Developing Countries and a New Round of WTO Negotiations*

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April 2000

* This paper summarizes some of the results and findings emerging from an ongoing World Bank research and capacity-building project “Preparing for the WTO 2000 Negotiations.” Output from this project can be downloaded from www.worldbank.org/trade. Earlier versions of this paper were presented at the annual meetings of the Latin American Economic Association (October 20-23, 1999) and the American Economic Association (January 7-9, 2000). Parts of this paper draw on collaborative work with Kym Anderson, Mike Finger, Joe Francois, and Aaditya Mattoo. We are grateful to them and to Philip English and Costas Michalopoulos for helpful comments and suggestions. The section on agricultural liberalization draws on the results of a parallel World Bank project led by Merlinda Ingco. In addition to being supported by the World Bank Institute and the World Bank’s Research Support Budget, the project is supported by a generous grant from the Department for International Development (DFID), United Kingdom. It has also received funding from the governments of Italy and the Netherlands; as well as Société Generale de Surveillance (SGS). The views expressed are personal and should not be attributed to the World Bank.
Developing Countries and a New Round of WTO Negotiations

Thomas Hertel, Bernard Hoekman and Will Martin

The Uruguay Round (UR) of multilateral trade talks, concluded in 1994 after eight years of often confrontational negotiations, was a landmark in the history of the trading system. Agriculture and textiles and clothing, two sectors that for all intents and purposes had been removed from the ambit of the General Agreement on Tariffs and Trade (GATT), were brought back into the fold. The system of multilateral rules was extended to include intellectual property rights and services, and, because of the Single Undertaking rule, all countries desiring to become members of the new World Trade Organization (WTO) accepted a variety of disciplines in areas ranging from customs valuation to subsidies.

Reflecting the very limited liberalization that had occurred in agriculture and services, the two agreements on these subjects included provisions calling for new negotiations within 5 years of the entry into force of the WTO. Other WTO agreements contained review provisions. In order to increase the scope for beneficial trade-offs across issues, the 1998 WTO ministerial meeting called for the development of an agenda for “further liberalization sufficiently broad-based to respond to the range of interests and concerns of all members.” In the lead up to the subsequent ministerial meeting that was expected to launch a new round, numerous proposals were submitted by WTO members regarding the issues that should be included on a negotiating agenda. In the event, the November 1999 ministerial meeting in Seattle turned out to be a fiasco, failing to launch a round.

There was a number of reasons for the failure to attain consensus on a broad negotiating agenda. Domestic US politics played a key role, which greatly reduced the willingness of the US administration to agree to put items on the table that were opposed by domestic lobbies. Strong differences on the scope of agricultural liberalization between the EU on the one hand and the US
and other agricultural exporters on the other were also important. Another major factor was the active and full-fledged participation by developing countries, many of which refused to accept the agenda being pushed by a number of high-income countries in some areas—most notably the US on labor standards. Many also expressed general dissatisfaction concerning the process through which a negotiating agenda was being set. Small countries in particular perceived themselves to be left completely in the cold, not having access to the fora where potential agenda-setting compromises were being crafted.

This paper summarizes some of the results emerging from a collaborative research and capacity-building project involving scholars in developing countries, international experts and World Bank staff. The aim of the project is to generate analysis, both cross-country and country-specific, on the costs and benefits of further multilateral rule-making and liberalization. The paper focuses both on market access issues (the potential gains from further liberalization of trade in agriculture, manufactures, and services) and topics that are of particular concern to developing countries—implementation of Uruguay Round agreements and the operation of the WTO, and attempts to expand WTO disciplines on national regulatory policies.

I. Agricultural Liberalization

Barriers to trade tend to be highest in agriculture and services. Average tariffs on agricultural imports are in the 15 to 20 percent range, with peaks for some commodities exceeding 100 percent in many countries, both developing and developed. In contrast, average manufacturing barriers are quite low in OECD countries, but significantly higher in developing

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1 For a concise report see the December 11, 1999 issue of The Economist. Wang and Winters (2000) discuss the implications of the Seattle failure for developing countries and for policies towards such countries.

2 In addition to researchers based in national think tanks, the project draws on the work of a number of research networks, including the Latin American Trade Network (LATN); the Economic Research Forum for the Arab Countries, Iran and Turkey (ERF); the African Economic Research Consortium (AERC); the
nations. However, certain manufactures (such as clothing) continue to confront high tariffs in many high-income countries. Tariff barriers faced by developing countries on their exports of agricultural products are estimated to average 15.6 percent in high income countries, and 20.1 in developing countries (Table 1). The rates for the industrial countries are much lower. Estimates of the implied tariffs paid (constructed by multiplying the marginal tariffs levied on the relevant trade flows by the value of the corresponding trade flow) suggest that more than half of the levies charged on developing country exports are associated with their exports to industrial countries.

Table 1. Patterns of protection in agriculture, 1995.

<table>
<thead>
<tr>
<th>Exporting region</th>
<th>Importing Region</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>High Income</td>
<td>Developing</td>
<td></td>
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<tr>
<td>Implied tariffs paid (US $ bn)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>High Income</td>
<td>37</td>
<td>20</td>
<td></td>
</tr>
<tr>
<td>Developing</td>
<td>16</td>
<td>14</td>
<td></td>
</tr>
<tr>
<td>World</td>
<td>53</td>
<td>34</td>
<td></td>
</tr>
<tr>
<td>Import-weighted average tariffs (%)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>High Income</td>
<td>15.9</td>
<td>21.5</td>
<td></td>
</tr>
<tr>
<td>Developing</td>
<td>15.1</td>
<td>18.3</td>
<td></td>
</tr>
<tr>
<td>World</td>
<td>15.6</td>
<td>20.1</td>
<td></td>
</tr>
</tbody>
</table>

Source: Hertel and Martin (2000)

These prevailing patterns of protection imply that many developing countries have a large stake in achieving significant agricultural liberalization. Hertel, Anderson, Francois and Martin (1999) build a model of the world economy in 2005—at which time UR commitments will have been fully phased in. They estimate that a 40 percent reduction in post-UR agricultural tariffs and export subsidies will cause an increase in global real income of about $60 billion per year. This figure increases by $10 billion if domestic support is also reduced by 40%, although the

Coordinated African Program of Assistance on Services (CAPAS); and the Trade Policy Forum of the
uncertainty in the degree to which such producer payments are linked to production decisions makes such analysis difficult (ABARE, 1999).

Measured in dollar amounts, developed countries capture the largest gains from liberalization, reflecting the reduction in the cost of agricultural support policies for OECD consumers. However, the percentage real income gains – reported in the first set of bars in Figure 1 -- are largest in developing regions such as South Asia (other than India) and Southeast Asia (other than Indonesia). Virtually all developing regions except the net food importing Other Middle East region experience overall gains from these multilateral reductions in agricultural protection. The bulk of these gains derive from efficiency improvements generated in the developing countries themselves (second set of bars in Figure 1).

Figure 1. Implications of a 40 percent reduction in agricultural trade barriers.


Pacific Economic Cooperation Council.
Modalities for Agricultural Negotiations

The precise outcome of the agricultural negotiations will depend heavily on the specific modalities used in the negotiations. Anderson, Hoekman and Strutt (1999) identify the priorities in further progress on agriculture as: reducing import barriers; disciplining domestic support; and elimination of export subsidies. As they make clear, substantial reductions in import barriers would be required to even begin to approach parity with the treatment of manufactures trade. Nothing short of elimination of export subsidies would be sufficient to do so. They also note there is a large overlap between the agricultural reform agenda and the ‘second generation’ regulatory issues that have been proposed for negotiation by a number of countries—competition policy, procurement, product standards, environmental regulation and investment regimes.

The UR led to virtually complete tariffication of agricultural border protection. Unfortunately, the process that achieved this allowed substantial “dirty tariffication” in developed countries—setting tariff bindings far above the tariff implied by prevailing non-tariff barriers—and very high ceiling bindings in developing countries (Hathaway and Ingco 1995). The gap between applied tariff rates and tariff bindings in agriculture is particularly large in many developing countries (Abbott and Morse, 1999), implying that substantial reductions in tariff bindings are required to achieve any liberalization in applied rates (Francois, 1999). One approach to dealing with the gap between bound and applied rates is to make applied rates the basis for future negotiations, in effect requiring all countries to bind at applied rates. This is unlikely to be feasible. It would also create perverse incentives for countries to keep applied tariff rates high in order conserve bargaining chips for future negotiations. A better approach is probably to devise a formula that imposes the largest reductions in the highest tariff bindings. Josling and Rae (1999) suggest the use of a “cocktail” approach in which the very highest tariffs, which are likely to contain a good deal of “water”, are reduced using a formula approach; moderate tariffs are subject to a uniform percentage cut; and nuisance tariffs are abolished.
Since the UR was completed, OECD countries have come to be intensive users of tariff rate quotas (TRQs) (Boughner and DeGorter, 1999). TRQs can be important market access barriers. Under a TRQ, there is an out-of-quota tariff that applies to imports above a specified quota quantity. Volumes below the quota limit pay a lower in-quota tariff. Elbheri, Ingco, Hertel and Pearson (1999) provide indicators of the extent to which TRQs are binding access constraints for a number of sensitive agricultural commodities such as sugar, dairy, meats and grains. They conclude that for the US, EU, Canada and Japan, imports exceeded the quota volume in 13 cases out of 16. The allocation of associated quota rents is uneven, with many countries allocating a substantial share of the quota rents to exporters. By contrast, in the Philippines and Korea, the two developing countries where Abbott and Morse (1999) find evidence of binding TRQ regimes, it appears that importers retain the quota rents.

Understanding the impact of TRQs is critical to predicting the outcome of attempts to liberalize trade. For example, reducing out-of-quota tariffs will increase imports only if the current demand for imports exceeds the quota amount such that the out-of-quota tariff is operational. If imports are less than the quota level, reductions in out-of-quota tariffs will be ineffective. On the other hand, marginal expansion of the TRQs will be ineffective if imports are greater than the TRQ—the only effect will be to increase the volume of imports on which scarcity rents are earned. If imports are less than the TRQ, expanding the quota will be also be ineffective. Only reductions in in-quota-tariffs will stimulate greater imports in this case. The conclusion drawn is that reductions in out-of-quota tariffs would be the most effective instrument for achieving market liberalization in the majority of cases. However, it could be desirable to accompany such cuts with expansion of the quotas.3

3 Elbheri et al (1999) find that reducing over-quota tariffs on sugar imported into the US and the EU by one-third results in losses for almost half of the exporting countries, a consequence of the reductions in quota rents. When the out-of-quota tariff reduction is paired with a 50 percent increase in the TRQ, most countries experience gains, and the remaining losses fall to negligible levels. Thus there may be some grounds for liberalizing on both price and quantity margins simultaneously in order to secure acceptance of the overall liberalization program by importing and exporting nations alike.
Agricultural liberalization, especially moves towards elimination of export subsidies may increase world prices of food products, and thus have a negative effect on net food importing developing countries. However, any such impact will be offset to some degree by the increase in domestic supply that will be stimulated by higher prices. Current policies result in large global price swings that are highly detrimental to developing countries, and farmers in many developing nations suffer from a significant anti-agriculture policy bias. Even if the prices of imports rise, complementary reforms at home can make net food importers better off: they are initially losing welfare by unnecessarily stimulating food imports and the price rise curtails that stimulus (Wang and Winters, 2000). However, mechanisms are needed to ensure that any price-increasing effects of reforms do not reduce the real income/consumption of the poorest in society. Such social safety nets may not exist or not function adequately in many countries. Multilateral trade liberalization generally takes a long period of time to be negotiated and implemented. This provides an opportunity for governments to develop and/or strengthen safety net programs and complementary policies to maintain real incomes of the poorest in society. It should be emphasized that the need for such mechanisms is quite general issue and not specific to agricultural reform. All types of policy reforms that are beneficial for the economy as a whole, as well as exogenous shocks of various kinds, may have detrimental consequences for the poor. Mechanisms to offset the negative impact of shocks should therefore be broad in scope and not be conditional on changes in trade policies only.

II. Industrial tariffs

There has been a sweeping change in the structure of international trade in the past two decades. In the mid-1960s, manufactures exports accounted for only around a quarter of developing country exports. By the early 1980s, it had only risen to around a third. Since then, growth accelerated and as of the mid-1990s the share had risen to around three quarters, and is projected
to go on rising (Figure 2). Much of the increase in the exports of developing countries during the past three decades has not followed a north-south pattern. The share of exports of developing countries going to other developing countries has risen sharply as the importance of developing countries in the world economy has risen, and barriers to trade in these countries have declined. Developing countries therefore have a strong interest in including industrial products in WTO negotiations. Although industrial countries impose low average tariffs on their imports of manufactures, the average tariff on imports from developing countries is four times higher than those originating in the OECD (Table 2). This is primarily because of the relatively high tariffs on products such as textiles and clothing. Estimates of the implied tariffs paid suggest that barriers that developing countries face in other developing countries account for over seventy percent of the total tariffs levied on their industrial exports. This contrasts sharply with the situation in agriculture (see Table 1 above).

Figure 2. The increasing share of manufactures in developing country exports.
Table 2. Patterns of protection in manufacturing, 1995

<table>
<thead>
<tr>
<th>Exports region</th>
<th>High Income</th>
<th>Developing</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Import-weighted average tariffs (%)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>High Income</td>
<td>0.8</td>
<td>10.9</td>
</tr>
<tr>
<td>Developing</td>
<td>3.4</td>
<td>12.8</td>
</tr>
<tr>
<td>World</td>
<td>1.5</td>
<td>11.5</td>
</tr>
<tr>
<td><strong>Implied tariff paid (US $ bn)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>High Income</td>
<td>16</td>
<td>93</td>
</tr>
<tr>
<td>Developing</td>
<td>23</td>
<td>57</td>
</tr>
<tr>
<td>World</td>
<td>40</td>
<td>150</td>
</tr>
</tbody>
</table>

Source: Hertel and Martin (2000)

A CGE analysis of the impact of a 40 percent cut in applied tariffs on manufactures by all countries suggests that global trade volume would expand by some $380 billion in 2005—or about 4.7% of projected merchandise and non-factor service trade. This increase is reflected in almost all products, including non-manufactures. The largest increase is for wearing apparel. Even after the phase-out of MFA quotas, trade volume in this sector rises by more than 20%, reflecting the heavy tariff protection in high-income countries. Textiles and autos follow in importance. Real income and efficiency gains, by region, as a share of 2005 income are reported in Figure 3. The difference between these two variables reflects terms of trade effects. (If the real income gain exceeds the efficiency gain, then the terms of trade effect are positive, and vice versa.) Efficiency gains depend on the degree to which a country liberalizes its markets. Sharp tariff cuts give rise to increased access to cheaper imported goods, and generate gains in consumption as well as improvements in the efficiency with which domestic resources are used.
The largest efficiency gains (as a share of income) occur in developing economies, with countries or regions where tariffs are highest in the 2005 base gaining the most (China, Other South Asia and India). China's greater gains, relative to India (which is projected to have higher protection levels in 2005), are due to the fact that the manufacturing sector in China is larger and more trade-oriented. Tariff cuts in the industrialized economies of Japan, Western Europe, Australia/New Zealand and North America generate almost no efficiency gains as tariffs are already extremely low. While their real income gains are somewhat larger due to positive terms of trade effects following increased exports from developing countries, the bulk of the gains go to the developing countries. The latter are estimated to receive three-quarters of the total gains from liberalizing manufactures trade.

*Source:* Hertel and Martin (2000)

Figure 3. Welfare impact of a 40 percent cut in manufactures tariffs
These results suggest that there are strong economic and political-economy reasons for developing countries to support the inclusion of industrial products in any multilateral round of negotiations. From a political perspective, industrial products make up a very large share of exports, and frequently these products are produced by a relatively small number of producers who can provide active support for the politically difficult reforms required by a trade negotiation. From an economic perspective, the substantial static welfare gains outlined above are a good reason to support their inclusion, as are the potential dynamic gains associated with moving to a more outward looking manufacturing sector.

The quantitative analysis of liberalization of trade in manufactures and agriculture that has been surveyed above is highly stylized and simplified. The use of a uniform percentage cut in applied rates of protection provides only a rough guide to the potential benefits from a broad-based liberalization. In practice, the policy instruments on which negotiations focus are tariff bindings—which may be higher than applied rates. The actual outcome will depend heavily on the precise approach to liberalization chosen. Theory predicts that the gains are likely to be larger than those indicated if negotiators choose a tops-down approach that reduces the variance of protection more than a uniform cut. The gains will be less if less reduction in the variance of protection is achieved—i.e., if politically sensitive tariff peaks are preserved. Further work that takes these potential differences into account is necessary.

The research summarized above uses static models and does not consider the dynamic effects of liberalization or the fact that many industries are imperfectly competitive. Current CGE techniques allow such factors to be incorporated into analyses. However, while this will affect the magnitude of the predicted net gains, it will not affect the basic message that emerges: developing countries have a major stake in the attainment of further reductions in barriers to trade in both agriculture and manufactures.
III. Services

In contrast to agriculture and industrial tariffs, it is much more difficult to employ numerical general equilibrium techniques to assess the potential gains from alternative liberalization options. The required information on prevailing barriers to trade and investment simply does not exist. In the case of merchandise trade the main barrier is the tariff. Although differences between tariff bindings and applied rates and accounting for preferential trade agreements and subsidies certainly complicates analysis, the prevailing policies are relatively straightforward to characterize. This is not the case with services. Frequently market access barriers are enforced “behind the border” and are embodied in regulations that control entry and/or operations, impose limitations on foreign equity holdings or nationality constraints, or require professionals to re-certify as a condition for operating on a market. Because services are often not tradable, either firms and/or providers have to move to the location of the buyer/consumer of a service (or vice versa). This implies that regulatory regimes pertaining to temporary (visa restrictions; economic needs tests) or longer-term entry (FDI policies) of service suppliers and consumers must be considered in determining the overall policy stance of a country towards trade in services.

Work is ongoing to improve tariff equivalent estimates of the effect of services policies so as to be able to use this information in CGE modeling (e.g., Brown and Stern, 1999). This also involves efforts to construct openness indicators for modes of supply, especially FDI, and for specific sectors, using qualitative assessments of the extent to which actual policies raise the costs of entry and/or operation post-entry. One noteworthy attempt has been made by the staff of the Australian Productivity Commission, who identify existing policies affecting FDI, assign each a weight, and sum across weights to obtain an overall restrictiveness index. Their results suggest that across APEC countries, communications, financial services and transport are subject to the

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4 See Warren and Findlay (1999) for an excellent survey of recent work.
greatest barriers to FDI, reflecting the existence of ownership limits or outright bans on foreign ownership. The most restrictive countries include Korea, Indonesia, Thailand and China—all countries that appear to have restrictive service sectors using a variety of other measures (Francois and Hoekman, 2000).

Developing countries have a large stake in enhancing the efficiency of domestic service providers and improving their ability to contest foreign service markets. Although the large OECD countries dominate global trade in services, developing countries dominate the list of countries that are most specialized in (dependent on) services exports as a source of foreign exchange. Often this reflects the importance of tourism and/or transportation services. But developing countries have also become large exporters of transactions-processing, back-office services (Jamaica) and information and software development services (India). The potential to exploit recent and emerging technological developments—such as E-commerce—that facilitate cross-border trade in services and provide firms with incentives to slice up the value chain geographically is enormous.

Recent research suggests the emphasis in the next set of GATS negotiations should be on three issues: (i) expanding the coverage of specific commitments; (ii) increasing transparency of prevailing policies; and (iii) improving multilateral disciplines.5

*Expanding the Coverage of the GATS*

The sectoral coverage of specific commitments on national treatment and market access is limited for many countries. By one measure, high-income countries only made commitments on about half of all services, of which only one-half involved commitments of “free access.” That is, governments committed to imposing no restrictions on market access or national treatment for only 25 percent of all service activities. Developing countries made even fewer commitments. In the case of major developing countries, on average “free access” commitments were made for
only 15 percent of the service sector (Hoekman, 1996). Subsequently, successful negotiations expanded the coverage of specific commitments for basic telecoms and financial services. These negotiations were important both for keeping momentum going, and because the services involved are vital intermediate inputs. Despite the success in concluding these agreements, they have not led to a significant increase in the coverage of the GATS, as the Hoekman (1996) compilation included commitments made as of 1994 in both sectors.6

Thus, many governments have refrained from even binding the status quo. More commitments have tended to be made with respect to FDI (“mode 3”) than other modes. A number of countries’ commitments favor infusions of foreign equity into existing firms over entry by new firms. As noted by Mattoo (2000), such protection of incumbents and/or existing market structures is difficult to rationalize and must be carefully monitored, as it can easily result in a transfer of rents to foreign firms rather than a socially desirable increase in competition and lower prices/higher quality output.

A strong case can be made that the GATS should cover all services. There is no rationale for excluding certain sectors or modes of supply from the national-treatment and market-access disciplines, given that the GATS allows for derogations of both principles. One way of moving towards this is to apply a formula approach to expanded coverage in the next round of negotiations, setting minimum coverage targets for GATS members, to be attained by a specified date (which may vary depending on per capita income level to allow for a transition period). This could include agreement that a specified share of all commitments involve full binding of status quo policies. A more ambitious approach would be to seek agreement on a deadline for full coverage to be reached. This should include politically sensitive but economically important sectors such as air and maritime transport. Weak (managed) competition on many international

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5 For a comprehensive discussion, see the contributions in Sauvé and Stern (2000).
6 However, the quality of the commitments, especially in basic telecom, improved substantially. Of particular importance was the adoption of the so-called Reference paper on regulatory principles. This is discussed further below.
transport routes—both sea and air—imposes large costs of developing countries (Francois and Wooton, 1999).

From a market access perspective, developing countries have a great interest in ensuring that substantially more commitments are made on mode 4—supply of services through temporary entry by services providers—and cross-border trade (mode 1), which is of great importance for e-commerce. Although the tradability of services has been increasing rapidly due to technological developments, in many cases it remains imperative that service providers be able to work on the premises of their clients. Currently virtually all GATS members maintain restrictions on such trade, usually through the application of economic needs tests and other requirements imposed on requests for entry visas. Achieving concrete agreements to liberalize access to services markets through mode 4 would go far towards making the GATS a more balanced market access liberalization instrument. The difficulties of making progress in this area are obvious, as there is vigorous opposition on the part of unions and sectoral interest groups in industrialized countries. But, there are also industries in the importing countries that have a large stake in being able to employ foreign service providers. The software industry in the US is just one prominent example—it was the major force behind a temporary expansion in the number of H-1B visas allocated by the US government for service professionals (Chanda, 1999). The challenge confronting developing countries is to build coalitions with domestic industries in large markets to achieve a permanent increase in the number of visas for service providers that may be issued (i.e., a quota expansion).7

Towards Greater Transparency and Better Rules

A major weakness of the GATS is that it does not force members to “come clean” regarding the measures that are used to restrict the ability of foreigners to contest domestic

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7 See Chadha (1999), Chanda (1999), and Mattoo (1999) for more detailed analyses and proposals in the area of trade in services.
service markets. It is very unlikely that negotiators will be willing to reopen the issue of scheduling commitments, and efforts to adopt a “negative list” approach are likely to be counterproductive. But, a negative list reporting exercise for transparency purposes deserves serious consideration. This would involve all members reporting information on all measures that affect market access and national treatment in all services sectors. It would result in a comprehensive database of status quo policies and provide a focal point for reform efforts.

Market access and national treatment only apply on a sector-mode basis under the GATS, and are subject to exceptions if governments schedule these. The ability to make commitments by modes of supply can distort the incentives to use alternative modes, or make a commitment in one mode irrelevant because providers need to have access to more than one. One way to reduce potential inconsistencies is to require one-to-one mappings between commitments relating to modes 1 and 3 (“non-discrimination across modes”). Such modal neutrality is an objective worth pursuing because, as is often emphasized in the literature, trade and investment have increasingly become complementary. It is also frequently noted that it will become increasingly difficult to maintain a clear distinction between trade in goods and trade in services, as technology may give producers the choice of delivering their products in tangible or in disembodied (digitized) form.

Ideally, scheduling of liberalization commitments should shift from the sectoral (specific) to the horizontal (general). This would allow negotiating efforts to center more on developing disciplines that make sense from a long-term growth and economic development perspective. In general, these are likely to focus on safeguarding the contestability of markets while maintaining national sovereignty to regulate activities to attain health, safety, prudential and related objectives. In this perspective, it may be useful to consider “generalizing” the appropriate parts of the so-called “Reference Paper” for telecoms to other infrastructure network services in order to establish a “horizontal” set of pro-competitive disciplines. Work could also usefully be done to strengthen the reach of the MFN principle and extend it to the area of standards and certification to ensure that (mutual) recognition agreements minimize discrimination.
A number of “outstanding” issues were left open after the Uruguay Round, including whether to adopt rules on procurement, subsidies and safeguards. Evenett and Hoekman (2000) argue GATS-specific disciplines on procurement should not be sought, as any disciplines should cover both goods and services. Moreover, what really matters for foreign firms is to have access to services procurement markets, and frequently this can only be achieved if they have a commercial presence in a country. In such cases the binding constraint is not a policy of discrimination, but the ability of foreign firms to establish (enter). This suggests the focus of attention should be on expanding market access commitments under the GATS.

Multilateral disciplines on subsidies might help avoid mutually destructive policies from the viewpoint of developing countries—e.g., seeking to attract FDI via the use of incentives. Subsidies are an important source of distortions in OECD markets for some services (e.g., transport). However, to be effective in disciplining the use of firm-specific fiscal incentives, subsidy rules will have to be quite comprehensive to ensure that countries cannot side-step them through the use of alternative policies. Here again the same conclusion arises as for procurement—any disciplines should be general, not sector-specific.

One area where a more compelling case can be made for service-specific rules concerns safeguards. The limited nature of liberalization commitments on mode 4—temporary movement of service providers—may in part be due to the non-existence of safeguards instruments. Given that this mode of supply is of major interest to developing countries, one could envisage a safeguard instrument that is tied to mode 4 liberalization commitments. These safeguards could be explicitly aimed at providing country governments with an insurance mechanism that can be invoked if liberalization should have unexpected detrimental impacts on their societies (Hoekman, 2000).
IV. Industrial, Investment and Export Development Policies

Many developing countries pursue a variety of industrial development, agricultural extension and export promotion programs. These may involve assistance with adopting new technologies, penetrating new markets, and general advertising campaigns that aim at ‘selling’ the country and enhancing the visibility of export products. During the 1990s an increasing number of countries have also implemented so-called matching grant schemes that subsidize a proportion of the cost of improving production facilities, obtaining ISO 9000 certification of management systems, and exploring new export markets.

Many developing country government have expressed concerns regarding their ability to pursue industrial policies without falling foul of WTO rules and disciplines. Multilateral rules on subsidies and related industrial policies were tightened substantially for developing countries in the Uruguay round. Export subsidies became prohibited (except for least developed countries), and trade-related investment measures (TRIMs)—e.g., local content schemes that imply discrimination against imports—were outlawed. The TRIMs agreement prohibits both mandatory measures as well as the more common policies with which compliance is necessary to obtain an advantage (such as a tax concession, import duty exemption or subsidy). Matching grant schemes—an instrument often used in developing countries—may be regarded as export subsidies insofar as the provision of the grant element is made conditional upon exports.

In almost all these cases, the rationale for activist policies is the existence of distortions created by market failures or other government policies. It is well known that if the source of the problem is policy-induced, the case for a subsidy is very much a second-best one (Bora, Pangestu and Lloyd, 2000). A good case can be made that the stricter disciplines on export subsidies and TRIMs are generally likely to be beneficial. Export subsidies are distortionary for the world as a whole and can easily be captured by private interests seeking rents. In practice they are very difficult to justify on the basis of distortions or market failure. In contrast, production subsidies (and taxes) can be an efficient way to offset externalities, and are allowed under WTO rules.
(although the effect of direct subsidies may be countervailed by importing countries if they can be shown to materially injure domestic competitors). The adoption of a ‘green box’ approach towards subsidies in the Uruguay round allows substantial freedom for governments to use subsidy instruments in cases where this is called for on economic grounds, and reduces the scope for other countries to second guess the motivation underlying the use of such instruments. The types of subsidies that are defined to be acceptable (i.e., as not countervailable) are subsidies where economic theory suggests intervention can help offset market failures (e.g., R&D support, certain types of agricultural input subsidies for developing countries). A good case can be made that no attempts should be made to tighten disciplines in this area, i.e., to narrow the range of ‘acceptable’ subsidies. Insofar as governments believe there are significant benefits associated with the use of programs that might fall foul of the export subsidy prohibition, efforts should also be devoted to achieving formal cover for such programs.

The need to abolish TRIMs has been resisted by many developing countries, who argue that they need such instruments to encourage industrialization. It was agreed in the Uruguay round that the agreement is to be reviewed in the year 2000 at which time it may be complemented by provisions on competition and investment policy (Low and Subramanian, 1996). As the five year review deadline coincided with the built-in negotiating mandate on topics such as services and agriculture, TRIMs not only became a potential negotiating topic for a ‘millennium’ round, but some countries argued in favor of wrapping this into a more general negotiation on FDI policies. This can be motivated on the basis that TRIMs are just part of the relevant policy landscape: investment measures are often general, not trade-related. Many countries apply licensing and approval regimes and impose related “red tape” costs on foreign investors. They may also prohibit entry through FDI altogether, or impose equity ownership restrictions. The TRIMs agreement does not apply to such non-trade-related policies, nor does it affect service industries.
Neither the economics nor the political economy of seeking WTO disciplines on FDI are straightforward (Markusen, 1999; Moran, 1998). Restrictive policies may reflect welfare-enhancing attempts to shift foreign profits to the domestic economy or welfare-reducing rent-seeking activities by bureaucrats and their constituents. Sometimes the effect of policies is simply to waste real resources (so-called frictional costs). A key question concerns the value added offered by multilateral rules in this area to developing countries, given that much can (and should) be done through unilateral reform to attract investment. This is an under-researched topic. Hoekman and Saggi (1999) argue that there are potential payoffs, but that these may be difficult to realize. They also argue that in the area where FDI matters most as a mechanism to contest markets—services—a WTO instrument already exists. The GATS extends to FDI policies as countries can make specific market access and national treatment commitments for this mode of supply for any or all services. Thus, a lot can already be achieved using existing structures.

As far as more traditional TRIMs are concerned, the available empirical evidence suggests that local content and related policies are generally ineffective or costly to the economy—they often do not achieve the desired backward and forward linkages, encourage inefficient foreign entry, and create potential problems for future liberalization as those who enter lobby against a change in regime (Moran, 1998). The major policy question is implementing the agreement—that is, phasing out illegal TRIMs. Governments may be constrained in eliminating costly status quo TRIMs because protected industries are politically powerful. The UR agreement incorporated transition periods, but these were not based on economic criteria. Some countries may need extensions of transition periods as well as assistance in designing effective and credible transition paths.

**V. Achieving Balance: Rule Making and Implementation**

Resource constraints impede the ability of many developing countries to identify and defend their interests in multilateral negotiations and WTO activities (Blackhurst, Lyakurwa and Oyejide,
2000). Even if countries are able to influence the set of subjects to be negotiated so that notional symmetry prevails in terms of defining the agenda, outcomes can easily be asymmetric, reflecting differences in negotiating power. Under GATT this asymmetry was exemplified by the exclusion of agriculture and textiles and clothing from many multilateral disciplines, and the use of various instruments of contingent protection, including some that were GATT illegal—e.g., voluntary export restraint agreements (VERs). In the Uruguay Round, negotiating power asymmetries were illustrated by the MFA/VER abolition for TRIPS deal—the extraction of “payment” for elimination of practices that violated the spirit, if not the letter, of the GATT—and by the fact that very little, if anything, was done to significantly enhance developing country opportunities to export services (e.g., through the movement of natural persons).

Asymmetry under the Uruguay Round also was reflected in the fact that developing countries became subject to a large number of disciplines in areas that under GATT were voluntary—including customs valuation, antidumping, subsidies, technical product standards, and sanitary and phyto-sanitary measures—as well as new rules in areas such as intellectual property. In these areas it is difficult, if not impossible, to trade ‘concessions.’ Negotiators focused instead on the identification of specific rules that should be adopted by all. In practice the norms chosen were those that were (are) applied in industrialized countries. In contrast to traditional trade liberalization, a “one size fits all” approach may not be optimal (Finger and Hoekman, 1999). Nonetheless, ‘one size fits all’ was a central pillar of the Uruguay Round—developing countries were only granted additional time in which to implement obligations. In many areas these periods were 5 years and expired at the end of 1999. Many countries are far from being in compliance, making extension of time limits for implementation—and possibly re-negotiation or granting of waivers—priority issues for many developing countries. No agreement on this emerged in Seattle. It is important that a decision is taken to exempt developing countries from dispute settlement actions related to non-implementation until the issue is resolved.
Implementation became an issue in part because the costs associated with complying with some WTO agreements can be significant. As noted by Finger and Schuler (1999), such costs can easily exceed the entire development budget of a least developed country.\(^8\) It is not at all clear from a development perspective that the resources required for implementation of WTO agreements, whatever the amount might be, would not be better used to build schools or improve infrastructure. Ensuring that WTO agreements are conducive to (consistent with) attainment of development objectives should be a major objective of the next round. This requires development of mechanisms and methods to determine whether and when disciplines in specific areas should be implemented, and flexibility to allow countries to experiment with domestic regulatory regimes and mechanisms that maximize national welfare.

At the time of the Uruguay Round, there was only limited developing country experience in the “new areas” on which the negotiators could draw. Poor countries have yet to attempt to create intellectual property regimes that makes traditional knowledge or cultural products into a negotiable and defensible asset. Nor have they identified the alternative options that can be used to upgrade and enforce national product, health and safety standards, or to regulate service sectors that are subject to market failures. In many of these areas, the trial and error experience—the assessments of the real-world impacts of alternative policy options—that can inform the effective incorporation of the development dimension into multilateral rules does not exist. The implication is that WTO rules should allow for experimentation and learning, and that implementation of UR commitments should be made conditional on this being done in a way that makes economic (development) sense (Finger and Hoekman, 1999). Often this will require much more than simply issuing a decree or passing a new law. In many countries it makes little sense to adopt WTO mandated customs valuation procedures without a major investment in improving the

\(^8\) While not costing high income countries anything, given that the rules basically codified existing practices in these countries.
operation of customs. Such implementation concerns must be addressed in future WTO negotiations.

**Intellectual Property Rights and Competition Policy**

The Uruguay Round TRIPS agreement obliged all WTO members to enforce intellectual property rights (IPRs), though with transition periods for developing countries. Whether developing countries will gain from stronger protection of IPRs is a matter of vigorous debate. Those in favor argue that dynamic benefits—operating through FDI, technology transfers and licensing, and innovation within and for the domestic market—will more than offset any static losses. Those against note that dynamic benefits are uncertain, while the on balance the short-run impact of the TRIPS régime—which will operate through higher prices, lower domestic output, and more imports—is likely to cause a transfer of income from poor to rich countries, with at best marginal impacts on economic efficiency, resulting in net transfers to firms in high income countries.9

The scale of the transfer very much depends on the market structures that prevail and the closeness of available substitutes. Estimates for Lebanon by Maskus (2000a) suggest that because Lebanon is a net importer of pharmaceutical products and technologies and currently has relatively little inventive capability in the sector, the static impacts of stronger patents are likely to be negative, increasing average prices by some 10 percent and resulting in lower output and fewer firms. But in other sectors where Lebanon produces IPR-sensitive products (such as printing and publishing, music, and film/video), stronger protection would be beneficial. The static net impact is therefore unclear. Dynamic effects are even more uncertain.

An important factor determining the impact of the TRIPS agreement is the ability of governments to intervene to offset socially detrimental outcomes. The agreement has a number of provisions that authorize the use of policy measures against abuses of IPRs. Competition law has an important role to play in this connection. For example, as right holders will frequently use their
IPRs to segment markets, developing countries may have a strong interest in applying an international exhaustion rule (which implies allowing parallel imports). This would imply that domestic buyers could purchase patented and branded products wherever they find the most favorable prices. This is fully compatible with the TRIPS agreement, even though both the EU and the US are active proponents of a national/regional approach to exhaustion. Whether to adopt an international exhaustion rule should be a matter for national authorities to decide independently. Of course, this is just one aspect of the inter-relationship between IPR and competition regimes, but it serves to illustrate that here again a ‘one size fits all’ rule should be avoided (Maskus, 2000b).

Developing countries have an interest in adopting strong competition policies, the main pillar of which should be a liberal trade and FDI policy stance. Competition law is required to ensure markets are contestable, especially in nontradable sectors. Antitrust legislation may also be required to maximize the benefits (or minimize the costs) of certain WTO agreements, the TRIPS agreement being one example. What matters from the point of view of WTO negotiations is whether attempts to agree on binding multilateral disciplines would be beneficial for developing economies. In principle, a commitment to more thorough policing by industrial countries of their own exporters, of global strategic alliances (e.g. in telecoms), and import-competing industries’ use of instruments of contingent protection could have very general benefits for developing countries (Maskus and Lahouel, 2000). Hoekman and Holmes (1999) argue that developing countries should use the occasion of a trade round to put their interests on the table, recognizing that the quid pro quo they can expect will depend importantly on what they are willing to offer. Seeking modifications in anti-dumping law and commitments by OECD competition authorities to provide assistance to developing country competition authorities are examples of the type of quid pro quo that could be sought. Realism suggests, however, that the primary focus should be on the design of appropriate national policies. Once more experience has been obtained with the design and implementation of

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9 See Primo Braga (1996) for a survey of the literature.
national regulations, countries will be better able to judge what type of multilateral agreement in this area is appropriate.

**VI. Labor, Environmental and Related Standards Issues**

The collapse of the Seattle ministerial meeting was in part due to differences in views between developed and developing countries on whether the WTO should regulate and enforce labor and environmental standards. Determining the extent to which multilateral disciplines should extend “behind the border” and cover more areas of domestic regulation is one of the key challenges facing WTO members. While the case for domestic regulation to address market failures or pursue non-economic objectives is indisputable, the case for international harmonization is not. Efforts to impose standards on all WTO members and enforce them via the threat of trade sanctions threaten to embroil the WTO in issues in which it has neither the technical ability nor the political legitimacy to act effectively (Rollo and Winters, 2000).

The TRIPS agreement reflects the first clear attempt at harmonizing domestic policy and setting certain minimum absolute standards of IP protection to which all members must adhere. The GATT was an instrument of negative integration—it revolved around agreements *not* to do certain things (discriminate in trade policy, raise tariffs above bound levels, etc.). TRIPS is the first major example of what has been called ‘positive’ integration (Tinbergen, 1954). One result is that for the first time failure to implement a certain type of regulatory regime (in this case prevent the use of production processes by domestic firms that violate IPRs) can give rise to dispute settlement and possibly trade sanctions.

A question that has arisen concerns the implications of TRIPS on the scope of the WTO. If IPRs can be brought into the WTO, why not other areas of domestic regulations as well? A useful approach to answering this question is offered by Maskus (2000b), who identifies a series of screens or criteria that should be used to determine if there is a good economic case for bringing a regulatory area under the WTO. These are that the issue: (i) be strongly trade-related;
(ii) gives rise to international externalities; (iii) is associated with policy coordination failures that can be addressed effectively through WTO dispute settlement; and (iv) has the potential to strengthen the trading system. In the case of labor standards, Maskus surveys the literature and concludes that, firstly, there is very little credible evidence that deficient enforcement of core labor standards has an impact on trade. Secondly, he finds that both the theoretical and empirical basis for arguing that lax labor standards in developing countries suppresses wages of low-skilled workers in OECD nations is very weak. Thirdly, he argues that WTO type enforcement (relying on trade sanctions) will worsen labor outcomes, and finally, he points out that the linkages between core labor standards and existing WTO disciplines are non-existent (Maskus, 1997; 2000b).

There is considerable international agreement that certain core labor rights should be globally recognized and protected. Development and encouragement of implementation of such rights is the task of the ILO. One of the principal arguments for inclusion of labor standards in the WTO is to provide an enforcement mechanism for ILO Conventions. However, trade remedies to enforce labor standards, as proposed by Rodrik (1997) and de Wet (1995) should be resisted: they would worsen the problems at which they are aimed (by forcing workers in targeted countries into informal or illegal activities), and burden the trading system (by increasing the likelihood of controversial disputes). Account should also be taken of the non-negligible danger that such instruments will be captured by protectionist interests, seeking to limit imports from labor-abundant developing countries. Attainment of core labor standards can be pursued more effectively through instruments that are targeted directly at improving outcomes. For example, efforts could be made to improve the quality of, and access to, primary education for poor children in order to reduce child labor exploitation, e.g., via programs to subsidize the purchase of school supplies, provide transportation, and reduce the costs of schooling. It is important to avoid a confrontational approach to this issue and to pursue collaborative solutions that help developing countries improve labor standards. Attempts to force countries to adopt standards that do not
reflect national preferences and conditions should be rejected (Bhagwati and Srinivasan, 1996). Gains from trade arise in large part because countries differ, and national social or environmental policies are simply one determinant of these differences. They do not constitute barriers to trade, or give rise to “unfair” trade.\(^{10}\)

In the case of the environment, the argument for adopting substantive rules in the WTO is also weak. However, one important difference as compared to labor standards is that trade policies may have adverse environmental consequences. An example would be subsidies and trade protection for the coal industry—this may discourage a shift to cleaner burning fuels. There may also be potentially important cross-border environmental spillovers. These give rise to a need for international cooperation. This has been reflected in various multilateral environmental agreements (MEAs). Such agreements might include trade sanctions as enforcement instruments. As this can give rise to WTO dispute settlement if a non-signatory is targeted by signatories, the WTO membership may need to devise procedures that set out the conditions under which they would permit such sanctions. Rollo and Winters (2000) suggest the following as necessary conditions to ensure legitimacy and reduce the chances of protectionist capture:

- sanctions must be genuinely a last resort;
- decisions to sanction a transgressor should be collective, with a very substantial majority of WTO membership;
- provision must be made for frequent review to determine if sanctions can be removed;
- the sanctions should be applied by all signatories of the MEA; and
- WTO members should have no discretion about what products to restrict.

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\(^{10}\) The focus here should be on policies, not outcomes. Thus, industries may shift production facilities abroad because environmental policies are less stringent in the host location, but as long as policies are appropriate to local conditions and reflect national (or local) preferences, this is desirable.
VII. Developing Country Participation

Many of the contributions that have emerged from the ongoing research on which we have drawn emphasize that participation constraints are a general problem, in particular for least developed countries; that lack of information and limited cross-country experience greatly constrains the ability of countries to exploit the “wiggle room” that is embodied in many WTO agreements; that there is a need to ensure that governments have the scope to pursue policies in a manner that make sense from a development perspective; that fulfillment of offers of financial and technical assistance by high-income countries have proven to be disappointing; and that provisions requiring such countries to take into account the interests of developing countries have proven to be meaningless. (Blackhurst et al., 2000; Finger and Schuler, 2000; Finger and Hoekman, 1999; Michalopoulos, 1999; Hoekman and Mavroidis, 2000).

The end result has been an absence of developing country “ownership” of many agreements, and a general suspicion of the WTO in large segments of civil society. This can only be remedied if the next round results in a more balanced outcome (Stiglitz, 2000), one that addresses the selective liberalization and rule-making that has been a characteristic of the system to date, and allows greater flexibility regarding the specific rules that are imposed on WTO members. The preconditions for achieving greater balance appear to be there—developing countries have demonstrated a willingness to participate actively and constructively in the WTO. This was reflected in the run-up to Seattle and the role played in the process of defining a negotiating agenda. The inability (unwillingness) of the industrial countries to accept the necessary compromises helped scuttle the talks, but arguably this has helped set the stage for a more balanced agenda to be crafted in the future. That said, to paraphrase Wang and Winters (2000), much will have to be done to “put Humpty Dumpty back together again” and repair the damage manifested in Seattle. Most developing country delegations left Seattle frustrated with WTO procedures that excluded them from deliberations. This compounded prior resentment
about the outcome of the Uruguay round and concerns about the burden of implementing WTO obligations.

It is important to separate initiatives that aim at directly reducing barriers to trade from initiatives to further expand and deepen WTO provisions pertaining to regulatory regimes. The available research strongly suggests that the potential benefits from vigorous pursuit of a market access agenda are significant. This conclusion spans agriculture, trade in manufactures, and services. Future efforts in the WTO should center on further reductions in traditional barriers to trade, which in the case of services include policies that restrict the ability of foreign firms to contest markets through a variety of entry modes, including FDI. Much of what an investment agreement might do can be achieved via the GATS. Significant scope exists for mutually beneficial quid pro quos within the services area. Although industrial products are notably absent from the “built-in” negotiating agenda, developing countries have a strong interest in taking up the banner of manufacturing tariff cuts given that manufactures account for some three-quarters of their merchandise exports. Efforts to further discipline the ability of governments to abuse instruments of contingent protection, minimize the trade-restricting impact of product standards, especially sanitary and phyto-sanitary measures, and facilitate trade more generally—while not discussed in this paper due to space constraints—are also of great importance (see UNCTAD, 1999 and Messerlin and Zarrouk, 2000).

Implementation and institutional issues rank high among the concerns of developing countries. They deserve to figure prominently on the WTO agenda. In contrast to past negotiating rounds, negotiating modalities should be developed to ensure that agreements are consistent with development strategies and priorities, thereby avoiding the types of implementation-related tensions that arose after the Uruguay Round. This requires both greater flexibility regarding the types of rules that are adopted, as well as binding commitments by high income countries to provide the financial and technical assistance that is required to assist countries in implementing WTO obligations in ways that support the economic development process. Political will and
leadership is required, to refrain from overburdening the institution by expanding its reach into areas that are not trade-related, where it has no expertise, or where it is clear that interests among members diverge too much for agreement to be feasible.

**VIII. Concluding Remarks**

This paper surveys some recent research regarding the interests of developing countries going into a new round of WTO negotiations. It is impossible to do full justice to the complexity of the issues that arise in many of the areas that could figure on the WTO negotiating agenda. Accordingly, readers are referred to the papers provided in the references for a more thorough treatment of these issues.\(^{11}\) It is also impossible to generalize regarding the interests of developing countries. Nations are very diverse, reflecting differences in per capita incomes, initial conditions, and endowments.

Starting in the late 1970s, assessments of trade rounds have relied heavily on computable general equilibrium (CGE) modeling techniques. These allow the economy-wide effects of policy changes to be simulated. Such models are particularly well-suited to assessing the impact across industries and countries of reductions in tariffs, quotas and subsidies. We have summarized some key findings from one such model with respect to agricultural and manufacturing liberalization in the wake of the Uruguay Round. We conclude that the biggest winners from further liberalization are likely to be developing countries. Indeed, given their heavy reliance on manufacturing exports, and the relatively high tariffs projected to remain after the Uruguay Round, developing countries are expected to reap the majority of the benefits from further tariff cuts in this sector. However, these CGE models are much less amenable to assessing the implications of rule making, and, as tariffs have fallen, this aspect of the negotiations has become increasingly prominent. It is therefore very difficult, if not impossible, to quantitatively assess the overall impact of multilateral trade talks. Many dimensions of WTO agreements simply cannot be

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\(^{11}\) Many of these papers that have been posted on the website: www.worldbank.org/trade.
quantified. Other instruments—ranging from the use of economic theory to careful cross-country case studies—must be used to assess the likely impact of rules that constrain the ability of governments to pursue regulatory policies or affect the operation of the WTO and the trading system.

A good case can be made for shifting away from attempts to introduce substantive rules on domestic regulatory and legal regimes that imply harmonization to high-income country standards. Instead, the focus could more fruitfully be on procedural disciplines that aim at ensuring transparency of policies, and facilitating the adoption of national policies that assist governments implement development programs and attain sustainable economic growth. Concretely, this implies a need to re-visit the issue of transition periods for certain UR agreements, rejection of attempts to negotiate substantive multilateral disciplines in areas such as investment and competition law in the next round—although these could be topics for future negotiations—and refusal to consider the inclusion of rules on labor standards and the environment. Such flexibility will help create a trading environment that allows developing countries to help themselves by specializing in sectors where they have a comparative advantage, expanding employment and reducing poverty in the process. Doubts can be expressed regarding the payoffs associated with the introduction of substantive disciplines in the WTO on domestic regulatory regimes if this entails harmonization to OECD norms that have not been determined to be in the interests of least developed countries. However, such doubts certainly do not extend to the bread and butter of the multilateral trading system—the progressive liberalization of barriers to trade in goods and services on a nondiscriminatory basis. This is an area where there still remains much to be done, and where traditional GATT negotiating modalities can be an effective mechanism to overcome resistance to reform, in both developing and developed countries.
References


