

Development and the Doha Agenda

The challenges confronting developing countries seeking to expand their international trade are primarily domestic. Countries that have expanded their share of global markets have generally shared certain conditions: a progressively more open domestic trade regime; a supportive investment climate; and complementary policies relating to education, health, and infrastructure. Most of this agenda is *national* and requires domestic policies to deal with prevailing constraints to increasing trade. The World Trade Organization (WTO) negotiating agenda is necessarily limited to a narrow subset of issues that overlaps only partially with priority development concerns for most countries (Finger 2001).

In this sense, the WTO is not a comprehensive development institution. It is a negotiating forum in which governments make trade policy commitments that improve access to each others' markets and establish rules governing trade. Developing countries can gain from both functions: first, because trade openness, growth, and poverty reduction are mutually reinforcing; and, second, because a rules-based world trading system protects small players that have little ability to influence the policies of large countries. Rules can reduce uncertainty by placing mutually agreed limits on the policies that governments may adopt—thus potentially helping to increase domestic investment and lower risks.

Historically, many WTO rules evolved to reflect the perceived interests of developed countries in an era when the participation of developing countries was limited. Many rules reflect the status quo practices that have already been adopted in industrial countries. The wider latitude accorded agricultural subsidization reflects the use of such support policies in many developed countries. The same is true for the permissive approach historically taken toward the use of import quotas on textile products—in principle prohibited by General Agreement on Tariffs and Trade (GATT) rules. New disciplines adopted in the WTO often mirror regulatory practices of rich countries. For example, the recent inclusion of rules on the protection of intellectual property rights has led to the perception that the WTO contract demands regulatory changes in developing countries without any corresponding changes in regulatory policies in industrial countries.¹

As developing countries have become more actively involved in the WTO, the challenge is to design rules that promote development. Meeting that challenge means evaluating the implications of various ways to achieve this objective. Rarely is this a straightforward process, especially when it comes to the “behind-the-border” regulatory policies that are increasingly the subject of multilateral discussions. Negotiating pro-development rules in such a context requires the active engagement of developing countries.

The developing countries' traditional approach has been to seek differential treatment. "Special and differential treatment" (SDT) provisions in the WTO span three core areas: *preferential access* to developed-country markets, typically without reciprocal commitments from developing countries; *exemptions* or deferrals from some WTO rules; and *technical assistance* to help implement WTO mandates. What constitutes a developing country is not defined in the WTO—a country's status is a matter of self-declaration. All in all, the current system has not worked especially well, and many countries are seeking a new approach.

Trade preferences have been disappointing in delivering market access: the dilemma

Developed countries grant preferences voluntarily rather than as part of a binding multilateral negotiation. Those preferences often come laden with restrictions, product exclusions, and administrative rules. Preference programs often cover only a share of exports from developing countries, and among those eligible countries and products, only a fraction of preferences are actually utilized. Products and countries with export potential often do not receive preferences, whereas eligible countries and product categories often lack export capacity.

Another problem is that preferences, even when effective, are likely to divert trade away from other excluded developing countries because the exports of developing countries tend to overlap more with each other than with those of developed countries.

Finally, preferences do little to help the majority of the world's poor. Most of those living on less than \$1 per day live in countries like China, India, Pakistan, and Association of Southeast Asian Nations (ASEAN) member countries, which receive limited preferences in products in which they have a comparative advantage. Meanwhile, many middle-income countries justify relatively high barriers to trade on SDT grounds, to the detriment of poorer developing countries whose access is impeded.

Nondiscriminatory trade liberalization for poor countries—and poor people—is critical

Recent initiatives by developed countries to extend duty- and quota-free market access for the least developed countries (LDCs) could, if fully implemented, make preferences more effective. But because offering deep, unilateral preferences to larger countries is not politically feasible, preferences can do little for the majority of the poor in non-LDCs. Providing opportunity for all of the world's poor, therefore, requires multilateral, nondiscriminatory liberalization of trade, so that all developing countries can develop their comparative advantage. Most of the gains from trade liberalization result from a country's own reforms. As reciprocity in the exchange of liberalization commitments is the engine of the WTO process, both low- and middle-income countries should harness reciprocity to gain market access.

Elements of a development-supportive trade regime would include a binding commitment by developed countries to abolish export subsidies, decouple agricultural support, and significantly reduce—or eliminate—tariffs on products of export interest to developing countries. Negotiations should target tariff peaks, specific tariffs, and tariff quotas, while aiming for a significant overall reduction in the average level of applied tariffs. The pursuit of these objectives would be more supportive of development than one that continues to emphasize nonreciprocal preferential access to markets.

Negotiating WTO rules that support development is a major challenge

Trade-policy disciplines that can be implemented through a stroke of pen, such as tariff reductions, are fundamentally different from regulatory disciplines and administrative rules that require institutional changes. In contrast to tariff reforms, administrative rules may require substantial resources to establish or strengthen implementing institutions. Domestic rules and regulations must be customized to

local circumstances. Thus, rules relating to regulatory practices are unlikely to be a development priority for *every* country, nor are the benefits to global partners likely to be proportional in all countries. The experience after the Uruguay Round with implementation of agreements by developing countries has demonstrated that limiting recognition of differential capacities and levels of development to uniform transition periods is inadequate, as are nonbinding offers of technical assistance. Allowing for greater differentiation among developing countries in determining the reach of WTO rules is important.

Aid for trade must be complemented by action in developing countries

Development assistance must play an important role in helping to expand and improve the trade capacity needed for countries to benefit from better access to markets. Low-income countries confront many challenges in identifying and addressing trade-related policy and public investment priorities. Those priorities should be made explicit in the form of a national development strategy. That strategy, not a WTO agenda, should drive technical and financial assistance. Diagnostic trade-integration studies completed for several LDCs reveal that action is required in areas lying far beyond the scope of WTO agreements. Trade facilitation and logistics are especially important. Additional development assistance could help low-income countries address such priorities. Such assistance should also help countries adjust and adapt to a gradual reduction in trade preferences and address the effects of possible increases in world food prices.

Special and differential treatment and the WTO

The idea that developing countries should receive SDT has a long history in the GATT/WTO system. It has three related dimensions. First, for certain products, develop-

ing countries are granted access to developed-country markets at tariffs lower than the most-favored-nation (MFN) rates through policies such as the Generalized System of Preferences (GSP). Second, they may be temporarily exempted from certain disciplines or granted greater discretion to apply restrictive trade policies. Third, they may request technical assistance from high-income countries to implement trade rules and related reforms.

The intellectual foundation of SDT was laid in the 1960s by Raoul Prebisch and Hans Singer, who argued that developing-country exports were concentrated mainly in commodities with volatile and declining terms of trade. They called for import-substitution policies, supported by protection of infant industries at home, and preferential access to export markets. Although the rationale for these policies remains controversial (see, for example, Bhagwati 1988), in 1968 the Generalized System of Preferences (GSP) was launched under United Nations Conference on Trade and Development (UNCTAD) auspices. This called on developed countries to provide preferential access to developing-country exports on a voluntary basis.² Because GSP programs violate the GATT's MFN rule, GATT contracting parties waived the MFN requirement in 1971 for 10 years, thereby placing GSP within the GATT framework. In 1979, at the conclusion of the Tokyo Round, permanent legal cover for the GSP was obtained through the so-called Enabling Clause,³ which called for preferential market access for developing countries and limited reciprocity in GATT negotiating rounds to levels "consistent with development needs." It also confirmed that developing countries should have greater freedom to use restrictive trade policies. An important feature of the Enabling Clause was that SDT was to be phased out when countries reached a certain level of development. That level was never defined, however, leaving eligibility for trade preferences to the discretion of preference-granting countries.

The existence of the GSP and limited reciprocity in GATT negotiations affected the patterns of MFN trade liberalization in both the Kennedy (1964–67) and Tokyo Rounds (1973–79) (see chapters 2 and 3). The end result was larger tariff reductions in goods primarily of export interest to industrialized economies.⁴ Average levels of trade protection in developing countries were reduced relatively little. Lack of engagement by developing countries also facilitated the emergence of restrictive quota regimes for textiles under the Multi-fiber Arrangement (MFA) and the effective removal of GATT disciplines on agriculture-related trade policies (Hudec 1987).

Under the pre-WTO trade regime, new rules extending the original GATT treaty were applied on a voluntary basis. Extensions were called “codes,” whose disciplines bound only the contracting parties that signed them (Hoekman and Kostecki 2001). This approach to rule extension was removed with the creation of the WTO. In contrast to the GATT, all WTO agreements and disciplines, with the exception of rules on government procurement and trade in civil aircraft, apply to all members regardless of level of development—although in many cases transition periods apply to developing countries. A consequence of this so-called Single Undertaking and the expansion in the coverage of multilateral rules to new areas, such as intellectual property and trade in services, was that developing-country governments were confronted with a significant implementation agenda as well as new policy constraints.⁵

In the runup to WTO’s 1999 Seattle ministerial meeting, SDT and implementation concerns figured prominently. The 2001 Doha Ministerial Declaration emphasized the importance of SDT, stating that “provisions for special and differential treatment are an integral part of the WTO agreements.” Paragraph 44 called for a review of SDT provisions with a view to “strengthening them and making them more precise, effective, and operational.” On the basis of this mandate, developing countries made over 85 suggestions to strengthen SDT

language in various WTO agreements. The proposals included calls for improved preferential access to industrialized countries, further exemptions from specific WTO rules, and binding commitments on developed countries to provide technical assistance to help implement multilateral rules. Despite intensive talks during 2002, no agreement on these proposals emerged. One reason was that many of the proposals sought to convert nonbinding, “best endeavors” language into obligations binding on developed countries. Another was disagreement over what types of provisions would promote development. The latter issue is fundamental, of course, but it was never the focus of explicit analysis and discussion in the relevant WTO committee (Keck and Low 2003).

Market access for development

International trade helps raise and sustain growth—a fundamental requirement for reducing poverty—by giving firms and households access to world markets for goods, services, and knowledge; lowering prices and increasing the quality and variety of consumption goods; and fostering specialization of economic activity in areas where countries have a comparative advantage. Through the diffusion and absorption of technology, trade fosters the investment and positive externalities that are associated with learning. Policies that shelter economic agents from the world market impede these benefits and dynamic gains. While adjustment costs and measures to safeguard the interests of poor households should not be neglected in the design of policies, openness to trade is associated with higher incomes (Irwin 2002). Moving toward an open trade policy and identifying the needed complementary domestic policies should consequently figure centrally in the design of national poverty-reduction strategies. Many developing countries have pursued unilateral liberalization of their trade regimes in the last two decades. They have also concentrated on obtaining preferential access to rich-country markets.

Preferences result in limited market access and are uncertain

Trade preferences granted by developed countries are voluntary. They are not WTO obligations. Donor countries determine eligibility criteria, product coverage, the size of preference margins, and the duration of the preference. Developed-country governments rarely have granted deep preferences in sectors where developing countries had the largest export potential. Indeed, preferences tend to be the most limited for products protected by tariff peaks (Hoekman, Ng, and Olarreaga 2002).

Developing countries often obtain only limited preferences in sectors where they have a comparative advantage (table 6.1).⁶ In some cases, developing countries face higher average tariffs because of the composition of their exports. Some subcategories include tariff peaks that further restrict access for developing countries. The primary reason for this pattern of protection is that in some sectors there is strong domestic opposition to liberalization in developed countries. However, it is also partly a consequence of the limited engagement by developing countries in reciprocal negotiations.

Benefits are often limited by design. Market share or value thresholds limit the extent to which recipients can export on preferential terms. In the United States, for example, a

country's GSP eligibility for a given product may be removed if annual exports of that product reach \$100 million⁷ or if there is significant damage to domestic industry. In the European Union, products classified as "sensitive" only benefit from a 3.5-percentage-point reduction of the MFN tariff rate, except for clothing, for which the reduction is 20 percent.⁸ Most chemicals, almost all agricultural and food products, and all textiles, apparel, and leather goods are classified as "sensitive."⁹ The European Union also excludes from GSP eligibility certain products from large countries—regardless of their per capita income. Examples include Brazil, China, India, and Indonesia. Finally, the European Union has a safeguard clause allowing preferences to be suspended if imports "cause or threaten to cause serious difficulties to a Community producer."

In numerous instances, products or countries have been removed from GSP eligibility, either as the result of specific criteria having been satisfied (see above) or because of lobbying by domestic interest groups in importing countries. The resulting uncertainty can only have a negative impact on incentives to invest in export sectors. Binding multilateral liberalization commitments under the WTO are more secure. The uncertainty of unilateral preferences also arises from conditions that may be attached

Table 6.1 Developing countries rarely receive significant preferences in sectors in which they would have a comparative advantage

Import revenues, market shares, and tariff rates for key products without GSP preferences in the European Union and United States in 2001 (percent, except where otherwise noted)

	Total imports (billions of dollars)		GSP recipients' market share		LDC market share		Average tariff rate		Average tariff rate faced by GSP recipients	
	EU	U.S.	EU	U.S.	EU	U.S.	EU	U.S.	EU	U.S.
Dairy products	1.4	1.2	15	11	1	1	9.9	13.4	15.9	19.7
Textiles and yarn	15.3	9.6	42	21	3	1	5.4	7.8	4.6	7.2
Apparel and clothing	48.7	60.8	54	47	8	7	10.2	15.3	8.8	15.9
Leather products	6.1	7.6	74	24	1	1	2.3	10.4	1.9	11.5
Footwear	6.5	16.1	67	18	1	1	7.5	10.6	7.4	10.0
Ceramics and glassware	6.2	8.7	27	13	1	1	5.1	6.3	3.8	8.2

Note: GSP countries only; LDCs may obtain deeper preferential treatment. China is included under EU GSP but excluded by the United States.

Source: World Integrated Trade Solution.

Table 6.2 Utilization rates for preference-eligible products with high MFN tariffs are low*Preference use by GSP recipients in the U.S. market, 2001 (percent, except where otherwise noted)*

Category	Total imports (billions of dollars)	Imports from GSP recipients (billions of dollars)	Share imported under GSP	Share under all preference programs	Average applied tariffs on all imports
Cut flowers	0.72	0.43	3	95	6
Prepared fish	0.72	0.47	7	13	9
Cane or beet sugar	0.56	0.41	29	77	6
Fruit, nuts	0.78	0.34	20	33	15
Unmanufactured tobacco	0.75	0.58	3	7	68
Acrylic alcohols	1.56	0.73	55	94	5
Ethers, ether-alcohols	1.78	0.34	84	84	5
Carboxylic acids	1.64	0.73	4	4	5
Trunks, suitcases	4.59	1.17	0	6	10
Articles of leather	2.68	0.52	18	21	8
Plywood and panels	1.10	0.46	18	22	5
Footwear	13.87	2.39	0	1	11
Apparel, knitted	25.00	11.50	0	25	14
Apparel, not knitted	35.10	15.90	1	15	14
Hats, headgear	0.96	0.33	0	2	7
Articles of jewelry	5.40	2.10	54	70	6

Note: Table reports data on imports (at the 4-digit HS classification) of products on which the United States applied tariffs that exceeded 4 percent in 2001, and where GSP recipient countries had significant exports to the United States.

Source: U.S. International Trade Commission.

to eligibility. Such conditions often relate to worker protection, human rights, intellectual property, and the environment.¹⁰

Recent initiatives by the European Union, the United States, and several other industrialized countries to provide either full or much increased duty- and quota-free access to their markets for exports from LDCs clearly improves the situation. However, excessively restrictive rules of origin remain an important impediment to full use of these deeper preferences, which, moreover, do not extend to many poor countries with substantial trade capacity.

The use of preferences is limited

All preferential programs, whether unilateral or reciprocal (under free-trade agreements), impose significant administrative costs related to enforcement of rules of origin.¹¹ These rules are imposed to prevent transshipment—that is, reexport of products produced in non-eligible countries. Rule-of-origin requirements and related inspection procedures can be quite costly. They also may be explicitly protectionist in intent. An example is the so-called triple transformation rule in textiles, which requires imported clothing to be made from textiles

produced with yarn spun in either the preference-granting or the beneficiary country. Although rules of origin are necessary for preferences to work and are beneficial in ensuring that value is added and employment created in the recipient country, it is important to ensure that rules of origin are not intentionally or inadvertently protectionist.

Rules of origin and associated paperwork and administrative requirements are likely to be a major reason that many eligible products do not enter developed-country markets under preference provisions—instead exporters pay the applicable MFN tariff. Except for certain alcohols, sugar, flowers, and jewelry, less than one-third of eligible exports from beneficiary countries entered the United States under any preference program in 2001 (table 6.2). An indicator of the restrictiveness of these rules is that only 65 percent of eligible apparel exports from the Caribbean and Central America enter the United States under all preference programs, despite a preference margin of more than 14 percent.

Limited use of preference programs is also observed in other countries. Sapir (1997) showed that in 1994, only one-half of Euro-

Table 6.3 Actual use of preference programs is declining*Quad country imports from GSP beneficiaries (billions of dollars) and ratio of use of available preferences (percent), 1994–2001*

Year	Total imports	Dutiable imports	Eligible for preference	Receiving preference	Rate of use of preferences (percent)
1994	448	283	162	83	51.1
1995	539	331	195	108	55.1
1996	585	351	178	100	56.0
1997	575	346	200	100	50.1
1998	543	311	183	74	40.6
1999	548	290	166	68	40.7
2000	623	308	171	72	42.0
2001	588	296	184	71	38.9

Source: Inama (2003).

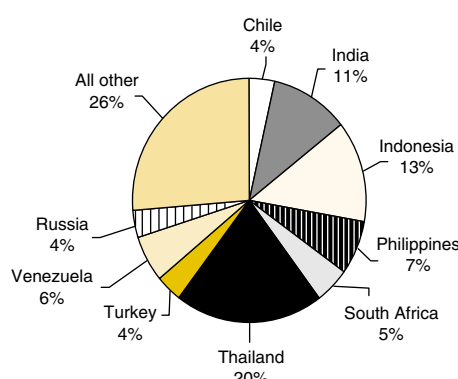
pean imports that could potentially benefit from GSP entered under this preferential regime, reflecting the combined effect of rules of origin and tariff quotas. In 2001, imports by the Quad (Canada, the European Union, Japan, and the United States) from GSP beneficiaries totaled \$588 billion, of which \$296 billion were subject to duties and \$184 billion were covered under various preferential programs (table 6.3). Only \$71 billion of the eligible exports actually received preferential treatment (approximately 39 percent of eligible exports). The share for LDCs, however, is higher at approximately 60 percent (Inama 2003), reflecting less restrictive treatment.

Who benefits from preferences?

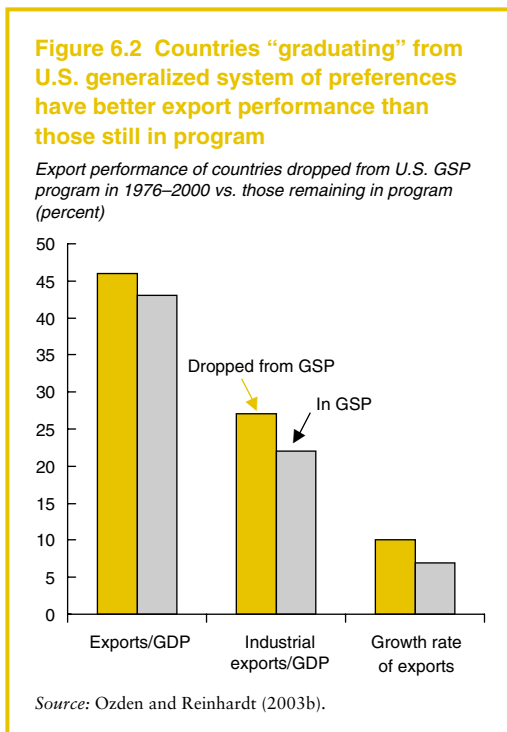
A relatively small number of mostly middle-income countries are the main beneficiaries of preference programs. These countries have the capacity to exploit the opportunities offered by meeting the administrative requirements. In 2001, 10 of the 130 eligible countries accounted for 77 percent of U.S. non-oil imports under GSP provisions (figure 6.1). The same countries accounted for only 49 percent of all imports from GSP-eligible countries. However, some small countries have benefited significantly from preferential access to markets where high tariffs, subsidies, or other policies are used to drive the domestic price of the product to levels well above the world market price. An example is Mauritius, which has

preferential access to the EU market for sugar and has been granted a relatively large quota (Mitchell 2003). Such benefits are obtained at high cost to EU taxpayers and consumers, and to other excluded developing countries.

There also is evidence that GSP programs are associated with success stories in countries with the capacity to benefit from access opportunities. Ozden and Reinhardt (2003b) compare the export performances of U.S. GSP beneficiaries with those of countries removed from eligibility (those said to have “graduated”). Their results suggest that countries removed

Figure 6.1 The benefits of U.S. trade preferences are distributed unequally*Top 10 beneficiaries of U.S. generalized system of preferences, 2001 (percentage of total GSP benefits)*

Source: USITC Dataweb.



from the GSP outperform those remaining eligible for GSP treatment (figure 6.2). Countries that are not on GSP tend to have higher ratios of exports to GDP, as well as higher export growth rates. This could be interpreted as evidence that for some countries—the successful ones—GSP played a role in generating the initial export expansion. While great care is required in attributing causality—clearly many other factors will be important in determining export performance—one reason for the better performance of countries that were removed from GSP is probably their own trade policies. Because import protection is equivalent to taxation of exports, liberalization is a precondition for substantially expanding exports.

Preferences have a hierarchy

The foregoing discussion has focused primarily on GSP. In practice, unilateral preferences granted by the European Union and the United States are implemented under many different programs (box 6.1). The differences

among these programs in product coverage, eligibility criteria, and administrative rules (especially rules of origin) have important implications, not only for the countries who benefit from them, but also for those excluded.

The United States, for example, has implemented the African Growth and Opportunity Act, the Caribbean Basin Initiative, and the Andean Trade Promotion Act, as well as several reciprocal free-trade agreements (with Israel, Jordan, and Mexico). Major EU programs include the Cotonou convention covering the African, Caribbean, and Pacific (ACP) countries, and the Everything-But-Arms initiative, which covers LDCs. The European Union also has concluded a large number of preferential trade agreements with neighboring countries in Europe, North Africa, and the Middle East (Schiff and Winters 2003).

These unilateral and reciprocal programs differ in several important respects from the GSP. First, they include sectors excluded by standard GSP programs—for example, apparel and food products. Thus, by 2009 Everything But Arms will cover all exports of beneficiary countries (the 49 LDCs) without exception—all duties and quotas will have been removed. Similarly, the Caribbean, Andean, and African programs of the United States include apparel, in contrast to its GSP program. Second, the administrative requirements of these deeper preferential schemes tend to be more relaxed regarding rules of origin and competitive needs tests (USTR 2002).

Notwithstanding these improvements, the overall impact of these programs has not yet been very significant, with the exception of apparel exports to the United States from certain African countries (more on this below). The share of LDCs in total imports of the United States and the European Union has not increased significantly in recent years (figure 6.3). In the case of Everything But Arms, this may reflect, in part, that the products that matter most to a number of LDCs—bananas, rice, sugar—will be liberalized only in 2006 or 2009. Most of the products exported by LDCs already were eligible for duty-free entry

Box 6.1 EU and U.S. preference programs

United States

Generalized System of Preferences (GSP): The U.S. GSP program has existed since 1976. Criteria for eligibility include not aiding international terrorists and complying with international environmental, labor, and intellectual property laws. Unlike the European GSP (see below), the U.S. program grants complete duty- and quota-free access to eligible products from eligible countries. China and several “graduated” countries are not eligible—among them Hong Kong (China), Republic of Korea, Malaysia, Singapore, Taiwan (China), and Malaysia.

Textiles and apparel, footwear, and many agricultural products are not eligible for the GSP. Certain products from certain countries can be excluded if the total exports pass the “competitive needs limit”—\$100 million per tariff line or \$13 million if the exporting country has more than a 50 percent share of U.S. imports. Total imports to the United States under GSP provision totaled \$14.5 billion in 2001, or 1.5 percent of total U.S. non-oil imports and 13 percent of all non-oil exports to the United States from GSP recipients. In most eligible sectors where the MFN tariff rate is above 5 percent, the share of exports entering under the program from eligible countries is only 30–40 percent, in part as a result of rules-of-origin requirements.

Caribbean Trade Preferences: The Caribbean Basin Economic Recovery Act (CBERA), commonly known as the Caribbean Basin Initiative (CBI), was enacted in 1984 and modified in 1990. Twenty-four countries are eligible. Duty-free treatment is granted on all products other than textiles and apparel, certain footwear, handbags, luggage, petroleum and related products, certain leather products, and canned tuna. In 1998, only 18 percent of exports from beneficiary countries were in eligible product categories. The 2000 Caribbean Basin Trade Partnership Act (CBTPA), provides NAFTA-equivalent treatment for certain items (mainly apparel) excluded from duty-free treatment under the CBI program.

Andean Trade Preferences: The Andean Trade Preferences Act (ATPA) extends preferences to Bolivia, Colombia, Ecuador, and Peru. Enacted in 1991 as part of U.S. efforts to reduce narcotic production and trafficking, it was modeled after the CBI and has similar eligibility requirements and product coverage.

Duty-free treatment is granted on all products except textiles and apparel, certain footwear, petroleum and related products, certain leather products, canned tuna, rum and sugar, syrup, and molasses. The main differences with GSP are that the Andean scheme covers more products, has more liberal qualifying rules, and is not subject to competitive need limits. ATPA rules of origin permit inputs from CBERA beneficiaries. ATPA was renewed in 2002 as the Andean Trade Promotion and Drug Eradication Act (ATPDEA) and expanded to include tuna, leather and footwear products, petroleum products, and apparel—subject, however, to restrictive rules of origin. For example, if apparel is assembled from U.S. fabrics, no quotas or duties apply, but if local inputs are used, duty-free imports are subject to a cap of 2 percent of total U.S. imports (increasing to 5 percent in equal annual installments).

African Trade Preferences: The African Growth and Opportunity Act (AGOA), passed in 2000, offers beneficiary Sub-Saharan African countries duty-free and quota-free market access for essentially all products. AGOA excludes textiles but extends to duty- and quota-free treatment for apparel made in Africa from U.S. yarn and fabric. If regional fabric and yarn are used, there is a cap of 1.5 percent of U.S. imports, increasing to 3.5 percent over eight years. African LDCs are exempt from all rules of origin for a limited period of time, helping to significantly expand apparel exports from countries such as Lesotho.

European Union

Generalized System of Preferences: Preferences under GSP are available to all developing countries, including China. Overall, 36 percent of tariff lines are eligible for reduced tariffs, and 32 percent are eligible for duty-free access. Twelve percent of tariff lines (mostly agricultural) are excluded and subject to full MFN duty. Excluded products include meat, dairy products, cereals, sugar, wine, and products for which the European Union sets minimum import prices. Approximately 36 percent of all products are classified as “sensitive”—often those with the highest MFN tariffs (Panagariya 2002). Sensitive products

(Continues on next page)

Box 6.1 (continued)

are subject to a flat 3.5-percentage point-reduction in the MFN tariff, implying that the higher the duty, the smaller the proportionate impact of the preference. Specific duties are reduced by 30 percent; if a product is subject to both ad valorem and specific duties, the specific duty is not reduced.

Additional tariff reductions are available under special incentive schemes for the protection of labor rights (an additional 5-percentage-point reduction), the environment (an additional 5 percentage points), and for countries that combat drug production and trafficking (duty-free access for certain products). Currently only one country, Moldova, has requested and satisfied the requirement relating to labor rights (but not the environment). A group of Latin American countries and Pakistan benefit from arrangements relating to drugs.

Countries can be excluded from the GSP (based on their development level) or from particular product categories. Sectoral exclusions are determined by specific criteria based on shares of EU imports from GSP-beneficiary countries and certain indicators of development and specialization.^a For example, Argentina is excluded from preferences for live animals and for edible products of animal origin, while Thailand is excluded from preferences for fishery products.

ACP countries (Cotonou Agreement): ACP countries are granted preferences that often exceed those available under the GSP. Most industrial prod-

ucts are duty and quota free. Preferences are less comprehensive for agricultural products. In 2000 duties were still applied to 856 tariff lines (837 of which were agricultural products). Of these, 116 lines were excluded from the Cotonou Agreement, although specific protocols govern access for sugar and bananas on a country-specific basis. An additional 301 tariff lines were eligible for reduced duties, subject to specific quantitative limits (tariff quotas) set for the ACP countries as a group. The remaining 439 products were eligible for reduced duties without limits on exported quantities.

Everything But Arms: Introduced in March 2001, this program grants duty-free access to imports of all products from the LDCs, with the exception of arms and munitions, without any quantitative restrictions. Liberalization was immediate except for three major products: fresh bananas, rice, and sugar. Tariffs on these three items will be reduced gradually to zero (in 2006 for bananas; in 2009 for rice and sugar), while tariff quotas for rice and sugar will be increased annually. Access to the EU market is governed by the rules of its GSP scheme. A key feature of the program is that in contrast to the GSP, preferences for the LDCs are granted for an unlimited period and are not subject to periodic review.

a. Some ad hoc exclusions are applied to China, the CIS countries, and South Africa in the fisheries and iron and steel sectors.

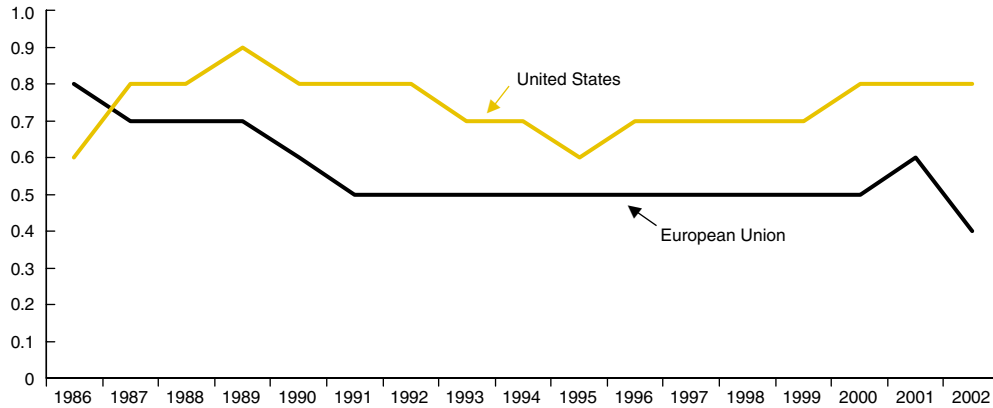
under GSP or Cotonou provisions. As a result, Everything But Arms had no immediate impact (Brenton 2003). In the case of the United States, export market shares of countries eligible under the three primary deep preference programs have not increased (figure 6.4).¹²

The primary exception is apparel, which shows remarkable export growth, especially in the case of AGOA. Total exports of apparel since 1996 increased by more than 200 percent for AGOA countries, and approximately 60 percent for Caribbean and Andean countries. As a result, in 2002, apparel exports to the United States from AGOA countries were ap-

proximately \$1.1 billion, compared to \$750 million from Andean countries and \$9.5 billion from Caribbean countries. These countries accounted for some 20 percent of the \$58 billion U.S. apparel import market. This growth is mainly a result of exemptions from quotas and tariffs imposed on other exporters. In the case of AGOA, rules of origin are removed temporarily for some countries for a limited period, providing an extra advantage. A crucial issue is how these regions will fare when remaining quotas (mostly faced by countries in South and East Asia) are phased out at the end of 2004, as required by the WTO

Figure 6.3 Preferences have not increased the share of the least developed countries in imports into the European Union and the United States

Share of LDCs in total imports of European Union and United States, 1966–2002 (percent)



Source: WITS.

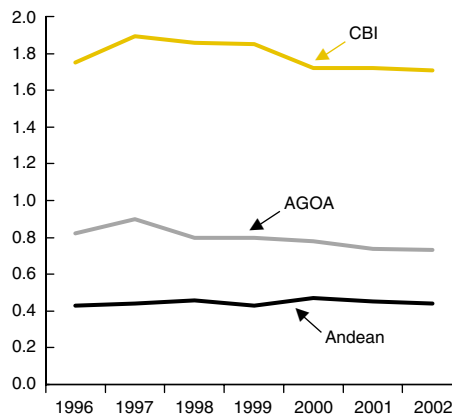
Agreement on Textiles and Clothing. This is also the time when liberal rules of origin under AGOA are set to expire. Competitive pressures are likely to increase substantially, giving rise to a need for adjustment and for investment programs to improve productivity and diversification of the export base. Extending the liberal rules of origin under AGOA would help reduce the impact of the abolition of the remaining import quotas on textiles and clothing.

The available evidence suggests that preferences by industrialized countries have the greatest effect on developing-country exports if they are granted on a reciprocal basis as part of a deep regional free-trade agreement. Spanish exports to the European Union and Mexican exports to the United States rose dramatically following accession to the European Union and NAFTA, respectively (figure 6.6). This supply response is not just the result of removing import barriers by northern partners, but also of the “regime change” that occurred in these countries and the consequent change in risk premiums, uncertainty, and investment incentives. A large part of the regime change involved changes in investment, regulatory, and administrative policies, not just preferential trade liberalization. These data

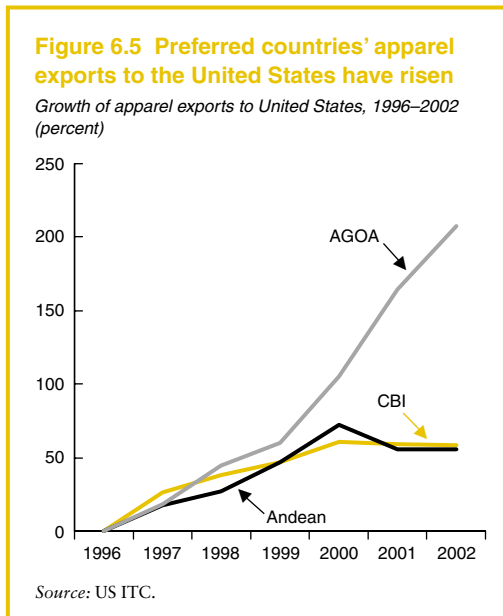
therefore suggest that a reciprocal liberalization strategy supported by complementary domestic policies may have a much larger impact than unilateral preferences.

Figure 6.4 Market shares of countries eligible for three U.S. “deep preference” programs have not increased

Shares of AGOA, Andean, and CBI countries in U.S. imports (excluding oil and precious metals), 1996–2002 (percent)



Source: US ITC.



Preferences have unintended consequences

Numerous side effects of unilateral preferences also must be considered when assessing the case for them. Preferences can lead to more protectionist trade policies in recipient countries. Ozden and Reinhardt (2003b) show that U.S. GSP recipients implement more protectionist trade policies than countries removed from the GSP program (figure 6.7). Although their finding does not prove causality, preferences can decrease the incentives for domestic exporters to mobilize in favor of more liberal trade policies. Because domestic trade policies affect developing countries' growth prospects more than barriers in their export markets, the perverse-incentive effect of unilateral preferences may be quite damaging. Similarly, preferential market access may lower the incentives for developing countries to participate actively in multilateral negotiations, in part because they believe that they will not receive any further concessions in the multilateral process or because of concerns about erosion of preferences. The latter may create conflicts of interest between preferred and nonpreferred developing countries. To the extent that countries specialize in similar product categories

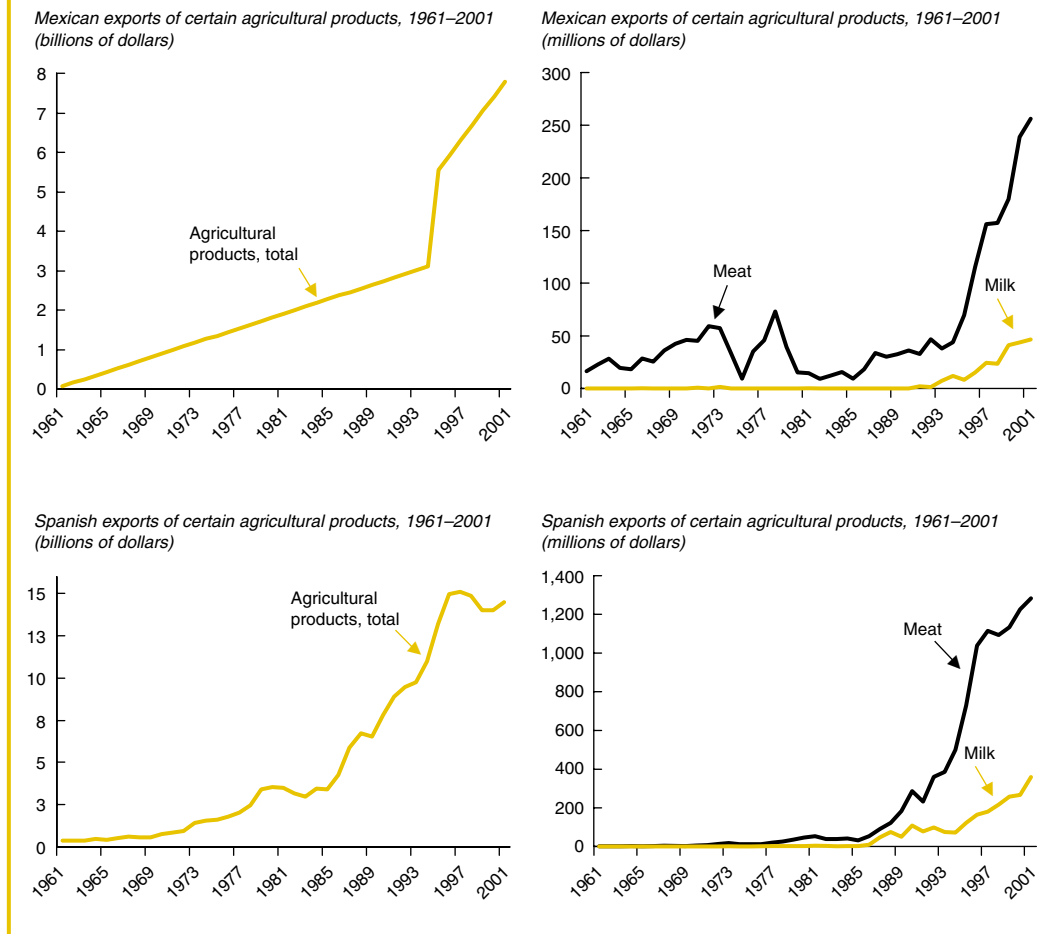
and sell at low margins in competitive markets, even small preferences in certain categories could make a difference for some countries, fueling those conflicts of interest.

As an example, 36 countries in Sub-Saharan Africa are eligible to export apparel products into the United States without any tariffs or quantitative restrictions under AGOA. These countries risk losing preference margins if MFN protection is reduced in the United States. Many of these countries temporarily face no rules of origin requirements. Twenty-four countries in the Caribbean and Central America enjoy similar privileges under the CBPTA. Through bilateral NAFTA preferences and unilateral Caribbean and African preferences, beneficiary countries managed to increase their share of U.S. apparel imports to around 32 percent (figure 6.8). Such countries may be concerned about the erosion of their preferences if MFN protection is reduced.

Sugar is a product for which preference erosion will have important consequences for several countries. Quota allocations in protected markets, such as the European Union, are currently very concentrated in a few countries that tend to have high costs relative to other producers. For example, Mauritius has 38 percent of EU quotas (Mitchell 2003). Given the extension by 2009 of duty- and quota-free access to the EU market for all LDCs, Mauritius will confront much greater competition in the EU market.

Most of the academic research on preference programs has concluded not only that they generally yield modest export increases (at best), but also that a significant portion of these gains is because of trade diversion from nonbeneficiaries. Multilateral liberalization would reduce some of the detrimental effects of preferential access to highly distorted markets. For example, moving to free trade in sugar markets not only would result in estimated global welfare gains (the sum of producer, consumer surpluses, and tax revenues) of \$4.7 billion, but also would yield a 38 percent increase in world sugar prices and boost sugar trade by about 20 percent. Brazil alone

Figure 6.6 Agricultural exports from Mexico and Spain rose dramatically after the two countries joined regional trade blocs



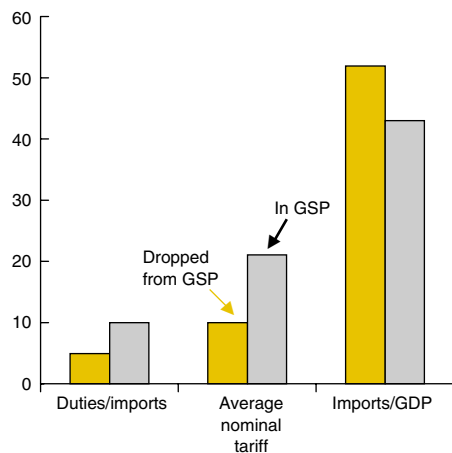
would experience a real income gain of some \$1.6 billion. Although countries such as Mauritius could lose significantly, coordinated global liberalization across all products would offset some of the lost rents. World sugar price increases alone would offset about one-half of the lost quota rents for countries that currently have preferential access. Moreover, the loss in preference rents would be much less than is commonly expected, because many of the beneficiaries are high-cost producers. Indeed, the cost to the European Union and United States of providing each \$1 of preferential access has been estimated to be more than \$5—a very in-

efficient way to provide development assistance (Beghin and Aksoy 2003).

How much preferences are likely to be eroded as a result of further multilateral trade liberalization will depend both on the benefits countries currently obtain from preference programs and the speed with which preferences are eroded. The foregoing discussion suggests that the overall benefits of unilateral market access preferences are limited by exclusions for sensitive products, rules of origin, and limited supply capacity. The fact that a substantial share of total exports from eligible countries under AGOA and Everything But Arms preferences

Figure 6.7 The trade policies of countries in the U.S. generalized system of preferences are more protectionist than those of countries not in the program

Import policies of countries in U.S. GSP versus those of countries dropped from GSP (percent)



Source: Ozden and Reinhardt (2002).

do not enter duty free (Inama 2003, Brenton 2003) is one illustration.

One way of obtaining a sense of the magnitude of possible preference erosion is first to assume that LDCs obtain full preferential access to Quad markets and then to assess the impact of a reduction in MFN tariffs. A recent exercise along these lines suggests that the aggregate impact of a 40 percent reduction in average MFN tariffs would lower LDC exports by about \$440 million, or 1.6 percent of total exports (IMF 2002). This estimate does not take into account terms-of-trade changes from the MFN tariff reductions, which on average can be expected to be positive for exporting countries, reducing the losses from preference erosion. Moreover, in practice, it is likely that part of the rents from preferences accrues to the importing countries, and especially to intermediaries (Tangermann 2002). Account also should be taken of the benefits to countries with preferences of the erosion in preferential access of other countries—especially members

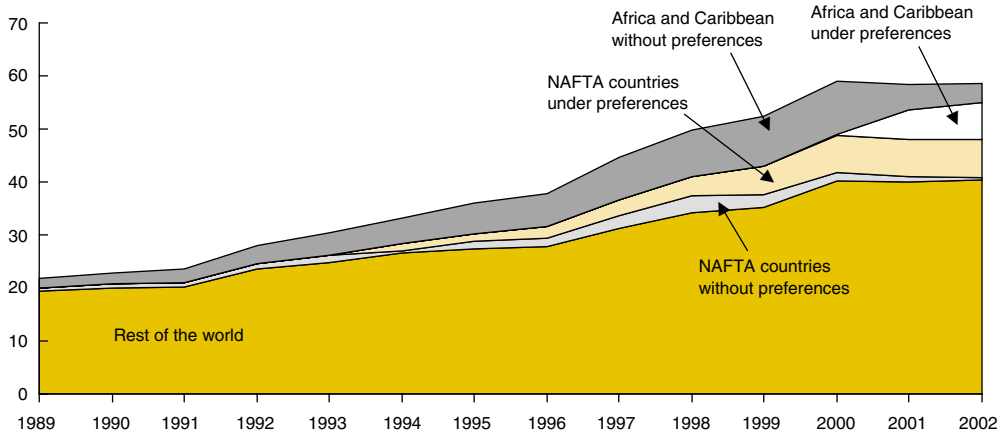
of free-trade agreements—and, as noted earlier, of the impact of rules of origin. As MFN tariffs are by definition not associated with rules of origin, such liberalization may well result in export gains for countries in products that in principle benefit from preferences. Thus, it may be more beneficial for developing countries to obtain more secure MFN reductions on their key exports than to seek to preserve preference margins on products with relatively high MFN tariffs (Laird, Safadi, and Turini 2003).

The available evidence and analysis suggests that preference erosion is unlikely to be a major issue for many countries, given that automatic compensation will result from broad-based multilateral liberalization of market access. However, specific developing countries and sectors in these countries may be hurt, and resources for adjustment need to be mobilized and allocated. Governments should prepare by determining where adjustment needs are likely to be most significant, so that technical and financial assistance can be provided. Actions of the type discussed in chapters 2 and 5 to facilitate trade, complemented by the adoption of more liberal rules of origin, will help to attenuate the impact of preference erosion.

The low share of exports entering under preferences, and the recent research suggesting that rules of origin play a role in that low share, suggest that the rules used to determine origin should be simplified. The recent experience under AGOA, under which several beneficiary countries significantly expanded apparel exports to the United States after origin restrictions were relaxed, illustrates this point. The WTO includes an Agreement on Rules of Origin that aims to foster the harmonization of the rules used by members. The agreement calls for a work program to be undertaken by a Technical Committee, in conjunction with the World Customs Organization, to develop a classification system regarding changes in tariff subheadings based on the Harmonized System (Hoekman and Kostecki 2001). The harmonization program provides a potential

Figure 6.8 Countries enjoying preferences have increased their exports of apparel to the United States

U.S. apparel imports, 1989–2002, by source (millions of dollars)



Source: U.S. International Trade Commission.

solution to rules-of-origin problems. While the harmonized rules are intended to be applied in cases of nonpreferential commercial policy—tariffs, import licensing, antidumping—they could be applied to preferential trade as well. A recent proposal by Canada to use a common value-added criterion and to allow for comprehensive cumulation (extending to major players such as China) is an alternative approach. Yet another option is to emulate the “visa” procedure for textile products used under AGOA—this could help to substantially reduce uncertainty for traders. Indeed, minimizing uncertainty is a critical feature of making preferential regimes effective.¹³

The ultimate goal is MFN-based, reciprocal liberalization

MFN-based market access will have the greatest beneficial impact on development.¹⁴ One reason is that it implies that elements of “reverse SDT”—special opt-outs and exemptions that benefit interest groups in industrialized countries at the expense of developing countries—will be removed. Eliminating agricultural subsidy programs, high protection for

textile and apparel products, tariff peaks, and tariff escalation would not only be beneficial to developing countries (and developed-country consumers), but also would facilitate further trade reforms in developing countries.

Developed *and* developing countries alike could affirm their commitment to poverty alleviation by accepting an ambitious program of liberalization that would include the abolition of export subsidies, substantial decoupling of agricultural support, and significant reduction of MFN tariffs on labor-intensive products of export interest to developing countries. The program must include significant trade liberalization by developing countries, a major source of the total potential gains. MFN liberalization should extend to middle-income countries, which are among the most dynamic markets in the world and where trade barriers are often substantially higher than in developed countries, and would usefully extend to LDCs as well.

In defining negotiating modalities to pursue desired MFN liberalization, WTO members should set a concrete timetable and agree on specific benchmarks for product coverage and

maximum tariffs. The challenge is to identify reciprocal commitments that make economic sense and support development. The overuse of nonreciprocity in past market-access negotiations has excluded developing countries from the major source of gains from trade liberalization—namely the reform of their *own* policies. Nonreciprocity is also a reason why tariff peaks today are largely on goods produced in developing countries. A willingness to pursue liberalization at home is critical to increase developing countries' participation in global trade, particularly South-South trade, which is subject to significant barriers (see chapter 3).¹⁵

Services are of great importance to development—it is difficult for firms to be competitive in the absence of efficient services sectors. Substantial opportunities exist to expand developing-country services exports and to liberalize further access to developing-country markets. While the latter would bring the greatest gains, temporary access to service markets (particularly labor markets) in developed countries also would generate large gains for developing countries (see chapter 4). In addition, binding the current set of liberal policies applied to cross-border trade (GATS Modes 1 and 2) would assist governments in pursuing domestic reforms. Many developing countries have begun to exploit opportunities offered by the Internet and telecommunication networks to provide services through cross-border trade. Currently such trade is generally free of restrictions, but that freedom is not locked in through the GATS (Mattoo 2003).

Toward a new regime for WTO rules

Several WTO agreements offer developing countries some latitude to pursue restrictive trade policies and provide transition periods and technical assistance to help in implementing agreements (box 6.2).¹⁶

Should trade rules apply to all developing countries? If so, should account be taken of differences in national capacities to implement and benefit from multilateral rules? In answer-

ing these questions, it is helpful to distinguish between (a) agreements and disciplines that pertain to the core business of the WTO—traditional trade policies such as tariffs, quotas, and export subsidies—and (b) rules whose implementation requires significant resources or the existence of well-functioning complementary institutions. With respect to the first category, developing countries would benefit from abiding by the same trade-policy disciplines that apply to developed countries. The overwhelming conclusion in the economic literature is that traditional trade-policy instruments should not be used in pursuit of development objectives.¹⁷

A country's trade policy is a key link in the transmission of price signals from the world market to the national economy. Undistorted price signals from world markets, in combination with an exchange rate that reflects macroeconomic conditions, encourages efficient resource allocation consistent with comparative advantage. An open trade regime gives consumers and firms access to a greater variety of goods and services, including capital and intermediate goods, and contributes to productivity growth through access to global technology and by forcing domestic firms to become more efficient.

Although numerous arguments have been developed that potentially provide a rationale for intervention to protect infant industries—most of which revolve around some type of market failure or externality—trade policy is rarely if ever an appropriate instrument. Moreover, well-known political economy problems are associated with protection of infant industries. The prospect of protection can give rise to unproductive rent-seeking behavior with associated scope for (legal) lobbying and (illegal) corruption (Bhagwati 1988). Moral hazard problems can easily arise because the reward for an industry doing well is the removal of protection, which can generate perverse incentives for firms to underperform so as to retain protection.

Economic first principles suggest that a subsidy-type policy generally will be less distorting (more efficient) than trade policy in offsetting

Box 6.2 Major WTO provisions allowing developing countries greater freedom to use restrictive trade policies

Infant industry protection. GATT Articles XVIII:a and XVIII:c allow for removal of tariff concessions or use of quotas if necessary to establish an industry in a developing country. Compensation must be offered to countries that would be negatively affected.

Balance-of-payments protection. Article XVIII:b allows a nation to impose trade measures to safeguard its balance of payments. In contrast to Articles XVIII:a and c, surveillance and approval procedures are less burdensome, and compensation need not be offered to affected countries. Not surprisingly, no country has invoked the infant industry provisions of the GATT since 1967, but numerous countries have made use of Article XVIII:b. In the Uruguay Round, Article XVIII:b was revised and surveillance procedures were tightened. WTO members must now publicly announce time schedules for the removal of restrictive import measures taken for balance of payments purposes and must, in principle, use price-based measures (such as tariffs).

Subsidies: The WTO Agreement on Subsidies and Countervailing Measures (ASCM) attempts to distinguish between subsidies (defined as financial contributions by government) that can be justified on the grounds of market failure, or on noneconomic

grounds, and those that distort the incentive to trade in a major way. Nonspecific subsidies (defined as those for which access is general or eligibility automatic on the basis of clear, objective criteria) are permitted and cannot be countervailed. Subsidies contingent on export performance or on the use of domestic rather than imported goods are generally prohibited. Permitted measures that create “serious prejudice”—defined to exist if the total ad valorem subsidization of a product exceeds 5 percent, if subsidies are used to cover operating losses of a firm or industry, or if debt relief is granted for government-held liabilities—can be countervailed or disputed. Subsidies that can be shown to have had a negative effect on a partner’s exports likewise may be countervailed or disputed. LDCs and countries with GNP per capita below \$1,000 are exempted from the prohibition on export subsidies. Developing countries that have become competitive in a product—defined as having a global market share of 3.25 percent—must phase out any export subsidies over a two-year period.

Source: Hoekman and Kostecki (2001).

an externality. From an economic viewpoint, the drafters of the GATT were therefore justified in placing relatively stringent constraints on the use of trade policy, and in particular, on the use of quantitative restrictions and local content requirements. Moreover, in cases in which import competition proves too fierce, the WTO allows for safeguards—emergency protection through safeguards. However, WTO safeguard provisions impose conditions that enhance certainty and help ensure that interventions are made only for good cause.

The foregoing does not imply that developing countries should be forced to sign away their ability to use trade policies—all countries have the right under the WTO to impose tariffs or export taxes if they so desire. Committing to

abide by the same rules on the use of traditional trade policies that pertain to developed countries, however, will benefit consumers and enhance welfare in developing countries.

The WTO does not identify or constrain what governments can do in the realm of non-trade policy to maximize the benefits of trade. As emphasized by Stern (2002), any credible poverty reduction strategy must rest on two pillars: a good investment climate to propel growth, and empowerment of poor people through participation in decisions that shape their lives. Although a sound trade policy is a major element of any successful development strategy, other factors are equally important. Institutions to manage the distributional implications of trade reforms and to ensure that

consumers, enterprises, and farmers have access to competitive markets for goods and services are critical to harnessing greater trade for development.

Nor does the WTO constrain the ability of governments to address market failures through subsidies or taxes. In many cases the intervention required to address an externality will be horizontal (general), not sector- or industry-specific, and thus be nonactionable. For example, food subsidies, household energy subsidies, and health and education programs are not vulnerable to WTO action. Similarly, factor-use subsidies—for example, for the wages of workers taken directly off the unemployment rolls—are permissible unless they are configured in such a way as to make them *de facto* subsidies to specific sectors. Overall, therefore, the sorts of subsidies of most use in fighting poverty and offsetting market failures are not constrained by WTO disciplines (McCulloch, Winters, and Cirera 2001).

Several policy options are open for future rules and regulations

Some developing countries and many civil society groups have charged that some WTO agreements do not support development. In such cases, the appropriate solution may be to reopen (renegotiate) agreements where members perceive the rules to be unbalanced or detrimental to their interests. This has been the approach taken by some proponents of the so-called Development Box in the Agreement on Agriculture (box 6.3). It is also the approach that has been suggested by the chair of the WTO General Council to address several proposals made by developing countries on SDT. In addition to the Agreement on Agriculture, an agreement often viewed as unbalanced is the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS).¹⁸

One lesson that emerged from the Uruguay Round is that it is important but difficult to assess what makes sense from a development perspective. In large part this is a reflection of the absence of strong trade interests and stake-

holders in developing countries who might inform their governments of their preferences and clarify the implications of various proposals (Finger 2001; Hoekman 2002). As a result, the “trade-related” aspects of international issues are often identified by constituencies in major trading powers and may not have much relevance for development.

Because countries differ widely in their domestic priorities and in their capacities to implement change, it is as important as it is difficult to identify how and where development will be promoted by proposals to expand the reach of the WTO into (new) regulatory areas.

With respect to behind-the-border policies affecting trade, it is difficult to design generic rules that apply to all. Even if negotiators get the economics right, there is a danger that good policies may be resisted. Dealing with these types of issues in the context of negotiation may also induce a predominant focus on costs, as reforms will be seen as concessions to foreign interests, as opposed to being in the national interest (Finger 2002). Given their complexities and the limited negotiating resources available in most low-income countries, such issues may be best left off the negotiating table (Winters 2002). However, if negotiations are launched on these topics, it will be important to recognize that for many countries they may not have a high priority.

Differential interests and capacities must be recognized

As noted previously, the challenge is to get the rules right from a development perspective. Even if this is done, in the sense that constituencies in developing countries are enthusiastic about what has been negotiated and governments regard implementation as being in the national interest, other issues may constitute a higher priority for investment of scarce administrative and financial resources.

These observations suggest the need for differentiation among developing countries in determining the reach of WTO rules that are resource intensive; that is, those that require

Box 6.3 A “development box” for the Agreement on Agriculture?

The primary focus of the Uruguay Round Agreement on Agriculture was to bring this sector back into the trading system—that is, to reimpose multilateral disciplines on trade-distorting domestic support policies. A major feature of the agreement was to distinguish between permitted subsidies (the “green box”) and subsidies subject to reduced commitments and disciplines. Because the objective of negotiators in the Uruguay Round was to reduce distorting types of support, it does not cover the types of market imperfections likely to be found in developing countries, nor does it recognize their need to pursue “second-best” policies where they do not have the institutional capacity to pursue the most efficient policies to combat poverty. As a result, several countries have sought to introduce a “development box” into the agreement, which would identify a set of measures to enhance food security, stimulate agricultural production, and reduce rural poverty in developing countries. Examples of such proposals:

- Direct and indirect investment and input subsidies or other supports to households below the national poverty level to encourage agricultural and rural development. Such supports could be product-specific as well as general, as long as they are effectively targeted to the rural poor.
- Programs supporting product diversification in small, low-income developing countries currently dependent on limited commodities for their exports, including programs involving government assistance for risk management.
- Domestic foodstuffs at subsidized prices in targeted programs aimed at meeting food requirements of the poor, whether urban or rural, as part of an overall effort to enhance food security.
- Transportation subsidies for agricultural products and farm inputs to poor remote areas.
- Programs involving government assistance for establishment of agricultural cooperatives or other

institutions that promote marketing, quality control, or otherwise strengthen the competitiveness of poor farmers.

- A “special” safeguard provision, available only to developing countries, to provide rapid, time-limited protection against import surges that hurt poor producers, especially dumped imports of subsidized goods.
- Acceptance that some products—especially key staple commodities critical to food security—would not be subject to liberalization commitments.

While often defended as examples of needed preferences, proposals for a development box effectively involve changing the terms of the Agreement on Agriculture. Many of the provisions have been included in the “Harbinson” draft, which suggests approaches for future liberalization commitments in the Doha negotiations on agriculture (WTO 2003). The draft also contains a large number of provisions permitting developing countries far greater leeway in protecting agriculture through border measures such as tariffs and tariff quotas than would be the case for developed countries. Such policies may be justified because low-income developing countries do not have the fiscal capacity to support agriculture through less trade-distorting direct-income supports, but they may lead to the same inefficiencies that have undermined competitiveness of many industries nurtured behind high protective barriers. While getting the economics right is important and requires careful analysis, the efforts to alter the terms of the Agreement on Agriculture is arguably the most appropriate method of addressing rules that are not perceived to support development.

Sources: Ruffer, Jones, and Akroyd (2002); Hoekman, Michalopoulos, and Winters (2003).

significant complementary legal, administrative, and institutional investments or capacity or that will result in large transfers from developing countries. The basic rationale for differentiation is that certain agreements may not be development priorities for some countries or may require that other preconditions be satisfied before implementation can be beneficial. Such preconditions can be proxied by the attainment of a minimum level of per capita income, institutional capacity, and economic scale (size). Some WTO disciplines may not be appropriate for very small countries, for example, in that the regulatory institutions required may be unduly costly.¹⁹

Several options could be considered to take country differences into account in WTO agreements.²⁰ Options include:

- Adopting a rule of thumb that makes a group of countries eligible to opt out of provisions that entail substantial implementation costs until specific criteria or benchmarks have been met. This rule would require renegotiating the current set of country groups recognized in the WTO (the LDCs, all developing countries, and developed countries). It would also require establishing criteria to identify which agreements are affected.
- Establishing an agreement-specific approach under which application of rules to any given country is determined by agreement-specific criteria, possibly linked to availability of technical assistance and an action plan for implementation.
- Adopting a country-specific approach that places trade-reform priorities in the context of national development plans as defined in Poverty Reduction Strategy Papers, and relying on multilateral monitoring to establish a cooperative framework under which countries may be assisted in gradually adopting WTO norms.

A common feature of these possibilities is that they require a narrower definition of eligibility for temporary exemptions from WTO

rules. Country classification is inevitably a sensitive issue, as is the question of determining the “coherence” of WTO rules with national development priorities and identifying the implications of different types of WTO rules. What constitutes “resource intensive,” for example? And what agreements would give rise to large implementation costs? These questions will require analysis. Determining implementation criteria would require input from relevant development institutions, national and international, to strengthen policy coherence at both levels. One advantage of an agreement-specific “implementation audit mechanism” is that it could avoid explicit country classifications, giving rise instead to a monitoring process to support developing countries in managing trade reforms and implementing WTO agreements by recognizing competing demands on scarce resources.

Involving development agencies may reduce the risk of inducing countries to adopt and pursue a program of trade and regulatory reform that may not, in fact, be suited to the country. During the Uruguay Round many countries were concerned about avoiding possible “cross-conditionality” between WTO and international financial institutions; this led to a ministerial declaration on “coherence” to call for “avoiding the imposition on governments of cross-conditionality or additional conditions” resulting from cooperation between the WTO and the international financial institutions.²¹ Indeed, care would be required to avoid “cross-conditionality.”

Several alternative options may therefore be feasible in recognizing differences in the ability to benefit from implementation of resource-intensive rules. Deciding on the best approach will require considerable thought and discussion. What matters most at this point is that WTO members acknowledge the issue. It might be expeditious to make a decision in Cancun to consider alternative approaches along the lines sketched out above. Given the steady expansion of the WTO into regulatory areas, doing so would help make development relevance more than a slogan.

WTO commitments must be enforced through monitoring and dispute settlement

While getting rules right is important, so is enforcement and accountability. Two aspects of enforcement of commitments are particularly important. The first is regular information on implementation of agreements and complementary actions being pursued in other forums and organizations. The second concerns the ability of developing countries to use WTO dispute-settlement mechanisms in instances in which partners have not respected the terms of an agreement. Developing countries may be at a disadvantage in using such mechanisms because of resource constraints and lack of retaliatory power. Proposals to address such biases are discussed below.

Strengthened assessment and monitoring

Strengthening mechanisms for regular monitoring of implementation of agreements and performance of both developed and developing countries would help improve transparency and accountability. This should extend to the provision of information on national trade-related priorities by developing countries, the funding and investment requirements these priorities involve, and the extent to which international and bilateral donors have provided assistance. A first step in compiling information on assistance provided was taken in 2002 by the WTO and the Development Assistance Committee of the Organisation for Economic Co-operation and Development (OECD), building on a database of bilateral and multilateral development projects. The WTO's *Trade Policy Reviews* provide a potential mechanism for bolstering monitoring, although the publication schedule of reports would need to be increased for timely information to be made available to WTO members. The type of mechanisms to put in place would depend in part on the approach taken to determine the reach of resource-intensive rules.

The weaker social safety nets and insurance mechanisms in the developing world, as well as higher rates of poverty and vulnerability to

external shocks, suggest that more attention and resources should be devoted to costing out the implementation requirements of proposed rules and to calculating their costs and benefits. The multiagency Integrated Framework for Trade-Related Technical Assistance could be used to support this objective in LDCs. Developing-country think tanks and policy research networks—for example, the Global Development Network—also have an important role to play in assisting governments with the required assessments at the national level, supported by bilateral and multilateral development institutions.

Dispute settlement

Whatever agreements eventually emerge from the Doha Round, enforcement will be important. But how well can low-income countries defend their rights in the WTO? During 1995–2002, 305 bilateral disputes were brought to the WTO, entailing over 1,800 “grievances”—specific allegations of violation of a WTO provision (Horn and Mavroidis 2003). Developing countries brought 123 of the 305 disputes, about one-third. Most of these complainants were middle-income economies. Low-income countries (defined by Horn and Mavroidis as those with a per capita income below \$800) were complainants in only 18 cases and respondents in only 21. LDCs did not participate at all—they never acted as complainant or respondent. Thus, well over half of the WTO membership does not participate in WTO dispute settlement.²²

That many developing countries have not participated in WTO dispute settlement reflects the manifold challenges of such participation. A first challenge to defending rights through the WTO is obtaining knowledge that a WTO provision may have been violated by a partner government. A second is convincing the government to bring the case forward—enterprises alone have no legal standing before the WTO. A third is expectation of a positive payoff from bringing a case—a function of the remedy available and the likelihood that the trading partner will actually implement it.

Small countries cannot credibly threaten retaliation—the ultimate threat that can be made against a member that does not comply with a WTO panel recommendation—because raising import barriers will have little impact on the target market, while being costly in welfare terms.²³ Thus, pressure to comply with panel rulings is largely moral. In practice, the system has worked rather well, in that recourse to retaliation has rarely been required to enforce multilateral dispute-settlement decisions. This is a reflection of the repeated nature of WTO interactions and the resulting value that governments attach to maintaining a good reputation. Nonetheless, asymmetry in enforcement ability can affect incentives to use the system. The classic recommendation by economists to address the problem is to change the rules so that nonimplementation of panel recommendations would be punished by withdrawal of market-access commitments by *all* WTO members. But suggestions to this effect have always been resisted (Hudec 1987, 2002).

Retaliation involves raising barriers to trade, which is generally detrimental to all parties. The power of retaliation may also be captured by protectionist interests in an importing country. A superior approach would be to strengthen compensation provisions. Developing countries have proposed, for example, that WTO panels should be authorized to recommend payment of financial compensation in cases where a developing country loses its trade in a product as a result of actions by a developed country that are inconsistent with WTO norms.²⁴ Such suggestions have a long history (Hudec 2002).²⁵ Mexico recently suggested allowing countries that have won a dispute but where implementation has not occurred to auction off the resulting retaliation rights.²⁶

While compensation or fines would be less distorting than trade sanctions, they may not be very effective in inducing compliance, as the costs would disperse among all taxpayers. Other options should therefore be considered, including stronger surveillance mechanisms and greater opportunities for interested parties to bring cases in national forums. Whatever is

done, it is important to halt the emerging trend toward escalating retaliation and the use of trade sanctions.

Aid for trade: addressing national priorities

Trade capacity is critical in ensuring that low-income countries are able to benefit from trade opportunities. Numerous studies—most recently the Diagnostic Trade Integration Studies undertaken in LDCs under the auspices of the Integrated Framework initiative—have identified institutional weaknesses and an adverse investment climate as a major source of comparative disadvantage.²⁷

The reports reveal that many countries remain largely without the appropriate institutional frameworks and systems to manage their trade policy and that trade costs severely limit the competitiveness of developing-country firms in export markets. Transport costs are often the single most important component of cost for exporters in several of the countries. The transport sectors (air, ports, trucking) are often plagued by a lack of domestic competition (see chapter 5).

These anticompetitive conditions impinge directly on the welfare of the poor. In most LDCs, the majority of poor households derive their income from agriculture and agro-processing. Agricultural trade integration can therefore increase both productivity and rural incomes by providing better access to modern inputs and technologies and by encouraging exports.²⁸ In addition to the fragmentation of markets and the remoteness of many farming communities, binding constraints include transportation bottlenecks that, combined with numerous informal fees and internal checkpoints, lead to high transaction costs (in Ethiopia, Guinea, and Nepal), lack of basic post-harvest marketing infrastructure (in Ethiopia, Guinea, Malawi, Mauritania, and Yemen), lack of water control infrastructure (in Ethiopia and Senegal), and a pervasive degradation of natural resources (Tsikata 2003). To improve competitiveness and extend the benefits of trade to the poorer segments of the population, better

domestic market integration should be a key policy objective in many LDCs.

Development assistance can play an important role in bolstering trade capacity, thereby allowing countries to benefit from liberalized access to international markets. Additional funds are needed to address both policy and public-investment priorities, to help low-income countries adapt to a reduction in trade preferences following further nondiscriminatory trade liberalization, and to assist poor net-importing countries to deal with the potential detrimental effects of a significant increase in world food prices, should these materialize. The world community made general commitments to this effect at the International Conference on Financing for Development in Monterrey in March 2002—the need now is to translate the “Monterrey consensus” into identification and financing of trade-related investment priorities.

Although more “aid for trade” would be beneficial, it is important to avoid a situation in which a desire by donor countries to see developing countries implement certain WTO agreements diverts assistance away from recipients’ own development priorities. This is one of the risks of suggestions to make technical assistance a requirement of new WTO rules and to link implementation of WTO agreements to the provision of such assistance. Ideally, identification and delivery of trade-related technical assistance should be embedded in the national policy-setting processes used by governments and the donor community—for example, the Poverty Reduction Strategy Papers. This would ensure that trade priorities are considered for funding along with other development priorities.

Putting development into the Doha agenda

Putting development into the Doha agenda requires actions by developing and developed countries alike. Interests and priorities differ from country to country, but improved access to markets in agriculture, manufactures, and services would be most beneficial.

In fact, liberalized market access on an MFN basis has the greatest potential payoff, in terms of development and poverty reduction, of any issue on the Doha agenda.

Because duty- and quota-free access to major markets can help to offset the many disadvantages that confront firms in poor countries, developed countries should continue to grant trade preferences to LDCs and similarly disadvantaged countries, emulating Europe’s Everything But Arms initiative. To maximize the benefits of such deep preferences, concerted action should be taken to minimize the trade-restricting effect of rules of origin and related administrative requirements.

But preferences are best viewed as a transitional instrument. What matters most in any effort to expand exports on a sustained basis is a good investment climate, including openness to trade. Indeed, most of the potential gains from trade reform could be realized by *unilateral* liberalization.

Traditional forms of preferential treatment cannot be the primary instruments to enhance the development-relevance of the WTO. Instead, countries must commit to engage in the reciprocal exchange of market-access concessions. Continuing to exempt developing countries from trade-policy disciplines is not likely to achieve development goals.

With regard to behind-the-border regulation, the same principle should apply as with trade-policy disciplines: ensuring that the rules support development.²⁹ Getting the rules right requires each country to think hard about what is in its national interest. Even where the potential benefit of an agreement may be clear, poor countries may not have the resources required to implement it immediately, perhaps because other issues command higher priority or because complementary policies and institutions must be put in place before implementation will be beneficial. In this regard, a new concept of special and differential treatment, one that would establish clear criteria and mechanisms to link implementation to development priorities and capacities, could be most fruitful.

Promoting the trade and development prospects of low-income countries requires action on many fronts. The key needs—to establish priorities for reforming domestic policy and enhancing trade-related capacity—grow more acute as MFN trade barriers are reduced, and the value of preferences is eroded. A precondition for effective use of additional development assistance—whether in the form of grants or development loans—is that the necessary priorities are determined appropriately. In many low-income countries much more should be done to integrate trade priorities into national development strategies and investment allocation decisions.

It should be possible to move rapidly toward providing greater access for all countries to others' markets in goods and services. As far as rule-making is concerned, agreement on an approach that recognizes the significant differences among countries will give development a much more solid place in the WTO. Most important is to address what is by far the most urgent challenge of expanding trade for development—identifying and dealing with trade constraints *within* countries, whether those constraints derive from policies, poor infrastructure, or limitations in capacity.

Notes

1. See World Bank (2002), Finger and Schuler (2000), and Hoekman and Kostecki (2001) for a discussion and references to the literature.

2. Hudec (1987) and Finger (1991) review the background in some depth, noting that SDT was heavily influenced by foreign policy considerations, especially the Cold War.

3. The full name is Decision on Differential and More Favorable Treatment, Reciprocity and Fuller Participation of Developing Countries. See Hudec (1987) for further discussion of the history.

4. This was first documented by Finger (1974, 1976).

5. Because WTO rules are often based on those prevailing in OECD countries, implementation costs are asymmetrically distributed. Post-Uruguay Round research—for example, Finger and Schuler (2000) and Finger (2001)—revealed that the costs associated with complying with certain WTO disciplines can be significant. This is in part because of the rules themselves,

but mostly because of the ancillary investments that are required to allow the rule to be applied.

6. Note that China and Mexico are included in the European Union's GSP recipients' list while they are excluded from the U.S. list. The United States has a free trade area agreement (FTA) with Mexico and does not grant GSP status to China. On the other hand, South Africa, Turkey, and Eastern European countries have FTAs with the European Union and, hence, are excluded from its GSP while they receive GSP status from the United States.

7. The limit is \$13 million if the exporting country has more than 50 percent market share.

8. For most textile and clothing products, the 20 percent reduction is less than 3.5 percentage points.

9. According to EU Council regulation 2501/2001, there are some nonsensitive agricultural and food products. According to Annex IV, these are artichokes, castor oil, frogs' legs, grapefruit, green tea, inactive yeasts, licorice extract, malt beer, papayas, pepper, and sweet potatoes.

10. U.S. intellectual property advocacy groups have used GSP eligibility as an instrument to induce a number of countries (including El Salvador, Honduras, Panama, Paraguay, Poland, and Turkey) to take actions in such areas.

11. Rules of origin are intended to prevent trade deflection and to determine where a good originates for duty purposes when two or more countries are involved in the production of a product. The general rule is that the origin of a product is the one in which the last substantial transformation took place, that is, the country in which significant manufacturing or processing occurred most recently. Significant or substantial is defined as the level of transformation sufficient to give the product its essential character. Various criteria can be used to determine if a substantial transformation occurred. These include a change in tariff heading (as when, as a result of whatever processing was performed the good is classified under another category of the Harmonized System), the use of specific processing operations, tests based on the value of additional materials embodied in the transformed product, or the amount of value added in the last country where the good was transformed.

12. These categories make up around 65–75 percent of the exports of the AGOA and Andean Program beneficiaries and tend to dominate general patterns with their volatile prices.

13. A major benefit of Everything But Arms is that the preferences are not time-limited.

14. This was the approach used in the GATT before the creation of the GSP. See Hudec (1987) and Finger (1991).

15. Given that many developing countries either have not bound tariffs at all or have high tariff bindings, this will automatically imply that credit will be given for past reductions in applied tariffs and—provided formulas are used—that autonomous liberalization (reduction in applied tariff rates) will not prejudice future WTO negotiations. See Francois and Martin (2003) for an in-depth analysis of alternative formula-based approaches.

16. This section draws in part on Hoekman, Michalopoulos, and Winters (2003).

17. See, for example, Hoekman, Michalopoulos, and Winters (2003), Noland and Pack (2003), Irwin (2001, 2003), and Hausmann and Rodrik (2002).

18. Research on the effects of TRIPS suggests that net transfers from low- to high-income countries could be substantial (World Bank 2001).

19. For example, despite remarkable reductions in customs clearance times that have been achieved by some LDCs (sometimes from weeks to days or hours, as in Senegal), the customs regimes in many participating countries are characterized by long clearance times, a plethora of informal fees, and inadequate performance monitoring indicators (see chapter 5). Many countries are struggling to implement the Agreement on Customs Valuation and to work with and reform other institutions whose actions impinge on customs efficiency such as security and enforcement.

20. These options are discussed further in Stevens (2002), Prowse (2002), Wang and Winters (1999), and Hoekman, Michalopoulos, and Winters (2003).

21. Declaration on the Contribution of the World Trade Organization to Achieving Greater Coherence in Global Economic Policymaking, December 15, 1993.

22. Busch and Reinhardt (2002) found that developing countries accounted for around 30 percent of complaints under both GATT and WTO, but that the share of cases against developing countries had risen from 8 percent to 37 percent during the period covered by their study. This suggests that the shift to the WTO—with the associated expansion of disciplines on developing countries—has given rise to a significant increase in the probability of engaging in dispute settlement. However, Holmes, Rollo, and Young (2002) concluded that the simple hypothesis that disputes will be proportionate to trade shares is not borne out by the data. They also found that income per head or measures of openness did not help to explain the incidence of disputes, suggesting that there is no significant bias between small and large countries, or between richer and poorer countries, in terms of participation in the system as complainants or respondents. Horn, Mavroidis, and Nordström (1999) similarly conclude that the evidence for “bias” is not particularly strong once one controls for the fact that disputes should be correlated

with the number of incompatible measures a country’s exporters encounter and the volume of trade, and takes into account that there is likely to be a threshold below which it is not worth bringing a case.

23. See Bown (2002) for a recent analysis and references to the relevant literature.

24. WT/GC/W/162

25. For a discussion of a proposal by Brazil and Uruguay to reform the dispute settlement system to include financial compensation, see Dam (1970, 368–73).

26. In their analysis of this proposal, Bagwell, Staiger, and Mavroidis (2003) conclude that the probability of the winning country being compensated is highest if such rights extend to the losing party.

27. The Diagnostic Trade Integration Study (DTIS) is an analytical tool developed to reexamine the policy and institutional constraints to trade for LDCs, and to identify technical assistance needs for the purpose of enhancing LDCs’ integration into the global economy. As of July 2003, DTIS reports had been completed for Burundi, Cambodia, Ethiopia, Guinea, Lesotho, Madagascar, Malawi, Mali, Mauritania, Nepal, Senegal, and Yemen. See www.worldbank.org/trade.

28. Increasing productivity in agriculture is critical for the transformation of these economies. Reducing the price of food products increases the real income of the whole population and allows higher household spending in nonagricultural products, thus favoring diversification.

29. The GATT/WTO may have it right when it comes to rules on the use of trade policy; for example, the ban on the use of quotas and the focus on binding tariffs. This is much less clear when it comes to other agreements, such as TRIPS. The solution in such cases is to reopen existing agreements, something that can readily be done. Many of the agreements are already subject to ongoing negotiations.

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