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India in the GATT and the WTO

India was one of the 23 founding Contracting Parties to the General Agreement on Tariffs and Trade (GATT) that was concluded in October 1947. The country's leaders served as spokesmen for developing-country concerns in the discussions that led to the GATT, and India has often led groups of less developed countries in subsequent rounds of multilateral trade negotiations (MTNs) under the auspices of the GATT.[1] India's participation in these international economic negotiations is illustrative of its (and other developing countries') ambivalence toward the importance of trade and of the world trading system in accelerating development. This history (recapitulated in detail in an appendix at the end of this chapter) provides a broader sense of why India, along with other developing countries, avoided international integration for decades. The legacy of the colonial era as described in chapter 1 as a determinant of India's distrust of the international economy is but one part of the history.

We begin this chapter with a discussion of the Uruguay Round, the eighth and last round of MTNs under the auspices of the GATT, and assess the wide-ranging agreements of that round, including the creation of the World Trade Organization (WTO) to subsume the GATT in 1995. This assessment leads us to make recommendations for India's role in the new round of MTNs launched by the Fourth Session of the Ministerial of the Conference of the WTO at Doha, Qatar, in November 2001. India's reluc-

1. We have drawn extensively from Srinivasan (1998a) in writing this chapter. In the World Trade Organization (WTO) context, multilateral agreements are those to which all members of the WTO are parties, whereas plurilateral agreements are those to which some but not all members are parties.

tance to endorse this new round until the concluding plenary of the Doha session stemmed from its dissatisfaction with the agreement that concluded the Uruguay Round and also from vestiges of its inward-oriented development strategy from decades before the 1992 reforms.

The Uruguay Round

The Uruguay Round, which turned out to be far-reaching in its scope and coverage of negotiating agenda compared to the earlier rounds, had a bumpy start.

Events Leading to the Round

The GATT ministerial meeting of 1982 was called to examine the functioning of the multilateral trading system since the conclusion of the Tokyo Round in 1979. The preparatory committee for the meeting had compiled a long list of items for the consideration of ministers. The list grew in part because the GATT Contracting Parties felt free to add issues concerning their own parochial interests (e.g., services). Although the United States would have liked the meeting to be the first step toward a new round of MTNs, it did not attract much support at the meeting. Brazil and India led a group of developing countries that were strongly opposed on the ground that they were not ready to negotiate on services on an equal footing with industrialized countries.

These countries' second objection was that the industrialized nations had not lived up to their obligations with regard to trade in textiles and agricultural products. They demanded commitments from industrialized countries to rescind existing GATT-inconsistent measures (the so-called rollback demand) and not to introduce new ones (the so-called stand-still demand). The drafting of a ministerial declaration at the conclusion of the meeting proved contentious, and the final text that emerged at the end of 5 days of the meeting (2 days beyond its scheduled closing) was not a consensus document. The operational part of the final text enunciated a 2-year work program for the GATT (until its next ministerial meeting in 1984) involving 17 topics.

Even before the work program was completed, Japanese prime minister Yasuhiro Nakasone broached the idea of a new round of MTNs in 1983, and the leaders of seven industrialized countries (the so-called Group of Seven or G-7) in their meeting in 1984 agreed to consult among their trading partners about the objectives and timing of a new round. Developing countries, led by Brazil and India, continued to criticize industrialized countries' policies, and the European Commission's (EC's) reservations had not dissipated either.

Nevertheless, informal discussions in the GATT on a new round began in early 1985, and a special meeting of the Contracting Parties was called. The EC, Brazil, and India lessened their opposition and agreed informally to start the new round before the parties met in November 1985. At the meeting, the parties decided to establish a formal preparatory committee to put together a set of recommendations by mid-July 1986 for adoption at the ministerial meeting at Punta del Este, Uruguay, in September 1986.

The preparatory committee ran into many conflicts. The topics before the committee had expanded from the 17 in the work program of 1982 to 31, of which only 19 eventually became the subject of specific negotiation mandates. Four others came to be mentioned in the preamble to the ministerial declaration launching the Uruguay Round. Apart from the committee, individual countries and overlapping groups of countries began to circulate draft texts for the ministerial declaration. These included Australia, Canada, Japan, the Group of Nine (G-9, consisting of Australia, Canada, New Zealand, and the members of the European Free Trade Area); and the Group of Ten (G-10) developing countries, led by Brazil and India and also including Argentina, Cuba, Egypt, Nicaragua, Nigeria, Peru, Tanzania, and Yugoslavia.

Three main texts were presented at the meetings. The G-10 did not attract more members and presented a minority text to the preparatory committee. The G-9, in contrast, was able to attract a group of 20 developing countries to meet with it. The G-9 eventually came to include them and other major industrialized countries, growing to a membership of 40 countries. This Group of Forty, or G-40, chaired by Colombia and Switzerland, presented the majority text. Argentina on its own presented a third text (Low 1993, chap. 10).

Winham (1989) provides a fascinating description of the drama of the Punta del Este ministerial meeting. Without a single agreed-on text from the preparatory committee, the meeting began with three texts, but the main contention was between the G-10 and G-40 texts. The G-10 texts reflected the resistance of some developing countries—India and Brazil foremost among them—to the US demand to include new issues: services, intellectual property, and investment measures. But the G-10 position eroded, and a growing consensus emerged around the US position once the United States, in effect, gave an ultimatum that it would withdraw from the conference altogether if these issues were not included. The EC did not fully accept the position of the G-40 text on agriculture.

After three days of meetings and creative efforts to foster agreements, the negotiation chairman, Enrique Iglesias (then minister of foreign affairs of Uruguay) restricted the debate. Iglesias created a small consultation committee, with membership by invitation only, of 20 nations representing the contending positions at the meeting. In addition, two substantive groups on services and agriculture were established to work simultaneously with the consultation committee. Iglesias, on his own initiative, decided to treat the G-40 text as the basis for discussion in the consultation committee over the protests of those developing countries supporting the G-10 text. He allowed amendments to the G-40 text that in turn drew protests from industrialized countries. Thirty-one amendments were initially offered, and they were subsequently reduced to 14.

Nothing substantial had been decided when the consultation committee met for the last time, less than a day before the ministerial meeting was to end. With the US delegation announcing with great fanfare that it would depart for the United States the next morning with or without a final declaration and threatening to call a vote in the committee rather than achieve a consensus, other members of the committee felt pressured to come to an agreement. India and the United States came to an agreement that the negotiation on services would be undertaken separately.

Other disputed items on the negotiating agenda of the round, such as trade-related intellectual property and investment measures, were quickly settled. An agreement was also reached on agriculture. With the settlement of these major issues, the 14 amendments to the G-40 text were discussed and withdrawn—except for a statement that was included in the objectives section of the final text. It called on nations to link actions on trade liberalization with efforts to improve the functioning of the international monetary system. The draft agreed to by the consultation committee was approved by the full plenary.

Brazil and India, the leaders of the G-10, did not attract more adherents to their main points of view in the prenegotiation phase of the Uruguay Round. Brazil's approach to the issues being negotiated subsequently shifted, reflecting a change of heart about the virtues of inward-oriented development strategies.[2] In fact, Brazil and India lagged behind other developing countries that had already started down the path toward international integration. Brazil adopted a series of liberalizing reforms only in mid-1991. India, the other major bastion of inward orientation in the G-10 group, initiated, also in 1991, a major dismantling of its barriers to trade and foreign direct investment after facing a severe macroeconomic crisis.

Many developing countries had at last come to understand that for their reforms to succeed, a liberal world trading order was essential, and their full participation in the Uruguay Round was a means of ensuring it. With the realization on all sides that too much was at stake for the round to be allowed to fail, an agreement was eventually reached.

2. Edwards (1995) argues that soul-searching about development began in Latin America in the early 1980s. It was driven by the failure of heterodox stabilization programs in Argentina, Brazil, and Peru; a realization of the contrast between Latin America's failure, by and large, with inward-oriented policies and the rapid growth of East Asia with outward-oriented policies; and a better appreciation of the Chilean experience with market orientation.

The Uruguay Round Agreement, India, and Developing Countries

The Uruguay Round Agreement (URA) as a single undertaking includes agreement on traditional GATT issues such as reductions of tariffs and tariff bindings, a not completely successful attempt to bring agricultural trade under multilateral disciplines, a major revamping and strengthening of the Dispute Settlement Mechanism (DSM), phasing out of the Multi-Fiber Arrangement (MFA) that was an egregious violation of GATT principles, an agreement on Trade-Related Investment Measures (TRIMs) and Trade-Related Aspects of Intellectual Property Rights (TRIPS), and a new General Agreement on Trade in Services (GATS). Since the conclusion of the Uruguay Round as envisaged, multilateral agreements on Financial Services and Telecommunications have been concluded as part of the GATS. In accord with the built-in agenda of the URA, a review of the agreements on agriculture and TRIPS was initiated in 2000. Negotiations on leftover items of the GATS (e.g., movement of natural persons and maritime services) have been folded into the post-Doha negotiation. We return below to the balance, from the perspective of developing countries, of the benefits and costs of implementing the commitments undertaken by the signatories of the URA.

The DSM of the WTO is stronger than the one in the GATT that it replaced. The GATT process was essentially political. A country against which a complaint was lodged could prevent the establishment of a panel to examine the complaint or veto the acceptance of the panel's report if one were established. The DSM of the WTO is a legal process: no member can prevent the establishment of a panel, and a consensus is needed to overturn the report of its Appellate Body if a party to a dispute appeals against the decision of the panel.

Although it is a good sign that many developing countries, including India, are using the process and that powerful countries such as the United States and the European Union members are abiding by its decisions, there is a serious danger of the DSM becoming inequitable. Because the dispute settlement process is more legal than political, an adversarial system has become its operating framework. Only those countries that can afford the costs of recognizing and litigating the violation of their rights by others, as well as defending themselves in cases brought against them make use of the system. Also, the DSM's Appellate Body has become very powerful, and in its interpretations of the GATT articles, particularly of Article XX, seems to have gone beyond what the GATT founders intended. Besides, it has chosen to accept amicus briefs from parties that do not represent WTO members. These are disturbing developments.

India stands to gain significantly if the market access commitments of the URA are implemented in full and in good faith. Bergsten (1999) cites estimates of gains, ranging from 0.5 percent to more than 4.5 percent of GDP for South Asia. Canonero and Srinivasan (1995) estimate that India's bilateral trade with the United States and the European Union in textiles and apparel will increase by 2.6 percent and 4.3 percent respectively once the MFA is phased out. François et al. (1996) estimate gains to South Asia in the range of 0.44 to 4.10 percent of GDP from the phaseout of the MFA. Much of the gain to South Asia is likely to accrue to its dominant economy, India.

However, these estimates do not take into account the likely impact of China's accession to the WTO in 2002. Ianchovichina and Martin (2002) estimate the impact on India's per capita income during a 12-year period (1995–2007) after the start of the implementation of the URA as minus 0.4 percent, with most of the loss coming from India's losing a large part of its textile and apparel exports to China after the phaseout of the MFA on January 1, 2005. China's deeper tariff cuts also contributed to India's loss. However, the overall loss is small and could easily be reversed if India were to open its economy beyond its commitments under the URA.

The realization of these potential gains will depend on two factors: on Indian producers continuing to be or, if necessary, becoming internationally competitive; and on industrialized countries not circumventing the phaseout of the MFA through other means. There are reasons to worry on both grounds. India has not in the past utilized its MFA quotas in full in several products and has recently been losing its market share to its competitors. As the estimates of Ianchovichina and Martin (2002) indicate, China's being internationally competitive means that once it is in the WTO, India will lose its share even more, unless India takes steps to become competitive. The industrialized countries are attempting to circumvent their commitment to liberalize trade in textiles and apparel by using WTO legal antidumping measures. For example, the EC recommended the imposition of antidumping duties on gray cotton cloth exports from India and a few other countries. This is egregious—after all, an exporter with a binding quota on exports has nothing to gain by dumping. Fortunately, the EU Council of Ministers rejected the EC's recommendation.

India's full integration with world markets could potentially have significant effects on world prices of certain agricultural commodities (e.g., rice, vegetable oils, and fats). Also the needed adjustment—in the form of shifting cultivated area away from crops in which India is unlikely to have comparative advantage and toward those in which it has—would be painful in the short run. There is the further problem that there is substantial variation across states in India in the productivity of crops, and shifts in cultivated areas across crops will also imply that in some states cultivation of certain crops might have to be abandoned altogether.

Notwithstanding the possible terms of trade effects and adjustments, Indian farmers will benefit from full integration with world markets, assuming that industrialized countries, including the members of the European Union and the United States, will phase out their distortionary interventions in the market for agricultural commodities. In our view, it is in India's own interest to join with other major agricultural traders of the Cairns Group in any future negotiations to press for the complete elimination of interventions in agricultural trade and for bringing such trade fully under the WTO disciplines that apply to trade in manufactured goods.[3]

Uruguay Round commitments by India have begun to affect its trade policies, but there is still substantial trade protection in place. India increased the proportion of tariff lines it bound from 6 percent before the Uruguay Round to 67 percent as part of its commitments in the agreement concluding the round. Tariffs for nonagricultural goods, with few exceptions, were bound at 40 percent for finished goods and 25 percent on intermediate goods, with the reductions from applied levels to the bounds to be completed by 2005.

After some hesitation, and after having been ruled against by the WTO's Dispute Settlement Mechanism (DSM) on a complaint from the United States, India has finally brought its domestic patent laws into conformity with what is required under the TRIPS agreement. Under the TRIMs agreement, India notified the TRIMs maintained by it and has since eliminated them. Under the Information Technology Agreement, India is committed to eliminating tariffs on 95 tariff lines by 2000, on 4 lines by 2003, on 2 lines by 2004, and on the remaining 116 lines by 2005.

Reforms have been slow, however. India invoked the balance of payments provision of Article XVIII(B) of the GATT in an effort to delay the implementation of its commitment to phase out its existing quantitative restrictions (QRs) on about 2,300 tariff lines consisting mostly of consumer goods. It entered into bilateral agreements with Australia, Canada, Japan, and the European Union for the pace of phaseout of QRs after these countries had filed a complaint against India with the WTO. The United States, however, persisted with its complaint, and the DSM ruled against India. India appealed against the ruling on the grounds that the DSM has no jurisdiction for ruling on the use of balance of payments provisions and that the WTO balance of payments committee should handle the matter. India lost this appeal, and all the QRs were phased out (partly in fiscal 2000 and partly in 2001).

The GATS, unlike the GATT, allows greater freedom to exempt particular services from the principles of the most favored nation (MFN) and national treatments (NT). It allows countries to choose sectors in which they take on commitments. India has made commitments in 233 activities.

3. The Cairns Group is named after Cairns, the town in Australia where it first met. As of March 2001, it included Argentina, Australia, Bolivia, Brazil, Canada, Chile, Cambodia, Costa Rica, Fiji, Guatemala, Indonesia, Malaysia, New Zealand, Paraguay, Philippines, South Africa, Thailand, and Uruguay.

India's unweighted average of bound tariffs on manufactured imports was as high as 51 percent (Mattoo and Subramanian 2000, table 2). In agriculture, like most other countries, India has participated in the shameful exercise of "dirty tariffication" and bound its rates at 100 percent on primary commodities, 150 percent on processed goods, and 300 percent on edible oil products. According to Mattoo and Subramanian (2000, table 4) the difference between bound rates and applied rates in 2000 exceeded 50 percent in 656 out of 673 tariff lines. Before the URA, India had bound its tariff at zero for some commodities. Since the URA, these bounds have been renegotiated and set at much higher levels. India, as a developing country, has availed itself of the full range of allowed exceptions and has made no commitments whatsoever with respect to market access or reduction of subsidies or tariffs.

TRIPS and India

In our view, it was a major mistake to have brought intellectual property issues into the WTO through the TRIPS agreement. As the late Nobel laureate Jan Tinbergen (Tinbergen 1952 and 1956) argued in his well-known work on policy assignment, there has to be at least one policy instrument per objective, and trying to use the same policy instrument to achieve more than one objective is a sure prescription for achieving none of the objectives efficiently and in full measure. The same logic applies equally to assignment of responsibility to international institutions such as the International Monetary Fund, the World Bank, the International Labor Organization, the World Intellectual Property Organization, and the agencies of the United Nations. The World Bank and the International Monetary Fund have their own mandates. So does the WTO. Going beyond the mandates of each to achieve unrelated objectives is inappropriate. There were already the World Intellectual Property Organization and the Paris and Bern conventions in the arena of intellectual property. There is the International Labor Organization for labor, and there is the United Nations Environment Program for the environment. There is no reason why these specialized agencies cannot be used as forums for negotiating and creating effective multilateral disciplines on intellectual property, labor, and environmental standards.

It is not too late to take TRIPS out of the WTO and put it into a redesigned World Intellectual Property Organization with a less legalistic and more economic focus as well as a more effective enforcement mechanism—although it is extremely unlikely to happen. We will return to possible amendments to TRIPS to make it more beneficial to India and other developing countries. Apart from the lack of rationale for TRIPS in the WTO, there is no compelling theoretical or empirical argument in favor of a uniform minimum life of 20 years for all patents regardless of the nature of the invention—or, for that matter, for monopoly rights through patents as necessarily the cost-effective means for encouraging innovation (Srinivasan 2001).

Bhagwati (2001) points out that unlike traditional trade liberalization, in which a liberalizer and its trading partners gain, intellectual property protection through TRIPS involves an unrequited transfer of royalties from user (developing) to producer (industrialized) countries. Maskus (2000, table 6.1) estimates a transfer of $8.3 billion to just four industrial countries. If one uses a broader measure, namely, net receipts from royalty and license fees, in 2000 only France, Sweden, the United Kingdom, and the United States had positive net receipts. The net *outflow* on this score from low- and middle-income countries amounted to $9.2 billion (World Bank 2002, table 5.11).

India has a vital interest in ensuring that any future agreement reached on the movement of natural persons is very liberal. It is likely to have comparative advantage in labor-intensive services as well as in certain skill-intensive ones such as software. Software is one of India's fastest growing industries in the electronics sector. Software exports grew by an impressive 43 percent a year between the periods 1991–92 and 1996–97 and by 68 percent in 1997–98. Even in 2001–02, when there was a recession in export markets (particularly the United States), export growth was 23 percent above the previous year. The industry expects export growth of 22 percent in 2002–03 (NASSCOM 2002b).

Although exports of software from a domestic base will continue to grow, provided the industry remains competitive, providing in situ services in foreign markets and keeping up with technological developments require Indian software technicians to have the opportunity to work abroad, without necessarily having to migrate permanently. Most of the Indian engineers entered the United States under a special category of nonimmigrant visas. In 1999, nearly 55,000 visas were issued to Indians, as compared with 6,700 to Chinese. But there is strong pressure to restrict the number of such visas issued. A liberal agreement on the movement of natural persons would facilitate such temporary migration.

Although India is a significant player in the world software market, there are reasons to believe that it may not realize its vast potential unless major policy changes are made. We noted in chapter 2 that a study by McKinsey and Company (2001, vol. 3, 143–61) highlighted this potential. It projects annual revenues of $87 billion, 2.2 million jobs, and a market capitalization of $225 billion for the Indian information technology sector by 2010. By the same year, that sector could account for 35 percent of India's exports, attract $5 billion in foreign direct investment each year, and contribute more than 7.5 percent to the growth of GDP.

In contrast to this potential, the actual situation as of 2001 is sobering: India accounts for less than 2 percent of the world software market. The industry's focus is on proprietary work for foreign organizations, which is only a small part of the global market. Indian industry has not penetrated the large off-the-shelf software market. India's cost advantage of having inexpensive software professionals will be eroded as other players with similar or lower costs enter the market. The benefits from an efficient software industry are not simply greater export earnings and foreign direct investment but the significant gains in the productivity of resource use in the domestic economy.

The single most urgent policy action needed for India to realize the potential of its software industry is to ensure that a vibrant and efficient world-class telecommunications infrastructure is in place. Unfortunately, a conflict between the Department of Telecommunications (DOT) and the Telecommunications Regulatory Authority of India (TRAI), as it was initially constituted, hampered progress toward an efficient telecom infrastructure. A national telecom policy was announced in 1999. TRAI was reconstituted in 2000, and its dispute resolution powers are now vested in a new quasi-judicial agency. The conflict of interest arising from DOT being both a policymaker for the industry and also a service producer through its overall control of public-sector telecom enterprises is also resolved. DOT as a service provider has been corporatized and separated from its policymaking role. There is reason for cautious optimism that an efficient telecom infrastructure will develop in the near future, as we discuss in chapter 4.

In customized software, India's recent share is a commanding 16 percent. In California's Silicon Valley,

> almost 3000 of the region's high-tech companies are run by Chinese and Indian engineers. . . . Apart from generating annual sales of almost $17 billion last year and providing 58,000 jobs in California's high-tech zone, Asian entrepreneurs have established long-distance business networks especially with Taiwan and India, which offer valuable openings for investment and trade. . . . Chinese and Indian chief executives ran 13 percent of the Silicon Valley technology companies started between 1980 and 1984 and 29 percent of those launched between 1995 and 1998. (*Financial Times*, July 3–4, 1999, 3)

With a liberal multilateral agreement on the movement of natural persons, India could potentially increase its share.

India and the New Round of Multilateral Trade Negotiations

Reminiscent of its lack of enthusiasm for the Uruguay Round, India was reluctant, for several reasons, to endorse the start of a new round of MTNs in the preparatory meetings for the Third Session of the Ministerial of the Conference of the WTO in Seattle during late November 1999. First of all, unlike agreements on earlier rounds of MTNs that largely covered commitments on measures at the border such as tariffs and quotas, the URA involved domestic policy commitments. Implementing the required behind-the-border commitments entailed institutional development—more than merely changing a duty rate in the customs code. The Uruguay Round "overlooked the costs of the institutional construction needed for the least developed countries" (Odell 2002, 403). Signatories undertook several "unprecedented obligations not only to reduce trade barriers, but to implement significant reforms both on trade procedures (e.g., import licensing procedures customs valuation) and on many areas of regulation that establish the basic business environment in the domestic economy (e.g., technical, sanitary and phytosanitary standards, intellectual property law)."[4]

Ostry has aptly described the shift from the GATT to the WTO system: "the inclusion of the new issues and the creation of the new institution, the WTO, was to transform the multilateral trading system. . . . The most significant feature of the transformation was the shift in policy focus from the border barriers of the GATT to domestic regulatory and legal systems—the institutional infrastructure of the economy. . . . Implicit in this shift . . . is a move away from a model of *negative* regulation—what governments must not do—to *positive* regulations, or what governments must do" (2002, 287–88; emphases added). Under the single undertaking rule, participating countries had to accept all the multilateral agreements related to goods and services, and also TRIPS understandings on dispute settlement and on trade policy review mechanisms. Thus they had no option to pick and choose among the many agreements for acceptance. In fact, there were only *four* plurilateral agreements (on civil aircraft, government procurement, dairy, and bovine meat) that did not form part of the single undertaking.

Second, a fairly strong case can be made that the URA was unbalanced: developing countries undertook many costly commitments and obtained only a few commitments in return. Industrialized countries agreed to phase out MFA quotas and undertake a limited liberalization of agricultural trade. In fact, on balance, there was virtually no liberalization of agricultural trade in the URA. Although subsidies on exports of manufactures (which some developing countries offered to their infant manufactured exports) were made WTO-inconsistent, agricultural export subsidies (which were used mainly by industrialized countries, particularly the members of the European Union) were reduced, but not eliminated. It is true that developing countries were given a longer time to implement their commitments as compared with industrialized countries. As the implementation began, however, many developing countries found that even the longer implementation periods might not be long enough. India wanted the issues of imbalance and implementation to be addressed before the start of any new round.

4. Finger and Schuler (2000, 511).

Third, in India's view the mandated review of the agreements on agriculture in the Uruguay Round, TRIPS, services, and the yet to be initiated negotiations on maritime services, would occupy negotiators for some time to come. Also, an agreement on the movement of natural persons is yet to be reached. Fourth, given the problems of implementation of Uruguay Round commitments, India felt that it was too soon to add commitments from a new round of negotiations. India's opposition to the start of a new round of MTNs continued even after the failure of the Seattle ministerial in the period before the fourth ministerial meeting opened in Doha in November 2001. Before turning to India's role at Doha, it is useful to explore the reasons for the failure of the Seattle ministerial.

The Failed Ministerial at Seattle

The first point is that there was no agreement at preparatory meetings on a draft of a ministerial statement for discussion at Seattle. Agricultural protection, in particular, was a divisive issue; agricultural exporters of the Cairns Group, Japan, the European Union, and the United States were deeply divided on the elimination of export subsidies and import restrictions. As was noted above, there was no agreed-on draft at the start of the Punta del Este ministerial—the division on agriculture among the European Union, Japan, and the United States then was equally wide, and developing countries were against the inclusion of new issues such as services in the negotiating agenda. Yet at the last minute, a compromise was reached that launched the Uruguay Round. However, this did not happen in Seattle. Why?

Although the demonstrations and the violence on the streets of Seattle did disrupt the meetings, they had little to do with the failure of the ministerial. It was clear that the demonstrators were merely exploiting for their own purposes the genuine unease in industrialized and developing countries over the impact of the forces of globalization. They did not represent the majority of the population of workers of the United States, let alone of the world as a whole. The position taken by the AFL-CIO labor organization in the United States, a participant in the Seattle demonstration, on linking trade with the observance of "core" labor standards, was not shared by some major labor unions in developing countries, including India. The AFL-CIO represents no more than 15 percent of US workers, and it certainly does not represent organized or unorganized workers in developing countries.

To say that demonstrators represented narrow segments of world opinion is not to say, of course, that all the concerns of the demonstrators were without merit. Indeed, the demand for greater transparency in the processes of decision making in the WTO, particularly of its dispute settlement mechanism, is not without merit. Nevertheless, the allegation that the WTO is a supranational agency that tramples over the sovereignty of its members to serve the interests of transnational corporations at the expense of the world's workers and the environment had no merit whatsoever. It was, in fact, based on a complete misunderstanding, if not a willful misrepresentation, of the fact that the WTO is simply a facilitating forum for its member governments to ensure that the agreements and commitments into which they have voluntarily entered are kept.

The reasons for failure are elsewhere. The experience of the Uruguay Round encouraged a cautious approach. Many developing countries had concluded that, in retrospect, the URA was unbalanced in that it included TRIPS and TRIMs agreements that overall certainly did not benefit them in the short run (and probably not in the long run) in return for a backloaded phaseout of the MFA. In terms of market access, even after the URA commitments on reductions were allowed for, tariff peaks and tariff evaluation remained—and they mostly affected the exports of developing countries.

It is plausible that most developing countries did not anticipate the outlines of the eventual TRIPS agreement when they consented to include intellectual property in the Uruguay Round agenda. There was genuine concern among developing countries that the distinction between discussions leading to an agenda for negotiations and substantive negotiations on items to be included on the agenda had become blurred. Further, they were being pressured to bring labor and environmental standards into the WTO. Developing countries justifiably feared that any compromise on their part on issues to be included in the negotiating agenda would hurt them in subsequent negotiations. With the high perceived cost to them of the final TRIPS agreement very much in mind, they were less willing to compromise on including items (e.g., the so-called Singapore issues relating to investment, competition policy, trade facilitation, and transparency in government procurement) in the agenda of any future round for fear that an eventual agreement on some might be costly to them.

Many developing countries also felt that they had no voice in the so-called green room process in which a select group of countries participated in the negotiations and decided on an agenda that they later presented to the plenary. The fact that the leader of the delegation of the most powerful trading nation also chaired the ministerial did not help.

The single most important reason for the failure, however, was the statement by then-US president Bill Clinton that trade sanctions could be used to enforce core labor standards. It ruled out any compromise on the part of developing countries. It is evident that domestic political considerations, particularly ensuring the support of the labor unions for the Democratic Party in the 2000 presidential elections, weighed heavily in his decision to make such a statement. He insisted on linking trade with labor standards from the Seattle meeting until the end of his term. It remains to be seen whether President George W. Bush will also do the same. We hope that as a self-proclaimed free trader, he would see through the deceptively appealing notion that lower labor standards in a country relative to those of its trading partners confer on it an unfair competitive advantage.[5]

Labor, Environmental Standards, and the WTO: Key Misconceptions

The inclusion of labor standards in international trade agreements dates back to the charter of the International Trade Organization. Article 7 of the stillborn organization stated, "The members recognize that unfair labor conditions, particularly in the production for export, create difficulties in international trade, and accordingly, each member shall take whatever action may be appropriate and feasible to eliminate such conditions within its territory." The articles of the GATT, however, did not deal with labor standards except to prohibit trade in goods made with prison labor. Various administrations in the United States, both Democratic and Republican, unsuccessfully proposed the inclusion of a labor standards article in the GATT during several rounds of MTNs. Political parties have made similar proposals in national parliaments in several European countries and also in the European Parliament.

The demand for the formal inclusion of a "social" clause in the mandate of the WTO was raised *after* the painful and lengthy negotiations of the Uruguay Round had been completed and almost held the negotiated agreement hostage. The agreement was signed, but with an understanding that the topic of labor standards could be discussed by the preparatory committee for the WTO. At the first two ministerial meetings of the WTO in Singapore and Geneva, in 1996 and 1998 respectively, the ministers firmly shut the door against a social clause in the WTO, a decision that they reaffirmed at Doha. Still, with the United States continuing to push for a social clause—and in fact including clauses relating to labor standards in its bilateral trade agreements—it would be unwise to assume that the issue has lost its salience.

The fact that the demand for a social clause is unlikely to be given up by its powerful protagonists such as the United States does not necessarily make it legitimate. Indeed, if ethical considerations were the only factor behind this recent interest in labor standards, there would be no rea-

5. Unfortunately, by recently imposing tariffs on steel on the grounds that imports were hurting domestic industry and signing a bill providing large subsidies to agriculture, he has tarnished this image. However there are hopeful signs of change. The recent proposal of the Bush administration in the WTO negotiations on agriculture seeks a "ban on export subsidies, payments provided to increase foreign sales and sharp cuts in domestic support [capping it] at 5 percent of a country's total farm output, a [cut in] tariffs on farm products from a worldwide average of 62 percent to 15 percent in five years" (*New York Times,* July 24, 2002, A6).

son for demanding a social clause. There are better ways to promote them.

Srinivasan (1998c) has examined the arguments for the use of trade policy instruments for enforcing labor standards and human rights more generally and does not find them persuasive. It is frequently argued that fair trade or level playing fields constitute a precondition for free trade and therefore that the harmonization of domestic policies across trading countries is necessary before free trade can be embraced to one's advantage.

This argument is most manifest and compelling in its policy appeal in the area of environmental standards. It can be shown (Bhagwati and Srinivasan 1996), however, that the arguments in favor of free trade and diversity of environmental standards across countries are essentially robust. This follows from a straightforward extension of the proposition that, under standard assumptions ensuring perfect competition in all relevant markets, free trade is globally Pareto optimal. The introduction of environmental externalities (both domestic and international) necessitates the use of appropriate taxes, subsidies, and transfers to internalize the externality but does not call for a departure from free trade to achieve a globally Pareto-optimal outcome. Although some policy problems do arise in the context of transborder externalities, it suffices here to say that trade policy remedies are rarely the appropriate ones with which to address them.[6]

Although there are far better means than trade sanctions to protect the environment, promote better working conditions, and keep children in school rather than allowing them to work in poor countries, the demonstrators in Seattle—namely, the nongovernmental organizations (NGOs) and unions—were either unaware of them or worse still deliberately ignored them so as to create the impression that they held the moral high ground in agitating for a social clause. By contrast, the traditional protectionist lobbies in industrialized countries could not justify their transparently selfish protectionist objective on ostensibly moral grounds. Bhagwati (2001) suggests that the moral ground claimed for the social clause made it difficult for developing-country delegations to have their voices of opposition heard.

India and Multilateral Trade Negotiations after Doha

Although many of the concerns of India and other developing countries discussed above are legitimate and have some force, it is our view that these concerns are unlikely to be addressed except as part of a new round of MTNs. There are also many other substantial reasons for India (and de-

6. We refer the reader to Bhagwati and Srinivasan (1996) for an elaboration of these problems.

veloping countries) to be in favor of a new negotiating round. Yet, as Panagariya (2002) points out, India joined the Fourth Session of the Ministerial of the Conference of the WTO in Doha in November 2001 with a rather extreme position. India's commerce minister and leader of the Indian delegation at Doha, Murasoli Maran, in his opening statement said, "Rather than charting a divisive course in unknown waters, let this conference provide a strong impetus to the on-going negotiations on agriculture and services, and the various mandated reviews that by themselves form a substantial work program and have implicit consensus . . . [on Singapore issues]. . . . Questions remain even on the need for a multilateral agreement" (quoted in Panagariya 2002, 280).

Though agreeing that India's opposition to the inclusion of Singapore issues is defensible, Panagariya (2002) found India's stance disturbing on three aspects: (1) a failure to lend unequivocal support to liberalization in industrial products and, indeed, outright opposition to such liberalizations where India was concerned; (2) unduly large dispensation of the negotiating capital on the virtually empty box of implementation issues; and (3) posturing that seemed to convey the impression that India was opposed to the launch of the new round altogether. We concur with Panagariya's assessment.

India did not succeed in halting the launch of a new round at Doha. The ministerial declaration at the conclusion of the Doha session not only launched it but also enunciated a work program for the WTO involving the negotiation agenda and steps for meeting the challenges of the multilateral trading system. On the Singapore issues of environment, investment, and competition, the ministers agreed that negotiations would take place on the basis of a decision made by explicit consensus on modalities at the next ministerial conference in Cancún, Mexico, in 2003. India had to content itself with the clarification by the chair of the conference that the phrase "decision to be taken, by explicit consensus" applied to both the start of negotiations and their modalities. The legal standing of this clarification is doubtful; for all intents and purposes, only modalities of negotiations will be decided at Cancún, and negotiations will start thereafter. In the end, Maran joined other ministers in supporting the decision to launch a new round. In fact, he even claimed that the decision is a victory for India!

Briefly stated, on issues of implementation of the Uruguay Round commitments on which India expended so much negotiating capital in insisting that they be resolved—more or less as a "down-payment up front," before the start of any new round of MTNs—the Doha ministerial declaration did not announce any substantive decisions other than the easing of procedural constraints, appeals to members to use restraint in exercising their rights in relation to developing countries, and requests to WTO bodies to examine proposals that may help them (e.g., a request to the council on trade in goods to examine the proposal that when calculating the quote levels for the remaining years of the MFA, members will apply the most favorable methodologies available).

On agriculture, the ministers, "without prejudging the outcome of negotiations," committed themselves to "comprehensive negotiations aimed at substantial improvements in market access; reduction of, *with a view to phasing out, all forms of export subsidies*; and substantial reductions in trade distorting domestic support" (WTO 2001, para. 13 and 14; emphasis added). If these new commitments and earlier ones to establish a fair and market-oriented trading system that is free of distortions in agricultural markets were kept, the gains to India and other developing countries would be substantial. On nonagricultural products, the ministers agreed to reduce or eliminate tariff peaks, high tariffs, and tariff escalations on products of urgent interest to developing countries. On TRIPS, the ministers, in their declaration of public health, clarified its compulsory licensing provisions.

It is evident that, tactically, there is very little India (or developing countries that even together do not account for a significant share of world trade) could do to stop a new round if major world trading powers wish to start one. The Uruguay Round drove home this fact. Winham (1989, 54) attributed to one official who was involved in the negotiations that led to the Uruguay Round the following description of those negotiations: "It was a brutal but salutary demonstration that power would be served in that nations comprising five percent of world trade were not able to stop negotiation sought by nations comprising ninety-five percent of world trade."

This being the case, India's negotiating capital could have been more wisely deployed to ensure that the negotiating agenda was in its interest rather than to attempt to forestall a new round. After all, India has to remain actively engaged in the multilateral trading negotiations and system in its own interests (Mattoo and Subramanian 2000). Such engagement facilitates and "locks in" domestic reforms, provides a means of making commitments to the pursuit of good policies credible, ensures and expands India's access to world markets, and above all strengthens the multilateral process against threats of regionalism.[7]

Bergsten (1999) identifies several issues that are of great interest to India and that, in his view, India could present for inclusion in the negotiating agenda of the new round:

- ensuring that high tariffs will not replace, especially in the United States, the MFA quotas on many Indian apparel and textile exports after the phaseout of the MFA;

7. China is in fact using the commitments that it has made in its WTO accession agreement as a means of accelerating and deepening domestic reforms.

- ensuring elimination of the very high tariffs on agricultural imports in many industrialized countries, especially on products of export interest to India (e.g., rice);
- reaching new agreements on foreign direct investment that would both expand its levels and help India achieve a fair share of its benefits;
- instituting tougher disciplines on the use of antidumping duties, especially by the United States and the European Union;
- liberalizing the movement of natural persons, where India has a strong competitive advantage, under the GATS;
- eliminating preferential tariffs in regional arrangements, including the European Union and the North American Free Trade Agreement (NAFTA), that discriminate against Indian exports; and
- further strengthening of the DSM to help protect the rights of countries with lower trade levels.

We would, however, strengthen a few of Bergsten's suggestions and add some of our own.

First, we would suggest that India focus on obtaining greater commitment on the part of industrialized countries to maintain liberal market access. Tariff peaks and tariff escalation continue to limit developing countries' access to industrialized-country markets. In particular, markets for agricultural products, textiles, and apparel have remained closed despite the stated aim of the URA to lower border protection.[8]

Many countries have also resorted to antidumping measures and other nontariff barriers to protect their markets, and India is a frequent target of these trade-preventing tactics. According to the WTO (*Annual Report 2001*, tables IV.5 and IV.6), between July 1, 1999, and June 1, 2000, products exported from India were subject to 11 antidumping investigations, the seventh largest in number. The EU Commission has also recommended the imposition of antidumping duties on gray cotton cloth exports from India and a few other countries, a suggestion that could be attributed only to crass protectionist motives.

Unfortunately, India appears to be emulating the worst practices of industrialized countries. Between the establishment of the WTO in January 1995 and the end of 2001, it initiated 248 antidumping actions, the second

8. According to a recent report by the Organization for Economic Cooperation and Development, or OECD (*Financial Times*, April 11, 2001, 11), the URA has had limited impact—subsidies to producers accounted for as much as 40 percent of farm income in 30 OECD countries, and for more than two-thirds in Japan, Norway, South Korea, and Switzerland. The OECD report concludes that agricultural protection in rich countries is largely responsible for the stagnation at 40 percent of developing countries' share of global agricultural trade, whereas their share of manufactured trade has doubled from 14 to 29 percent in the past two decades.

largest number after the United States (255), and slightly larger than the 246 initiated by the EC. There were 69 antidumping measures initiated against India during the same period (http://www.wto.org, July 2002).[9] We deplore this trend and would recommend that India commit to eliminating the use of antidumping measures and to reducing its own tariffs (still high in comparison to those of other Asian developing economies) in return for market access.

Second, India and other developing countries have to be united in ensuring that the use of trade sanctions—for enforcing non-trade-related objectives such as intellectual property rights, human rights, and labor and environmental standards—do not get legitimized by expanding the mandate of the WTO in any future round. As was mentioned above, the TRIPS agreement has imposed high costs on India and other developing countries. The Trade and Environment Committee of the WTO could also be costly for India because the current linkage between market access and the enforcement of labor standards may offset the comparative advantage of India and other labor-abundant countries in labor-intensive products.[10]

These agreements are unlikely to be renegotiated or removed from the international agenda, however, and thus our advice focuses more on ways to mitigate their impact. The Doha ministerial declaration on public health, besides clarifying the compulsory licensing provisions of TRIPS, has extended the time period of implementation for least-developed countries. These are useful steps. More could be done to benefit poor countries.

For example, India could propose two amendments to TRIPS: first, to extend for all developing countries the period allowed to bring national patent regimes into compliance with TRIPS requirements and to institute a peace clause precluding the use of the WTO's DSM for TRIPS disputes for 10 years; and second, to expand the scope of the compulsory licensing provisions to allow countries (mainly very poor ones) that have no production capacity of their own to license to producers in other developing countries with such capacity to produce life-saving drugs under patents for their own use.

The Doha declaration, while taking note of this health issue, left the decision on it to the General Council of the WTO. India, a developing country with production capacity for drugs and pharmaceuticals, would potentially benefit from such an amendment. India should also emphasize its willingness to negotiate on environmental and labor standards in other arenas, such as the International Labor Organization or the United Nations Environment Program.

9. Imports from China were most frequently targeted, with 255 initiations. In May 2001, antidumping duties were imposed by India on imports of phosphoric acid from China, polyester film from Indonesia and South Korea, and ferrocyanide from the European Union.

10. I have elsewhere (Srinivasan 1998c) analyzed the economics of linking market access with the enforcement of labor standards.

Third, India should place negotiations toward further liberalization of movement of natural persons high on its agenda. It has a comparative advantage in labor-intensive services and in some skill-intensive services such as computer software. Though exports of software from its domestic base will continue to grow—to be able to provide in situ services in foreign markets and to keep up with technological developments—it is essential that Indian software technicians have the opportunity to work abroad without necessarily having to migrate permanently. Most Indian engineers entered the United States under a special category of nonimmigrant visas, but there is strong pressure to restrict the number of such visas issued. A liberal agreement (as part of the GATS of the WTO) on natural persons would facilitate such temporary migration.

Fourth, India like many other developing countries is moving in the wrong direction by championing regional agreements such as the South Asian Preferential Trade Agreement (SAPTA) and clamoring to become a member of other regional agreements. As happened when the Uruguay Round negotiations were stalled, the failure at Seattle to launch a new round has in part encouraged initiatives for negotiating preferential trade agreements (PTAs) in many parts of the world. India has to recognize that if progress in multilateral liberalization is slow, regional liberalization will become a serious, though much less desirable, alternative to multilateral liberalization.

The threat to the multilateral trading system from the proliferation of PTAs on a regional basis cannot be underestimated. As of mid-2000, there were 114 such agreements in effect and notified to the WTO by one or more WTO members (WTO, *Annual Report 2001*, 37). Virtually all WTO members, other than China (including Hong Kong and Macau), Japan, and Mongolia, were partners in at least one regional trade agreement (RTA).

The European Union is a partner in the largest number of agreements, encompassing Europe, Africa, Asia, and, as of 2000, Latin America. The WTO recognizes that "the trend to the conclusion of RTAs, which took off in the 1990s, continued to be very strong in 2000; indeed, perhaps the term 'regional' is increasingly superfluous to describe the plethora of new agreements linking countries around the globe" (WTO, *Annual Report 2001*, 39). In April 2001, US President George W. Bush and the leaders of 33 other nations met in Quebec City, Canada, at a summit. They instructed their ministers to conclude, no later than January 2005, negotiations on a free trade area extending from the high Arctic in the north to Tierra del Fuego in the south. Finally, the expansion of the European Union, with the admission of some Central and Eastern European countries, is likely to take place in the very near future.

It has been claimed (World Bank 2000b) that contemporary RTAs involve benefits from "deeper" integration through the harmonization of standards, competition and investment rules, and so on, and that there are political benefits such as greater national security, greater bargaining power in global negotiations, and the possibility of "locking in" domestic reforms by invoking commitments undertaken in an RTA. However, no convincing case or evidence has been offered as to why preferential trading is a perquisite for reaping these unconventional benefits. The argument that preferential trade liberalization on a discriminatory regional basis and on a multilateral, nondiscriminatory basis are mutually reinforcing is utterly convincing. The fact that the results of preferential regional liberalization in South Asia through SAPTA have been very disappointing, and that no other regional agreements appear to be open for India, suggests that India should now become an active promoter, rather than a staller as in the past, of wider and deeper liberalization of trade in the new round of MTNs launched at Doha.

In our judgment, the discriminatory and trade-diverting aspects of PTAs, regardless of whether they are "open" or not, far outweigh any benefits to be reaped. "Open regionalism" is almost an oxymoron—either a trading arrangement is open in the only relevant sense, namely, it does not discriminate among trading partners, or it is regional and discriminates against nonmembers outside the region. It cannot be both. Allowing membership in a PTA to be open for anyone to join it does not eliminate its discriminatory features and cannot make it acceptable in a nondiscriminatory trading system.

The bargaining strength of large trading nations in bilateral and regional negotiation, moreover, is enhanced in comparison with multilateral negotiation. This is already seen in agreements like NAFTA and the United States–Jordan Free Trade Agreement—the United States has been able to incorporate labor and environmental standards into them. For these reasons, India should push to replace Article XXIV of the GATT dealing with customs unions and free trade areas with the requirement that preferences granted to partners in any PTA should be extended on an MFN basis to all members of the WTO within a specified period, say, 5 to 10 years. It should not devote energy to asking for the elimination of preferential tariffs against Indian exports in RTAs and PTAs of which India is not a member.

Fifth, India and other developing countries also have a vital interest in reforming the WTO's decision-making procedures. It is now a body of 142 members. Satisfying the principles of transparency and representation—while ensuring an orderly and efficient decision-making process in such a large body whose members have diverse interests and resources—is a challenge. Clearly, requiring consensus among all members for any decisions, though it bestows bargaining power to otherwise weaker members of the body, could paralyze decision making in a large body. Other means, such as requiring an appropriately specified majority (e.g., two-thirds of the members of which the proportion of developing-country members exceeds a threshold) could be used to give bargaining power to weaker members.

Sixth, as we noted above, the WTO's dispute settlement mechanism replaced the political process of the GATT with a costly adversarial legal process in which the DSM's Appellate Body has become very powerful. By accepting amicus briefs from groups that do not represent members of the WTO, it has moved into uncharted waters. India could propose a review and rethinking of the DSM.

The possibility of allowing NGOs to be represented in the decision-making bodies of the WTO, of which acceptance of amicus briefs by the DSM's Appellate Body is just one example, is a second important procedural issue to resolve. An affirmative answer implies that national governments do not adequately represent the views of the private groups in their own countries. The NGOs claim "that national pursuit of environmental, labor, and human rights goals are being deflected by economic considerations." Business interests, however, claim "that the government's pursuit of the nation's economic interests is being unduly restrained by concerns about more ephemeral political interests" (Hudec 1999, 47).

We do not deny that the legitimacy of rules, procedures, and practices of the WTO as a body created by treaties among governments ultimately rests on whether such treaties are entered into and ratified by a domestic process in each country that is perceived to be legitimate. But we feel that granting NGOs representation could have potentially serious consequences and that India should strongly oppose it. We take this position for several reasons. First, allowing groups to override their failure in domestic processes through their participation in intergovernmental bodies dulls incentives either to push for sustainable democratic processes or for participation to emerge. Any concession toward participation granted to domestic groups by their government, purely in response to being pressured by such groups in international bodies, is unlikely to be sustained.

Second, allowing nongovernmental participation in international affairs is likely to exacerbate inequalities between citizen groups. India is a pluralistic and participatory democracy and is home to a large number of NGOs involved in social, economic, religious, and charitable activities. A few of them, such as labor unions and lobbying groups, are formally organized, with a constitution, rules for membership, and procedures for making decisions. Most are informal, however, and there is no way of judging whom they represent and whether in any sense their own internal organization is participatory. Even if some reasonably well-defined and verifiable criteria are applied to which organizations will be entitled to send observers to meetings of the WTO, the World Bank, or another comparable body, it is almost certain that governments in power will have to face them at two levels, in the domestic political arena and in an international organization. Third, the possibility that governments' actions taken after due debate at home will be challenged again in international bodies by opponents who failed in the domestic arena is likely to have a significant paralyzing effect on the governments.

Appendix 3.1
Origins and Founding of the GATT

The origins of the GATT can be traced to the Proposals for an Expansion of World Trade and Employment (hereafter, the Proposals) circulated by the United States in December 1945. The United States subsequently invited 15 countries, including India, to participate in negotiations to reduce trade barriers and sponsored a resolution in the United Nations Economic and Social Council calling for a Conference on Trade and Employment with the Proposals as a possible agenda. This conference, prepared by Chile, Lebanon, and Norway as well as the United States and the original 15 invitees, was held in Havana from November 1947 to March 1948. Four more countries—Burma, Ceylon (Sri Lanka), Southern Rhodesia, and Syria—later joined the negotiations on reducing trade barriers. A discussion on a draft charter for an international trade organization (ITO) to be presented to the Havana conference and the negotiations on tariff reduction went on simultaneously in Geneva.

From the outset, in the preparatory committee for the Havana conference, Brazil, Cuba, and India criticized the US proposals as being motivated by a desire of industrialized countries to keep developing countries dependent on them. Development issues inspired the most violent and protracted controversies at the conference itself. The draft charter for the ITO drawn up by the preparatory committee for the Conference was almost unanimously denounced by the developing countries, including India, as being against their interests. Nonetheless, after a prolonged deadlock and a series of compromises, a charter was adopted with only three countries—Argentina, Poland, and Turkey—dissenting (Wilcox 1949). After all this, however, the ITO did not come into being, mainly because some countries (including the United States) did not ratify the charter.

Meanwhile, the Geneva negotiations for reductions in tariffs were successfully concluded with the GATT even before the opening of the Havana conference in November 1947. Some of the signatories to the GATT feared that the trade concessions agreed to in the GATT might unravel if their implementation were delayed until the GATT could be subsumed in the ITO after the Havana conference. Other signatories wished to avoid going through the ratification process twice, once for the GATT and then for the ITO.[11] As a compromise, the GATT was brought into force through a provisional protocol of application that was adopted and signed by 23 Contracting Parties, including India, and the newly created Pakistan in October 1947. From October 1947 until the establishment of the WTO in January 1995, the GATT operated under its provisional protocol. The

11. Signatories are "Contracting Parties" in GATT parlance, denoting independent customs jurisdictions such as Hong Kong as well as countries.

attempt in 1955 by the Contracting Parties to create an organization for trade cooperation failed.

In the words of the eminent legal scholar John Jackson (1989, 89), "The GATT has limped along for nearly 40 years with almost no 'basic constitution' designed to regulate its organizational activities and procedures." The convention of arriving at decisions through consensus has given each party near-veto power and has imparted a remarkable stability to the agreement. The only substantial formal amendment to the GATT was a protocol to the articles of agreement adopted in 1965 to add a fourth part dealing with trade and development.

The fundamental principle of nondiscrimination among its Contracting Parties was enshrined in Articles I and III respectively on most favored nations and on the national treatment requirement of the GATT. The first required that any tariff concessions granted by one Contracting Party on imports from another be automatically extended to imports from all other Contracting Parties. The second ensured that once imports from one party entered another party's markets after the payment of applicable customs duties and other charges at the border, such imports were treated on par with domestic output with respect to *domestic* tax and nontax measures. Although derogations from this principle were already in the GATT (e.g., exceptions for customs unions and free trade areas), they did not seriously compromise it.

The GATT and Developing Countries

The GATT appears to have contributed significantly to the growth of world trade. Eight successful rounds of MTNs on reducing barriers to trade have been concluded under the GATT's auspices. The volume of world trade grew at an unprecedented average rate of 8 percent a year between the founding of the GATT in 1947 and the first oil shock in 1973. Although the annual rate of growth declined significantly during the period of adjustment to the two oil shocks to 3.7 percent during the period 1973–80 and 4.3 percent during the period 1980–90, it recovered to 6.5 percent during the period 1990–99. In all periods, it still exceeded the rate of growth of world output. In fact, during the period 1950–94 as a whole, the volume of merchandise trade grew to nearly 15 times its level in 1950, while output grew to six times its level in 1950. Against this background, however, India's share of world trade *declined* from more than 2 percent in the early 1950s to about 0.7 percent in 2000.

India and other developing countries with inward-oriented development strategies have not taken full advantage of this growth in world trade and have acted to counter some of the GATT's trade-opening influence. In retrospect, it could be argued that the fact that the ITO did not come into existence was fortunate because it would have allowed developing countries to easily exempt themselves from trade agreements. Wilcox (1949, 148) points out that more than three-fourths of the economic development chapter, consisting of Articles 13 and 15, "[was] devoted to an elaboration of methods by which underdeveloped countries may obtain release from commitments assumed under trade agreements and under the charter with respect to commercial policy." This conditional and temporary release was considered inadequate at the time by developing countries.

Provisions within the original charter of the GATT have nevertheless allowed developing countries to retain trade restrictions. Article XVIII, a holdover from the above-mentioned Article 13 of the ITO charter, was the principal provision in the GATT dealing with trade problems of developing countries until the adoption of Part IV on trade and development in 1964. Given the consultations, annual reporting requirements, and reviews needed for taking advantage of most sections of Article XVIII for imposing trade-restricting measures for any extended period of time, few developing countries made major use of them. Instead, they availed themselves of its provision under Section B that allowed the use of QRs for containing balance of payments deficits. India invoked this provision as late as in 1998, after 7 years of reforms, to justify its slow pace of phasing out QRs on imports of consumer goods. This was challenged in the WTO by the United States among others, and the Dispute Settlement Mechanism ruled against India. As was noted above, India lost its appeal against this ruling in the DSM's Appellate Body and had to remove all its QRs in 2000 and 2001.

Developing countries also succeeded later in formally incorporating "a differential and more favorable treatment" for themselves into the GATT in the agreement concluding the Tokyo Round of multilateral trade negotiations. This treatment included not having to reciprocate any tariff concessions by industrialized countries. By demanding and receiving an apparently differential and more favorable treatment, developing countries including India triply hurt themselves: once through the direct costs of their being able to continue their counterproductive import-substitution strategies without fear of retaliation by their trading partners; a second time by having to accept blatantly GATT-inconsistent trade barriers erected by industrialized countries, for example in textiles and apparel, through the MFA; and a third time by giving the opportunity to the industrialized countries to maintain higher than average MFN tariffs on goods of export interest to themselves.

Incorporation of Part IV of the GATT

In 1958, a decade after the GATT's coming into force, a panel of GATT-appointed experts chaired by Gottfried Haberler examined the trade relations between less developed and industrialized countries.[12] Their report concluded that barriers of all kinds in industrialized countries to the import of products from developing countries contributed significantly to the trade problems of developing countries. The GATT responded to the Haberler report by establishing the so-called Committee III, which was to review the trade measures restricting less-developed-country exports and to recommend a program for trade expansion by reducing trade barriers.

The response of industrialized countries to the Committee III report, although positive, did not result in substantial reductions in barriers. Indeed, some of the barriers identified by Committee III, such as significant tariffs on tropical products, tariff escalation, QRs, and internal taxes, continued to exist nearly three decades later at the start of the Uruguay Round negotiations. They have not been completely eliminated even after the reductions in trade barriers agreed to in the round.

Twenty-one developing countries, including India—disappointed with the response of industrialized countries to the report of Committee III—introduced a resolution in the GATT in 1963 calling for an action program. This consisted of a standstill on all new tariff and nontariff barriers, elimination within 2 years of all GATT-illegal QRs, removal of all duties on tropical primary products, elimination of internal taxes on products wholly or mainly produced in developing countries, and adoption of a schedule for the reduction and elimination of tariffs on semiprocessed and processed products.

The GATT ministerial meeting of 1963, in response to the demand for an action program, appointed a committee to draft amendments to the GATT to provide a legal and institutional framework within which the GATT Contracting Parties could discharge their responsibilities toward developing countries. Dam (1970) remarks that this step was also a reaction to the preparations already in progress for the first United Nations Conference on Trade and Development. The proposed amendments were approved in 1964 and became Part IV of the GATT, entitled "Trade and Development."

Dam concludes that apart from its symbolic importance in sensitizing the Contracting Parties to the new role of the GATT in development, less-developed countries achieved little by way of precise commitments (and even these were highly qualified) but a lot in terms of verbiage. Among the major provisions of Part IV is that on reciprocity (or more precisely, nonreciprocity): the industrialized countries decided not to require reciprocity for their commitments to reduce tariff and other barriers from developing countries. Far from benefiting developing countries, this provision actually placed them in a weaker bargaining position to combat GATT-inconsistent barriers in industrialized countries against their exports.

12. The other members of the panel were Oswaldo Campos, James Meade, and Jan Tinbergen.

The Generalized System of Preferences

After the incorporation of Part IV in 1964, the next major GATT event from the perspective of developing countries was the grant of a 10-year waiver from the MFN clause with respect to tariffs and other preferences favoring the trade of developing countries. Under the waiver, any Contracting Party could deviate from MFN for a period of 10 years and charge a lower tariff on imports from developing-country Contracting Parties than on similar imports from other Contracting Parties. The waiver specified that such preferences must be nondiscriminatory.

This so-called Generalized System of Preferences (GSP) was later included under the rubric of the enabling clause of the Tokyo Round (1973–79), which formalized the "differential and more favorable treatment" of developing countries in the GATT. Contrary to the provisions of the waiver, industrialized countries chose the countries to be favored, the commodities to be covered, the extent of tariff preferences, and the period for which the preferences were granted when implementing the GSP.

Some countries, in fact, linked the granting of preferences to the performance of a developing country in non-trade-related areas. The United States, for example, withdrew GSP status from Chile in 1987 because Chile did not provide its workers "internationally accepted" rights. Some of the more advanced developing countries benefited to a greater extent from the GSP and expanded their exports to industrialized countries. This led industrialized countries to demand the "graduation" of such countries from the ranks of those entitled to the GSP. As was the case with reciprocity, the benefits, if any, from the GSP for developing countries were far outweighed by the cost in terms of weakening their case against other GATT-inconsistent barriers in industrialized countries to their exports.

Developing Countries and the GATT: Two Opposite Interpretations

The experience of developing countries in the GATT up to the conclusion of the Tokyo Round in 1979 could be interpreted in two diametrically opposed ways. On the one hand, it could be said that from the Havana conference to now, developing countries again and again have been frustrated in getting the GATT to reflect their concerns. Tariffs and other barriers in industrialized countries on their exports were reduced to a smaller extent than those on exports of industrialized countries in each round of the MTNs. Products in which they had a comparative advantage, such as textiles and apparel, were taken out of the GATT discipline altogether. Agriculture, a sector of great interest to developing countries, largely remained outside the GATT framework. "Concessions" granted to developing countries, such as the inclusion of Part IV on trade and development and the Tokyo Round enabling clause on special and differential treatment, were mostly rhetorical. Others, such as the GSP, were always heavily qualified and quantitatively small. In sum, one interpretation is that the GATT was indifferent, if not actively hostile, to the interests of developing countries.

The other interpretation is that developing countries, in their relentless but misguided pursuit of the import-substitution strategy of development, in effect opted out of the GATT. If they had participated fully, vigorously, and on equal terms with industrialized countries in the GATT negotiations and unilaterally adopted an outward-oriented development strategy, they could have achieved far faster and better growth than that achieved by demanding and receiving crumbs—such as the GSP and a permanent status of inferiority under the "special and differential" treatment clause—from the rich man's table. The experience of rapidly growing economies of East Asia, notwithstanding the financial crisis that engulfed them in 1997, provides evidence in support of this view. Given India's early start in industrialization before the East Asian countries, India certainly would have grown faster under an outward-oriented policy regime.

MEKONG ECONOMICS

Special Economic Zones as a Trade Facilitation Measure

Asia-Pacific Trade Facilitation Forum 2011

By Adam McCarty (www.mekongeconomics.com)

5 October, 2011 – COEX, Seoul, Republic of Korea

SEZs presentation content:

1. What are SEZs and what role do they play?
2. Experience with SEZs and emerging trends and practices.
3. Lessons learned and looking forward.

Types of zones: for rich and poor countries

	Objective	Typical Size	Location	Eligible Activities	Markets
EPZ	Export manufacturing	< 200 hectares	Ports, airports	Mostly manufacturing	Export
Industrial Zone	Industrial development	< 100 hectares	Mixed	Industry	Domestic and export
Free Trade Zone	Support trade	< 50 hectares	Ports, airports	Mostly trade-related processing and services	Re-export, domestic
Enterprise Zone	Urban area renewal	< 50 hectares	Inner city areas	All	N/A
SEZ/Freeport	Integrated development	> 100 km2	Mixed	Multi-use	Domestic, internal, export

MEKONG ECONOMICS

The typical purpose for having SEZs:

- Attract FDI
- Increase exports + forex earnings
- Diversify exports
- Create jobs

→ **Trade and investment policy (STATIC trade facilitation)**

- Generate spillovers of knowledge / technology to support upgrading
- Facilitate development of clusters
- "Laboratories" (pilots) for reform
- Regional development

→ **Spatial industrial policy (DYNAMIC)**

MEKONG ECONOMICS

South Korea used Zones as Catalysts for broader reform

- Equal footing policies extended to firms in domestic customs areas enhanced competitiveness.
- Almost $200 million of local capital and intermediate goods purchased be zone firms per month.
- Liberal FDI policies were tested in free zones before being extended countrywide.

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How do SEZs achieve these aims?

- Overcoming constraints to serviced industrial land
- Concentrating investments to overcome infrastructure gaps
- Improving the regulatory and administrative environment
- Streamlining trade procedures
- Facilitating agglomeration

SEZs are often “second best” trade facilitation solutions for developing countries

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The traditional approach to zone development

Objectives

- Promotion of exports
- Promotion of FDI

Physical Characteristics/Development Approach

- Located as fenced-in enclave, often in remote area – geographical de-limitation
- Public sector monopoly

Policy Features

- 70-80% export requirement: oriented to FDI
- Duty-free Area
- Manufacturing-oriented: Neglected services, intermediaries, logistics
- Extreme view of extra-territoriality
- Tax Incentives

Institutional Features

- Zone Authority owns, operates, regulates the zone
- Zone funded by government; typically subsidized services & facilities
- Zone Authority exerts little power over other government bodies
- Separate Customs Area, recognized by Kyoto Convention

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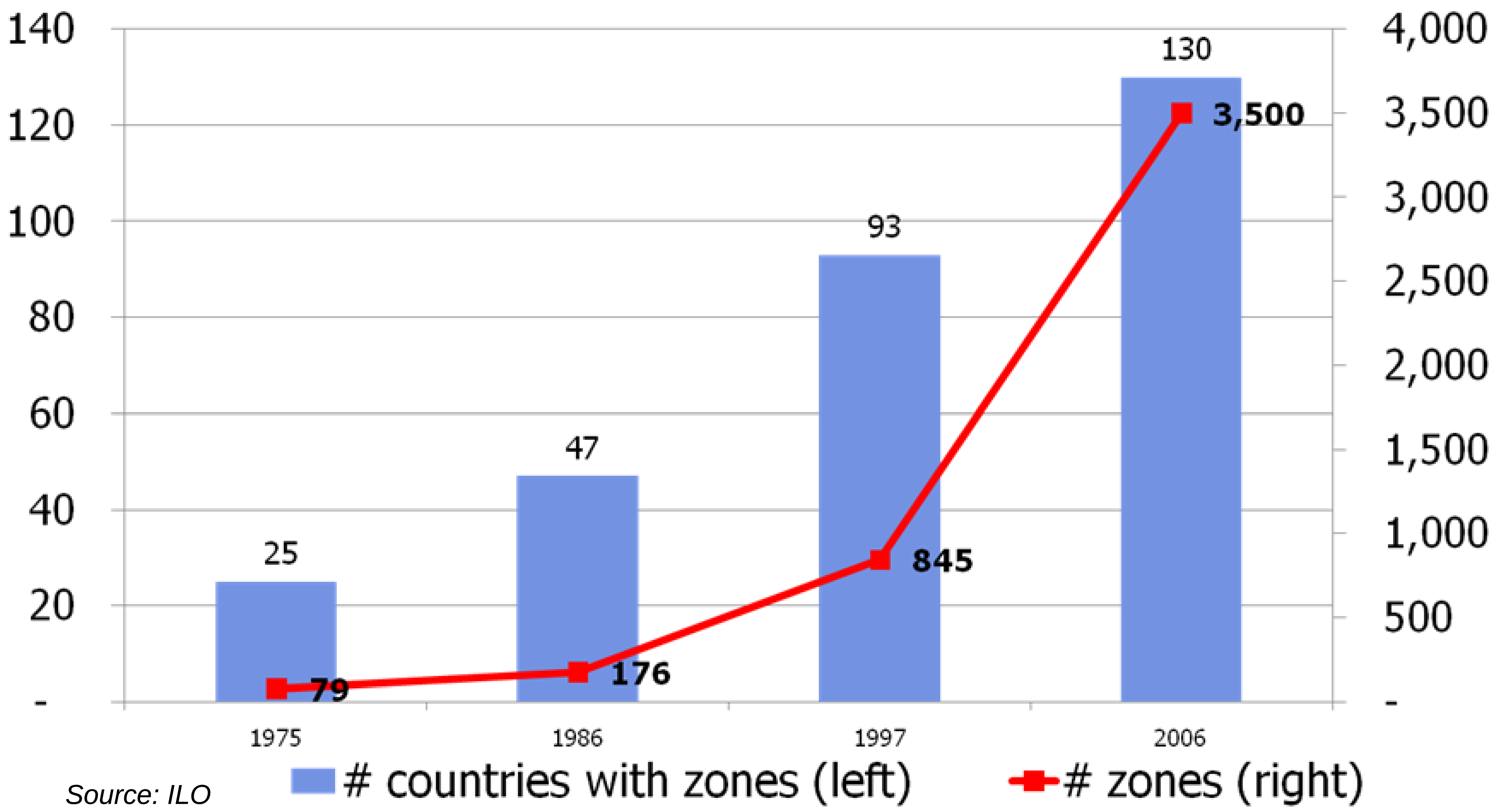
SEZs have proliferated in recent years



Source: ILO

Summary of economic impacts: global experience

- Most zones have had a significant economic impact in terms of
  - Rapid employment generation especially for women
  - Higher pay levels and growth rates
  - Exports, especially in smaller countries
  - Skills and technology transfer

- But success has been more limited in other areas
  - Low net exports due to low local value-added
  - Linkages (local content, etc.)
  - Development of lagging regions
  - Unclear cost/benefit structure with incentives, infrastructure…
  - Continued levels of administrative barriers
  - Social issues

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Long term trends relating to SEZs

Trade and investment trends that remain critical for free zones

1. Global production networks (continue to evolve)
2. Dominance of Asian manufacturing
3. Rise of services sector and trade
4. Global integration through WTO combined with growing regional blocs (and economic corridors)
5. Niches in standards-related differentiated global markets (e.g. environmental compliance).

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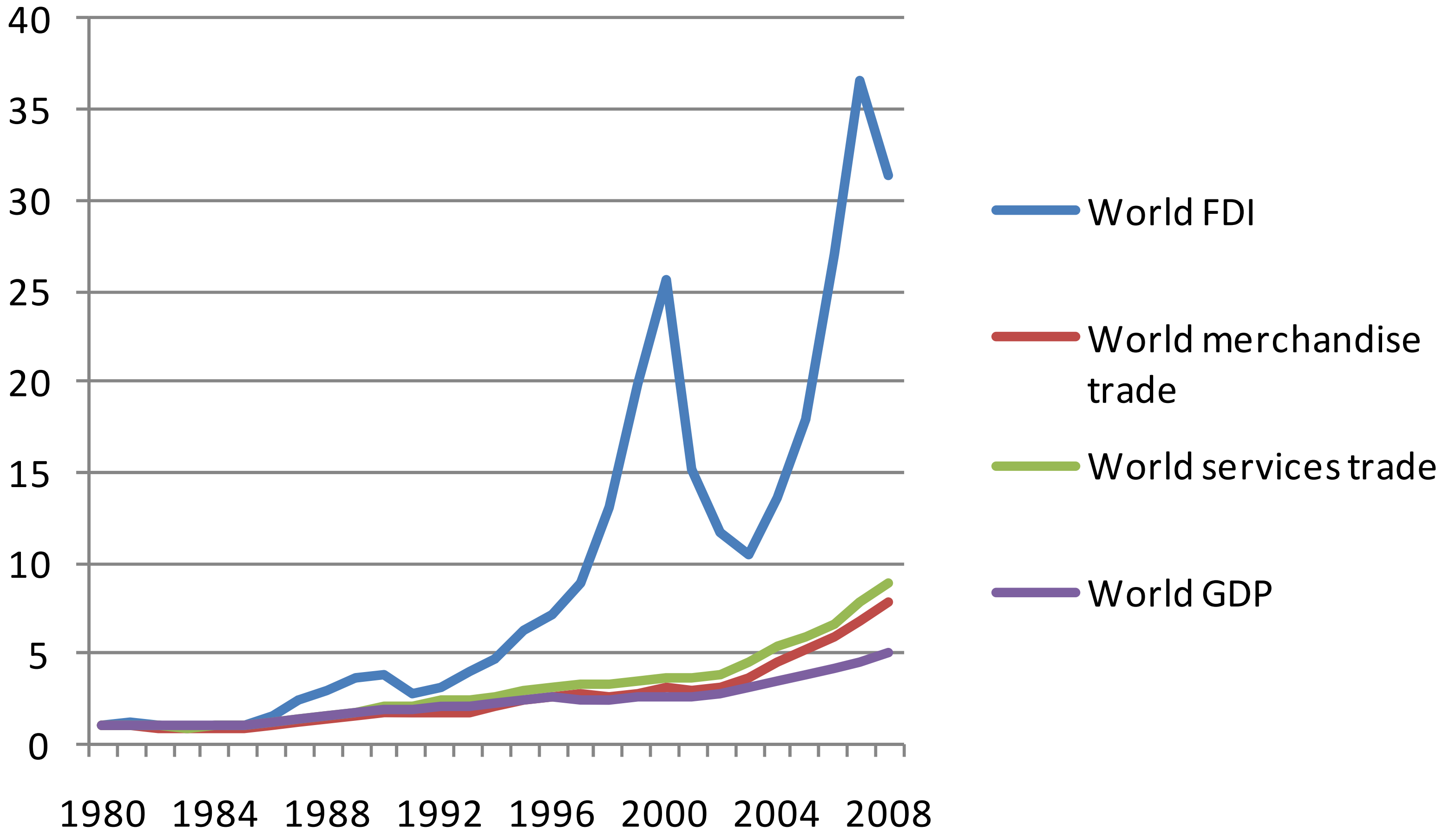
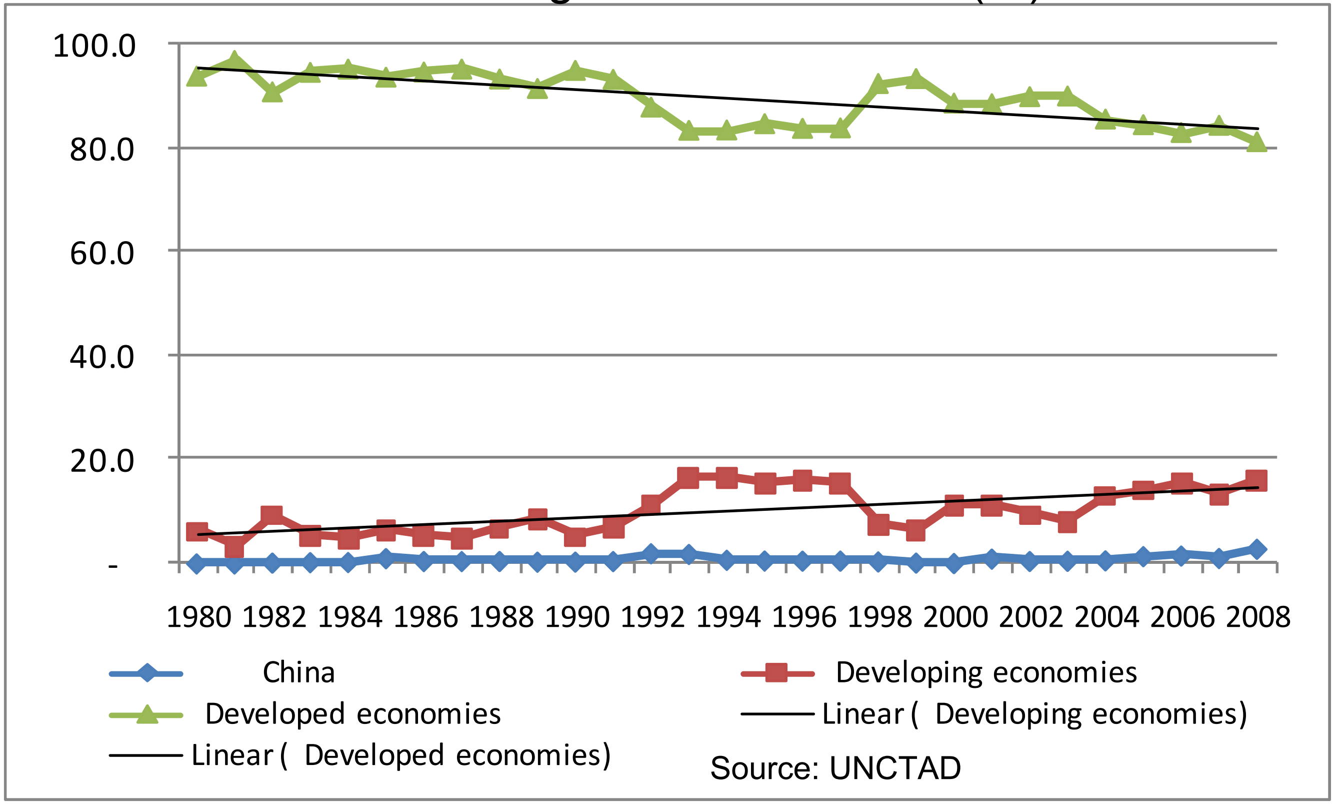
Global trend: FDI growth has been exceptional for two decades



Trends impacting zones: shift in FDI sources

Share of global FDI outflows (%)



- China's FDI (less than 2% of global direct investment) on par with Singapore, but very small compared, for example, to UK (12.8%) and USA (17.6%)

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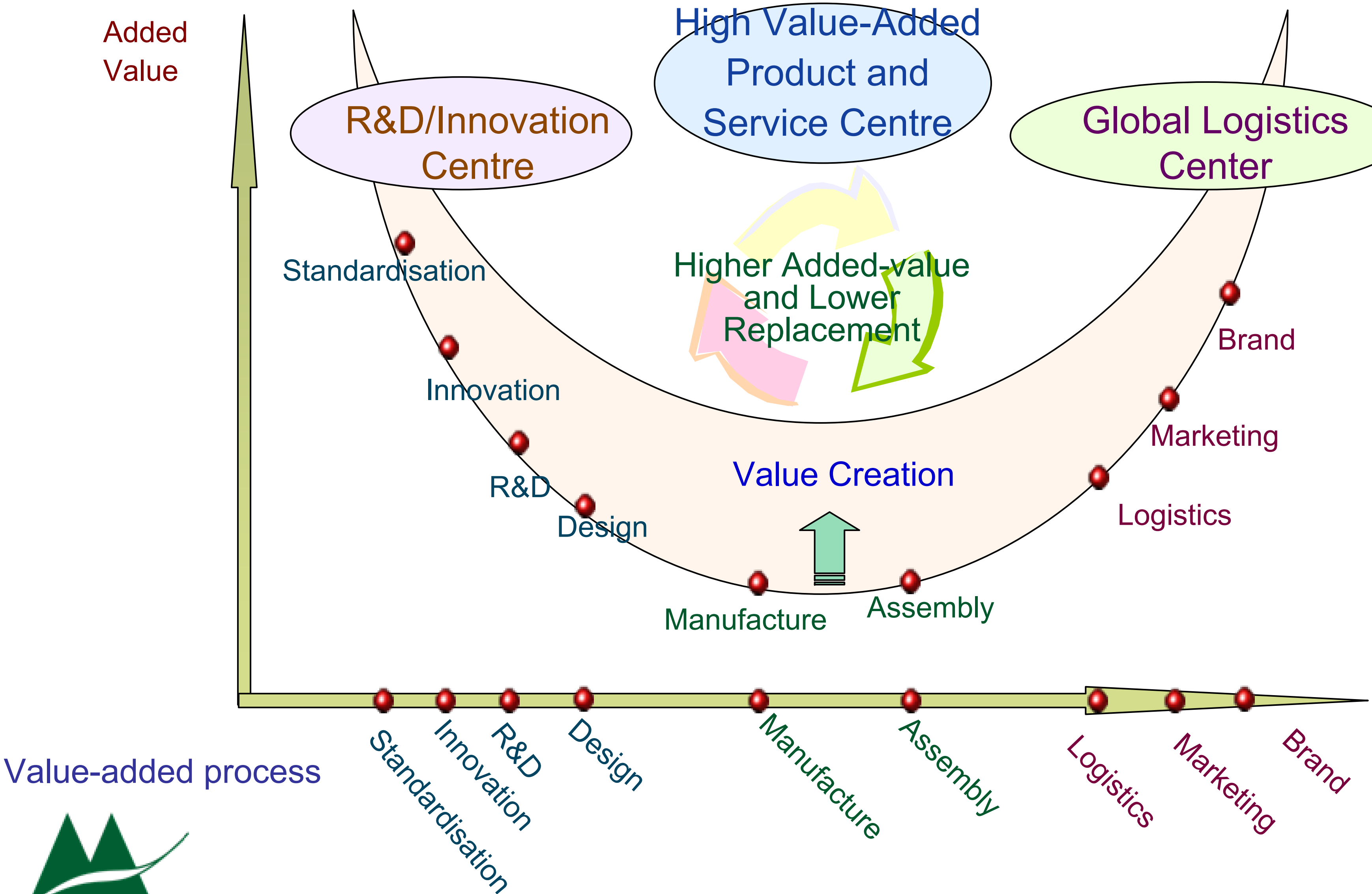
Global trend: Services

- Services are rapidly becoming the greatest contributor to economic activity in developed and developing economies alike, currently worth around $2.4 trillion in global exports.
- Services now account for 67% of global economic output.
- In developing countries, the share of GDP generated by services has been growing; it rose from 37% in 1970 to 45% in 2006.
- The biggest contributors to the recent growth have been the knowledge-intensive business services such as telecommunications, computer and IT Services, R&D Services, financial services, legal, accountancy, management consultancy services, architecture, engineering, advertising, market research, media and energy and environmental services.

"Smiley Face": conceptual model of the shift to a high value added, globally integrated, services economy

(*Source:* Business Week International online extra, May 16, 2005)



SEZ Policy in the Context of WTO Rules

- Number of WTO member states: 153 ... and growing
- SEZs not specifically mentioned in WTO agreements, but several types of incentives subject to WTO disciplines
- Most notably export subsidies and domestic content subsidies are prohibited by WTO → impacting terms of trade
  - SEZs have not YET been the subject of GATT / WTO disputes.

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SEZ policies that are WTO consistent

- Exemptions of duties and indirect taxes on:
  - Exported goods;
  - Imported goods consumed in the production process;
  - Production waste when it is exported/discarded;
  - Goods stored in SEZs
- Measures imposed by private-sector entities unless they are implementing a government directive or the benefit is funded by government
- Non-specific subsidies, based on objective criteria and eligibility is automatic

SEZ policies that are WTO illegal

- Agreement on Subsidies and Countervailing Measures:
  - Direct subsidies contingent on export performance or similar discrimination in favor of production for export rather than the domestic market
- Agreement on Trade-Related Investment Measures:
  - Measures that restrict imports to favor the use of domestic inputs
- General Agreement on Tariffs and Trade:
  - Requirements or preferences to use domestic inputs (violation of National Treatment);
  - Use of quotas and/or licenses to restrict trade

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SEZ policies that are WTO questionable

- Duty and tax free treatment of production equipment
  - Status of capital goods used in SEZs unclear
- Government subsidies for infrastructure development
  - But only if subsidies conditional on export performance
- Government subsidies to zone-based companies that export most production, but no *de jure* government export requirement
  - *De facto* interpretation (e.g. Australia: Automotive Leather)

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Looking Forward for SEZs:

- Need to balance market / FDI focus
  - Opportunities in domestic/regional markets, Asia and elsewhere (economic corridors)
- Shift from manufacturing cost-driven to wider supply-chain driven bases of competition
  - Building competitive locational advantages, including reliable infrastructure, utilities, and multi-modal transport
  - Using zones to develop competitive value chains (e.g. agri-based)
- Seek out opportunities in services sectors
  - SEZs can play a role in getting around regulatory/monopoly hurdles
- Shift from hard to soft and "WTO-smart" incentives
  - Competitiveness based on services and <u>efficiency</u>
- Opportunities in "green" zones / facilitating environmental compliance?

ZONES CAN ALSO PLAY AN IMPORTANT ROLE IN INCUBATING WIDER NATIONAL POLICY REFORMS

Looking Forward: Emerging zone development approaches

Physical features

- Integrated, mixed-use, large-scale “mega zones”
- IT systems & networks
- Purpose-built facilities (clusters and market niches)

Development Approach

- Public-private partnerships OR Private developer builds/owns/operates zones on cost-recovery basis

Policy Framework

- Special (“First World”) Regulatory Environment
- Multi-market, not just export
- Wide range of activities permitted
- Deregulation and demonopolization
- Streamlined procedures, automation
- Shift towards universal taxes/ Low Tax Area
- Adherence to universal labor rights
- Sector specific regulations

Institutional Framework

- Zone authority regulates activities within just one zone
- One-stop shop for zone regime regulation

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The future for SEZs

- They have grown incredibly rapidly over the past 20 years, as a cause and consequence of FDI flows.
- HOWEVER, "achieving success with SEZ programs in the future will require adopting a more flexible approach to using the instruments of economic zones in the most effective way to leverage a country's sources of comparative advantage, and to ensure flexibility to allow for evolution of the zone program over time. Most fundamentally, this will require a change in mind-set away from the traditional reliance on fiscal incentives and wage restraint, and instead focusing on facilitating a more effective business environment to foster firm-level competitiveness, local economic integration, innovation, and social and environmental sustainability.**"** **Special Economic ZonesProgress: Emerging Challenges, and Future Directions** (2011) Thomas Farole and Gokhan Akinci (eds.) World Bank.

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Questions?

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9

CONCEPT OF LIBERALIZATION, PRIVATIZATION AND GLOBALIZATION

Unit structure

9.0 OBJECTIVES

1. To understand the concepts of liberalization, privatization and globalization

2. To study the growth of information technology and communication and it's impact manifested in everyday life.

3. To examine impact of globalization on industry; changes in employment and increasing migration.

4. To bring out the changes in the agrarian sector due to globalization; rise in corporate farming and increase in farmer's suicides.

9.1 CONCEPT OF LIBERALIZATION

Globalization and privatization have become the buzzwords in the current economic scenario. The concepts of liberalization, globalization and privatization are actually closely related to one another. This LPG phenomenon was first initiated in the Indian Economy in 1990 when the Indian Economy experienced a severe crisis. There was decline in the country's export earnings, national income and industrial output. The government had to seek aid from IMF to resolve it's debt problem. That is when the government decided to introduce the New Industrial Policy (NIP) in 1991 to start liberalizing the Indian economy.

Liberalization means elimination of state control over economic activities. It implies greater autonomy to the business enterprises in decision-making and removal of government interference. It was believed that the market forces of demand and supply would automatically operate to bring about greater efficiency and the economy would recover. This was to be done internally by introducing reforms in the real and financial sectors of the economy and externally by relaxing state control on foreign investments and trade.

With the NIP' 1991 the Indian Government aimed at integrating the country's economy with the world economy, improving the efficiency and productivity of the public sector. For attaining this objective, existing government regulations and restrictions on industry were removed. The major aspects of liberalization in India were ;

1.Abolition of licensing : NIP'1991 abolished licensing for most industries except 6 industries of strategic significance. They include alcohol, cigarettes, industrial explosives, defense products ,drugs and pharmaceuticals, hazardous chemicals and certain others reserved for the public sector. This would encourage setting up of new industries and shift focus to productive activities.

2.Liberalization of Foreign Investment : While earlier prior approval was required by foreign companies, now automatic approvals were given for Foreign Direct Investment (FDI) to flow into the country. A list of high-priority and investment-intensive industries were delicensed and could invite up to 100% FDI including sectors such as hotel and tourism, infrastructure, software development .etc. Use of foreign brand name or trade mark was permitted for sale of goods.

3.Relaxation of Locational Restrictions : There was no requirement anymore for obtaining approval from the Central Government for setting up industries anywhere in the country except those specified under compulsory licensing or in cities with population exceeding1 million. Polluting industries were required to be located 25 kms away from the city peripheries if the city population was greater than 1 million.

4.Liberalization of Foreign Technology imports : In projects where imported capital goods are required, automatic license would be given for foreign technology imports up to 2 million US dollars. No permissions would be required for hiring foreign technicians and foreign testing of indigenously developed technologies.

5.Phased Manufacturing Programmes :Under PMP any enterprise had to progressively substitute imported inputs, components with domestically produced inputs under local content policy. However NIP'1991 abolished PMP for all industrial enterprises. Foreign Investment Promotion Board (FIPB) was set up to speed up approval for foreign investment proposals.

6.Public Sector Reforms : Greater autonomy was given to the PSUs (Public Sector Units) through the MOUs (Memorandum of Understanding) restricting interference of the government officials and allowing their managements greater freedom in decision-making.

7.MRTP Act : The Industrial Policy 1991 restructured the Monopolies and Restrictive Trade Practises Act. Regulations relating to concentration of economic power, pre-entry restrictions for setting up new enterprises, expansion of existing businesses, mergers and acquisitions .etc. have been abolished.

9.2 CONCEPT OF PRIVATIZATION

Privatization is closely associated with the phenomena of globalization and liberalization. Privatization is the transfer of control of ownership of economic resources from the public sector to the private sector. It means a decline in the role of the public sector as there is a shift in the property rights from the state to private ownership. The public sector had been experiencing various problems , since planning, such as low efficiency and profitability, mounting losses, excessive political interference, lack of autonomy, labour problems and delays in completion of projects. Hence to remedy this situation with Introduction of NIP'1991 privatization was also initiated into the Indian economy. Another term for privatization is Disinvestment. The objectives of disinvestment were to raise resources through sale of PSUs to be directed towards social welfare expenditures, raising efficiency of PSUs through increased competition, increasing consumer satisfaction with better quality goods and services, upgrading technology and most importantly removing political interference.

The main aspects of privatization in India are as follows;

1.Autonomy to Public sector : Greater autonomy was granted to nine PSUs referred to as 'navaratnas' (ONGC, HPCL, BPCL, VSNL, BHEL) to take their own decisions.

2.Dereservation of Public Sector : The number of industries reserved for the public sector were reduced in a phased manner from 17 to 8 and then to only 3 including Railways, Atomic energy, Specified minerals. This has opened more areas of investment for the private sector and increased competition for the public sector forcing greater accountability and efficiency.

3.Disinvestment Policies : Till 1999-2000 disinvestment was done basically through sale of minority shares but since then the government has undertaken strategic sale of it's equity to the private sector handing over complete management control such as in the case of VSNL , BALCO .etc.

9.3 CONCEPT OF GLOBALIZATION

Globalization essentially means integration of the national economy with the world economy. It implies a free flow of information, ideas, technology, goods and services, capital and even people across different countries and societies. It increases connectivity between different markets in the form of trade, investments and cultural exchanges.

The concept of globalization has been explained by the IMF (International Monetary Fund) as 'the growing economic interdependence of countries worldwide through increasing volume and variety of cross border transactions in goods and services and of international capital flows and also through the more rapid and widespread diffusion of technology.'

The phenomenon of globalization caught momentum in India in 1990s with reforms in all the sectors of the economy. The main elements of globalization were;

1. To open the domestic markets for inflow of foreign goods, India reduced customs duties on imports. The general customs duty on most goods was reduced to only 10% and import licensing has been almost abolished. Tariff barriers have also been slashed significantly to encourage trade volume to rise in keeping with the World trade Organization (WTO) order under (GATT)General Agreement on Tariff and Trade.
2. The amount of foreign capital in a country is a good indicator of globalization and growth. The FDI policy of the GOI encouraged the inflow of fresh foreign capital by allowing 100 % foreign equity in certain projects under the automatic route. NRIs and OCBs (Overseas Corporate Bodies)may invest up to 100 % capital with repatriability in high priority industries. MNCs and TNCs were encouraged to establish themselves in Indian markets and were given a level playing field to compete with Indian enterprises.

3. Foreign Exchange Regulation Act (FERA) was liberalized in 1993 and later Foreign Exchange Management Act (FEMA) 1999 was passed to enable foreign currency transactions.
4. India signed many agreements with the WTO affirming it's commitment to liberalize trade such as TRIPs (Trade Related Intellectual Property Rights), TRIMs (Trade Related Investment Measures) and AOA (Agreement On Agriculture).

9.3.1 Impact of Globalization:

Advantages of Globalization:

- There is a decline in the number of people living below the poverty line in developing countries due to increased investments, trade and rising employment opportunities.
- There is an improvement in various economic indicators of the LDCs (Less Developed Countries) such as employment, life expectancy, literacy rates, per capita consumption etc.
- Free flow of capital and technology enables developing countries to speed up the process of industrialization and lay the path for faster economic progress.
- Products of superior quality are available in the market due to increased competition, efficiency and productivity of the businesses and this leads to increased consumer satisfaction.
- Free flow of finance enable the banking and financial institutions in a country to fulfill financial requirements through internet and electronic transfers easily and help businesses to flourish.
- MNCs bring with them foreign capital, technology, know-how, machines, technical and managerial skills which can be used for the development of the host nation.

Disadvantages of Globalisation:

- Domestic companies are unable to withstand competition from efficient MNCs which have flooded Indian markets since their liberalized entry. It may lead to shut down of operations, pink slips and downsizing. Moreover skilled and efficient labour get absorbed by these MNCs that offer higher pay and incentives leaving unskilled labour for employment in the domestic industries. Thus there may be unemployment and underemployment.
- Payment of dividends, royalties and repatriation has in fact led to a rise in the outflow of foreign capital.

- With increased dependence on foreign technology, development of indigenous technology has taken a backseat and domestic R and D development has suffered.
- Globalization poses certain risks for any country in the form of business cycles, fluctuations in international prices, specialization in fewexportables and so on.
- It increases the disparities in the incomes of the rich and poor, developed nations and LDCs. It leads commercial imperialism as the richer nations tend to exploit the resources of the poor nations.
- Globalization leads to fusion of cultures and inter-mingling of societies to such an extent that there may be a loss of identities and traditional values. It gives rise to mindless aping of western lifestyles and mannerisms however ill-suited they may be.
- It leads to overcrowding of cities and puts pressure on the amenities and facilities available in urban areas.

The International Environment

The International Environment

International managers face intense and constant challenges that require training and understanding of the foreign environment. Managing a business in a foreign country requires managers to deal with a large variety of cultural and environmental differences. As a result, international managers must continually monitor the political, legal, sociocultural, economic, and technological environments.

The political environment

The political environment can foster or hinder economic developments and direct investments. This environment is ever-changing. As examples, the political and economic philosophies of a nation's leader may change overnight. The stability of a nation's government, which frequently rests on the support of the people, can be very volatile. Various citizen groups with vested interests can undermine investment operations and opportunities. And local governments may view foreign firms suspiciously.

Political considerations are seldom written down and often change rapidly. For example, to protest Iraq's invasion of Kuwait in 1990, many world governments levied economic sanctions against the import of Iraqi oil. Political considerations affect international business daily as governments enact **tariffs** (taxes), **quotas** (annual limits), **embargoes** (blockages), and other types of restriction in response to political events.

Businesses engaged in international trade must consider the relative instability of countries such as Iraq, South Africa, and Honduras. Political unrest in countries such as Peru, Haiti, Somalia, and the countries of the former Soviet Union may create hostile or even dangerous environments for foreign businesses. In Russia, for example, foreign managers often need to hire bodyguards; sixteen foreign businesspeople were murdered there in 1993. Civil war, as in Chechnya and Bosnia, may disrupt business activities and place lives in danger. And a sudden change in power can result in a regime that is hostile to foreign investment; some businesses may be forced out of a country altogether. Whether they like it or not, companies are often involved directly or indirectly in international politics.

The legal enviroment

The American federal government has put forth a number of laws that regulate the activities of U.S. firms engaged in international trade. However, once outside U.S. borders, American organizations are likely to find

that the laws of the other nations differ from those of the U.S. Many legal rights that Americans take for granted do not exist in other countries; a U.S. firm doing business abroad must understand and obey the laws of the host country.

In the U.S., the acceptance of bribes or payoffs is illegal; in other countries, the acceptance of bribes or payoffs may not be illegal—they may be considered a common business practice. In addition, some countries have copyright and patent laws that are less strict than those in the U.S., and some countries fail to honor these laws. China, for example, has recently been threatened with severe trade sanctions because of a history of allowing American goods to be copied or counterfeited there. As a result, businesses engaging in international trade may need to take extra steps to protect their products because local laws may be insufficient to protect them.

The economic environment

Managers must monitor currency, infrastructure, inflation, interest rates, wages, and taxation. In assessing the economic environment in foreign countries, a business must pay particular attention to the following four areas:

Average income levels of the population. If the average income for the population is very low, no matter how desperately this population needs a product or service, there simply is not a market for it.

Tax structures. In some countries, foreign firms pay much higher tax rates than domestic competitors. These tax differences may be very obvious or subtle, as in hidden registration fees.

Inflation rates. In the U.S., for example, inflation rates have been quite low and relatively stable for several years. In some countries, however, inflation rates of 30, 40, or even 100 percent per year are not uncommon. Inflation results in a general rise in the level of prices, and impacts business in many ways. For example, in the mid-1970s, a shortage of crude oil led to numerous problems because petroleum products supply most of the energy required to produce goods and services and to transport goods around the world. As the cost of petroleum products increased, a corresponding increase took place in the cost of goods and services. As a result, interest rates increased dramatically, causing both businesses and consumers to reduce their borrowing. Business profits fell as consumers' purchasing power was eroded by inflation. High interest rates and unemployment reached alarmingly high levels.

Fluctuating exchange rates. The exchange rate, or the value of one country's currency in terms of another country's currency, is determined primarily by supply and demand for each country's goods and services. The government of a country can, however, cause this exchange rate to change dramatically by causing high inflation—by printing too much currency or by changing the value of the currency through devaluation. A foreign investor may sustain large losses if the value of the currency drops substantially.

When doing business abroad, businesspeople need to recognize that they cannot take for granted that other countries offer the same things as are found in industrialized nations. A country's level of development is often determined in part by its infrastructure. The **infrastructure** is the physical facilities that support a country's economic activities, such as railroads, highways, ports, utilities and power plants, schools, hospitals, communication systems, and commercial distribution systems. When doing business in less developed countries, a business may need to compensate for rudimentary distribution and communication systems.

The sociocultural environment

Cultural differences, which can be very subtle, are extremely important. An organization that enters the international marketplace on virtually any level must

make learning the foreign country's cultural taboos and proper cultural practices a high priority. If a business fails to understand the cultural methods of doing business, grave misunderstandings and a complete lack of trust may occur.

Management differences also exist. In China, a harmonious environment is more important than day-to-day productivity. In Morocco, women can assume leadership roles, but they are usually more self-conscious than American women. In Pakistan, women are not often found in management positions, if they're in the workplace at all.

In addition, the importance of work in employees' lives varies from country to country. For example, the Japanese feel that work is an important part of their lives. This belief in work, coupled with a strong group orientation, may explain the Japanese willingness to put up with things that workers in other countries would find intolerable.

Likewise, culture may impact what employees find motivating, as well as how they respond to rewards and punishments. For example, Americans tend to emphasize personal growth, accomplishment, and “getting what you deserve” for performance as the most important motivators. However, in Asian cultures, maintaining group solidarity and promoting group needs may be more important than rewarding individual achievements.

Finally, language differences are particularly important, and international managers must remember that not all words translate clearly into other languages. Many global companies have had difficulty crossing the language barrier, with results ranging from mild embarrassment to outright failure. For example, in regards to marketing, seemingly innocuous brand names and advertising phrases can take on unintended or hidden meanings when translated into other languages. Advertising themes often lose or gain something in translations. The English Coors beer slogan “get loose with Coors” came out as “get the runs with Coors” in Spanish. Coca-Cola's English “Coke adds life” theme translated into “Coke brings your ancestors back from the dead” in Japanese. In Chinese, the English Kentucky Fried Chicken slogan “finger-lickin' good” came out as “eat your fingers off.”

Such classic boo-boos are soon discovered and corrected; they may result in little more than embarrassments for companies. Managers should keep in mind that countless other, more subtle blunders may go undetected and damage product performance in less obvious ways.

The technological environment

The technological environment contains the innovations, from robotics to cellular phones, that are rapidly occurring in all types of technology. Before a company can expect to sell its product in another country, the technology of the two countries must be compatible.

Companies that join forces with others will be able to quicken the pace of research and development while cutting the costs connected with utilizing the latest technology. Regardless of the kind of business a company is in, it must choose partners and locations that possess an available work force to deal with the applicable technology. Many companies have chosen Mexico and Mexican partners because they provide a willing and capable work force. GM's plant in Arizpe, Mexico, rivals its North American plants in quality.

Consumer safety in a global marketplace

The United States leads the world in spending on research and development. As products and technology become more complex, the public needs to know that they are safe. Thus, government agencies investigate and ban potentially unsafe products. In the United States, the Federal Food and Drug Administration has set up complex regulations for testing new drugs. The Consumer Product Safety Commission sets safety standards for consumer products and penalizes companies that fail to meet them. Such regulations have resulted in much higher research costs and in longer times between new product ideas and their introduction. This is not always true in other countries.

Functions of the International Manager

Global competition has forced businesses to change how they manage at home and abroad. The increasing rate of change, technological advances, shorter product life cycles, and high-speed communications are all factors that contribute to these changes. The new management approach focuses on establishing a new communication system that features a high level of employee involvement. Organizational structures must also be flexible enough to change with changing market conditions. Ongoing staff development programs and design-control procedures, which are understandable and acceptable, are outcomes from this new approach. Management values are changing, and managers must now have a vision and be able to communicate the vision to everyone in the firm.

Although the international manager performs the same basic functions as the domestic manager, he must adjust to more variables and environments. Therefore, each of the five basic management functions must change when operating in a foreign market.

Planning

The first stage of international planning is to decide how to do business globally: whether to export, to enter into licensing agreements or joint ventures, or to operate as a multinational corporation with facilities in a foreign country.

To develop forecasts, goals, and plans for international activities, the manager must monitor environments very closely. Key factors include political instability, currency instability, competition from governments, pressures from governments, patent and trademark protection, and intense competition.

Organizing

International firms should be sure that their plans fit the culture of the host country. Typically, U.S. firms feel that long-term plans should be three to five years in length; but in some cultures, this time period is too short. Many countries must plan with the assistance of governmental agencies. And working through bureaucratic structures, policies, and procedures is often time-consuming.

International businesses must be organized so that they can adapt to cultural and environmental differences. No longer can organizations just put "carbon copies" or clones of themselves in foreign countries. An international firm must be organized so that it can be responsive to foreign customers, employees, and suppliers. An entire firm may even be

organized as one giant worldwide company that has several divisions. Above all, the new organization must establish a very open communication system where problems, ideas, and grievances can quickly be heard and addressed at all levels of management. Without this, employees will not get involved, and their insights and ideas are crucial to the success of the business.

As an organization extends its operations internationally, it needs to adapt its structure. When the organization increases its international focus, it goes through the following three phases of structural change:

Pre-international stage. Companies with a product or service that incorporates the latest technology, is unique, or is superior may consider themselves ready for the international arena. The first strategy used to introduce a product to a foreign market is to find a way to export the product. At this phase, the firm adds an export manager as part of the marketing department and finds foreign partners.

International division stage. Pressure may mount through the enforcement of host country laws, trade restrictions, and competition, placing a company at a cost disadvantage. When a company decides to defend and expand its foreign market position by establishing marketing or production operations in one or more host countries, it establishes a separate international division. In turn, foreign operations begin, and a vice president, reporting directly to the president or CEO, oversees the operations.

Global structure stage. A company is ready to move away from an international division phase when it meets the following criteria:

The international market is as important to the company as the domestic market.

Senior officials in the company possess both foreign and domestic experience.

International sales represent 25 to 35 percent of total sales.

The technology used in the domestic division has far outstripped that of the international division.

As foreign operations become more important to the bottom line, decision making becomes more centralized at corporate headquarters. A functional product group, geographic approach, or a combination of these approaches should be adopted. The firm unifies international activities with worldwide decisions at world headquarters.

Staffing

Because obtaining a good staff is so critical to the

success of any business, the hiring and development of employees must be done very carefully. Management must be familiar with the country's national labor laws. Next, it must decide how many managers and personnel to hire from the local labor force and whether to transfer home-based personnel.

For example, U.S. firms are better off hiring local talent and using only a few key expatriates in most cases, because the costs of assigning U.S.–based employees to positions overseas can be quite expensive. Simply, expatriates (people who live and work in another country) are expensive propositions even when things go well. Adding up all the extras—higher pay, airfare for family members, moving expenses, housing allowances, education benefits for the kids, company car, taxes, and home leave—means that the first year abroad often costs the multinational company many times the expatriate's base salary. The total bill for an average overseas stay of four years can easily top $1 million per expatriate. In any case, managers need to closely examine how to select and prepare expatriates.

Directing

Cultural differences make the directing function more difficult for the international manager. Employee attitudes toward work and problem solving differ by country. Language barriers also create communication difficulties. To minimize problems arising from cultural

differences, organizations are training managers in cross-cultural management. Cross-cultural management trains managers to interact with several cultures and to value diversity.

In addition, the style of leadership that is acceptable to employees varies from nation to nation. In countries like France and Germany, informal relations with employees are discouraged. In Sweden and Japan, however, informal relations with employees are strongly encouraged, and a very participative leadership style is used. Incentive systems also vary tremendously. The type of incentives used in the U.S. may not work in Europe or Japan, where stable employment and benefits are more important than bonuses.

Controlling

Geographic dispersion and distance, language barriers, and legal restrictions complicate the controlling function. Meetings, reporting, and inspections are typically part of the international control system.

Controlling poses special challenges if a company engages in multinational business because of the far-flung scope of operations and the differing influences of diverse environments. Controlling operations is nonetheless a crucial function for multinational managers. In many countries, bonuses, pensions, holidays, and vacation days are legally mandated and considered by many employees as rights. Particularly powerful unions exist in many parts of the world, and their demands restrict managers' freedom to operate.

Personal Challenges for Global Managers

Building an internationally competent workforce whose members know the business and are flexible and open-minded can take years. Multinational organizations can no longer rely on just a few managers with multicultural experience or a few experts on a particular country to succeed. In short, all employees must have some minimal level of international expertise and be able to recognize cultural differences that may affect daily business communications and working relationships.

In general, overseas managers share common traits with their domestic counterparts. Wherever a manager is hired, he or she needs the technical knowledge and skills to do the job, and the intelligence and people skills to be a successful manager. Selecting managers for expatriate assignments means screening them for traits that predict success in adapting to what may be dramatically new environments.

Beyond the obvious job-specific qualifications, an organization needs to consider the following qualities and circumstances when selecting expatriates for positions in foreign countries:

A willingness to communicate, form relationships with others, and try new things

Good cross-cultural communication and language skills

Flexibility and open-mindedness about other cultures

The ability to cope with the stress of new situations

The spouse's career situation and personal attributes

The existence of quality educational facilities for the candidate's children

Enthusiasm for the foreign assignment and a good track record in previous foreign and domestic moves

Of course, the factors that predict a successful expatriate assignment are not identical for everyone. These differences—which reflect variations in the expatriate's home culture, his or her company's human resource management practices, and the labor laws specific to the foreign country—must also be factored into the selection process.

Even if these complexities are taken into account in the selection process, a person chosen for a foreign assignment may decide not to accept the job offer. The financial package needs to be reasonably attractive. In addition, family issues may be a concern. Most candidates, after a position is offered, also want information about how the foreign posting will impact their careers.

If a potential candidate accepts the job offer, he or she should be aware of the potential for cultural shock—the confusion and discomfort a person experiences when in an unfamiliar culture. In addition, ethnocentrism, or the tendency to view one's culture as superior to others, should be understood and avoided.

The Multinational Corporation

In the period after World War One, America fell under the sway of "America First" thinking. In 1929, a great financial disaster occurred, and America suffered its worst depression. At first, laissez faire economic methods were adopted, but with the election of Franklin Roosevelt, a British economist's theories were tried. John Maynard Keynes came up with the idea that government should "prime the pump" of the national economy with spending programs. It seemed to work. After World War II, America took the opposite approach and helped its world neighbors rebuild their economies.

The die was cast for more international involvement.

Before many years had passed, American companies had invested money in many foreign lands. Revlon, Coca-Cola, GM, most of the oil companies, and even major banks all had large international operations.

If a company wants to venture into the international marketplace, it can use several different methods. In each case, the levels of risk and control move together. The four most common approaches include the following:

Exporting. The selling of an organization's products to a foreign broker or agent is known as **exporting.**The organization has virtually no control over how products are marketed after the foreign broker or agent purchases them. Because the investment is relatively small, exporting is a low-risk method of entering foreign markets. The only real danger here is what the foreign agent might do with the products to hurt the organization's or product's image.

Licensure agreement. This approach allows a foreign firm to either manufacture or sell products, or the right to place a brand name or symbols on products. Disney World, for example, has licensure agreements with many foreign firms. This approach provides more control than an export sale, as a firm can require that certain specifications be met, yet it is still not the manufacturer in the foreign market.

Multinational approach. With this approach, a firm is willing to make substantial commitment to a foreign market. Normally, products or services are modified to meet the foreign market demands, and in many cases, substantial fixed investments are made in plants and equipment. The most common ways to become a multinational firm are to form joint ventures or global strategic partnerships, or to establish wholly-owned subsidiaries.

Joint ventures occur when a company forms a partnership with a foreign firm to develop new products or to give each other access to local markets. Normally, the roles and responsibilities of each organization are clearly spelled out in the joint-venture agreement. This approach increases both control and risk.

Global strategic partnerships are much larger than a simple joint venture. Two firms join together and make a long-term commitment, in the form of time and investments, to develop products or services that will dominate world markets. This approach does not modify products for a particular market but develops a single product market strategy that can be utilized in all markets in hopes of dominating the worldwide market for that product.

Wholly-owned subsidiaries occur when a firm purchases either controlling interest or all of a foreign firm. Often, the subsidiary firm is given considerable freedom in terms of how to operate in the foreign market, and heavy use of foreign managers and employees is very common. The owning firm does have the most control, but it also has substantial investment risk.

Vertically integrated wholly-owned subsidiaries exist where a firm owns not only the foreign manufacturer but the foreign distributors and retailers as well. Again, the main emphasis is on dominating a worldwide product or service area with a single product market strategy. True global products are very difficult to develop, and it is even more difficult to dominate all global markets.

Of these approaches, **multinational corporations,** defined as organizations operating facilities in one or more countries, are major forces in the movement toward the globalization of businesses. Common characteristics of successful multinational corporations include the following:

Creation of foreign affiliates

Global visions and strategies

Engagement in manufacturing or in a restricted number of industries

Location in developed countries

Adoption of high-skills staffing strategies, cheap labor strategies, or a mixture of both.

Last modified: 3:44 pm

The World Bank

PREMnotes

December 1998

Number 11

Economic Policy

Export processing zones

Export processing zones are potentially useful tools for export promotion. To foster development, however, zones must be set up properly, managed well, and integrated with other reforms.

Over the past three decades export processing zones have become popular instruments of trade policy, offering firms located in them free trade conditions and a liberal regulatory environment. In 1970 only a handful of countries permitted such zones, but by 1996 there were more than 500 zones in 73 countries (OECD 1996). This note outlines the general features and objectives of these zones, highlights country experiences with them, and offers policy recommendations for establishing them.

What is a zone?

An export processing zone is one of many export promotion tools, including bonded warehouses and temporary admission schemes. Today's export processing zones have evolved from their original definition as "an industrial estate, usually a fenced-in area of 10–300 hectares, that specializes in manufacturing for export." (World Bank 1992, p. 7). Many firms, called export processing firms, now benefit from the incentives offered in the zones without being physically fenced in. In addition, countries have liberalized domestic sales—Mexico, for example, allows 20–40 percent of its zones' output to be sold domestically.

Export processing zones have three main goals. They are to provide a country with foreign exchange earnings by promoting nontraditional exports. They are to create jobs and generate income. And they are to attract foreign direct investment, engendering technology transfer, knowledge spillover, demonstration effects, and backward linkages.

Zones generally share several common features:

- They allow duty-free imports of raw and intermediate inputs and capital goods for export production.
- Government red tape is streamlined, allowing "one-stop shopping" for permits, investment applications, and the like. In addition, labor laws are often more flexible than for most firms in the domestic market.
- Firms in zones are given generous, long-term tax concessions.
- Communications services and infrastructure are more advanced than in other parts of the country. Utility and rental subsidies are common.
- Zone firms can be domestic, foreign, or joint ventures. Foreign direct investment plays a prominent role.

Two main features differentiate export processing zones, however. First, zones can be publicly or privately owned or managed. Over the past 10–15 years the number of privately owned or managed zones has grown substantially because they are believed to achieve superior results. Second, zones can be "high-end" or "low-end," depending on the quality of the management, facilities, and services they provide firms.

As export processing zones have become more widespread, the policies governing them have become more important

Zone experiences

Not all export processing zones have served as engines of industrialization and growth, as some proponents anticipated (Warr 1989, 1993; World Bank 1992). Zones have been engines—among others—in the economy when they have been given their proper place as a policy tool, and when their ultimate costs and achievements are taken into account. Zones have been very successful in Mauritius, for example, but have failed in Senegal.

Properly managed, zones can generate income and create jobs

Export processing zones are sensitive to the national economic environment and perform better when the host country pursues sound macroeconomic and realistic exchange rate policies. Properly managed, however, zones can generate income and create jobs—especially nontraditional employment and new employment opportunities for women (table 1). Their long-term contribution is twofold. A competitive, efficient zone provides an industrial infrastructure that many countries lack. In addition, zones build human capital directly and through their catalyst and demonstration effects on host country entrepreneurs.

Export processing zones build human capital in two ways. Previously unskilled workers benefit from job training and learning by doing (Rhee, Katterbach, and White 1990). These benefits are limited, however, because most production is low-skill and low-tech. Still, workers earn income and learn industrial work discipline and routine. Training also occurs at the supervisory and managerial levels, with local employees establishing foreign contacts and learning new organizational and managerial methods, negotiation and marketing skills, general business know-how, and a spirit of entrepreneurship.

Catalyst and demonstration effects are also common in the host economy (Rhee, Katterbach, and White 1990; Rhee and Belot 1990), though backward linkages between zones and domestic firms have not always occurred. In general, some linkages have occurred in countries that did not already have a solid industrial base. But these linkages have been spotty and inconsistent, with some zone firms complaining of the poor quality or incompatibility of local inputs. (Exceptions include the Dominican Republic and Mauritius.) Linkages have also occurred in economies—the Republic of Korea, Taiwan (China)—that had a solid industrial base prior to the establishment of the zones. In these cases, however, export processing zones were only one of the tools used to foster growth.

Zones have increased gross foreign exchange earnings. In Mauritius zone export earnings jumped from 3 percent of gross export earnings in 1971 to 67 percent in 1995. Net foreign exchange earnings have not always lived up to expectations, however. In 1996 gross exports of three Jamaican zones

Table 1 Employment creation and exports in selected export processing zones

Region and economy	*Year of first zone*	*Year of data*	*Number of workers*	*Number of firms*	*Zone exports/ gross exports (percent)*
Africa					
Cameroon	1990	1995	2,567	16	32.5
Mauritius	1971	1995	80,466	481	67.0
Senegal	1974	1990	600	10	1.8
Asia					
Bangladesh	1983	1995–96	37,533	2 zones	11.1
Philippines	1972	1994	81,559	from 4 zones	11.0
		1991	43,858	—	7.7 (1990)
Sri Lanka	1979	1998	85,323	6 zones	—
		1990	60,000	—	23.0
Taiwan (China)	1966	1995	55,191	235 (3 zones)	5.6
Latin America and the Caribbean					
Costa Rica	1972	1996	24,000	191	21.0
El Salvador	1976	1991	6,500	14	14.5
Honduras	1976	1991	19,000	49 (9 zones)	12.0
Jamaica	1976	1996	16,804	56 (3 zones)	16.2 (2.0 of net exports)

Source: World Bank data.

totaled $235 million, but net exports were just $29 million. Such earnings may not cover a country's investment in a zone. Similarly, the opportunity cost of such investments may not warrant the concessions granted (on income taxes and tariffs) to accommodate a zone. In fact, some zones may have a negative net present value for the country.

Wages in most export processing zones are equal to or higher than average wages outside the zones, though there is considerable variance around this mean. For instance, in Thailand in 1990 and Sri Lanka in 1992 wages in export processing zones were higher than outside the zones. But in Mauritius in 1986 and Taiwan (China) in 1988 they were lower. And lax labor, safety, and health laws in many zones have raised concerns about workers' welfare.

The environmental impact of zones and lax regulation and monitoring have also raised concern. Environmental pollution has been confirmed in some zones (for example, in the Dominican Republic and Mexico). But systematic analysis is lacking that would lead to well-targeted, sensible regulation and monitoring. Some observers argue that government attitudes toward worker and health conditions in and the environmental impact of zones may not be much different from prevalent national practices. Still, these are important concerns.

Some analysts consider a successful zone a model for host country policymakers to mimic in liberalizing the rest of the economy. Others argue that a successful zone may become a stumbling block for liberalization by providing jobs and foreign exchange earnings, and thus easing the pressure on policymakers to undertake economywide reforms (as in India and Tunisia). Other countries (Uganda) have considered or established zones after macroeconomic and trade reforms to bolster foreign direct investment.

General recommendations

In distorted economies an export processing zone is one of a number of tools used to offset anti-export bias. But just like other export promotion tools (bonded warehouses, export credit insurance), an export processing zone is a second-best policy choice.

Zones can play a long-term dynamic role in their host country's development if they are set up properly, managed well, and integrated with a national reform and liberalization program. At the very least they should not become impediments to reform.

For three reasons zones should not be established in liberal, low-protection economies. First, lower than expected or unsatisfactory foreign direct investment may be due to inadequate laws or regulations, or to other distorted economic incentives (such as weak private property laws). Second, zones are distortionary trade instruments and introduce an element of discretion in the policy environment. Finally, even if export promotion is appropriate (and compatible with World Trade Organization guidelines), an export processing zone may not be the best way to achieve that goal. If post-reform economies are intent on establishing new zones, differential fiscal incentives should be minimized to reduce their distortionary impact on the host economy.

Zones should not be established in liberal, low-protection economies

Policies for success

An export processing zone is more likely to succeed when monetary and fiscal policies are sound and stable, private property and investment laws are clear, firms are free to repatriate earnings at market rates, and there are no restrictions on foreign exchange.

Zone firms should be moderately taxed. There is no need for overly generous tax incentives (permanent tax holidays, waiving of all taxes). Indirect taxation and licensing should be rationalized and minimized, and zones' imports and exports should be free of trade taxation and tariffs.

Utilities (water, electricity, sewage, and the like) should not be subsidized; doing so discourages economically rational use of resources and factors of production, undermining zones' benefits for host countries. Providing infrastructure outside the zone—telephony, roads, ports—can have positive spillovers for the local and national economy by facilitating transportation and communications. But onsite

Governments should be fully appraised of the costs and benefits of the incentives they offer to export processing zones

infrastructure—pavement, building shells—should be privately financed.

Business-friendly labor laws lower labor costs. But strengthening regulations and monitoring can mitigate potential labor law infractions and improve working conditions, reducing turnover and absenteeism and increasing worker productivity.

An essential first step toward minimizing environmental impacts is to develop a qualitative and quantitative understanding of industrial refuse and its effects on air, soil, water, and human health. Follow-up regulations, incentives, and monitoring should be tailored accordingly.

Zones in countries that are members of preferential trade arrangements (regional or bilateral) may be more attractive to firms targeting these markets, because such a membership enlarges potential market size and eases entry barriers (as in Mauritius). Exports from these zones may, however, face complex rules of origin regulations and restrictions.

Administration, regulation, and incentives

Governments should be fully appraised of the costs and benefits—to the budget and to the country—of the incentives they offer to export processing zones. Incentives should be compatible with World Trade Organization rules and timelines on export promotion instruments; otherwise host countries may face retaliatory actions by importing countries. In addition, zones and export processing firms should be allowed to locate in various locations (as in Mauritius).

Government should provide efficient, streamlined, and prompt services for setting up and running export processing zones (approval of investment applications, customs and other supervisory institutions).Privately owned and managed zones should be encouraged. If zones are public, considerable autonomy should be granted (as in Taiwan, China).

Zone firms exporting from one member of a trade arrangement should be aware of potentially complex rules of origin and restrictions.

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Prepared for World Bank staff

1

The WTO and GATT: A Principled History

While the World Trade Organization in current existence provides its membership with forums for three interrelated functions—negotiation, illumination, and litigation—it is probably best known for the first of these. This chapter provides a brief overview of the negotiating forum of the General Agreement on Tariffs and Trade and its WTO successor, as well as how each has been used by the world's major trading nations since 1947.

Since the ultimate focus of this book is on developing countries and dispute settlement, it may appear strange to start with a topic that has little obvious relation to either. This chapter describes the relative success of the negotiating forum of the GATT—an agreement to which developing countries largely did not have a proactive contribution. A careful analysis of the origins of the GATT, as well as some of its later history, offers a tremendous number of lessons for developing countries and for the settlement of disputes. The underlying political and economic forces that create the incentives that shape trade relations between sovereign nations—be the countries developed or developing—remain relatively consistent over time. Thus the evidence from later chapters will substantiate that there is much to learn from the relative successes of the GATT and its negotiating history. These successes are particularly important to understand and appreciate given the extremely negative and pessimistic view that developing countries have of the current WTO bargain, which is described in chapter 2.

In the next section, I provide a brief introduction to the original GATT that was negotiated to conclusion in 1947, as well as the subsequent trade liberalization negotiations that took place over the next forty-five years. The third section presents the principles on which the GATT and the WTO are built—reciprocity, most-favored-nation treatment, and national treatment—and their practical relevance for shaping the outcomes of the negotiations. The final section describes some of the emerging evidence from more formal scholarship that finds that the GATT and the WTO (GATT/WTO), as well as these foundational principles, have an impact on government policies and subsequently on the trade flows and economic activity that such policies affect.

A Brief History of GATT Negotiations

The current WTO agreements are the legacy of commitments that countries have voluntarily negotiated with each other, on a repeat basis, in the decades since 1947. To understand the causes of the present patterns of import protection across WTO member countries as well as across products and industries within those countries, it is important to turn to the past.

The 1930s and 1940s era of the Great Depression and World War II provide important reminders of globalization's last dark episode of protectionism. The U.S. imposition of the Smoot-Hawley tariffs and the international retaliatory response in the 1930s led to the virtual halting of international commerce. Table 1-1 illustrates the pattern of the new trade barriers that were implemented by the United States and a number of other European countries during the Great Depression. What is clear is that the level of tariffs during the Depression was much higher than what most developed economies impose today.

At the conclusion of World War II, twenty-three countries, led primarily by the United States, Canada, and the United Kingdom, negotiated the General Agreement on Tariffs and Trade.[1] The goal was to create an agreement that would ensure postwar stability and avoid a repeat of the mistakes of the recent past, including the Smoot-Hawley tariffs and retaliatory responses, which had been a contributor to the devastating economic climate that culminated in the death and destruction of the Second World War. The 1947 GATT created a new basic template of rules and exceptions to regulate international trade between members (referred to as *contracting parties*) and locked in initial tariff

1. The twenty-three countries engaging in the Geneva negotiations that led to the signing of the GATT in 1947 were Australia, Belgium, Brazil, Burma (Myanmar), Canada, Ceylon (Sri Lanka), Chile, China, Cuba, Czechoslovakia (Czech Republic and Slovakia), France, India, Lebanon, Luxembourg, Netherlands, New Zealand, Norway, Pakistan, South Africa, Southern Rhodesia (Zimbabwe), Syria, United Kingdom, and United States. For a discussion of the negotiating history leading up to the GATT, see Irwin, Mavroidis, and Sykes (2008).

Table 1-1. *Average Tariff Levels for the United States and Major European Countries*

Country	*1913*	*1925*	*1931*	*1952*	*2007*[a]
Belgium	6	7	17	n.a.	5.2
France	14	9	38	19	5.2
Germany	12	15	40	16	5.2
Italy	17	16	48	24	5.2
United Kingdom	n.a.	4	17	17	5.2
United States	32	26	35	9	3.5

Source: Data for 1913, 1925, 1931, and 1952 are from Irwin (2002, table 5.1, p. 153). Data for 2007 are from WTO (2008c).

n.a. = Not available.

a. Tariff levels for each European Community member country represent the EC-wide import tariff rate.

reductions that these countries committed to establish. Even as early as 1952, the tariff cuts had reduced average tariffs substantially, as shown in table 1-1, for a number of these countries.

Over the next forty-seven years, more countries signed on to the GATT, and further trade liberalization negotiations ensued.[2] As table 1-2 documents, between 1947 and 1994, the GATT contracting parties began and concluded eight separate negotiating rounds of voluntary trade liberalization. The last of these completed rounds was the Uruguay Round, which ended the GATT era in 1994 by ushering in the World Trade Organization. By 1994, the GATT membership had simultaneously expanded from an initial 23 contracting parties to 128 participating countries. With a number of new members acceding to the WTO since its 1995 inception, more than 150 countries have signed the agreement.

The Negotiating Rounds and Negotiating Approaches

The first five rounds of GATT negotiations covering the initial 1947–61 period were typically dominated by major exporting countries, or those with a "principal supplying interest" in a particular product, getting together and negotiating reciprocal market access improvements.[3] The initial negotiators under the

2. Barton and others (2006) provide an economic, legal, and political assessment of the trade regime from the GATT through to the WTO.

3. For a discussion, see Dam (1970, chapter 5). Hoekman and Kostecki (2009, chapter 4) discuss not only the negotiating history but also the economic outcomes of different negotiating approaches of principal suppliers versus tariff formulas and exceptions. Ludema and Mayda (2009) provide an economic theory that rationalizes participation by the largest exporters in negotiations, and thus supports the principal supplier rule as a feature of the negotiations. Their theory justifies the principal supplier rule as a means to overcome the otherwise nontrivial concern of externalities that can lead to the failure of multilateral negotiations attributed to the free rider problem. Then,

Table 1-2. *GATT and WTO Negotiating Rounds of Multilateral Trade Liberalization*

Year	*Name (location)*	*Subjects covered*	*Number of countries*
1947	Geneva	Tariffs	23
1949	Annecy	Tariffs	13
1951	Torquay	Tariffs	38
1956	Geneva	Tariffs	26
1960–61	Dillon Round (Geneva)	Tariffs	26
1964–67	Kennedy Round (Geneva)	Tariffs and antidumping measures	62
1973–79	Tokyo Round (Geneva)	Tariffs, nontariff measures, "framework" agreements	102
1986–94	Uruguay Round (Geneva)	Tariffs, nontariff measures, rules, services, intellectual property, dispute settlement, textiles, agriculture, creation of WTO, and so on	128
2001–present	Doha Round	To be determined	To be determined

Source: WTO website, "The GATT Years: From Havana to Marrakesh" (www.wto.org/english/thewto_e/whatis_e/tif_e/fact4_e.htm).

GATT, especially those with a principal supplying interest, were developed economies. They focused their negotiation efforts on reducing import barriers in other countries that were of primary interest to their own exporters, and they used the political trade-off of expanded market access abroad for exporting industries against increased market access granted at home to foreign industries and thus the losses to industries competing against these imports.

Since the trade barriers targeted for elimination were typically those in the import markets of other developed countries, the primary result was that developed countries were asked to reduce their tariffs. Put differently, since most developing countries were neither principal suppliers nor major importing markets, little was asked of them in terms of their own trade liberalization, and little of what was of direct export interest to developing countries was liberalized by others. Such an outcome is consistent with the pattern of import tariff protection that persists today, which is explored in more depth in the next chapter, a remnant of the form of the negotiations begun in the 1940s.

using data on the United States, they also provide evidence for how the principal supplier rule affects the imposition of tariffs, finding that a higher concentration of exporters in a sector reduces free riding and thus results in a lower tariff.

Starting with the Kennedy Round of negotiations in 1964 through the Tokyo Round in the 1970s, countries participating in the trade negotiations used formulaic approaches to reduce further the remaining trade barriers across the board. Certain tariff-cutting formulas can be preferable to reciprocal negotiations between principal suppliers, in that they can serve to reduce average tariff levels as well as their *dispersion.* The dispersion of tariffs within a country, and even for products within an industry, is related to the difference between the average tariff and the country's highest tariffs, or the phenomenon of "tariff peaks," which is discussed in more detail in chapter 2.

Although formulas can be preferable to simple negotiations between principal suppliers if the formulas are applied rigorously, inevitably the formulaic approaches applied during the Kennedy and Tokyo Rounds did not turn out to be sufficiently "pure" in practice to fully achieve this effect. In the rounds in which formulas were applied, negotiating countries sought and were granted exemptions for "sensitive products" that they could remove from the list of goods whose import tariffs would be subject to the formula. In this manner countries typically avoided having to reduce the highest tariffs in products that the formulaic approach was trying to attack in the first place. The result is a persistent pattern of protection across countries and industries that likely looks quite similar to the reciprocity-based, bid-offer approach between principal suppliers of different products.

Important Commercial Sector Exemptions to the GATT

In addition to the general problem of certain products effectively being excluded from multilateral trade liberalization rounds because of the principal supplying interest and formula-exemption approaches to the GATT negotiations, the contracting parties deepened the severity of the problem in certain sectors by essentially taking two industries off the negotiating table—agriculture and apparel and textiles.

First, most agricultural trade was exempted from GATT disciplines beginning in the 1950s. The United States initiated the trend by requesting a GATT waiver to that effect; the emerging European Economic Community subsequently supported this decision as it undertook substantial government intervention in agricultural markets through its Common Agricultural Policy (CAP). This lack of discipline concerning trade in agricultural products would ultimately result in a complicated web of domestic policies throughout the sector—excesses in import restrictions as well as substantial domestic support (subsidies) programs, which can have the effect of choking off imports and making suppliers artificially competitive in third country (export) markets.

Second, beginning with Japan's accession to the GATT in 1955, special trading rules also were introduced to deal with potentially disruptive imports in clothing and textile products.[4] What began as the Short-Term Arrangement covering cotton textiles (1961) turned into the Long-Term Arrangement (1962–73) and subsequently the Multifibre Arrangement (MFA) (1974–94). These agreements managed global textiles and apparel trade through a complex system of quantitative restrictions and voluntary export restraints. The products covered by these agreements thus fell outside of the GATT system of rules, disciplines, and ultimately enforcement.[5]

As discussed in chapter 2, the creation of the WTO in 1995 has provided a framework to resolve these problems. Nevertheless, these particular two sectors are of fundamental interest to exporters in many developing countries. Thus the effects of the negotiating legacy of such sectors do contribute to complaints being made by developing countries about the WTO today, especially because countries continue to impose high import tariffs on these products.

The Fundamental Principles of the GATT and the WTO

The General Agreement on Tariffs and Trade established the forum for negotiations on cutting tariffs that subsequently would take place over the following decades through multilateral trade rounds. In addition, the initial negotiations resulted in an agreement that established a set of basic rules and disciplines that participating countries were to follow, as well as a forum for dispute resolution if countries deviated from them. Perhaps the most important and enduring of these basic rules embodied in the GATT 1947 are the fundamental principle of *reciprocity* and two nondiscrimination principles—*most-favored-nation treatment* and *national treatment.*

Reciprocity

The GATT fundamental principle of reciprocity enters into the agreement in a number of different ways, both formally and informally.[6]

4. Japan's entry into the GATT in 1955 as a major developing country exporter of clothing and textile products, and the associated fear of disruption of economic activity due to the integration of this country into the GATT system, has a number of marked similarities with China's accession to the WTO in 2001. See the discussion in Bown and McCulloch (2007a).

5. For a more complete discussion, see Hoekman and Kostecki (2009, chapter 6).

6. Unlike the principles of nondiscrimination (most-favored-nation treatment and national treatment) described in the next two subsections, there is no article of the GATT 1947 that clearly identifies reciprocity as a foundational principle. Nevertheless, the articles in the GATT 1947 that govern how countries are to renegotiate concessions—in particular Articles XXVIII and XIX—if

First, as discussed above in the section about the process of GATT rounds of multilateral trade negotiations, these negotiations were typically undertaken on a reciprocal basis—frequently between countries with a principal supplying export interest in the other's import market. While this particular approach to negotiations was successful, it was more of a rule of thumb in the negotiations phase. There is nothing in the GATT texts that requires countries to reciprocally negotiate market access liberalization.

Second, once a contracting party had committed to opening up access to its market, reciprocity did become a formal rule for renegotiations if that country subsequently wanted to back off from its commitment. There are two broad ways that countries have backed off prior commitments, and the GATT/WTO response to both has typically been based on reciprocity.

The first instance is when a country seeks to follow GATT/WTO legal procedures when raising its import tariffs to levels higher than the "bound" commitments (or limits) it had promised to offer to the rest of the membership during an earlier negotiating round. Adversely affected trading partners are then permitted to negotiate a reciprocal market access change in another area of interest. Although it is possible that this might occur through additional trade liberalization in another sector of interest to the affected exporter, typically it is implemented through a new "market closing," which, while retaliatory, is limited by this reciprocity principle so as to rebalance the deal.

The second instance is when a country backs off commitments to opening market access in a way that is not "GATT/WTO legal," whereby adversely affected trading partners use the dispute settlement process to obtain a legal ruling that allows them to rebalance market access obligations. Case law that has emerged under the formal trade dispute settlement procedures adjudicated at the WTO has also resulted in use of the reciprocity rule for instances in which compensation needs to be allocated to adversely affected exporters after legal breaches of the GATT/WTO bargain.[7] This second point indicates that reciprocity is thus an extremely important principle when it comes to the issue of disputes and is therefore a topic that is dealt with in greater detail in subsequent chapters.

Most-Favored-Nation Treatment

The second fundamental principle of the GATT is the most-favored-nation (MFN) treatment, that is, nondiscrimination by importers across different

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one country seeks to amend the initial bargain, do contain explicit language about reciprocity that therefore arguably feeds back to how initial negotiations are conducted. See the economic modeling framework in Bagwell and Staiger (1999, 2002) and also the discussions in Bown (2002a, 2002b).

7. See, for example, the discussion in Bown and Ruta (forthcoming) as well as a number of other chapters in Bown and Pauwelyn (forthcoming).

foreign export sources. MFN in the GATT is a rule for both negotiations and renegotiations.[8] In a negotiating round, when one GATT contracting party offers to lower its tariff to increase the market access available to foreign exporters in another GATT country, that same lower tariff and terms of market access must be then granted to all other GATT countries on a nondiscriminatory, MFN basis. This is clearly one of the most important reasons for desired membership in the agreement. Even if a country did not seek to utilize the GATT for its own tariff liberalization negotiations or as an external commitment device to facilitate internal reform (for reasons described in the next section), joining the GATT was useful because it provided some guarantee that the country's exporters would receive the "best" treatment made available to any other country in the agreement. This helps to explain why developing countries would want to join the GATT/WTO and establishes that there was some theoretical benefit to them of doing so.

Nevertheless, while MFN is an important principle in all aspects of the GATT and the WTO—during formal trade liberalization negotiations as well as renegotiations, for example, that might occur during the settlement of a dispute—this treatment becomes increasingly diluted in the presence of GATT/WTO-permitted exceptions to MFN. In particular, the GATT/WTO does permit members to sign preferential trade agreements (PTAs) between one another and thus offer lower-than-MFN tariff rates to preferred partners provided that this covers "substantially all trade." Furthermore, and as chapter 2 describes in more detail, the GATT/WTO also encourages members to offer lower-than-MFN tariff rates to developing country exporters through the Generalized System of Preferences (GSP).

National Treatment

The second fundamental principle of nondiscrimination embodied in the GATT/WTO is the rule of national treatment. The basic idea is simple—once a foreign-produced good has paid the price of entry into an import market (an import tariff), it has to be treated just like a nationally produced good.[9] The good cannot then be subject to additional taxes or regulatory barriers that would otherwise differentiate it from a domestically produced good, once the import tariff has been paid. The national treatment rule is there to prevent policymakers from eliminating the market access promised by tariff cuts through subsequent recourse to other domestic policies, such as taxes or subsidies.

8. The principle of MFN treatment is found in Article I of the GATT 1947. For a legal and economic discussion of the MFN rule, see Horn and Mavroidis (2001).

9. The principle of national treatment is found in Article III of the GATT 1947. Horn (2006) provides a recent theoretical treatment of the national treatment principle on which the GATT/WTO are modeled as an incomplete contract.

Evidence that the coverage of the national treatment principle is broad and powerful is that it is the core issue in a large number of the formal WTO disputes, many of which are examined in later chapters. In fact, in almost any dispute in which a WTO member is alleged to have differentiated unfairly between domestic and foreign-produced goods—whether it be because of a discriminatory tax code, an explicit or implicit subsidy, or a regulatory barrier motivated by concerns over environmental or consumer safety—the heart of the issue is the applicability of and the potential limits to the national treatment principle.

The Theories and Empirical Evidence that the GATT and the WTO Are Relevant

For years, even serious scholars had difficulty reconciling the apparent successes of the GATT/WTO—and what appeared to be relatively mercantilist approaches taken by negotiators under its auspices—with basic economic theory. Nevertheless, the last decade in particular has seen much research progress made in understanding the relevance of the GATT/WTO as an important and necessary component of international economic relations.

In this section I make a brief detour to highlight some of the insights provided by this increasingly sophisticated political and economic scholarship on the GATT and the WTO. In particular, I describe a substantial literature in economic theory that ascribes two potential complementary benefits to a trade agreement such as the GATT or the WTO. I refer to these as the *market access theory* and the *commitment theory.*

The market access theory is based on the well-established fact that large importing countries, whose tariff policies can affect world market prices because of the country's size, require an external motivation to agree to reduce and bind their import tariffs. The GATT and the WTO, and the principle of reciprocity in particular, provide this inducement by allowing any one country's change in trade policy—either a lowering of trade barriers under a negotiating round or a raising of trade barriers subsequently bound by the agreement—to be accompanied by an equivalent, reciprocal change in market access by trading partners.[10] The theory suggests that without the reciprocal inducement during negotiations of increased access to foreign markets, a large

10. More typically, the market access theory is referred to in the academic economic literature as the *terms of trade theory* and dates to the seminal work of Johnson (1953–54). A more recent treatment that now dominates the scholarly literature on international trade agreements is based on Bagwell and Staiger (1999, 2002). In particular, Bagwell and Staiger (2002, chapter 11) documented how the terms of trade theory and the market access theory are equivalent, largely addressing one issue of critics who previously found the terms of trade theory unconvincing because trade negotiators discuss import volumes (market access) rather than world prices (the terms of trade).

importing country would not unilaterally offer its own market access to foreign exporters through tariff liberalization. Furthermore, without the threat that this foreign market access will be taken away if one country deviates from the agreement by imposing new trade barriers, market access openings could not be sustained through renegotiations either.

Supporting the dominant market access theory of why the world trading system needs an institution like the GATT/WTO is increasing empirical evidence. A first study by Broda, Limão, and Weinstein uses new empirical techniques and data to provide two pieces of evidence broadly consistent with the theory.[11] They estimated disaggregated foreign export supply elasticities, which are one component in answering the important economic question of whether the importing country is "large" in its ability to affect world prices. They found that countries that are not WTO members systematically set higher tariffs on goods that are supplied inelastically. Thus WTO nonmembers—countries that have not agreed to limit their policies toward imports—tend to impose higher import tariffs on goods for which they are large and need a trade agreement inducement to get these tariffs lowered. Second, for the United States, the authors found that trade barriers are significantly higher on products not covered by the WTO agreement for which the United States has more market power.

A second recent study by Bagwell and Staiger focuses on a set of countries newly acceding to the WTO between 1995 and 2005.[12] They examined whether the motive of gaining access to markets affects these countries' tariff cut commitments and found evidence consistent with the importance of this effect. Specifically, the farther the tariff to which a country negotiates is below its original (pre-WTO) tariff level, the larger is its original, pre-WTO import volume. This result is also consistent with negotiating behavior predicted by the market access theory.

These studies seek to explain why the world needs the GATT/WTO, because the fundamental problems that these agreements are designed to tackle would not be addressed if market forces were left unfettered and government policies were not coordinated internationally. These pieces of evidence indicate that the GATT/WTO has had important real effects on countries' trade policies and the resulting trade flows.[13] The evidence is consistent with what economists predict for government behavior, especially for large, developed countries. The GATT/WTO system has created incentives for such countries to restrict their import tariff barriers compared to the tariffs they would levy in the absence of a

11. Broda, Limão, and Weinstein (2008).

12. Bagwell and Staiger (2006).

13. In chapter 2 a number of other studies are described that present related results that the GATT/WTO has affected country-level trade flows, including Subramanian and Wei (2007); Goldstein, Rivers, and Tomz (2007); Tomz, Goldstein, and Rivers (2007).

GATT/WTO-like agreement. Simply compare current policies with what these large developed economies were doing in the 1930s (see again table 1-1): unilaterally imposing mutually destructive import barriers toward one another because they could not coordinate reciprocal market access opening. This underscores one fundamental benefit that the GATT/WTO provides to the world trading system.

According to the second major theory of trade agreements, the commitment theory, even for countries that are not large (in the sense of market access described above), the GATT/WTO may help struggling governments take on efficiency-enhancing, national welfare–improving economic reforms, including trade liberalization.[14] This potential role for the GATT/WTO comes into play when a government faces entrenched political interest groups demanding special policies that make it difficult for the government to act unilaterally.[15] In this case, the GATT/WTO might also help the government convince its domestic sectors that it is serious about reform and a long-term policy of more liberal trade.

Although there has been little empirical research formally testing the practical relevance of the commitment theory, one particular element should be noted with regard to the issue of GATT/WTO enforcement. As highlighted repeatedly throughout this book, the GATT/WTO institution does virtually no enforcement on its own. Rather, the GATT/WTO is a set of self-enforcing agreements: member countries enforce trading partners' commitments embodied in the agreements by challenging each other's missteps through formal dispute settlement. Thus, as described in substantial detail in later chapters, for a country to take advantage of the potential commitment-device role that the GATT/WTO might offer to government policymakers, some other trading partner must be willing to enforce the commitments that a country takes on. If there is no external enforcement—and this is especially relevant to the case of the poorest WTO member countries whose commitments are almost never enforced through dispute settlement—the WTO essentially provides the country seeking the external commitment with nothing.

14. See the work of Tumlir (1985). More recent theoretical treatments of focus in the academic literature include the work of Maggi and Rodríguez-Clare (1998, 2007) as well as Staiger and Tabellini (1987).

15. A related problem discussed by Staiger and Tabellini (1987) is the concern over time consistency. Although a government may have an incentive to announce trade reforms, it may find it difficult to follow through with them without an external commitment device. Because firms and workers recognize that the government will eventually face this time inconsistency problem (in the absence of external enforcement via a trade agreement), they undertake too little efficiency-enhancing change—whether it be investment in or adjustment to a new and growing sector.

Conclusion

This brief introduction to the General Agreement on Tariffs and Trade and the World Trade Organization identifies a number of important lessons for the remainder of this book. First, the results from the history of the GATT and the WTO negotiations—tariff barriers in developed economies that are massively lower today when compared with those during the Great Depression era of the 1930s—is an unprecedented multilateral outcome for international economic relations. Second, the underlying principle of reciprocity that served to influence these early negotiations turns out to have been an important international force allowing governments to coordinate and simultaneously lower trade barriers. Furthermore, this reciprocal balance of trade obligations across countries is what has allowed them to keep the trade barriers low toward one another, for the most part, over the next 60 years.

Although ultimately a more detailed analysis of this latter point is of interest—how WTO members use the dispute settlement process to self-enforce the agreement and maintain this reciprocal balance in the face of relatively challenging political and economic circumstances—first, in the next chapter, the history of the GATT/WTO negotiations are retold from the perspective of developing countries.