Why the WTO is deadlocked: and what can be done about it

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Introduction[1]

Much of the recent literature on the Doha Round critiques negotiating particular positions.[2] In this paper my concern is more fundamental: why failure is likely to be inherent without substantial changes in design. The WTO has a larger membership than the GATT, and its remit is much wider. Both differences make it harder to reach agreements, a problem evident from the lack of progress in the Doha Round to date. In this paper I attempt to diagnose the problems inherent in the current design of the WTO and to suggest remedies.

The essence of trade policy is that trade restrictions transfer income to favoured groups. They are costly instruments for transfers, inflicting large deadweight losses, but are common because they are not well understood by the majority who suffer the losses, while usually being well-understood by the few who reap the benefits. A basic and ineradicable misunderstanding is that the losses are borne by foreigners. As a result, the only effective way of curbing trade restrictions is through international reciprocity – each country's liberalization being presented as the 'price' for achieving liberalization in other countries. This in turn generates a coordination problem. Both the GATT and its successor organization the WTO have provided this coordination - they have supplied an international public good.

The core role of the GATT was to facilitate the negotiation of reciprocal reductions in tariffs. Tariffs could have been reduced without the GATT through *ad hoc* bilateral negotiations – this

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[1] A previous version of this paper was prepared as a background paper for the International Task Force on Global Public Goods.

[2] Among the important recent papers, see Deardorff and Stern (2003), Charlton and Stiglitz (2005), and Panagariya (2005).

was indeed the pattern in the late nineteenth century. However, the GATT provided a public good that accelerated this process through a common negotiating forum and timetable, and through the interaction of the Most Favoured Nation clause and the requirement of reciprocity. A second public good was the promulgation of rules both to enforce agreements and to limit trade-affecting policies which proliferated as government became more extensive and economies more complex. The GATT had limited powers of rule promulgation – for example, it created the concept of 'bound' tariffs, established common procedures for dispute settlement and enforcement, and banned some non-tariff protectionist policies, notably quotas. The WTO has more extensive powers, reflecting its wider remit.

The GATT was hugely successful and this might suggest that the international public goods needed for trade liberalization are already well-supplied. The WTO is an expanded version of GATT, with both a global membership and a comprehensive coverage of trade: why can't it use the same model to replicate this success? Yet to date it has been markedly less successful.

In Part 1 I discuss why the WTO faces much more severe problems than the GATT in reaching agreements among its members. In Part 2 I propose six sets of possible solutions for these problems. The first two focus on resolving tensions that appear to be inherent in the present design of the WTO. Section 2.1 tries to reconcile the inherited role of the WTO as a forum for bargaining, with the more usual developed-to-developing country transfer role of international organizations. Section 2.2 tries to resolve the tension between the WTO's expanding role in rule promulgation with concerns about sovereignty. The next three sections focus on core aspects of how developing countries might engage with the WTO. Section 2.3 focuses on the 'marginalized' countries that have little scope for bargaining. Section 2.4 focuses on the 'integrating' developing countries and how they might liberalize trade vis-à-vis the OECD. Section 2.5 focuses on how developing countries might liberalize trade with each other. Some of the proposals discussed in these sections have implications for the internal functioning of the WTO and Section 2.6 considers some internal design issues.

Part 1: Defining the Problems

Why the GATT succeeded

The success of the GATT was partly because of its historical moment, partly because of its restricted membership, and partly because of its restricted scope.

A historical moment

Post-1945, all developed countries recognized the rationale for some trade liberalization. They had inherited from the pre-1945 era severe trade restrictions that had built up during the 1930s as a means of combating high unemployment. Post-1945, better instruments were available for combating unemployment – notably Keynesian economics. Hence, the inherited high trade barriers were seen as dysfunctional. Trade liberalization could not, however, be unilateral because it would generate balance of payments problems. Coordinated trade liberalization eliminated such problems. Once the era of flexible exchange rates arrived in the 1970s, the fear of balance of payments crises was replaced by the fear of inflation-inducing exchange rate depreciation: coordinated trade liberalization continued to be preferred to unilateral action.

A membership restricted to the willing, with little free-riding

There was thus a clear need for reciprocal trade liberalization, and in turn this needed some forum for coordination. The GATT met this need to coordinate reciprocity by confining its *active* membership to willing liberalizers. The GATT was not a *global* institution. It was basically a marketplace for OECD countries to strike deals for reciprocal trade liberalization. The emergence of the EU as the pre-coordinator for a common European trade policy further simplified negotiations. For much of this period there were only three dominant players, all with large shares of world trade – the USA, the EU, and Japan. This made reciprocity easy since each player was too large to free-ride. GATT negotiations could basically be conducted around the dinner table between three parties all keen to reduce inherited trade barriers. Few developing countries were members of GATT, and even these were marginalized, or chose to marginalize themselves, through the formula of 'Special and Differential Treatment'. In substance this meant that such countries did not participate in bargains, and since the GATT was simply a bargaining forum, the consequence was that they achieved only concessions that were decorative. The addition of Part IV, which 'legalized' non-reciprocity, was an important early attempt at inclusion, but it included through permitting non-participation.

A restricted scope

The scope of the GATT negotiations was largely confined to manufactures. All three of the big negotiating blocs were major producers of manufactures and had the potential to be major exporters to each other. Liberalization offered each bloc the chance to reap economies of scale within manufacturing, raising efficiency without contracting the sector. The resource reallocations triggered by liberalization were thus intra-sectoral. Further, for much of the period growth was rapid and so these intra-sectoral adjustments could be accommodated within the context of overall expansion. This restriction of scope to manufacturing made the negotiations much easier. Being confined to a single sector, the effects of a liberalization were basically common to all participants. Further, manufacturing was an easy sector because there were large and well-understood economies of scale, and because factor mobility within the sector was high. Notably, the GATT did not attempt to negotiate agricultural liberalization among its members.

With the historical moment in its favour, a membership restricted to willing liberalizers, and the scope restricted to a single, easy sector, the GATT was hugely successful. By the time it was transformed into the WTO, intra-OECD manufacturing trade was virtually free of tariff barriers.

From the GATT to the WTO

Once the tariff barriers to intra-OECD manufacturing trade were removed, the future agenda for trade liberalization inevitably changed. The remaining trade liberalization agenda is overwhelmingly about developing countries. It has three components: OECD liberalization vis-à-vis developing countries; developing country liberalization vis-à-vis the OECD; and intra-developing country liberalization. To service these processes, developing countries must thus be central to the negotiating organization and so, unlike the GATT, the WTO inevitably needed a large developing country membership. Indeed, in practice, membership has become virtually global with 147 countries.

The importance of agriculture in many developing countries, and the rapid shifting of manufacturing to some of them, implied that many of these negotiations would need to be *inter-*

sectoral. Developing countries wanted better access to developed country markets in manufactures, but also access to agricultural markets. The key thing that the OECD countries wanted in return was not access to developing country markets for manufactures. Rather, they wanted access to the market in services, defense of IPRs, and security for investment. The WTO thus became not only global, but multi-sectoral, with the key negotiations being inter-sectoral.

Why the Success of the GATT is not a Precedent for the WTO

Although the historical moment for the WTO had some analogies to the circumstances which enabled the GATT to succeed, in other respects it is unpropitious. Further, neither of the other basic reasons for the success of the GATT apply, or can apply, to the WTO.

A more difficult historical legacy

The nearest parallel to the success of the GATT is perhaps that the WTO started from the collapse of the USSR. Among its other effects, this signaled that the economic future for all developing countries lay with integrating into the world economy. Further, the dramatic success of China in this process proved that it was feasible. An indication of how these events changed perceptions is that India, once the epicentre of trade barriers, began its own liberalization in 1991. Thus, shortly before the WTO was established, at least for some important developing countries there was a recognition that inherited barriers were dysfunctional.

However, the collapse of the USSR is not the only global change of importance. The world has changed in two important respects that have made the functioning of the WTO more difficult than that of the GATT.

First, the world has to an extent democratized since the end of the Cold War, with developing countries expecting a voice in decisions that affect them not derived from superpower rivalry but by right. This has impacted upon the WTO from the moment of its creation, with the organization deadlocked for a long time over whether its first Director-General should be from an OECD country or from a developing country. The developing countries will collectively deny legitimacy to an international organization that does not serve their perceived interests. In effect, developing countries are seeking a *transfer* of power, albeit of modest proportions, from the OECD to themselves.

Secondly, the challenge of reducing global poverty has become more prominent: OECD populations expect their governments to do something about it. Further, the notion of policy coherence is becoming more widespread: the range of instruments that can be used to reduce poverty has broadened beyond aid, and by far the most prominent of these other instruments is OECD trade policy. This broadening of the set of development instruments has the consequence of changing the rationale for OECD trade policy. The concept of 'policy coherence', and its implication that an appropriate objective of trade policy should be to promote development, is not consistent with the continued use of trade policy purely for self-interest. Hence the GATT bargaining model of reciprocated concessions is no longer entirely appropriate. The donor agencies are fond of using the language of 'partnership' to emphasize that both they and the governments of developing countries have a common objective – the donors providing aid and the governments providing reform. However, with policy coherence, partnership shifts some of the burden of reform onto the donors – OECD trade policies must be reformed even if that is not in the direct self-interest of the OECD. As with democratization, the rise of policy coherence in poverty reduction creates expectations, or at least aspirations, in developing countries of *transfers* from OECD countries.

Finally, the *principle* of transfers, although not the reality, can reasonably be regarded as having been conceded within the GATT through the notion of Special and Differential Treatment (SDT). The utter failure of SDT simply demonstrates that the GATT was not a transfer agency: the GATT needed to get on with its core business – which did not include market access for developing countries - and negotiations were greatly facilitated by the exclusion of developing countries. The real rationale for SDT in the GATT was to legitimize this exclusion. Indeed, SDT included a right to protect, through a number of Articles, as well as a right of access. Issues of market access for developing countries obviously cannot be ignored in the WTO. However, to the limited extent that they were handled in the GATT they were handled through SDT and, if that were to continue, market access would be conceded as a transfer rather than negotiated as part of a mutually advantageous package. The aspirations for non-reciprocated market access thus in part reflect wider recent political aspirations, and partly follow from the design of the GATT.

At present these aspirations are fairly amorphous and this in turn greatly complicates the process of reaching a bargain. Basically, while ever developing countries seek a *transfer* and developed countries seek a *bargain*, any deal that is signaled as acceptable by the developed countries risks being seen as unacceptable within developing countries.

The membership is not restricted to the willing, and there is a free-rider problem

The new members of the WTO are largely developing countries. However, they are not cohesive. To simplify, there are two substantial groups.

One is made up of countries that are sufficiently integrated into the new world economy, and sufficiently large, to have a genuine interest in bargaining for reciprocal liberalization. India, China and the other large emerging economies are in somewhat analogous positions to the OECD post-1945, with trade barriers that they recognize as being dysfunctionally high and with an interest in negotiating reciprocal liberalization both with each other and with the OECD. The lock-in capability that the WTO provides is also of potential use to reformers in these countries who want to increase the credibility of liberalization. However, even these countries have shares of world trade far smaller than the big three of US, EU and Japan, and so the incentive to free-ride is much greater than in the internal OECD negotiations.

The other group of developing countries consists of those that are for one reason or another sufficiently marginalized in the world economy that they do not have a realistic interest in bargaining over market access. The smaller and poorer developing countries, especially those in Africa, are very different from the OECD post-1945. Generally, these countries do not regard their trade restrictions as being dysfunctionally high (even though this is the view of most informed outside observers). They have liberalized little, and even some of the liberalization they have done has been under the duress of conditionality. There is no equivalent to the desire to liberalize, frustrated by a fear of balance of payments crises, that once characterized the OECD countries. Further, they have little to offer in the bargaining ‘marketplace’, especially individually, and so even if they came to regard their trade restrictions as excessive, they could not credibly negotiate reciprocal non-preferential agreements either with each other or with the OECD. Thirdly, they have been granted various ‘special and differential’ market access advantages by the OECD, which would be eroded by *generalized* trade liberalization. Finally, many of these countries have not participated in global growth and do not regard themselves as likely to do so. They may well see themselves as *relatively* better off in an environment of global stagnation than one of rapid global growth in which they continue to be marginalized. These countries did not join the WTO to enter a bargaining ‘marketplace’. Some of them may well have decided to join predominantly because being left out of an organization which the larger and more advanced developing countries were choosing to join would have left them looking even more marginalized.

The existence of a substantial membership with little or no perceived opportunities to gain from bargaining for liberalization is both a problem in itself, and compounds the first problem. It is a problem in itself because the organization is therefore likely to fail to be useful to precisely its most needy members. It compounds the first problem because it is difficult for the group of ‘integrating’ developing countries (the G20) to reach a deal with the OECD to which the ‘marginalized’ group (the G90) are hostile. Either the G90 are marginalized within the WTO, or the WTO is changed to include something of genuine interest to them. The only thing that such countries will recognize as being in their interest is transfers. By ‘transfers’ I do not mean direct financial transfers such as aid, but rather all forms of unreciprocated generosity, such as the granting of market access on an unreciprocated basis.

The scope is not restricted to manufacturing

The need of the WTO to reach an inter-sectoral deal is intrinsically more difficult than the manufacturing deals achieved by the GATT. The newly covered sectors include agriculture, the 'network industries', and the public sector. For all three sectors governments use a vast array of trade-affecting policies other than tariffs. OECD agriculture benefits from a highly complex and expensive pattern of subsidies. Network industries require a degree of regulation but such rules can easily be used for protectionism. The public sector is often both a privileged producer and a handicapped purchaser – rules protect it from competition in production and limit its rights to competition in supply. Hence, for the WTO to succeed, it will need to rely far more upon the promulgation of rules than did the GATT. Such rules by their nature constitute limitations on sovereignty. They are very different from the *ad hoc* deals that one state might strike with another. Two radically different types of government might reasonably see themselves as losers from such an expansion of rule-making. As discussed above, the marginalized countries may well feel that they have nothing to gain from global liberalization and so the rules that facilitate it become restraints without offsetting benefits. Indeed, in many areas such countries are sensitive about encroachments on their sovereignty. At the other end of the spectrum, although the USA probably has more to gain than any other country from an acceleration in global integration, it is sufficiently powerful that it has alternative ways of influencing the behaviour of other countries. Support for a rule-based system may not be its best strategy in that such rules would inevitably limit its own scope for action. Thus, not all members of the WTO have an interest in using the organization to promulgate rules, but without rule promulgation its ability to extend much beyond manufacturing is quite limited. The GATT was able to proceed by gradually chipping away at manufacturing tariffs, constantly finding incremental deals that gave all parties the same *type* of benefits – namely, expanded manufacturing markets. By contrast, the WTO will need to find 'grand bargains' in which, although all parties still benefit, the benefits are of radically different types, with some countries gaining in one sector and others in another.

There is a successful example of an international, inter-sectoral, rule-intensive, 'grand bargain', namely that between France and Germany that created the EU – France opening its market for manufactures in return for German subsidies for French agriculture. However, the circumstances which made that deal feasible were obviously heavily reliant upon history. Further, even that deal did not require agricultural liberalization. The OECD countries do not find it attractive to liberalize agriculture. This is because, while the OECD has very largely abandoned tariff restrictions as instruments for achieving employment goals, it has not abandoned agricultural trade restrictions as instruments for rural development. The very opacity and indirectness of agricultural trade restrictions as income transfers, and the confusion with goals of self-sufficiency and health standards, makes them attractive to rural constituencies. Direct income transfers would be far cheaper but would leave beneficiaries humiliated as welfare recipients, and exposed to political attack. If the OECD insists on holding out for a mutually beneficial bargain, which to date has been the basis for the GATT/WTO, the 'price' of agricultural liberalization is thus going to be set very high.

Summary: Three Problems of the Doha 'Development Round'

To summarize, the marketplace model that worked so well for the GATT is unlikely to work so well in the WTO. There is little scope for a deal linking OECD liberalization vis-à-vis developing countries to developing country liberalization vis-à-vis the OECD that all countries would *regard* as beneficial. Although economic models show the potential for massive mutual gains, for the

OECD this ignores the problem of how to defend agriculture in a politically sustainable way, and for many developing countries it ignores the fact that trade restrictions are still regarded as pro-developmental despite the evidence to the contrary. The labeling of the Doha Round as a 'development round' reflected the evident fact that developing countries were central to the new trade liberalization agenda, but it papered over three key difficulties.

First, there are currently radically different aspirations among WTO members. Developing countries now aspire to an element of transfer. Since transfers are not mutually beneficial, they are not natural consequences of bargaining. It is no surprise that finding a deal that the OECD regards as beneficial and that the developing countries regarded as acceptable has proved so fraught. In effect, until either the OECD decide to introduce an element of transfer into the WTO, or the developing countries accept the WTO as merely a forum for mutually beneficial bargains, no deal can be struck.

Secondly, even abstracting from this problem, one group of the new WTO membership are sufficiently marginalized from the world economy that they perceive themselves as having no basis for bargaining to mutual advantage. A way needs to be found either to marginalize such countries within the WTO, or, better, to give them a genuine interest in the organization.

Third, even for those other developing countries which do have a genuine scope to bargain to mutual advantage, the task of reaching a deal is considerably harder than in the GATT. The deal must be cross-sectoral, and so needs to rely heavily upon the promulgation of rules, yet such a use of the WTO is not attractive to many members. It also needs to overcome a severe free-rider problem.

Finding ways around these three problems is the task of the subsequent sections.

Part 2: Finding Solutions

2.1: Resolving the Tension between Bargains and Transfers

A legacy of the GATT is the elimination of tariff barriers on OECD internal trade but the continuation of high barriers against developing countries. This can easily be seen as hypocritical in the context of the conventional OECD rhetoric of 'development partnership' adopted in the other global organizations.

While the 'integrating' developing countries have an interest in the WTO purely as a bargaining organization, at present, even these developing countries have aspirations that OECD trade policy should contain an element of partnership as opposed to bargain. Further, to the extent that the GATT set a precedent as to how to deal with market access issues for developing countries, that precedent was SDT – that is, as a transfer rather than as a bargain. Until this is resolved one way or the other, no deal is reachable.

Why the core function of the WTO must remain as bargaining

To state the obvious, the past failure of SDT shows clearly that for the group of developing countries that want to achieve substantial improvements in market access it is vital to bargain. Without bargaining – that is, without reciprocity – developing countries will not be offered very much. In turn, this may provoke them into using their ultimate weapon of wrecking the entire negotiations. However, such a wrecking strategy is not really in their own interest. The developed countries can relatively easily conclude the trade negotiations they want outside the context of the

WTO if necessary. Intra-OECD negotiations scarcely need a global forum, and OECD-developing country negotiations can be undertaken on a bilateral basis, as with NAFTA. Hence, the real losers from the destruction of the WTO would be those G20 developing countries that now need an organization to negotiate reciprocal liberalization.

Introducing an Explicit Transfer Role

The need for bargaining does not, however, preclude the scope for explicit transfers – that is, for an element of non-reciprocated market access. The evolution from the GATT to the WTO can usefully be compared with that of the IBRD into the World Bank. The IBRD was not, and could not be, a truly global institution. It was mutually beneficial to a range of middle-income economies who, by pooling risk and subjecting themselves to common restrains (through a Board with substantial OECD representation), could radically reduce the cost of borrowing. This arrangement did not involve any transfers from the OECD to developing countries. In effect, the IBRD phase of the World Bank was like the GATT phase of the WTO: it could not benefit the 'marginalized' developing countries and it did not involve transfers.

The IBRD transformed itself into the World Bank through the creation of IDA. IDA is a transfer from the OECD countries to developing countries administered by the Bank. In turn, this made the organization of interest to low-income countries. The equivalent to IDA for the WTO would be the granting of access to OECD markets on 'concessional' terms: that is, on terms that would not be reached by a GATT-style process of perceived mutual benefit.

Continuing with the IDA analogy, one role of the World Bank is to negotiate contributions to IDA every three years. This is an explicit process of quantitative burden-sharing. Were this model to be applied to the WTO, the secretariat would be charged with negotiating a quantified non-reciprocated component of OECD liberalization. To fully de-link the transfer component, it would be negotiated (among the OECD members) at the start of the round, and implemented at a set date which would be the target date for the end of the round, but would not be conditional upon concluding the round. Thus, to induce any developing country liberalization *through bargaining*, the OECD would need to go beyond this already-agreed transfer component.

Advantages of an Explicit Transfer

Such a predetermined transfer element to market access would have five benefits.

First, by having an international secretariat quantify the contribution of each participant to a common methodology, it would facilitate reaching intra-OECD burden-sharing in granting market access.

Secondly, the quantification could readily make the contribution of each OECD country to market access comparable to its contribution to development aid. This would both emphasize the importance of policy coherence in development strategies, and would build on the new think-tank work of comparing the overall development contribution of each OECD country, in effect, regularizing it.

Third, by quantifying the overall contribution of market access concessions to developing countries, it would provide a benchmark for subsequent trade rounds, with a presumption, as in IDA, that contributions would normally in aggregate rise.

Finally, and probably most important, by quantifying and de-linking the transfer component of any trade round from bargaining, the trade negotiation itself would be less easily contaminated by developing country aspirations. The bargaining would take as its starting point the transfer component of OECD trade liberalization. This separation of stages would preserve the principle that the inter-member business of the WTO was purely the negotiation of mutually beneficial bargains while introducing a bounded transfer component analogous to IDA in the Bank and PRGF in the Fund. Hence:

Proposal 1: Introduce an explicit, quantified, unreciprocated increase in market access for developing countries at the start of each trade round, with intra-OECD burden-sharing negotiated by the WTO secretariat.

2.2: Resolving the Tension between Rule Promulgation and Sovereignty

The need for rule promulgation

It was entirely sensible that the GATT should focus only on manufacturing - the easy sector. However, manufacturing is a very small share of any modern economy and so the WTO indeed has to be more ambitious. In turn this implies that rule promulgation is unavoidable. Government trade-related intervention in other sectors is so complex that reliance cannot be solely on negotiating about the specific deployment of each instrument in each country as and where it happens to be used. Rule promulgation through standards and codes has become an important part of the international economic system. These rules are generated in various international bodies such as the ILO, the IMF and the BIS, or even generated by *ad hoc* organizations such as the Kimberley Process which now regulates the diamond trade for over thirty countries. Rather than have a plethora of trade-related standards and codes generated by such *ad hoc* bodies, it seems preferable to integrate them as far as possible within the organization that the world has established for trade-related issues.

The plurilateral approach

A possible solution to this dilemma is the use of 'plurilateral agreements': that is permitting the organization to promulgate rules that only apply to those countries that choose to subscribe to them. Evidently, the power to promulgate rules within the WTO should be limited to issues related to the remit of the WTO, that is trade in goods and services, intellectual property rights and foreign investment. However, these issues open a wide area of potential regulation. Once the plurilateral role were properly established, it would presumably work incrementally rather than through a sudden major extension of international economic rules.

The plurilateral approach is controversial, facing two types of criticism. The most vocal is that from some developing countries which recognize that once a rule is adopted by a majority of countries there are likely to be strong pressures on other countries to adopt it also. The alternative criticism is that an international organization needs rules that are applied to all of its members and allowing some members to opt out creates a two-class organization.

Despite these criticisms, the plurilateral approach has three robust precedents. First, the most successful multinational organization, the EU, has itself chosen plurilateralism on a wide range of issues, reflecting the different needs and interests of its members. Second, the oldest of the international organizations, the ILO, has long adopted the practice whereby conventions are adopted by the organization, but then accepted or not by individual members. Third, within the GATT itself, SDT was an example of plurilaterism: countries chose whether to self-designate as developing, and thereby chose whether to be bound by reciprocal bargaining processes.

It is unrealistic to imagine that the WTO can undertake its remit of multi-sectoral trade-related issues without rule promulgation, and also unrealistic to imagine that such rule promulgation can only be on the basis of universal approval. Allowing a willing majority to impose rules upon itself seems to be the minimal requirement for progress.

While the EU has adopted plurilaterism, it has also determined that some rules must apply to all its members. In effect, the EU divides its rules into those that are core and those that can be adopted optionally. Similarly, the IMF treats some articles as core - such as banning the use of multiple exchange rates, and others as optional - such as an open capital account. The GATT did not have two classes of rules so much as two classes of member – active and non-active. For example, its ban on quotas applied to all OECD members, it was not (at least in theory) optional for them. By contrast, for the non-active members, no rules applied. If the WTO is to be a genuinely global organization it should aim to avoid non-active members. Since, as discussed above, the organization inevitably has some members who have no basis for participating in *bargaining*, if these members also have the power to exempt themselves from all the rules they are not in any genuine sense of the term active members. Hence, it seems appropriate that the organization should agree on some core rules to which all members must be bound. Indeed, an obvious one to start with would be the banning of quantitative restrictions. SDT was basically a device not for *favouring* developing countries, but for *excluding* them.

However, the EU has also determined limits to its own rule-making remit. The principle of 'subsidiarity' constrains the EU from making rules in areas more appropriately handled at national or sub-national level. Without such limitations, countries that fear the abuse of rule-making would have no choice but to block the power to make any rules. In the context of the WTO, the major fear of developing countries is that WTO rule-making power will be extended to areas such as the environmental and labour standards. The WTO enforcement mechanism of trade sanctions would then come to be linked to these areas. Choices of environmental and labour standards are inevitably related to income. Thus, the OECD countries will inevitably want higher standards than those chosen by developing countries. Linking trade sanctions to environmental and labour standards would thus provide the OECD countries with unlimited scope for protectionism. If OECD countries want the WTO to make substantial progress on rule-making, they will therefore need to accept that rules on environmental and labour standards should lie outside the remit of the WTO: any global rules in these areas would need to be enforced by penalties other than trade sanctions.

A grand bargain: linking plurilateralism to transfers

The dilemma remains that at present there is substantial opposition to the plurilateralist approach. Given that there seem to be no credible alternatives which leave the organization as effective, the question becomes one of finding new incentives for its adoption.

As discussed in the previous section, were explicit transfers – that is, non-reciprocated market access concessions - to be introduced into the WTO, they would, necessarily, not be part of the normal bargaining process. Market access bargaining would begin from what the unreciprocated concessions had granted. However, this need not imply that the granting of market access as a transfer should be unconditional. Market access transfers would explicitly be made analogous to other forms of development transfer, and for these it is normal practice to condition them on either the adoption of certain *policies* or the adherence to certain *processes*. It is clearly undesirable to extend the WTO into a wide range of issues that are not trade-related. As discussed, it would be unwise to condition market access upon compliance with environmental standards. If conditionality is to be confined to trade-related issues, the transfer could not be conditioned upon *policy* without collapsing back into a negotiated bargain. That is, were the market access transfer conditioned upon developing country trade policies it would cease to be a transfer: in effect market access to the OECD would be exchanged for market access to developing countries. There is, however, scope to condition a transfer upon trade-related *processes*. The condition might be that developing countries should accept the process of plurilateral rule generation. Thus, the proposed grand bargain would be that developing countries would acquiesce in plurilaterism in return for the introduction of an explicit transfer role into the WTO.

A grand bargain might extend beyond plurilaterism. Given the desirability of establishing a common core of rules, this too might form part of the deal in exchange for transfers. In effect, the old SDT approach to rules would be transformed from a bloc of countries being excluded from all rules, to a situation in which all countries were subject to core rules and other rules were adopted on an *ad hoc* basis by each country. Hence:

Proposal 2: Make the acceptance of plurilateralism and a core set of rules that applied to all members a condition for the introduction of an explicit transfer component into the WTO. However, explicitly restrict the scope of both plurilateral and common core rules by excluding environmental and labour standards.

2.3: Giving the Marginalized Countries an interest in the success of the WTO through temporary preferences

A large number of small countries, mainly in Africa, are currently marginalized in the world economy. Marginalization is the conjunction of low income, slow or even negative growth over a prolonged period, and an export structure that has failed to diversify from primary commodities. Further, many of these countries see their own trade restrictions as instrumental for development, however false this perception may be. This group of countries currently has little interest in the attainment of global trade liberalization and nothing to offer by way of a bargain. Yet, precisely because they are the poorest and least hopeful parts of the world, any WTO strategy which appears to ignore their interests is likely to appear illegitimate. In turn, this opens up the prospect of an alliance between protectionist interests in major countries and the marginalized countries which would be jointly sufficiently powerful to wreck the organization.

The challenge for the international community is in the longer term to get these countries better integrated into the world economy, and in the shorter term to give them an interest in the success of the trade rounds.

Precisely because the exports of these countries are largely primary commodities, the scope for assisting them purely through conventional MFN liberalization is unfortunately quite limited. That is, even if the 'transfers' envisaged above – unreciprocated concessions of market access granted by the OECD to all countries – were pushed to the limit, the benefit would be relatively modest.

The only way by which OECD trade liberalization can generate both a significant benefit to the marginalized countries and a powerful incentive for their diversification is if it is *preferential*, that is exempted from the MFN condition. Such a concession could be made conditional upon the support of marginalized countries for the rest of the trade round.

Temporary Preferences as an offset to the economies of agglomeration

The objective that would really interest many marginalized countries is industrialization. From the perspective of many of these governments this is the holy grail of development. This has, indeed, been part of the rationale for their adoption of high trade barriers, although of course the strategy has been ineffective and offers no prospect of success.

With the rise of Asia as an exporter of manufactures, the opportunities for those countries that remain marginalized to industrialize has drastically deteriorated. When Asia broke into global markets for labour-intensive manufactures – which was the big trade event of the past two decades – it did not have to compete against any established low-wage manufacturers. It had a wage advantage over the existing competition (in OECD countries) of around forty-to-one. Initially this huge wage advantage just compensated for the accumulated advantages generated by established industrial agglomerations. As Asian cities themselves became established agglomerations of industry the continuing wage advantage induced explosive growth which is continuing. Like Asia before this breakthrough, the currently marginalized countries have no significant industrial agglomerations. However, in contrast to Asia at the time of its breakthrough, they have no wage advantage whatsoever over established agglomerations – namely those of Asia. To give the marginalized countries now a chance equivalent to that taken by Asia twenty years ago requires that they receive some preference not offered to Asia.

Textiles post-MFA

The obvious starting point for such a temporary preference would be textiles. With the end of the MFA in December 2004 there are already many changes in process in this sector. The ending of quota restrictions creates a unique opportunity to use the single most important labour-intensive industry as an engine for growth in the marginalized countries. Although quotas have ended, the industry remains highly protected through tariffs in OECD countries and these will only be negotiated down slowly over the coming trade rounds. Hence, for around a decade OECD tariffs on textiles will remain sufficiently high for preferences to offer a significant terms of trade advantage to those who receive them.

Although the main gain in market share for the marginalized countries would come at the expense of the market share of established developing country producers, their actual loss of income would be modest. At the margin price is almost equal to cost, so that squeezing out marginal Asian exports would not imply large income losses, especially since this would be in the context of major expansion of the Asian industry. The Asian textile industry would simply expand a little less that it otherwise would have done consequent upon the ending of the MFA. The cost of temporary preferences would fall predominantly on OECD governments, since instead of collecting tariff revenue on imports of textiles from Asia they would waive payment on replacement imports from the marginalized countries. However, even this has to be set in the context of greatly expanded OECD revenues from imports of textiles which are a consequence of the ending of the MFA. Far from facing an absolute decline in revenue from tariffs on textile imports, the OECD governments are experiencing a massive increase as the removal of quotas permits import expansion. In effect, a temporary tariff preference on textiles would be broadly equivalent to an OECD aid programme that targeted the diversification of the exports of marginalized countries into textiles. The differences with an explicit program reveal both the advantages and limitations of the approach. An advantage is that OECD governments could credibly commit to a long timetable for a tariff preference, just as they committed to a decade-long timetable for the phase-out of the MFA. There is no equivalent for aid-financed commitments so a tariff preference would have a considerable credibility advantage over an aid-financed subsidy. However, a tariff preference would not provide finance for directly fixing some of the impediments to exporting from the marginalized countries, such as poor infrastructure and mis-governance. Its effect would be to provide a temporary offset to such disadvantages. Were they not fixed during the period of temporary preference then exports may well collapse once the preferences ended. Nevertheless, temporary preferences might induce these complementary changes. The creation of a group of textile export firms facing an eroding advantage in a country would generate some lobbying pressure upon the governments of marginalized countries to improve services. Further, since the use of temporary preferences would be based on an explicit OECD strategy to induce export diversification in the marginalized countries, it would be natural for them to coordinate it with aid programs targeted to finance complementary improvements in infrastructure.

AGOA and EBA and the Hong Kong offer

AGOA and EBA already provide such a temporary preference to marginalized countries, and they were proposed in the Hong Kong offer by the OECD countries in December 2005. Hence, the deployment of the instrument has already been conceded in principle, first by both the USA and the EU, and then by the entire OECD. However, each of these agreements has major deficiencies. There are considerable advantages to negotiating a single, generous, coordinated agreement on temporary preferences as part of the trade round.

In all three the devil is in the detail. One important aspect of detail is the rules of origin (ROOs). In the absence of any ROOs Asian exports would simply be shipped through marginalized countries for relabelling so that there would be no domestic value-added. If, however, ROOs become too strict, the cost of producing in a marginalized country becomes prohibitive. In the case of AGOA the ROOs are too strict, making most marginalized countries uneconomic as manufacturing locations. A common OECD-wide scheme would be likely to adopt more generous ROOs. First, all inputs from anywhere in the OECD would be treated as meeting ROOs, instead of, for example with AGOA, just those from the USA. Secondly, lobbies in particular OECD countries, such as the cotton lobby in the USA, would have less power to influence an OECD-wide negotiation.

A second important limitation of AGOA and EBA is that they are complex and not thoroughly understood even by customs officers. In fact, AGOA appears to be much better understood than EBA, which is unfortunate since most of the potential market for marginalized countries is in the EU rather than the USA. Evidently, having two different schemes is more challenging for exporters that would be a single OECD scheme.

A third limitation of AGOA and EBA is that they omit substantial parts of the OECD. In effect, there is at present an internal OECD free-rider problem as the burden of this transfer programme to the marginalized countries is not being shared equally.

A fourth limitation of AGOA and EBA is that neither of them has an appropriate timeframe. AGOA has a very short horizon for phase out, essentially encouraging only highly footloose activities to relocate to marginalized countries temporarily. By contrast, EBA has no specified end-date, hence providing no incentive for the complementary measures that would make the program unnecessary. A minimum sensible timeframe for a preference is around eight years. Since the donor community has chosen 2015 as the date for attaining the MDGs, it might be appropriate to harmonize this particular development instrument with that date. By coordinating on common dates the credibility of future commitments is increased.

Beyond textiles

The basic objective of temporary preferences would be to diversify exports away from traditional primary commodities. Different marginalized countries can be expected to have different opportunities for diversification. Not all are in a position to develop textile exports – for example, some are landlocked and so are probably fundamentally uneconomic as locations for global manufacturing. Another activity in which marginalized countries have potential long term advantage is in the products of temperate agriculture such as horticulture. Fortunately, from the perspective of the ability to offer preferences, the OECD currently levies high tariffs on these products. Hence, there is substantial scope to provide valuable preferences.

Defense from Anti-dumping suits

The incentive effect of any preferential agreement could be considerably enhanced by granting temporary exemption from anti-dumping suits. Currently, the ability to bring anti-dumping suits powerfully discriminates against the marginalized countries. This is because the costs inflicted once such a case is brought (regardless of its outcome) are proportionately markedly higher if the target is a firm in a marginalized country. Partly, this is because exporting firms are likely to be smaller, and so find the high fixed legal costs more burdensome. Further, because of the much smaller size of the domestic market, there is much less chance of diverting blocked export production onto the domestic market. It is, of course, precisely the firms that would find even a spurious anti-dumping suit ruinous that are the most likely to be faced by them. The 'trade-chilling' effect of the potential threat of anti-dumping suits is thus more serious for the marginalized countries.

Exemption from anti-dumping suits has already been granted by some countries to other countries and the practice is not bound by the MFN clause. For example, The EU currently favours Iceland: no anti-dumping suit can be brought against Iceland from anywhere within the EU (although Iceland is not a member of the EU). There is thus no legal obstacle to extending such an exception temporarily to the countries that most need it.

Eligibility

Evidently, countries could not be allowed to self-select into eligibility for such preferences. For the first time in the WTO objective criteria would need to be agreed. Obviously, there are many precedents in other international organizations for objective criteria for eligibility to transfer programmes (of which preferences are a variant). Thus, both the UNDP and the World Bank have income cut-offs for their transfer programs. It was indeed only because the purpose of SDT was exclusion rather than meaningful transfers that countries were permitted to self-select.

The criteria for eligibility to preferential access should basically follow from the core objective of the program to diversify exports of those low-income countries that have to date failed to break out of traditional primary commodities to any significant extent. Thus, only countries with both a low per capita income and a very low share of 'non-traditional' exports in GDP would be eligible. Countries which, though poor, have already accumulated substantial economies of agglomeration for non-traditional exports, such as Bangladesh and Vietnam, would not therefore be eligible. Such restrictions are important for the benefits to be well-targeted. However, both EBA and the Hong Kong excessively restrict eligibility: both are confined to the Least Developed Countries. While superficially this sounds well-focused, in fact it is radically miscast. Those marginalized countries that are in a position to benefit from preferences are not the countries right at the bottom of the world economy, but those that already have broadly adequate policies and infrastructure but need to be pump-primed into global markets. It is countries such as Ghana, Senegal and Kenya that might break into diversified global markets, not Liberia, Somalia and the Democratic Republic of the Congo. In this respect, AGOA is the only one of the three schemes to be well-designed.

Embedding temporary preferences within the trade round: a bargain, not a transfer

To summarize, AGOA covers the wrong market, and the wrong time horizon. EBA and the Hong Kong offer had precisely the wrong eligibility. Neither AGOA nor EBA were negotiated as part of a trade round. However, placing a common OECD temporary preference within the context of the trade round would provide advantages to all parties.

First, by making the arrangement part of an explicit WTO agreement, the temporary nature of the preferences would become binding and hence more credible. It would also be easier to negotiate a common OECD position if this were set in the context of negotiating a grand bargain with developing countries, for in such trade round negotiations the OECD is indeed forced to find a common position.

Secondly, one condition for the preferences could be that the marginalized countries benefiting from the preferences would agree to support other parts of the trade round. A further condition could be that in return for this SDT on tariffs, the marginalized countries could not have a collective SDT position on adherence to rules. Thus, this could be part of the bargain by which the marginalized countries accepted the 'core' rules of the organization, discussed above. A further condition might be added that even the marginalized countries take meaningful steps to trade liberalization – for example, that they broadly match the concessions negotiated by the integrating developing countries.

The most difficult group from whom to gain agreement would evidently be the 'integrating' developing countries in potential competition with the marginalized countries. However, even here there are two reasons for them to support such an arrangement. First, the granting of preferential access would increase the cost of any given level of tariffs to the OECD and so increase pressure for their reduction - which is the core interest of the integrating countries. Secondly, the integrating countries would have the most to lose from an alliance between the marginalized countries and OECD protectionists. Hence:

Proposal 3: Introduce an OECD-wide, time-bound preference for a defined group of currently undiversified, marginalized countries. Include exemption from anti-dumping suits in this preference. Require eligible countries to accept plurilateral and common core rules as a condition for such preferences.

2.4: Facilitating a bargain between the OECD and the integrating developing countries

The group with the most to gain from using the WTO as a bargaining forum are the 'integrating' developing countries. This involves a huge psychological step for such countries: essentially from reactive to pro-active (Mattoo and Stern, 2003). Instead of shielding themselves from the intra-OECD push to trade liberalization, as during the GATT, countries such as India now have a strong interest in better access to OECD markets, and realistically this will be achieved predominantly through reciprocity. The shift of manufacturing from the OECD to some developing countries has two implications for such a trade bargain. First, because manufacturing was the focus of the GATT negotiations, through the MFN clause developing countries already have reasonable access to OECD manufacturing markets (with the exception of textiles). Thus, the key market access issues for developing countries are going to be agriculture and services. Second, because of the declining interest of the OECD in manufacturing exports, what the OECD wants from developing countries is not predominantly access for manufactures, but rules concerning IPR, government procurement, investment, and trade in services. Hence, unlike the GATT negotiations, the main scope for a trade deal between the OECD and the 'integrating' developing countries is a cross-sector deal – access to OECD agriculture in return for rules on IPR, government procurement, investment, and the opening of the market for services. The integrating developing countries face a major problem of coordination among themselves in determining what they are prepared to offer, and in the medium term any agreed offer is likely to be limited. To secure significant agricultural liberalization it is therefore important to reduce its political cost within the OECD.

Compensating OECD agriculture

The heart of any OECD liberalization will inevitably be agriculture. The most important trade-related agricultural interventions of OECD governments are not only tariffs and quotas but various forms of production subsidy. All the economic analyses show that the EU, USA and Japan are shooting themselves in the foot with their current agricultural policies. But the very robustness of these policies in the face of such evidence (over decades) tells us that the economic analyses miss something important. What they miss is that the rural constituency that benefits from these policies does not trust any alternative means of achieving an income transfer, and indeed fears that any change in the transfer mechanism would open up the possibility of further – adverse – change. The economic analyses show us that there is scope for being very generous – moving to an income transfer mechanism that offers the rural sector higher incomes, but it gives no guidance as to how to reduce the problem of credibility. In essence, why should farmers trust a new system to continue, given that the move to a new system creates the precedent of abandoning a system of rural support?

One way of increasing the confidence of the OECD rural constituency in any compensation for the removal of production subsidies would be to make such compensation an explicit part of the trade round. Indeed, since without proper compensation any reduction in production subsidies is likely to be eroded, this would be a sensible requirement on the part of trade negotiators. Such compensation might be in the form of direct income support or through a switch to subsidies for environmental protection.

In addition to adding to the credibility of the agreement, there is a further potential advantage from making compensation an explicit part of the trade round. OECD farm lobbies are highly successful rent-seeking organizations and, faced with the prospect of the introduction of other forms of subsidy, whether income support or environmental subsidies, combined with the phasing out of production subsidies, they will rationally support the former, but oppose the latter, hoping to *add* the new subsidies to the already considerable range of subsidies won by the farm lobby. The past history of agricultural subsidies suggests that this is quite a likely outcome. For example, the main groups that want environmental protection have no intellectual or emotional attachment to the cause of trade liberalization. Although the main beneficiaries of phasing out agricultural production subsidies would be OECD consumers, this group is not an effective lobby: the main pressure for phasing out production subsidies comes from developing countries. Other than in the context of trade negotiations, developing countries have no place at the table to discuss OECD production subsidies. Thus, since the most promising instrument for such a phase out is the conversion to other forms of subsidy, bringing them into the trade round may be the best way to ensure that there is a switch between subsidies rather than an accumulation.

Compensating marginalized countries that lose

Reciprocal trade liberalization, properly negotiated, creates net gains in nearly all societies. Within societies some groups inevitably lose and it is the responsibility of national governments to arrange compensating redistributions as they judge to be appropriate. While the WTO may have a strong interest in ensuring that such compensation is paid, (as discussed above in the case of OECD agriculture), it can hardly itself be the agency executing such *intra-country* transfers. However, there is a much stronger case for explicit WTO financing of *inter-country* compensation for the minority of 'marginalized' countries that would otherwise risk losing from a trade round. Losses will arise from two main sources, changes in world agricultural prices, and the costs of complying with standards and codes that are part of WTO agreements.

Notably, agricultural trade liberalization by the OECD would create some losers among those low-income African countries who currently benefit from special market access. Of course, to the extent that a generously expanded preferential system for the marginalized countries can be introduced into the round (as discussed above), the number of net losers would be reduced. However, some countries have so few credible alternative export opportunities that any deal which reduced the price of their current exports would be liable to generate net losses. There is thus a case for supplemental direct transfers to the governments of those few countries that can be shown to be net losers. The issue of how to finance such transfers will be taken up after a consideration of the other important cost of a WTO deal, namely compliance with procedures.

Developing countries are already signed up to trade procedures that are administratively very expensive. For the poorer countries this was probably inadvertent: they were not in a position to scrutinize and cost what they had agreed to do. As rules become a more important part of the WTO, which seems inevitable, and as even the marginalized countries get drawn into the adoption of many of these rules, the administrative costs of compliance will become substantial for some countries. Again, there is a case for direct transfers both to build capacity and to cover these administrative costs.

To finance such transfers it has recently been proposed that a small, common import duty be levied within the OECD – perhaps at the rate of 0.25% (Hoekman, 2004). While this would, in effect, give the WTO resources to finance transfers, there are several disadvantages. The tax would be hypothecated, breaking a basic principle of taxation, and it would involve the WTO in imposing a tariff when its core business is removing them. An alternative would be to build on ‘policy coherence’, using part of aid budgets to meet these needs, but making this an explicit commitment of the trade round. To avoid the need to specify the burden-sharing among bilateral aid programs, this compensation could be made a requirement of IDA. Hence:

Proposal 4: Incorporate into the trade round explicit, legally binding undertakings both for intra-country compensation, financed out of the relevant national budget, and inter-country compensation, financed out of IDA.

Expanding Trade in Services

Trade in services has enormous potential for expansion. This is probably the main case in which there is scope for mutual gains that are *intra*-sectoral and so the bargaining should in principle be considerably easier than the 'grand bargain' needed for the rest of the trade round.

The basic form of an intra-service sector deal would be that the OECD would not impose restrictions on outsourcing, in return for expanded market access for OECD companies in the integrating developing countries (perhaps extended automatically to the marginalized countries if this was part of the preferential access bargain as discussed above). It would be strongly in the interest of the integrating developing countries to conclude such a deal, pre-empting what is otherwise liable to be a significant protectionist backlash. OECD protectionist sentiment against outsourcing seems to be far stronger than that against low-wage manufactures. Partly the difference may merely be one of familiarity, but additionally, with a pure labour service the labour time is directly traded, and the only reason for trading it is due to wage differences. By negotiating an intra-sector deal, OECD governments would be able to present to their electorates gains in market access that were sufficiently similar to the outsourcing trade to be recognized as commensurate. Although the true benefits of outsourcing to the OECD do not depend upon such reciprocated market access, mercantalist perceptions of trade are so deeply rooted in the OECD electorate that demonstrated reciprocity may be the most effective counter to protectionist pressures.

Enforcing Agreements

A critical part of the GATT was its enforcement mechanism. Under defined circumstances countries – essentially the EU, the USA, or Japan – were permitted to deploy retaliatory trade sanctions, which since they were permitted, did not risk spiraling into a trade war. Because all three countries had large markets on which significant industries in the other countries depended, retaliation could be designed to trigger domestic political pressure on the offending government to desist from its offence.

Evidently, if one of the big three OECD countries breaches its agreement with a developing country this right to retaliation is very unlikely to work. Few developing countries have markets that are sufficiently important to industries in the big three to exert political pressure through retaliatory sanctions. This is an example of a more general phenomenon, that to create for developing countries the same opportunities that the GATT created for OECD countries, the rules need to be modified. One relatively straightforward way of modifying the enforcement mechanism is to make the right to retaliation transferable. A country which had suffered due to a breach in an agreement but was not in itself in a position to exert pressure, could then transfer its entitlement to retaliate to a country that was in a position to impose sanctions that would be politically damaging. Such transferability could be done either through a non-financial bidding process in which the country with the entitlement judged which among countries willing to sanction would generate the most pressure, or by a market. Hence:

Proposal 5: permit the right to retaliate to be transferable

2.5: Facilitating intra-developing country liberalization

Trade barriers between developing countries are much higher than those between developing and developed countries. Developing country exports to markets in other developing countries face higher barriers than those to OECD markets, and also higher barriers than faced by OECD exports to the same markets. Since, in aggregate, developing country markets are growing more rapidly than developed country markets, these differentially high barriers are likely to become a serious impediment to accelerated growth. Developing countries have yet to reap the gains from intra-sector specialization that were the main rationale for intra-OECD trade expansion. Currently, there are two routes to trade liberalization between developing countries, trade blocs, and the MFN route. For developing countries both of these routes work much less well than they do for developed countries – which is why intra-developing country barriers are so high. After discussing the nature of these limitations I suggest a possible hybrid which might work better.

PTAs

Intra-developing country liberalization through regional preferential agreements has to date been the preferred strategy of most developing countries. However, despite the proliferation of developing country trade blocs – there are more blocs than countries – they have largely failed to reduce trade barriers.

One problem is that the incentives for compliance are weak. Often, heads of state treat regional trade bloc agreements as gesture politics – many agreements are signed without serious intentions of implementation and indeed are mutually inconsistent. Complex and inconsistent preferences provide customs officers with huge powers of discretion, so that the agreements generate corruption rather than trade.

A second problem is that were the agreements actually implemented they would usually generate large redistributions among neighbours, with some clear losers. As a general rule, a trade bloc favours the member with endowments closest to the global mean, at the expense of members furthest from the mean (Venables, 2003). Thus, a developed country trade bloc favours those of its member countries with the lowest incomes, and so experiences convergence: as with Portugal and Ireland in the EU. By contrast, a developing country trade bloc favours those member countries with the highest incomes, and so experiences divergence.

Potentially, developing country trade blocs could reduce the problem of the multiplicity of countries all trying to bargain. The EU facilitated the GATT because negotiating trade rounds became a matter for the EU rather than for each of member country. However, in practice this has not happened. The developing country trade blocs are not customs unions and so do not impose a single common tariff structure on members, each of which continues to bargain individually. Thus, if anything, such trade blocs complicate rather than facilitate WTO negotiations.

These disadvantages make it unlikely that trade blocs will ever be the dominant route by which intra-developing country trade barriers are reduced. Nevertheless, the barriers are currently so high that trade blocs may have some role to play in reducing them. The issue is then how to make them more effective.

One possible approach is to link preferential agreements between developing countries to improved access to OECD markets. The link with OECD markets is both a good in itself and can help to enforce intra-developing country market access. Thus, NAFTA is both a north-south preferential trade area and an intra-south trade area. The REPAs introduced by the EU are a similar concept.

MFN

Based on the experience of the OECD, the most promising route to intra-developing country liberalization should be for the big players such as China, India, Mexico, Brazil and Indonesia to negotiate trade liberalization with each other while being bound by the MFN clause to extend this to other countries. This may, indeed, work. However, the difference with the GATT is that even these large developing countries have far smaller shares of world trade than the major OECD negotiating units and so the free-rider problem is much more acute.

A limited MFN?

Trade blocs – the only currently permitted exceptions to MFN - are regional, based on geographic contiguity. There is no political possibility of a *maritime* trade bloc between the big five developing countries since this would span continents. Yet, from the perspective of internalizing the benefits of trade liberalization, such a maritime bloc would be desirable. One way of simulating such an effect – making the inter-developing country negotiations look more like the intra-OECD negotiations of the GATT period – would be to modify the MFN clause, permitting a developing country to reduce its trade barriers without preference as between all *developing* countries but not to the OECD countries. In their bargaining with the OECD developing countries would still be bound by the full MFN clause, so that any liberalization to the OECD would have to be granted to all countries. However, it would be permitted for developing countries to liberalize purely with each other, but without intra-developing country discrimination, should they choose to do so. This would enable the big five to conduct reciprocal liberalization negotiations with a much higher proportion of the benefits being captured by the countries themselves, and this internalization should increase the incentives for intra-developing country liberalization. The concept might be thought of as introducing a *Most Favoured Developing Nation* (MFDN) rule as an optional alternative for developing countries to the MFN rule.

As with the proposal of temporary preferences for the marginalized countries, this is an example of where, in order to create conditions that give some countries today the same chances that other countries took in the past, it is necessary to modify the rules. Opportunities do not only depend upon the rules but upon structural characteristics of countries. The radically smaller shares in world trade of the big five developing countries as compared to the USA and the EU is a structural difference that makes the MFN clause much more destructive of the incentive to bargain with each other. Hence:

Proposal 6: permit developing countries to make tariff reductions that applied to all developing countries but not to developed countries (MFDN) as an alternative to being bound by the MFN rule.

2.6: The internal organization of the WTO

The WTO is a hybrid of two models: the GATT and the IFI/UN agencies. Viewed as the former the key change is that the ‘marketplace for reciprocity’ has been expanded to cover services, intellectual property and investment. Viewed as the latter, the key change is that membership is now virtually global. If the WTO is to evolve into an agency comparable to the major IFI/UN agencies, it should establish an agreed goal, achieved by a secretariat charged with a mission that is supervised by governments, and a component of this goal should include a ‘transfer’ from OECD countries to developing countries. Many of the new members of the WTO – developing countries – joined not to take part in a marketplace, but to participate in such a purposive and redistributive global agency.

Facilitating the marketplace

GATT negotiations basically involved three parties, the USA, the EU and Japan. WTO negotiations cannot be determined by these three parties in anything like the same way, yet moving from two to 147 bargaining units makes the sheer mechanics of reaching agreements within a very limited timetable much more difficult. In response to this most countries have joined into one or more negotiating blocs. However, these are at present fluid and have no formal status in the negotiations. It may be useful to construct more purposive blocs and to give them formal recognition. It may even be possible to move to a Board structure analogous to the IFIs. For illustrative purposes, the Board might consist of the USA, the EU, other OECD, the big five developing countries, other middle-income countries, and other low-income countries. Each of these blocs would automatically have representation in all negotiating committees. Each might have the power of veto, while within blocs countries could come to their own agreement as to whether unanimity was required. Such structures would make it easier to get swift consultation among countries during the meetings.

Empowering the secretariat

The proposals and suggestions above would retain inter-country bargaining as the core function of the WTO – its key public good is indeed the provision of a marketplace for such bargaining. However, they would add functions such as the negotiation within the OECD of a non-reciprocated improvement in market access as a 'transfer', which would make the organization more like the IFIs. Such additional functions would require that the secretariat move from pure facilitation to the achievement of stated goals, and this in turn would be helped by a modified structure for supervision of the secretariat. Hence:

Proposal 7: create formally recognized blocs of countries, each represented on a supervisory WTO Board and with veto power, and empower the secretariat to undertake specified new functions, subject to this supervision.

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