WTO & Poverty/Development Problems

What Can WTO Do to Ensure Sustained Growth of Developing Countries?

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Introduction – "Development": a Challenge for WTO

The World Trade Organization (WTO) came into effect in 1995 based on the outcome of the Uruguay Round, the eighth round of multilateral negotiations for freer trade held between 1986 and 1994 under the framework of its predecessor, the General Agreement on Tariffs and Trade (GATT). The Doha Development Agenda (DDA) is the first round of multilateral negotiations under the WTO. It was named after Doha, the capital of Qatar, where a WTO ministerial conference took place in November 2001.

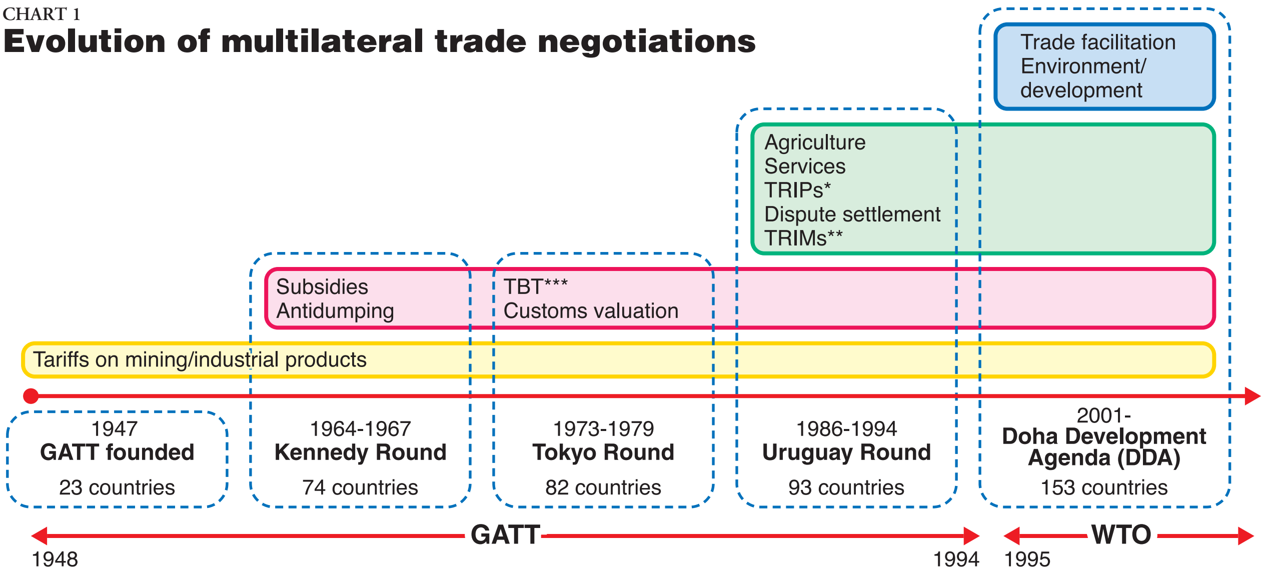
The DDA is not officially called a round for good reason, unlike the previous GATT-based rounds *(Chart 1)*. It is summarized in the language of "development," which is mentioned more than 50 times in the "Doha Ministerial Declaration," the basis of the DDA that suggests a fundamental direction in which it should proceed. Developing countries account for the bulk of the WTO's 153 member countries except for the 30 members of the Organization for Economic Cooperation and Development (OECD). Developing countries strongly argued that matters related to their "development" be high on the agenda for the DDA. The past rounds of trade negotiations under the GATT failed to produce what developing countries had hoped for. The "push-back" stemming from their frustration is symbolically expressed in the DDA.

But negotiations based on the DDA remain stalled at the moment. Since the ministerial meeting held in Cancun, Mexico, in 2003, the DDA has dropped the so-called "Singapore issues" such as "trade and investment," "trade and competition" and "transparency of government procurement" from its agenda. It has made little progress other than that. Having removed those new rules from the table of negotiations, the DDA has narrowed its focus of attention down to the issue of "market access." In this process, the DDA has run aground amid a head-on clash between developing and developed countries over agricultural trade and nonagricultural trade *(Chart 2)*.

With the DDA deadlocked eight years after its launch, countries have come to put little hope on the multilateral negotiations, rushing to conclude preferential trade agreements (PTAs) such as free trade agreements. About 150 PTAs were said to have come into being by 2006. These included not only ones between developing and developed countries but ones between developing countries. However, not a few developing countries have been unable to join the global club of PTAs. Many that did conclude PTAs have been forced to offer concessions to their stronger developing or developed countries at the expense of reciprocity.

Faced with the stalled DDA multilateral negotiations, developed countries and weighty developing countries have been able to seek alternatives by concluding PTAs. Tariff concessions brought across the board by non-conditional most-favored nation treatment mean a great deal for resource-poor developing countries as they can benefit from them even without getting directly involved in negotiations. There is no denying that they lose a lot by missing out on a chance to benefit from such concessions. In fact, the hardest hit by the DDA's setback are many of those developing countries. For the moment, the WTO remains unable to deal with this situation in an effective manner.

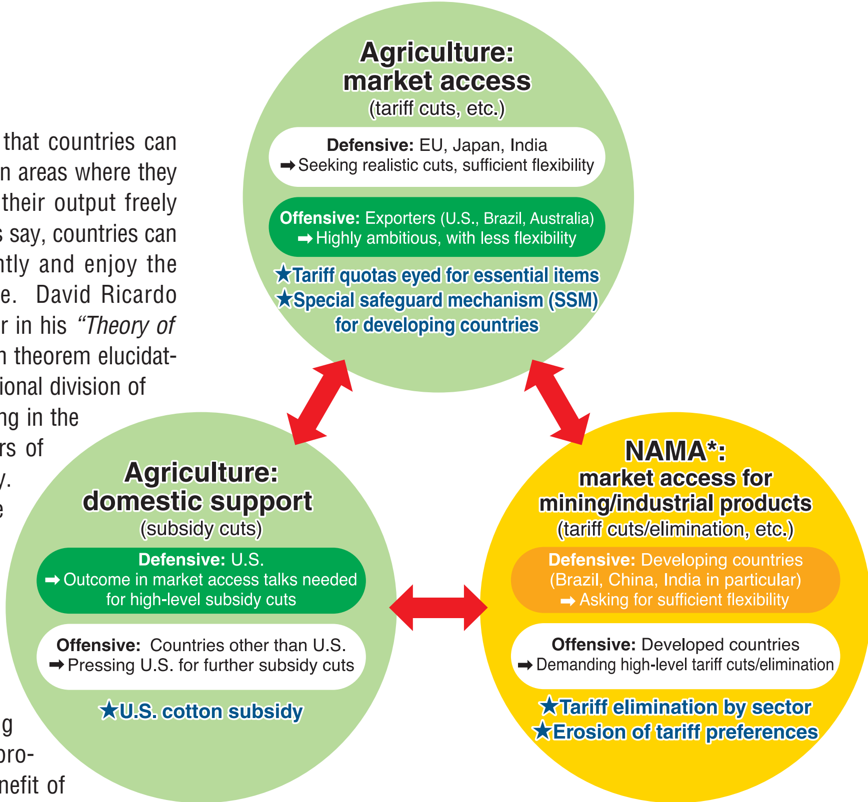
CHART 1
Evolution of multilateral trade negotiations



*Note: * trade-related aspects of intellectual property rights; ** trade-related investment measures; *** technical barriers to trade*
Source: Ministry of Foreign Affairs, modified by author

CHART 2

Confrontation at WTO/DDA



Note: ★Main points of dispute yet to be resolved
**NAMA stands for Non-Agriculture Market Access.*
Source: Ministry of Foreign Affairs, modified by author

Why Trade Matters

Textbooks in international economics teach us that countries can enhance their economic standards by specializing in areas where they have comparative advantage and by exchanging their output freely across national boundaries. By so doing, the books say, countries can use the world's limited resources most efficiently and enjoy the "income effect" derived from international trade. David Ricardo explained the merit of international division of labor in his *"Theory of Comparative Advantage,"* while the Heckscher-Ohlin theorem elucidated that a country can generate the merit of international division of labor and display its competitive edge by specializing in the production of goods for which the required factors of production are relatively abundant within its territory.

The world of free trade described by those economists is based on the key concept of "specialization" and "factor endowments." In reality, however, things do not always work that well. People who take a negative view of free trade and globalization argue that free trade makes rich countries richer and poor countries poorer. To be sure, it looks that least developed countries having no industries to specialize in and no factors of production other than labor are utterly denied the benefit of free trade. It is true that prolonged fixing of a trade pattern that allows a country to import high value-added industrial goods and export low value-added raw materials will turn the terms of trade to less advantage for the material exporter, making it harder for all participating countries to benefit from trade.

However, this does not necessarily mean that developing countries which export raw materials will have no chance to develop for good and all. Singapore was a quiet fishing hamlet when Sir Thomas Stamford Raffles landed there in the 19th century. Today, it is one of East Asia's busiest cargo transport hubs and is known as a powerful financial center along with Hong Kong. Singapore's per capita GDP has exceeded $32,000 and is coming closer to that of Japan. Malaysia was a monoculture economy solely dependent on natural rubber until the beginning of the 1970s. It has attained phenomenal development by dint of its "Look East Policy" and through aggressive induction of foreign investment. Now its capital Kuala Lumpur is a modern city complete with a monorail system.

What terms are necessary for trade to contribute to a country's development? Or under what circumstances can it not? An OECD journal on development, *Trading Out of Poverty(2009),* points out that "innovation" is a crucial key to connect trade to economic growth. According to the report, it is "fairly well" understood that "innovation" can bring "growth" in the chain of "trade," "innovation" and "growth." However, it says, the link between "trade" and "innovation" is less understood. The report refers to five channels that allow trade and its liberalization to help stimulate innovation.

(1) Increased competition: Stronger competition has particularly powerful effects on productivity in countries far away from the technological frontier, reflecting stronger incentives to adopt new technologies. Trade openness makes markets more competitive, reducing prices and raising incentives for innovation while also boosting productivity. Free trade improves efficiency and productivity by leaving the domestic industry exposed to competition on the international market.

(2) Technology transfer: Trade allows firms in developing countries to access technologies essential for improving their productivity and competitiveness, which will generate economic growth and more job opportunities. In particular, trade accompanied by foreign direct investment (FDI) is likely to promote the transfer of skills and innovation. In addition to this direct effect of technology transfer, trade has an indirect effect of lowering prices and hence the cost of technology access. As newly industrialized Asian countries demonstrated from the 1960s through the 1990s, latecomers can benefit from the latest technical developments by simply purchasing new technologies at relatively lower prices and fewer risks if the right preconditions and determinants are in place.

(3) Economies of scale: Companies producing goods not only for the domestic market but also for overseas markets can better recoup their R&D investments on larger sales than those selling their products only at home.

(4) Globalization of value chains: Trade and its liberalization can promote the global networking of production processes in a number of ways. Networking is further accelerated by promoting harmonization of international technical standards and certification procedures to which firms involved in value chains must conform. On the other hand, bilateral or regional PTAs usually contain rules of origin aimed at restricting the application of preferential access to partner countries. When such rules are too rigid, low-cost suppliers within value chains may find themselves in a disadvantageous situation.

(5) Intellectual property rights (IPRs): Recent OECD analysis shows a positive link between IPR protection and increased transfers of technology-intensive goods/services and capital to developing countries, increasing the stock of inward FDI in developing countries by 1.6%. More importantly, the analysis proves a strong positive correlation between patent protection and innovation in developing countries.

One may consider that through these channels, trade and its liberalization can step up innovation, which in turn can promote economic growth. Thus, trade can offer opportunities for increased wealth and poverty reduction, albeit indirectly. Actually, however, whether poor people can partake in the benefit of trade depends on several factors. These may include:

(1) How much of the trade-induced growth occurs in sectors where a large number of poor people are economically active.
(2) How much of that growth translates into job creation and wage increases.
(3) How much growth trickles down to other sectors that can absorb excess labor.
(4) How well the poor are equipped in terms of human, economic and financial assets to take advantage of the new job opportunities resulting from trade.

Depending on those factors, the OECD journal notes trade and its liberalization will have different impacts on individual developing countries and sections of the community, giving rise to "winners" and "losers."

Why Has Trade Failed to Spur Development?

According to statistics made available by the International Monetary Fund (IMF), the global goods and services market dramatically expanded between 1980 and now. World trade value grew fivefold during the period, with its share in world GDP rising to 55% from 36%. The biggest factor that brought the expansion was substantial drops in the costs of transportation and communication during the period. The reduction of trade barriers has prompted the integration of China, India and East European countries into the international trade system.

In developing countries, the ratio of trade to GDP has been on the rise. Their exports have been growing faster than the world average. Still, many of those countries face enormous difficulties expanding and diversifying their exports. There remains concern over their "marginalization" in global trade.

According to an OECD survey, low-income countries in sub-Saharan Africa have been suffering modest falls in their per capita exports while medium-income countries have been improving their records to a large extent *(Chart 3)*. Where does this gap come from?

One external factor is the difficulties these countries have in entering the markets of developed countries. The Uruguay Round of multilateral negotiations has brought about tariff reductions almost equivalent to those made at the Tokyo Round. However, the tariff cuts the OECD members offered to non-OECD countries averaged 30% as compared to 45% they offered to one another. The trade-weighted average tariff rate levied by the OECD countries on imports from one another was 3%. The corresponding rate the OECD members applied to imports from non-OECD countries was higher at 4.8%. At its multilateral market access negotiations, the DDA needs to agree on a further tariff reduction for developing countries at an early date, along with other issues such as tariff escalation and non-tariff barriers.

Internal factors are too numerous to mention. Among them are the low level of human capital, supply-side constraints stemming from the inadequacy of governance and institutions, and fragile basic structures such as insufficient infrastructure. The brittleness in developing countries generates restrictive factors in internal policies that make it harder for them to step toward trade liberalization. One such factor is their external debt. They become reluctant to liberalize imports for fear their debt may further increase. Developing countries are also worried that if tariff cuts are carried out under a new multilateral agreement, they may lose some of the benefits they are entitled to under the European Union's "Everything But Arms" (EBA) policy and the initiatives based on the United States' African Growth and Opportunities Act (GOA). The view remains persistent in developing countries that tariff cuts will have a negative impact on government revenues through reduced customs earnings.

How "Marginalization" Can Be Stopped?: Aid for Trade & Capacity-building

Then, what can be done to see trade and its liberalization help low-income developing countries shift away from poverty and underdevelopment to sustained economic growth? As the reference to "external factors" suggests, one important thing that developed countries can do is to agree at the DDA market access negotiations on a major reduction of tariff and nontariff barriers to products from developing countries, in particular LDCs. They need to make drastic improvement in market access in such sectors as agriculture and textiles.

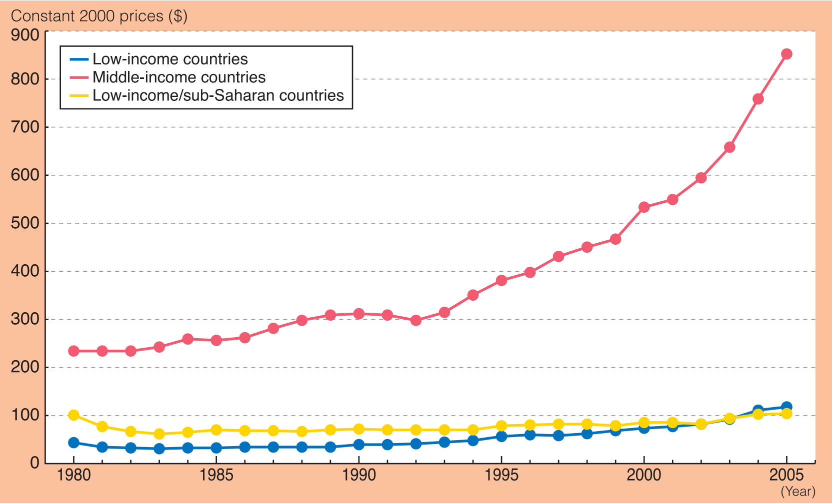
[Aid for Trade]

At the same time, there is the need to address the "internal factors" in developing countries, such as their structural problems and supply-side bottlenecks. Here, Aid for Trade (AFT), endorsed in 2005 at a WTO ministerial conference in Hong Kong, can play an important role. According to the OECD journal, the following three policy means may be considered under the AFT.

(1) Policies to overcome supply-side constraints and build production capacity (e.g. improving access to infrastructure, particularly transportation and water/electricity, reducing trade costs, upgrading the business environment, developing human capital, and identifying export opportunities)

(2) Policies to expand opportunities for the poor to share in the benefits from trade (e.g. improving access to nontraditional markets, working out marketing policies to link poor farmers to the market and setting up institutions that can reduce their marketing costs, and providing support for greater participation by developing countries in the agro-food industry)
(3) Policies to mitigate the cost of adjustment (e.g. pursuing government revenue sources that can compensate for reduced tariff revenues, formulating social safety nets and assisting vocational training)

CHART 3
Exports (goods/services)
in constant prices per capita (1980-2005)



Source: "World Development Indicators," World Bank

[Capacity-building]

Important here is that governments implement those policies in a coordinated manner to ensure their coherence. What is needed to this end is a sense of ownership on the part of developing countries and support to enhance their capacity-building. The capacity here naturally includes hardware such as computers, which are necessary to systemize port facilities and customs services as physical infrastructure. But more important is the software capacity to link and activate infrastructure and systems. Enhancing the coherence of policies to step up economic development of developing countries through trade should be the key role to be played by trade-related capacity-building.

Within the framework of the WTO, developed countries are providing capacity-building assistance in various forms. In Japan's case, the Japan International Cooperation Agency (JICA) takes the initiative in organizing seminars and sending specialists to developing countries to help them deepen the understanding of WTO agreements and improve the ability to implement them. It also helps developing countries become WTO members, better utilize its dispute settlement procedures, and legislate investment-related and IPR protection laws. These activities can help government officials in developing countries better understand what rights and obligations they will have by joining the WTO system, what cost they will have to bear to enforce the WTO agreements and what benefit they will be able to expect in return (see *"Chapter 11: Capacity-building of Developing Countries," WTO Handbook* published by JETRO).

[Trade Facilitation]

Trade facilitation negotiations under the mandate of the WTO/DDA are closely related to enhancement of developing countries' administrative capacity to deal with trade regulations. One of their prime objectives is to clarify and improve GATT Article V (Freedom of Transit), Article VIII (Fees and Formalities Connected with Importation and Exportation) and Article X (Publication and Administration of Trade Regulations). The negotiations also have much to do with the obligations of developing countries to enforce WTO agreements, their ability to implement them and their capacity-building for that purpose.

Specific matters on the agenda include reinforcement of the principle of nondiscrimination in transit trade, which is crucial to landlocked countries, elimination of mandatory consular procedures in importing countries at the time of exportation, enhancement of principles related to the imposition of fees, abolition of obligations to employ customs brokers, publication of and consultation on trade regulations prior to their effectuation, promotion of customs cooperation, and publication on the Internet of trade-related regulations. Developing countries have been generally positive toward the negotiations, with more than 100 of them implementing their "Trade Facilitation National Self-Assessment of Needs and Priorities" programs so far. Developing countries in need of help in the assessment process can accept specialists from the WTO Secretariat, the World Bank, the World Customs Organization (WCO) and the United Nations Conference on Trade and Development (UNCTAD). Japan and other developed countries are also supposed to send government officials to assist them.

These activities will prove instrumental to those developing countries which are prepared to enhance the implementation and enforcement of the WTO agreements. They may also help mend the relationship of trust between developed and developing countries that has sometimes been impaired in the process of the market access negotiations.

Conclusion

Freer trade will surely contribute to ensuring optimum allocation of the world's limited resources and making most participating stakeholders richer by dint of its income effect. At the same time, however, there is no denying that some people remain unable to benefit from trade due to various human and physical impediments. Human wisdom needs to correct what market mechanisms cannot. We need to sustain and reinforce the WTO's transparent, highly predictable multilateral trade regime through the AFT, capacity-building, trade facilitation negotiations and all other available means. That necessity has never been greater. JS

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