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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 held at the Washington offices of Hogan & Hartson, the international law firm, in the Columbia Square Building (pictured above), designed by I.M. Pei.



Reproduced here is the paper arising out of the remarks by **John Barceló** (above) at the meeting.

The paper also appears in the Summer 2005 issue of the *Cornell Law Forum* (Vol. 32, No. 1), published by the Cornell Law School.

PAUSE FOR REFLECTION...

Moving to a One-tier Open Trading System

John J. Barceló III

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

The world of trade policy, law and negotiations is changing, however, in another way. Developing countries, led by India, Brazil and China, are playing an increasingly important role and are having a dramatic impact on the WTO's agenda. The earliest signs of this second transformation were visible in the Uruguay Round negotiations of 1986-94 that led to the WTO's founding. This shift might be described as a transition from a "Trade as Aid" to a "Trade as Trade" regime for developing countries – a transition that is still unfolding.

Pre-Uruguay Round, Two-tier GATT

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

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He has held visiting posts at St John's College, University of Oxford (1987), the University of Siena (1987), the Université Paris I Panthéon-Sorbonne (1996 and 1998) and the Pompeu Fabra law faculty in Barcelona (2002).

Professor Barceló has been a visiting professor at the Central European University, Budapest, since 1995.

Other Speakers

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

Besides Professor Barceló, the other speakers were: **Carlos Primo Braga** and **Richard Newfarmer** and **Alan Winters**, economic advisers at the World Bank; **Hugh Corbet**, president of the Cordell Hull Institute, T.N. **Srinivasan**, of Yale University; 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.

otherwise run afoul of Article XI's prohibition on quantitative restrictions.

In 1979, the GATT contracting parties expanded this exceptionalism for developing countries by adopting the Enabling Clause, a provision that allows industrial countries to grant the Third World non-reciprocal, preferential access to their markets. The industrial countries did not allow similar access to other GATT countries and they got nothing in return. This violated two cardinal principles of the trade regime: (i) non-discrimination and (ii) reciprocity. Non-discriminatory, most-favored-nation treatment (MFN) is enshrined in GATT Article I, as well as GATT Article XIII. Article XXIV provides for departures from Article I to form a customs union or a free trade area, laying out the conditions for such departures, but the MFN principle is still the touchstone of the multilateral trading system. Reciprocity is also central. It normally takes the form of mutually exchanged trade concessions agreed at periodic negotiating rounds, such as the current Doha Round.

The 1979 Enabling Clause, agreed at the end of the Tokyo Round negotiations of 1973-79, authorized the regime known as the Generalized System of Preferences (GSP), introduced in the early 1970s, and provisions in other agreements for special-and-differential treatment in favor of developing countries. Most of the OECD countries, including the European Union and the United States, have enacted such a regime, in each case for a select group of developing countries and a select group of products. These GSP programs allow duty-free or reduced-duty access for eligible developing-country goods, with no reciprocal concessions in return.

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

Uruguay-Round and Developing Countries

This two-tier GATT system began to change during the Uruguay Round negotiations from 1988 to 1994. For the first time, the GATT membership tried to bring the developing countries into the trade regime as fully functioning partners. For example, the WTO came into being on the basis of what was called the "single undertaking", an understanding that all participants in the Uruguay Round negotiations would be parties to all the agreements

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-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 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 developing countries are bent on preserving "policy space" for the future and others worry about "preference erosion" with the prospect of MFN tariffs being further reduced or eliminated.

On the other hand, the countries that are 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.

reached. All contracting parties withdrew from the GATT and its many side agreements and simultaneously became members of the new WTO and all of its sub-agreements – one of which is the original GATT as amended, now cited as the GATT 1994 to distinguish it from the GATT 1947. Developing countries were required to go along with the new arrangement.

This arrangement reflected a basic bargain. The developing countries accepted once again the core GATT rules, but also all of what had previously been side-agreements. The bargain also required them to accept the new WTO agreement on protecting intellectual property, the Agreement on Trade-related Aspects of Intellectual Property Rights (TRIPS). On the other side of the ledger, they gained advantages in agriculture and textiles. Although these rights were limited, they were still real. A new WTO Agreement on Agriculture initiated reforms, which have the potential to liberalize agricultural trade in the long term, and the WTO Agreement on Textiles and Clothing (ATC) set a deadline of January 1, 2005, for the phasing out of industrial-country quotas against developing-country exports of textiles and apparel, as laid out in the Multi-fiber Arrangement of 1974.¹ But the agreement did not reduce the high tariff levels on textiles and clothing.

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

Perverse Positive Discrimination

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

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 Round issues, those bearing on 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.

Moreover, attaching political conditions ("conditionality") to the "gift" has been irresistible. Thus, to be eligible for GSP treatment under the U.S. plan, a developing country must afford adequate protection for intellectual property, not expropriate the property of U.S. citizens, guarantee adequate worker rights, enjoy a clean bill of health on enforcing arbitral awards in favor of U.S. citizens, support U.S. efforts to combat terrorism and so on.² Also various "rules of origin" conditions limit the benefits that might otherwise flow to non-eligible countries that produce components for a final product assembled in an eligible country.

But the greatest drawback to the GSP regime is its potential for perverse effects on development itself. Both theoretical analysis and empirical studies³ tend to confirm that development rates are more favorable for countries not participating in the preferential regimes. This seems to be largely – if not exclusively – because of political-economic effects within the developing country itself. Recall that the GSP regime gives exporters market access without asking for reciprocity. Thus the exporter constituency – normally the most vigorous in advocating for free trade – is absent from the lobbying hallways of GSP-beneficiary capitals. In consequence, the import-competing constituency, in the industrialized countries, finds itself in the happy position of calling all the shots on trade policy. The result is an isolated (and inefficient) home market protected behind high tariff and non-tariff walls. Thus the GSP system tends to produce high import barriers at home and unstable, politically conditioned access abroad – a bargain of Faustian proportions. The high import barriers cause misallocation of resources and inefficiencies that actually retard development.

Paradoxical Negative Discrimination

The negative discrimination against developing country exports is perhaps even more pernicious, and also derives from two-tier GATT – in particular, from the non-participation of developing countries in the bargaining give-and-take of the periodic negotiating rounds. The dominant GATT players have been the United States, the European Union and Japan, each of which significantly subsidizes and protects agriculture. Similarly, the United States and the European Union have traditionally blocked open trade in textiles and clothing. Many developing countries have natural comparative advantages in these sectors and would reap benefits from their liberalization.

Prior to the Uruguay Round negotiations, however, agriculture and textiles appeared to be more or less off-limits because the major industrial countries did not seem to be interested in liberalizing, while the developing countries were not even in the game. The culprit could be said to be the two-tier GATT system. But there was more to it than that. After the Haberler Report of 1958,⁴ the United States joined the smaller agricultural-exporting countries like Argentina, Australia, Canada and New Zealand in pressing for

the multilateral trade-liberalizing process to be extended to the agricultural sector, but the European Union was only prepared to consider market-sharing international commodity agreements, the antithesis of trade liberalization.⁵

The winds of change first stirred in the Tokyo Round negotiations of 1973-79 and in the early stages of the Uruguay Round negotiations. By then, considerable rethinking had occurred in the field of development economics. By the early 1980s, economists increasingly recognized that closed markets were inefficient and counter-productive, even for developing countries, and that outward-looking, export-led growth was particularly promising. Both sides of that equation (opening up at home and pursuing comparative advantage abroad) called for more normal and fuller participation of developing countries in the reciprocal give-and-take of the world trade system. The Uruguay Round thus saw the beginning of the transformation away from two-tier GATT – a transformation still in progress. With developing countries participating more fully than ever before, agricultural liberalization gained a foothold in the Uruguay Round Agreement on Agriculture. The round also, as mentioned, liberalized textile trade

Doha Round Challenges

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

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

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



The **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 from 1933 through most of 1944.

"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

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The very existence of the current preferential regime feeds opposition to such a change. Even if preferential market access is insecure, limited and politically conditioned, some producers benefit and can be expected to lobby against change. They will want to hold on to what they have. At the same time, another trend may undercut their influence and even their incentive to lobby forcefully. Influential voices in the trade community are urging industrial countries to pursue a "zero tariff" target for MFN trade.⁶ The closer the negotiators come to this goal, the less important trade preferences will be. So if preference margins are certain to shrink, lobbying for continued preferential access may not be worth the candle.

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

It is true that some countries in the least-developed group would be harmed both by the elimination of preferential access and – as net food importers – by the phasing out of food subsidies. For these countries, some have proposed a special compensatory fund, perhaps administered by the World Bank or other international organization, which could be used to ease the burden of transition.⁷

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

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

¹ Formally, the Arrangement Regarding International Trade in Textiles, first negotiated in 1973.

² See 19 U.S.C. sec 2462

³ See Caglar Ozden & Eric Reinhardt, "The Perversity of Preferences: GSP and Developing Country Trade Policies, 1976-2000", February 15, 2002 (<http://userwww.service.emory.edu/~erein/research/gsp2.pdf>; video presentation available following links at www.worldbank.org); Arvind Panagariya, "EU Preferential Trade Policies and Developing Countries," 25 *World Economy* 1415 (2002).

⁴ Gottfried Haberler *et al.*, *Trends in International Trade* (Geneva: GATT Secretariat, 1958).

⁵ For an authoritative discussion of the issues, see D. Gale Johnson, *World Agriculture in Disarray* (London: Macmillan, for the Trade Policy Research Centre, 1991; and New York: St Martin's Press, 1991), first published in 1973.

⁶ See Peter Sutherland *et al.*, *The Future of the WTO* (Geneva: World Trade Organization, 2004), available at <http://www.wto.org>.

⁷ See Bernard Hoekman, "Overcoming Discrimination Against Developing Countries" at 32-34 (2004) (paper presented at a Cornell-Cordell Hull Institute joint conference on the "WTO and the World Economy" held in Paris, in July, 2004. The paper will be included in a conference volume on *Rethinking the WTO*, edited by John Barceló and Hugh Corbet scheduled to appear in 2005.