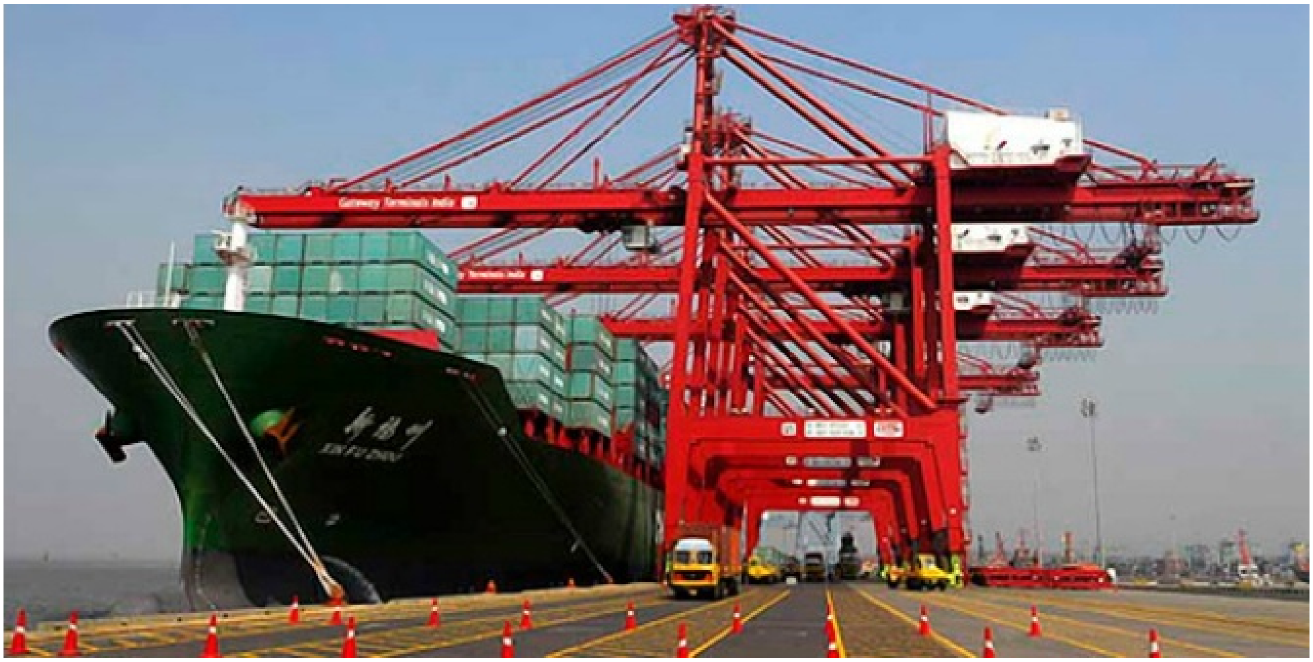
Does special treatment in trade benefit developing countries?

blogs.lse.ac.uk/businessreview/2016/08/09/does-special-treatment-in-trade-benefit-developing-countries/

8/9/2016



At the launch of the Doha Round, ministers of the World Trade Organization (WTO) stated that a central goal of the negotiations was “to improve the trading prospects [and to] ensure that developing countries […] secure a share in the growth of world trade commensurate with the needs of their economic development.” Fifteen years later, the Doha Round has hit a wall. Yet the notion that there should be a special treatment for developing countries in the multilateral trading system is alive and well. In fact, throughout history policies aimed at ‘making it easier’ for developing countries have become commonplace.

For example, developing countries have traditionally been allowed to adopt fewer liberalization commitments in multilateral trade negotiations. This has produced significant trade policy differences across WTO members. Consider the level of bound tariffs—i.e., the ceilings on how high import tariffs can be—and of applied tariffs—duties actually charged by customs. Both are considerably higher in developing countries than in developed economies. Moreover, sectors in which developing countries possess comparative advantage, like agriculture and clothing, tend to be more protected worldwide than most other sectors. Table 1 illustrates this general pattern with the corresponding figures for one developed and two developing economies that have participated in all rounds of multilateral negotiations since 1947.

Table 1: Applied and bound average tariffs for selected WTO members, 2013

Country (GDP per capita)	Products	AVG bound tariff	AVG applied tariff
U.S.	All	4	3
(US$ 53000)	Agricultural	5	5
	Clothing	12	12
Brazil	All	31	14
(US$ 11208)	Agricultural	35	10
	Clothing	35	35
India	All	49	14
(US$ 1498)	Agricultural	114	34
	Clothing	38	13

Source: World Trade Organization Tariff Profiles and World Bank.

Furthermore, WTO members are allowed to offer nonreciprocal preferential market access to developing countries. This possibility, epitomized by the Generalized System of Preferences, stands in stark contrast with the main pillars of the WTO, of nondiscrimination and reciprocity in trade negotiations.

The underlying justification for such special and differential treatment for developing countries (SDT) is that temporary protection and preferential access to larger markets would foster their infant industries and help diversify their industrial base, ultimately leading to sustained, faster economic growth. But can this set of exceptions in the multilateral trading rules deliver on those promises? And has it, so far?

In recent research, I assess the theoretical foundations and empirical evidence about SDT. On theoretical grounds, there is little basis for such a special treatment. Rather, the main theories of trade agreements view developing countries as ineffective 'free riders' of the multilateral trading system. While advanced economies have negotiated market access reciprocally, developing countries were often not required to reciprocate. General equilibrium forces then imply that the expansion of their export sectors ought to be severely constrained by the lack of their own liberalization.

An aggravating problem is that SDT policies are designed *by the industrialized economies*. It is unrealistic to presume that they would prioritize the interests of developing countries. Indeed, if anything the design of SDT policies looks biased *against* the interests of developing countries. First, as mentioned above, the sectors where developing countries would benefit the most from better foreign market access tend to be the least open worldwide. Furthermore, several features of the system of preferences offered by rich economies tend to neutralize their efficacy. One is the rules for "graduation," whereby countries lose preferential access if they export "too much." Another is the insecurity of the preferences. The rules can change anytime—and they do change often—at the discretion of the 'donor' country. This makes long-run investment planning based on preferential foreign market access all but unviable. Finally, intricate rules of origin create sourcing distortions and bureaucratic hurdles that can render the preferences useless.

Empirically, evaluating the impact of SDT policies as a whole is challenging, as disentangling their effects from other contemporaneous policies is typically unfeasible. A limited but feasible strategy is to assess how nonreciprocal preferences affect the exports of developing countries. The few studies that are based on reliable statistical analysis show that nonreciprocal preferences promote exports of the affected products. A caveat is that the positive effect is relative to a control group of products that do not receive preferences, so the studies may be simply capturing substitution across products. Furthermore, even if the preferences do stimulate exports of beneficiary countries more generally, the answer to the deeper, more relevant question of whether they promote economic growth remains elusive. This is not an easy question to answer empirically, but a central one for a conclusive appraisal of those programs.

Another concern is that the existing schemes of preferences, whereby advanced economies (implicitly) use preferences as bargaining chips to demand cooperation in nontrade areas, can constitute a force toward keeping multilateral tariffs high. This follows from a line of research that shows that *nonreciprocal* preferences are associated with "tariff substitutability": lower tariffs to a group of countries induce higher tariffs vis-à-vis all other countries. Conversely, there is also evidence that *reciprocal* exchange of preferential access tends to yield "tariff complementarity": lower tariffs to a group of countries leading to lower barriers also on imports from other countries. This suggests that, if preferential tariff concessions had to occur in the context of full-fledged free trade areas—as the European Union has been required to do, under Economic Partnership Agreements, vis-à-vis the preferences it has historically offered to its former African, Caribbean and Pacific colonies—we may observe instead lower multilateral tariffs as a result of preferences to developing countries.

Overall, the theoretical foundation for the special and differential treatment for developing countries in the multilateral trading system is shaky, whereas the empirical evidence is inconclusive. Nonreciprocal preferences may foster exports of specific products in beneficiary countries, but there is no support for them as a growth-promoting strategy. A widespread system of nonreciprocal preferences can also have the unintended consequence of slowing multilateral liberalization. Going forward, we need further research to better understand the consequences of SDT disciplines, and to gear the system toward delivering its promised benefits.

♣♣♣

Notes:

- *This post is based on Special and Differential Treatment for Developing Countries, forthcoming in the Handbook of Commercial Policy and available as CEP Discussion Paper No 1415.*
- *The post gives the views of its author, not the position of LSE Business Review or the London School of Economics.*
- *Featured image credit:Jawaharlal Nehru Port Trust By Jaxer at English Wikipedia, CC BY 3.0, https://commons.wikimedia.org/w/index.php?curid=6927198*
- *Before commenting, please read our Comment Policy*

Emanuel Ornelas is an Associate Professor of Managerial Economics and Strategy at LSE's Department of Management, and Professor at the São Paulo School of Economics-FGV.