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Snipings

The rubric 'Snipings' is intended for contributions which, while rigorous, are shorter and therefore less extensively developed and documented than our standard length articles. This offers, among other things, an opportunity for early analyses targeting topical policy issues affecting the multilateral trading system. Submissions – which should be in the 1,500 to 4,500 word range – are reviewed by independent referees.

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Common values for the Development Round

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1. Introduction

In the traditional theory of international trade, multilateral trade agreements should be easy because self-interested governments unilaterally commit to reduce their own protection and, as a bonus, they reap positive externalities from liberalization by other nations. In practice national governments do not behave as though they are maximizing the welfare of a representative citizen, but instead they respond to pressure from a diverse mix of constituencies and competing special interests. Governments attempt to manage domestic trade-offs within international negotiations, so progress is slow and protection persists. The practical operation of trade negotiations, emblemized by the infamous 'green rooms', is characterized by factionalism, horse-trading, and brinkmanship.

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In the aftermath of Seattle there was a change of spirit. The new round of negotiations was dubbed the 'Development Round'. There was recognition in some quarters that the previous round had benefited the advanced industrial countries much more than the developing countries and this was accompanied by a mood to view the new round as an opportunity to redress the imbalance.[1]

Just four years later in Cancun, the wheels had fallen off the cart. Developing countries felt that there had not been enough progress on agriculture and not enough attention given to other issues of importance to them, such as persistently high protection on labor-intensive goods and services. It seemed as though the round was moving in the wrong direction. The Singapore Issues embodied in the so-called 'new trade agenda' contained proposals which were mainly of interest to industrialized countries. Indeed, the Development Round now seems to be more spirit than substance, and, as the United States turns away from multilateralism,[2] even the spirit is fading fast.

One reason the Development Round is faltering is that the WTO (like its predecessor the GATT) is, by process and structure, a mercantilist institution that works on a principle of self-interested bargaining. The concept of a development round implies a fundamental departure from the system of mercantilism towards a collectively agreed global social welfare function. However there has been almost no discussion, let alone agreement, on what that function should be. The lack of a commonly agreed objective function has deprived the WTO's members of any means to collectively choose optimal policies from among competing proposals.

Recent years have witnessed several expressions of global values across various areas of international policy. In September 2000 the world's leaders adopted the UN Millennium Declaration which recognised 'a collective responsibility to uphold the principles of human dignity, equality and equity at the global level'. These values were initially supported by commitments to stronger global efforts to reduce poverty, improve health and promote peace, human rights and environmental sustainability (the Millennium Development Goals). Similar values were applied to foreign aid policy. The Monterrey Consensus that emerged from the March 2002 UN Financing for Development conference led to commitments of rich and poor countries to provide the resources to meet global challenges.

Progress in the Development Round needs to be accompanied by a debate about values, how those values apply to trade, and how they should be implemented in the current round of negotiations. In this paper we make a contribution to this

1 A widely quoted World Bank study estimated that Sub-Saharan Africa was actually worse off as a result of the terms of trade effects generated by the Uruguay Round of trade negotiations. The United Nations Development Programme estimates that under the WTO regime, in the period 1995–2004, the 48 least developed countries will actually be worse off by $600 million a year, with sub-Saharan Africa actually worse off by $1.2 billion. The UN Development Programme also says that 70% of the gains of the Uruguay Round will go to developed countries, with most of the rest going to a relatively few large export-oriented developing countries. UNDP (1997).

2 Zoellick (2003).

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debate by considering several fundamental questions: What are the appropriate boundaries for the WTO's agenda? What would constitute a 'fair' agreement? What are the characteristics of a 'fair' negotiating process? There are no universal answers to these questions, but there are answers that derive legitimacy from commonly agreed values implemented in a democratic process. This paper presents a set of values with a Rawlsian flavor, which we believe is consistent with the development focus of this round and a concern for social justice. In some cases we make the implications of these principles for the outcome of the negotiations explicit, however in most cases we refer the reader to more detailed discussion in Stiglitz and Charlton (2004).

2. The policy space

Defining the policy space appropriate for attention within the WTO is a difficult task. There has been a tendency to expand the WTO's agenda to include a wide range of international economic problems from intellectual property rights to protection for foreign investors. The international community has found that bringing formerly intractable international issues within the ambit of trade provides both a convenient negotiating forum and a ready mechanism for enforcement of agreements. If the only test of inclusion in the agenda is that a policy must affect trade flows, then the boundaries of WTO activity are very hard to define because almost all international economic problems can be linked to trade flows in some way. In this regard, policymakers have liberally employed the prefix 'trade related aspects of' to pragmatically expand the WTO's mandate.

However the growth of the WTO's policy space comes at a price. First developing countries have limited capacity to analyze and negotiate over a large range of issues. Second the experience of the Singapore issues suggests that larger agendas burden the negotiations. Third, the expansion creates room for developed countries to use their superior bargaining power in trade negotiations to exploit developing countries over a larger range of issues. For instance when the agenda was extended to competition policy, the issues relevant to the foreign business interests of developed countries became the main focus of negotiations, while insufficient attention was given to key areas of concern for developing countries, such as rules against predation and global anti-trust enforcement. Similarly the focus of intellectual property negotiations has been determined by the pharmaceutical industry in the industrialized world. Almost inevitably, the determination of these issues will reflect the consequences of the exercise of power.

For these reasons a 'principle of conservatism' needs to be introduced to guide the growth of the WTO's mandate beyond market access reform. Further issues should only be included in the agenda if they score highly on three criteria that seem sensible to impose on a development round of trade negotiations: (i) the relevance of the issue to trade flows, (ii) its development friendliness, and (iii) the existence of a rationale for collective action.

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This limit on the growth of the policy space also reflects a general presumption in favor of national sovereignty. There is no reason to force nations to undertake certain actions unless their actions have effects on the trade of others. This principle is analogous to the presumption of consumer sovereignty, which holds that society should only interfere with individual choices when those choices have consequences for others, i.e., when there is a need for collective action, which justifies curtailing individual freedom.

There are areas in which a trade agreement is absolutely essential. These include an international rule of law (procedures) for dealing with trade disputes and or agreements to prevent beggar-thy-neighbor trade policies. There are areas in which international agreements would be beneficial to manage cross-border externalities or global public goods.[3] Trade agreements might also be useful as a mechanism for governments to overcome domestic political opposition to trade reform. But modern trade agreements have been extended into areas which intrude into national sovereignty with no justification based on the need for collective action and without clearly identified and fairly distributed global benefits.

3. A 'fair' agreement

Previous rounds of multilateral trade negotiations did not contain a principle of fairness. Arguably one was not necessary because agreements were produced by a process of negotiation between self-interested governments. Beginning in the Uruguay Round, the consensual voting system combined with the 'Single Undertaking' provided a constraint that ensured any agreement would make every nation better off (but this was only true if all countries had perfect information and if powerful countries did not try to affect the bargain with conditionality on outside issues).

However a process of self-interest is patently unable to deliver the kind of progressive outcome envisaged by the launch of a development round. Instead any agreement should be subject to a commonly agreed 'fairness constraint'. In a development round it should be essential that any agreement be progressive, i.e. that a larger share of the benefits accrue to the poorer countries. Thus any agreement that differentially hurts developing countries more or benefits the developed countries more, measured by the net gains as a percentage of GDP, should be presumptively viewed as unfair. The nature of trade agreements is, of course, that not every provision in the agreement is viewed to be 'fair'. Some are intended to give more to one party, others to another; it is the package as a whole which should be viewed as fair.

There are several difficulties in interpreting this requirement. One is that many of the costs of, say, agricultural subsidies are borne by the developed countries.

3 For a discussion of the concept of global public goods, see Kaul *et al.* (2003). See also Stiglitz (1994, 1995).

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Not only are there huge budgetary costs associated with the subsidies, but the subsidies distort production, and thus incur a deadweight loss. Were developed countries to eliminate their subsidies, they would (as a whole) be among the main beneficiaries. Thus, a refinement of the above criterion would look at the benefits net of domestic efficiency effects; in competitive markets, it would be reflected in the general equilibrium terms of trade effects received by producers or paid by consumers; in non-competitive markets (or markets with quota restrictions) it would be the value of access granted.

How does the principle of fairness relate to the issue of reciprocity? There are obviously significant political and economic costs associated with trade liberalization – otherwise why would multilateral negotiation be necessary? Several aspects of trade liberalization reduce the freedom of national governments to pursue their own economic development policy and there are a range of adjustment costs. Both of these types of costs are largest in poor countries where the development challenges are most acute and the impact of adjustment costs is largest. In one sense these adjustment costs can be thought of as the price to be paid for the benefits of multilateral trade liberalization. It is these adjustment costs together with the trade benefits that determine the net effect of trade reform for each country. The Doha Round has placed renewed emphasis on the importance of sharing the *benefits* of trade reform fairly among developed and developing countries. However there has been less attention to the distribution of adjustment costs among countries. The fact that implementation and adjustment costs are likely to be larger in developing countries, unemployment rates are likely to be higher, safety nets weaker, and risk markets poorer are all facts that have to be taken into account in trade negotiations.

Currently, developing countries have higher tariffs than developed countries.[4] If the developed countries require that developing countries cut their tariffs proportionately; this would entail a greater absolute tariff reduction by the developing countries. Which formula for reciprocity is fair: absolute or proportional? In the simplest trade theory framework, this question does not arise because trade liberalization is mutually beneficial. But this framework does not explain the necessity of enforceable multilateral trade agreements unless it is augmented with elements of political economy, such as domestic pressure from protected special interests. For this argument to work, those pressure groups must be powerful enough to prevent their country unilaterally acting to liberalize, but not powerful enough to prevent multilateral liberalization.

Balancing these concerns are those dealing with historical inequities. If a country's relative weakness in part is due to a colonial heritage, or, more pertinently, to earlier unfair trade agreements (e.g. that resulting from the Opium War

4 For manufactured goods, average tariff rates are 1.5% for developed countries and 11.5% for developing countries. For agriculture, average tariff rates are 15.6% for developed countries and 20.1% for developing countries (Hertel *et al.*, 2000).

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in the nineteenth century in China), to what extent does fairness and equity demand that current agreements reflect these past injustices? Trade negotiators from the North would like to pretend that such inequities never occurred. Those from the South might argue that one cannot separate events today from the historical context. Certainly each trade agreement is forward looking; there are implicit and explicit understandings about the direction of future agreements. After the Uruguay Round, there was a clear understanding that there would be further liberalization of agriculture, and there was a presumption that the textile quotas would not simply be replaced by high tariffs, but that this market too would open. In the case of agriculture, there is a strong sense that the United States has reneged on that commitment; whether the huge increase in agricultural subsidies is an explicit violation of earlier agreements is of less importance than that it represents a violation of the spirit of the agreement (or at least was taken as the spirit of the agreement by the developing countries). Just as the agreement has to be viewed as a whole, so, too, a Development Round agreement has to be viewed in the context of the unbalanced agreements that preceded it.

Fairness between foreign and domestic producers

While most of the discussion of this paper concerns 'fairness' among countries, there is a related issue: fairness between domestic and foreign producers. One of the purposes of trade liberalization is to ensure that foreign producers are treated 'fairly'. But again, there are questions, what does that mean? Foreign producers and domestic producers are often inherently in different situations. In developing countries, the foreign producer may have greater access to capital and will almost certainly have greater access to international technology.

In the context of these existing inequities, there may be important learning benefits from protection of some domestic industries. And while economists have typically argued in favor of open subsidies, and or government loan programs, rather than the hidden subsidies protection provides, direct subsidies may, for a variety of reasons, be difficult or impossible to implement. In a second-best world, some protection may be efficient.[5] By the same token, it is hard to justify demanding developing countries to provide foreign firms with greater protections than provided domestic firms. While there is some debate about the validity, or abuse, of the infant industry argument, there is no argument for protection of the 'grown up industry'.

Other problems in the interpretation of fairness

One of the most difficult issues is how to treat policy failures within each of the countries. Suppose the (arguably) regressive effect of the Uruguay Round could have been reduced if only the developing countries reformed their economies. They

5 For a historical argument, see Chang, Ha-Joon (2002). More recent theoretical analysis includes that of Dasgupta and Stiglitz (1985).

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might, for instance, have been able to benefit more from the reduction in tariffs on manufacturing, if only they had invested more in infrastructure, so that they could have attracted more manufacturing.

By the same token, to what extent should the international trading regime be blamed for inequities which arise, in part, because of how other parts of the international system operate? Suppose, for instance, that a 'fair' trade negotiation occurs within the WTO, but that after the trade negotiations are over, the developing country has to turn to the IMF for assistance; and that the IMF imposes, as a condition for assistance, further trade liberalization. Viewing the two negotiations together, as a package, clearly the developing country may have given far more than it got within the trade package, but of course, it got, in addition, some foreign assistance.[6]

Similarly, when international institutions encourage tax policies, which have the effect of distorting production towards the informal sector, it implies, as noted above, that the West's subsidies of agriculture have a greater adverse effect on the developing countries than they otherwise would have had. In talking about the inequities of the trade regime, should we assess its fairness, coming on top of distortions imposed or encouraged by the North, or in terms of what the incidence would have been, had a more neutral tax system been imposed? Should we view the two actions together, assessing the incidence of the two policies in conjunction, or should we only assess the fairness of the trading regime itself?

By the same token, when countervailing duties are imposed against a developing country which has 'subsidized' interest payments by bringing them down from the usurious levels insisted upon by the IMF, to levels still slightly higher than in international capital markets, is this unfair? Should the government only be viewed as undoing a distortion? The problems are exacerbated by demands (included in the recent bilateral trade agreements between the United States and Chile and the United States and Singapore) for capital market liberalization. Capital market liberalization increases economic volatility, and the increased economic volatility increases the risk premium that investors demand,[7] effectively increasing the interest rate charged. It seems unfair to force upon the developing countries provisions which effectively increase the interest rate they have to pay, and then when the government tries to undo the consequences, to have a countervailing duty slapped upon them.

In the South, of course, there is a tendency to see the actions as coordinated, driven by economic interests in the North. While they may see more coordination than actually occurs, the impacts are often closely akin to what they would be if they were coordinated. The high interest rates, tax policies, and trade liberalization policies demanded by the IMF do exacerbate the effects on developing

6 Admittedly, in the case of many of the bail-outs, the primary beneficiary of the bail-outs may be banks in the more advanced industrial countries.

7 See Stiglitz (2000).

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countries of whatever trade liberalization measures they agree to within the WTO. The two cannot be seen in isolation.

With such disparate views of fairness, it is no wonder that the South may feel that a trade agreement proposal is grossly unfair, and yet the North might feel no pangs of conscience. Some might conclude that, as a result, we should simply drop the criterion of equity among the desiderata of a Development Round agreement. That would be a mistake. In a democracy, any trade agreement must be freely entered into, and the citizens of the country must be persuaded that the agreement is essentially fair. Moreover, there are several philosophical frameworks – in particular that of Rawls[8] – which are widely accepted, and that at least provide some guidance for thinking about whether any agreement is fair.

The need for incidence analysis

Underlying conflicts about perceptions of fairness is the fact that, because the circumstances of the different countries are different, any agreement that applies 'fairly' or 'uniformly' to all countries may still have large differential effects. This is why an 'incidence analysis', an assessment of the differential effects on different countries, is a necessary prerequisite for the determination of fairness. However there is surprisingly little economic analysis of the precise consequences of various potential trade agreements on participant countries. Where analytical studies have been done, they have not penetrated into the core of negotiations and do not seem to play a central role in setting the agenda.

The WTO Secretariat should be responsible for producing a general equilibrium incidence analysis for its member countries, analogous to what is conducted when taxes are imposed, attempting to assess how different countries are affected by different proposals. Publicly available analysis would benefit developing countries and consumer groups, many of who are at an information disadvantage relative to developed countries and producer lobbies.

The interpretation of general equilibrium analysis must recognize that models are sensitive to their assumptions. Much of the analysis of the impacts relies on a particular model of the economy, the neo-classical model, which assumes full employment of resources, perfect competition, perfect information, and well-functioning markets. These assumptions are of questionable validity for any country, and are particularly problematic for developing countries. Under full employment general equilibrium models often predict significant welfare gains from trade liberalization because it enables resources to be redirected from low

8 See Rawls (1971). He emphasizes that we should assess whether (in the current context) a particular change in the trade regime would be generally agreed to from *behind a veil of ignorance*. One application of this (although not one discussed in Rawls' initial work) would involve a hypothetical negotiation in which the participants did not know whether they were to be born in a less developed or a more developed country. For alternative frameworks (which in the current context would arrive at quite similar views) see Sen (1999).

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productivity protected sectors to more productive sectors as the economy specializes in its areas of comparative advantage. However if there is unemployment, trade liberalization may simply move workers from low productivity protected sectors into unemployment. This lowers the country's national income and increases poverty.

A complete incidence analysis must also include adjustment costs. Most of the tools used to analyze general equilibrium effects of trade liberalization are static models. They describe the movement from one 'steady state' to another but do not incorporate the costs associated with transition or the consequences for economies which are initially out of steady state. Even if trade liberalization had no impact on the equilibrium level of unemployment, it may take the economy considerable time to adjust, and the costs of adjustments – lost income and increased poverty – may be considerable. The fact that implementation and adjustment costs are likely to be larger in developing countries, unemployment rates are likely to be higher, safety nets weaker, and risk markets poorer are all facts that have to be taken into account in conducting a relative incidence analysis.

It is important that any incidence analysis take into account other pre-existing distortions. For instance, tax policies (often advocated by international institutions), which effectively tax the informal sector less than the formal sector, already distort production in favor of the informal sector. In this context, trade regimes which further lower the international price of agricultural goods, typically produced by the informal sector, have a larger adverse effect than would be the case if tax policy were more neutral.

4. Procedural fairness

Procedural fairness becomes an important complement to the kind of fairness discussed in the preceding section when there is some ambiguity about what should be meant by 'outcome fairness'. Procedural fairness focuses on the openness and transparency of the negotiation process, and the manner in which the discussions are conducted. There is now a large literature which establishes that setting the agenda may have a large effect on the outcome; hence having voice in the setting of the agenda is essential. The agenda in previous trade negotiations has been unbalanced. This is evidenced by the fact that issues of benefit to the developed countries have been at the center of the discussion. For example the liberalization of skilled labor intensive services have been on the agenda, while issues like liberalization of unskilled labor intensive services have been off the agenda.

Transparency is essential because it enables more voices to be heard in the negotiating process. This is particularly important for developing countries, because of the limited size of their negotiating teams. Of particular concern is the lack of transparency of the 'green room' negotiations, in which only a few chosen countries from the developing world engaged in negotiations with the United

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States and Europe. This process limits outside scrutiny and places the developing countries in a disadvantageous position because of the complexity of the negotiations and their limited staffs.[9]

Indeed, the very distinction between the manner in which international rules are arrived at and the manner in which domestic rules are determined reflects the lack of democratic guarantees. Within a democratic country, there are parliamentary processes. These processes involve negotiations, but they are not just negotiation between interested parties. We do not have businesses and labor negotiating labor legislation, for instance; though, in the deliberation, the views of both are listened to carefully. At the international level, we have no analogous parliamentary body. We have a 'negotiation'. In the past, the terms of the negotiation have largely been set by the United States and Europe. The negotiators mandate is to get the best deal for their country, using whatever tactics they can employ, whether it be threats, promises, secret meetings, etc. This contrasts markedly with at least the language used in parliamentary processes, in which the objective is to find a set of rules and regulations which are fair and efficient. The participants in the discussions, while mindful of the interests of those they represent, defend their positions in terms of principle, and look for principled solutions, reflecting social justice and solidarity.

The WTO's dispute settlement system also lacks procedural fairness in some important ways. In trade disputes, the system favors developed countries both *de jure* and *de facto*. Thus, the costs to a developing country of attacking a claim to intellectual property by a Western company in a case involving bio-piracy may be very high; even if the two sides of the dispute had equal access to legal resources, in practice the developing country is at a disadvantageous position in any process entailing resort to complicated and expensive legal proceedings.

Thus the WTO dispute system favors rich countries with the resources to use it effectively for their own interests. The EC, Japan and the US were complainants in almost half (143 of 305) of all bilateral disputes in the WTO Dispute Settlement system between 1995 and 2002. By contrast the 49 members classified by the UN as less developed countries did not bring a single challenge in that period.[10] Moreover, were a developing country to prevail in a WTO tribunal against the United States or Europe, the enforcement system is asymmetric, and consequently unfair. The sanction for violating a WTO agreement is the imposition of duties. If Ecuador, say, were to impose duties on goods that it imports from the United States, it would have a negligible effect on the American producer; while if the United States were to impose a duty on goods produced by Ecuador, the economic impact is more likely to be devastating. In practice, the WTO system has no

9 See for example the open letter, dated 6 November 1999, sent by 11 developing countries to the WTO chairman Ambassador Ali Mchumo of Tanzania, expressing their concern over the lack of transparency in the WTO Green room process.

10 Horn and Mavroidis (2003).

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effective way of enforcing an unfair trade action, the main impact of which is on small developing countries.[11]

There is a long history within developed countries of those in positions of power using the legal system to maintain their privileges. More recently, many developed countries have tried to come to terms with the resulting inequities by providing public legal assistance. Similarly in WTO disputes the developed countries should provide assistance to the less developed countries to help create a more level playing field.

5. Conclusion

In several important ways, the WTO and its members were under-prepared for the Development Round. In his speech at the close of the Cancun conference, EU Trade Commissioner, Pascal Lamy, called the WTO a 'medieval organization', blaming its 'rules and procedures' for the failure of the meeting.[12] This paper suggests that the problem has an additional dimension in the context of a Development Round because the pursuit of common objectives requires a set of common values as well as appropriate procedures.

If the WTO is to move, as the Development Round suggests, from a system of bargaining between self-interested parties towards the pursuit of common development objectives, then it requires some agreement between its members of what those objectives should be. We propose that the WTO's current agenda should be based on principles of social justice, procedural fairness, and respect for national sovereignty. Without commonly agreed values, the WTO has no mechanism with which to choose among competing proposals and little prospect of reaching a conclusion to the current round that would, true to its name, promote development in the poorest countries.

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11 When, of course, a major industrial country takes a global action – such as the US imposition of tariffs on steel – then there can be a global response, and this can induce a response (as we have seen).

12 Press Conference closing the World Trade Organisation 5th Ministerial Conference, Cancún, Mexico, 14 September 2003.

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