Although the principle of more favorable treatment for developing countries has a long history and is firmly embedded in the WTO, the existing system of differential treatment has left both developed and developing countries dissatisfied. In terms of the current Doha trade negotiations and in the implementation of multilateral trade rules, it is among the more important issues to be resolved. The medium-term viability of the global trading system is dependent on an effective mechanism that allows all developing countries (that is the majority of the WTO membership), to fully benefit from increased international trade—an outcome vital for economic growth, development and poverty alleviation.

Currently, ‘special and differential treatment’ (SDT) provisions in the WTO call for preferential access to developed country markets, exemptions (transitory and permanent) from certain rules, and promises of development assistance. There are good reasons for SDT. One is that very small and/or low-income economies lack the institutional development or minimum scale to manage the full panoply of WTO rules or, at least, might find the returns to creating the institutions to apply them outweighed by the costs. Small and/or poor countries may also lack the resources to overcome natural obstacles to trade or to pursue policies most suitable to addressing market failures or pursuing non-economic objectives.

The Doha Declaration called for a review of SDT provisions, with a view to “strengthening them and making them more precise, effective and operational”. Developing countries made some 88 specific suggestions to strengthen SDT language. They call for improved preferential access to industrialized country markets, exemptions from specific WTO rules, binding requirements to provide technical and financial assistance to help developing countries implement multilateral rules and benefit from negotiated rights, and an expansion in aid to address supply side constraints. Despite intensive talks and numerous meetings, no agreement proved possible on strengthening SDT provisions.

One reason for this was that a common element of many of the proposals was to convert existing nonbinding (unenforceable) language—so-called best-endeavors provisions—into binding obligations that could be enforced through WTO dispute settlement procedures. Another reason for the lack of an agreement is a difference in views on what types of exemptions (SDT) make economic sense. Indeed, the debate on strengthening SDT overlaps to a significant extent with the broader issue of making the WTO more supportive of development. This is a major challenge—perhaps the most fundamental development challenge confronting the WTO—given the huge differences in the level of development among WTO members.

Breaking the deadlock will require actions by both developed and developing countries, to bolster the three major pillars of SDT: greatly improved market access for developing countries, mechanisms to ensure
that WTO rules and disciplines support development, and increased development assistance ("aid for trade"). What follows sketches the outlines of a possible package that would make SDT more effective.

**Market access for disadvantaged countries**

Trade preferences have been a mainstay of SDT since the late 1960s. Unfortunately, evidence suggests that preferences generally deliver less than expected. First, for most goods, particularly manufactures, the tariff preference margin granted to developing countries is often small. For example, Amjadi, Reinke and Yeats (1996) show that, at the end of the Uruguay Round transition period, Sub-Saharan African countries will have preference margins averaging slightly under 2.5 percentage points. (One should consider preferences in terms of the price advantage they confer—i.e., percentage points—rather than, as is quite common, the percentage of the tariffs they remit. To have 100% remission of a 1% tariff is worth far less—1 percentage point—than a 50% remission of a 10% tariff—5 percentage points.)

Of course, there are cases where tariffs are higher or where domestic price support policies provide preferred partners with deeper preferences that are potentially more valuable. But these are not as common as they may appear on the surface. Consider, for example, textiles and clothing. This simple and labor-intensive sector is one in which developing countries clearly have some competitive advantage, and which as a result of having some of the highest MFN tariffs, potentially offer the greatest margins of preference. Unfortunately, however, the United States does not generally grant preferences on textiles and clothing, although it does to some particularly favored partners—most recently to select African nations under the African Growth and Opportunity Act. The EU does grant tariff preferences on textile and clothing exports under GSP, Cotonou and various regional agreements—and, since 2001, to the least-developed countries (LDCs) under the Everything But Arms (EBA) initiative—but they are subject to restrictive and cumbersome rules of origin.

As illustrated in Table 1, developing countries do not receive significant tariff preferences in key product categories, in which they tend to have a comparative advantage. In general, for products where tariff peaks exist, preferences tend to be the most limited (Hoekman, Ng and Olarreaga, 2002). While this has been changing—e.g., the EBA gives duty and quota free access to LDCs for virtually all products—countries where most of the world’s poor live, including Brazil, China, Indonesia, India, Malaysia, Pakistan and Thailand, tend to be granted only limited preferences, if any.

In summary, research suggests preferences are often of little value because they exclude important items such as textiles or agricultural products; there are binding limits on the value of exports that benefit from preferences, including so-called ‘competitive needs’ tests; or other non-tariff measures are used to restrict access. Combined with complex administrative requirements and red tape, including documentation of origin, the effect is to reduce investment in activities that could in principle benefit from preferences.
Table 1. **Key Products without GSP preferences in the EU and US**

<table>
<thead>
<tr>
<th></th>
<th>United States</th>
<th>European Union</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>TOTAL Imports ($bn)</td>
<td>GSP recipients' market share (%)</td>
</tr>
<tr>
<td>Dairy Products</td>
<td>1.1</td>
<td>13%</td>
</tr>
<tr>
<td>Textiles &amp; Yarn</td>
<td>9.8</td>
<td>21%</td>
</tr>
<tr>
<td>Apparel &amp; Clothing</td>
<td>58.5</td>
<td>47%</td>
</tr>
<tr>
<td>Leather products</td>
<td>7.2</td>
<td>24%</td>
</tr>
<tr>
<td>Footwear</td>
<td>15.3</td>
<td>18%</td>
</tr>
<tr>
<td>Ceramic &amp; Glassware</td>
<td>7.9</td>
<td>13%</td>
</tr>
</tbody>
</table>

*Note:* GSP countries only; LDCs obtain deeper preferential treatment (see text). China is included under EU GSP but excluded by the US. *Source:* WITS.

One way to strengthen SDT would be for developed countries, before or upon the conclusion of the Doha talks, to extend EBA-type duty- and quota-free market access to all developing countries. However, this is simply not feasible politically—the most that may be possible is to extend such treatment to LDCs and other small and poor countries. This would be beneficial in helping target SDT on those who need it most, but ignores the fact that most of the world’s poor live in non-LDCs.

From a global poverty reduction point of view—which must be taken in light of the Millennium Development Goals—a good 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—such as China and India. Limiting preferences to the poorest countries—while appropriate in light of limited institutional and infrastructure weaknesses in these countries—ignores the majority of the poor in the world today. Research suggests that the poor confront tariffs on world markets that are more than twice as high as those confronting non-poor producers (World Bank, 2002).

Given that deep trade preferences for larger economies are not politically feasible, action is required to liberalize trade in goods and services in which developing countries have a comparative advantage on a nondiscriminatory basis. A binding commitment by developed countries to abolish export subsidies, decouple agricultural support and significantly reduce—ideally abolish—tariffs on labor-intensive products of export interest to developing countries on a non-discriminatory basis should be a key element of any improved SDT regime. Acceptance of ambitious liberalization benchmarks would provide a strong signal of commitment to poverty alleviation by developed countries. A commitment by industrialized countries to expand temporary access for developing country service providers by a specific amount—say by 1 percent of the workforce—and not to restrict cross-border trade in services would

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also bring substantial benefits (Walmsley and Winters, 2002).

MFN-based market access is not traditionally considered an element of SDT. However, a strong case can be made that this will have the greatest beneficial impact on development. One reason for this is that it involves an element of ‘rebalancing’ of the WTO as it implies that elements of ‘reverse SDT’—special opt-outs and exemptions that benefit interest groups in industrialized countries at the expense of developing countries—would be removed. Agricultural subsidy programs, high protection for textile products, and tariff peaks and escalation that imply high rates of effective protection for developed country industries are examples. Reversing this situation would not only be beneficial to developing countries (and developed country consumers), but also make further trade reforms in developing countries more feasible.

**Implementation of WTO rules**

SDT in the WTO includes derogations or exemptions from some WTO rules. A basic issue here is whether existing or proposed new rules will generate a positive net benefit for poor countries if they are implemented. While this is something that presumably is considered by governments in the course of negotiations, past experience suggests that the necessary analysis and consultations often were not undertaken in many developing countries, explaining why there is now a lack of “ownership” of—support for—WTO rules in many of these nations.

In considering the net benefit of WTO rules, it is important to make a distinction between trade policy disciplines, and rules that require significant up front investment of resources to establish or strengthen institutions. While a good case can be made that trade policy disciplines should apply to all WTO members (Hoekman et al, 2003), when it comes to domestic regulation and related institutions, one size does not necessarily fit all. Aspects of certain WTO agreements may not be development priorities. They may require many other preconditions to be satisfied before implementation will be beneficial. Some disciplines may not be appropriate for very small countries in that the regulatory institutions that are required may be unduly costly—countries may lack the scale needed for benefits to exceed implementation costs.

These observations suggest there is a need for ‘differentiation’ between developing countries in determining the reach of resource-intensive WTO rules. There are broadly three options that could be used to take into account and operationalize such country differentiation in determining the reach of WTO agreements:

- total flexibility (exemptions) for developing countries when this does not harm any other member country;
- a country-approach: more narrowly defining eligibility for rule-related SDT provisions that would apply to an agreed set of agreements, so as to limit such SDT to countries that need it most—i.e., the poorest countries and very small states;
- an agreement-specific approach: setting objective criteria within certain agreements that would link implementation by developing countries to local conditions, priorities and capacities, based on an audit that shows costs are significant, and linked to availability of technical assistance.

Of these options, the first has implicitly underpinned the approach taken in the current proposals made by many countries, and as the status of those negotiations suggests, is unlikely to prove fruitful. The second would require renegotiating the three country classifications currently used in the WTO—LDCs, all other developing countries, and the developed country group. A good case can be made for this, given that many countries that define themselves as
developing have per capita incomes that are many multiples of the poorest countries. However, this has been a politically sensitive issue in the WTO. The third option would allow the issue of defining general eligibility to be avoided, but clearly involves significant transaction costs.

The specific approach that is chosen towards strengthening rule-related SDT requires substantial thought and discussion. What matters most at this point is that WTO members recognize that capacities and priorities differ hugely across the membership. One way to do so would be through a decision in Cancun to consider alternative approaches along the lines sketched out above so as to make SDT more effective. Given the steady expansion of the WTO into regulatory areas, this is arguably critical if development-relevance is to be more than a slogan.

Renegotiation of certain WTO disciplines

Much of the debate on SDT in the WTO implicitly, if not explicitly, reflects a perception by developing countries that the rules in some WTO agreements are not supportive of development. Rather than seek opt-outs under the guise of SDT, a preferable approach is to renegotiate these agreements. For example, in agriculture, it may be useful *inter alia* to introduce a new rules to ensure that developing countries have the freedom to pursue policies that support the rural poor. In TRIPS, the world community has an interest in ensuring that developing countries have the flexibility to provide their poor with access to drugs at affordable prices and that traditional knowledge is protected and properly remunerated.

Aid for Trade

Development assistance can play an important role in helping to build the institutional and trade capacity needed to benefit from better access to markets. While more funds are needed to address trade-related policy and public investment priorities, it is important to avoid a situation in which a desire by donor countries to see developing countries implement certain WTO agreements diverts assistance away from recipients’ own priorities. This is one of the downsides of suggestions to make technical assistance mandatory under the WTO and to link implementation of WTO agreements to the provision of such assistance. A better approach is to support efforts to embed trade-related technical assistance in the national priority-setting processes that are used by governments and the donor community—e.g., the Poverty Reduction Strategy Paper (PRSP). This is critical in order to ensure that trade priorities are identified for funding. But once this has been done, donors and international financial institutions must stand ready to expand assistance to help bolster trade capacity and strengthen trade-related institutions in developing countries.

The Quid Pro Quo

Reciprocity is the engine of WTO negotiations and will be needed to move forward. The overuse of ‘nonreciprocity’ has, in the past, excluded developing countries from the major source of gains from trade liberalization – namely the reform of their own policies.\(^2\) Non-reciprocity is also a reason why tariff peaks today are largely on goods produced in developing countries. A willingness to pursue own liberalization is necessary to move forward on market access. This can be pursued in ways that grant negotiating “credit” to developing countries that have already taken significant unilateral, autonomous reforms. One way to achieve this is through the adoption of a formula approach to tariff negotiations that uses the level and extent of reduction in tariff bindings as the focal point of liberalization commitments.\(^3\) Given that many developing countries either have not bound tariffs at all or have high tariff bindings, this will automatically imply that credit is given for past reductions in applied tariffs.

On the rules side, an important quid pro quo that will help shore up the trading system...
would be for developing countries to accept that core WTO trade policy rules are beneficial. The overwhelming tendency of the economic literature is to conclude that the case for using traditional trade policy instruments to achieve economic development objectives is weak (Hoekman et al. 2003). This does not imply that developing countries should be forced to sign away all flexibility to use trade policies—countries have the right under the WTO to impose tariffs and export taxes if they desire to do so—but rather that these are not efficient tools to promote industrial development. Abiding by WTO procedural rules on the use of such instruments will benefit consumers and enhance welfare in developing countries. Doing so would help focus attention on areas where SDT would make a real difference.

Conclusion

The heart of moving forward on SDT is to put in place a mechanism that will effectively promote the interests of developing countries, with an emphasis (priority) on the needs of the poorest countries to benefit more fully from participation in the multilateral trading system. Greater differentiation arguably must be part of a new grand bargain—the existing two-fold country classification system in the WTO of LDCs (UN-defined) and other developing countries (self-declared) has resulted in an ineffective mechanism for all.

Of the three major dimensions of SDT—much improved access to export markets for developing countries for goods and services, implementation and enforcement of WTO rules, and expanded development assistance (‘aid for trade’)—rapid movement is possible on the first and last. In principle, commitments to this effect can be made in Cancun. Agreement on how to deal with implementation constraints and the reach of resource-intensive rules will take time to reach. However, here also a commitment in principle to develop a new approach along the lines sketched out above could be made in Cancun. Much follow up work would be needed to develop the specifics of any approach.

One way of pursuing this agenda would be for a high-level group operating under the auspices of the WTO General Council to elaborate how a new mechanism for rule-related SDT might operate in practice, including possible criteria to determine which rules should be eligible for SDT. The membership of this group must go beyond trade officials to include national economic policymakers and representatives of the international development community.

SDT cannot be a one-way street. Differentiation implies that only a subset of developing countries should be eligible for SDT, implying acceptance on the part of the more advanced that they are not eligible and a willingness by all developing countries—both low and middle income or higher—to engage in the exchange of trade policy commitments (market access). An element of credit for past autonomous reforms can and should be part and parcel of the negotiating modalities that are adopted, but the viability of the trading system requires that the core principles and rules apply to all members.

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1 In 1965, developing country demands for special status in the multilateral trading system led to the drafting of a new Part IV of the GATT. This introduced the concept of SDT for developing countries. In 1979 a Framework Agreement was negotiated, which included the so-called ‘Enabling Clause’. Officially called Differential and More Favorable Treatment, Reciprocity and Fuller Participation of Developing Countries, it provided for departures from MFN and other GATT rules. The Enabling
Clause created a permanent legal basis for the operation of the general system of preferences (GSP) established under UNCTAD auspices and codified principles, practices and procedures regarding the use of trade measures by developing countries, giving developing countries more flexibility in applying trade measures to meet their ‘essential development needs’.

2 Ozden and Rheinhart (2002) argue that countries with preferential access to developed country markets—even if it is of limited value due to administrative requirements and exceptions—have less of an incentive to pursue trade liberalization.

3 See Francois and Martin (2003) for an in-depth analysis of alternative formula-based approaches.

References


Further Reading


*This Trade Note was written by Bernard Hoekman, World Bank. It draws on joint work with Caglar Ozden, Costas Michalopoulos, Susan Prowse and Alan Winters. The views expressed in this paper are personal and should not be attributed to the World Bank.*