Changing Developing Country Trade Policies and WTO Engagement*

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Abstract: This paper focuses on developments in the engagement of developing countries in the multilateral trading system in light of the recent re-issue of Robert Hudec's seminal book, *Developing Countries in the GATT Legal System.* Starting in the late 1980s, just after Hudec published his book, a major shift occurred in the trade policies of many developing countries. The major drivers of the associated reforms and their consequences for the approaches taken towards participation in the global trade regime are discussed. As a result of both policy and technological changes, some of which could not have been foreseen by Hudec, trade-related policy priorities for developing countries today are different from those that are the primary focus of GATT/WTO disciplines and Hudec's analysis.

Keywords: trade liberalization, developing countries, trade costs, WTO, Robert Hudec

JEL classification: F1, F2, F5, L80

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Introduction

Average import tariffs in 1950 were in the 20-30 percent range (WTO, 2007). A variety of nontariff barriers complemented the effects of tariffs. Many developing economies maintained particularly high barriers to trade for much of the post-Second World War period, reflecting infant industry and import substitution objectives. The effects of trade policy barriers were augmented by multiple exchange rate regimes, capital controls and overvalued real exchange rates. As a result of the plethora of restrictive policies global trade was highly distorted during the 1950-1980 period. Starting in the mid 1980s, however, average levels of protection in both industrialized and developing countries were gradually lowered. As of 2010, the average level of import protection had dropped to some 10 percent or less in many developing countries, and the average uniform tariff equivalent of merchandise trade policies in OECD countries had fallen to less than 4 percent (Kee, Nicita and Olarreaga, 2009). Imports of many manufactures are now duty-free. High rates of protection continue to prevail for many agricultural products – especially in a number of OECD member countries – but for the majority of goods trade policies around the world are dramatically less restrictive than they were in 1980.

Trade policy reforms during the last three decades have been complemented by technological changes that have greatly reduced trade costs. Examples include telecommunications, air and maritime transport (the spread of containerization), and distribution services (the express industry; logistics). These developments were to some extent related: policy reforms to make markets more contestable helped stimulate managerial innovations and technological change, while technological changes helped drive reforms in trade and investment policies.

The trade response to both technological and policy changes was spectacular. The value of global trade in goods and services passed the US$15 trillion mark in 2006, up from around US$1 trillion in the late 1970s (measured in current dollars). The global value of the stock of foreign direct investment (FDI) rose more than 6-fold between 1990 and 2008, substantially faster than the growth in trade, which increased 'only' 3.5 times over the same period. Much of this FDI was associated with services and was driven in part by decisions by many governments around the world to privatize state-owned utilities (such as telecommunications) and open access to foreign provision of services. However, much of it continues to be focused on natural resource sectors and manufacturing and related activities.

Developing countries are increasingly producers and traders of manufactures. The share of manufactures in total exports of developing countries increased from just 30 percent in 1980 to over 70 percent today – almost as high as in high-income countries. A substantial proportion of this global trade in manufactures comprises intra-industry trade—the exchange of similar, differentiated products. Intra-industry trade ratios are frequently above 60 percent for OECD countries. Since the 1990s they have risen to similar levels for dynamic developing and transition economies. The mix of policy reforms and technical improvements have driven this shift, generating changes in the organization of global production that stimulated a dramatic increase in vertical specialization, with firms (plants) in different countries concentrating on (specializing in) different parts of the value chain for a product.

Of course, there is substantial variation in the share of manufactures in exports. Sub-Saharan African countries in particular remain heavily dependent on (specialized in) natural resources and agricultural products. And although there has been a sea change in trade policy everywhere, the poorest countries often tend to have the highest barriers. Among developing countries, East Asian economies took the lead in specializing in labor-intensive manufactures. Initially concentrating on simple labor-intensive

manufactured products such as garments and footwear, these countries now produce a diversified mix of goods and participate very intensively in the process of global production sharing. East Asian global exports of components grew at an annual rate of 15 percent during 1984–2006, more than four percentage points above the growth rate for all trade. Exports of intermediates to other East Asian markets grew even faster (about 21 percent per year). As a result, the share of all parts and components exports destined for regional markets doubled from 25 to some 50 percent (Hoekman and Kostecki, 2009). About half of all East Asian exports of manufactured goods go to other East Asian economies.

For reasons discussed in depth in Hudec (1987), the GATT played at best a marginal role in the trade policy reform process in developing countries. Developing country liberalization of trade was implemented unilaterally, supported by the international financial organizations, driven by a mix of exogenous global shocks and unsustainable domestic policies. The significance of the trading system for developing countries only began to rise after the creation of the WTO in 1995, largely as a *result* of the unilateral changes in trade and other policies that were implemented in the 1980s and 90s and the export growth this helped generate. Exports mattered because they mobilized domestic interest groups to take more of an interest in using the WTO as a mechanism to improve and safeguard access to foreign markets.

Many countries now have a much greater stake in the operation of the multilateral trading system. Developing country participation in the WTO differs substantially from that during the GATT years. As discussed further below, there is much greater diversity and differentiation in the approaches and positions taken by individual countries than when Hudec wrote in the mid 1980s. But one thing arguably has not changed substantially: domestic policy reform is still primarily a function of autonomous decisions by developing country governments. Multilateral trade negations have always been more about locking in national trade reforms than they have been about negotiated reductions in *applied* levels of protection. An important exception to this statement concerns the subset of some 20 developing and transition economies that had not joined the GATT before the creation of the WTO, and the 25 or so that have yet to join. In contrast to GATT, the process of acceding to the WTO is invasive: governments generally are required to implement numerous reforms before accession is approved. As a result, the WTO has been more of a force driving trade policy reforms in countries that acceded to it after 1995 than the GATT ever was or could have been (the WTO covers many more policy areas than the GATT did, in part because under GATT developing countries were able to opt out of disciplines that had been added in the Kennedy and Tokyo Rounds—see Hoekman and Kostecki, 2009).

The plan of the paper is as follows. Section 1 briefly characterizes the engagement by developing countries in the GATT/WTO over time, describes the shift that occurred in the second half of the 1980s in the trade policies of many developing countries and the drivers of the reforms that were pursued in the 1980s and 1990s. Section 2 discusses the economics of the use of import protection to attain industrial development objectives, and the gradual "internalization" of the arguments against the use of trade policy by policymakers. Section 3 turns to the post-1987 ("post-Hudec") period and discusses the differentiated, much more pro-active role that developing countries are playing in the WTO. Noteworthy in this regard is the increased use of dispute settlement procedures, including several major cases with negative implications for poorer/smaller developing countries. While the post-1995 WTO period has been one where special and differential treatment (SDT) remained prominent in the strategies of the poorest countries (the LDCs), relative to the GATT years the focus today is more on enhancing the competitiveness of firms and farmers by reducing trade and other transactions costs. The challenge for the WTO membership looking forward is to build on the progress and lessons to date of what has been done on trade facilitation and aid for trade and apply this to other policy areas that matter for economic

growth and development – such as service sector regulation. Section 4 briefly discusses WTO accession and contrasts this with the GATT situation before 1995, noting that this is one dimension in which the WTO has "teeth" in terms of affecting applied trade policies in the acceding countries. This is one area where there is arguably a good case for SDT for the poorest countries, as opposed to being treated similarly to more advanced nations. The process takes up an excessive length of time and imposes significant burdens on LDCs, raising the question whether the benefits outweigh the costs. Section 5 concludes.

1. Changing engagement by developing countries

Engagement by developing countries in the multilateral trading system since the 1950s has oscillated between reciprocity and disengagement. Four stages can be identified (Hoekman and Kostecki, 2009):

1. Limited membership of low-income countries in GATT (12 of the original 23 signatories were developing economies) based on a formal parity of obligations (1947–64);
2. Substantial expansion of developing country membership, based on the concept of more favorable and differential treatment (1965–86);
3. Deepening integration of developing countries into the GATT-WTO system, with a return to greater reciprocity (1987-97); and
4. A shift back to an emphasis on special and differential treatment (SDT), especially for LDCs, increasing *de facto* differentiation and heterogeneity of approaches (1998-present)

The Uruguay Round – launched around the time that Hudec published his book – ironically marked a (temporary) break with the pattern of non-reciprocity, insistence on SDT etc. that he had analyzed. Developing countries participated actively in the new round. All developing-country GATT contracting parties joined the WTO, adopting the results of the Uruguay Round as a Single Undertaking. Following the creation of the WTO, the demarcation between the poorest countries – the LDCs – and the more dynamic, higher growth developing economies became more distinct. This bifurcation reflected differences in economic performance and economic size. Although all countries participated more actively in WTO deliberations, the poorest countries have continued to focus on SDT, complementing the traditional push for freedom to use trade policy for industrial policy purposes with an effort to mobilize more development assistance funding to improve supply capacity. Milestones that resulted from this effort included the Integrated Framework for Trade-related Assistance for Least Developed Countries, created at the Singapore ministerial meeting in 1997; improvements in preferential access (such as the EU's Everything But Arms program and the US African Growth and Opportunity Act), and movement on the part of some of the major high-income markets to adopt more liberal rules of origin.

Special and differential treatment in the 1960s and 70s

As noted by Hudec (1987; 2010), the underlying justification for the emphasis put on SDT in the GATT reflected development thinking in the 1950s and 1960s. This was premised on the argument that developing countries needed to foster industrial capacity both to reduce import dependence and to diversify away from traditional commodities. Diversification was needed in part because commodities were held to be subject to long-term declining terms of trade (because of low income elasticity of demand) as well as short-term price volatility. The fear was that if developing countries relied upon exports for growth, their supply of commodities would exceed what could be absorbed by the world. The resulting excess supply and consequent decline in world prices justified trade restrictions by developing countries—in effect, they should impose tariffs to improve their terms of trade and to

protect infant/import-substitution industries. Developing countries needed protection to achieve industrialization and generate demand at home. It was also argued that developing countries suffered from foreign exchange shortages and that protectionist policies were needed to protect their balance of payments. At the same time it was recognized that exports were important as a source of foreign exchange and that the national market might be too small for a protected domestic industry to be able to realize economies of scale. This resulted in calls for preferential access to export markets—a general system of preferences that would give developing countries better than most-favored-nation (MFN) treatment in industrialized countries.

Increasing pursuit of economic self-interest in the late 1980s

Developing country stances towards trade policy changed in the early 1980s. Drivers for this change were varied but to some extent related.

- One important driver was the global recession of the early 1980s following the second OPEC oil price shock and the debt crisis that emerged around the same time. The associated need to generate more foreign exchange and improve economic performance—whether to service debt, cover import bills or to compensate for the reduced access to capital/credit and rise in global real interest rates—required an increase in net exports. The fiscal costs and burden of non-performing loans associated with financial support for infant industries was a contributing factor to the macroeconomic adjustment problems confronting many governments.
- Another, more structural, driver of reform was the demonstration effect of the success of many countries in South-East Asia in pursuing an export-oriented development strategy. Not only did the Asian “tigers” sustain high trade and economic growth rates, most also avoided the debt service problems that affected many other developing nations – as a result of their economic development strategies.
- A third driver was the gradual collapse of central planning. The dissolution of the Council for Mutual Economic Assistance (Comecon) and the USSR in the late 1980s forced a number of developing countries to re-think their economic policies. Disillusionment with the failures of managed trade (e.g., ineffective international commodity agreements; domestic marketing boards) created additional incentives for countries to move towards greater reliance on market mechanisms to allocate resources.
- A fourth factor was the “demonstration effect” of deregulation programs launched in a number of OECD countries and the privatization of state-owned enterprises. Although in practice financial considerations often dominated decisions in developing countries to undertake privatization, a conviction that State ownership or control was part of the problem also played an important role in decisions to privatize firms and open industries to (foreign) competition.
- Finally, mention should be made of the analysis of import substitution by academics – including major projects in the late 1970s led by leading scholars (Bhagwati, 1978; Krueger, 1978) – and the advocacy by the World Bank and IMF in support of outward-oriented development strategies.

Compared to the GATT, the international financial institutions (IFIs) played a significant role in supporting trade reforms in developing countries. As stressed in J. Michael Finger’s Introduction to the 2010 re-issue of Hudec (1987), the emphasis in the GATT on SDT implied that there was little scope for the GATT to engage on what constituted good (or better) trade policies. The GATT did not have the mandate to provide advice on or analysis of the design of trade policies or the sequencing of trade-related reforms. Nor did it have the ability to identify the need for complementary reforms and

investments or to engage in a policy dialogue on areas not subject to GATT disciplines—such as the level of the (real) exchange rate, the exchange rate regime, capital controls, or macroeconomic policies (monetary, tax, public expenditures, etc.). Nor did the GATT have a capacity to provide its members with financial assistance. In contrast, the IFIs could and did provide technical analysis and advice on the design and sequencing of policy reforms, engaged in policy dialogue with governments on these matters, and had the capacity to provide financial resources to assist countries meet the costs of policy reforms and improve supply capacity – transport infrastructure, energy, training and technical assistance, etc.

Between 1987 and 2004, for example, the World Bank allocated some 8 percent of its total loans and credits to programs and projects aimed at trade policy reforms, strengthening trade-related institutions and infrastructure (e.g., product standards; Customs) (World Bank, 2006). The total amount of resources committed was some $38 billion. Trade accounted for some 40-50 percent of the total conditionality in those World Bank structural adjustment loans in the 1980s and early 1990s that focused on improving economic management (World Bank, 2001). The World Bank generated a large volume of analysis and research on trade issues, ranging from the design of reforms to assessments of the impacts and results of different types of trade policies. Several influential multi-country case studies of prevailing trade policy regimes and economic performance played a role in identifying priorities for reform in the mid- to late 1980s (e.g., Bhagwati, 1978; Krueger, 1978; Choksi, Michaely and Papageorgiou, 1991;.Thomas et al., 1991).

The focus of IMF and World Bank activities was to reduce disincentives to engage in export production, boost export performance and improve resource allocation, thereby making economies more robust to changes in the world economy—be they technological in nature or short term exogenous shocks. The objective was to increase incentives for investments in new activities and products so as to diversify the economy and generate new sources of foreign exchange. A key part of many programs was to enable firms to have access to the inputs they needed at world market prices – thereby allowing them to compete on a level playing field with foreign competitors, and confronting firms with competition from imports, thereby ensuring that resources went to sectors in which a country had a comparative advantage. Creating an incentive framework that would generate a more efficient allocation of domestic resources (labor, capital) was seen as a precondition for sustaining higher economic growth over time.

Trade reforms generally had common features: a removal of quantitative restrictions (QRs) on imports and exports – with QRs often being replaced with a less restrictive tariff; a reform of the structure of the tariff – generally moving towards a simpler and more transparent system of a limited number of tariff bands; the removal of tariff exemptions of various kinds; reducing net taxation of agriculture; and lowering the average level of the tariff. Frequently the tariff structure that was recommended involved higher tariffs on final products than on inputs—the idea being to afford industries a continued positive rate of effective protection against imports.[1] The experience of many countries that implemented such trade reform packages was that tariff revenues – a major concern for many low-income countries – often did not decline (because the removal of tariff exemptions and the tariffication of QRs generated offsetting revenue). Over time, as economic activity increased and trade expanded, tariff revenues could also increase as a result of import growth.

Reforms generally went beyond narrow trade policy (tariffs, quotas). In many cases reform programs included an extensive focus on macroeconomic management – driven by the need to move countries

[1] The best tariff structure was often argued to be a uniform, low rate, but this was generally a bridge too far for most countries, Chile being one of the few outliers—see Tarr (2002).

towards a more sustainable fiscal situation; controlling inflation, etc. The successful export-led growth strategies of developing countries have often been associated with policies that were aimed at ensuring a "competitive" exchange rate(Aizenman and Lee, 2008). In many instances trade reforms included a devaluation of the real exchange rate. Depreciation created incentives to switch expenditures away from imports, thus helping to move the balance of payments towards surplus. Devaluation also played an important political economy role in helping to implement and sustain trade liberalization: by making imports more costly, some of the protection that was lost through lower trade barriers was offset. Conversely, devaluation made it easier for export-oriented firms to expand output and generate employment opportunities for workers in import substituting sectors that were negatively affected by liberalization. Complementary measures that were often pursued included the introduction of indirect tax systems (excises, value added taxation)[2] and projects to bolster the supply side of the economy: efforts to restructure firms/industries with a view to improving efficiency, investments in infrastructure and education, etc.

There have been many assessments of the trade reform programs and the assistance provided by the IFIs (see e.g., Dean, Desai and Riedel, 1992; Sharer, 1998; World Bank, 1992, 2001 and 2006). While reform programs did not always have the desired effects and many were not sustained, there is increasing evidence that reforms increased growth rates by generating additional investment into the tradable sectors—see for example Wacziarg and Welch (2008) for a careful analysis of performance of a large number of countries before and after trade reform.[3] Whatever the relative importance of the different drivers of reform, the result was a significant reduction in anti-export bias, greater neutrality in the incidence of policies across sectors—including a reduction in the relative taxation of agriculture compared to other sectors (Anderson, 2009), and increases in investment, output and trade.

Trade growth led to a change in the internal political balance of power in many developing countries. Export interests became more significant – their success generated a stronger constituency for further reform of policies affecting the investment climate. Baldwin (2010) argues that an important driver of unilateral trade reforms was the emergence of the international supply chain and the end of what Cooper (1988) has called the "ship and forget" type of trade (i.e., goods are produced, put on a ship, and that is the end of the end of it). As the stages of production of a final good increasingly came to be distributed across a number of countries – driven in part by FDI into developing countries, in turn facilitated by the ICT revolution and associated reduction in communications and coordination costs – the incentives to maintain high tariffs on imports fell.

Increasing exports helped generate greater interest in supporting efforts by their governments to get better access to export markets, both in the WTO and through preferential trade agreements. Foreign investors that responded to privatization opportunities, had taken equity stakes in local firms or engaged in greenfield investments were another source of pressure for better policy and actions by governments to lower the costs of doing business—including measures to reduce the costs of imported intermediate inputs they needed to produce their goods and services. The growth in the size and power of private sector interest groups seeking a more open trading regime in turn helped change the terms of

[2] At some point tariff revenues will fall as a result of tariff reductions: the deeper the trade reform and the lower the average tariff, the less revenue would be collected. This called for the creation of alternative tax bases—an area in which the IMF was active.

[3] See also Greenaway et al. (2002). Krueger (2003) discusses the importance of the interplay between politics and the nature of governments across countries and the effectiveness of economic policies and policy reform.

developing-country participation in the multilateral trading system, as well as stimulating a renewed focus on deeper preferential trade agreements, both North-South and South-South.

2. The demise of the case for trade policy to protect infant industries

Industrialization is generally regarded to be an integral dimension of the process of economic development. Accordingly, many developing countries historically have provided a variety of support programs for the industrial sector, including protection against import competition, special tax concessions, low tariff rates for imports of machinery and equipment, subsidized credit, guarantees, and so forth. The intellectual foundation for providing temporary support for infant industries is based on the existence of some type of market failure (e.g., credit market imperfections) and dynamic positive externalities such as worker learning-by-doing. It has long been recognized in the economic literature that one must distinguish between learning processes that are internal to the firm and those that are external. As the former are appropriable by the firm, only the latter warrant government intervention, and then only if the reductions in cost over time compensate for the higher costs incurred during the period of assistance. Moreover, this argument does not provide a justification for blanket assistance to all firms in an industry: the existence of an externality and the required cost saving must be demonstrated on a case-by-case basis (Pack and Saggi, 2006).

Hausmann and Rodrik (2003), for example, emphasize a specific type of learning externality. They argue that the private payoffs to successful investments in new activities may be much lower than the social benefit because the private gains may be eroded quickly if investments are successful as a result of entry by other entrepreneurs into what has been revealed to be profitable businesses. This suggests a role for government to increase the incentive to undertake 'exploratory' investments in new (non-traditional) activities—in addition to providing standard public goods such as property rights, security, etc. to deal with the non-appropriability problem. At the same time, policies to foster investment (self-discovery) must be complemented by measures to ensure the exit of firms that pursued new activities in which it is revealed that country does not have a comparative advantage. What is needed therefore is a balance of government promotion of new activities and discipline.

Achieving such a balance in practice is a major challenge. Particularly important is to identify and employ instruments that are effective in addressing the externality. A key insight of analyses of the infant industry argument was that a tariff provides no incentive for a firm to acquire more knowledge (Baldwin, 1969; Bhagwati, 1971). Because tariffs are output-based (that is, they provide incentives for greater production), a firm will increase output by the least costly method, not necessarily by acquiring more technology. To capture the learning related spillovers of production a subsidy related to knowledge creation is called for; e.g., a subsidy to those workers/firms who learn by doing. As most knowledge or skill acquisition is process- or job- or product-specific, any subsidy should be targeted to the process, job or product. The implication is that trade policy (protection) will not be an effective instrument to deal with the market failure. Indeed, firms entering into new activities will need to have access to inputs from the rest of the world, including technologies. Moreover, the economy-wide effects of trade intervention in one industry also need to be borne in mind—a tariff on an input will cause the effective protection of downstream users to decline.

The various theoretical arguments against the use of trade policy to protect infant industries did not resonate much with policymakers in the 1970s. What proved more powerful was disillusionment with restrictive trade policies: the effects of protectionism proved disappointing. In addition to often not

generating viable (competitive) industries, trade barriers led to lobbying for the right to import (to capture the rents created by the difference between world and domestic prices) and to lobbying by industries for exemptions for inputs they needed from abroad. The result often was a very complex and nontransparent trade regime. The inefficacy of restrictive trade policies and the associated rent-seeking led to a re-thinking of policy. As noted above, the rapid rise of East Asian countries which relied on systems that ensured that firms had access to inputs at world prices and were oriented towards producing for the world market helped to shift the focus of industrialization policies away from trade protection.

The dynamics of trade policy were also affected by technological changes, especially the rapid decline in transport and communications costs in the 1990s. As "frictional" trade costs fell, the political economy of protection of producers of intermediates changed – downstream industries in developing countries had less incentive to accept (support) protection of domestic upstream suppliers (Baldwin, 2010). The process of vertical specialization and fragmentation of production, in conjunction with extensive flows of FDI into developing countries has greatly attenuated the incentives to use trade policy to protect specific industries. As of the early 21st century it makes little sense for governments to use trade policy for infant industry purposes as it will hurt, not help. International exchanges today are increasingly about trading in tasks. Being able to compete in a specific niche or activity requires that firms are able to integrate into the relevant value or production chains. Significant levels of import protection would impede their ability to do so. This does not imply that there is no role for government policy and measures to address market failures of the type that have long been identified in the economic literature – to the contrary. But traditional import protection generally will have little useful role to play.

The 2008 financial crisis and subsequent global recession illustrated the change in the incentives to use traditional import protection instruments – there was very little widespread recourse to such measures, in stark contrast to what happened during the global recession of the early 1980s when there was widespread resort to 'voluntary' export restraints and quantitative restrictions for products such as cars, textiles and steel. But governments did intervene in an effort to support demand, and to improve the competitiveness of firms located in their territories. Calls on surplus countries to allow exchange rates to appreciate and fears of beggar-thy-neighbor policies to depreciate exchange rates are where the pressure points are today.

Thus, although trade policy is likely to feature much less prominently in the toolbox of governments, other instruments such as the exchange rate or specific types of industrial (sectoral) policy continue to have an important role to play. These are appropriate instruments for governments to use in the pursuit of growth and development goals,[4] but they also can have beggar thy neighbor features and generate international tensions. Addressing these tensions – which are in part the consequence of successful pursuit of export led growth – in a cooperative manner is important both to prevent recourse to unilateral 'retaliation' by trading partners and to allow those countries that are most in need of effective pro-active policies to use them without fear of negative reactions from the rest of the world (Haddad and Hoekman, 2010).

There are no disciplines on exchange rate policies in the WTO, even though it is an instrument that can be used to have the same effect as a combination of import barriers and export subsidies. While this

[4] Rodrik (2008) for example argues that real undervaluation can promote economic growth by increasing the profitability of the tradable sector, which is often confronted with a bad investment climate and high operating costs as a result of a variety of domestic distortions.

was recognized by the drafters of the GATT/WTO, it is left to the IMF to address exchange rate misalignments (under Art. XV GATT).[5] If a country's exchange arrangements or exchange rate level is such as to help generate a large trade surplus, there are no legal ramifications under the GATT. Dealing with the conflicts that are generated by sustained use of policies – including the exchange rate – that generates large-scale surpluses is a matter that is now squarely on the international policy agenda. However, the forum for such cooperation revolves around the IMF and the G20, not the WTO.

3. Diverging interests and increasing participation in the GATT/WTO

The shift towards more liberal trade policies and the associated expansion of export production increased developing country participation in the GATT/WTO. As emphasized by Hudec (1987), one consequence of the traditional SDT strategy was that (until the Uruguay Round) trade negotiations were essentially conducted among developed trading nations, who concentrated on their own trade interests. Products of major importance to developing countries such as agriculture or textiles and clothing were either excluded from GATT or granted protectionist treatment on an ad hoc basis. Indeed, the fact that developing countries were not playing the GATT game was one explanation for the continued existence of protectionist policies on textiles and clothing, footwear and other 'sensitive' labor-intensive sectors in OECD countries in the 1980s. Once developing country governments started to pursue unilateral liberalization and export-oriented strategies, the existence of high market access barriers in these sectors mobilized export lobbies to support more active engagement in the GATT.

Unilateral changes in national policy stances led to a major shift in both the strategy and the tactics of developing countries in the GATT. They participated actively in the Uruguay Round, including the reciprocal exchange of 'concessions', and had a significant impact on the design of the GATS, the Agreements on Textiles and Clothing, Safeguards and Agriculture. This influence was manifest from the very start of the talks. At the 1986 Punta del Este ministerial meeting, a group of smaller developing and developed economies (the Swiss-Colombian coalition) played an important mediating role between the US, the EU, and large developing countries such as Brazil and India. This marked a sea change not just in terms of increased participation, but also because it became obvious that it was no longer appropriate to regard developing countries as a bloc. (This had never been the case but it became increasingly obvious in the Uruguay Round). Instead, countries pursued their self-interest in a much more open way than in the past. This included teaming up with high-income countries. The Cairns Group was a prominent example of a North-South coalition of countries that sought to liberalize world trade in agricultural products.

Although the Uruguay Round single undertaking implied a dramatic change for developing countries, the creation of the WTO did not imply the demise of SDT. The Punta del Este Ministerial Declaration explicitly stated that

> CONTRACTING PARTIES agree that the principle of differential and more favorable treatment embodied in Part IV and other relevant provisions of the General Agreement ... applies to the negotiations ... [D]eveloped countries do not expect reciprocity for commitments made by them

[5] GATT Article XV calls for the WTO to cooperate and consult with the IMF on matters relating to monetary reserves, the balance of payments and or foreign exchange rate arrangements; requires that Members "shall not, by exchange action, frustrate the intent of the provisions of the GATT nor, by trade action, the intent of the provisions of the Articles of Agreement of the IMF; and allows Members to apply exchange controls and restrictions if consistent with the Articles of Agreement of the IMF. Art. XV has never been formally interpreted by WTO Members or been the subject of a dispute settlement proceeding.

> in trade negotiations to reduce or remove tariffs and other barriers to trade of developing countries (GATT, 1986: 7).

Special provisions for developing countries included a lower level of obligations, more flexible implementation timetables, commitments by developed countries to take into account developing country interests, more favorable treatment for LDCs, and promises of technical assistance and training.

While the rhetoric of SDT continues to be a staple feature of the approach taken by many developing countries in the WTO, in practice there is substantial (and increasing) differentiation. Large countries such as Brazil and India have become very influential, and many middle-income countries in Latin America and Asia engage very actively in the deliberations of the WTO – whether negotiations, the regular work program of the institution or the dispute settlement mechanism. These countries increasingly take a leadership role – most prominently through the G-20 group of developing countries that was created in the run-up to the Cancun ministerial in 2003. But the poorest countries are also much more active (and pro-active) than during the GATT years, in part as a result of combining into coalitions such as the Africa Group and the LDC group.[6]

A key indicator of the change that has occurred in the approach of developing countries to the WTO is the use that is made of the DSU to defend national economic interests. Developing countries accounted for about 40 percent of all complaints between 1995 and 2007. They increasingly use WTO procedures against each other. Developing countries were defendants in only 8 percent of all the cases brought during the GATT years; in the 1995-2007 period this rose to 40 percent (Hoekman and Kostecki, 2009). Particularly noteworthy in this connection is the use of the DSU by large developing countries to attack unilateral preference programs that benefit poorer/smaller developing countries. Examples include a December 1998 decision by Brazil to contest the EU GSP scheme as inconsistent with the Enabling Clause and the MFN rule, resulting in the impairment of benefits accruing to Brazil (the Enabling Clause requires that preferences be “generalized, non-reciprocal and nondiscriminatory”). This request for consultations, joined by a number of other Latin American nations, led to a 6-year waiver being negotiated for EU preferences for African, Caribbean and Pacific (ACP) countries in Doha in 2001, and the launch of the negotiations between the EU and the ACP to establish reciprocal Economic Partnership Agreements (EPAs). Other examples are the 2003 cases brought by India against the EU GSP+ program and by Brazil against EU export subsidies for sugar. The latter had major implications for ACP countries that had benefitted from guaranteed access to the highly protected EU market.

At the same time, LDCs have targeted “better and deeper” SDT in the WTO. This was reflected inter alia in calls to address Uruguay Round implementation concerns and insistence that they not be expected to make market access commitments in the Doha Round. In these efforts they have had some success, e.g., with the ‘Doha round for free’ decision that was formalized at the Hong Kong ministerial in 2005. In addition, LDCs have been able to obtain better preferential access to major OECD markets. The EU’s “Everything-but-Arms” duty- and quota-free initiative for LDCs, the US African Growth and Opportunity Act, and similar schemes adopted by other OECD members, all provide better access than their GSP programs by expanding product coverage, completely removing tariffs and in some cases offering more liberal rules of origin (AGOA and, more recently, the EU in the context of the EPAs). Moreover, at the Hong Kong ministerial an agreement was reached to extend such duty-free access as a permanent WTO commitment for at least 97 percent of the exports of LDCs.[7]

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[6] See Hoekman and Kostecki (2009) for a more extensive discussion of developing country coalitions in the WTO.
[7] The deepening of preference regimes for LDCs may in part be a response to the increasing pressure being exerted

Beyond Tariffs: Reducing Real Trade Costs

In addition to better preferential market access for LDCs, starting in the late 1990s initiatives were launched to do more to assist countries improve their competitiveness and export supply capacity. The ability of firms to benefit from trade opportunities depends on their ability to produce goods that can compete on world markets. Domestic supply constraints are the main reason for the lack of trade growth and diversification in many of the poorest developing countries. Without action to improve supply capacity, reduce transport costs from remote areas, increase farm productivity through extension services, and improve the investment climate more generally, trade opportunities cannot be fully exploited and the potential gains from trade will not be maximized.

Poor roads and ports, poorly performing customs, weaknesses in border management, inadequate regulatory capacity, and limited access to finance and poor business services are all factors that undermine trade performance. They are all also areas where development assistance can help support reform efforts of governments and enhance the capacity to trade. For example, enterprises in Tanzania report that on average it takes about 12 days for exports and 19 days for imports to clear customs.[8] In comparison, it takes only 2 and 3 days for exports and imports to clear customs in the Philippines. It takes 116 days to move an export container from the factory/farm in Bangui (Central African Republic) to the nearest port and fulfill all the customs, administrative, and port requirements to load the cargo onto a ship. It takes 71 days to do so from Ouagadougou (Burkina Faso). In contrast, it takes only 20 days in China, Malaysia or Chile. On average it takes three times as many days, nearly twice as many documents and six times as many signatures to trade in a poor country as it does in rich countries.

A major achievement by low-income developing countries during the Doha Round was the launch of the “aid for trade” initiative and the establishment of the Enhanced Integrated Framework for trade-related technical assistance. Although not formally tied to the Doha negotiations or to enforceable WTO commitments, these initiatives signified recognition by the membership that market access and rules were not enough. While this is obvious, what the aid for trade initiative did was to engage development agencies (bilateral and multilateral) more in the trade integration agenda and raise the profile of trade issues in the process of determining priorities for investment and policy reform at the country level.

From a competitiveness and economic development perspective it is the trade cost agenda that is today the priority for many low income countries. Various aspects of the underlying policy reform agenda are on the WTO table, including in the trade facilitation and services negotiations in the Doha Round. To a significant extent the “trade cost policy agenda” revolves around services: reducing the costs of service inputs and increasing the variety and quality of such inputs are important determinants of the ability of firms and farmers to produce and sell their products on local, national and global markets and the rate of return they will obtain. The urgency of reducing trade and production costs has increased as a result of the rapid growth of China and other emerging markets. To compete with firms in China requires that producers are not shackled with high cost structures. Wages in much of Africa are not higher than in China, and as China continues to grow real wages will increase there. While the growth of China and

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by Latin American and Asian countries that did not benefit from the EU’s ACP regime to reduce the extent to which they confront trade diversion costs. As the WTO allows deeper preferences for LDCs, and almost by definition these are countries with limited supply capacity and thus not a major threat as competitors, other developing countries supported these LDC initiatives. An exception is Bangladesh, a significant exporter of textiles and clothing. The fact that Bangladesh is an LDC does much to explain why in Hong Kong it was not possible to obtain agreement to grant LDCs duty- and quota-free access for 100 percent of LDC exports.

[8] This paragraph draws on material in Hoekman and Kostecki (2009). All data are from the World Bank *Doing Business* report.

other large developing countries is a challenge for other countries, it also offers opportunities (Canuto and Giugale, 2010).

Realizing those opportunities requires trade and operating costs to come down. Doing so is a complex, multi-dimensional challenge. Trade liberalization has a role to play, but much of the agenda revolves around other policies. One example is border management – enhancing the efficiency of enforcing regulatory and fiscal policies (McLinden et al., 2010) Another example is regional integration, which can create larger markets and lower the costs of transit transport—a key factor for land-locked countries in particular (Arvis, Raballand and Marteau, 2010). Regional cooperation on measures to facilitate trade between neighboring countries can stimulate the type of intra-industry specialization that characterizes much of the exchanges that take place in East Asia, Europe and NAFTA. The importance of reducing the costs of accessing and transiting neighboring markets and attaining scale and agglomeration economies through convergence of administrative procedures and trade-related regulatory regimes helps to explain the increasing participation in regional trade agreements by developing countries. Much of the agenda, however – as in the past – will involve autonomous, unilateral reforms.

The WTO arguably can play a more constructive role today in helping countries deal with the "real trade costs" agenda than the GATT could do during the period when Hudec wrote his book. The reason is that the ineffectiveness of the traditional SDT strategies that Hudec analyzed so cogently has increasingly been recognized by WTO members. Innovations have occurred that are focusing more attention at national level on priorities for reform and the mobilization of resources to implement changes. The trade facilitation negotiations in the Doha Round illustrate how the WTO can be used by developing countries to make a difference on the ground for traders and producers. While the trade facilitation agenda spans much more than the three GATT articles (Arts. V, VIII and X) that are the focus of negotiations, the way the process has been structured suggests a model to move forward on other parts of the trade cost and competitiveness agenda. A key feature of the trade facilitation talks was a decision by developing countries to introduce a formal link between implementation of any agreement and to the provision of financial and technical assistance. Another feature of the negotiations was to engage the specialized agencies with expertise in the area – such as the World Customs Organization, the World Bank, UNCTAD, and the IMF – in the process. These agencies, together with the WTO, undertook assessments at country level of the trade facilitation situation, gaps and priorities.

Although the conclusion of a trade facilitation agreement is tied to the overall fate of the Doha Round, the process raised national awareness of the importance of trade facilitation. This awareness raising affected the development (donor) community as well. A plethora of research on the net benefits of facilitating trade induced by the launch of the negotiations identified the high rate of return of investments in this area (and the high opportunity cost of not dealing with the issue). As a result, the number of projects and level of resources allocated to this area increased significantly relative to the late 1990s and early 2000s. Even if the Doha Round never comes to a successful conclusion, this is a positive outcome that is due in part to the launch of the negotiations and the focal point they provided.

Emulating this approach in other areas of trade-related regulation could help make the WTO a more effective mechanism to assist countries reduce trade costs/improve competitiveness. Perhaps the most obvious and important area is services. As argued at greater length in Hoekman and Mattoo (2010) and Hoekman, Mattoo and Sapir (2007), efforts to negotiate an expansion in market access commitments for service sectors have not proven to be very fruitful in the Doha round. An approach that goes beyond a narrow focus on market access and takes regulatory concerns and constraints seriously may increase the prospects of moving forward on services policy reform.

Significant movement in the direction of liberalization of services policies is constrained by the great diversity in regulation and regulatory capacity. In practice the process of identifying, designing and implementing policies that address market failures and ensure wider access to services may take years. Mechanisms that bring together sectoral regulators, trade officials and stakeholders to assess current policies and identify beneficial reforms are needed. Implementation of the priority reforms that are identified could be assisted by the development community under the "aid for trade" initiative. The financial and technical support for strengthening the relevant implementing institutions will require the engagement of a variety of bodies and institutions (national, regional and international) that deal with specific services, including regulators, and the development community.

4. An Aside on Accession

Some two dozen countries have joined since the WTO was established – the majority of them developing and transition economies. The process of accession to the WTO is a long hard road for most countries, often requiring major policy changes, adoption of new legislation and establishment or strengthening of domestic institutions. This compares to the accession at a stroke of a pen that applied to former colonies when they acceded to GATT upon independence – the result of Art. XXVI:5(c) GATT, a provision that expired with the creation of the WTO. The changed regime with respect to accession is one area in which the terms of engagement of *some* developing countries (the non-GATT-1947 members) with the trading system is very different from when Hudec wrote his book.

A number of efforts by LDCs to join the WTO have not been happy experiences. Nepal and Cambodia were the first "non-GATT" LDCs to join the WTO in 2004. In the case of Cambodia the process took almost 10 years. It took a similar length of time for other LDCs such as Nepal and Cape Verde to accede. Mongolia "only" took 6 years to complete the process. In 2001, after 6 years, Vanuatu decided to suspend accession talks. This led to a December 2002 decision by the General Council that calls for the exercise of restraint by WTO members in seeking concessions and commitments from acceding LDCs and calls on them to ensure greater parity between what is sought of new LDC members and what those that had joined in the GATT years were committed to. [9] In practice this decision has not appeared to have had much impact—the post-2002 accession process for LDCs remained arduous and complicated, with WTO Members continuing to make little distinction between LDCs and large countries such as China or Russia. Of the 29 countries in the accession queue at the end of 2009, 16 had been engaged in the process for over a decade. The difficulties incurred by poor countries that were not GATT contracting parties in acceding to the WTO result in a two-tier system, in that the LDCs concerned are held to standards that are higher than those applicable to many incumbents.

The accession experience reveals that those countries that used them as a mechanism to pursue broader domestic economic reforms at the same time as bringing their trade policies into line with WTO requirements got the most out of the process in terms of enhanced economic growth performance.[10] Examples include Cambodia, China and Vietnam. How much of the improved economic performance by

[9] Vanuatu, which sought accession in 1995, suspended accession talks in 2001. Reasons included perceptions that too much was being asked and a general lack of ownership and understanding of the (net) benefits that would accrue to the country. As discussed in Gay (2005), one reason was a disconnect between the development concerns and objectives of the Vanuatu government and the hard-nosed negotiating stances that were taken by major WTO members, which applied the whole panoply of WTO rules to Vanuatu's trade regime without consideration of the specific circumstances that prevailed. Another factor was the lack of adequate impartial technical assistance.

[10] See Braga and Cattaneo (2009) for a comprehensive discussion of the debate and the literature on accession.

these countries can be attributed to the WTO accession process is impossible to determine, however: accession was one element of a comprehensive reform program undertaken by the countries concerned, with the WTO process one mechanism to overcome interest group resistance to opening the economy. The cost-benefit ratio of the accession process for small, poor countries is less clear—in part because the constraints that impede economic growth in many of the countries concerned have little to do with the trade policies that are subject to WTO disciplines.

The accession experience suggests that Hudec's presumption that fuller application of the disciplines of the GATT would be beneficial to developing countries may need some qualification. Complementary actions to improve economic policies more broadly and to invest in trade-related infrastructure will determine the rate of return on trade reforms. Regional integration of the type discussed above may be critical to reduce trade costs. Given the increasing importance of global (and regional) value chains, regional cooperation and trade agreements with major markets may do much more to attract investment than WTO accession alone, helping to explain why greater effort is being put into the implementation of regional or preferential trade agreements.

5. Concluding remarks

Since Bob Hudec published his seminal book on developing countries in the GATT legal system much has changed in terms of the relative economic weight of developing countries in the world economy. Economic growth rates in much of the developing world have been such that developing countries as a group are expected to account for over half of world GDP by 2015 (Canuto and Giugale, 2010). The growth has largely been the result of autonomous reforms pursued by the governments of these countries. The GATT/WTO played only a limited direct role in the "rise of rest," although the principles of openness, predictability and transparency that underpin the trading system have obviously been very beneficial in supporting the growth in global trade that has occurred.

The role of – and approaches by – developing countries in the WTO has changed substantially. The poorest countries have continued to push for SDT, but in a way that has been more effective than in the GATT years. Relative to the mid 1980s, preferential access programs for LDCs are more meaningful in that there are fewer product exclusions and more liberal rules of origin in the major OECD markets. More generally, the growth in the size of export industries in many developing nations and their increasing integration into global value chains has meant that the WTO regime has become more relevant to these countries. One reflection of this is the recourse to the WTO dispute settlement mechanism to defend market access benefits and the willingness by the more advanced (and thus 'less-preferred') developing country governments to put pressure on high-income countries to abide by the WTO rules. This has at times led to developing countries taking actions that (indirectly) have adverse consequences for other developing economies. Noteworthy examples have been cases seeking to enforce the rule that all developing countries benefit from non-reciprocal preference programs and that "better treatment" be limited to the LDCs. While arguably a positive development for the multilateral trading system, this has had significant implications for the countries that benefitted from preferential treatment, such as the ACP countries.[11]

[11] The ultimate impact on the ACP countries will depend on the economic impacts of the Economic Partnership Agreements (EPAs) that have replaced the EU unilateral preference regime for non-LDCs. Many have argued that from a development perspective the design of the EPAs leaves much to be desired, not least as there is significant scope for welfare-reducing trade diversion because ACP countries will not liberalize some 20 percent of the value of current imports. Much will be determined by the extent to which the EU partners will extend liberalization on an

The changes that have occurred in the structure of the world economy as a result of policy reforms and technological advances—reflected in production fragmentation and geographic splintering of value chains—have resulted in strong incentives for countries to lower trade costs and much reduced incentives to protect domestic markets. One consequence has been that many developing countries have become much more active in negotiating and implementing preferential and regional trade agreements and pursuing cooperation with neighbors and other trading partners to reduce trade costs. Indeed, for many governments the primary focus of trade-related policy initiatives is regional, not WTO-centric. This is an important development with unclear implications for the WTO. Insofar as the primary focus of regional cooperation is on actions that reduce trade costs and lower barriers for all traders the rise of regionalism may be "multilateralizing."[12] Whatever the case may be, the ever increasing number and depth of regional trade agreements is another illustration of how developing country approaches towards trade policy have changed since Hudec (1987) was published.

The emergence of aid for trade on the global agenda is one more development that illustrates the change in the engagement of developing countries. It suggests that WTO members recognize that trade liberalization alone is not enough to benefit poor countries, and that promises to provide technical assistance and grant longer transition periods (the "GATT approach") is an inadequate response to concerns regarding the ability of poorer countries to benefit from the trading system's rules and disciplines. While the substance of the "aid for trade" agenda is certainly not a new one – indeed, all of the areas for potential intervention have been pursued by developing country governments and donors over many years – the recognition that this is a matter that concerns both the international trade and development communities should help shift the focus of policy attention towards the domestic factors that today are the primary constraint on investment and export growth.

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MFN basis instead of limiting it to the EU and undertake complementary reforms that will enhance the competitiveness of their firms and farmers and make it more attractive to invest in their countries.

[12] See the contributions to Baldwin and Low (2009) for further discussion and analysis.

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