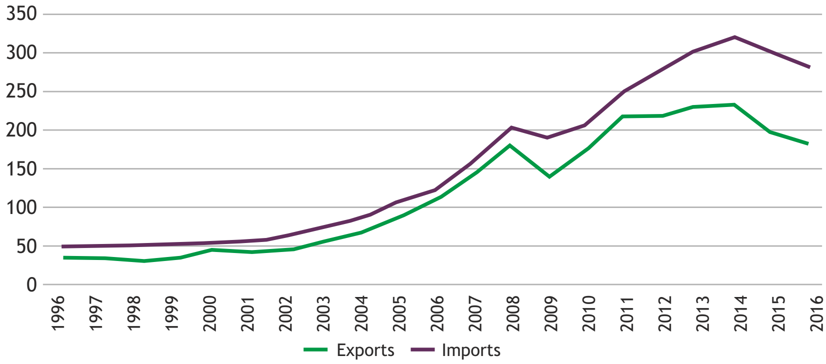
Promoting Capability Enhancing Development

The World Trade Organization's Eleventh Ministerial Conference in Buenos Aires did not deliver on special and differential treatment (S&DT). Partly, this is because the debate on S&DT and policy space rests on different views on the optimal nature and scope of trade policies, and on the role of governments in promoting structural transformation. The discussions presented in this policy brief bring to light the need to acknowledge the rising call from a number of lower income developing countries to consider ways in which multilateral trade rules can best support the design of trade and trade-related policies enabling of economic transformation. WTO members could further seize this opportunity to open up a broader debate on how new technologies, the configuration of global value chains, and regional and bilateral trade and investment agreements influence the nature and scope of today's trade and industrial development policies.

1. Introduction

International trade has the potential to deliver economic development, as shown by those developing countries which have successfully seized trade not only to reduce poverty but also set in motion structural processes of economic diversification and technological upgrading. For most developing countries, achieving higher levels of prosperity and structural transformation to enhance overall capabilities has therefore been one of the central objectives of their subscription to the multilateral trading system. Yet, more than two decades after the conclusion of the Uruguay Round, the majority of developing countries continue to suffer from low industrialisation, high vulnerability to external shocks, and overdependence on a narrow basket of raw commodity exports. By and large, services sectors and the incorporation of the digital economy remain behind relative to advanced economies.

Figure 1. Least developed country exports and imports of goods and services (US$ bn)



Notes: Data are reported in current (or "nominal") prices for each year, i.e. in the currency for that particular year. For example, current price data shown for 1990 are based on 1990 prices, and for 2000 are based on 2000 prices. Therefore, current series are influenced by the effect of price inflation.
Source: Author calculations from World Development Indicators database, http://databank.wordbank.org/data/.

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In response to these concerns, the international community committed in 2015 to the Sustainable Development Goals (SDGs) including the aim to eradicate poverty and end hunger by 2030, the achievement of which heavily hinges on economic development with an important international trade component. While development concerns arguably cut across every aspect of the World Trade Organization (WTO) agreements and negotiations, discussions on these matters in the trade body have largely crystallised around the notion of implementation issues and concerns, and the concept of special and differential treatment (S&DT).

2. Exploring Approaches to Special and Differential Treatment

The concept of S&DT is a central element of WTO frameworks and ongoing negotiations, both in its own right and within subject specific talks. S&DT recognises that countries at different stages of development may require flexibilities and on-boarding mechanisms in various forms to address specific vulnerabilities and foster their integration into the multilateral trading system. Provisions cover transitional time periods, flexibility of commitments, measures aimed at increasing the trade opportunities of developing countries and safeguarding their trade interests, and trade-related technical assistance. Some S&DT elements also specifically address the WTO's poorest members, the least developed countries (LDCs).

In 2001, ministers agreed in Doha that all S&DT provisions contained in WTO agreements should be reviewed, with a view to strengthening them and making them more precise, effective, and operational. This mandate, as contained in paragraph 44 of the 2001 Doha Ministerial Declaration, has since formed the basis for the work on S&DT undertaken by WTO members in the WTO Committee on Trade and Development special sessions (CTD-SS). For the last 17 years however, consensus on most of these issues has remained elusive. At the Bali ministerial conference in 2013, WTO members established a monitoring mechanism to serve as a focal point for S&DT provisions, based on written input from members and other WTO bodies. So far, however, substantive discussions in that framework have suffered from limited written submissions. Furthermore, the mechanism focuses on challenges facing members in implementing existing S&DT provisions but does not serve as a forum to examine the adequacy of existing measures and proposals for newer approaches or provisions.

In terms of new input, out of an original set of 88 proposals tabled in the CTD, WTO members have only reached agreement on five LDC-specific ones, including a 2005 decision on duty-free quota-free (DFQF) market access. At the Bali and then Nairobi ministerial conference in 2013 and 2015, this approach, consisting of focusing on a set of LDC-specific proposals—perceived as easier to generate consensus—led to some important outcomes notably on DFQF, rules of origin, and trade preferences in services (Box 1). While there might be some scope to further advance those LDC-specific issues, no new negotiating proposal has been circulated by LDCs on these topics since Nairobi.

Box 1. A focus on LDC packages

DFQF market access

In 2005, WTO ministers in Hong Kong agreed that "developed country members shall [...] provide duty-free and quota-free market access on a lasting basis, for all products originating from all LDCs." However, another provision toned down the scope of the decision, stating that "members facing difficulties [...] shall provide duty-free and quota-free market access for at least 97 percent of products originating from LDCs," while taking steps to progressively achieve full coverage. To date, many developed members provide either full or nearly full DFQF market access to LDC products, with some sectoral exceptions related to their respective markets. A number of developing countries have also notified their DFQF market access schemes for LDCs to the WTO. Recently, members agreed to ask the WTO secretariat to examine the implementation of the DFQF market access decision for LDCs in order to inform future discussions.

Although some progress has been made since then, significant hurdles remain and the debate has concentrated on the potential gains under a 97 percent DFQF scheme—since the 3 percent

Box 1. *Continued*

of excluded tariff lines could potentially cover 90—98 percent of all LDC exports—versus full coverage, as well as on the position of some members regarding increasing duty-free tariff lines for LDCs. One of the hurdles comes from within the LDC Group itself, as some members fear the possibility of “preference erosion.” Many LDCs benefit from non-reciprocal preferences granted primarily by developed countries, but applying DFQF to all LDCs could result in some countries losing their competitive advantages that such preferences have provided, notably in sectors such as textiles and clothing.

Preferential rules of origin for LDCs

The 2005 Hong Kong Ministerial Declaration (WT/MIN(05)/DEC) calls upon developed countries and developing countries in a position to do so to design “simplified and transparent rules of origin so as to facilitate exports from LDCs.” At the 2013 Bali ministerial conference, WTO members took a significant step by adopting a set of multilateral guidelines on this topic. Two years later, in Nairobi, they adopted another ministerial decision on preferential rules of origin (RoO) for LDCs, building on the previous Bali decision and providing additional guidance on specific aspects. Whilst there is no decision from the Buenos Aires ministerial conference, important technical work mandated by the Nairobi decision has been conducted since its adoption. In particular, WTO members agreed in March 2017 on a common template for notifying preferential RoO schemes for LDCs, with the objective of improving transparency and comparability between requirements.

Services waiver

In 2011, WTO members adopted a waiver that would allow them to grant preferential treatment to services and service suppliers from LDCs. Efforts to operationalise the LDC services waiver decision in a commercially meaningful way have been ongoing since its adoption. The Nairobi ministerial conference extended the duration of the waiver until 31 December 2030, and encouraged both developed and developing members “in a position to do so” “to redouble efforts” to notify preferences in line with the collective request submitted in July 2014.

To date, 24 members have submitted notifications regarding the preferential treatment they would like to grant to LDC services and services suppliers, and the LDC Group has reiterated the need for additional aid and further discussions in order to take full advantage of these notifications.

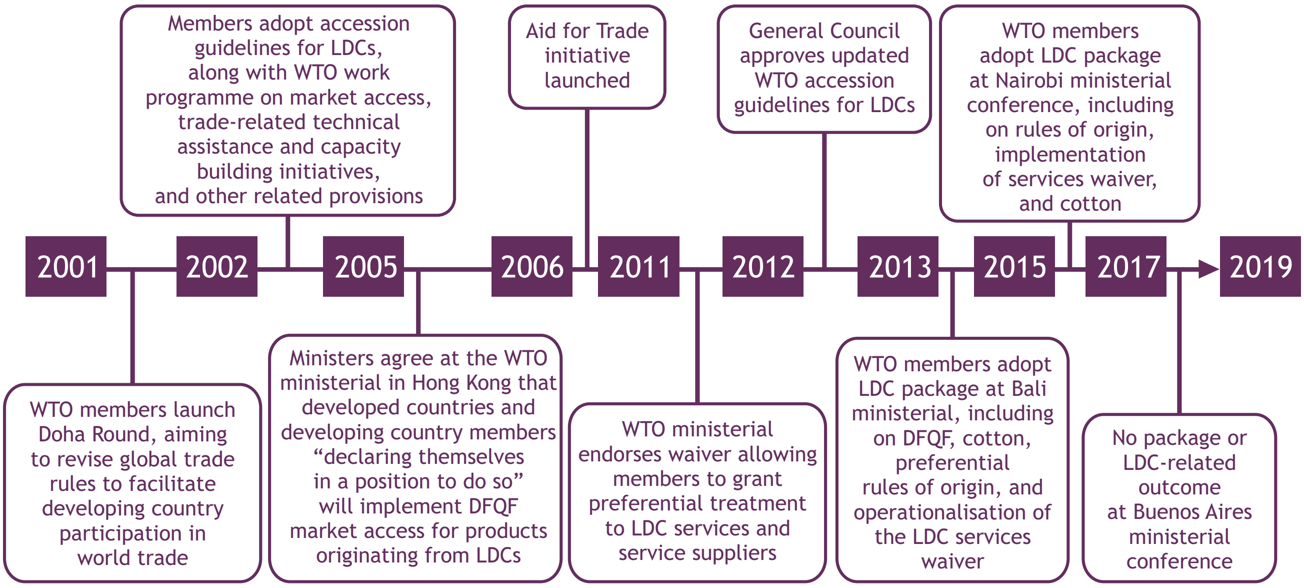
Source: ICTSD 2017

In the run up to Buenos Aires, negotiations have focused instead on a new G90 submission circulated on behalf of the African, Caribbean, and Pacific group of states (ACP), LDCs, and Africa Group (JOB/DEV/48 – JOB/TNC/60).[1] The submission built on previous attempts at narrowing down the scope of the 88 proposals originally tabled in the CTD (Box 2). The G90 submission was extensively discussed in the CTD’s special session. A limited number of advanced countries raised questions regarding the rationale for the proposed amendments, the specific challenges faced by developing countries, and how such proposals would apply in practice. The question of defining which members would be able to benefit from the proposed provisions also became a key stumbling block, as several OECD countries appeared unwilling to grant emerging economies the same rights they would grant LDCs.

With positions remaining far apart, ministers failed to resolved any of these issues in Buenos Aires and did not provide any guidance on how to address them moving forward. In the post-Buenos Aires environment, achieving progress in this area may require exploring alternative approaches to tackle the underlying concerns behind existing proposals.

1 The G90 Group at the WTO consists of the African Group plus the ACP and the LDCs.

Figure 2. Timeline of action on least developed countries at the WTO



Box 2. The G90 submission on special and differential treatment

The submission builds on previous attempts at narrowing down the scope of the 88 original proposals. With no consensus reached in Nairobi, it prioritises 10 proposals, including eight which have already been discussed, on issues such as the Agreement on Trade-Related Investment Measures (TRIMS), the General Agreement on Tariffs and Trade (GATT), non-tariff barriers, and subsidies. There are also two new proposals on technology transfer and LDC accession.

- On TRIMS, the submission envisages exemptions for developing countries for up to 15 years if a proposed measure fulfils certain development objectives related to industrialisation, socioeconomic transformation, economic upgrading, environmentally friendly production, or closing the digital divide.

- On GATT Article XVIII.A and C, the proposed disciplines would allow developing countries, in particular LDCs or developing country members facing “constraints,” to temporarily modify or withdraw concessions through a simplified and faster process, with no obligations to compensate or allow affected parties to suspend similar concessions for a five year-period. As with the TRIMS proposal, this flexibility would only apply for achieving certain objectives, such as infant industry protection, industrial upgrading, or recovering from natural disaster.

- On sanitary and phytosanitary measures (SPS) and technical barriers to trade (TBT), the proposal seeks to operationalise certain technical assistance and S&DT provisions, including defining what is a “reasonable time” for LDCs and developing countries to make comments on new SPS/TBT measures or allowing a “longer time frame for compliance.” It also proposes a system of compensatory adjustments to allow developing countries to maintain their market share and adjust to new measures.

- On subsidies, the G90 proposes that some subsidies related to various development goals, including research and development (R&D), diversification, regional development, or environment protection should be considered as non-actionable for a certain period. This was originally envisaged under Article 8 of the WTO’s Agreement on Subsidies and Countervailing Measures (ASCM), though that provision has since expired. To use these flexibilities, beneficiaries would need to demonstrate that they face certain challenges—for example, lack of diversification, decline in commodity prices or in manufacturing, or the digital divide.

Box 2. *Continued*

It also envisages certain exceptions to the prohibition on subsidies which are contingent on local content requirements.

- On customs valuation, the proposal suggests different valuation techniques for LDCs facing difficulties in establishing the true value of an imported good, until implementation capacity has been acquired through technical cooperation.

- On market access, the proposed disciplines would oblige trade preference granting countries to take into account the needs of developing countries and LDCs when designing their preferential schemes to ensure that their products of export interest are provided meaningful preferences.

- On transfer of technology, the proposal calls for measures to allow effective access to technology on fair, non-discriminatory, and reasonable terms. Developed countries shall establish a "Publicly Owned Technology Inventory" making available information concerning technologies that receive at least half of their funding from public bodies. It also calls for technical assistance to help LDCs improve their technological base and innovation capacities.

- Finally, on LDC accession, the proposal states that members shall fully implement the benchmarks for goods and services concessions agreed in the 2012 General Council decision, which updated the accession guidelines for the WTO's LDC members. It also calls for disciplining the fast-track accession procedure recently used in LDC accessions.

Source: ICTSD 2017

3. Structural Transformation as the Underlying Concern

At the most fundamental level, the G90 proposals on S&DT are premised on the need for flexibilities for developing countries to enable them to pursue a range of policies aimed at promoting structural transformation without violating current WTO obligations. From an economic perspective, two processes contribute to structural transformation: the rise of new industries and within-industry productivity growth.

Many developing countries face significant challenges in establishing new industries because the nature of global value chains (GVCs) has made it increasingly difficult for new entrants to compete with established producers. Moreover, developing countries struggle to fill large productivity gaps within sectors due to the dual nature of their economies: small, informal firms operate next to large, modern plants. This duality extends to modern vs. traditional, formal vs. informal, traded vs. non-traded, cash crops vs. subsistence crops (Rodrik 2014). This has prompted several experts to call for policies related to infant industry promotion and technology upgrading.

Against this background, the debate on S&DT and policy space rests on fundamentally two different views on the optimal nature and scope of trade and trade-related policies, and on the role of governments in promoting structural transformation. These diverging views concern what governments should be doing and how.

Addressing market failures

Broadly speaking, at one end of the spectrum, there are those who advocate that policies should address market failures. These views find their economic basis in neo-classical economic theory combined with specific assumptions, namely that resource allocation is optimised by agents responding to free markets and the best development policy is to remove obstacles to the functioning of markets. Whilst some argue for very narrow policy scope and minimal government intervention, there is almost a general consensus on this side of the debate that government intervention is required and policies should address market failures. Market failures are situations where markets by themselves do not lead to efficient, or desirable, resource allocations (Greenwald and Stiglitz 2012). These include under-investment by firms in skills development or R&D because they cannot fully appropriate gains, or information asymmetries that cause capital markets not to provide credit for new activities.

In this context, it is argued that the best policy option consists of horizontal policies which remedy generic market failures or removing inefficiencies, thereby enabling firms to operate competitively within markets. These may include streamlining administrative procedures, lowering the costs of doing business, strengthening institutions, investing in human capital, or developing infrastructure. These policies tend to have economy-wide implications and carry fewer risks in terms of unforeseen consequences in policy-induced relative price relationships. Government intervention is also justified on the ground of addressing negative externalities, such as of an environmental nature. This view also posits that government failure is more prevalent than market failure, because policymakers have limited ability to foresee the consequences of public policy, and are likely to be captured by special interests. In other words, policymakers should not distort markets and "pick winners" because they are likely to get it wrong. Hence certain forms of subsidies and local content measures are not likely to achieve their objectives. From a WTO rules perspective such an approach may not require significant flexibilities, not least because existing disciplines largely allow for such government interventions.

Beyond market deficiencies

On the other side of the spectrum, some argue that developing countries should be allowed to adopt selective policies, targeting high potential sectors. This is justified because some sectors have higher potential for technological upgrading, productivity growth, and forward and backward linkages than others. Governments have limited resources and need to allocate these to higher potential sectors. Moreover, this view sees a strategic role for the government to incentivise firms to invest into higher technological capabilities. Firms in developing countries, they argue, face structural challenges because acquiring technological capabilities is costly and risky and industry-specific. State intervention is necessary to generate the incentives to explore technological possibilities, create and strengthen private sector actors, and support the accumulation of capacities and knowledge, based on an appreciation of the differences between sectors.

Development policy should go beyond correcting existing market deficiencies—where markets can be in equilibrium at low levels of income and growth—and augment endowments and parameters in order to create new comparative advantages, deepen industrial bases, and create technological capabilities (Lall 1996). Whilst institutional capabilities may be a concern, it is argued that policy learning is not as much a pre-condition of industrialisation, but rather coincides with the industrialisation process and the optimal balance between government intervention and market forces changes over time (Ohno 2013). The weight of government intervention depends on, and should change based on, industry characteristics (capital intensity, gestation periods, product type, market volatility), policy capability, dynamism of the private sector, and changing industry conditions.

To a large extent, these debates have traditionally shaped the different views on policy space and S&DT at the WTO.

4. Industrial Policy in the 21st Century

Significant changes in the nature and organisation of global production and trade that have occurred in the past three decades add an additional element of complexity. The rise of global value chains implies that inter-firm and intra-firm linkages are particularly important in determining who supplies what, where, and how. Lead firms, mostly originating from developed countries, procure globally by setting strict requirements in terms of price, quality, volume, standards, and, increasingly, private sustainability standards. This "governance" determines whether suppliers will be encouraged to upgrade into better or new products, improved production processes, etc. Recent innovation in information and communications technology (ICT) and digitalisation, as well as trade facilitation measures, have also profound impacts on the functioning of GVCs. An increasing range of services inputs are now outsourced and offshored; the effectiveness of customs procedures and logistics services are increasingly crucial elements of firm competitiveness; and digitalisation is changing production processes, and relationships between suppliers, global buyers, and consumers.

For developing country governments seeking to maximise benefits from value chain participation, a major concern has been to capture domestically a higher share of value added in existing chains to promote objectives such as enhanced productivity, the deployment of new technologies, increased employment, and more diversified and resilient economies. The international fragmentation of production processes arguably calls for new industrial policies. In the past, typical industrial policy strategies would aim to protect targeted industries from foreign competition until those industries were competitive enough to participate in the global economy. New industrial policies, however, tend to focus on promoting openness and linkages from an early stage, in order for targeted industries to access the knowledge needed to increase productivity and thereby become more competitive. Minimising trade frictions such as delays in border clearance or low quality distribution facilities is critical. Another key factor is connectivity, including transport, logistics services, and ICT networks.

In contrast, some policymakers and analysts have stressed the need for more targeted policies to promote development outcomes through GVC integration and upgrading. Central to the critique is a certain scepticism about the benefits of foreign direct investment, and hence the need for industrial policy to secure development outcomes from such investments (Draper and Freytag 2014). In the absence of backward linkages with the rest of the economy, they point to the footloose nature of efficiency-seeking investments, especially those operating in the lower value part of the value chains (e.g. clothing industry), which are constantly looking for cost savings and are willing to relocate rapidly. Critics also caution against the risk for resource exporting countries of being caught in the "resource trap" when the main purpose of foreign direct investment is to extract natural resources with limited incentives to invest in ancillary activities. Others suggest that in the absence of active policies, low- and middle-income countries often lack sufficient absorptive capacity to effectively benefit from technology upgrading as a result of GVC integration. Such approaches would call for targeted interventions in the form of local content requirements or subsidies and may run against certain WTO provisions.

5. The Road Forward

As members resume discussions at the WTO, there is a need to acknowledge the growing call from some lower-income developing countries to reconsider how multilateral trade rules can support the design of trade and trade-related policies supportive of economic transformation. Members should engage with the merit of these proposals, seizing this opportunity to open up a broader debate on how new technologies, the configuration of GVCs, and regional and bilateral trade and investment agreements influence the nature and scope of today's trade and industrial development policies.

In doing so, members will have to tackle the issue of differentiation. While it appears clear that developing countries at very different stages of development cannot be treated in the same way, it is equally clear that creating new categories of countries within the WTO has proven to be a non-starter so far. In order to break the deadlock, one option might consist in tailoring S&DT provisions to address specific development situations defined through a set of objective indicators and terms rather than defining *ex ante* which category of countries could benefit from such flexibilities.

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Citation: ICTSD. 2018. *Promoting Capability Enhancing Development*. WTO: Paths Forward. Geneva: International Centre for Trade and Sustainable Development (ICTSD).

WTO: Paths Forward

WTO: Paths Forward is an ICTSD initiative that builds on the outcomes of the Eleventh Ministerial Conference in December 2017. The cycle of publications and events will provide a platform for discussion and analysis on possible options for WTO-based processes going forward and into the Twelfth Ministerial Conference in 2019. The issues selected for the initial series of policy briefs are agriculture, development, disciplines on domestic regulations in services, e-commerce, fisheries subsidies, fossil fuel subsidies, and investment facilitation.

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About ICTSD

The International Centre for Trade and Sustainable Development (ICTSD) is an independent think-and-do-tank, engaged in the provision of information, research and analysis, and policy and multistakeholder dialogue, as a not-for-profit organisation based in Geneva, Switzerland; with offices in Beijing and Brussels, and global operations. Established in 1996, ICTSD's mission is to ensure that trade and investment policy and frameworks advance sustainable development in the global economy.

ICTSD is grateful for the support from its core donors including the UK Department for International Development (DFID); the Swedish International Development Cooperation Agency (SIDA); the Ministry of Foreign Affairs of Denmark (Danida); and the Netherlands Directorate-General of Development Cooperation (DGIS).

ISSN 1995-6932