



Cordell Hull Institute

Trade Policy Analyses

Vol. 6, No. 15

October 2004



As part of its project on the Role of the WTO in the World Economy, supported by the Netherlands Ministry of Foreign Affairs and the Berger International Legal Studies Program at Cornell University, the Cordell Hull Institute held a one-day meeting in Washington, DC, on October 20, 2004, on Developing Countries in the WTO System.

The meeting was at Hogan & Hartson, attorneys-at-law, in its Washington office in the Columbia Square Building (pictured above), designed by I.M. Pei.



Reproduced here is the paper by **L. Alan Winters** (above) that was presented at the meeting.

About the Author

L. Alan Winters has been, since April 2004, director of

PAUSE FOR REFLECTION...

Importance of the Principle of Non-discrimination

L. Alan Winters

NON-DISCRIMINATION is a sound economic principle on two grounds. First, discrimination is divisive and corrodes cooperation, which is, after all, the necessary glue of a modern economy. Beyond that, the threat of discrimination erodes trust, for trade negotiators fear that any agreement they reach may be overtaken by a more favorable deal between their partners and a third party. Essentially discrimination undermines social processes and increases transaction costs for a society as a whole.¹

Second, discrimination fosters inefficiency. As noted by scholars in the fields of race and gender, as well as by Jacob Viner in international trade, the point of discrimination is to purchase a good or a service from a supplier who would not be competitive in a straightforward auction. It is designed to move activity away from the most efficient providers. The argument is made that, in spite of this, discrimination can have net benefits if it is packaged with other policies that are efficiency enhancing (tariff reductions in the case of regional trade arrangements), or if it addresses market failures or non-efficiency-related aspects of welfare (as, for example, if the very poor are favored).

I would not deny these possibilities in principle, but would argue that, given the pernicious side of discrimination, the burden of proof lies very firmly with its advocates to show (i) that net benefits exist, (ii) that greater benefits would not be available if their energy went towards achieving non-discriminatory solutions to the problems they perceive and (iii) that the systemic effects of discrimination do not offset the private net benefits from each act of discrimination individually.

This paper considers two manifestations of discrimination in current international trade policy: briefly regionalism and bilateralism and then, at slightly greater length, special-and-differential (S&D) treatment for developing countries.

the Development Research Group at the World Bank in Washington, DC, on leave from the University of Sussex where he has been a professor of economics since 1999. At an earlier period in the Development Research Group, he was research manager for international trade.

Dr Winters previously held chairs in economics at the universities of Birmingham and Wales; and before then taught at Cambridge and Bristol universities.

In addition, Dr Winters has advised, among others, the OECD, the European Commission, the WTO, UNCTAD and the Inter-American Development Bank.

Other Speakers

The meeting was attended by 55 trade-policy specialists, mostly from the Washington, DC, area.

Besides Dr Winters, the others speakers were: **John J. Barceló III**, professor of law, Cornell University; **Carlos Braga** and **Richard Newfarmer**, economic advisers, World Bank; **Hugh Corbet**, president of the Cordell Hull Institute, and **Douglas Oberhelman**, group president of Caterpillar Inc., Peoria, IL.

The meeting was chaired by **Clayton Yeutter**, of Hogan & Hartson, and **Harald Malmgren**, of Malmgren O'Donnell Ltd, financial advisers, London and Washington, DC.

About the Meeting

In August 2004, after the WTO General Council's "July package" of framework agreements – without detailed negotiating plans – on agriculture and non-

Regionalism and Bilateralism²

"Who but a staunch protectionist could have anything against a 'free trade agreement'? 'Preferential trade agreements' sound less benign, while 'discriminatory trade agreements', yet another name for the same thing, sound nasty."

– Martin Wolf, *Financial Times*, October 28, 1996

Bilateral and regional trade agreements typically do not represent the best policy options for their members, for they hurt excluded countries, if only slightly in most cases, and they tend to discourage MFN liberalizations by their members. Most worryingly, in the context of the Cordell Hull Institute's current focus, there are also sound reasons to worry that regionalism is gradually undermining the multilateral trading system.

Most attempts to analyze the impact of regional trade agreements on the multilateral trading system have concluded that the tariffs that non-cooperating governments charge each other tend to increase with the spread of regionalism. In some cases, it has been argued that regional integration has brought other countries to the negotiating table to agree a new round of multilateral trade liberalization – for example, the formation of the European Community in the 1950s followed by the launch of the Kennedy Round negotiations in the 1960s. Closer examination, however, casts serious doubt on this argument. Would rounds of trade negotiations under the General Agreement on Tariffs and Trade (GATT), of which the Kennedy Round was the sixth, have ceased if the Community had not been created? Moreover, even if it were true, using such coercive tactics to get other countries to reduce their tariffs is extremely dangerous.

It is also possible that one act of regionalism will beget another – giving rise to so-called "domino regionalism". This helps to explain the proliferation of regional trade agreements during the 1980s and 1990s. For example, Canada sought access to the U.S.-Mexican talks that eventually created the North American Free Trade Agreement (NAFTA), with several Latin American and Caribbean countries seeking accession afterwards. Chile and Bolivia sought to reach association agreements with the newly created the Mercado Comun del Sur (Mercosur). But one cannot infer that regionalism is benign just because it is spreading. If there is gang warfare in your neighborhood, you may be best advised to belong to a gang, but that does not make gangs a good thing.

Enlarging a regional trade agreement may increase the incentives for new members to join, but it does not necessarily increase the incentives for existing members to let them in. Because RTAs discriminate against excluded countries, insiders will have a vested interest in stopping expansion well short of the whole world. There is no point in being on the inside if there is no one on the

agricultural market access, the prospects for the Doha Round negotiations began to look better.

It looked as if the next problem to be overcome in the negotiations would be the development dimension, for there are serious divisions over special-and-differential treatment, with the many of developing-country proposals on the subject bearing on agricultural trade.

On the one hand, the developing countries are pressing for special-and-differential treatment through (i) preferential access to markets, (ii) relief from reciprocating fully in market-access negotiations, (iii) deferrals or exemptions from some WTO rules and (iv) technical assistance in implementing new WTO agreements. Some of the countries are bent on preserving "policy space" for the future and a number of others worry about "preference erosion" with the prospect of MFN tariffs being further reduced or eliminated.

On the other hand, those familiar with the system point out that the WTO is not a development agency, but a framework of contractual agreements, setting out internationally agreed rules that promote transparency, predictability and stability – important to businesses in conducting international trade and planning [trade-related] investments.

But the trouble, some say, is that WTO rules are often asymmetrical, reflecting conditions in industrialized countries, as with those on subsidies, anti-dumping actions and intellectual property rights.

The most intractable Doha

outside to exploit. It is sometimes argued that we could circumvent this problem by insisting on open access to all RTAs – that any country that could adhere to the rules of an RTA would be entitled to join it. In practice, however, accession has to be negotiated, because the rules of nearly all RTAs entail more than tariff reductions, so there is no operational way to insist on open access.

If regional trade agreements made multilateral trade negotiations easier to conduct, they might help the world to evolve towards global free trade. They might facilitate progress just by reducing the number of players represented in negotiations. If blocs were genuinely unified, this may be true, but it is rarely so. The gain from having fewer players in the last stage of a negotiation is offset by the complexity of agreeing joint positions in the first place. The European Union's problems in this regard are well known.

It is sometimes argued that regional trade agreements provide a way to develop blueprints for dealing with technically complex issues before they come to a global level, or a way to tackle politically difficult issues that cannot yet be agreed globally. In fact, this practice is less widespread than its proponents think. RTAs usually avoid difficult subjects – for instance, agricultural subsidies. Moreover, to the extent that RTAs are justified in terms of opening up sectors that were previously closed, it is important to ensure that the subsequent switch from regionalism to multilateralism is actually achieved.

The benefits of developing regional blueprints depend heavily on whether they are liberalizing and, for developing countries, on whether they are well suited to their needs and capacities. Major powers already use access to their Generalized System of Preferences (GSP) programs to impose environmental and labor conditions on developing countries. The European Union looks for action in such areas and on intellectual property as part of its Europe Agreements; and the United States has used NAFTA as an instrument to force labor and environmental standards on Mexico. By undermining the natural cohesion of developing countries on these subjects in the WTO, regional trade agreements could lead to very different outcomes than would occur in a purely multi-lateral system. It is likely that the outcomes will suit developing countries less, and they may also be less open and less liberal.

The origins of the European Union – after the failure of the proposed European defense community – lay in using trade and integration as a route to peace. This is an old idea stretching back at least to Emmanuel Kant, but it is worth observing that its success is far from assured (e.g., the American Civil War, the breakup of Pakistan). Moreover, the greatest modern advocate of this position was clear that non-discrimination was an essential ingredient for the trade-peace recipe.

Round issues, namely liberalizing agricultural trade and trade in labor-intensive manufactures, essentially arise out of discrimination by country and by product.

Recent studies at the World Bank show that generalized tariff preferences, in place since the early 1970s, have not significantly benefited developing economies and that today the proliferation of preferential trade arrangements is adversely affecting developing economies as a whole, even if each one may be benefiting the parties directly involved.

The studies were drawn together in the World Bank's Global Economic Prospects 2005, focusing on trade, regionalism and development.

In seeking to

- liberalize trade in agricultural products and light manufactures,
- make sure WTO rules apply equally to all member countries and
- integrate developing countries into the world economy,

the time may have come to restore non-discrimination to its original position as the cornerstone of the multilateral trading system.

"I have never faltered, and I will never falter, in my belief that enduring peace and the welfare of nations are indissolubly connected with friendliness, fairness, equality and the maximum practicable degree of freedom in international trade."

– Cordell Hull, *Economic Barriers to Peace*

Growth of S&D Treatment

The WTO is a forum both for negotiating improved market access and for agreeing to "rules of the game" for trade-related policies. Developing countries gain from both dimensions as a result, in particular, of the principle of non-discrimination, the core principle of the WTO system. A rules-based world trading system is beneficial to developing countries because they are mostly small players on world markets with little ability to influence the policies of large countries. WTO rules are also beneficial because they reduce uncertainty regarding the policies that will be applied by governments – thus potentially helping to increase domestic investment and reduce risks.³

Much depends, however, on getting the rules "right". To a significant extent WTO rules reflect the "interests" of rich countries. They are less demanding about distortionary policies that are favored by these countries and they largely mirror the ("best practice") disciplines that have over time been put in place by them. Thus, the much greater latitude that exists in the WTO for the use of agricultural subsidies, for example, reflects the use of such support policies in many developed countries. More recently, the inclusion of rules on the protection of intellectual property rights has led to perceptions that the WTO contract continues to be unbalanced.⁴

Ensuring that the rules are supportive of development and are seen to be so by the majority of stakeholders in society is perhaps the most fundamental challenge confronting the WTO from a development point of view. Traditionally, developing countries have sought and obtained special-and-differential treatment, formally made a permanent feature of the trading system in 1979 through the so-called Enabling Clause. This calls for preferential market access for developing countries, limits reciprocity in negotiating rounds to levels "consistent with development needs" and provides developing countries with greater freedom to use trade policies than would otherwise be permitted by GATT rules.

The Doha Ministerial Declaration called for a review of the provisions in the WTO for S&D treatment with the objective of "strengthening them and making them more precise, effective and operational". Efforts to date to come to agreement on how to do this have not been successful, reflecting deep divisions between WTO members on the appropriate scope of S&D treatment. A central issue confronting members is how to recast S&D treatment

in a way that would assist the development of low-income countries, be seen to do so by developing countries and be regarded as both "legitimate" and appropriate by developed-country members. There is widespread agreement that, as it stands today, S&D treatment does not simultaneously ensure that poor countries see the WTO as a helpful institution and allow the membership as a whole to improve market access and multilateral rules through recurring rounds of multilateral trade negotiations.

Questions on Market Access

Historically, the major focus of efforts to operationalize S&D treatment have centered on preferential access to developed-country markets through the Generalized System of Preferences (GSP) and limiting the extent of reciprocity in trade negotiations. Experience has shown that preferences can have a positive effect on the exports of recipients, but that the extent of gains depends very much on supply capacity, on the ability to put the rents generated to good use and on the ancillary documentary requirements that are imposed by preference-granting countries. Recent research suggests that liberal rules of origin are critical for preferences in sectors such as textiles and clothing to be meaningful.

Preferences are by definition discriminatory – to give some countries preferential access implies, and depends for its effects on, not giving such access to others. In practice there is a hierarchy of preferences, with the most preferred countries generally being members of reciprocal free trade agreements (European Union, NAFTA, etc.), followed by least-developed countries, which in principle often have duty- and quota-free access to major markets, and then other developing countries, which generally get GSP preferences.

Thus, in many jurisdictions, GSP status actually implies adverse discrimination. From a poverty-reduction point of view – and in light of the "millennium development goals" – preferences should focus on the poor, wherever they are located geographically, and not on a limited set of countries. In absolute terms, most poor people live in countries that are not least-developed countries; one only has to think of China and India. Limiting preferences to least-developed countries or concentrating on a specific geographic region, such as sub-Saharan Africa, may be appropriate in light of limited institutional capacity and infrastructure weaknesses in these countries, but it ignores the majority of the poor in the world today. This suggests that the way forward is to revert back to non-discrimination and agree on a single tariff rate (zero) – on an unconditional MFN basis – for all products in which developing countries have an export interest.

Extending duty-free access to large countries such as India and China will be very difficult politically – one reason why duty-free

access for much of Africa and the least-developed countries could be implemented is that these countries account for less than 1 percent of world trade. Thus zero-duty treatment will require a willingness on the part of developing countries to engage in reciprocity. This is in their own interest, for much (indeed, most) of the benefit from trade-policy reforms is generated by a country's own actions.

Reciprocal MFN liberalization is something that the WTO is designed to deliver. Thus a prime recommendation is to give priority to MFN liberalization of trade in goods and services in which developing countries have an actual or potential export interest,⁵ in the process "re-balancing" the WTO by removing elements of "reverse S&D treatment" – exemptions that benefit interest groups in industrialized countries at the expense of developing countries. Examples include agricultural export subsidies, textile import quotas and tariff peaks and escalation in products such as footwear, textiles and apparel. Continued protection of these products implies that things poor people produce are subject to higher tariffs than things produced by the non-poor.

This will generate some erosion of preferences and it is important that alternative instruments be made available to assist countries adjust to MFN reforms. Given that income transfers through trade preferences come at a high cost to importing countries, and that preferences have not been effective in assisting the poorest countries diversify out of commodities, a shift to aid would be a Pareto improvement. I have argued elsewhere that a modest time-limited facility to ease adjustment to the loss of preferences is desirable and feasible. It could be financed from the savings made by cutting agricultural support and by ear-marking certain tariff collections in developed countries during the transition phase of an agreement in the Doha Round negotiations.⁶

Development and WTO Rules

Much of the debate over S&D treatment centers around making the WTO more development relevant and the perceived need both to revisit some of the existing disciplines and to take action to ensure that, in the future, new rules support development. In my view the "core" WTO rules on trade policy make sense from a development perspective.⁷ But when it comes to regulatory disciplines, one size does not necessarily fit all, especially if implementation is costly and the benefits are not obvious. These observations suggest there is a need for "differentiation" between developing countries in determining the reach of "resource-intensive" WTO rules.

Several options have been proposed to take into account country differences in determining the applicability of WTO disciplines that have significant resource allocation implications. Many involve greater explicit differentiation between developing countries on the



The **mockingbird** is the state bird of Tennessee. Cordell Hull represented a district of Tennessee in the Congress of the United States, and was elected a senator from there, before becoming U.S. Secretary of State (1933-44).

"The mockingbird is known for fighting for the protection of his home – falling, if need be, in its defense. Mockingbirds are not intimidated by animals larger than themselves and have been known to attack eagles"

– Diana Wells, *100 Birds and How They Got Their Names* (Chapel Hill, NC: Algonquin, 2002)

Trade Policy Analyses

Papers in the online series, *Trade Policy Analyses*, are published by the Cordell Hull Institute, which is a non-profit organization incorporated in Washington, DC, and is tax exempt under Section 501(c)(3) of the Internal Revenue Code.

The Institute's purpose is to promote independent analysis and public discussion of issues in international economic relations.

The interpretations and conclusions in its publications are those of their respective authors and do

basis of specific criteria to determine eligibility. This is opposed by many developing countries, but in practice seems unavoidable. A simple rule of thumb approach – based on criteria such as size and income per head – could allow the bulk of identified difficulties to be tackled at low (or zero) negotiating cost, assuming agreement could be obtained to revisit the current two-fold classification of developing countries in the WTO – the least-developed countries and all other developing countries. All low income as well as small economies should be eligible for S&D treatment; others should not.

An alternative approach is to apply S&D treatment on an issue-by-issue or country-specific basis conditioned on economic analysis and a rational process of identification of development priorities. This could do much to enhance the "ownership" of the WTO in developing countries, but would be much more resource-intensive and negotiation-intensive and much more open, too, to manipulation for political or commercial reasons.

Whatever the specific approach chosen, greater efforts to determine *ex ante* the costs and benefits of implementation are needed. This is also needed in order to allocate financial and technical assistance to the trade priorities of developing countries. A major constraint limiting export growth in many least-developed countries and other small and low-income countries is weak supply capacity and the high-cost environment in which firms must operate. Development assistance must play an important role in helping to build the institutional and trade capacity needed to benefit from increased trade and better access to markets.

Conclusion

The traditional approach to S&D treatment in the multilateral trading system has not been a success in promoting development. Indeed, a good case can be made that the approach is fundamentally flawed in that it helped create incentives for developing countries not to engage in the process of reciprocal liberalization of trade barriers and the rule-making process. It has also not helped the institution move forward in the rule-making arena. There is a need to recast S&D treatment if the WTO is to become more effective in helping developing countries to use trade for development.

Preferences are not the answer. A concerted effort is needed to reduce barriers to market access and agricultural trade distortions on a non-discriminatory basis. In order to assist low-income developing countries to benefit from market-access opportunities and adjust to a loss in preferences, a significant increase is needed in technical and financial assistance to support programs. What is required is to de-link development assistance from trade policy – a shift from the current strategy of permitting a small sub-set of countries to benefit from the large distortions created by develop-

not purport to represent those of the Institute which, having general terms of reference, does not represent a consensus of opinion on any particular issue.

Copyright © 2004 by the Cordell Hull Institute and L. Alan Winters

Permission is granted to quote from the paper, but it would be appreciated if the source could be acknowledged in the usual way.

ed countries in their markets, to one that puts the emphasis on direct support to expand trade capacity and improve performance.

Turning to rules, it needs to be recognized that resource constraints in small and low-income countries may require temporary exemptions from multilateral rules. A more "flexible" approach towards rule-making and enforcement is needed to ensure that the implementation of rules is consistent with national development priorities. The heart of the issue on S&D treatment revolves around the need to recognize that one size may not fit all when it comes to regulatory disciplines and the "behind the border" policy agenda that is increasingly being pursued in the WTO system. Differentiation is required, both in terms of negotiating mechanics (how much reciprocity should be sought) and the reach of disciplines across countries.

¹ The findings, interpretations and conclusions expressed in this paper are entirely those of the author and do not necessarily reflect the views of the board of executive directors of the World Bank or the governments they represent. I am grateful to Hugh Corbet and Bernard Hoekman for comments and to Audrey Kitson-Walters for logistical help, but absolve them of all responsibility for the note's remaining shortcomings.

² Here the discussion draws freely on Chapter 8 of Maurice Schiff and L. Alan Winters, *Regional Integration and Development* (Oxford: Oxford University Press, 2003), from which more details and evidence can be obtained.

³ This section is based on Bernard Hoekman, Constantine Michalopoulos and Winters, "Special and Differential Treatment of Developing Countries in the WTO: Moving Forward After Cancún", *The World Economy*, Oxford and Boston, Vol. 27, pp. 481-505. References to the literature on particular points can be found in the article.

⁴ The *ex post* dimension to the asymmetric balance of rule-making in the WTO is also important historically. Rules that are perceived to be "too difficult" to abide by are honored by large players only in the breach – for example, the GATT Article XI ban on quantitative restrictions and disciplines on trade-distorting policies in agriculture, for which the United States obtained a waiver in 1955.

⁵ There are substantial opportunities to expand trade in services, especially through the temporary movement of workers – so-called mode 4 of the General Agreement on Trade in Services. Research suggests this would be particularly valuable in generating welfare (real income) gains.

⁶ Winters, "Adjustment Assistance for Trade Liberalization", a paper for a meeting of Commonwealth Ministers of Finance held in St Kitts & Nevis, September 28-29, 2004.

⁷ By "core" elements I mean non-discrimination (both MFN and national treatment), the ban on quantitative restrictions, tariff bindings, transparency and participating in periodic market-access negotiations.