries, is that it allows the poorest countries to retain a veto over a Round in which they are contributing very little. This creates a 'hold-up' problem which does not benefit their interests in the system—it merely encourages the OECD nations to liberalize further outside of the WTO system, which takes us back to the problems of previous rounds.

Moreover the 'Round for Free' approach may result in forgone opportunity costs on developing countries by robbing them of the

⁸ MFN is enshrined in the first article of the GATT, which governs trade in goods. MFN is also a priority in the GATS (art. 2) and the TRIPS Agreement (art. 4), although in each agreement the principle is handled slightly differently.

benefits of liberalization of South–South trade. If developing countries suffer from barriers in other developing countries, then proposals in the Doha Round to allow minimal liberalization by poor countries could backfire. Developing countries now account for around one-third of global trade. Intra-developing country, or South–South, merchandise trade has grown at twice the pace of world trade over the past decade. Yet barriers to South–South trade are high. For example, Latin American exporters of manufactures face average tariffs in the rest of Latin America that are seven times as high as tariffs in industrialized countries (ESCWA 2004). East Asian exporters face tariffs in other East Asian countries that are 60 per cent higher than in rich nations. Indeed, developing countries stand to benefit a great deal from improved market access to other developing countries. The World Bank (2002*b*) estimates that developing countries stand to realize welfare gains of more than US\$30 billion per year if other developing countries eliminate tariffs on industrial goods and a further US\$30 billion if they remove their barriers to agricultural trade.

A Doha Round Market Access Proposal

In this section we describe a framework—the Doha Market Access Proposal (MAP)—which maintains the ‘rules-based’ trading system, but differentiates between rich and poor countries.⁹

The challenge is to design special and differential treatment which gives developing countries flexibility to deal with their development problems and minimizes adjustment and implementation costs, without marginalizing their participation in the global trading system or forgoing the gains from South–South liberalisation. To achieve this, all WTO members could commit themselves to providing free market access in all goods to all developing countries poorer and smaller than themselves. Thus all developing countries could expect free access to all markets with (1) a larger GDP and

⁹ This proposal is based on Charlton (2005).

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(2) a larger GDP per capita. This special and differential treatment provision would bind developing and developed countries alike. For example, a middle-income country like Egypt, with GDP per capita of US\$1,390 and total GDP of US\$82 billion, would receive free market access to countries like the United States, but would be required to give free market access to a country like Uganda (GDP per capita of US\$240 and GDP of US\$6.2 billion).

The principle underlying this proposal is that all countries should participate in an enforceable system of preferential market access in which rights and obligations are distributed progressively according to objective criteria. The proposal presented in this section represents one straightforward means of implementing this principle. Additional provisions for specific sectors, alternative dimensions to differentiate between countries, implementation periods, and various other complexities that would undoubtedly be part of any applied version of this proposal are left out of the exposition in this section.

Advantages

This proposal has several advantages over alternative schemes:

1. *It involves significant liberalization.* Fig. 6.1 plots the GDP and GDP per capita of WTO members. The dotted lines illustrate the implications of the proposal for Egypt, a country in the middle of the distribution in both size and wealth. MAP would require Egypt, after a negotiated implementation period, to provide free market access to more than fifty developing countries to its south-west in Fig. 6.1 (with total market size of US\$500 billion). In return it would receive free market access to more than twenty developed and upper-middle-income countries to its north-east in the figure (with a total market size of US\$28 trillion).¹⁰

As with existing preferential schemes, the effect of MAP would to some extent be limited by rules of origin. It is beyond the scope of

¹⁰ In this calculation the EC is treated as one member; this makes little difference to the market size numbers.

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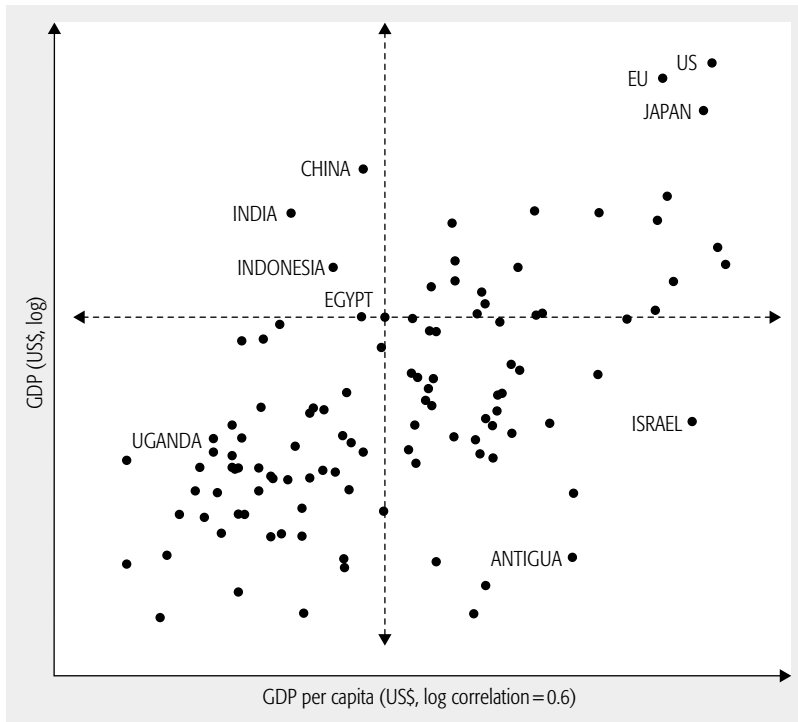


Figure 6.1. WTO members' GDP and GDP per capita

this discussion to describe options for rules of origin that might be required to implement MAP, but it is worth noting that MAP would significantly reduce the distortionary effect of rules of origin on LDCs' trade compared to current SDT approaches, since many of the middle-income countries from which LDCs might import intermediate inputs would also receive preferential access under MAP to some of the rich countries to which the final goods are exported. Thus, while not eliminating the problem of rules of origin in SDT, MAP would reduce its effect in practice compared to the status quo.

2. *In Particular, it involves significant South-South liberalization.* Another advantage of MAP P in MAP = proposal is that it takes South-South liberalization seriously. Many existing types of SDT (and several proposed changes) do little to promote South-South trade, the liberalization of which, we have noted, could bring large gains to developing countries. Indeed most Doha Round estimates

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indicate that the scope for welfare gains for developing countries is larger from the liberalisation by other developing countries than from liberalisation by developed countries (Francois, van Meijl, and van Tongeren 2004).

South–South liberalization has progressed slowly. Attempts at preferential market access agreements have been made outside the WTO under the auspices of the Global System of Trade Preferences among Developing Countries (GSTP).¹¹ Unfortunately, the GSTP is based on reciprocity—one reason for the low participation of least developed countries among its members—and it has struggled to make significant progress.¹² Bilateral and regional free trade agreements (FTAs) between developing countries are increasing in number, but it should not be assumed that South–South FTAs are unequivocally good for development, since they discriminate against third-party developing countries and the margin of discrimination is higher than is the case in North–North FTAs because developing country MFN tariffs tend to be higher. Thus, there may be a strong case for introducing a development dimension into South–South agreements. There are schemes being considered by some larger developing countries including India, China, and Brazil which would give special access to the least developed countries. While additional market access would be welcome, these schemes, like the existing GSP schemes operated by the advanced industrial countries, would be a patchwork of discretionary and conditional promises rather than clear legal rights enforceable within the WTO.

Within the WTO, developing countries have often been urged to reduce their MFN tariffs on the grounds that this would lead to an increase in South–South trade. MAP recognizes that, for this purpose, liberalization need not occur on an MFN basis.

3. *Obligations are distributed progressively.* MAP is progressive in the sense that it requires significant South–South liberalization from middle-income countries and very little from the poorest and most vulnerable countries. It requires the most liberalization from

¹¹ The GSTP, established in 1988 and promoted by UNCTAD, provides trade preferences to developing countries without extending them to developed countries.

¹² The two previous GSTP rounds, in the past two decades, were not as successful as expected, due to the economic situation of the poorest developing countries and the poor negotiating capacity of member states.

the countries in the north-east of Fig. 6.1 (in particular the Quad countries—Canada, the EU, Japan, the US) and less of those in the south-west of the figure (mostly African LDCs). Under this scheme, all but the very poorest countries do *not* get the 'Round for Free', since all countries accept the obligation to provide market access to other WTO members smaller and poorer than themselves. In return the developing countries receive considerably more market access, under well-defined commitments, than under existing preferential schemes, which are discretionary schemes operated by industrialized countries that are not subject to detailed WTO regulation governing their implementation.

All developing country WTO members benefit from the scheme.¹³ Even the largest and richest developing countries receive free access to markets, whose total size is more than seven times the size of the markets to which they must give free access. The median ratio of market access rights to obligations under MAP is 303 : 1, i.e. the median developing country receives access to markets 303 times the size of the markets to which it must *give* free access. Alternatively, measured by imports, the median developing country receives free market access to countries whose total imports are 113 times the size of the imports of the countries to which it is required to give access.

4. *Countries can manage major import threats.* The proposal imposes no extra obligation on developing countries to open their markets to larger or more developed economies. This gives developing countries the *option* to provide their key industries with some protection from imports from economies with cost advantages derived from either the scale of their economies (e.g. larger countries, particularly China) or technological advantages (more developed countries). The prevalence of import barriers in some sectors indicates that developing countries wish to protect particular industries from import competition. This protection may form part of an industrial strategy based on 'infant industry' protection,¹⁴ but is

¹³ For purposes here, developing countries are defined as those that had a GDP per capita below US\$10,000 in 2003.

¹⁴ Although this would not be particularly desirable from a theoretical point of view and, indeed, seems unlikely to be a major motivating factor, since infant industry policies have been shown to be ineffective (Baldwin 1969) and inferior to alternative forms of industry assistance (McCulloch, Winters, and Cirera 2002).

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more likely to originate in a desire to avoid adjustment costs, which could be particularly severe in developing countries characterized by high unemployment, weak risk markets, and low levels of social insurance.

As Hoekman *et al.* (2003) point out, protectionism can be self-defeating for developing countries in a world where multinational corporations have made production increasingly fragmented internationally. For many developing countries, 'the only option to reach the minimum scale required for sustained growth in output is integration with the rest of the world' (Keck and Low 2004).

This proposal facilitates integration by providing all developing countries with significantly increased market access to larger and richer markets, while providing the option of protection from imports from countries which are at later stages of development or have scale advantages.

5. *It is consistent with other MFN liberalization schemes.* It is important to point out that this proposal is not opposed to openness. It does not involve any increases in existing MFN rates. Each country would continue to apply MFN rates uniformly to larger and more developed countries.

In addition, this proposal is squarely in the realm of SDT. There is still a role for the WTO to negotiate MFN tariffs, i.e. it complements other proposed modalities for MFN tariff reduction, rather than replacing them.

One concern with the proposal is that it may affect the bargaining positions of developing countries in future rounds. One of the unfortunate side-effects of existing preferential schemes is that they create an inbuilt incentive for developing countries to block MFN liberalization which would erode their preference margins. But this problem is much less severe for MAP than for existing preference schemes because MAP is far less distortionary: large rich countries do not give LDCs preferences that they do not also give to middle-income countries. Thus MFN liberalization by developed countries does not cause LDCs to lose out relative to middle-income countries.

6. *It transforms discretionary preferential schemes into well-defined obligations within the WTO.* One of the main advantages of

this proposal over existing types of SDT is that it delivers clearly defined and legally binding rights to developing countries in a way that existing preferences do not. Many of these existing preference schemes were originally spawned by part IV of the GATT, which includes provisions on preferential treatment for developing countries. This exception was further expanded in 1979 in the decision which has come to be known as 'the Enabling Clause'. This consolidated the concept of 'differential and more favourable treatment' for developing countries as well as the principle of non-reciprocity in trade negotiations.¹⁵

However, the problem with this (potentially) wide-ranging clause is that it has never placed any formal obligations on developed countries. Instead, piecemeal preferential deals have been established which cover a limited range of goods from a limited group of countries. These preferences, the most important of which are offered by the Quad countries, often divert trade from other poor countries.

Another problem with preferential schemes is their uncertainty. Keck and Low (2004) argue that SDT should enshrine 'legal rights and obligations', whereas existing preferences have become merely 'legally unenforceable statements of intent or best-endeavour undertakings'. Preferences are not binding on the countries which grant them, and can be altered to exclude certain products or withdrawn entirely at the discretion of the preference provider. For example, in 1992 the US withdrew \$60 million worth of pharmaceutical imports from their preference scheme because the US Trade Representative determined that India had weak patent protection which adversely affected US companies.

Without binding obligations, preference providers have faced pressure from their own import-competing domestic lobbies to minimize the scope of their preferential schemes. As the Sutherland report notes, it is 'grantor, rather than grantee, country interests [which] have determined the product coverage and the preference margins in GSP schemes' (Sutherland 2005:).

¹⁵ The most significant provision of the Enabling Clause is that which enables members to accord differential and more favorable treatment to developing countries as a departure from the MFN Clause. It stipulates that 'contracting parties may accord differential and more favourable treatment to developing countries, without according such treatment to other contracting parties'.

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7. *It balances simplicity against the need to differentiate.* The idea that SDT should be provided to countries based on objective access criteria has been previously addressed by Stevens's (2002). Stevens's proposal suggests that a new SDT regime involve 'greater differentiation of treatment between WTO members which, in turn, implies the establishment of objective criteria on which to determine the differentiation'. For example, he suggests that access to some types of SDT in agriculture should be based on measurable criteria relating to food security, e.g. countries could qualify for special treatment if they have a per capita calorie intake of less than a certain level (indicating vulnerability to food insecurity) and a high share of agriculture in GDP (indicating the importance of agriculture in livelihoods) and a high share of food imports to GDP (indicating import dependency). Stevens's approach involves setting objective criteria on an agreement-by-agreement basis. Thus, special and differential treatment would be available to countries which met objective preconditions indicating their need for exception and/or assistance. The appeal of this approach is that it closely matches the needs of specific countries to special treatment in different provisions. In addition, it provides more certainty to developing countries since, once the conditions are predetermined, eligibility would be automatic rather than at the discretion of other WTO members.

The disadvantage of this approach is that it would add to the complexity of trade negotiations and greatly increase transactions costs. SDT measures are already overly complicated in many areas. Hudec (1987) refers to preferences as systems of 'refined complexity', determined by an 'orgy of fine-tuning'. The process of tailoring objective criteria for SDT in each agreement requires countries to agree on measurable criteria and on eligibility cut-offs. As Stevens (2002) himself notes, 'the whole process is likely to be fraught with political difficulty'. It is likely that neither the international consensus on these issues nor the necessary negotiating capacity currently exists to operate such an ambitious and resource-intensive SDT system.

By contrast, the MAP proposal is simple to negotiate. It would entirely do away with the whole 'spaghetti bowl' of GSP preferences (although not FTA preferences) and it would save the EC the bother

of negotiating the market access part of the economic partnership agreements with African, Caribbean, and Pacific states.¹⁶

Moreover, it includes an inbuilt flexibility that removes the need for renegotiation over time. As countries develop and overtake others, they will, after an implementation period, lose some preference rights and accept obligations to poorer countries. Alternatively, the scheme could be designed to include a 'one-way' provision so that free trade would monotonically increase in a dynamic world where rankings change.

Concluding remarks

Developing countries have been understandably reluctant to commit themselves to large reductions in their tariff levels. They are concerned that open borders will lead to a flood of cheap imports from more efficient producers, which could destroy their fledgling industries before they have a chance to develop. Because they are already characterized by high unemployment and weak private and social insurance, many developing countries believe that the adjustment costs from significant MFN tariff reduction are too large to be seriously considered. Consequently developing countries have not offered large reductions in border protection in WTO negotiations. As a result, South-South trade has suffered, and developing countries have little bargaining power in their negotiations with developed countries.

The proposal in this chapter distributes new market access progressively, ensuring that the largest gains accrue to the smallest and poorest countries, and it distributes liberalization obligations progressively, requiring that the largest and richest countries liberalize most. There are many other issues associated with tariff reduction in poor countries, including adjustment costs and declining revenue to governments. These issues, and their implications for the need for

¹⁶ The Cotonou Partnership Agreement between the African, Caribbean, and Pacific (ACP) countries and the European Union, signed in June 2000, mandates the negotiation by 2007 of a series of economic partnership agreements (EPAs) between regional groups of ACP states on the one hand and the EU on the other.

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technical and development assistance to poor countries, are not discussed here. The advantage of MAP is that it provides significant liberalization, does not demand reciprocity from poor nations to richer ones, and places simple and well-defined obligations on both rich and poor countries alike.

Special and differential treatment in rules

In the previous chapter we suggested that the WTO's 'policy space' be limited to areas in which there are clear international spillovers or development gains to justify the prioritization of multilateral disciplines over national-policy autonomy. There is now a recognition that many WTO agreements which impose 'behind the border' rules may have gone too far in the direction of restricting the autonomy of developing countries to determine their own industrial policies. The WTO's Agreement on Subsidies prohibits export subsidies for all but least developed countries. The Trade Related Investment Measures (TRIMS) Agreement prohibits the use of a number of investment-performance-related measures that have an effect on trade, including local content and sourcing requirements. Both of these policies were widely used by East Asian economies during their rapid industrialization in the last century. Further restrictions have been imposed by the WTO's TRIPS Agreement, negotiated in the 1986–94 Uruguay Round, which introduced intellectual property rules into the multilateral trading system. The TRIPS Agreement has considerable implications for technological and industrial policy. By strengthening intellectual property rights in developing countries, it is likely to increase the royalty payments demanded by technology holders there, and also to create or reinforce monopolistic positions in small markets. It also restricts reverse engineering and other important methods of imitative innovation, thereby limiting the ability of firms in developing countries to reduce their technological disadvantage.

To prevent further incursions on their policy autonomy, developing countries should demand exemptions from restrictive multilateral rules. This includes proposals by developed countries in the Doha

Round to develop multilateral disciplines for national competition and investment policies. Proponents of an investment agreement would like binding global rules that allow foreign investors the rights to enter countries without any conditions and regulations which do not apply to domestic firms, i.e. to be granted 'national treatment'. This type of international investment agreement is designed to maximize foreign investors' rights while minimizing the authority, rights, and policy space of governments. Similarly, the proposals in the Doha Round to introduce multilateral disciplines in competition policy would limit the ability of governments and local firms in developing countries to take actions which are to their advantage.

Certainly the WTO can serve as a device for commitment to good policies, but such commitments should be part of voluntary plurilateral agreements rather than compulsory elements of the WTO's 'single undertaking'. Compulsory commitments should not be made in areas where the purported gains are controversial and where implementation and opportunity costs are high. And where the gains are certain and the costs are low for developing countries (such as in efforts to liberalize some aspects of foreign direct investment regulations), there is no need for compulsion, because developing countries can be persuaded of the benefits of taking unilateral action. For example, in FDI policy, developing countries have been persuaded of the benefits of more open foreign investment regimes. In 1999 alone, there were 140 changes to FDI regulations worldwide; 131 of these liberalized conditions were for FDI (UNCTAD 2000). Developing countries have acted responsibly in their own interests, without the need for multilateral compulsion.

There is a growing recognition that the WTO needs to move away from agreements which enshrine compulsory rules under the 'single undertaking'. Hoekman (2004) suggests dividing the WTO's disciplines into 'core' and 'non-core' agreements. Core disciplines would be required to be unconditionally accepted by all countries. Developing countries could be permitted to pass over non-core WTO rules on development grounds.¹⁷

¹⁷ Hoekman (2004) suggests a consultative multilateral mechanism within the WTO to authorize policies which deviate from 'non-core' commitments. This authorization would be based on an assessment of the effectiveness and impact of such policies.

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Such differential treatment would facilitate the design of trade agreements which are more likely to promote economic development. A blanket proscription against government subsidies to technology (industrial policies) is likely to have an adverse effect on developing countries and, indeed, it is likely in practice to be unfair: the United States conducts its industrial policy largely through the military, which supports a wide variety of technological developments that eventually have important civilian applications. And it is hard to conceive of a trade agreement that would prohibit the transfer of such technologies.

Thus, each provision of a trade agreement should be assessed for its impact on development, and designed to ensure that development is enhanced, employing where necessary provisions for special and differential treatment. Moreover, the totality of the trade agreement should be assessed to ensure that a fair share of the benefits (the net incidence) accrues to developing countries.

