

**Is NAMA a Tool of Development?
or Another Manifestation of Asymmetries in WTO Rules?**

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The negotiation on the Doha Round of trade liberalization was halted twice since early summer last year. The latest was in late June 2007. In both instances, it was triggered by the refusal of the United States to agree to the reduction of the ceiling on the amount of domestic subsidies paid to the US farmers. Mr. Pascal Lamy, the WTO Director General gave the label of “crisis” to the deadlock in negotiation at the time of the collapse of the talks in 2006. Some thought it was a “failure” of the Round as the result of which developing countries would be the main losers. Yet, others, particularly a number of NGOs, believed it was a success for development and went on to celebrate. The divergence of views on the collapse of the talks is as wide as the divergence of interests among various groups, particularly developed and developing countries, involved in the negotiations. Although the negotiation process resumed in autumn 2007, so far there has not been a break through. In the case of NAMA, while developed countries have insisted on the approval of the proposed text by the chairman, developing countries have made their own proposals. While the talks are still in deadlock, bullying and the blame games continue.

We will argue, in this brief, that although the talks collapsed triggered by the disagreement on agricultural subsidies, there are some other fundamental reasons behind it. These are related to the contradictions in design and implementation of WTO rules and

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the inconsistencies between the agreed Doha Text and the subsequent proposals made by developed countries during the process of negotiations. With respect to the Doha round, we will concentrate on the issues related to NAMA (non-agricultural market access) as an example.

According to an editorial in *International Herald Tribune*, the Doha Round was 'sold as the "development round"¹. But in practice, it was turned into "market access" round by developed countries. In fact, according to Charlene Barshefsky, previous US trade representative, the wealthy nations have not "genuinely pursued a development round"². They have been pushing developing countries to substantially cut tariffs on their industrial and agricultural goods as well as on services and reduce restrictions on activities of multinationals, in exchange mainly for a slight cut in their tariffs on industrial goods and in their domestic support for agriculture. Therefore, while developed countries would gain significant market access in developing countries particularly for manufactured goods, developing countries would lose their policy space to develop their industrial sector in accordance with the principle of "dynamic comparative advantage". Of course, they would gain slight market access for products for which they have static comparative advantage. This is the gist of the problem which is also related to the philosophy behind GATT/WTO rules based on the neo-classical static comparative cost advantage theory. This theory is based on unrealistic assumptions including the lack of differences between technological capabilities of countries, firms, scale of production and externalities involved in various economic activities and interests of individual, nations and the world as a whole, tastes of people in various countries; smallness and passivity of firms; and the lack of interdependence of present production cost and production costs in the future³. The proponents of the theory ignore "the ethical principle that equal treatment of unequal constitutes inequality"⁴.

The dissatisfaction of developing countries with this philosophy, thus with the new Trade Round" has surfaced since the WTO meeting in Seattle in autumn 1999. But as a distinguished Yale University Scholar put it: "what Seattle showed was that there is a lot more angst beneath the surface"⁵. This angst is related to that philosophy and the contradictions in the design and the implementation of GATT/WTO rules that also manifested themselves during the Doha Round, for the negotiation on NAMA.

While GATT/WTO trading system aims at trade liberalization, it suffers from a number of contradictions⁶ which reminds oneself of exceptional clauses of the "Animal Farm" story. For example:

- The power and influence of the government in the flow of international trade has to decline, but the power and influence of TNCs in international trade is allowed to increase continuously⁷.
- Since the inception of GATT, trade in manufactured goods has been subject to liberalization, but agricultural products have been largely excluded.

- The amount of agricultural subsidies paid by OECD countries is about one billion dollar a day.

- The overall trade-distorting support of the US increased from \$16.3 billion in 2002, the year before the Doha Round started, to nearly \$19 billion in 2005⁸.

- The US's official offer for Overall Trade Distorting Subsidies for agriculture to the Doha Round was 22.7 billion which was higher than the applied amounts of 19.7 billion in 2005⁹.

- Even in the case of manufactured goods, products of interest to developing countries have been restricted either under exceptional arrangements (e.g. textiles and clothing until recently) or through tariff peaks, tariff escalations, safeguard measures and arbitrary anti-dumping practices.

- According to the Uruguay Round (UR) Agreements, developing countries were forbidden to protect their infant industrial exports, but developed countries benefited from infant industry protection of their new technology for over 20 years through TRIPS.

- In a speech to the ECOSOC in 2007, the US representative, clearly defended the need for protection of technology: "...technological change is driven by protection of IPRs [Intellectual Property Rights]. If we do not provide the incentives of IPRs, our technological progress will slow or dry up"¹⁰. It is not clear how change in the structure of exports of developing countries from primary commodities to manufactured goods does not need incentive through protection, but technological change does.

- Even US exporters of manufactured goods enjoy subsidies (see below).

- The agreements on TRIMS, GATS as well as TRIPs are all biased in favour of developed countries to the extent that according to a famous scholar: "With a touch of hyperbole the agreement [TRIPs, TRIMS and GATS] could be called a slow-motion Great Train Robbery".¹¹

- Further, developed countries did not fully implement even those rules to which they agreed in the UR, e.g.:

- In the case of the Agreement on Textiles and Clothing, developed countries did not fully implement the Agreement on Textiles and Clothing, approved in the Uruguay Round, which was supposed to decrease quota on imports of developing countries. The items chosen and the timing of the removal of quota was such that did not fully confer with the spirit of the Agreement.¹²

- Contrary to the UR Agreement on subsidies, many companies in the USA and elsewhere benefited from government subsidies¹³.

- Manufacturing enterprises below 40 million dollars are eligible to receive loans at about 50 per cent of prime rate, subsidized by the federal Government. In 1999, there were 821 different tax credit schemes promoting investment in 50 states of the US.¹⁴

- US government subsidization of exports of industrial goods by US companies, including large ones, such as IBM and Microsoft, against which the Dispute Settlement Mechanism of WTO gave verdict against the USA, is well known¹⁵.

- In fact, the US's subsidization of the industry is widespread: e.g. \$5 billion of aid and \$10 billion guaranteed loans to airline companies after 9/11; providing tax breaks to industries (for instance \$3.4 billion over 5 years to the oil companies and \$2.5 billion to mining companies, etc.

- Providing subsidies to exporters and US firms investing abroad by instituting the US government as an enforcer for overseas' partners' financial obligations¹⁶.

Generally speaking there is a lot of difference between what developed countries preach developing countries should do and what they actually they do themselves. According to an ex-USA official: "...[president] Regan himself, despite his devotion to open market in general and free trade in particular, granted more income relief to US industry than any of his predecessors in more than a century"¹⁷.

In a nutshell, while developed countries preached developing countries to liberalize, they have tried to avoid it themselves in many cases. Thus, the Nobel Prize winner, Professor Stiglitz, once said: "I found myself in uncomfortable position of an American saying "do as we say, not as we do". This is the main source of the "angst" behind WTO rules, negotiations and practices of developed countries. Even Mr. Lamy, the Director General of GATT and former trade representative of EU, admitted, in his speech to ECOSOC on July the second, 2007, that: "...today a number of the current substantive rules of the WTO do *perpetuate* [our italics] some bias against developing countries."

The NAMA negotiation is the most obvious case of inconsistencies between the agreed text of the "Doha Development Round" and the proposals made by developed countries during the process of negotiations. Developed countries have been pushing developing countries to reduce tariffs on their industrial products, according to the Swiss Formula, substantially and bind their *individual* tariff lines, rather than average tariffs¹⁸, at low levels. Their latest proposal is to apply coefficients of 15 for developing and 10 for developed countries, receptively¹⁹. This magic and complicated formula has a few main characteristics:

- ❖ The coefficient (e.g. 15), determines the maximum tariff rate possible under the formula irrespective of the country's present tariff rates.
- ❖ The higher the initial tariff rate, the higher the rate of reduction in tariff.
- ❖ The lower the coefficient, the higher will be the rate of reduction in tariff.
- ❖ For high tariff rates the rate of reduction in tariffs is higher than when a simple linear formula is applied (in which case the same percentage reduction is applied to all tariff lines).
- ❖ Finally, the formula will lead to lower rates of percentage reduction than those generated by a tariff-independent linear reduction in a certain range of low tariff rates²⁰.

Hence, the Swiss formula with a low coefficient fits the interests of the developed countries, while it goes against the developing countries' interests. Initial tariffs for developing countries are much higher than that of developed countries. The former would be subject to significantly greater reduction in their tariff rates in terms of percentage as well as percentage points despite the fact that the principal of less than proportional reciprocity, in favour of developing countries, was agreed upon in Hong-Kong.

For example, with coefficients of 10 for developed countries, a tariff rate of 5 per cent will be reduced to 3.33 per cent, a reduction of 1.67 percentage point. In contrast, a coefficient of 15 per cent for developing countries will reduce a tariff rate of 50 per cent to 11.5 per cent, a reduction of 38.5 percentage points.

Yet it is surprising that developed countries complained that in the draft text prepared by the chairman of NAMA in July 2007, developing countries were asked to cut tariffs by small margins²¹. The US Ambassador clearly stated that "the US criterion (for the Round's success) is whether people pay less tariffs after the round is over"²². This is in contrast to the objective of the Round, according to which the criterion should be the positive impact of the Round on development of developing countries. Instead of benefiting from "less than full reciprocity" in cutting tariffs as agreed upon in Doha and Hong-Kong, developing countries are requested to pay for the Doha Round in a way which is no doubt governed by "more than full reciprocity".

The application of the coefficients proposed by developed countries will have a significant detrimental long-term effect on industrialization of developing countries, with no negative effects on developed countries. Developed countries are already industrialized; they have the supply capacity to produce capital/skill/technology-intensive products in which they have comparative advantage. By giving up some trade barriers on imports in exchange for market access in developing countries, developed countries do not sacrifice their long-run industrial development. Of course, their upgrading of the industrial sector depends on the development of new technology. But they have firmly secured protection of their new technologies through the WTO's TRIPS Agreement.

By contrast, the use of tariffs is almost the only remaining trade policy instrument for developing countries. Yet the industrial sector of most developing countries, unlike that of developed countries, is underdeveloped. Some, e.g. most African countries, need to develop their supply capacity; some others, like next-tier NIEs need to upgrade their industrial structure. Thus, they need to apply higher tariffs to some of their industries, particularly new ones. The low and bound tariffs rates being proposed will disarm them of an important policy tool for establishing new industries and upgrading the existing ones. Clearly, by obtaining further market access in developed countries, they will improve the prospects for expanding exports for their existing efficient industries, i.e. industries in which they have static comparative advantages. But binding tariffs at low levels deprives them of the tool of expansion of supply capacity in new industries in which they may wish to develop dynamic comparative advantage. Therefore, even when market access is provided for such potential products, the prospects for their supply expansion will be absent due to the lack of policy space. **In other words, for the sake of slightly better access to markets for their current export products, they sacrifice their ability to establish new industries or upgrade into new products; their policy space is exchanged for slight increase in their market access to developed countries.** Such a trade off will result in deepening of their static comparative advantage. The lower-income countries with low industrial capacity will be locked in production and exports of primary commodities; those with some industrial capacity will face problems in deepening their industrialization.

The experience of successful early and late industrializers indicates²³ that:

- With the exception of Hong Kong, no country has managed to industrialize without going through the infant industry protection phase; but across-the-board import substitution and prolonged protection have also led to inefficiency.
- Government intervention, both functional and selective, in the flow of trade and in the economy in general has played a crucial role in industrialization.
- When their industries matured, they began to liberalize selectively and gradually.
- When the USA started liberalizing pre-maturely in mid 1850s, the industrial sector was adversely affected and the government reversed its trade policies.
- While different countries did not follow exactly the same path, all learned from the experience of others; the USA from the UK, Germany from the USA, Japan from Germany, Republic of Korea from Japan, etc.
- When their industrial sector matured, all main early industrializers tried to open the markets in other countries and limited their policy space
- The outcome of the imposition of pre-mature trade liberalization on the colonies was devastation and led to de-industrialization.

The results of a study, of about 50 developing countries which have undertaken trade liberalization during the 1990-2004 indicates²⁴ that:

- Only 20 countries, or 40% of the sample, have shown high (more than 10% a year) rate of growth of exports of manufactured goods. And of these, only in about 10 countries (mostly in East Asia) were high growth rates of exports accompanied by increasing or high growth rates of Manufacturing Value Added (MVA).
- In half of the sample countries de-industrialization took place over 1980-2000; they included countries which undertook across-the-board liberalization.
- When exports expanded, this growth was mainly in resource-based industry and some assembly operation without much upgrading.
- The manufacturing industry suffered from low investment; in Latin America, where liberalization was more extensive, FDI crowded-out domestic investment.
- Countries which liberalized less performed better during the world-wide economic recession in the early years of this century.

Hence, low and uniform bound tariff rates, particularly if they tend to zero in the next round, would imply the end of industrialization, or upgrading, of many developing countries. It will lock the structure of production and exports of the majority of them into primary commodities, simple resource-based and labour intensive products and at most assembly operations.

If so, developing countries will not lose anything by the collapse of the talks. One should not confuse ends and means. An agreement should serve the purpose of development, it should not be concluded simply for the sake of having an agreement; development should not be sacrificed for reaching an agreement. **The failure to reach a bad or damaging agreement will in fact be a success for development.**

However, developing countries should not accept being bullied to unequal bilateral free trade agreements being subject to the “prisoner’s dilemma” either. Such agreements could suffer from the fallacy of composition leading eventually to little increase in market access at lower export prices for developing countries. Further, often more policy space is lost in exchange for market access than those incorporated in WTO rules.

As long as the philosophy behind GATT/WTO is not changed and the related contradictions are not dealt with, “do not hold out hopes for the Doha round” or fair treatment of developing countries in the future. What is needed first of all is that before conducting trade negotiation, developing countries should have a clear concept of their industrial development policy. This is a necessary condition. The sufficient condition is that World Trading System should be changed in a way that would allow a dynamic trade policy with dimensions of space and time according to which the trade rules would²⁵:

- Accommodate countries with different levels of industrialization and development at each point in time.
- Therefore SDT should be allowed as a general rule, not as an exception;
- Allow change of trade policy in each country as the country develops;
- Permit the use of export performance requirements by developing countries;
- Let easier transfer of technology to developing countries by changing TRIPS Agreement.

Of course, such a re-conceptualization of the trading system will not take place overnight, but it eventually needs to happen²⁶. However, the problem, according to C. Barshefsky, the former US trade representative at the moment is that:

"the developing world is not hearing what we are saying and we're not hearing what developing world is saying. We are passing [each other] like ships in the night."

Notes

¹ "Trade talks that were meant to help the poorest", *International Herald Tribune*, 22.10.2007: p.6.

² See "Charlene Barshefsky on Doha", *International Herald Tribune*, Managing Globalization "Business Blog", 31, January 2007.

³ For details see Shafaeddin, M. "Towards an Alternative Perspective on Trade and Industrial Policies", *Development and Change*, (2005), 36.6:1143-1162; Wade, (2007), "Does trade liberalization promote economic prosperity", in Haas,P. and Hirs, J. (2007), *Controversies in Globalization*, (Congressional Quarterly Press).

⁴ Wade (2007), Ibid : p.8.

⁵ Jeffrey Garten, *International Herald Tribune*, 9 December 1999.

⁶ For details of deficiencies in WTO rules and ways of its improvement see also Das, B.L. (1998) *The WTO Agreements ; Deficiencies, Imbalances and Required Changes*, (Penang, TWN) and Das, B. L (2003); *WTO, The Multilateral Trading System: Past, Present and Future* (London, New York, and Penang, ZBooks and TWN).

⁷ Around year 2000, 500 companies accounted for about 70 per cent of world trade.

⁸ SUNS, 5 October 2007.

⁹ SUNS, 16 August 2007.

¹⁰ SUNS, 4 July 2007.

¹¹ Wade, R.(2005), “What Strategies Are Viable for Developing Countries Today? The World Trade Organization and Shrinking of Development Space”, in Gallagher, K.P.(ed). (2005), *Putting Development First, the Importance of Policy Space in the WTO and IFIs*, (London and New York, ZED Books): 80-101, particularly p.89.

¹² for details see Shafaeddin, *Trade Policy at the Crossroads; the Recent Experience of Developing Countries*, Palgrave, Macmillan, 2005.

¹³ The dispute between the USA and EU on Government subsidization of exports by US companies, and the cotton scandal, for both of which the Dispute Settlement Mechanism of WTO gave verdicts against the USA Government are only two examples. For details see Shafaeddin, *Trade Policy at the Crossroads, Op. cit.*

¹⁴ Reinert, F.S.(2000), *The other Cannon: The other Cannon and the History of Economic Policy*; Norsk Investor forum and SVN (Oslo, University of Oslo, Centre for Development and Environment): 18-19.

¹⁵ For details see Shafaeddin, *Trade Policy at the Crossroads, op. cit.*

¹⁶ For details see Testimony of Ralph Nader Before the Committee on Budget, US House of Representatives, June 1999 and Boillier S. and Weissman, R, “US gave huge industrial subsidies, while now proposing WTO ban”, *SUNS*, 16 July 2007.

¹⁷ Bergsten, C. F. (2001), “Fifty Years of Trade Policy: the Policy Lessons”, *Journal of World Trade Law*, 1-13: p. 8 based on remarks by Treasury Secretary James A. Baker before a conference sponsored by the Institute for International Economics (14 September 1987).

¹⁸ For the advantages of binding average tariffs rates as compared with binding individual tariff lines see Akyuz, Y (2005), “the WTO Negotiations and Industrial Tariffs: What is at Stake for Developing Countries?”; Geneva, Third world Network.; a paper presented to a Workshop on NAMA Negotiations and Implications for Industrial Development in Developing Countries”, Geneva, 9 May 2005.

¹⁹ It is also proposed that at least 95 per cent of their individual tariff lines be bound.

²⁰ For details see Khor, M. and Goh, C.Y. (2005), *Market Access for Non-Agricultural Products: A Development View of the Principles and Modalities*, TWN Study No. 20 (Penang, TWN) and Shafaeddin, M., “Beware of NAMA’s Slippery Slope to Industrialization” available at : <http://www2.unine.ch/webdav/site/irene/shared/documents/SUNS15-Shafaeddin.pdf>

²¹ *SUNS*, 2007 July 2007.

²² *SUNS*, 26 July 2007

²³ See Shafaeddin (2006), *Is Industrial Policy Relevant in the 21st Century?* (Kuwait, Arab Planning Institute) www.arab-api.org/c_beirut06_6.pdf www.g24.org/msha0306.pdf.

²⁴ For details see *Does Trade Openness Favour or Hinder Industrialization and development?* a paper presented to the Technical Group Meeting of Intergovernmental Group of 24 on International Monetary Affairs, Geneva, United nations, 16-17 March 2006 (Geneva, TWN).

²⁵ For details see Shafaeddin, M. “Towards an Alternative Perspective...”, *Ibid.*

²⁶ See Helleiner, G. K. "Markets, Politics and Globalization: can the Global Economy be Civilized?", 10th Raul Prebisch Lecture, Geneva, UNCTAD, 2005