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Special and Differential Treatment: A Mechanism to Promote Development?

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Much has been made of “special and differential” treatment in the Doha Development Round of WTO negotiations. In particular, a conscious effort has been made to infer that special and differential treatment will promote development. While special and differential treatment may be a necessary evil given developing countries’ higher adjustment costs, dignifying it as a development mechanism plays into the hands of protectionist interests. In particular, by allowing a general increase in the ability of developing countries to isolate their economies, it may reduce the efficacy of important forces that prod institutional reforms in developing countries. As institutional reform is one of the keys to economic development, lionizing special and differential treatment in the WTO is likely to be counterproductive.

Keywords: development, institutional reform, protectionism, special and differential treatment, WTO

2. International trade can play a major role in the promotion of economic development and the alleviation of poverty. We recognize the need for all our peoples to benefit from increased opportunities and welfare that the multilateral trading system generates. The majority of WTO members are developing countries. We seek to place their needs and interests at the heart of the Work Programme adopted in this Declaration. ... [W]e shall continue to make positive efforts designed to ensure that developing countries, and especially the least-developed among them, secure a share in the growth of world trade commensurate with the needs of economic development.

Doha Ministerial Declaration (WTO, 2001a)

44. We reaffirm that provisions for special and differential treatment are an integral part of the WTO Agreements. We note the concerns expressed regarding their operation in addressing specific constraints faced by developing countries, particularly least-developed countries. ... We therefore agree that all special and differential treatment provisions shall be reviewed with a view to strengthening them and making them more precise, effective and operational.

Work Programme,
Doha Ministerial Declaration (WTO, 2001a)

As a multilateral organization that requires consensus among numerous members that have disparate objectives and agendas, it is not surprising that the official pronouncements of the World Trade Organization sometimes exhibit internal inconsistencies. In some cases, these inconsistencies have little impact on the efficacy of the underlying agreements, the ability of the Secretariat to undertake its work or the evolution of the organization through negotiations. In other cases, such as the one illustrated by the quotes above from the Doha Ministerial Declaration, the inconsistency both is egregious and hobbles the organization in its pursuit of one of its core objectives – in this case trade liberalization.

Attempting to dignify the “special and differential” treatment granted to developing and least-developed countries as a mechanism that fosters or facilitates the contribution trade can make to economic development not only is spurious but also plays into the hands of protectionists. It is wise to remember that the major reason the influence of protectionist interests has waned over the last half century is that they have been stripped of their intellectual legitimacy (Kerr and Perdakis, 1995). The long intellectual battle that disassociated protectionism from society’s interests was won through the rigorous examination by economists of theories that advocated restrictions

on trade. Starting with Adam Smith's devastating attack on "mercantilism" in 1776,¹ protectionist arguments such as "distortions in commodity or factor markets", "domestic full employment", "stable exchange rates", "national security", "revenue-raising tariff", "infant industry", "senile industry", "infant economy", "import substitution industrialization", etc. have been debunked by economists, for example, Bhagwati and Ramaswami (1963), Hindley (1983), Winters (1990), Baldwin (1969), Flanders (1964), Morgan (1959) and a host of others including those who work for multilateral organizations (IBRD, 1987).² The rigorous refinement of neoclassical trade theory over the last century has created a powerful logic that is widely accepted among members of the economics profession, as well as more generally, due to its having become the dominant paradigm in economics education pertaining to international trade.³ It is also the economic model that underlies the WTO (Isaac and Kerr, 2003).⁴ The result has been that requests for protection have been fully exposed and understood as pandering to vested interests. The absence of "social legitimacy" has made obtaining protection through the political process much more difficult and costly; hence, this absence has assisted the long-term trend toward liberalization of trade that has taken place over the last half-century.

One fundamental lesson of the long debate surrounding free trade versus protectionism is that while protectionists may suffer local setbacks, they are never vanquished – the stakes are too high. Protectionists are worthy opponents, well able to exploit chinks in the armour of trade liberalization to their advantage. What they crave above all is the cloak of "social legitimacy" – to be able to have their particular cause associated with the "general good" rather than the narrow garnering of trade policy rents. Currently, this seeking of "social legitimacy" can be seen most blatantly in the rise of antidumping actions. Antidumping actions are dignified with legitimacy through the ability of those initiating a case to brand those from whom protection is sought as "unfair" traders whose activities threaten legitimate domestic businesses, jobs and, sometimes, the viability of communities. The cachet of being able to accuse foreigners of "unfair" pricing practices, even when it is easy to show that the label is unwarranted in the vast majority of cases (Kerr, 2001), is extremely valuable for protectionists and, as a result, reform of antidumping policy is vociferously resisted even when less cumbersome, but transparently protectionist, alternative safeguards exist (Kerr and Loppacher, 2004). Other examples of protectionists seeking the "cloak of legitimacy" can be found in attempts to have clauses pertaining to "environmental standards" and "labour standards" included in regional trade agreements. While a variety of interests may want to have these "social goals" recognized in trade

agreements, often their most fervent supporters are labour unions with a vested interest in limiting foreign competition.

Protectionists do not reside only in developed countries. Protectionist interests are equally likely to be present in developing countries. In fact, given rigidities in labour markets and other institutional failings in developing countries, the costs of adjustment associated with liberalization may be higher than in developed countries, leading to even larger incentives to pursue protectionism. Protectionists in developing countries are no different from their counterparts in developed countries in their craving for the “cloak of legitimacy”. Special and differential treatment at the WTO currently provides that legitimacy for protectionists in developing countries.

Special and differential treatment may well be a political compromise necessary to bring developing countries to the table at the negotiations. It has long been recognized that developing countries may find the process of adjusting to declines in their international competitiveness more difficult to deal with because their labour forces are less well educated and therefore may be less able to transfer among industries as trade liberalization leads to the predicted adjustments associated with moving resources from relatively inefficient industries to relatively efficient industries. Given that the private costs of adjustment may be higher, and the resources available to mitigate those costs through retraining, relocation and social welfare payments are far fewer, concessions to developing countries may need to be made to allow, for example, longer transition periods or temporary trade barriers.⁵ Special and differential treatment granted for these reasons is a result of not being fully developed as an economy – a concession to the political reality faced by trade policy makers in developing countries. This is a far cry from the deliberate association of special and differential treatment with economic development in the Doha Ministerial Declaration (2001a). The declaration creates the impression of a strong (causal) association between special and differential treatment and economic development. This impression has opened the door to legitimization of protectionism as an adjunct or fosterer of economic development. For example, twelve developing countries⁶ brought forward a *Proposal for a Framework Agreement on Special and Differential Treatment* as part of the preparations for the Fourth Session of the Ministerial Conference (WTO, 2001b). This document sought to further cement the idea of a causal relationship between special and differential treatment and economic development. WTO (2001b) states at various points:

Special and Differential treatment was based on the recognition that the developing countries were placed differently in international trade and that these difficulties as well as the imperative of *promoting social and*

economic development required that developing countries be treated differently in the Multilateral Trading System (emphasis added) (p. 2)

There is an urgent need for such a S&D regime which mainly focuses on enhancing market opportunities (for developing countries) and provides policy options aimed at unlocking their *growth and development* potential. The guiding basis, therefore, should be that (i) the liberalisation of trade is not an end in itself but the means to an end, that is, *economic growth and development* of all Members and (ii) different levels of development achieved by members require different sets of policies to achieve *economic growth and development* (emphasis added) (p. 3)

S&D treatment that *facilitates developing countries to grow and develop* will ultimately benefit all not just in terms of more and affluent markets but by ensuring a more peaceful world (emphasis added) (p. 3).

Some of the elements which can form part of the Agreement on S&D could be as follows: ... Without an evaluation of the fact that whether an Industrial Policy has a demonstrable adverse impact on trade, there shall be no prohibition of policies which *promote growth and development in developing countries* (emphasis added) (p. 4).

The change in the status of special and differential treatment, from being a necessary evil arising from the political reality of trade policy making in developing countries to being a central focus of how trade policy can promote economic development, is a major coup for protectionist interests in developing countries.

Special and differential treatment is antipathetic to the promotion of economic development. Stripped of its rhetoric, special and differential treatment for developing and least-developed countries is simply a polite term for protectionism. It is important to be able to separate the fact that a policy of trade liberalization will lead to some members of a society losing in the adjustments that must take place from the fact that the less transparent benefits that arise from the movement of resources between sectors will provide the efficiency – and welfare – gains expected. Protectionists are always better able to identify the potential losers from trade liberalization than those promoting integration into the global economy can point to potential winners. Further, as protectionists' claims during debates over liberalization are seldom examined after the debates are over – either because they win the debate and liberalization does not take place or they do not prevail and the advocates of liberalization have no interest in examining the predictions of their adversaries – they are often able to amplify their predictions of doom (Kerr and Foregrave, 2002). Policy makers in developing countries may be more susceptible to protectionist arguments due to the narrower economic bases of their economies, and in particular their “modern” sectors. Modern

sectors tend to be viewed as success stories and national champions – even if their success is a direct result of significant trade barriers – attracting better educated executives who are able to articulate their protectionist arguments. Thus, there probably is a natural tendency for trade policy makers in developing countries to be sensitive to protectionist arguments. This bias toward protectionism, however, is not the major difficulty special and differential treatment creates for economic development. All countries have to find the appropriate balance in trade policy between the gains from trade liberalization and the adjustment costs imposed on particular sectors. Developed countries exhibit varying degrees of openness and are clearly willing to forgo a certain proportion of the potential gains from trade.

Isolation from external economic forces represents the major detriment to economic development that arises from special and differential treatment. While it is true that protected firms do not have to become more competitive, isolation of the economy means also that local institutions do not face pressure to modernize. Banks and other financial institutions fail to modernize because they do not have to compete implicitly with the services provided to foreign firms competing in their domestic market. Government bureaucracies can remain inefficient and corrupt because they can retain their monopolies over the services they provide. For example, open economies mean that domestic firms can seek better government services elsewhere, if necessary moving operations to countries whose bureaucracies are less inefficient or corrupt and exporting back to their original country of operation. The need to respond to the potential for firms to “flee” puts considerable pressure on domestic policy makers to initiate reforms. Considerable evidence of the institutional reforms that economic openness can bring is to be found in the experience of transition economies (Hobbs et al., 1997).

In those Central and Eastern European countries that were geographically contiguous with countries of the European Union, and were seeking membership in the EU, economic openness was a requirement. That meant, for example, that Czech firms that could not get modern banking services from domestic banks had the option to obtain financing from Germany. While there were transaction costs associated with dealing with German banks, they were less than the costs imposed by the inefficiency of local banks. As a result, the efficiency of domestic banks improved dramatically. This has not been the experience in the economies of countries such as Ukraine, Moldova or Georgia, which are geographically separated from western Europe and do not have to open their economies due to the near-term prospect of accession to the EU (Gaisford et al., 2003; Considine and Kerr, 2002).

Further, opening an economy to foreign competition also allows for corporate raids to be made on poorly performing assets in the developing country. If foreign firms see opportunities for reforming domestic enterprises so that they can receive a better return on their investment than the local management can provide, they will acquire the assets and initiate reforms. While this loss of local control is often decried by those opposed to globalization, the threat of a foreign takeover is a major spur to other domestic firms to reform to stave off potential raiders in the future. Hence, the loss of local control in a few instances provides a powerful signal that other domestic firms ignore at their peril. These types of reforms lie at the heart of economic development.

In a similar fashion, firms in transition countries bordering western Europe, when faced with government corruption and inefficiency, were able to threaten to set up shop in Austria or Finland to obtain licences without corruption costs, to have transparency in tax regimes and to possess secure property rights and then export via short international supply chains to connect with already existing distribution networks. As a result, monopolies on government services were indirectly broken and those services improved, transparency in tax regimes increased and the rule of law replaced bureaucratic largess over rights to property. Strengthening property rights is particularly important to the process of economic development. Progress in strengthening property rights may be thwarted by those in government who benefit directly from their ability to (arbitrarily) allocate rights to use productive resources, and economic reforms may stall at suboptimal institutional arrangements (Kerr and MacKay, 1997). Openness to foreign alternatives may help tip the balance toward further institutional reforms.

One of the major inhibitors of economic development is high transaction costs arising from poorly developed institutions (Hobbs and Kerr, 1999). Special and differential treatment allows a developing country to choose a general level of isolation from outside forces. This isolation increases the ability of governments to resist change. In particular, given that economic isolation allows corruption to flourish, protectionism may well have new beneficiaries (and new proponents) that see special and differential treatment not so much as a mechanism to provide benefits to particular private economic interests but rather as a mechanism to allow their corrupt practices to continue.

Hence, in the case of such isolation, it is the positive externalities for economic development, rather than the direct benefits of trade, that are forgone. The loss of these externalities represents the major danger arising from attempting to associate special and differential treatment in a causal way with economic development. In

other words, without special and differential treatment, developing-country governments would still have industries or sectors they wish to protect and would have to negotiate hard to retain the level of protection desired – just like every other country. Special and differential treatment, however, allows for a higher general level of protective isolation, thus reducing the positive externalities trade can bring to development. Legitimizing this additional degree of protectionism in the WTO by suggesting it is development enhancing would seem to be counterproductive.

Sometimes it is argued that while the ability of developing countries to restrict market access in the name of special and differential treatment does not contribute to development, the important aspect of special and differential treatment is that it allows preferred access to the markets of developed countries. Beyond the mercantilist roots of this view – “exports are good” – preferential access leads to the same failure to adjust that barriers to market access allow. One has only to look at the fate of the EU’s banana suppliers that received preferred access to the EU market. Unless preferred access, and its inherent distortions, can be maintained in perpetuity, difficult adjustments eventually will have to be made (Read, 2001; Guyomard and Le Mouël, 2003). This is no different from the false development that takes place behind barriers to market access. Another example arises as the United States progressively offers preferred market access to more countries through bilateral trade agreements, and those who first received preferred market access, such as Mexico, attempt to find ways to retain their advantage (Kerr, 2005; Yeung et al., 2004). The final dismantling of the WTO’s arrangements on fibres, textiles and clothing has seen the erosion of many specially granted preferences, primarily protection from competition from China, and the likelihood of costly adjustments having to be made.

While special and differential treatment may be a necessary evil given the higher cost of adjustment faced by developing countries if they remove trade barriers, dressing it up as a facilitator of development plays into the hands of those who fear the reform-fostering externalities that arise from opening economies. This is not a way for the WTO to play a positive role in the process of the economic development of its members.

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Endnotes

1. Many editions of Smith's classic exist, including Smith (1994).
2. See Kerr and Perdakis (1995, pp. 39-56) for a summary of these theories and their debunking.
3. This is not meant to imply that the neoclassical paradigm has been developed or accepted without debate. In fact, the vigorous debate that has accompanied its development is one of the sources of its appeal (Perdakis and Kerr, 1998).
4. While the neoclassical trade model underpins the broad goals of the WTO, it is also clear that the approach taken by the parties in negotiation is often deeply rooted in mercantilism, with its emphasis on the desirability of exports and minimization of imports.

5. See Leger et al. (1999) for a discussion of the circumstances under which temporary trade restrictions may have a legitimate role in dealing with terms-of-trade shocks.
6. Cuba, Dominican Republic, Honduras, India, Indonesia, Kenya, Malaysia, Pakistan, Sri Lanka, Tanzania, Uganda and Zimbabwe.

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