

Operationalizing the Concept of Policy Space in the WTO: Beyond Special and Differential Treatment*

Bernard Hoekman

World Bank, Groupe d'Economie Mondiale, Sciences Po and CEPR

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Abstract: There are large differences between WTO members in terms of resource capacity constraints and national trade policy and investment priorities. These affect the ability and willingness to incur the costs associated with implementation of new rules, as well as the net benefits of doing so. The ‘adjustment burden’ of new rules mostly will fall on developing countries, as such rules will reflect the status quo in industrialized countries (‘best practice’). This paper discusses options that have been proposed to address country differences and increase the “development relevance” of the WTO. These include shifting back to a club approach, more explicit special and differential treatment provisions in specific WTO agreements, and a concerted effort to establish a mechanism in the WTO where development concerns can be considered. A case is made for the latter—involving a serious effort to increase the transparency of applied policies, including assessments of their effectiveness and the magnitude of any negative spillovers imposed on other developing countries.

Keywords: Trade policy, economic development, trade negotiations, WTO

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A major constraint impeding progress in the Doha round is how to deal with demands by many developing country WTO members for strengthened and more effective “special and differential treatment” (SDT). Traditionally, developing countries have sought ‘differential and more favorable treatment’ in the GATT/WTO with a view to increasing the development relevance of the trading system (Hudec, 1987; Finger, 1991). Formally, SDT was made an element of the trading system in 1979 through the so-called ‘Enabling Clause’, (Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries). 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 premise behind SDT is couched in the belief that trade liberalization under most favored nation (MFN) auspices does not necessarily help achieve growth and development insofar as industries in developing countries need to be protected from foreign competition for a period of time. This infant industry (import substitution) rationale is reflected in greater flexibility and “policy space” for developing country trade policies, as well as the call for preferential access to rich country markets. However, SDT goes beyond market access and limited reciprocity—it also spans the cost of implementation of agreements and the approach towards the possible negotiation of disciplines on new issues (e.g., investment and competition policy).

The Doha Ministerial Declaration reaffirmed the importance of SDT by stating that ‘provisions for special and differential treatment are an integral part of the WTO agreements’. It called for a review of WTO SDT provisions with the objective of “strengthening them and making them more precise, effective and operational” [para. 44]. The Declaration also states that “modalities for further commitments, including provisions for special and differential treatment, be established no later than 31 March 2003” [para. 14].

Efforts to come to agreement on SDT during 2002-03 were not successful, reflecting deep divisions between WTO members on the appropriate scope and design of SDT. In part this reflects wide differences between WTO members in terms of resource capacity constraints and national policy and investment priorities, with consequent differences in the ability (willingness) to incur the costs associated with implementation of new rules, as well as differences in the net benefits of doing so. The ‘adjustment burden’ of new rules will mostly fall on developing countries, as the rules that are likely to emerge will reflect the status quo in industrialized countries (‘best practice’). Longer transition periods—the approach used in the Uruguay Round—is now recognized as an inadequate response, as these are arbitrary and are not accompanied by or based on an objective assessment of whether (and when) implementation of a specific set of (proposed) rules will be beneficial to a country. If the Doha Development Agenda is to live up to its name, the fact that country priorities and capacities differ enormously will need to be addressed. There are two basic options: shift back to a club approach, or pursue universal membership agreements that are accompanied with more effective development provisions.

While most of the Singapore issues have now been taken off the multilateral negotiating table, it seems clear that many members will continue to seek to expand the scope of the WTO (if only because this is also being pursued through regional agreements). One approach to moving forward on new areas that could address the problem of differences in priorities and capacities across the WTO membership is to expand the number of plurilateral agreements in the WTO. This would allow WTO members to decide whether to sign on to new disciplines on a voluntary basis, while allowing all countries to be involved in the negotiating process. Another option is to develop a set of general rules that in principle apply to all members but to adopt specific development provisions that apply to (subsets of) developing countries. Yet another is to seek to adopt a new “development framework” in the WTO to determine the reach of disciplines.

Many of the provisions of the WTO make good sense from an economic development perspective. However, some agreements may not pass a cost-benefit analysis test. Insufficient attention is generally paid to issues related to the costs of (and

preconditions for) implementation of resource-intensive agreements. These considerations suggest that an approach that allows for greater flexibility while at the same time maintaining—indeed, preferably, increasing—the accountability of governments for performance could provide the basis for a more effective approach to address development concerns and objectives in the WTO.

1. The “Old Approach”

The traditional approach to SDT comprises trade preferences through the Generalized System of Preferences (GSP), limited reciprocity in trade negotiations, and temporary exemptions from certain rules, conditional on level of development (albeit undefined).

1.1. Non-reciprocal trade preferences

Nonreciprocal trade preferences have been a major feature of North-South trade relations for decades. Recent years have witnessed the deepening of trade preferences for least developed countries (LDCs) and sub-Saharan Africa.¹ While these schemes can have a positive effect on the exports of beneficiary countries, much depends on their supply-side capacity—often very limited; the share of any associated rents that accrue to exporters—often much less than 100 percent; and the impact of ancillary documentary requirements imposed by preference-granting countries, such as rules of origin, which have been shown to be a major impediment, especially for key sectors such as clothing, leading to low utilization rates. Research suggests that most countries have not benefited much from preferential trade programs given uncertainty/costs created by “political conditionality”, product exclusions and rules of origin.² The importance of liberal rules of origin has been demonstrated in the context of the African Growth and Opportunity Act (AGOA)—where (temporary) relaxation of triple transformation or yarn-forward rules underpinned an export boom in countries such as Lesotho (Mattoo et al, 2003).

Preferences are discriminatory in nature—they not only imply but depend for any 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, followed by LDCs (which often enjoy free access to major markets), and

¹ Two examples of these are the EU Everything But Arms Initiative and the US African Growth and Opportunity Act (AGOA).

² See, e.g., Brenton (2003), World Bank (2003).

other developing countries (which generally get GSP preferences). From a poverty reduction point of view a case can be made that preferences should focus on the poor, wherever they are geographically located, and not on a limited set of countries. In absolute terms, most poor people live in countries that are not LDCs—especially the large countries of East and South Asia. Moreover, efforts to maintain (or deepen) preference margins on a selective basis have the potential (indirect) downside of reducing pressure on high-income countries to reform their most trade distorting policies—farm policies, tariff peaks, etc.—on an MFN basis, which is critical for these “less preferred” countries. Finally, preferences are a costly way to transfer resources—it has been estimated that one US dollar worth of additional income created by preference programs may cost five dollars (World Bank, 2002).

Giving priority to MFN liberalization of trade in goods and services in which developing countries have an export interest is superior in global welfare terms to piecemeal preferences (Hoekman, Michalopoulos and Winters 2004). The recent trend has been towards a mix of MFN liberalization (through tariff reductions, the phase out of the MFA as of Jan. 1, 2005) and deepening of reciprocal preferential trade agreements (FTAs). The implication of both developments is that those nonreciprocal preferences with value to recipients are increasingly being eroded, independent of what may happen in the Doha round. These trends, and the presumption that an MFN-based approach to liberalization is first-best for the world as a whole, suggest that efforts are needed to assist countries deal with the negative impacts of any erosion, as well as more generally to meet adjustment costs and enhance supply capacity. A credible commitment to replace trade preferences with more efficient instruments of assistance should be an important part of any new approach towards development and the WTO.

1.2. Market access, core disciplines and reciprocity

Government interventions are justified where there are market distortions and to achieve social (equity) objectives. In the case of market failures, policy interventions should directly target the source of the failure. Trade policy will rarely do so. Even if trade policies are used, there is a clear efficiency ranking of trade policy instruments, with quotas and quota-like instruments being particularly costly. WTO rules that impose disciplines on the use of such instruments will benefit consumers and enhance welfare in

developing countries. Similarly, there are benefits to binding tariffs—not least of which is that this is negotiating coin in trade rounds—and abiding by WTO rules and criteria for taking actions against imports that are deemed to injure a domestic industry.

There is a huge literature on these issues.³ The main conclusion suggested by both theory and practice is that a good case can be made that the core trade policy rules of the WTO make good sense for all countries, developed and developing. Core rules arguably span MFN, national treatment, the ban on quantitative restrictions, committing to ceiling bindings for tariffs, and engaging in the process of reciprocal trade liberalization (Hoekman, Michalopoulos and Winters, 2004). Currently, these core principles do not apply equally to all members, due to SDT provisions and the Enabling Clause (which calls for reciprocity in negotiating rounds by developing countries to be limited to what is “consistent with development needs”).

Reciprocity is the engine of the WTO, the means through which to obtain concessions from trading partners. More important, it is also in a country’s own interest insofar as what is being conceded is a “bad”, i.e., a policy that does not increase welfare. In practice, much of the benefit from trade policy reforms is generated by a country’s own actions. Overuse of the ‘nonreciprocity’ clause has, in the past, excluded developing countries from the major source of gains from trade liberalization – namely the reform of their own policies. Non-reciprocity is also a reason why tariff peaks today are largely on goods produced in developing countries. While there is certainly a need for differentiation between developing countries in determining the extent of reciprocity in market access—some countries rely substantially on tariffs for revenue, and countries with high tariffs will need to reduce them gradually to manage adjustment costs—the WTO can, has and is providing mechanisms through which market access liberalization can be tailored to reflect the interests of individual (groups) of countries. Not employing the “technology” offered by the WTO—i.e., a commitment mechanism for credible, gradual market access reforms—reduces the value of membership.⁴

³ See, Noland and Pack (2003) for a review of the East Asian experience and the relevant literature; more generally, on the economics of the WTO, McCulloch et al (2001).

⁴ The foregoing is not to deny that weak institutional capacity, market imperfections and lack of financial resources may require that developing countries pursue second best trade policies. However, existing WTO provisions—allowing tariff bindings above applied rates, safeguards, waivers, and renegotiation of concessions—arguably provide ample scope for countries to do so.

1.3. Regulatory and “resource-intensive” disciplines

Increasingly, the focus of high-income WTO members has turned to international cooperation on “behind the border” regulatory policies. Often these may entail pecuniary spillovers on other members, but this is not necessarily the case. In part the expansion of the agenda is driven by a need to mobilize (political) support for reducing the trade distorting effects of policies in areas such as agriculture. The Uruguay Round was premised on such a grand bargain, with developing countries accepting new disciplines in a variety of areas (TRIPS, services) in return for the elimination of the MFA, outlawing of VERs and inclusion of agriculture into the WTO. The regulatory standards that are written into the WTO generally start from the status quo prevailing in OECD countries, so that the lion’s share of associated implementation costs tends to fall on developing countries. In recognition of the differential capacity of developing countries to incur the implementation costs associated with the new disciplines, SDT was provided in the form of longer transitional periods and offers of technical assistance from rich countries. By the end of the 1990s many countries had come to the view that the WTO was unbalanced, reflected *inter alia* in numerous implementation-related issues and concerns (Finger and Schuler, 2000). The net returns to implementation were perceived to be low, i.e., there was a lack of “ownership” of agreements by domestic constituencies.⁵

If the Uruguay round demonstrates that uniform transition periods are inadequate for agreements that require investments of scarce human and financial resources as well as institutional development and strengthening, the experience pre- and post Seattle that culminated in the 2003 Cancún WTO ministerial illustrated that seeking to expand the negotiating set by adding ‘behind the border’ issues can be counterproductive. The strategy of adding investment, competition law and procurement to the agenda proved divisive, with many poor countries in particular concerned that multilateral rules might not be in their interest and would do little to promote progress on key market access issues such as agriculture. Post-Cancún, an increasing number of calls could be heard on

⁵ One consequence has been that the relevant committees in the WTO—e.g., on customs valuation and technical barriers/SPS—became focal points for discussions on implementation and technical assistance. I argue below that the activities of such committees in considering capacity constraints could be the basis for a more general approach to address differences in circumstances across countries.

the part of demandeurs for new disciplines to consider shifting from a universal membership approach for new disciplines to a “code” or club approach with voluntary membership as a way of avoiding the need to define SDT and allow movement on new areas. Many others argued instead that both the Uruguay Round itself and the ambitious proposals to expand the WTO’s ambit further had clearly been misconceived and called for a return to “basics”—a market access agenda.

Trade-related technical assistance is an important part of the SDT agenda. A major problem with provisions in the WTO offering help to countries is that there were no mechanisms to link these to the actual provision of development assistance. Much has been done post-Seattle to integrate such assistance more integrally into the activities of the WTO. A major example is the Integrated Framework for LDCs; more generally, there is a greater awareness of the need to incorporate trade into national processes through which policy reform and investment priorities are determined (Prowse, 2002). However, as discussed below, much more can and should be done to enhance the “coherence” of trade and development policies and to assist poor developing countries make use of market access opportunities.

2. Options for a New Framework

The traditional approach to SDT sketched out above has not been effective. The predominant view among analysts and practitioners is that many if not most SDT provisions are either exhortatory or unlikely to be beneficial.⁶ A solution will require actions (and concessions) by both rich and developing countries. One way forward is to distinguish between the market access and rule-making dimensions of the WTO. The approach could involve three basic elements:

- Acceptance by developing countries to accept the core disciplines of the WTO on market access, including undertaking liberalization commitments, albeit differentiated across countries.
- Adoption of a cooperative, “enabling” approach for the use of a to be determined (negotiated) set of WTO rules. This would span resource-intensive agreements requiring investments and complementary reforms, as well as disciplines where governments believe (continued) use of policies that are subject to WTO rules are

⁶ See Hoekman et al. (2004), Hart and Dymond (2003), Pangestu (2000) and Whalley (1999).

warranted for development purposes. The approach would involve commitments by developing countries to identify clearly the underlying objectives that motivate the continued use of such policies, and accepting multilateral scrutiny to determine the impact of these policies. It would act as a “circuit-breaker” in cases where otherwise dispute settlement procedures may have been launched, but would not remove issues from the reach of the DSU—if actions by one member are considered by another member to impose serious negative spillovers, recourse to the DSU would remain possible.

- Credible commitments by high-income countries to assist countries/groups to benefit from trade opportunities, by removing policies that negatively affect developing countries, adoption of internal mechanisms to enhance the coherence of domestic policies, and the use of aid resource transfers to poor countries to assist in meeting adjustment costs from reforms.

2.1. A (very) short review of recent proposals on SDT

Several options have been proposed in the literature for a new approach to SDT:

- Acceptance of the principle of ‘policy space’—implying flexibility for all developing countries as currently (self-) defined in the WTO whether to implement a specific set of (new) rules, as long as this does not impose significant negative (pecuniary) spillovers (Stevens, 2002);⁷
- A country-specific approach that would make implementation of new rules a function of national priorities. WTO disciplines implying significant resources would be implemented only when this conforms with or supports the attainment of national development strategies. A process of multilateral monitoring and surveillance, with input by international development agencies, would be established to ensure that decisions are subject to scrutiny and debate (Prowse, 2002).
- An agreement-specific approach involving the *ex ante* setting of specific criteria on an agreement-by-agreement basis to determine whether countries could opt out of the application of negotiated disciplines for a limited time period. Criteria could include indicators of administrative capacity, country size and level of development, and implementation could be made conditional upon adequate financial and technical assistance being offered (Wang and Winters, 1999; Keck and Low, 2003);

⁷ As in practice small countries are likely not to be confronted with the DSU, in effect this would to some extent formalize the prevailing status quo.

- A simple rule-of-thumb approach that would allow opt-outs for resource-intensive agreements for all countries satisfying broad threshold criteria such as minimum level of per capita income, institutional capacity, or economic scale (Hoekman, Michalopoulos and Winters, 2004).⁸ The presumption here is that this would allow the bulk of identified difficulties to be tackled at little or no negotiating cost. The criteria would apply to *all* new resource-intensive agreements. Invocation of an opt-out would be voluntary. As countries come to surpass thresholds over time, disciplines automatically would become applicable.

A common element of all these proposals is that use is made of economic criteria to determine the applicability of (resource-intensive) rules.⁹ This is controversial, as it implies differentiation among countries, something that is rejected by many developing country representatives in the WTO. Currently, whether SDT is invoked is left to individual members (i.e., whether or not to self-declare as a developing country) and a mix of unilateral action and bargaining by developed country members whether to accept this and provide SDT.

Country classification inevitably creates tensions among governments as to which countries would be counted in and which out. A major advantage of simple criteria is that it is “clean”—there is no need for additional negotiation. The disadvantage is that criteria are inherently arbitrary, and of course this is not a route that has proven successful to date. The alternative is a case-by-case approach to determining the criteria that define the reach of rules. What constitutes “resource-intensive”, for example, and the extent to which specific agreements will give rise to implementation costs are questions that are country-specific. Past experience illustrates that agreeing on a rule- or agreement-specific set of criteria is feasible—witness the Subsidies Agreement per capita income threshold for the use of export subsidies or the net food importers group in the Agreement on Agriculture. The downside is that poor countries will be confronted with inevitable negotiation costs and the need to allocate scarce human resources to issues that may not be priorities (Winters, 2002). Neither type of approach does much to engage governments and stakeholders, or to help them identify better policies or areas where complementary actions/investments are needed. Instead, the focus is purely “legalistic”: SDT is needed as

⁸ Some WTO disciplines may not be appropriate for very small countries if the institutions that are required are unduly costly—that is, countries may lack the scale needed for benefits to exceed implementation costs.

⁹ This is also the case in the first option, as implicitly this approach introduces a size criterion.

a mechanism to prevent countries from undertaking investments or implementing rules they do not wish to and to avoid being confronted by the threat of retaliation for noncompliance.

2.2. Towards a more cooperative approach?

A basic issue that underlies the calls for strengthening of SDT by developing countries is a perception that many WTO rules are not beneficial. One can also point to the disparity between the current binding enforcement regime—which does not permit blocking dispute settlement and delegates ultimate enforcement decisions to a very small number of people (panelists and Appellate Body members)—and the fact that most of the current disciplines were negotiated in an institutional framework where there was no such binding enforcement.¹⁰ One way forward is to renegotiate the rules. Another, complementary approach is to focus on the enforcement side of the picture, and make recourse to the DSU conditional on a “development test” for some issues. Various options could be considered to implement this, including the creation of a formal “circuit-breaker” mechanism that would make recourse to panels under the DSU conditional on a prior process of consultation mediated by an independent body that focuses not solely on legal issues but on the likely net benefits of (non-)implementation and the magnitude of any negative spillovers associated with the use of policies that are subject to WTO disciplines.

A precondition for ownership of international agreements is that governments and stakeholders perceive the rules to benefit the economy overall. A more economically based discussion of instances where countries are not in conformity with WTO rules could help enhance such ownership. That is, rather than invoke the (immediate) threat of a panel, a more cooperative approach could be envisaged that is geared towards assisting countries attain their objectives in an efficient manner as opposed to one that is aimed solely at safeguarding or attaining market access or minimizing negative terms of trade externalities. An important corollary of such an approach would be greater accountability of governments for performance and outcomes—a determination of whether the policies that are used are effective.

¹⁰ I owe this point to Claus Dieter-Ehlermann.

Such an empowerment or enabling mechanism implies a shift at the margin towards a so-called soft law approach.¹¹ Soft law involves establishment of a framework for international cooperation focusing on the provision of information and learning through regular interactions of relevant policymakers and constituents (stakeholders), peer review, and (multilateral) monitoring of the impacts of policies and their effectiveness in attaining stated objectives. From an economic development perspective, depending on the issue, a soft law approach towards identifying ‘good practices’ may make good sense, as often these will differ across countries. There is an emerging literature that argues in favor of a ‘learning’ approach to international cooperation in complex regulation-intensive domestic policy domains.¹² One premise that underlies arguments for soft law (be it implicit or explicit) is that the mechanism of reciprocity may be inappropriate to define common rules for ‘behind the border’ regulatory policies. The specific content of regulation should reflect national (or local) circumstances. Thus, what may be most appropriate from an economic welfare (development) perspective is to create a framework for assisting governments to identify good policies, not a system that aims at harmonization enforced by binding dispute settlement.¹³ This could also allow a more considered and flexible approach towards determining at what level cooperation on *new* issues should occur—bilateral, regional, or multilateral.

Pros, cons and open questions

Some of the advantages of a “softer” approach have already been noted. A major advantage is that it could allow the WTO to avoid the vexed problem of agreeing on country classification and dealing with the issue of “graduation”—matters that have proven to be hugely controversial, although in practice one can observe acceptance of greater differentiation in specific WTO discussions.¹⁴ As there is currently no legal basis in the WTO for greater differentiation across developing countries, and insofar as a necessary element for any solution on SDT is that there is no *a priori* exclusion of any

¹¹ To some extent, this can be seen as building on the consultations part of the DSU, with the difference that the focus goes beyond compliance narrowly defined.

¹² E.g., Abbott and Snidal, 2000; Chayes and Chayes, 1995; Helleiner, 2000; Finger, 2002, Sabel and Reddy, 2002.

¹³ This is clear-cut if there are no pecuniary spillovers.

¹⁴ This is most prominent in Doha discussions on market access negotiating modalities on agriculture and NAMA. The TRIPS/public health decision also differentiates between developing countries, as does the WTO subsidies agreement.

country (still an open issue, of course), a soft law option could help WTO members advance on the “development dimension.” The approach implies that the WTO would take development considerations more seriously—and this is after all a premise of the Doha agenda. A mechanism that involves the need to explicitly assess the impact of trade policies on specified development objectives could also help raise the profile of trade issues in national capitals, a potentially significant benefit given the difficulty the national trade community often has in ensuring trade issues and problems are considered in domestic priority setting processes.

Related to this, another potential benefit is that it would provide a context to identify more efficient instruments that might be supported by the donor community to achieve specific objectives. For example, basic economics suggests that subsidies are more efficient instruments to address market failures than trade policies. If binding budget constraints in a developing country precludes the use of subsidy instruments, these may be overcome through development assistance. This also has the advantage of introducing a credible exit mechanism, a key condition to prevent capture and control rent seeking. The process can help reveal where such interventions can make trade policies redundant, in the process also enhancing policy coherence. Finally, and perhaps most important, an enabling-cum-peer review process can increase the accountability of governments by creating incentives—the need—to reveal (identify) true differences across countries (and true preferences of governments).

Among the concerns (cons) that are likely to arise regarding a move towards soft law are free riding and the possible negative spillovers created by the use of a policy that is otherwise subject to WTO rules if developing country status—and thus access to the mechanism—continues to be defined by self-declaration; the reduction in certainty associated with conditional enforcement or non-enforcement of rules for developing countries; a hollowing out of the principle of a rules-based trading system; the likely difficulty of obtaining agreement on what set of rules the mechanism should apply to (i.e., what are the core rules that should apply to all WTO members unconditionally and be subject to the DSU?); the transactions (and possible negotiation) costs that will be associated with the operation of the mechanism; and, more generally, the desirability of

using the WTO as a forum for development-oriented policy dialogue on trade-related issues.

These are all valid concerns. Insofar as the policy (policies) in question impose negative pecuniary spillovers on other countries, one option would be to allow affected countries to document the magnitude of such spillovers, and agree that the soft law option is conditional on there not being significant spillovers—otherwise recourse could be made to renegotiation or the DSU. Spillovers could also be considered as part of the functioning of the relevant WTO monitoring mechanism, and perhaps factored into recommendations for the use of less trade-distorting policies (e.g. aid). In many cases, the developing economies concerned will be too small to impose substantial harm on large trading partners, although the impact of their policies on other small developing countries may be significant—one reason why recourse to the DSU should remain possible.

Arguments concerning the need for (benefits of) legal certainty and the importance of safeguarding the integrity of the rules-based trading system, while relevant in principle, do not have much force as long as it is clear what the rules of the game are. The process of determining the impact and effectiveness of a particular policy should in itself enhance both transparency and accountability of governments; indeed, the associated monitoring of the incidence (impact) of policies provides scope for those that pay for the use of inefficient policy instruments to press for policy changes. If the mechanism leads to greater substitution of inefficient trade instruments for less distorting subsidy type intervention—e.g., financed by aid—spillover effects will also be attenuated.

Perhaps the major potential downsides concern the possible hollowing out of the reach of the DSU and the transactions costs associated with the process. The latter is very much a cost-benefit issue, i.e., will the benefits outweigh the costs? This cannot be determined *ex ante*, but clearly thought must be given to the potential for redundancy as the type of policy dialogue and review that is proposed is also undertaken to some extent by institutions such as the World Bank, IMF and European Commission (in the context of accession negotiation, Association Agreements and assistance programs). However, this also suggests there is potential for synergies. The Integrated Framework diagnostic process already brings together 6 agencies to identify technical assistance needs; a focal

point in the WTO that focuses on the development impacts of trade-related policies of a country, as well as the effects of partner country policies, could help improve overall policy coherence. That said, it must be recognized that the suggested approach will impose a burden on already very scarce administrative and human resources in low-income countries. There is a strong counter argument that it would be preferable to maintain the status quo and let development organizations take the lead on such policy dialogue (Finger, 2002).

What about concerns pertaining to a hollowing out of the DSU? Here again clarity regarding the conditions (limits) on the proposed “soft law” approach will be important. As mentioned, from an economic perspective a (temporary) “circuit breaker” that involves constraining access to panels (the Dispute Settlement Body) is likely to generate downsides for developing countries primarily insofar as actions of one developing country impinge negatively on another developing country. The small size of most developing countries in world trade suggest that negative spillovers imposed on OECD members will be small. This suggests countries should have the opportunity to raise spillover objections in the context of the operation of the proposed WTO “monitoring” or consultative body and that this should factor into the recommendations that are made. One could also envisage developing countries that perceive that a policy imposes a significant negative externality continue to have the opportunity to invoke the DSU, whereas this would not be available to high-income countries.

2.3. Plurilateral agreements as an alternative?

Another option that can be used to reflect differences across countries in priorities and capacity is to adopt a dynamic variable geometry approach that would break issues and agreements into parts.¹⁵ This might involve only some minimum disciplines applying to a set of countries, and stronger or additional rules applying to others. Over time, countries could elect on a voluntary basis to shift category and take on more disciplines.¹⁶ In this approach, presumably either countries would recognize the value of the disciplines and have established the preconditions for benefiting from their implementation, or they could be induced to take on additional disciplines in the context of a quid pro quo

¹⁵ This terminology is due to Eduardo Perez-Motta.

¹⁶ Alternatively, they could be required to do so if specific criteria or indicators have been met—although that raises the issue of country classification.

elsewhere.¹⁷ The most straightforward approach in pursuing such a variable geometry approach is to expand the use of plurilateral agreements.

WTO Art. X:9 states: “The Ministerial Conference, upon the request of the Members parties to a trade agreement, may decide exclusively by consensus to add that agreement to Annex 4.” Annex 4 lists so-called Plurilateral Trade Agreements that have been accepted by the membership.¹⁸ Art. II:3 WTO specifies that the agreements and associated legal instruments included in Annex 4 are part of the WTO Agreement “for those Members that have accepted them, and are binding on those Members. The Plurilateral Trade Agreements do not create either obligations or rights for Members that have not accepted them.” Thus, (i) the creation and addition of new plurilateral agreements under Annex 4 requires consensus; and (ii) signatories are not required to apply them on an MFN basis.

Plurilateral agreements are close in effect to those SDT options that allow for countries to opt out from specific agreements. A key difference, however, is that in the case of a plurilateral, there is no presumption that eventually a country will join and thus be subject to the rules—this would be the case if the rules in principle apply to all. Plurilaterals used to be more prevalent under the pre-WTO GATT regime reflecting the difficulty of amending the GATT. In the Kennedy and Tokyo Rounds, for example, a number of agreements were negotiated that bound only signatories. Most of these agreements did not attract many developing country contracting parties. During the Uruguay Round, virtually all of the GATT codes of conduct were transformed into multilateral agreements that are binding on all WTO members.

Useful criteria in assessing the upsides and downsides of a plurilateral approach are whether (i) it permits all countries to engage in the negotiation of a proposed rule even if they may not apply it immediately, if at all; (ii) whether they are able to engage in a fully informed way, i.e., are able to determine the ‘return’ to applying a proposed rule (this requires taking into account direct administrative costs and the size of net economic

¹⁷ Yet another approach that could address this issue in the case of new rules/agreements is to limit membership of (binding) agreements to the minimum set of countries that internalizes most of the spillovers—as was done with the Information Technology Agreement (ITA).

¹⁸ Currently there are only two plurilateral agreements: the Agreement on Government Procurement and the Agreement on Civil Aircraft.

impact of implementation); (iii) if agreements are implemented on an MFN basis; and (iv) whether and how the DSU would apply.¹⁹

Although a plurilateral approach to determining the country coverage of new disciplines would ensure that developing countries that do not want to apply new rules could opt out, there are nonetheless a number of downsides to the pursuit of this option. First, the approach would move the WTO towards a two-track regime. Many developing countries have argued that this is contrary to the basic character of the WTO and conflicts with the consensus-based approach that has historically been the norm (Bangladesh and others, 2003). A major advantage of continued efforts to agree to multilateral disciplines that apply in principle to all members—even if SDT implies that some will not implement for some time—is that all countries have a say in whether an issue belongs in the WTO.

Second, plurilateral agreements would define the rules of the game in a specific area. Even if countries opt out, over time there would undoubtedly be pressure for non-members to sign on.²⁰ Moreover, the rules are likely to reflect the interests and current practices of high-income countries, in part because of negotiating capacity constraints, and in part because of the expectation that many developing countries will not sign a specific agreement. This makes it less likely that the agreement will address issues that are of primary concern to low-income economies. Experience illustrates that it is very difficult to amend (re-negotiate) disciplines, so that a plurilateral approach may well become analogous to the *Acquis Communautaire* for prospective members of the EU—i.e., non-negotiable.

2.4. Beyond access and rules: trade capacity and trade-related assistance

The discussion so far has centered mostly on the “policy space” dimensions of the SDT debate. Also important is what rich countries could do pro-actively to assist developing countries. A major constraint limiting export growth in many small and low-income countries is a lack of supply capacity and a high-cost business environment. Firms in

¹⁹ Lawrence (2004) provides a set of criteria for plurilateral agreements to be consistent with the objectives of the WTO. Suggested requirements are that all members be able to participate in the negotiations, membership is voluntary, and cross-retaliation be prohibited—i.e. enforcement threats would be limited to withdrawal of the commitments made within the subject area covered by an agreement.

²⁰ This has been emphasized by the NGO community as a major downside of plurilateral agreements in the WTO. See e.g., Green and Melamed, 2003.

these countries may also find it difficult to deal with regulatory requirements such as health and safety standards that apply in export markets. In the literature a useful distinction between market access (trade policy) and market entry has been developed. The latter pertains to the ability of firms to make effective use of (benefit from) market access opportunities. A frequent example of such a ‘barrier to entry’ is health and safety standards, which may be excessively strict and weigh disproportionately heavily on low-income country producers. Within these countries trade facilitation and trade-related transactions costs—including the costs and quality of services inputs—are important determinants of competitiveness.

Development assistance can play an important role in helping to build the institutional and trade capacity needed to benefit from increased trade and better access to markets. This assistance must go beyond the implementation of trade agreement rules narrowly defined and focus on supply capacity more broadly, as well as addressing adjustment costs associated with reforms. While priorities will differ, in many cases assistance will be needed to address trade-related policy and public investment priorities, to help adapt to a reduction in trade preferences following further nondiscriminatory trade liberalization, or to assist in dealing with the potential detrimental effects of a significant increase in world food prices should these materialize. The development community made commitments to this effect at the International Conference on Financing for Development in Monterrey in March 2002—what is needed is a clear articulation of trade-related requests by developing countries, complemented by action on the part of high-income countries to allocate funding to address the priority areas for finance and technical assistance.²¹

One option to be considered in connection with this is to establish a multilateral facility that would temporarily expand the financial envelope available to support the adjustment process that is associated with trade reforms. Mobilizing such funding should be feasible as the aggregate (global) gains from trade are much greater than the aggregate losses associated with restructuring. The problem is that in practice the compensation

²¹ In order to maximize financing for trade-related assistance and to ensure that assistance in this area addresses priority areas for intervention, the trade-related technical assistance and capacity-building agenda must be embedded in a country’s national development plan or strategy. In the case of low-income countries the primary example of such an instrument is the PRSP—implying that governments and stakeholders must take action to embed trade in PRSPs in those instances where trade is seen as a priority.

(transfers) that is called for often does not occur domestically, and barely occurs at all internationally, as reflected in low ODA levels—in the US\$55 billion range—relative to the estimates of the net income gains associated with past multilateral rounds (in the \$200-500 billion range), the magnitude of total support to farmers in OECD countries (currently some \$350 billion), or the potential gains from further global liberalization (upwards of \$500 billion, especially if services trade is included).²²

There are various ways in which such redistribution could be realized. The most direct way would be through a small consumption tax on goods and services whose prices will be falling as a result of the implementation of negotiated multilateral liberalization commitments. Administrative convenience and collection cost considerations may make a small uniform levy on imports whose tariffs are being cut more feasible. To give a sense of the orders of magnitude involved, a 0.25 percent levy on imports of OECD countries would be equivalent to over US\$ 12 billion (total OECD imports are some \$5 trillion). However, as much of trade into OECD countries is duty free, and it is not desirable to reimpose duties on such trade, any such levy should be restricted to currently dutiable imports where tariffs are subject to reduction commitments. An option to consider here would be to negotiate commitments that all or a certain share of currently collected revenue would be made available to low-income countries.²³ As tariffs are gradually lowered—as is the case in WTO agreements—the total revenue available would automatically decline over time, which is appropriate given that the motivation is to facilitate adjustment. Indeed, it is important that there be general acceptance that any such levy not be an additional tax, but is explicitly based on the recognition that any process of multilateral liberalization will create losers as well as winners. Despite the well-known case for and potential feasibility of compensating losers, in practice this often does not occur. A small reduction in the price gains/benefits that will accrue to consumers as a result of liberalization is one practical means of redistributing some of the gains from trade reform to those who gain less or may lose.²⁴

²² See Anderson (2004) for a review of the estimates found in the literature.

²³ What follows draws on discussions and joint work in progress with Alan Winters.

²⁴ This funding mechanism could also help to address the preference erosion problem that will emerge for those countries that rely heavily on export revenues on preferences. Research suggests the number of such countries is small, but that some countries may confront a substantial adjustment burden, ranging up to 5

3. Concluding Remarks

The traditional approach to SDT in the GATT/WTO has not been a success in promoting development. Indeed, it is fundamentally flawed. It has helped create incentives for developing countries not to engage in the WTO process, resulting in the highest trade barriers—in both the North and the South—being on goods in which developing countries have a comparative advantage. Trade preferences have proven to be a double-edged sword, offering only limited benefits and substantial downsides (see Hoekman and Ozden, 2004 for a review of the literature). Further, the traditional approach has not helped the WTO move forward in the arena of rule making by not taking differences in country circumstances and priorities seriously. In short, SDT has not focused on helping to put in place policies that will promote development. Hence the need for SDT to be recast if the WTO is to become more effective in helping poor countries use trade for development.

There is a basic choice to be made between the pursuit of universal rules that in principle apply to all members, and that will by necessity require SDT-type provisions to account for country differences, and a move to a two- or multi-track trading system based on a plurilateral approach (and regional trade agreements) without SDT. The latter appears to be an attractive way of allowing a subset of the membership to move forward in the absence of consensus. However, many developing countries are on record in the WTO as opposing moves towards greater use of such agreements, primarily on the basis of resistance to the creation of a multi-tier trading system (Bangladesh et al., 2003). Such an approach also does little to help promote development. A recast framework that aims to take development concerns seriously could do much to make plurilateral agreements redundant by both facilitating new rule making *and* improving the substance of disciplines from a development perspective. Key elements of a possible new approach could include:

- Acceptance of the core rules by all WTO members: MFN, national treatment, the ban on quotas, and binding of maximum tariffs, as well as engagement in the market access dimension of WTO negotiating rounds;

percent of current exports, or higher. See Alexandraki and Lankes (2004), Page and Kleen (2004) and Stevens and Kennan (2004) for further discussion.

- Greater reliance on explicit cost-benefit analysis to identify net implementation benefits for countries and the magnitude of negative (pecuniary) spillovers created by development-motivated policies on other countries;
- Movement towards the adoption of mechanisms that strengthen the consultative and “pre-panel” dimensions of WTO dispute settlement by mandating a focus not just on the legality of a policy instrument but consideration of the rationale and impact of policies used by developing countries that may be inconsistent with WTO disciplines, with the aim of assisting governments to attain their objectives in an efficient way; and
- A credible commitment to establish a global funding mechanism to provide the resources to address adjustment costs, including those resulting from an erosion of trade preferences, and enhancing supply capacity, in recognition of the need to transfer some of the gains from trade from winners to losers.

Clearly this type of approach will be significantly more resource-intensive than a simple set of rules of thumb that allow countries to opt out from certain WTO agreements. The latter has a number of important advantages, including simplicity and minimal transactions (negotiating) costs (Hoekman, Michalopoulos and Winters, 2004). However, it is vigorously resisted by many developing countries, and, as discussed, does not do much to actively assist countries in the development process. A shift away from opt outs and arbitrary transition periods towards the creation of a process that involves policy dialogue and accountability on all sides could do much to enhance the development relevance of the WTO, while at the same time reducing the perceived downside risk of undertaking new commitments for developing countries.

A fundamental question that must be answered if members are to move down this track is whether the WTO should be the focal point for this type of international cooperation on trade-related policies. Compelling arguments have been made in the literature—e.g., Finger (2002), Winters (2003)—that the WTO should not become embroiled in development issues. Many will agree that the WTO is not a development organization and should not become one—this is certainly my view as well (Hoekman, 2002). Many of the questions that will come up in discussions will revolve around prioritization, sequencing, complementary reforms and investment needs/decisions. Development banks and similar institutions have the mandate, mechanisms, and capacity to engage in such policy dialogue with governments. Will the benefits of engaging in such discussions in the WTO outweigh the costs? The potential for a positive return are certainly there, but much will also depend on how the mechanism is implemented, who is

involved, how it relates to the activities of development institutions—who clearly will have to play a role in any policy dialogue that occurs in a WTO setting, etc. It is important to keep in mind that the focus of discussions in the WTO would be limited to policies that are covered by the institution—i.e., the review and dialogue process would have pre-defined boundaries. Moreover, while the suggested approach may seem a rather far-reaching change in the modus operandi of the WTO, there are already numerous mechanisms in the WTO that can be—and at times are—used to engage in policy discussions. These include the committees that oversee the operation of specific agreements and the Trade Policy Review Mechanism. One committee that explicitly includes a multilateral process of assessment of the prevailing economic situation in countries as a justification for the use of trade restrictions is the Balance of Payments Committee—which operates with inputs from the IMF on the balance-of-payments situation in a member that invokes the relevant GATT articles as cover for trade barriers. In practice deliberations have mostly been “cooperative”, with only very few cases of recourse being made to the DSU (Prowse, 2002).

The foregoing has just sketched the outlines of a possible way forward. Much work will be required to map out how the suggested mechanisms might work. Issues to be determined include what agreements/rules the new development framework would apply to—what are “core” disciplines in addition to market access commitments that should apply to all members on an unconditional basis? What national and international entities would participate/have standing in the multilateral trade and development body? To what extent could/should this be linked to the TPRM? Under what conditions would countries be able to initiate panel proceedings under the DSU? How might a (global) trade adjustment facility be financed? What mechanisms would be used to allocate the revenue generated? Clearly there are many open questions. What matters most at this point is that a decision in principle be taken to consider a new approach to recognizing the huge disparities in capacity and priorities across the WTO membership. The options include simple country-based criteria; greater reliance on plurilateral agreements; and/or a shift to a case-by-case approach that relates multilateral disciplines to national circumstances and is accompanied by explicit and credible mechanisms through which to transfer additional financial resources to low-income countries—“aid for trade”. The

latter will be the most challenging to operationalize, but offers the greatest potential to promote development and increase policy coherence.

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