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## More Favorable Treatment of Developing Countries: Ways Forward

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Although the principle of more favorable treatment for developing countries has a long history and is firmly embedded in the World Trade Organization (WTO),<sup>1</sup> the existing system of differential treatment has left both developed and developing countries dissatisfied. In the current Doha trade negotiations, as in the implementation of multilateral trade rules, it is among the more important issues to be resolved.<sup>2</sup>

Currently, “special and differential treatment” (SDT) provisions in the WTO rules 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 low-income economies lack the institutional strength to manage the full panoply of WTO rules and might well find the returns to developing the necessary strength outweighed by the costs. Small and poor countries may also lack the resources to overcome natural obstacles to trade or to pursue policies to address market failures.

The Doha Declaration called for a review of SDT provisions, with a view to “strengthening them and making them more precise, effective, and operational.” During 2001-02, developing countries made some 88 specific suggestions to strengthen SDT—among them 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, however, no agreement has yet proved possible on strengthening SDT provisions.

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

Breaking the deadlock will require actions by developed and developing countries alike 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

- Increased development assistance (“aid for trade”).  
The outlines of a possible package of measures to make SDT more effective are sketched out below.

### **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 margin of tariff preference 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 would have preference margins averaging slightly less than 2.5 percentage points.<sup>3</sup>

Of course, there are cases where tariffs are higher or where quotas 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 comparative advantage. It also has some of the highest most-favored-nation (MFN) tariffs, potentially offering the greatest margins of preference. But the United States, for example, grants no general preferences on textiles and clothing, although it does offer some to particularly favored partners—such as the African nations covered by the African Growth and Opportunity Act. The European Union does grant tariff preferences on textile and clothing exports under its general system of preferences (GSP), the Cotonou Agreement, and various regional agreements—and, since 2001, to the Least-Developed Countries (LDCs) under the Everything But Arms (EBA) initiative—but all of these are subject to restrictive and cumbersome rules of origin.

In key product categories in which they have a comparative advantage, developing countries receive no significant tariff preferences (table 1). In general, preferences tend to be the most limited where tariff peaks exist (Hoekman, Ng, and Olarreaga 2002). This has been changing—for example, the EBA gives duty- and quota-free access to LDCs for virtually all products. But the countries that are home to most of the world’s poor, including Brazil, China, India, Indonesia, Malaysia, Pakistan and Thailand, are granted only limited preferences, if any.

In summary, research suggests that preferences are often of little value (a) because they exclude textiles, agricultural products, or other important items, (b) because they place limits on the value of exports eligible for preferential treatment (including so-called competitive needs tests), or (c) because other nontariff measures are used to restrict access. Combined with complex administrative requirements and red tape, notably restrictive rules of origin, the effect is to reduce investment in activities that could otherwise benefit from preferences.

One way to strengthen SDT would be for developed countries to extend duty- and quota-free market access, as under the EBA, to *all* developing countries. From the perspective of the Millennium Development Goals, a good case can be made that preferences should focus on the poor, wherever they are 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, who confront tariffs on world markets that are more than twice as high as those confronting nonpoor producers (World Bank 2002).

But deep trade preferences for larger economies are not politically feasible. Therefore, action is required to liberalize, on a nondiscriminatory basis, trade in goods and services in which developing countries have a comparative advantage. A binding commitment by developed countries to abolish export subsidies, decouple agricultural support and significantly reduce—or abolish—tariffs on labor-intensive products of export interest to developing countries would provide a strong signal of commitment to poverty alleviation by developed countries. A corresponding commitment 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 also bring substantial benefits (Mattoo 2005).

MFN-based market access is not traditionally considered an element of SDT. But it may well have the greatest impact on development. For one thing, it could rebalance the WTO by removing “reverse SDT”—special opt-outs and exemptions

**Table 1. Key products lacking GSP preferences in the European Union and United States**

	United States				European Union			
	Total imports (\$bn)	GSP recipients' market share (percent)	Average tariff rate (percent)	Average GSP recipients faced by (percent)	Total imports (\$bn)	GSP recipients' market share (percent)	Average tariff rate (percent)	Average GSP recipients faced by (percent)
Dairy products	1.1	13.0	13.4	19.7	1.0	16.0	9.9	15.9
Textiles & yarn	9.8	21.0	7.8	7.2	16.1	42.0	5.4	4.6
Apparel & clothing	58.5	47.0	15.3	15.9	43.4	56.0	10.2	8.8
Leather products	7.2	24.0	10.4	11.5	5.6	80.0	2.3	1.9
Footwear	15.3	18.0	10.6	10.0	8.5	67.0	7.5	7.4
Ceramics & glassware	7.9	13.0	6.3	8.2	5.5	28.0	5.1	3.8

*Note:* GSP countries only; LDCs obtain deeper preferential treatment. China is included in the European Union’s GSP but excluded by the United States.

*Source:* WITS.

that benefit interest groups in industrialized countries at the expense of developing countries. Examples include agricultural subsidy programs, high protection for textile products, and tariff peaks and escalation that imply high rates of effective protection for developed country industries. Removing such distortions would not only benefit developing countries (and developed country consumers), but would also promote further trade reforms in developing countries.

### **Implementation of WTO rules**

SDT includes derogations or exemptions from certain WTO rules. Is this a good thing? Not if poor countries would derive a positive net benefit from implementing the rules. While governments presumably consider that possibility in the course of negotiations, past experience suggests that the necessary analysis and consultations often are not undertaken, explaining why there is now a lack of “ownership” of—support for—some 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 upfront investment of resources to establish or strengthen institutions. Trade-policy disciplines should apply uniformly to all WTO members (Hoekman, Michalopoulos, and Winters 2004), but when it comes to trade institutions and domestic regulation, one size does not necessarily fit all. A given country’s development priorities may not leave room for effective compliance with some aspects of WTO agreements. Certain measures may require many preconditions before implementation will be beneficial. Some disciplines may not be appropriate for very small countries, in that the regulatory institutions that they require may be unduly costly—countries may lack the scale needed for benefits to exceed implementation costs.

These observations suggest there is a need to differentiate among developing countries when determining the reach of resource-intensive WTO rules. Possible approaches to differentiation are:

- Total flexibility for developing countries to invoke exemptions as long as these do not harm any other member country.
- Country-specific determinations of eligibility for rule-related SDT provisions that would apply to a predefined set of agreements, so as to limit SDT to countries that need it most—the poorest countries and very small states.
- An agreement-specific approach in which objective criteria in each agreement would link implementation by developing countries to local conditions, priorities, and capacities (based on an audit of costs), and to availability of technical assistance.

Of these approaches, the first is clearly discernible in many countries’ current proposals. As the status of the negotiations suggests, it 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 developed countries.

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A good case can be made for reclassification, 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 it involves significant transaction costs.

Any approach to strengthening rule-related SDT will require substantial thought and discussion among WTO members, as well as recognition that capacities and priorities differ hugely across the membership. Given the steady expansion of the WTO into regulatory areas, a serious discussion of rule-related SDT is critical if development-relevance is to be more than a slogan. A first step discussed in Hoekman (2005) could be to allow for greater policy flexibility for developing countries, accompanied by greater efforts on the part of WTO members to assist developing countries attain their trade objectives, with a regular multilateral monitoring of outcomes and effects of the policies pursued.

### **Renegotiation of certain WTO disciplines**

Many developing countries believe that the rules in some WTO agreements are not development friendly. Rather than seek opt-outs through SDT, however, it may be preferable to renegotiate the agreements. For example, in agriculture, it may be useful to introduce new rules to ensure that developing countries have the freedom to pursue policies that support the rural poor. With respect to intellectual property, the world as a whole 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. Two examples of direct relevance to the SDT and development debate where WTO disciplines can be improved are rules of origin and the requirements for regional integration. On the first, there is a strong case for substantial relaxation of such rules to allow goods to benefit from preferential access programs as long as a minimal amount of labor value has been added. Current rules of origin for processed goods tend to require too high local content in terms of intermediates, or else require that such inputs are sourced from the country granting the preference. This works against the exploitation of comparative advantage and the need to specialize in narrow parts of the value chain—a key requirement for firms and countries as the world economy becomes more integrated. The experience with AGOA for those countries benefiting from relaxed rules of origin has illustrated that such rules can be a binding constraint on the development and expansion of manufactured exports. The second example concerns the design of North-South regional integration. Here a beneficial rule change would require Southern members of such agreements to pursue partial MFN liberalization as opposed to requiring complete preferential (discriminatory) liberalization in favor of the high-income partner. This would avoid trade diversion costs while also attenuating the fiscal impacts—giving more time to put in place alternative tax collection mechanisms.

### **Aid for trade**

Development assistance can play an important role in building the institutional and trade capacity that developing countries need if they are to benefit from better access to markets. But the desire of donors to see developing countries implement certain WTO agreements should not divert assistance from recipients' own priorities. The risk of such diversion is one of the downsides of proposals to make technical assistance mandatory under the WTO and to link implementation of WTO agreements to the provision of such assistance. To ensure that trade priorities are identified for funding, a better approach is to support efforts to embed trade-related technical assistance in national priority-setting processes, such as the Poverty Reduction Strategy Paper (PRSP), used by governments and the donor community. Once trade-related needs have been embedded in national priorities, donors and international financial institutions must stand ready to expand assistance to help bolster trade capacity and strengthen trade-related institutions in developing countries.

Export diversification was the primary motivation for preferences. But many of the poorest countries have not managed to use preferences to diversify and expand exports. Benefiting more from integration into the trading system requires improving the productivity and competitiveness of firms and farmers in the poorest countries. Supply constraints are the primary factors that have constrained the ability of many African countries to benefit from preferences. Improving trade capacity can be pursued through a shift to more (and more effective) development assistance that targets domestic supply constraints as well as measures to reduce the costs of entering foreign markets.

Recognizing the importance of complementary policy actions and the need for support for adjustment and integration to achieve successful trade reform in low-income economies does not imply that the Doha Round should be any less ambitious or deliberately slowed. The reverse is true. But it should be complemented by actions to redistribute some of the global gains from trade reform to help address the trade and growth agenda in the poorest countries—in the process helping to attain the original objective motivating preferential access regimes.

### ***The quid pro quo***

Reciprocity is the engine of WTO negotiations. In the past, however, the lure of nonreciprocal preferences has kept developing countries from exploiting the major source of gains from trade liberalization—namely the reform of their *own* policies.<sup>4</sup> Unilateral liberalization could be linked to market access by granting negotiating “credit” to developing countries that make significant autonomous reforms. One way to achieve this would be through a formula approach to tariff negotiations that

used the level and extent of reduction in tariff bindings as the focal point of liberalization commitments.<sup>5</sup> Given that many developing countries either have not bound tariffs at all or have high tariff bindings, such an approach would ensure that credit was given for past reductions in applied tariffs.

On the rules side, an important *quid pro quo* to shore up the trading system would be for developing countries to accept that core WTO trade policy rules are beneficial. This does not imply that developing countries should be forced to sign away all flexibility to use trade policies. But the economic literature has shown that tariffs and other traditional trade policy tools are poor instruments for the achievement of economic development objectives (Hoekman and others 2004). Abiding by WTO procedural rules on the use of such instruments will benefit consumers and enhance welfare in developing countries. It will also help focus attention on areas where SDT could make a real difference.

### Conclusion

Moving forward on SDT requires a mechanism to enable developing countries, particularly the poorest, to benefit more fully from participation in the multilateral trading system. Greater differentiation among developing countries arguably must be part of a new grand bargain within WTO. The existing country classification system of LDCs (as defined by the United Nations) and other developing countries (self-declared) has resulted in a mechanism that is ineffective for all.

Of the three major dimensions of SDT—better market access for developing countries' exports of 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. Agreement on how to deal with implementation constraints and define the reach of resource-intensive rules, however, will take time. The formation of a high-level group operating under the auspices of the WTO General Council to discuss options for a new mechanism for rule-related SDT, could be a first step forward.

SDT cannot be a one-way street. Differentiation implies that only a subset of developing countries should be eligible for SDT, and that the more advanced should accept that they are not eligible. All developing countries, even those that qualify for SDT, should engage in the exchange of trade policy commitments (market access). Providing credit for past autonomous reforms can and should figure in 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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**Notes**

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, the Enabling Clause provided for departures from MFN and other GATT rules. It also 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. This Trade Note was written by Bernard Hoekman, Manager, World Bank. It draws on joint work done with Caglar Ozden, Costas Michalopoulos, Susan Prowse and Alan Winters.

3. Preferences should be assessed in terms of the price advantage they confer rather than, as is quite common, the percentage of the tariffs they remit. To have 100 percent remission of a 1 percent tariff is worth far less—1 percentage point—than a 50 percent remission of a 10 percent tariff—5 percentage points.

4. Ozden and Rheinart (2005) 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. Nonreciprocity also helps to explain why tariff peaks today are largely found on goods produced in developing countries. In the absence of a willingness by developing countries to open access to their own markets there was less incentive for OECD countries to reduce barriers in areas of export interest to developing countries.

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

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**Further Reading**

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## MORE FAVORABLE TREATMENT

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