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The Doha Round of Trade Negotiations: An Agenda to Promote Development and Facilitate Adjustment

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Task Force on Trade

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1 Introduction

The development focus of the Doha Round emerged from a renewed spirit of collective responsibility for the challenges faced by poor countries, and also as a response to the perceived inequities generated by previous rounds of trade negotiations. Unfortunately, in the years since it was launched, the Doha Round has not delivered on its development mandate in several important respects. First, there has been little progress on the issues of interest to developing countries (especially agriculture, labor mobility, and labor-intensive manufactures and services). Second, the new issues on the agenda, the so-called ‘Singapore Issues’, primarily reflect the interests of the advanced industrial countries and have been strongly opposed by many developing countries. Third, the domestic and bilateral actions of several OECD countries have led to questions about their commitment to the multilateral development agenda.¹ Finally, there has been only limited reform to the culture and procedures of the WTO.

In the aftermath of the failure of Cancun, there is a need to reassess the direction of global trade negotiations. In Doha, the nations of the world agreed to a new round of trade negotiations, which would redress some of the imbalances of the past, imbalances which it was widely felt had benefited the advanced industrial countries at the expense of developing countries. There was, in fact, considerable basis for the complaints of the developing countries, in terms both of the manner in which trade negotiations had been conducted in the past² and of the outcomes.³ Many of the

¹ See the US Farm Bill of 2002 (Farm Security and Rural Investment Act 2002) which substantially increases domestic support to agricultural producers and the European Commission’s Luxembourg reform of the common agricultural policy which did little to cut the total level of European agricultural support.

² Of particular concern was the lack of transparency (including “green room negotiations, in which only a few chosen countries from the developing world engaged in negotiations with the United States and Europe) and the disadvantageous position the developing countries had in these negotiations, simply because of the complexity of the negotiations and their limited staffs. See for example the open letter, dated 6 November 1999, sent by 11 developing countries to the WTO chairman Ambassador Ali Mchumo of Tanzania, expressing their concern over the lack of transparency in the WTO Green room process.

³ A widely quoted World Bank study estimated that Sub-Saharan Africa was actually worse off as a result of the terms of trade effects generated by the Uruguay Round of trade negotiations (Martin and Winters 1996). The United Nations Development Programme estimates that under the WTO regime, in the period 1995 to 2004, the 48 least developed countries will actually be worse off by \$600 million a year, with sub-Saharan Africa actually worse off by \$1.2 billion. The UN Development Programme also says that 70% of the gains of the Uruguay Round will go to developed countries, with most of the rest going to a relatively few large export-oriented developing countries. UNDP HDR [1997]. Similar concerns are raised about the “allowed” trade restrictions. Textiles remain the one major area of quotas, and though these are supposed to end in 2005, there is concern that the developed countries

participants in the Cancun meeting felt that Europe and the United States had reneged on the promises that had been made at Doha, emblemized by the lack of progress in agriculture.

This paper takes a step back from these disputes. It attempts to support progress in the current round by asking, what would a true Development Round of trade negotiations look like, one that reflected the interests and concerns of the developing world and was designed to promote their development? What would an agreement that was based on principles of economic analysis and social justice—not on economic power and special interests—look like? Our analysis concludes that the agenda would look markedly different from that which has been at the center of discussions for the past two years, and that the fears of the developing countries that the Doha round of trade negotiations (were the demands of the developed countries acceded to) would disadvantage them were in fact justified.

Section 2 addresses the need for a Development Round. It examines some elements of the experience of developing countries in previous trade negotiations and briefly reviews some of the potential gains available from further liberalization. Section 3 is a brief review of the Doha round so far, and the extent to which it has lived up to the expectations of developing countries. It makes clear that there is a huge discrepancy between the Development Round trade agenda, both as it was formulated at Doha and as it has evolved since, and a true Development Round agenda. Such an agenda would promote growth in developing countries and work to reduce the huge disparity that separates them from the more advanced industrial countries.

Most of this paper is what is sometimes called “blue sky” analysis: it approaches the issues from a fresh start, relatively unencumbered by concerns of politics and what has happened in the recent past. Section 4 outlines the principles of a Development Round of trade negotiations. The primary principle of the Doha Round must be to ensure that the agreements promote development in poor countries. To make this principle operational, the WTO needs to foster a culture of robust economic analysis to identify pro-development proposals and promote them to the top of the agenda. The agreements must enshrine both *de jure* and *de facto* fairness. This means ensuring that developing countries are not prevented from unlocking the benefits of free trade because of a lack of institutional capacity. In this regard, developing countries will require special assistance to enable them to participate equally in the WTO.

The principle of fairness should also be sensitive to countries’ initial conditions. Special and differential treatment is needed to recognize that adjustment to new trading rules involves particularly high costs for developing countries whose institutions are weakest and whose populations are most vulnerable. Prescriptive

will either not fulfill their commitments (a ten year transition period was provided, to facilitate “adjustment,” but little adjustment occurred in the first nine years); or they will replace the quotas with extremely high tariffs; or they will use safeguards or other non-tariff barriers. While it is often emphasized that average tariffs of developing countries remain higher than those of developed countries, it is also true that *developed countries average tariffs against developing countries are higher than their average tariffs against developing countries, even taking into account existing preferences.*

multilateral agreements must not be allowed to run roughshod over national strategies to deal with idiosyncratic development problems.

Section 5 presents pro-development priorities that should form the core of the Doha Round agreements. Much of the recent discussion has focused on agriculture, but there is much more to a true Development Round. Primary attention should be given to market access for goods produced by developing countries. There is, for instance, an urgent need to reduce protection on labor-intensive manufactures (textiles and food processing), and unskilled services (maritime and construction services). Priority should also be given to the development of schemes to increase labor mobility – particularly the facilitation of temporary migration for unskilled workers. As tariff barriers have come down, developed countries have increasingly resorted to non-tariff barriers; these need to be circumscribed.

Section 6 considers the potentially costly process of adjustment to the kind of new trading regime envisioned in this paper. In one sense, adjustment costs can be thought of as the price to be paid for the benefits of multilateral trade liberalization. It is these adjustment costs together with the trade benefits that determine the net effect of trade reform for each country. The Doha Round has placed renewed emphasis on the importance of sharing the benefits of trade reform fairly among developed and developing countries. However there has been less attention to the distribution of adjustment costs among countries. The fact that implementation and adjustment costs are likely to be larger in developing countries, unemployment rates are likely to be higher, safety nets weaker, and risk markets poor are all facts that have to be taken into account in trade negotiations.⁴

Section 7 considers instruments to assist those countries for whom the costs of adjustment are large relative to the gross gains from liberalization. For the some of the smallest and poorest states, the adjustment costs of trade liberalization may significantly outweigh the benefits available. In particular we review the adjustment problems facing small states whose industries are substantially dependent on preferential market access schemes.

If the Development Round is to bring widespread benefits to people living in developing countries - and if there is to be widespread support for the continuing agenda for trade reform and liberalization - the developed world must make a stronger commitment than it has provided in the past to giving assistance to the developing world. Assistance is required not only to help bear the often large costs associated with trade reform, but also to enable developing countries to avail themselves of the new opportunities provided by a more integrated global economy.

⁴ This is especially true because under these conditions, trade liberalization is much less likely to be growth enhancing.

2 The need for a Development Round

2.1 Redressing past imbalances

In June 1993 the Uruguay Round (UR) was finally brought to a close. Part of the impetus for members to conclude the round was the promise of large welfare gains that had been projected by many researchers. In 1992-1993, the World Bank, the Organization for Economic Cooperation and Development, and various other institutions made projections of welfare gains in the order of \$200 billion a year.⁵ A large share of the gains was predicted to accrue to developing countries.⁶

In hindsight these estimates – particularly in relation to developing countries - were over-optimistic. More than 70% of the gains of the Uruguay Round will go to developed countries, with most of the rest going to a relatively few large export-oriented developing countries. Indeed many of the poorest countries in the world would actually be worse off as a result of the round. Some estimates report that the 48 least developed countries will actually lose a total of \$600 million a year as a result of the Uruguay Round. Many of the net losers are among the poorest countries in the world. In particular, a large share of the net losses accrue to sub-Saharan African countries which have been collectively estimated to lose \$1.2 billion as a result of the round (UNDP HDR [1997]). One reason was that the modeled scenarios were not fully reflected in the actual agreements and the subsequent events.⁷ Several reforms which were significant sources of predicted gains did not proceed as had been hoped early in the negotiations; the Agreement on Textiles and Clothing (ATC) was structured to significantly backload liberalization⁸; the ability of tariff-rate quotas

⁵ Indeed after Marrakech, the GATT secretariat put forward a larger estimate of the minimum gain of \$500 billion per year. For a discussion of the projections see Safadi and Laird, 1996, "The Uruguay Round Agreements: Impact on Developing Countries", World Development, Volume 24, No7, pp.1223-1242. For a survey of the various estimates see Dani Rodrik, "Developing countries after the Uruguay Round", paper prepared for the Group of 24, mimeo, August 1994, Will Martin and L. Alan Winters, editors, The Uruguay Round and the Developing Countries, Cambridge University Press, 1996, and T. N. Srinivasan, Developing Countries and Multilateral Trading System, Westview Press, 1998 for comprehensive surveys and assessment of the achievements of the developing countries in the Uruguay Round.

⁶ The gain to developing countries was estimated at up to 90 billion dollars, or roughly one third of the total gains (OECD 1993).

⁷ The models themselves also make assumptions that may not be fully appropriate for less developed countries. See Charlton and Stiglitz [2004]

⁸ As we noted, the developed countries were given a decade to remove their textiles quota; the argument was that the extra time would allow them a smoother adjustment process. In practice, since little if any adjustment has occurred, only the day of reckoning was postponed. In the United States, the legislation implementing the Uruguay Round, by not adopting a steady phase out of the quotas, made clear that this postponement was the real motivation.

(TRQs) to liberalize agricultural market access was overestimated; and the costs of implementation were almost completely ignored.

The Uruguay Round agenda reflected, in large part, the priorities of developed countries. Market access gains for example were concentrated in areas of interest to developed countries and there was only marginal progress on the priorities of developing countries (particularly in agriculture and textiles). The result of this regressive asymmetry was that *after the implementation of Uruguay Round commitments, the average OECD tariff on imports from developing countries is four times higher than on imports originating in the OECD* (Laird 2002). Domestic protection (particularly agricultural subsidies) is also much higher in developed countries, amounting to more than US\$300bn in 2002. The impact of this protection is particularly regressive since producers in the poorest developing countries are the most affected by OECD policies. Only 4 per cent of the exports of developed countries are subsidised by another WTO member, but 6.4 per cent of the exports of middle income countries are subsidised. By contrast, a much larger share (29.4 per cent) of the exports of the poorest countries (not including China and India) are subsidised by another WTO member.⁹

As well as receiving a small share of the gains from the Uruguay Round, developing countries accepted a remarkable range of obligations and responsibilities. New trade rules and domestic disciplines were introduced, but they too reflected the priorities and needs of developed countries more than developing countries (e.g., subsidies were permitted for agriculture, but not industrial products). Many of the rules acted to constrain the policy options (such as industrial policies) of developing countries, in some cases prohibiting the use of instruments that had been used by developed countries at comparable stages of their development.

2.2 Unfinished business

The 1994 Agreement on Agriculture defined a framework in which agricultural protection could be negotiated in the WTO, but it did not deliver significant benefits to developing countries. Martin and Winters (1996) note that the Agreement on Agriculture achieved “little in terms of immediate market opening.” Indeed the level of OECD farm protection was not noticeably reduced. In 1986-88 transfers were equivalent to 51 percent of all OECD farm production, and fourteen years later, after the implementation of Uruguay commitments, at roughly \$300 billion, they still account for 48 per cent of all farm production (OECD [2003]). Trade-distorting measures of industrialized nations displace the agricultural exports of developing countries. By suppressing world prices, these policies have a direct effect on farm

⁹ These may underestimate the relative effects of subsidies if developing countries' exports are more concentrated in those agricultural products which attract subsidies.

incomes. Moreover, there may be dynamic effects, as investment is also suppressed in countries whose trade is adversely affected by OECD support.¹¹

In non-agricultural goods, there is also scope for further liberalization. The significant liberalization of manufacturing tariffs in developed countries over the last two decades might suggest that there is little to gain from further negotiations on industrial products. However if this is true to some extent for developed countries, it is certainly not the case for developing countries. While average developed country tariff rates are low, they maintain high barriers to many of the goods exported most intensively by developing countries. When weighted by import volumes, developing countries face average manufacturing tariffs of 3.4 per cent on their exports to developed countries, more than four times higher than the average rate faced by goods from developed countries, 0.8 per cent (Hertel and Martin, 2000). Moreover aggregate data hides the existence of tariff peaks.¹² Tariff peaks and tariff escalation are manifestly unfair and have a particularly pernicious effect on development by restricting industrial diversification in the poorest countries.

After the Uruguay Round, there was also a widely held view that the TRIPS agreement needed to be reviewed, particularly in its application to public health as well as bio-piracy. Article 71.1 of TRIPS provided for a review of the implementation of the TRIPS Agreement after year 2000, and for possible reviews "in the light of any relevant new developments which might warrant modification or amendment". Many developing countries felt that the Agreement as it stood primarily reflected IPRs protection suitable for developed countries, but which largely disregarded important factors in developing countries.

International rules for IPR have potentially huge public health effects and global distributional consequences. Unbalanced rules—and there is a concern that present rules are unbalanced—can impede efforts to close the north-south 'knowledge gap'. Additionally the WTO also has the responsibility to protect indigenous knowledge. While there have been a few dramatic bio-piracy cases,¹³ the full impact of expanded patentability remains uncertain. Patent laws need to be changed so that the onus of

¹⁰ Estimates of the downward impact on world prices caused by OECD domestic support are between 3.5-5% for many agricultural commodities including wheat and other coarse grains and oilseeds (Dimaranan et al. (2003)).

¹¹ Diao, Diaz-Bonilla, and Robinson (2003) report that protectionism and subsidies by industrialized nations cost developing countries about US\$24 billion annually in lost agricultural and agro-industrial income. Latin America and the Caribbean lose about US\$8.3 billion in annual income from agriculture, Asia loses some US\$6.6 billion, and sub-Saharan Africa, close to US\$2 billion. Their estimates do not include dynamic effects.

¹² In the United States, post-Uruguay-Round tariff rates on more than half of textile and clothing imports are between 15 and 35 per cent, while in Japan 22 per cent of textile imports face tariffs of 10-15 per cent (UNCTAD 1996). Similarly in the processed food sector, Canadian, Japanese and EU tariffs on fully processed food are 42, 65 and 24 per cent respectively. By contrast, the least processed products face tariffs of 3, 35, and 15 per cent in these countries (World Bank 2002). Such tariff escalation serves to discourage the development of food processing in less developed countries since the *effective* tariff rate on "value added" in food processing is very high.

¹³ In May, 1995 the US Patent Office granted to the University of Mississippi Medical Center a patent [#5,401,504] for "Use of Turmeric in Wound Healing." The United States Patent and Trademark Office (USPTO). revoked the patent after dozens of references to the procedure were found in Indian texts.

proof reversed and companies should give an undertaking that the patent they are seeking is not based on traditional wisdom.

2.3 New areas of importance

Services represent an increasingly large share of GDP and trade in both developed and developing countries. With manufacturing dwindling to 14% of U.S. GDP,¹⁴ it was natural for the U.S. to shift the focus of trade liberalization to services.¹⁵ But the Uruguay Round focussed on the liberalization of those service industries of primary interest to firms in OECD countries (like financial services). There was significantly less attention given to low-skilled labor intensive services in which developing countries have a comparative advantage.¹⁶ Developing countries have increased their exports of services by more than four times since 1990, despite the large trade barriers facing many of their most promising industries such as construction, shipping services, and health services (OECD 2002).¹⁷ In these industries developing countries have legitimate and substantial interest in the outcome of a new round of liberalization.¹⁸

Some of the areas of service sector liberalization that were advanced in the Uruguay Round may well have disadvantaged the developing countries. Financial market liberalization, for instance, may have weakened domestic financial firms, reducing the already scant supply of credit available to domestic small and medium sized enterprises.¹⁹

This agenda of “new issues” and “unfinished business” is markedly different from the agenda of the Doha round. The new “Singapore issues”²⁰ all centered around

¹⁴ An irony of the Uruguay Round was that it seemed as if the agreement, centered around manufacturing, would, in the future, be of greater benefit to China than to any other country.

¹⁵ Additionally, given the apparent barriers to service trade, there might be large gains from liberalization. (See Brown, Deardorff and Stern, 2002. They estimate of the global gains from service liberalization are as high as \$400bn. However these may overstate the benefits to liberalization if many of these barriers are exogenous, not related to economic policy.)

¹⁶ Developing countries are capturing a growing share of trade in services. More than one quarter of the world’s top 40 service exporters in 2002 were developing countries.

¹⁷ In doing so, they have increased their share of the global marketplace from 14 percent (1985-1989) to 18 percent (1995-1998) (World Bank, 2002)

¹⁸ As we discuss in the next section, these labor intensive services are not the ones that have been given priority in the Doha Round so far.

¹⁹ Worse still, it is not clear whether measures to promote disadvantaged groups, such as America’s Community Reinvestment Act, would be allowed under the new trade regime.

²⁰ These centered around (i) government procurement; (ii) trade facilitation; (iii) competition; and (iv) investment. The names, however, are somewhat misleading. ‘Competition’ did not focus, for instance, on anti-trust. The developing countries had already expressed their hostility to the initiative by the OECD for a multilateral investment agreement. There was no reason to believe that the WTO provided a venue in which an agreement acceptable to the developing countries could be worked out. In any case, it was clear that this was an initiative of the developed countries, not of the developing countries. Similarly, while developed countries hoped to have greater access to government procurement in developing countries, there was little hope that developing countries could make much

concerns of the developed countries. There was one, competition policy, which in principle could have been of benefit to the developing countries—had dumping duties been brought into the discussion. But the developed countries were adamantly opposed.

inroad in procurement by developed countries, especially in the central area of defense. This too was a developed country agenda item.

3 Doha's development record so far

Despite the expressions of goodwill at Doha, progress on the Development Round has been slow. Part of the problem is that, while the interests of different developing countries differ, the evolving agenda itself was not really designed to reflect their real concerns. Throughout 2002 and 2003 it became apparent that many developing countries felt that the Doha Round was moving in the wrong direction on many key issues. They felt that the new round offers them few immediate benefits but carries the risk of additional obligations. As a consequence developing countries walked away from the Cancun Ministerial in September 2003.

Up to that point, Doha had achieved little progress on most of the critical development issues. One of the key disappointments has been agricultural reform, which many developing countries²¹ and NGOs²² viewed as the primary objective of the round. The March 2003 deadline for agreement on agricultural modalities was missed. When the US and EC finally presented a joint paper on agriculture modalities in August, the framework was widely criticised by developing countries, correctly in our judgment, for ignoring their interests.²³ On the key issues of market access, domestic support, and export subsidies the text was perceived to fall short of the level of ambition of the Doha mandate; indeed, in some respects, what was offered was a step backward.²⁴

At the same time, agricultural initiatives within OECD countries seemed to be undermining multilateral efforts. The U.S. Farm Bill in 2002 increased the level of support to U.S. farmers²⁵ and strengthened the link between subsidies and production

²¹ Section 7 of 6th June 2003 Communication from Argentina, Bolivia, Botswana, Brazil, Chile, China, Colombia, Cuba, Dominican Republic, Ecuador, El Salvador, Gabon, Guatemala, Honduras, India, Malaysia, Mexico, Morocco, Nicaragua, Pakistan, Paraguay, Peru, Thailand, Uruguay, Venezuela and Zimbabwe, (TN/C/W/13), makes it clear that "Reform of agricultural trade is of central importance for many developing countries" and is "an essential ingredient of the negotiation and its outcome." (original emphasis.)

²² Oxfam (2000) argues that "agriculture is the key to unlocking the Doha development agenda, and without constructive steps on this issue, the broader negotiations cannot really restart."

²³ See the statements by Indian Ambassador K.M. Chandrasekhar, Brazil's Ambassador, Luis Felipe de Seixas Correa, and China's Ambassador Sun Zhenyu.

²⁴ On domestic support, no specific figures were given for reducing the most trade distorting support. The text potentially widened the scope for the use of blue box support – a step backwards in terms of liberalization. Also the text did not focus on trade distorting elements of the Green Box measures. See the critical response by Kenyan Ambassador Ms. Amina Chawahir Mohamed who said that "the EC-US text falls short of our expectations and as such we find it difficult to accept it as a basis of our further work".

²⁵ The U.S. Farm Security and Rural Investment Act (FSRIA) of May 2002 has a value of about \$190 billion over the next 10 years, about \$83 billion more than under previous programs. It sets target prices which are lower than the pre 1996 levels, but the total effective support is larger because average world commodity prices have declined and the range of commodities included in FSIRA is

decisions.²⁶ One year later, the EC's 2003 Luxembourg reform of the common agricultural policy (CAP) was also disappointing. The EC reform shifts support from the 'Blue Box' (production limiting) to the 'Green Box' (deemed to be less trade-distorting). However the level of producer support will remain virtually constant – projected to fall from 57 per cent to 56 per cent (OECD 2004). Moreover the reform has little impact on export subsidies or import barriers. Both of these initiatives fell far short of expectations and signaled the limited commitment of the US and EC to agricultural reform. Consequently both plans had a depressing effect on the mood of multilateral agricultural negotiations.

After the Uruguay round, there was a clear understanding that there would be further liberalization of agriculture. There is now a strong sense that the United States has reneged on that commitment; whether the huge increase in agricultural subsidies is an explicit violation of earlier agreements is of less importance than that it represents a violation of the spirit of the agreement (or at least was taken as the spirit of the agreement by the developing countries.)²⁷ Just as the agreement has to be viewed as a whole, so too, a Development Round agreement has to be viewed in the context of the unbalanced agreements that preceded it.

In addition to their disappointment on agriculture, developing countries are sceptical about the effects of the new items on the agenda. There is significant opposition from developing countries to the Singapore Issues. In the space of a month from early June 2003, 77 developing countries, including over half the WTO membership, made public statements urging that the Singapore Issues not be included as part of the Doha Round.²⁸ Since these issues are not priorities for developing countries, their centrality in the agenda prior to Cancun was an incongruous feature of the 'development' round.

Several developing countries see the Singapore issues as incursions into their national sovereignty that are not justified by the benefits they bring. Multilateral regulatory disciplines hold the spectre of repeating the worst elements of Uruguay by restricting the options for individual governments to pursue development policies based on their own national priorities and problems.

In addition there are concerns that the initiatives based on the Singapore issues may impose a large burden on the administrative capacity of developing countries. There are significant costs associated with both the creation and enforcement of new regimes in competition policy, investment regulations, and trade and customs

larger than in the 1996 FAIR Act. That act was intended to phase out farm subsidies, but even before the passage of FSRIA, farmers had achieved additional support through emergency measures.

²⁶ It provides counter cyclical payments (CCPs) to U.S. farmers which respond negatively to the world prices. This type of measures has allowed the U.S. to dump its farm surplus on world markets. For example, the U.S. exports corn at prices 20 percent below the cost of production, and wheat at 46 percent below cost. See Cassel (2002).

²⁷ The recent preliminary WTO ruling against American cotton subsidies (based on a complaint from Brazil) has lent support to the critics. America claimed, remarkably, that their subsidies did not adversely affect other cotton exporting countries. Such claims clearly undermine the credibility of the position of the developed countries.

²⁸ CAFOD (2003) 'Singapore Issues in the WTO: What do developing countries say?'

procedures.²⁹ Many developing countries have been unable to meet their Uruguay Round obligations because of these high costs.³⁰

There was also little or no progress on other items that are of concern to developing countries, from non-tariff barriers like dumping duties to bio-piracy.

In summary the agenda for the 'Development Round' has evolved disappointingly for developing countries. It has done little to address their concerns in agriculture and it has done little to address problems posed by non-tariff barriers. It has not prioritized a developing country service sector agenda and there were no reforms in basic procedures.

In addition, the proposed agenda's new issues could have made life worse for developing countries. The U.S. wanted capital market liberalization as part of investment agreement, even though weight of evidence was that capital market liberalization did not promote growth but did lead to more instability. Under competition policy, rather than creating a true competitive environment—hindering use of dumping duties as protectionist devices—there was fear of restricting development and socially oriented preferences

In the South, of course, there is a tendency to see the actions as coordinated, driven by economic interests in the North. While they may see more coordination than actually occurs, the impacts are often closely akin to what they would be if they were coordinated. The high interest rates, tax policies, and trade liberalization policies demanded by the IMF do exacerbate the adverse effects on developing countries of whatever trade liberalization measures they agree to within the WTO. The two cannot be seen in isolation.

Since the failure of Cancun, the developed countries seem to have largely taken the Singapore issues off the table and made additional commitments in agriculture, sufficient to restart talks. But those commitments were viewed by many observers as lacking specificity, giving rise to continuing pessimism about the eventual outcome.

²⁹ Finger (2000) estimated the implementation of three of the Uruguay Round's six agreements that required regulatory change (customs reform, intellectual property rights, and sanitary and phytosanitary (SPS) measures). His analysis suggests that the average cost of restructuring domestic regulations in the 12 developing countries considered could be as much as \$150 million.

³⁰ By January 2000, up to 90 of the WTO's 109 developing country members were in violation of the SPS, customs valuation, and TRIPs agreements.

4 Principles for a Development Round

What would a development agenda really look like? We begin with an analysis of the principles that should underlie a development round of trade negotiations. It seems self-evident that:

1. *Any agreement should be assessed in terms of its impact on development; items with a negative effect on development should not be on the agenda.*
2. *Any agreement should be fair.*
3. *Any agreement should be fairly arrived at.*
4. *Any agreement should be limited in scope.*

While these principles may be widely agreed to, there may be important differences both about the meaning of terms and about how to respond to conflicts among the principles.

4.1 Impact assessment

Any agreement should be carefully designed to promote, not hinder, development. There is surprisingly little economic analysis of the precise consequences of various potential trade agreements on participant countries. Where analytical studies have been done, they have not penetrated into the core of negotiations and do not seem to play a central role in setting the agenda. The absence of this type of analysis raises the question of what is driving the prioritization of trade issues on the WTO agenda, other than a *mélange* of prevailing orthodoxies and the momentum of special interest groups?

The WTO Secretariat should be responsible for producing a general equilibrium incidence analysis,³¹ attempting to assess how different countries are affected by

³¹ *Incidence* analysis is commonly employed to analyze the consequences of tax measures in advanced industrial countries; it assesses who *really* bears the burden of taxation. However, such analysis is less common in trade policy. The interpretation of general equilibrium analysis must recognize that models are sensitive to their assumptions. Much of current analyses of the impacts relies on a particular model of the economy, the neo-classical model, which assumes full employment of resources, perfect competition, perfect information, and well functioning markets. These assumptions are of questionable validity for any country, and are particularly problematic for developing countries. Full employment general equilibrium models often predict significant welfare gains from trade liberalization because it enables resources to be redirected from low productivity protected sectors to more productive sectors, as the economy specializes in its areas of comparative advantage. However if there is unemployment, trade liberalization is not needed to ‘release’ resources; trade liberalization may simply move workers from

different proposals. Publicly available analysis would benefit developing countries and consumer groups, many of who are at an information disadvantage relative to developed countries and producer lobbies. This information should be used to focus the WTO's agenda on those policies which are shown to maximize welfare gains, particularly for developing countries.

A complete incidence analysis must also include adjustment costs. Most of the tools used to analyze general equilibrium effects of trade liberalization are static models. They describe the movement from one 'steady state' to another but do not incorporate the costs associated with transition or the consequences for economies which are initially out of steady state. Even if trade liberalization had no impact on the equilibrium level of unemployment, it may take the economy considerable time to adjust, and the costs of adjustments—lost income and increased poverty—may be considerable. The fact that implementation and adjustment costs are likely to be larger in developing countries, unemployment rates are likely to be higher, safety nets weaker, and risk markets poor are all facts that have to be taken into account in conducting an incidence analysis.

4.2 A fair outcome

Previous rounds of multilateral trade negotiations did not pay much attention to fairness. Trade arrangements were the result of bargaining among self-interest parties; thus it was to be expected that the agreements that emerged would be advantageous to the economically powerful developed countries.³² Beginning in the Uruguay Round, the consensual voting system combined with the 'Single Undertaking' provided a constraint that ensured any agreement would at least make every nation better off (but this was only true if all countries had perfect information and if powerful countries did not try to affect the bargain with conditionality on outside issues)—even if the gains of trade accrued disproportionately to the rich.

However a process of self-interest is patently unable to deliver the kind of progressive outcome envisaged by the launch of a development round. Instead any agreement should be subject to a commonly agreed 'fairness constraint'. In a development round it should be essential that any agreement be progressive, i.e. that a larger share of the benefits accrue to the poorer countries. Thus any agreement that differentially hurts

low productivity protected sectors into unemployment. This lowers the country's national income and increases poverty.

³² Thus, rules for international trade were arrived at in a way which was fundamentally different from the way that rules governing domestic commerce are formulated. In the determination of domestic policies, there is a legislative process which is in most cases more than just the bargaining between vested interests; appeals are made to principles of fairness, and indeed, the entire debate is couched in terms of what is good for the country.

developing countries more or benefits the developed countries more,³³ should be presumptively viewed as unfair.³⁴

There are several difficulties in interpreting this requirement.³⁵ One is that many of the costs of, say, agricultural subsidies are borne by the developed countries. Not only are there huge budgetary costs associated with the subsidies, but the subsidies distort production, and thus incur a deadweight loss. Were developed countries to eliminate their subsidies, they would (as a whole) be among the main beneficiaries. Thus, a refinement of the above criterion would look at the benefits net of domestic efficiency effects; in competitive markets, it would be reflected in the general equilibrium terms of trade effects received by producers or paid by consumers; in non-competitive markets (or markets with quota restrictions) it would be the value of access granted.

The nature of trade agreements is, of course, that not every provision in the agreement is viewed to be “fair.” Some are intended to give more to one party, the other to another; it is the package as a whole which should be viewed as fair. But each trade agreement is forward looking and backward-looking; there are implicit and explicit understandings about the effects of past agreements and the direction of future agreements.

4.3 Procedural fairness

Procedural fairness becomes an important complement to the kind of fairness discussed in the preceding section (where fairness is judged in terms of the *outcomes*) when there is some ambiguity about what should be meant by “outcome fairness.” Procedural fairness focuses on the openness and transparency of the negotiation process, and the manner in which the discussions are conducted. It is hoped that the outcomes that are achieved through fair procedures are more likely to be fair, though, of course, even an open and transparent bargaining process is likely to result in “unfair” outcomes when the parties to the bargaining are of markedly different strengths. But it should be clear: A fair agreement is unlikely to result from an unfair process.³⁶

³³ Measured, for instance, by the net gains as a percentage of GDP,

³⁴ Underlying conflicts about perceptions of fairness is the fact that because the circumstances of the different countries are different, any agreement that applies “fairly” or “uniformly” to all countries may still have large differential effects. This is why we have emphasized (under point 1) the importance of an incidence analysis, an assessment of the differential effects on different countries.

³⁵ For further discussion of the principle of fairness in trade negotiations see Stiglitz and Charlton (2004).

³⁶ There is now a large literature which establishes that setting the agenda may have a large effect on the outcome; hence having voice in the setting of the agenda is essential. The agenda in previous trade negotiations has been unbalanced. This is evidenced by the fact that issues of benefit to the developed countries have been at the center of the discussion; issues like liberalization of unskilled labor intensive services have been off the agenda, while liberalization of skilled labor intensive services have been on the agenda. Since the bargaining process affects the outcome of the bargain, the WTO needs to ensure that the process has clear rules that ensure the effective participation of the weakest players.

Transparency is essential because it enables more voices to be heard in the negotiating process and limits abuses by the powerful. This is particularly important for developing countries, because of the limited size of their negotiating teams. Of particular concern is the lack of transparency of the ‘green room’ negotiations, in which only a few chosen countries from the developing world engage in negotiations with the United States and Europe. The ‘green room’ process limits outside scrutiny and places the developing countries in a disadvantageous position because of the complexity of the negotiations and their limited staffs.³⁷ Procedural fairness needs to deal with the asymmetry of power and the asymmetry of information among WTO members. While the effect of power disparities are difficult to reduce, informational disadvantage can be remedied.³⁸

The WTO’s dispute settlement system also lacks procedural fairness in some important ways. In trade disputes, the system favors developed countries both *de jure* and *de facto*. Thus, the costs to a developing country to attacking a claim of intellectual property by a Western company in a case involving bio-piracy may be very high. In practice the developing country is at a disadvantageous position in any process entailing resort to complicated and expensive legal proceedings. Thus the WTO dispute system favors rich countries with the resources to use it effectively for their own interests. The EC, Japan and the US were complainants in almost half (143 of 305) of all bilateral disputes in the WTO Dispute Settlement system between 1995 and 2002. By contrast the 49 members classified by the UN as Less Developed Countries did not bring a single challenge in that period.³⁹

By the same token, even were a developing country to prevail in a WTO tribunal against the United States or Europe, the enforcement system is asymmetric, and consequently unfair. The sanction for violating a WTO agreement is the imposition of duties. If Ecuador, say, were to impose duties on goods that it imports from the United States, it would have a negligible effect on the American producer; while if the United States were to impose a duty on goods produced by Ecuador, the economic impact is more likely to be devastating. In practice, the WTO system has no effective way of enforcing an unfair trade action, the main impact of which is on small developing countries.⁴⁰

³⁷ See for example the open letter, dated 6 November 1999, sent by 11 developing countries to the WTO chairman Ambassador Ali Mchumo of Tanzania, expressing their concern over the lack of transparency in the WTO Green room process.

³⁸ Both increased transparency and the provision of (impact assessment) information discussed in section 4.1 reduce information asymmetries.

³⁹ Horn, H. and Mavroidis, P. (2003) ‘Which WTO Provisions are Invoked by and Against Developing Countries’ CEPR.

⁴⁰ When, of course, a major industrial country takes a global action—such as the U.S. imposition of tariffs on steel—then there can be a global response, and this can force a retraction of the abusive action (as we have seen.)

4.4 Limited policy space

Defining the policy space appropriate for attention within the WTO is a difficult task. There has been a tendency to expand the WTO's agenda to include all manner of international economic problems from intellectual property rights to protection for foreign investors. The international community has found that bringing formerly intractable international issues within the ambit of trade provides both a convenient negotiating forum and a ready mechanism for enforcement of agreements. In this regard, policymakers have liberally employed the prefix "trade related aspects of" to pragmatically expand the WTO's mandate.

However the growth of the WTO's policy space comes at a price. First developing countries have limited capacity to analyze and negotiate over a large range of issues. Second the experience of the Singapore issues suggests that larger agendas burden the negotiations. Third, the expansion creates room for developed countries to use their superior bargaining power in trade negotiations to exploit developing countries over a larger range of issues. For instance when the agenda was extended to competition policy, the issues relevant to the foreign business interests of developed countries became the main focus of negotiations while insufficient attention was given to key areas of concern for developing countries, such as rules against predation and the development of global anti-trust enforcement. Similarly the focus of intellectual property negotiations has been determined by the pharmaceutical industry in the industrialized world. Almost inevitably, the determination of these issues will reflect the consequences of the exercise of power.

For these reasons a 'principle of conservatism' needs to be introduced to guide the growth of the WTO's mandate. Further issues should only be included in the agenda of a development round if they score highly on three criteria: (i) the relevance of the issue to trade flows, (ii) its development friendliness, and (iii) the existence of a rationale for collective action.

This third element reflects a general presumption in favor of national sovereignty. There is no reason to force nations to undertake certain actions unless their actions have effects on the trade of others, which require collective action to resolve. There are areas in which a trade agreement is absolutely essential. These include an international rule of law (procedures) for dealing with trade disputes and/or agreements to prevent beggar-thy-neighbor trade policies. There are areas in which international agreements would be beneficial to manage cross-border externalities or global public goods.⁴¹ But modern trade agreements have been extended into areas which intrude into national sovereignty with no justification based on the need for collective action and without clearly identified and fairly distributed global benefits.⁴² The presumption of consumer sovereignty is based on the premise that society should

⁴¹ For a discussion of the concept of global public goods, see Kaul et al. [2003]. See also Stiglitz [1994, 1995]

⁴² Trade agreements might also be useful as a mechanism for governments to overcome domestic political opposition to trade reform.

only interfere with individual choices when those choices have consequences for others, when there is a need for collective action, and the same is true in trade.⁴³

⁴³ Such intrusion carries with it a cost that goes beyond the direct loss of sovereignty: it is likely to lead to less diversity, and less adapting of policies to the circumstances and preferences of the country.

5 Ten Priorities for a Development Round

5.1 Liberalization of labor flows and labor intensive services

The General Agreement on Trade in Services (GATS) recognises four modes of service delivery. The temporary movement of natural persons (Mode 4) has received by far the smallest attention in terms of the volume of scheduled concessions. Yet differences in factor payments across countries provide evidence that factor movements would substantially increase global productivity. If factor payments equal marginal products⁴⁴, then the largest discrepancies are associated with the payments to unskilled labor, then to skilled labor, and lastly to capital. Accordingly, agreements that provide for the mobility of unskilled labor would do most to increase global efficiency.

At the same time, such agreements would significantly improve living standards in developing countries through the remittances that they would generate,⁴⁵ through the accumulation of capital which would be repatriated when such individuals return to the country of origin, and through the general equilibrium effects on relative factor supplies within the developing countries. The temporary movement of less skilled workers from developing countries (where they are in oversupply) to developed countries (where they are relatively undersupplied⁴⁶) is estimated to increase world welfare by hundreds of billions of dollars, even if the scale of the labor flow was modest. Walmsley and Winters (2002) estimate that a flow of workers to developed countries equivalent to 3 per cent of their labor forces would generate a global welfare gain of \$US156bn.⁴⁷ For these reasons a development round of trade negotiations should focus on what can be done to facilitate migration of unskilled labor and surrogates for unskilled labor—trade in unskilled intensive commodities and services.

Yet despite the tremendous development potential of this reform, the limited progress that has been made in this area has been largely associated with the intra-corporate

⁴⁴ They may not, and the disparity between factor payments and the value of marginal products may differ across countries, if the degree of market imperfections differs.

⁴⁵ In 2002, the Inter-American Development Bank reported \$32bn in remittances sent to the countries of Latin America and the Caribbean. This was far greater than total ODI and only slightly less than foreign direct investment (Ellerman 2003).

⁴⁶ Foreign workers can be an important source of labor in developed countries. London's catering industry depends on migrants for 70 per cent of its labor force and a large proportion of seasonal agricultural workers are foreign (Home Office 2000).

⁴⁷ Computable general equilibrium analysis based on the GTAP model and database. As noted earlier, these computable general equilibrium models are based on competitive equilibrium models, and as such may underestimate the welfare gains that may arise from labor force migration.

movement of skilled personnel – an issue of interest to developed countries. Thus far Mode 4 has not progressed in a way that allows developing countries to use their comparative advantage in low and medium skill labor-intensive services. Nor has there been enough attention given to proposals to facilitate remittances. Governments have a role to play in maximizing both the value of remittances and their impact on development. Efforts to formalize the structure of remittance flow (much of which currently moves through informal channels) could make it easier, safer, and cheaper to transfer funds. For example, governments could ensure migrants have access to secure and low cost financial services and regulate remittance-handling intermediaries to prevent malpractices. As well as increasing the flow of remittances, remittance policies can improve the development impact of remittances at the receiving end. For example, micro-finance and micro-enterprise support initiatives have encouraged remittance-receiving clients (especially small businesses) to access credit and savings accounts.⁴⁸ Finally, the further development of remittance-backed bonds could help liquidity constrained developing countries to use future flows of remittances to raise external finance relatively cheaply.⁴⁹

As well as facilitating the movement of natural persons (mode 4), there is scope for liberalization of other service industries of importance to developing countries. Services account for, on average, 50 per cent of developing countries GDP, but developing countries account for only 25 per cent of the world's services exports. While the last decade has seen considerable liberalization of high skill services, there has been less progress in those unskilled-labor-intensive services of interest to developing countries.

A large portion of benefits from services liberalization derive, not from seeking better market access abroad, but from the increased competitiveness and efficiency of the domestic market. However in addition to these 'efficiency gains' developing countries have important export interests in further services liberalization (OECD 2004). Many developing countries have capitalised on their comparative advantage in low-skill services to develop competent and highly specialised industries. Examples are maritime services including port services and the shipping industry; construction services; back office services including data processing, and call centers.

⁴⁸ For an example initiative in this area see the case of the financial institution PRODEM in Bolivia which focuses on the promotion of savings and the offer of new financial services to remittance receivers. See UNDP (2003) Worker Remittance as an Instrument for Development, *Comparative Research – UNDP El Salvador*. A number of best practice scenarios from Latin America and Asia were presented and documented in the November 2000 ILO conference in Geneva on "Making the best of Globalization: Migrant Worker Remittances and Micro-Finance."

⁴⁹ In 2001, Banco do Brasil issued \$300 million worth of bonds through Merrill Lynch using the future yen remittances from Brazilian workers in Japan as collateral. The terms of these bonds were more favourable than those available on sovereign issues (with a BBB+ Standard and Poors rating compared to BB- on Brazil's sovereign foreign currency rating). For a review of securitization of remittance flows see Ketkar, Suhas and Dilip Ratha (2000) Development Financing During a Crisis: Securitization of Future Receivables, *mimeo*, Economic Policy and Prospects Group, The World Bank, Washington DC.

5.2 Careful reform of agricultural market to limit adverse consumption effects

Section 2.2 highlighted the persistently high levels of agricultural protection in the OECD.⁵⁰ Yet agriculture is crucial to developing countries. It represents almost 40 per cent of their GDP, 35 per cent of exports, and 70 per cent of employment.

Because agriculture is such an important part of both national economic development and daily livelihoods in developing countries, agricultural reform must proceed carefully. Agricultural liberalization presents developing countries with the benefits of increased market access, but also the (potential) costs of higher prices for domestic consumers. The fundamental point is that consumers benefit from lower prices that result from large agricultural subsidies, and producers lose.⁵¹ The producers are typically poor farmers, often far worse off than the urban net consumers. Given the limited capacity of developing countries to effect redistributions, there can be a significant welfare loss from such adverse distributional impacts.

The net effect of wide-ranging agricultural reform varies across developing countries depending on the composition of their exports and imports of different commodities, and the price sensitivity of those commodities to liberalization. The potential for losses highlights the need for a more fine grained approach, which would differentiate among crops and countries, and emphasizes the importance of adjustment assistance.. such adjustment assistance will need to vary among developing countries, depending on the magnitude of the adverse impact.

The WTO should focus on liberalizing those commodities which have the largest positive effect on producers and the smallest adverse consumption effects. One important determinant of the net effect of this kind of reform is the level of protection for each commodity and the consequent impact of liberalization on prices.⁵⁴ Another important determinant of the welfare effects of liberalization is the agricultural trade balance across countries. There is a division between temperate products (program crops and livestock) where developing countries are largely net importers and developed countries are largely net exporters, and tropical products for which developing countries are largely net exporters. Most developing countries are net

⁵⁰ Total OECD spending on agricultural subsidies is more than US\$300 bn per year. This is almost six times the total aid from OECD countries to all developing countries (US\$50-60 bn per year).

⁵¹ There is another reason to be wary of an *excessive* focus on agriculture. Development requires less developing countries to move into sectors with higher rates of potential productivity improvements, to develop their *dynamic* comparative advantage, not just their static comparative advantage.

⁵²
⁵³ There are large differences in the extent to which different agricultural crops are subsidized. Tariffs are particularly high in the feed grains, dairy, and food grains sectors, while dairy products, meat, and livestock are the worlds most subsidised exports. Producer payments are highest for grains and oilseed sectors and lowest for meat, livestock and dairy (Hertel et al. 2000).

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importers of program crops,⁵⁵ which are precisely the commodities that have the highest domestic support and stand to experience the largest price increases. It is therefore not surprising that most studies predict that most developing countries are worse off as a result of the terms of trade effects following this kind of reform. Indeed Dimaranan, Hertel and Keeney (2003) find that gains accrue primarily to developed countries in the Cairns group as well as the two largest developing country exporters, Argentina and Brazil. These countries are the strongest advocates for the existing agricultural reform agenda. Still, it is possible that, as producer prices increase, some developing countries will switch from being net importers to net exporters.

The existence of net losses for developing countries in some areas of reform should not imply that no reform is required – rather it suggests that a selective and gradual approach is needed and that considerable adjustment assistance may be required. The most important subsidies to eliminate would be those where the consumption benefits of the current subsidies are small relative to the costs to producers. Attention should be focused on the elimination of tariffs and quotas on tropical products, processed foods, and other commodities which developed countries export or for which they have high export elasticities with respect to price. Elimination of cotton subsidies would raise producer prices for cotton, but have a small effect on standards of living in developing countries as a result of the small increase in the price of cloth. Similarly, subsidies for crops which are disproportionately consumed by the wealthy will have the least adverse distributional effects. Soy beans, for instance, may largely go into the production of animals (beef and chicken).

Furthermore, the potential adverse effects of agricultural liberalization on large segments of society suggests the importance of a gradual approach, allowing urban workers time to adjust. It would also be desirable for developed countries to give some of the money they previously expended on subsidies to assist the developing countries in the transition. In addition, countries which are importers of subsidized commodities as well as producers should be allowed to impose countervailing duties on countries which persist with subsidies. Such duties would simultaneously enable producers to receive prices that would correspond more closely to what they would have received in the absence of the distortionary subsidies in the advanced industrial countries and provide the revenues with which these countries could protect consumers from the adverse consequences of the price increase. Moreover, since those in the advanced industrial countries would receive less benefit from their distortionary subsidies, such a reform might reduce political pressures for the subsidies.

The WTO makes a distinction between explicit export subsidies and other forms of domestic subsidies, yet both types of payment can increase production and exports and depress world prices.⁵⁶ Since, domestic subsidies are treated more permissively in

⁵⁵ This includes Mexico, 'Rest of South America' (a regional average which excludes Argentina and Brazil), China, Indonesia, Korea, 'Rest of South Asia' (a regional average which excludes India), Tanzania, Zambia, 'Rest of Sub Saharan Africa' (a regional average which excludes Tanzania and Zambia), and the average of the Middle East and North African Countries. Brazil, India, Argentina and Vietnam are net exporters (Dimaranan, Hertel and Keeney, 2003).

⁵⁶ The WTO classifies domestic subsidies according to their distortionary effect on trade: amber (directly trade-distorting); blue (indirectly trade-distorting production payments); green (non-trade

the WTO several OECD countries have reduced their export subsidies and increased their direct domestic support payments to comply with their WTO commitments. In the US and EU, the annual values of export subsidies for cereals and beef declined by US\$4.1 billion between the base period and 1998 and 1999. In the same period, domestic support in the form of exempt direct payments for those commodities rose by an estimated US\$18.9 billion a year in the European Union alone (ABARE 2001). However the trade effects of various types of domestic subsidies are often understated. While the impact of export support on developing countries per dollar of subsidy is greater than production-based support, the difference is small if the elasticity of demand is small, which is the case for many agricultural commodities. Even non-production based support ('decoupled' payments primarily in the 'green box'), have an impact on output and prices. These payments advantage OECD producers by providing them with funds to potentially use for investment and expansion of production.

Finally developing countries should reflect on the items that are missing in the Doha Declaration. First, the Declaration does not foreshadow further attempts to reduce export dumping (see section 5.4).⁵⁷ Second, one of developing countries' most important proposals, the "development box" that would allow poor countries to shape their farming and food policies to maximize development, is also absent.

5.3 Liberalization of industrial goods

While average developed country tariff rates are low, developed countries maintain high barriers to many of the goods exported most intensively by developing countries. When weighted by import volumes, developing countries face average manufacturing tariffs of 3.4 per cent on their exports to developed countries, more than four times higher than the average rate faced by goods from developed countries, 0.8 per cent (Hertel and Martin, 2000).⁵⁸

Moreover aggregate data hides the existence of tariff peaks (discussed in section 2.2). OECD tariffs are particularly high for goods of importance to poor countries such as low skill manufactures (especially textiles) and processed foods. Such tariff peaks

distorting). The fact that the United States claimed that its cotton subsidies were non-trade distorting, while the preliminary WTO ruling is that they are not, makes clear that the distinction is not a clear one. See WTO dispute documents: United States - Subsidies on Upland Cotton (WT/DS267). As we noted below, even the so-called non-trade distorting subsidies may in fact be trade distorting.

⁵⁷ The adverse effects of this dumping can be particularly serious because even a single year of low agricultural prices may deprive peasants in developing countries of the funds they need to finance fertilizer and seed, and therefore have deleterious effects for years. Similarly, dumping of processed agricultural goods may force processors in developing countries into bankruptcy; furthermore, the fact that such sales occur periodically discourages entry.

⁵⁸ The distortion is even larger if one recognizes that the quantities imported are reduced as a result of the high tariff barriers. (In the measure cited, a prohibitive tariff would have no weight in the measure, since there would be no imports.)

have a particularly harmful effect on development by restricting industrial diversification in the poorest countries.

A second reason that developing countries should be pushing to have industrial tariffs prioritized in the Doha Agenda is that barriers to south-south trade are quite high. The average import-weighted tariff on the exports of manufactured goods from developing countries to developing countries is 12.8 per cent (Hertel and Martin, 2000). Anderson et. al (2000) estimate that the welfare gains to developing countries derived from the liberalization of trade in manufactures by other developing countries is \$US31bn.

5.4 Non-tariff barriers

It is not surprising that as tariffs have come down, non-tariff barriers have assumed increasing importance. Trade agreements may do little to alter protectionist sentiment—and the politics of special interests; they do, however, change the form that such protection can take. Just as developed countries have discriminated against developing countries in the structure of their tariffs, so too do many of the non-tariff barriers have particularly adverse effects on developing countries.

There are four important categories of non-tariff barriers. Dumping duties, which are imposed when a country sells products below costs, countervailing duties, which can be imposed when a country subsidizes a commodity, safeguards, which can be imposed temporarily when a county faces a surge of imports, and restrictions to maintain food safety or avoid, say, an infestation of fruit flies. The advanced industrial countries have used all of these at times to restrict imports from developing countries, when they have achieved a degree of competitiveness which allows them to enter the markets of the developed countries. Many of these measures are described as ensuring “fair trade,” but from the perspective of developing countries, they ensure “unfair trade.” They are evidence of the hypocrisy of the North. Increasingly, however, developing countries are using such measures against each other and against the advanced industrial countries, and in that sense they represent a hidden threat to a trade liberalization scheme.

There has been a large increase in the number of antidumping claims.⁵⁹ Part of the problem with the schemes is how they have been implemented. With dumping duties, for instance, the accused must respond in a short period of time to a long demand for information (in English), and when the accused is unable to do so, the U.S. government acts on the “best information available,” usually the information which has been provided by the American company trying to keep out its rivals. High initial duties are imposed, which regularly get revised downward, when better information becomes available. But meanwhile, long term damage has been done, as

⁵⁹ There were 2,063 dumping cases initiated between 1995 and 2002. The three most common initiators were the U.S. (279), India (273), and the EC (255). See Finger and Zlate (2003).

American buyers will not purchase the commodity, given the uncertainty about the level of tariffs they may have to pay. The foreign producer is driven out of business—precisely the intent of the dumping duties—and especially with the high cost of credit in developing countries, reentry is difficult if not impossible.

Dumping, selling goods below costs, is of course an issue addressed under domestic competition policy, under the rubric of ‘predatory pricing.’ Well developed standards have been established—and under those standards few cases of dumping would be successfully brought. There is a double standard for foreign and domestic firms. There is a simple solution: there ought to be a single regime for anti-competitive practices, applying both to foreign and domestic firms.

5.5 Explicit recognition of rights to use industrial & other development policies

The economics literature has long recognised that there may be important learning benefits from protection. While economists have typically argued in favor of open subsidies, and or government loan programs, rather than the hidden subsidies protection provides, direct subsidies may, for a variety of reasons, be difficult or impossible to implement. In a second best world, some protection may be efficient.⁶⁰

The international community has recognized that developing countries need and deserve differential treatment. The Uruguay round circumscribed the ability of countries to engage in industrial subsidies. There is a concern that the provisions for special and differential treatment will not be sufficient to ensure that developing countries in different stages of development are able to respond to their idiosyncratic development challenges with appropriately-tailored second-best solutions.

The problems are emblemized by demands (included in the recent bilateral trade agreements between the United States and Chile and the United States and Singapore) for capital market liberalization. Capital market liberalization increases economic volatility, and the increased economic volatility increases the risk premium that investors demand,⁶¹ effectively increasing the interest rate charged.

By the same token, when countervailing duties are imposed against a developing country which has “subsidized” interest payments, by bringing them down from the usurious levels insisted upon by the IMF, to levels still slightly higher than in international capital markets, is this unfair? Should the government only be viewed as undoing a distortion? It seems unfair to force upon the developing countries

⁶⁰ For a historical argument, see Chang, Ha-Joon [2002] More recent theoretical analysis include that of Dasgupta and Stiglitz [1985]. Direct subsidies may be particularly difficult for developing countries, which face severe constraints on their ability to raise revenues. On this account, tariffs become particularly attractive, as they generate revenue for the government at the same time they effectively subsidize the protected industry.

⁶¹ See Stiglitz [2000] and Stiglitz [2002]

provisions which effectively increase the interest rate they have to pay, and then when the government tries to undo the consequences, to have a countervailing duty slapped upon them.

5.6 Restrictions on tax competition to attract investments

One arena in which an international agreement might be of immense benefit to developing countries concerns their competition for investment through concessionary tax rates and financial subsidies. The main beneficiary of that competition is international business and often countries suffer large fiscal losses without commensurate gains to either their domestic economy or to the efficiency of the location of international production.⁶³ If authorities were to embark on cross-country (or cross-jurisdiction) policy action, there are essentially three options, representing three levels of ambition with regards to the objectives being pursued. In ascending order these are: i) transparency-enhancing obligations on firms and countries;⁶⁴ ii) co-operation between jurisdictions;⁶⁵ and iii) the putting in place of enforceable international rules.⁶⁶

Just as international agreements circumscribe subsidies in general, there should be a strong proscription on firm specific competition. The spirit of the WTO's Agreement on Subsidies and Countervailing Measures (SCM) could be extended to investment competition. Under the SCM, subsidies are actionable if they can be shown to cause

⁶² We have in mind particularly tax competition that takes the form of privileged tax treatment for new firms establishing themselves within the given country. Of course, competition among countries to provide efficiently a mix of services that meets the needs of consumers and businesses is desirable. Note the distinction between an international agreement restricting tax competition and one involving capital market liberalization. If there were benefits from capital market liberalization to developing countries, each country would want to adopt it on its own, *with or without an international agreement*. Hence, an international agreement is not needed to achieve whatever benefits might accrue. But any single country that did not engage in tax concessions would be put at a disadvantage, *unless there is an international agreement*. Accordingly, such an agreement is essential. That is why such a restriction is consistent with the principle of conservatism described earlier.

⁶³ For a discussion of harmful tax practices see OECD (1998). For welfare losses from international tax competition see Charlton (2003).

⁶⁴ Oman, Charles (2000) *Policy Competition for Foreign Direct Investment: A Study of Competition among Governments to Attract FDI*, Development Centre Studies, OECD, Paris.

⁶⁵ OECD countries adopted a similar approach in their efforts to identify and reduce "harmful tax competition" (OECD 1998). While the OECD's mandate here covers mainly general tax rates rather than specific incentives, the criteria used to determine "harmful" tax policies is instructive for investment incentives. Two of the criteria cover transparency and discrimination between foreign and domestic firms. The European Commission's 1999 "Code of Conduct (Business Taxation)" has taken a similar approach.

⁶⁶ Three alternative frameworks could regulate incentives with reference to either their i) size (capping the total financial benefit available); ii) use (e.g. specifying geographical areas or sectors in which they are allowed/prohibited); and iii) instrument (proscribing instruments perceived to be particularly harmful).

adverse trade effects. One of the adverse effects triggering actionability under Part III is: “serious prejudice to the interests of another member” – a principle which could be analogously applied to the incentive instruments used in investment competition.

The European Union provides an example of how rules might be developed. The EU has been operating state aid guidelines now for several decades. Although grants & subsidies to foreign direct investors are not explicitly targeted by Commission policy, in practice they are one of the main forms of state aid regulated by it. The definition of state aid clearly encompasses traditional instruments of investment attraction. Indeed the European Commission classifies state aid as including i) grants to firms; ii) loans and guarantees; iii) tax exemptions; and iv) infrastructure projects benefiting identifiable end-users. These payments are regulated by the European Commission, which claims some success in reducing subsidies in the EU.⁶⁷

5.7 TRIPS minus—rebalance intellectual property rights

Whether within the WTO or through an alternative forum,⁶⁸ a new intellectual property regime needs to be created which balances more carefully the interests of the users (in both developed and less developed countries) and the producers of knowledge.⁶⁹

There is a clear need to revise the TRIPS Agreement so as to ensure that the objective of fostering the transfer and dissemination of technology (Article 7) is effectively realized. The long-term goal of closing the north-south knowledge gap and the urgent need to ensure that those in the less developed countries are not deprived of access to life saving drugs will require the revision of several elements of the TRIPS Agreement.⁷⁰

Article 27.1 (the requirement of universal novelty as a condition for patentability) should be strengthened to protect traditional knowledge. This could be done in part by amending TRIPS to comply with the United Nations Convention on Biodiversity

⁶⁷ See Charlton (2003) for a discussion of the EU’s state aid regulations as applied to foreign investment incentives.

⁶⁸ For example the World Intellectual Property Organisation (WIPO) might be an appropriate forum. As we noted earlier, it is not clear that the WTO is the best forum in which intellectual property rights should be established and arbitrated.

⁶⁹ Knowledge is a global public good, and thus it is particularly appropriate that the funding for such global public goods be provided by those that are most able to pay, i.e. those in the advanced industrial countries.

⁷⁰ Areas in need of reform include Article 31(b) which should be extended to allow compulsory licensing beyond national emergencies to broader "refusal to deal" scenarios in which developing countries are unable to access products patented by corporations which choose not to serve their market. Article 40 should extend the right of WTO Members to provide in their national legislation for the prevention of anti-competitive licensing practices in respect of IPRs. Finally, pursuant to Article 66.2, new and additional measures need to be developed to ensure the transfer of technology from developed countries to least-developed countries. See Non-Paper Submitted to the Council for Trade-Related Aspects of Intellectual Property Rights by South Africa WTO Ref: Job(02)/156

(CBD), which was signed by 170 countries in 1993. The CBD recognises the collective rights of the village communities over those of individuals or companies and decrees that a rich country's demand for patent rights should come at the expense of the conservation of plant diversity. This should be reflected in all the provisions, including the tests of novelty⁷¹, as well as the breadth and scope of the patent.

5.8 Fairer mechanisms for enforcement:

An enforcement mechanism which relies on the threat of small countries imposing trade sanctions against large countries is of only limited effectiveness. As discussed in section 4.3, the sanction for violating a WTO agreement is the imposition of duties. If a small country were to impose duties on goods that it imports from the United States, it would have a negligible effect on the American producer. Thus in practice, the WTO system has no effective way of enforcing an unfair trade action stemming from the action of a large industrialised country against a small or poor country. This seriously weakens the bargaining position of individual developing country WTO members.

One solution to this asymmetry would be to require non-compliance with WTO rulings to be punished by all WTO members. However there has been considerable resistance to this kind of proposal because it would be difficult to coordinate and because the principle of retaliation has been that the value of retaliation is limited to the value of the damage. Of course, a classic problem with enforcement through retaliatory protectionism is that it is not in the interests of the enforcing country. Thus an alternative proposal would be to require that trade losses be compensated with financial payments, either as reparations from the responsible country, or from the proceeds of an international auction of the right to retaliate (Bagwell, Mavroidis, and Staiger, 2003).

5.9 Anti-corruption policies and arms sales restrictions

While trade in general may benefit developing countries, some kinds of cross border transactions clearly harm them. One particularly insidious interaction between foreign firms and developing countries is the rampant corruption: it is often less expensive to bribe government officials to obtain, say, a concession, than to pay the full market price. International non-bribery legislation (such as America's Foreign Corrupt Practices Act) should be made part of an international agreement. There should be full disclosure of all payments made to foreign companies (publish where

⁷¹ Patents should not, for instance, be granted for traditional medicines or goods, or slight variants of those traditional medicines, when the usefulness of those commodities has already been recognized within the developing country.

you pay). There should be an agreement that only disclosed payments will be tax deductible; but even stronger enforcement measures should be undertaken. There should also be a commitment to repatriate funds ‘stolen’ or otherwise illegally obtained (e.g. through corrupt transactions) from developing countries. And transactions giving rise to other sources of illicit revenues, particularly those which support armed insurrection, such as ‘conflict diamonds’ should be proscribed.

Secret bank accounts facilitate corruption, by providing a safe haven for funds stolen from a country. This greatly adversely affects developing countries. There should be an international agreement proscribing bank secrecy (the importance of which has recently been recognized in the case of terrorism.) This too can easily be enforced. No bank should be allowed to deal with any bank in a country which does not conform to the agreed upon transparency standards.

Finally, as we have noted, arms sales have had a devastating effect on many of the poorest of the developing countries. The developed countries are the major source of these arms. They should make a commitment to restrict these sales.

5.10 Extending Unilateral Disarmament

Europe recognized that opening its markets to the least developed countries would have little impact on itself, but be of enormous benefit to developing countries. Given the asymmetries of bargaining powers, there can be no meaningful bargaining. The fundamental concerns that provide the rationale for a Development Round imply that the developed countries should be willing to open up their markets *without reciprocity*. To be sure, trade liberalization—at the right pace—would make sense for the developing countries, and most of them are in the process of doing so.

Unfortunately, the effectiveness of earlier initiatives has been limited because of detailed provisions, such as those pertaining to the rules of origin.

A true development round would not only extend trade opening to more countries, but eliminate these restrictions.

5.11 Institutional reforms

There is widespread dissatisfaction with the way that trade agreements are made, partly stemming from a belief that current procedures put developing countries at a marked disadvantage. This is particularly important, given the increasing role that such trade agreements have in our societies. They define a wide set of rights and obligations. Yet they are arrived at in a manner that is distinctly different from the way that other kinds of legislation are adopted. The terms are often negotiated behind

closed doors, with little public debate about specific provisions. The legislative process is often truncated. The result is agreements, like Chapter 11 of the NAFTA agreement or the TRIPS agreement, which contain provisions which would probably never have been accepted by a democratic parliament with open discussion in a deliberative process.

A second problem is that as the number of WTO members has grown, and the demands for a more inclusive bargaining process have increased, the current system appears to be increasingly unwieldy.

It is not the intent of this paper to provide a detailed analysis of alternative proposals for institutional reform that would address these and other problems, but rather to highlight its importance, to emphasize why such reforms should in fact be viewed as a priority in current discussions, and to suggest some directions that such reforms might take.

It is apparent that the opening up of the WTO to so many members makes negotiations cumbersome and difficult. But the arbitrary and capricious nature of the Green Room procedures (in which certain developing countries are chosen to negotiate with the major global players) needs to be replaced. In other areas of democratic decision making, especially those based on consensual processes (as *in principle*) trade negotiations are supposed to be, the principle of *representativeness* is well accepted: a small group of countries is chosen to reflect the various interests and constituencies—say the largest trading countries, United States, EU, Japan, China; a representative or two of the middle income countries, say Brazil and one other country; a couple of representatives of the least developed countries; a representative of the Cairns group, etc. Each would then consult with those that they are representing on a regular basis. An open and transparent process would ensure that the views and voices of all are heard.

Trade negotiations entail a myriad of proposals for changing the rules of the game, and developing countries are often at a disadvantage in assessing the impact of each of these proposals on themselves, let alone the general equilibrium impact on the global trading system. Thus another useful addition to the WTO would be a new body responsible for assessing the impacts of proposed trade provisions on development and developing countries. Its objective would be to look objectively at the consequences of alternative proposals for all the countries of the world, recognizing that economic science is not at a stage where there is agreement about the “right” model. Such a body might help too in the enforcement of current agreements, providing guidance for instance on whether a particular proposed bilateral or regional trade agreement is consistent with the principle that ‘trade diversion’ should be limited, and less than the amount of trade creation.

6 The Costs of Adjusting to the Doha Round

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 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 'trade regime' resulting from a new agreement. Significant trade liberalization will also affect the distribution of income among factors of production: the relative price of the factor which is in relative scarcity will decline, while that of the abundant factor will increase.⁷²

As well as these direct costs of 'adjustment', investment will be required to take advantage of the opportunities offered by multilateral liberalization. Developing countries will be required to make investments – by government in infrastructure and by exporters in new facilities or technologies – before they can capitalise on the opportunities offered by improved access to foreign markets.

There are many reasons why developing countries might suffer larger adjustment costs than developed countries. This section reviews some of the issues associated with the proposals emerging from the Doha round. First, the reduction of tariffs has serious fiscal consequences for many developing countries. Over 30 countries – mostly small and poor – derive more than 25 per cent of their public budgets from tariff revenue. For these countries, trade liberalization will necessitate massive reform of the taxation system to avoid fiscal crises. Second, developing countries face disproportionately high implementation costs, for example from the proposals related to the Singapore issues. Third, and for some small countries most importantly, the reduction of MFN tariff rates will lead to the erosion of the preference margins currently benefiting the exports of the least developed countries under various non-reciprocal market access preference schemes.

The empirical evidence supports the view that the adjustment process resulting from the proposals emerging from the Doha round will impact particularly harshly on the people and governments of developing countries – especially small developing countries, and suggests several further reasons for this asymmetry. First, developing countries are most vulnerable to policy shocks because their export industries are the least diversified – many are dependent on the export and hence world price of just

⁷² This is the implication of the renowned Stolper and Samuelson (1941) theorem; but even if the restrictive conditions under which it holds are not satisfied, there is a presumption that relative rewards to different factors will change in the way indicated.

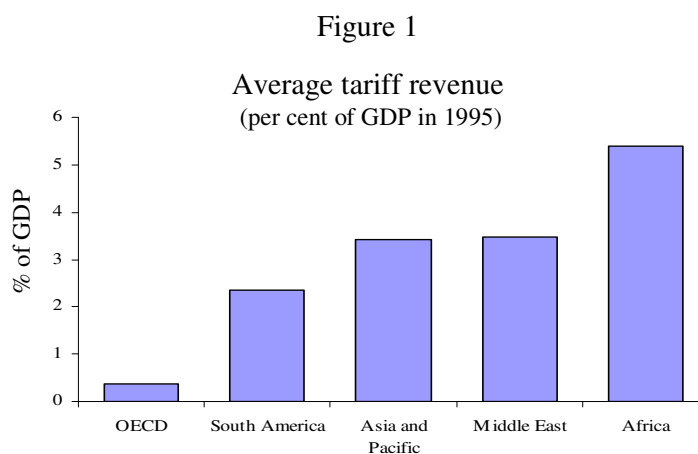
one or two commodities. Second, developing countries are likely to need to make the largest changes to comply with international regulations such as those embodied in the Singapore issues. Third, the structure of world trade is most distorted in the industries of importance to developing countries. World markets for agriculture, processed foods, textiles and other critical goods are the most distorted by developed countries tariff policies. Consequently these industries will be highly impacted by liberalization – even where reform has long-run net positive effects for developing countries, they will have to cope with adjustment costs, investment costs, and redistributive effects.⁷³ Fourth, and most importantly, developing countries are home to the world’s poorest people and the weakest credit markets. These people are particularly vulnerable to adjustment costs.

For these reasons, the adjustment to new trading rules is a radically different experience for developed and developing countries. This section briefly studies the process of adjustment and some of the costs it implies for developing countries.

6.1 Fiscal effects

In some countries tariff revenues make up a substantial part of total government revenue. Many of these countries are concerned that trade liberalization will have a significant adverse effect on public revenue and the ability to fund public expenditure.

Taxes on international trade account for around one per cent of government revenues in developed countries and around 30 per cent in the least developed countries. Small countries are the most reliant on tariffs. For example tariffs make up 62 per cent of tax revenue in the Bahamas, 54 per cent in the Solomon Islands, and 75 per cent in Guinea.⁷⁴ Figure 1 shows the ratio of tariff revenue to GDP for five country groups. African governments are most reliant on revenue from tariffs, followed by Middle Eastern and Asia/Pacific countries.



Source: Ebrill, Stotsky, and Gropp (1999)

⁷³ Recall the observation made earlier that even though developing countries as a whole may benefit from the elimination of agricultural subsidies, large consuming countries may suffer considerably.

⁷⁴ See Ebrill, Stotsky, and Gropp (1999).

The reduction of tariffs would, of course, reduce revenues significantly in countries dependent on tariff revenue. This scenario would require developing countries to fundamentally change the structure of their taxation systems and raise revenues from other sources. However, developing countries find it often difficult, expensive, or even impossible to raise substantial revenues from other sources. Taxes which are relied upon in developed countries, such as the income tax, may be virtually impossible to implement in a fair and efficient way with reasonable administrative costs. The desirability of replacing revenue from trade taxes with domestic revenue sources also raises the issue of relative efficiency of alternative forms of taxation. There is some theoretical research suggesting that reducing trade taxes and replacing them with a consumption tax is welfare-enhancing (Keen and Lightart, 1999) on the basis that they are broader and less distortionary. More recently, however, Emran and Stiglitz (2004) have shown that in developing countries with an informal sector in which, say, a V.A.T. cannot be imposed, this result is *not* true and it is desirable to retain some trade taxes, e.g. to tax imports at a higher rate than domestic production.

The main point in this section is that global trade reform has large consequences for the fiscal structures of developing countries, whereas developed countries are by and large immune. Developing countries are likely to suffer either a loss of total tax revenue, or at best, a large administrative cost – and even more economic distortions – associated with the implementation of a new taxation system.

6.2 Implementation costs

While traditional market access agreements such as tariff and quota reductions incurred small implementation costs, the ‘new’ trade agenda embodied in the Uruguay round, and even more in the Singapore issues may impose a much larger implementation burden. Implementation costs are another example of how WTO agreements may impact differentially poor and rich countries. Compliance with WTO agreements is harder for developing countries whose administrative systems usually require larger reform to meet agreed standards. In addition developing countries have the weakest government institutions and most constrained public resources. Implementation of an agreement incorporating the Singapore issues would require expenditure on: system design and drafting of legislation; capital expenditure on buildings and equipment; personnel training; as well as the ongoing costs of administration and enforcement.

The implementation of regulatory agreements will often draw money from the development budgets of poor countries. For this reason such agreements should be analysed in terms of their rate of return and compared to the alternative development priorities on which the same money could be spent.⁷⁵

⁷⁵ For further discussion see Finger (2000). In eight of the countries he studied, implementation costs were larger than the entire annual development budget.

The costs of implementing the regulatory agreements that could potentially emerge from the Doha round will vary widely across countries. However many of the proposed reforms within the Singapore issues could be costly. For example, were there to be new competition regimes (which seems unlikely), such regimes would be difficult to implement. Competition law is technical and requires institutional skills and resources that are in short supply in many developing countries. In addition competition law enforcement is expensive.⁷⁶ Similarly the costs of trade facilitation could be large for some countries.⁷⁷ The size of the implementation costs associated with the Singapore issues raises questions about the appropriateness of their inclusion in the Doha agenda. The important lessons from the Uruguay Round is that regulatory changes imposed a large and (especially in the case of the many non-compliant countries) unacceptable burden on developing countries. The rules seemed to be developed with little awareness of development problems and little appreciation for the institutional capacities of least developed countries.

6.3 Loss of preferences

Several developed countries offer non-reciprocal preferential market access which reduce the tariff rates on the goods of least developing countries below MFN rates. Almost 12 per cent of US imports subject to MFN tariffs enter the US from LDCs under lower tariff rates through non-reciprocal preference programs. Many LDCs fear that reductions in MFN tariff rates through multilateral trade liberalization would harm their exports by eroding their preferential margins.

Preferential tariffs for LDCs have formed an important part of the global trade architecture since the inception of the Generalised System of Preferences (GSP) in 1968. Recently there have been a number of initiatives in OECD countries to further discriminate in favour of LDCs. Most notable among these are the EU's Everything But Arms (EBA) initiative and the US's African Growth and Opportunity Act (AGOA).

Preference schemes have been adopted in an effort to support the development of poor countries and assist them to integrate into the global trading system. Preferences increase the exports of beneficiaries, partly by diverting trade from countries that do

⁷⁶ OECD and national sources indicate that the annual budget of the antitrust office in OECD countries is in the \$15-50 million plus range. For developing countries with enforcement agencies the budgets are lower but still significant (Hoekman and Mavroidis 2002). For example, the costs of antitrust offices in Mexico (\$14m), Poland (\$4.1m), Argentina (\$1.4m), Hungary (\$2m). There are doubts about whether these sums provide adequate enforcement.

⁷⁷ For example, the World Bank assisted Tunisia in its program of streamlining and modernising its customs procedures. The total value of World Bank loans to Tunisia for this purpose was \$35m in 1999. Similarly the World Bank lent \$38m to Poland for upgrading physical and managerial infrastructure of its port facilities (See Wilson (2001). Projects to implement the WTO Agreement on Customs Valuation, which also includes broader customs reform, have been estimated to cost between US\$1.6 million and US\$16.2 million. For example, a six-year programme in Tunisia to computerize and simplify procedures cost an estimated US\$16.2 million (Finger and Schuler, 2000). Bolivia implemented a broad customs reform programme that cost US\$38.5 million.

not receive preferences. This competitive advantage may help LDCs to develop through increased investment, employment, and growth. Additionally preferences may encourage industrial diversification in countries that previously relied on the production of primary goods.

However analysis of preferential schemes on LDC exports perhaps surprisingly shows only limited impact.⁷⁸ The reported benefits are small because in practice LDCs are often not able to realise the much of the benefit promised by market access preferences.⁸⁰ This is evident in the low degree of utilisation of preference schemes. For the EU, over 50 per cent of the eligible exports are not getting preferential access (Brenton 2003). Part of the reason for this is stringent rules of origin which are designed to prevent trade deflection, whereby products from non-beneficiary countries are routed through LDCs to exploit the preferences.

However, even if the aggregate effects of preference schemes are small, large effects on individual industries and countries can be hidden in regional-level analysis. Addressing the problems of adjustment in critical industries in vulnerable countries should be a key component of any multilateral reform proposal. There are many examples of critical industries – particularly in small countries – which face large negative consequences from preference erosion. We discuss these problems in more detail in section 7.2.

⁷⁸ Brenton (2003) studies the impact of the EBA initiative which the EU has argued will “significantly enhance export opportunities and hence potential income and growth” for LDCs (CEC 2002). In 2001 the EBA initiative granted duty-free access to imports of all products from the least developed countries (except arms and munitions). However, not all the preferences were implemented immediately; some will be delayed until 2009. The calculations here ignores these future impacts. Total exports from these LDCs to the EU increased by 9.6 per cent in 2001. However in practice, the EBA was only relevant to the remaining 919 products (of the EUs 10,200 tariff lines) which had not previously been granted duty free status under either the GSP or Cononou Agreement. Of these 919 products, imports from LDCs were recorded in just 80 products in 2001. Brenton (2003) notes that total exports of these products actually fell from 3.5 million euros in 2000 to 2.9 million euros in 2001. Moreover trade in these goods in 2001 amounted to just two-hundredths of one per cent of the total value of LDC exports to the EU. Thus it appears that the direct impact of the EBA initiative has not been significant in the short term and given the small size of trade in affected products, is not likely to be large in the medium term. (Supporters of the EBA initiative are more optimistic; they focus on the fact that its provisions are being implemented only gradually over time. As the discussion in the text indicates, the devil is often in the detail, and this provides some grounds for skepticism, unless changes are made. With the growing awareness of these problems, a commitment has been made to make changes)

⁷⁹ Laird, Safadi, and Turrini (2002) evaluate the effects of the GSP scheme by analysing the welfare consequences of replacing GSP with MFN tariff rates. Their computable general equilibrium (CGE) simulations identify the costs and benefits of the GSP to different regions. The largest beneficiaries in percentage terms are Africa and the Asian NICs. Overall the effects are quite small, amounting to less than 0.2 per cent of real income in any region.

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7 Adjustment Assistance

In one sense, the adjustment costs described in the previous section can be thought of as the ‘price’ to be paid for the benefits of multilateral tariff reduction. Together these adjustment costs and trade benefits determine the *net* effect of trade reform for each country. The Doha Round has placed renewed emphasis on the importance of sharing the *benefits* of trade reform fairly among developed and developing countries. However there has been less attention paid to the distribution of adjustment *costs* among countries.

If the global gains from trade liberalization are as large as some researchers suggest – the World Bank estimates that further liberalization could yield an increase in real income by 2015 of more than US\$500bn⁸¹ – then it is reasonable to enshrine a principle of compensation whereby those countries that suffer significant adjustment costs relative to welfare gains should receive offsetting assistance.

A principle of compensation is important for at least two reasons. First, if the ‘development focus’ of the Doha round is to have any meaning, then WTO members must be mindful of the fact that the cost of adjusting to their agreements will have serious consequences for development. Not only do adjustment costs impact particularly harshly on the poorest people in the world because they are least able to afford them, but the costs also consume resources that would otherwise be spent on alternative development priorities. For many people, the impact of trade reform will overwhelm the effects of other economic development programs.

The second motivation for the provision of compensation for adjustment costs is the pragmatic need to win political support for reform. High adjustment costs give some countries a vested interest in the status quo. Providing incentives for countries to increase competitiveness and diversify into new, higher-growth sectors may be an effective way of removing impediments to welfare-improving global policy changes

7.1 General instruments

Trade liberalization can contribute to increased economic growth in the long run. However in the short run, some groups in developing countries may be negatively

⁸¹ The World Bank estimates that further liberalization of trade can generate up to US\$500bn in static and dynamic gains by 2015 (World Bank 2003). These estimates assume the elimination of agricultural export subsidies and domestic support, a tariff ceiling of 10 per cent for agricultural products and 5 per cent for manufacturing in OECD countries, and a 15 per cent ceiling for agricultural products and 10 per cent for manufacturing in developing countries.

affected by changes in the prices of the goods they consume and produce. Trade reform must therefore be designed in conjunction with a range of complementary policies to protect vulnerable social groups.

The Uruguay Round Decision on Measures in Favour of Least Developed Countries called for “substantially increased technical assistance in the development, strengthening and diversification of their production and export bases including those of services, as well as in trade promotion, to enable them to maximize the benefits from liberalized access to markets” (GATT 1994). Such a commitment was felt necessary partly because many of the new obligations in the Uruguay agreement imposed significant burdens on developing countries. In return the least developed countries were promised financial assistance with implementation costs and extensions of preferential market access schemes. The common feature of these commitments is that they were non-binding on developed countries. As a consequence developing countries found themselves at the mercy of the goodwill of developed countries. As Finger and Schuler (2000) aptly note: “the developing countries took a bound commitments to implement in exchange for unbound commitment of assistance”. Insufficient attention has subsequently been paid to the enormous demands upon developing countries in implementing the outcome from the Uruguay Round. Agreements related to intellectual property, customs valuation, technical barriers to trade and agricultural food safety have been particular targets of criticism in this regard.⁸²

The main purpose of technical assistance is to improve the trade performance of developing countries through policy and institutional strengthening. The responsibility for technical assistance has fallen largely on international organisations. Both the World Bank and the WTO have increased their technical co-operation activities. However as much as 90 per cent of financing for these activities is provided by trust funds provided by two or three bilateral donors, while the WTO itself has typically allocated for technical co-operation activities less than one per cent of its total annual budget – less than half a million US dollars, (Michalopoulos 2000).⁸³

In light of the significant adjustment costs which trade liberalization may impose on some poor countries, the scope and generosity of assistance should be increased. Assistance needs to be proactive. It should strengthen the recipient country’s ability to determine its own development priorities and its ability to influence the outcome of WTO agreements. A full analysis of the assistance needs of developing countries and the appropriate means of delivery is beyond the scope of this paper. Nonetheless there

⁸²Many developing countries have been unable to meet their Uruguay Round obligations because of these high costs. By January 2000, up to 90 of the WTOs 109 developing country members were in violation of the SPS, customs valuation, and TRIPs agreements. Estimates of the cost of compliance to the Uruguay agreements vary widely depending on the quality of the existing systems and the strength of institutions in each country. Hungary spent more than \$40 million to upgrade the level of sanitation of its slaughterhouses alone. Mexico spent more than \$30 million to upgrade intellectual property laws. Finger (2000) suggests that for many of the least developed countries in the WTO compliance with these agreements is a less attractive investment than expenditure on basic development goals such as education.

⁸³ See Michalopoulos (2000).

are clearly many areas in which technical assistance needs to be increased and new areas into which it must be expanded. For example, a useful expansion of technical assistance would extend its scope towards ensuring that developing countries are able to access equal protection under the WTO's dispute settlement system. Lack of institutional capacity limits developing countries' ability to present and defend cases in the dispute systems, causing it to be manifestly unfair in practice. Developing countries are disadvantaged in complex and expensive legal proceedings. An expansion of existing legal assistance schemes will be an important prerequisite for institutional fairness.

7.2 Instruments for preference-dependent countries

The principle of compensation should be extended to *all* developing countries experiencing significant adjustment costs relative to their gross welfare gains from trade liberalization. Without denying the claims of other groups, the Commonwealth has ably championed the cause of preference-dependent countries – most of which are small and island states – and proposed concrete facilities through which assistance could be financed. In this section we briefly review the potential effects of trade liberalization on preference-dependent economies and discuss some desirable features of potential assistance instruments.

7.2.1 Identifying the needs of preference-dependent economies (PDEs)

The net effect on LDCs of preference erosion through reduction in MFN tariffs depends on whether the loss of 'trade diversion' (the negative switching or substitution that occurs as the margin of their preferences declines) exceeds the gains from 'trade creation' (the increase in global trade resulting from improved market access). For the larger, diversified developing economies, the net gains will be significantly larger than for the smaller developing countries. For such countries, gains in one area more than offset the losses in others. But this may not be so for small undiversified developing countries.

Protection in developed countries has led to high domestic price premiums above world prices in sensitive sectors, most notably in agricultural products and textiles/clothing. Many small developing economies lack economies of scale, large consumer markets and a diversified resource base, raising their operating cost structure to a high level. Preferential access to protected markets has allowed developing country exporters to overcome substantial disadvantages and capture a substantial price premium in a small number of sectors. This premium has raised the rate of return to investment in those sectors, generating an incentive for these economies to allocate resources to those sectors receiving significant advantages from preferences. Since most economic activity in small and poor PDEs exhibit high levels

of risk (and correspondingly prohibitive risk-adjusted interest rates) investment in other sectors not receiving significant advantage through preferences has tended to be small.

This longstanding market-distortion has led many small economies to become particularly reliant on the export of a small number of goods.⁸⁴ In particular, Grynberg and Remy (2004) demonstrate that many small and poor island countries rely heavily on the income generated by the export of goods receiving preferential access. This reliance on a narrow export base exposes these countries to large swings in their terms-of-trade when world prices fluctuate. For these countries, the erosion of preferential access due to multilateral trade liberalization may have large negative welfare consequences. Many preference-dependent economies will face shrinking markets, large-scale rationalization, and substantial decreases in output, employment and export revenues in what is in most cases their primary export sector. Given the weakness of credit markets in these countries, and the low capability of governments to provide social insurance, the adjustment costs for these countries may be severe and persistent.

Some of the analytical studies of the effect of multilateral trade liberalization on small states have suggested that the erosion of preferences may have a large impact on some critical industries. *LMC International (2004)* use aggregated current and hypothetical future cost curves at the country level, to forecast market exit based on individual country competitiveness vis-à-vis expected changes in world prices. In several of the scenarios modelled by the LMC study, sugar production will disappear entirely in several ACP countries (Barbados, Belize, Cote D'Ivoire, Jamaica, Madagascar, St. Kitts and Trinidad) while falling by up to 76% in Tanzania, 43% in Guyana and 28% in Zimbabwe. Several studies also predict large adjustment costs in the banana, beef, and textiles industries.⁸⁵

7.2.2 Instruments to finance adjustment in preference-dependent economies

Assistance for vulnerable industries in preference-dependent economies is a preferred solution to the maintenance of preference margins. There are two reasons to prefer assistance to significantly delayed MFN liberalization. First, delayed liberalization discriminates against developing countries which do not benefit from preferences. The second reason for preferring assistance is that the maintenance of long term preferences induces beneficiaries to continue to specialise in activities in which they may never be competitive once preferences are removed. This discourages industrial diversification and increases adjustment costs when the preferences are eventually removed.

⁸⁴ Even without these distortions, it is likely that particularly the very small economies would have only limited diversification.

⁸⁵ See Milner (2003) and CEC (2003).

An assistance scheme to finance adjustment in preference-dependent economies should have the following characteristics that have been emphasized in the Commonwealth's proposals⁸⁶:

A forward-looking focus on diversification: To minimize the social and economic impact of adjustment, industrial diversification away from preference dependent industries should begin *before* a shift in relative prices occurs. An effective assistance program should attempt to facilitate new investment in alternative industries before the preference erosion shock hits the wider economy. A reasonable *ex ante* assessment of potential country needs, and an immediate disbursement of financing to bankable projects, can help mitigate the “too little, too late” characteristic of previous adjustment efforts.

Focus on the Private Sector: The private sector can play a vital role in directing sustainable investment decisions in a competitive, global market. Encouraging private-sector export diversification investments, ideally through the small and medium enterprise (SME) sector, can potentially generate flexible, broad-based growth and poverty reduction. But there are a number of prerequisites for private sector export diversification, including access to affordable credit and the provision of adequate infrastructure.

Adequate Scale & Concessionalty of loan instruments: many preference-dependent economies are already high on the UN's Economic Vulnerability index, and suffer from the compounded disadvantages of poverty, smallness, and high debt levels. If the economy is already heavily indebted,⁸⁷ contracting new loans (even on a highly concessional basis) may easily aggravate debt burdens creating a simultaneous export-sector and balance-sheet crisis. The scale of existing financing constraints implies that many preference-dependent economies may not be able to finance the post-trade-liberalization adjustment without significant external assistance not just in the form of concessional loans, but also as grants.

For a more detailed discussion of specific assistance proposals for preference-dependent economies, see the Commonwealth Secretariat's (2004) paper.⁸⁸

⁸⁶ This section draws on more detailed discussion in Commonwealth Secretariat (2004).

⁸⁷ Many preference-dependent economies have debt/GDP ratios above 100 per cent: for example, Guyana, Congo, Belize, and Mozambique.

⁸⁸ Commonwealth Secretariat (2004) “Preference-Dependent Economies and Multilateral Liberalization: Impacts and Options”. Paper prepared by the Economic Affairs Division, Commonwealth Secretariat, London.

8 Conclusion

The international community should resolve to have a true development round based on a spirit of collective responsibility for the challenges faced by poor countries, and a recognition of the perceived inequities generated by previous rounds of trade negotiations. The round of trade negotiations that began in Doha does not yet deserve the epithet of a “Development Round”. Indeed once again, as in the past, the agenda for the new round reflected the interests of the advanced industrial countries. The new issues that have been added to the agenda are not priorities for developing countries; indeed some of their provisions would have actually been harmful to them.

This paper presents an alternative way forward for the Doha Round based on principles of social justice and economic analysis. To this end, the WTO needs to establish a source of impartial and publicly available analysis of the effects of different initiatives on different countries. Based on this type of analysis, any agreement that differentially hurts developing countries or provides disproportionate benefits to developed countries should be presumptively viewed as unfair. The agreements must enshrine both *de jure* and *de facto* fairness. This means ensuring that developing countries are not prevented from unlocking the benefits of free trade because of a lack of institutional capacity.

This paper presents eleven pro-development priorities that should form the core of the Doha Round agreements. Primary attention should be given to market access for goods that represent the current comparative advantages and potential dynamic comparative advantages of developing countries. There is an urgent need to reduce protection on labor-intensive manufactures (textiles and food processing), agricultural goods, and unskilled services. Priority should also be given to the development of schemes to increase labor mobility, particularly the facilitation of temporary migration for unskilled workers. Something needs to be done about the non-tariff barriers, that are becoming of increasing importance as tariff barriers are brought down.

Instead of imposing uniformity across countries, there is now general agreement that different circumstances in developing countries warrant special and differential treatment. But this agreement must be translated into meaningful forms, including the elimination of trade restrictions against the least developed countries and allowing all developed countries latitude to pursue development oriented trade and industrial policies.

Significant change in the outcomes of multilateral trade agreements must be supported by institutional reforms. Reform of the procedures of the WTO would facilitate the achievement of fair and pro-development agreements.

The Doha round must pay more attention to the distribution of adjustment costs among countries. The fact that implementation and adjustment costs are likely to be larger in developing countries, unemployment rates are likely to be higher, safety nets weaker, and risk markets poorer are all facts that have to be taken into account in trade negotiations. This is particularly true for some of the smallest and poorest states, for whom the adjustment costs of trade liberalization may significantly outweigh the benefits available.

This agenda has been formulated on the hypothesis that the developed countries truly want a Development Round; that the commitment to a development round at Doha was not just rhetoric. Regrettably, that may not be the case. If the United States and the EU continue to push for a trade agreement in the manner that they did following Doha, the discontent with globalization will grow, as will the conviction that the positions of the developed countries are marred by hypocrisy and self-interest.

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