



ISSUES IN BRIEF

The Future of the WTO

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The WTO was just an idea in 1944, at the Bretton Woods conference that established the other major international financial institutions, the World Bank and the International Monetary Fund; the WTO wasn't formally established until 1995. Just 13 years later the organization's future appears to be in jeopardy. Some question whether the organization will last through the next five years, let alone the next 35 or more. This issue brief argues that the future of the institution — and of its ability to deliver on its stated trade and development goals — rests on the successful completion of the current round of negotiations.

One reason for the current impasse in the WTO is that the potential gains in terms of market access from the deals on the table are quite small for developing countries. Another is that many developing countries argue that the very policies that many developed and middle income countries used between 1944 and 1995 to orchestrate a longer-range development path could be outlawed under new proposals from the developed countries. Developing countries are being asked to trade market access to the developed world in return for new agreements that may curtail the developing world's ability to deploy a long-run development strategy.

The WTO has a long future if it focuses on implementing and maintaining its original agreements that attempt to provide a level playing field for the global economy and provide a transparent system for settling disputes. If the institution continues to crowd out the space for developing countries to deploy effective policies for longer-run development, it may lose its footing as the premier organization governing the world trading system. That will not be good for the WTO, nor for global development aspirations.

Why Developing Countries Feel They Are Being Asked To “Do as We Say, Not As We Do.”

Though Uruguay Round negotiations were successfully completed in 1994 and culminated in the establishment of the World Trade Organization (WTO) in 1995, when the developed world proposed another round of global trade talks in 2001 in Doha, Qatar, developing countries balked, citing the shortcomings of the previous round. Indeed, they accepted new negotiations only on the condition that development issues form the centerpiece of the negotiations.

On the blackboard, making trade work for the poor is fairly simple: dismantle tariffs and other restrictions on imports, and free nations to produce as much as they can

sell of the goods they produce best relative to other countries and other options in their own economies (i.e., produce and export where they have a comparative advantage). If every country did that, producers would get access to more markets, and consumers would have optimized choice, low prices, and high quality — all nations would benefit, at least in the short run.

On the blacktop, however, things are different.

One important difference between theory and reality is that the theory of comparative advantage is a static one. Countries focus on what they have a comparative advantage in during the present, rather than thinking long-term about what they might like to have a comparative advantage in further into the future. For instance, if South Korea fully liberalized its economy in 1960 it would have had a comparative advantage in rice. That may have worked well for a few years until rice prices fell. Instead, they orchestrated a long-run development path that put them at the technological frontier in electronics and automobiles. The opportunity costs of charting such a path in the short and medium run were fairly high, but now that they enjoy an OECD-style standard of living most Koreans think it was worth it.

At the trade talks, developing nations were asked to open their doors to the global corporations with major reductions in import tariffs and investment regulations, while the United States and Europe made limited cuts in agricultural tariffs and subsidies. The poorer nations saw themselves as a group of kindergarteners playing the Italian national soccer team: their domestic farmers and industrial capitalists were doomed to fall by the wayside. The World Bank estimates cited below show that developed countries would have earned five times as much in monetary gains as the developing world, where average income gains would have been less than one penny per day per person.

Nonetheless, after five years of negotiations, a bargain seemed plausible in theory — developing countries could have access to the agricultural markets of rich countries in exchange for rich countries having access to the industrial markets of developing countries. Benin could sell its cotton to the Gap; the United States could sell its pharmaceuticals in Brazil. However, the Western nations, where most of the mega-

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companies are headquartered, were demanding that developing countries open their markets immediately.

That might be good for the short run, but societies are concerned with long-run growth, not just quick fixes. The question, therefore, is whether short-term gains would be at the cost of longer-term benefits. Developing countries often look at the example of the U.S. and European economies, and more recently, the economies of South Korea and China, all of which moved into the world marketplace slowly and strategically, protecting their major exporting industries in order to nurture them into world markets. China's computer maker, Lenovo, is an example. The company was created by the government and integrated into the world market strategically over a period of many years; it recently purchased IBM's PC division and is now a world leader in high-technology electronics. Acer Computer from Taiwan and Hyundai and Kia Motors from South Korea followed similar longer-range development paths. Poorer countries thus see developed country proposals as policies of "do as we say, not as we do."

Shrinking Gains

In a negotiation developing countries might be willing to "trade away" some of the space to deploy the policies discussed above in exchange for increased market access to developed countries. What has made such a deal questionable is that the gains from market access to developed countries are relatively small, especially when juxtaposed with the potential costs.

The initial prospects of a Doha deal seemed promising for developing countries in terms of market access. At the 2003 Cancun Ministerial meeting of the WTO, Eveline Herfkens, former World Bank executive director and current executive coordinator for the United Nations' Millennium Development Goals (MDGs), asserted: "A pro-poor Doha Round could increase global income by as much as \$520 billion and lift an additional 144 million people out of poverty. This is why so many hundreds of us come together today."¹

Yet new projections, from the same sources cited by Herfkens, now estimate potential welfare gains at just \$287 billion in the year 2015 — just one-third of their level two years ago. Projections of gains for developing countries have dropped to \$90 billion — 0.8 percent of GDP — a reduction of 83 percent, while developing countries' share of global gains has fallen from 60 percent to just 31 percent.² This is of grave concern given that the current negotiations are billed as the "development round" of global trade talks.³

Perhaps more alarming is that these estimates presume a scenario of "full" global trade liberalization. In other words, the models assume that all tariffs and non-tariff trade barriers are completely eliminated in the world economy, a highly unlikely scenario for the current round. To reflect more accurately the more probable results of the present

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negotiations, the new reports include projections for a “likely Doha scenario” of partial liberalization.

The “likely” Doha benefits that the models predict are exhibited in Table 1. Under this scenario, global gains for 2015 are just \$96 billion, with only \$16 billion going to the developing world. The developing country benefits are 0.16 percent of GDP. In per capita terms, that amounts to \$3.13, or less than a penny per day per capita for those living in developing countries. Although the most attention in the negotiations has been focused on agriculture, developing country gains from “likely” agricultural reforms amount to less than 0.1 percent of GDP — just \$9 billion. Likely gains from northern subsidy reductions are projected at barely \$1 billion.⁴ Of the benefits that will flow to developing countries, only a few countries will receive those benefits. Half of all the benefits to developing countries are expected to flow to just eight countries: Argentina, Brazil (which stands to receive 23 percent of the developing country benefit), China, India, Mexico, Thailand, Turkey, and Vietnam.⁵

Another major area of negotiation in the Doha Round is services negotiations. Services trade has been growing faster than goods trade since the 1980s. Developed countries

are pushing developing countries to open up their services markets — especially in the financial and telecommunications sectors — in exchange for market access in agriculture.

Like the estimates in goods trade, services trade liberalization is expected to yield relatively small benefits, the majority of which would go to developed countries.

Adding the liberalization of goods and services trade together, the total benefits for developing countries amounts to \$123.5

billion under full liberalization — 1.1 percent of GDP — and \$28.7 billion under a more conservative, likely Doha scenario. Goods and services trade combined, a likely deal would bring a one-time increase of 0.28 percent in the level of global GDP in 2015.⁷

Real Costs

The benefits from trade liberalization, albeit shrinking, are real. But so are the costs, both in the short term and the long. The costs and benefits of trade liberalization are not evenly distributed across countries, within them, or across generations. Far too little attention has been paid to the costs of trade liberalization and to how the gains should be redistributed to those who are adversely affected by it. Key among the costs of liberalization are those associated with adjustment, which take the form of tariff revenue

Doha Benefits vs. NAMA Tariff Losses⁶

<i>in US 2001 billions</i>	“likely benefits”	NAMA tariffs losses
Developed	79.9	38.0
Developing	16.1	63.4
Selected Developing Regions		
Middle East and North Africa	-0.06	7.0
Sub-Saharan Africa	0.4	1.7
Latin America and the Caribbean	7.9	10.7
Selected Countries		
Brazil	3.6	3.1
India	2.2	7.9
Mexico	-0.9	0.4
Bangladesh	-0.1	0.04

losses and job losses. Table 1 juxtaposes the projected benefits of the Doha Round with estimates of projected tariff revenue losses. The World Bank models and other models of trade liberalization make the assumption that nations' fiscal balances are fixed — in other words, any losses in tariff revenue are offset by lump-sum taxes. In the real world, however, such taxation schemes face stiff resistance.⁸ The United Nations Conference on Trade and Development (UNCTAD) has published data on projected tariff revenue losses under the Doha Round for a scenario which resembles the likely Doha outcome. Tariff revenue losses can be significant. Total tariff losses for developing countries under the “non-agricultural market access” — or manufactured goods — aspect of the negotiations could be \$63.4 billion, or almost four times the level of benefits.⁹

Slashing tariffs (that are already fairly low) will restrict the ability of these countries to foster new industries so that they may integrate into the world economy and maintain social programs for the poor. Such programs are vital components of a longer-range development strategy. Most developing countries rely on tariffs for more than one quarter of their tax revenue. For smaller nations with little diversification in their economies, tariff revenues provide the core of government budgets. In a recent issue of *Foreign Affairs*, Jagdish Bhagwati commented: “If poor countries that are dependent on tariff revenues for social spending risk losing those revenues by cutting tariffs, international agencies such as the World Bank should stand ready to make up the difference until their tax systems can be fixed to raise revenues in other, more appropriate, ways.”¹⁰ While there is indeed evidence that consumption taxes are superior forms of generating welfare, economists have shown that tariffs may be preferable in developing countries with large informal sectors that cannot be taxed efficiently.¹¹

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Although the net benefits for many countries are projected to be positive, such benefits will be the result of significant structural changes away from the development of knowledge-based assets and back toward primary commodities and low-technology manufacturing. Primary commodities are experiencing a temporary upswing in prices, but the long-term trends are not encouraging. According to the Food and Agriculture Organization (FAO), the price of non-energy commodities have declined by 30 percent between 1980 and 2005, and they are likely to continue to do so in the future. What's more, the terms of trade—the average prices of agricultural commodities sold by developing countries relative to the price of manufactured goods purchased from developed countries — have fallen by close to 70 percent during the period between 1961 to 2001.¹²

Taking the longer-term view, it is evident that when commodity prices go down again, there may not be much industry left to pick up the slack in some developing countries since almost all of the projected employment increases would be in the agriculture or

apparel industries. Manufacturing industries such as machinery, non-ferrous metals, electronics, and motor vehicles would be particularly hard-hit. For Brazil and Argentina, this would translate into job losses in cities and expansion in the countryside. In Asia, there would be a movement of people out of higher technology manufacturing and into apparel jobs. Both adjustments underscore the slide in wages and level of technological sophistication that would occur under a liberalization scenario that does not devote significant attention to paying adjustment costs.

A Way Forward

At present, the negotiations for the Doha round are not likely to resume with much vibrance until well after the 2008 U.S. presidential elections. Such a break is actually welcome. Negotiators need to sit back and remember that they are dealing with an institution that is in its infancy and that needs to last far into the future. That will only happen if countries see its benefits as long-lasting.

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Developing countries have thus far received the short end of the stick in these talks because they constitute a small part of global markets and thus have less negotiating clout — even though the negotiations were specifically aimed at addressing this fact. By reintroducing development to the Doha round, the negotiations are more apt to be successful, the

institution will be more apt to be intact, and a fairer playing field will be set for long-run development in the poorer regions of the world.

For this to occur, developed countries must make several changes in their policies.

First, the United States and Europe should agree to honor WTO rulings that have deemed their subsidies for cotton and sugar to be in violation of existing trade rules that forbid exporting products at prices lower than what it cost to make them. This would give a tangible boost to farmers in West Africa and Latin America and send a strong signal to developing countries that developed nations are willing to honor the rules of the WTO.

Second, Western nations should take seriously the proposal by many African nations to tame global businesses that demand unfair prices for resources used in farm production and reap billions in profits on the sale of final products. African nations made numerous proposals during the round to this end, specifically to make room for international supply management schemes to raise prices and to curb the oligopolistic behavior of large foreign commodity firms, but were ignored by the developed nations.¹³

Third, negotiators should recognize the long-standing WTO principle of “special and differentiated treatment” for poorer nations. Developed nations should roll back patent laws that impede poorer nations from manufacturing cheaper generic drugs, and they should allow poorer countries to exempt staples of their local economy such as corn, rice and wheat from deregulation. One proposal is to allow nations to have a “situational” approach that would allow them to waive certain parts of their

commitments to pursue a specific long-run development plan submitted to the WTO ahead of the plan's implementation.

Fourth, for the measures that are agreed upon, international institutions such as the International Monetary Fund (IMF) and World Bank should step in and help developing nations cover the costs of adjustment such as tariff losses and job retraining until the proper policies can be put in place on the ground. The IMF's Trade Integration Mechanism is already in place for such a task but is not ambitious enough and should not come with additional conditionality. The IMF plan also leaves little room for incorporating costs of adjustment and the Fund is often criticized for tying further reforms to their policies.¹⁴

Fifth, there should be a moratorium on regional and bilateral trade deals. These deals exploit the asymmetric nature of bargaining power between developed and developing nations, divert trade away from nations with true comparative advantage, and curtail the ability of developing countries to deploy effective policies for long-run development.

One hopes the WTO will survive this crisis and that five years from now – and 35 years from now – there *will* be a WTO. Its work is not finished and there is much that it can contribute to global development. To do so, however, it will need to realign itself to its stated development goals. To survive – indeed, to thrive – it needs to redefine itself as a development institution. That will be good for the WTO, good for the future of global development, good for developing countries, and indeed good for industrialized countries. ●

Notes

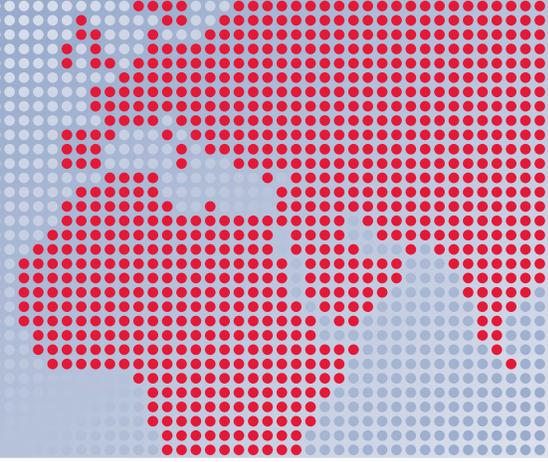
- 1 “A Doha Scorecard: Will Rich Countries Once Again Leave Developing Countries as Beggars at the Feast?” Speech by Eveline Herfkens, Cancun 2003.
- 2 All projections of the benefits of the Doha Round in this paper are from the following: Kym Anderson and William Martin, eds., *Agriculture Trade Reform and the Doha Development Agenda* (Washington DC: World Bank, 2005), Tables 10, 12.14; Kym Anderson, William Martin, and Dominique van der Mensbrugghe, “Global Impacts of the Doha Scenarios on Poverty,” in T. W. Hertel and L. A. Winters, eds., *Putting Development Back into the Doha Agenda: Poverty Impacts of a WTO Agreement* (Washington DC: World Bank, 2005), Chapter 17. For a critical review of these estimates see Frank Ackerman, “The Shrinking Gains from Trade: A Critical Assessment of the Doha Projections” (Working Paper 05-06 Global Development and Environment Institute, Tufts University, Medford, 2005).
- 3 The changes in estimates from 2003 to 2005 are due to modeling improvements and the fact that much trade liberalization has occurred since the last time estimates were generated. Specifically, the World Bank updated their “base year” from 1997 to 2001. Such an exercise brings China's accession to the WTO into the base as a reform already achieved. The new versions of the models also incorporate the European Union's expansion, the expiration of the Multi-Fiber Agreement, and more detailed data on applied versus bound tariffs, including the effect of trade preferences and regional trade agreements.
- 4 New research by the Carnegie Endowment for International Peace using similar modeling exercises puts the potential gains to developing countries at \$21.5 billion. See Sandra Polaski, “Winners and Losers: Impact of the Doha Round on Developing Countries” (Washington, DC: Carnegie Endowment for International Peace, 2006), Figures 3.1-3.8.
- 5 Kym Anderson, William Martin, and Dominique van der Mensbrugghe, “Global Impacts of



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the Doha Scenarios on Poverty,” in T. W. Hertel and L. A. Winters, eds., *Putting Development Back into the Doha Agenda: Poverty Impacts of a WTO Agreement* (Washington DC: World Bank, 2005), Chapter 17.

- 6 For Doha benefits see note 3, Anderson et al., Tables 10, 12.14. For tariff losses see note 10, Vanzetti and De Cordoba, Table 11.
- 7 See note 3.
- 8 For example, Mexico was not able to pass a tax increase during the entire six-year term of President Vicente Fox.
- 9 “Likely” benefits from Anderson (2005). Tariff losses from Santiago Fernandez De Cordoba and David Vanzetti, “Now What? Searching for a Solution in WTO Industrial Tariff Negotiations,” in *Coping with Trade Reforms*, ed. Sam Laird and Santiago Fernandez De Cordoba (Hampshire: Pgrave MacMillian, 2006), Table 11.
- 10 See Jagdish Bhagwati, “From Seattle to Hong Kong,” *Foreign Affairs* (December 2005).
- 11 Emram, M.S., and J. Stiglitz (2004), “On Selective Indirect Tax Reform in Developing Countries.” *Journal of Public Economics*, 89, 599-623.
- 12 Food and Agriculture Organization, *The State of Agricultural Commodities Markets 2004* (Rome, FAO, 2004), 75; World Bank, “Primary Commodity Prices” in the 2006 World Development Indicators, <http://devdata.worldbank.org/wdi2006/contents/Section6.htm>, Table 6.5.
- 13 Gibbon, Peter. (2007), “Africa, Tropical Commodity Policy and the WTO Doha Round,” *Development Policy Review*, 25(1), 43-70.
- 14 See for example Joseph Stiglitz, *Globalization and Its Discontents* (New York: Norton, 2002).



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