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1
The WTO, Trade and Development: An Introduction

Basudeb Guha-Khasnobis

There are sound theoretical reasons how free trade in an ideal world can augment world output by guiding resources to their best possible usages at any given point of time. Free trade is also endowed with considerable dynamic energy, which can sustain this efficient usage of resources over a period of time for a given country or group of countries, resulting in higher growth rates. Such beneficial effects of free trade are unambiguously true at an aggregate level, in the sense of making *every* country better off, although to different extents. However, theory does not say that free trade makes every individual better off. In fact, quite to the contrary, any reasonable theory of trade predicts that free trade has differential impacts on various population groups within a country. Thus, quite clearly, there are two potential sources of conflict which will affect any movement towards freer trade. The first source of conflict is the sharing of free trade benefits between countries. In this respect, the world trading community is divided into two broad groups, developing and developed countries, and their quarrels reflect essentially how to split the spoils of free trade. The second source of conflict is inherent within countries. Certain groups of people gain relatively more than others. Some groups may even lose from freer trade, at least in the absence of any redistribution of income by the government.

There are subtle differences in the ways the two sources of conflict manifest themselves. Developing countries as a group are *not* against freer trade, although they are often misunderstood as being so! Developing countries are basically unhappy about what they have received as benefits of a freer world trading regime relative to what they are being seemingly forced to offer. On the other hand, certain groups of population within both developing as well as developed countries *are* against freer

trade because they stand to lose from it at least in the short run, in the absence of any guarantees for compensation.

These conflicts have been part and parcel of the successive rounds of the GATT and, since 1995, the WTO regime, during which the world community has been trying to move towards freer trade. The WTO regime, especially, has been increasingly turbulent, with the developing countries voicing their concerns about the development credibility of the new regime. The November 2001 'Doha Development Agenda' recognizes the concerns of developing countries explicitly and promises to seek an outcome that will resonate with their ongoing effort to reduce poverty, foster human development and ensure economic growth. Can the WTO reassert its development credibility by ensuring that Doha becomes truly the Development Round? What should be the negotiating strategy of the developing countries?

While examining the key features of the political economy of the trading system in Part I of the volume, we note in Chapter 2 that a necessary condition for success will be to recognize the political economy of reform, both at home and in partner countries. Little progress will be made on key issues unless there are major stakeholders within countries that perceive the overall package to be beneficial. Such 'domestic ownership' of WTO agreements is a prerequisite for multilateral negotiations to succeed. The primary onus for doing the groundwork necessary for an open domestic trade regime, a supportive investment climate and good human development policies relating to education and health lies with the respective governments. At the same time, development assistance must play an important role in helping to expand and improve the trade capacity that is needed for countries to benefit from better access to markets. Several commitments were made by both developed and developing countries in Monterrey in 2002. The priority is now to identify the policy measures seen by developing-country governments as urgent areas for action and to address the associated resource needs. It will be judicious to approach the problem of resource needs in a two-pronged manner. The first will be to try and enhance as well as stabilize export earnings for developing countries. The second is to create new and innovative sources of financing. The latter is the responsibility of the international community as a whole, especially the various aid agencies.

Ensuring that multilateral negotiations under its auspices shape world trade flows in ways that enable the developing countries to generate enough resources to meet growth and development objectives, is what the WTO needs to achieve if the scepticism regarding its

development relevance is to be dispelled. The subsequent chapters in this volume have tried to assess the state of the world trading situation as it pertains to developing countries, in both agriculture as well as manufacturing. Will the political constituencies in the OECD allow it to reform its domestic support policy in a way that benefits the developing countries? How big are the regional disparities in the effects of agricultural trade reform in the developing countries? Are the Preferential Trading Agreements (PTAs) doing enough for the least developed countries? How much more can the United States, the European Union and Japan do to increase LDC exports? These are some of the questions the subsequent chapters try to answer.

Part II of the volume examines the liberalization of trade in agriculture, which remains one of the most contentious issues in WTO negotiations. According to estimates noted in Chapter 3, farm product markets remain the most costly of all goods market distortions in world trade. In fact, of all the economic gains to be had in 2005 from removing the barriers to trade in goods that will still be in place after all Uruguay Round commitments have been implemented, almost half (48 per cent) will come from agricultural and processed food policy reform in OECD countries. Another one-sixth of the welfare gains will come from reform of farm and food policies of developing countries. Thus it is essential that negotiations for agricultural trade liberalization continue without a pause. Evidence based on GTAP modelling also suggests that the gains from global trade liberalization in agriculture will be even more for some of the developing countries, if they carry out complementary reforms of their respective domestic policies as well.

Having said that, it is important to note that the welfare impacts on developing countries depend on whether they are net exporters or net importers of protected products as well as on the bilateral trade patterns. In Chapter 4, trade specialization indexes calculated since the 1970s for programme crops,[1] bounded between +1 and –1, describe the export (positive sign) and import (negative sign) orientation of each region. With few exceptions, these show substantial declines over this period. For example, Indonesia falls from –0.57 to –0.88 and ASEAN4 falls from +0.58 to +0.20. Several regions show shifts from net exporter to net importer status. For example sub-Saharan Africa's index falls from +0.39 in the 1965–75 period to –0.17 in the 1986–98 period, while the trade specialization index for Latin America outside of Brazil, Argentina and Mexico falls from 0.36 to –0.08. As these developing countries rely on imports of grains and oilseeds from the subsidized OECD economies, they are exposed to agricultural reforms that raise the prices of these specific

products. The estimates from a GTAP model shows that an across-the-board, 50 per cent cut in all domestic support for OECD agriculture leads to welfare losses for most of the developing regions, as well as for the combined total group of developing countries. The 50 per cent cut in domestic support also results in large declines in farm incomes in Europe as well as North America. This makes such a reform package an unlikely political event. Chapter 4 suggests an alternative approach to reforming agricultural policies in the OECD, which would be to focus on broad-based reductions in market price support. In the European Union for instance, domestic support has increasingly replaced border measures. According to the chapter's modelling results, a shift from market price support to land-based payments could generate a 'win–win' outcome whereby farm incomes are maintained and world price distortions are reduced. This is indeed the direction charted by the OECD in its 'Positive Agenda for Reform' for agriculture (6 November 2002).

Just as with the case of reforming domestic support policy in the OECD countries, the political feasibility of any agricultural liberalization in the developing countries depends on exactly how it affects the farmers. The impact of trade liberalization on Indian rice exporters is taken up as a case study in Chapter 5. In the case of India, free trade in rice will certainly reduce its price and, similarly, free imports of fertilizer will raise its price. The exact geographic location of the farmers within India is particularly important. In the case of an exportable crop, the farmer's reference export price would be the FOB price at the port, less handling and transport charge from the production centre concerned. This means that farmers in an interior state or a remote centre would find themselves at a disadvantage compared to those in a location near a port. The farmer would gain from the export only if the external price exceeded the prevailing domestic price fetched. For traded input the farmer's price would analogously be the CIF import price at the port plus the handling and transport charges. Thus, in the context of large developing countries, there can be substantive differences in the impact of agricultural trade liberalization on the welfare of farmers, depending on where they are located. Any aggregate or average estimate of such welfare effects can be misleading, at least as far as the political feasibility of such liberalization, as well as the implication for poverty alleviation, are concerned.

On their part, developing countries may be well advised to focus their efforts on improved agricultural market access to the OECD economies. To this end, the use of tariff rate quotas (TRQs) was legitimized as a market access instrument in the Uruguay Round Agreement on Agriculture (AoA). The motivation behind this instrument was to guarantee minimum

levels of market access and to safeguard current levels of access in the face of the high MFN tariffs resulting from tariffication. Whether and in what ways TRQ access should be extended is a subject of some interest in the Doha negotiations on further agricultural trade liberalization. A number of countries made proposals to improve the administration and size of TRQs in the Special Session on Agriculture at the start of the Doha negotiations. Chapter 6 focuses on the value of TRQ access to developing countries, whether under global or bilateral quotas, and finds that around 10 per cent of the EU's agricultural imports by value enter under TRQ arrangements, and developing countries account for over 60 per cent of these imports. TRQs, when they are binding, also create rents, and in many cases it is the rent element which becomes the most significant benefit of TRQ access. The majority of this rent (57 per cent) was appropriated by import agents as a result of the way TRQs are administered in the European Union. A reduction in in-quota tariffs, where they are currently positive, would be an effective means of providing some temporary compensation for the erosion of quota rents through MFN tariff reductions. Also relevant in some cases might be the introduction of specific changes in the licensing rules to ensure a greater transfer of the quota rents to developing country exporters – for example, by requiring export certificates be supplied by the exporting country.

Part III of this volume is devoted to market access issues in manufacturing. Chapter 7 examines where the WTO members stand with regard to their objective of achieving a substantial reduction of tariffs and eliminating discriminatory treatment in the area of non-agricultural tariffs. Two indicators are examined: the first is the percentage of MFN bound duty-free tariff lines for a sample of members, and the second indicator is the share of imports under MFN bound duty-free tariff items for a sample of members. Approximately 6 per cent of the total number of non-agricultural items in the sample of WTO members' tariff schedules is bound duty-free. This small number of duty-free items, even though they account for one-third of the value of world trade in industrial products, confirms that there is still a considerable amount to be achieved in multilateral tariff negotiations. The universal adoption of the MFN principle remains the ultimate goal of the ongoing process of such trade negotiations, but its all-inclusive character makes it a time-consuming, long-term possibility at best. PTAs are crucial as quick and stop-gap solutions. It is through PTAs that the rich and poor countries interact in more substantive ways. PTAs have proliferated in recent years, a phenomenon which is often cited as an

indication that the WTO is a failing process. Without trying to underestimate the gravity of some obvious problems with the WTO, one may differ with that interpretation and assert instead that the WTO has been an important catalyst in triggering PTAs and enhancing trade flows between countries.

The European Union, Japan and the United States offer a number of PTAs to developing countries. These include the well-known Generalized System of Preferences (GSP) and more recent ones such as the African Growth and Opportunity Act (AGOA, United States), the Everything But Arms Initiative (EBA, European Union) and the 99 Per Cent Initiative (Japan). The need to grant substantial trade preferences to the LDCs was emphasized in the Doha Ministerial Declaration. For the Caribbean beneficiaries, total trade under the programmes has expanded considerably since 1989. While total US imports from the 24 countries in this region rose more than 200 per cent between 1989 and 2001, total preference trade rose more than 500 per cent. Similarly, in 2001, AGOA imports totalled almost US$8.2 billion, making almost 50 per cent of all imports from these countries duty-free. In Chapter 8, an econometric framework that makes the distinction between the *trade-reduction* and the *trade-diversion* effects was used to estimate the potential effects of removing *all* remaining tariffs in the Triad countries. Both the trade reduction and the trade diversion effects are bigger for the United States compared to other Triad economies. EU trade is the least sensitive. For the United States, on average, a 1 per cent increase in the average tariff reduces imports by 8.3 per cent. Further, a 1 per cent tariff preference leads to a 19.4 per cent increase in trade for the exporter in question. These numbers are reasonably large, suggesting significant benefits for LDCs from the unilateral preference programmes. Much more can be done, especially with respect to the US programmes.

The aggregate worldwide distribution of gains and losses of the EBA initiative was assessed using a computable general equilibrium (CGE) simulation model (GTAP). Partial equilibrium simulations were used to examine the effects of a complete removal of both tariff and non-tariff barriers (NTBs) faced by LDCs in the EU market. The results, reported in Chapter 9 showed moderate, but useful, welfare and trade gains from the EBA initiative, with the largest gains being recorded for sub-Saharan Africa. In particular, the EU sugar market appeared as the single most important source of change. The increased market access for LDCs comes mostly at the expense of other preference-receiving countries (ACP countries, in particular), although the changes are not large. There are some small negative effects on other countries that currently

enjoy duty-free access to the EU market or enjoy MFN market access (for example, Polish and Romanian exports of live animals or US and Argentine exports of cereals). The estimates showed that only a handful of LDCs would see total trade increase by more than US$100,000, from a combination of trade-creation and trade-diversion effects. Malawi, the biggest winner, stands to increase its cane sugar exports by more than US$25 million. Other African LDCs (Madagascar, Tanzania and Zambia) are likely to see their cane sugar exports increase by between US$5–10 million. The only Asian LDC that shows incremental exports of more than US$100,000 is Myanmar. The estimates also suggest that Sudan is likely to see significant increases in its exports of molasses and cereals. The largest losers from negative trade diversion, in absolute values, are the current major ACP sugar exporters (Mauritius, Aruba, Fiji and Guyana).

The developing countries themselves are often pro-active in promoting their own exports. Chapter 10 discusses such export promotion measures – subsidies, to be specific – in three countries, South Korea, Brazil and India. A key message that emerges from the discussion is that export promoting subsidies were deemed as necessary in India and Brazil essentially to correct for the anti-export bias that existed in these countries due to their erstwhile import-substituting development strategies. Once overall reforms are implemented, such anti-export bias will be eliminated and reduce the need for subsidies on that count. However, even in countries that are outward-oriented to begin with, subsidies can be important instruments in wresting larger export market shares in the presence of imperfect competition. While the current agreements allow for export subsidies in selected developing countries for at least some time in the future, the fine print is rather cumbersome. Developing countries are seeking clarification of some of the existing clauses and would like to hope that these are interpreted in a manner which makes them truly useful.

Note

1. Programme crops are the grains and oilseeds which receive a large share of the domestic support in OECD countries.

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