

The multilateral trading system: The need for basic reform

by **Bhagirath Lal Das**

A multilateral system with contradictions

The current negotiations in the World Trade Organization (WTO) are virtually at a standstill and prospects for a quick recovery are bleak. Even if some sort of agreement is worked out in due course either by lowering of ambitions or by deft drafting or both, it is doubtful if the problems will be over. The deep differences that emerge in the negotiations from time to time are merely the symptoms of basic and structural problems of the system. Patching up these differences may give an impression of harmony and agreement, but it cannot instil the stability and durability which is so vitally necessary for a useful multilateral system. The time has come to go deeper into the root of the malaise and find a means of durable cure.

The General Agreement on Tariffs and Trade (GATT)/WTO system continues to be the main framework for the multilateral trading system even though a sizeable portion of cross-border trade is not strictly covered by its main disciplines. Since its inception about six decades ago, it has passed through various vicissitudes. Its creation in 1947, mainly at the initiative of the United States and the United Kingdom, was centred around the objective of tackling the economic

problems of post-World War II Europe. Now the situation is vastly different. The system has gone on a long march since its establishment and has assumed the role of a guardian of international trade. It is a complex task considering that it now has a membership of around 150 countries that are spread over a vast spectrum of developmental levels, strategies and experiences.

The system has not kept up with the times. The basic deficiencies of a multilateral trading system enveloping both rich and poor countries became apparent within a decade of its operation. A mild corrective effort was made through the inclusion of Part IV in the GATT that sought to introduce a differential between the treatment of the developing and the developed countries. But it was very much ineffective because it was not taken seriously and there was no mechanism for putting it into practice. In the meantime, many more developing countries joined the system and international economic relations also became more complex. The old model that served its purpose in some way or another for nearly half a century is now grossly inadequate and deficient to tackle the current and emerging situation. The system is in urgent need of basic reform in order to perform its role in a world that has changed much over the 60 years of its existence.

TWN THIRD WORLD NETWORK is a network of groups and individuals involved in bringing about a greater articulation of the needs, aspirations and rights of the people in the Third World and in promoting a fair distribution of world resources and forms of development which are humane and are in harmony with nature.

Address: 131, Jalan Macalister, 10400 Penang, MALAYSIA
E-mail: twnet@po.jaring.my **Website:** www.twinside.org.sg

Tel: 60-4-2266728/2266159 **Fax:** 60-4-2264505

The need for reform is dramatically reflected in two paradoxes and contradictions that we notice in the system currently. Firstly, while the developing countries criticize the system persistently and severely, they are joining it in large numbers. Secondly, the rules of the system are truly democratic, with the provision of one-country-one-vote and decision by majority, yet the system is often criticized for its undemocratic workings. These two contradictions are linked, as will be made clear later. And they also lead to some thoughts on the path of reform.

Let us start by examining why the developing countries are eagerly joining the system. There are four main reasons. Firstly, joining the multilateral trading system obviates the need for entering into a series of bilateral agreements with various countries for import and export. Secondly, it gives them some protection against possible subjective actions of powerful countries. Thirdly, closely associating with other countries in a multilateral forum provides opportunities for learning from others. Fourthly, remaining outside a multilateral system that has been functioning for a long time appears odd and is likely to erode a country's credibility with the economic players of the world.

Why, then, are the developing countries so critical of the GATT/WTO system? The reasons can be put into four groups: (i) basic approach in the formulation of rules, (ii) content of the rules, (iii) operation of the rules, and (iv) decision-making process. These are explained below with some illustrations.

Inappropriate tools: limitations of “liberalization”, “reciprocity” and “retaliation”

The GATT/WTO system has adopted liberalization of trade in goods and services as the main instrument for achieving its objectives. [We are leaving out the subject of intellectual property rights that gategashed the system in 1995 and really does not belong in the remit of the system at all.] And liberalization is sought to be effected through the exchange of concessions among countries on the basis of reciprocity. Further, for the enforcement of countries' rights and obligations, retaliation is the ultimate tool. Thus “liberalization”, “reciprocity” and “retaliation” are at the core of the system. These principles and instruments can be relevant and workable in a system with countries at nearly similar levels of development and economic strength. But

they become impractical and inadequate when the membership consists of countries at vastly differing levels of economic development and strength, as is explained below.

Liberalization of trade in goods and services gives direct benefits to those countries that possess a developed supply capacity in these areas. Most of the supply capacity in goods and services is in the developed countries, while the developing countries, with very few exceptions, have very weak supply capacity. Naturally the developing countries perceive the emerging agreements in pursuance of liberalization as being of little benefit to them.

Further, the exchange of concessions on the basis of reciprocity implies that a country that can give more gets more and one that is unable to give more and thus gives less also gets less. The cycle of “giving” and “getting” thus keeps expanding for the countries that are economically developed. For the others, it implies a gradual shrinking of their “getting” and capacity for “giving”. In this manner the current system has an in-built mechanism and structure for enhancing the disparity between countries.

Similarly, retaliation as the ultimate instrument for the enforcement of rules has the deficiency of favouring the strong countries and disfavouring the weak. While a rich and strong country may be promptly willing to embark on a course of retaliation with ease, a weak and poor country will have great hesitation and inhibition in using it. After all, retaliation has political and economic costs. It is not a practical and convenient tool for a poor and weak country in case of need.

The WTO membership now includes a very preponderant proportion of the developing countries. The WTO has a wide diversity of levels of economic development among its membership. This makes the basic principles of reciprocity and retaliation highly improper and deficient in the current multilateral trading system.

The weakness of the current structure did not cause much problem until the mid-1980s as the exchange of concessions till then was mostly among the developed countries. The developing countries were not asked to make significant concessions. Of course, in this process, through the operation of the principle of reciprocity, they did not get much either. But they did not have to undertake many obligations. Now the picture has changed dramatically and the developing

countries have become the main target in the WTO negotiations. The major developed countries, sensing big opportunities in these markets, are putting pressure on the developing countries to make more and more concessions in almost all areas. This trend in the system was exposed in its raw form towards the end of the 1986-94 Uruguay Round of negotiations by the developed countries' insistence on commitments from the developing countries in the new areas of services and intellectual property rights. Now it has emerged in a more virulent form in the current negotiations under the WTO's Doha Work Programme, with the developed countries first insisting on the introduction of further new areas like investment and competition and, lately, pressurizing the developing countries to cut their industrial tariffs to low levels. These trends have brought out the flawed basics of the system in bold relief.

There is a growing perception among the developing countries that the system is meant merely for seeking concessions from them without giving them much in return. This has given rise to heightened tension in the system.

Skewed rules and skewed implementation

With liberalization, reciprocity and retaliation as the main pillars of the GATT/WTO system, it is not surprising that the rules that have emerged are out of tune with the development process of the developing countries. Their policy options get constrained. Some examples are given below.

- (i) The principle of "national treatment", which is one of the main pillars of the GATT system, prohibits more favourable treatment to a domestic product as compared to a like imported product, thus constraining the developing countries in providing support to their domestic production.
- (ii) Prohibition of import control restricts the developing countries in protecting their domestic production against competition from the products exported by large multinational firms backed by huge financial and technological resources, and also in balancing the outflow and inflow of foreign exchange.
- (iii) Restraint on subsidy provision has the potential of hindering technological upgradation of industrial production in the developing countries. A developmental multilateral system should permit the use of subsidies for fast

technological development and enhancement of productivity in the developing countries. There is no such provision at present. The irony is that the rules specifically permitted subsidies for certain specific purposes which were mostly used by the developed countries, viz., those for research and development, regional development and environmental adaptation. (This provision in the rules remained operational from 1995 to 1999. It lapsed thereafter and has not been renewed.)

(iv) In agriculture, there is a provision for a "special safeguard" for the protection of domestic production, but the precondition for its use is such that only the developed countries and a very small number of the developing countries can invoke it.

(v) In the matter of technical standards of products, significant primacy is given to international standards. Theoretically, all countries can participate in the process of standard formulation, but a large number of the developing countries are unable to participate in it effectively because of their weak financial and technical resources. Hence their special situations and attributes are likely to be ignored in the formulation of standards, which may have an adverse impact on the export prospects of their products.

(vi) In the enforcement of rights and obligations, the process of dispute settlement can take up to nearly 30 months. Such delay is particularly harmful for the developing countries that have rather weak resilience in their trade and trading channels. By the time the relief is available, irreparable damage might have already occurred.

These are only some glaring instances of the deficiencies, imbalances and iniquities in the rules. If one were to examine the rules in detail, many more such examples may be noticed.

Apart from the various adverse aspects of the rules themselves, the implementation of the rules by the major developed countries has often been cause for worry among the developing countries. The major developed countries fulfilled their obligations in some significant areas merely in a technical sense. Simultaneously they took neutralizing actions with the result that the benefits did not flow to the developing countries. For example, the major developed countries reduced those agricultural subsidies which the rules required them to cut,

but raised those subsidies that were immune from the reduction commitment, with the result that their total subsidies in agriculture in fact increased. Earlier (1995-2004), in the textiles sector, they fulfilled their obligation of liberalization in a technical sense, but selected for liberalization during the phaseout period mainly those products that were not under restriction in the first place. Thus the developing countries hardly got any benefit in real terms from such 'liberalization' in that period.

While the major developed countries have cleverly utilized the loopholes in the rules as illustrated above, thus denying benefits to the developing countries, they have also aggressively taken trade-restrictive measures particularly against the developing countries on the grounds of public health, environmental protection and anti-dumping. Sometimes these actions have been found to be inconsistent with the rules and have thus been withdrawn, but the damage would already have been done in the form of dislocation and uncertainty in trade.

Then there is a broader issue in the rules that has not caught much attention. Subsidies of a general nature, i.e., those given to industry in general and not limited to a particular sector or a particular unit, are immune from action in the WTO. Also, there are the hidden subsidies, like a government passing on to a domestic industry some research results and technology that it had developed in the course of research on defence. Though all countries have these facilities, it is only the developed countries that can really use them in a big way. The developing countries do not possess the financial resources that the major developed countries have for this purpose. This imbalance puts the manufacturing and trading entities of the developing countries at a disadvantage in comparison with those of the major developed countries.

These are merely some illustrations of deficient and inadequate rules and their defective implementation. In fact, in preparation for the WTO's Seattle Ministerial Conference in 1999, the developing countries compiled a list of nearly 100 instances of unsatisfactory rules and their implementation. But probably because of the overwhelming load of other pressing issues in the areas of agriculture and industrial tariffs, these systemic issues have not received any significant attention in the ongoing negotiations.

Non-participatory decision-making

Apart from the rules and their implementation, there is serious concern about the process by which decisions are taken in the WTO negotiations. Most of the developing countries do not generally get the opportunity to participate in the decision-making process. The democratic provisions of one-country-one-vote and decision by majority do not get reflected in the actual process of decision-making in the WTO. Normally important decisions are first taken in small group meetings in which most of the developed countries are there, but only a very small number of the developing countries are present. The proposal is then brought to the full WTO membership in formal meetings. But at that time, any developing country that notices adverse elements in the agreement would be reluctant to raise its voice as it will be singled out and blamed for blocking an agreement. Decisions are thus taken without the full and effective participation of a large number of the developing countries even though the emerging decisions add to the obligations of all.

Stability in danger, utility in doubt

All this has led to grave discontent and frustration among the developing countries. They have expressed such feelings frequently, particularly during the WTO Ministerial Conferences that take place once every two years and during other critical high-level meetings. A multilateral system cannot work effectively with a large number of the constituents so deeply dissatisfied.

Apart from the need for introducing equity and fairness, reform is needed for instilling stability in the system and making it more useful. The real strength of a multilateral system lies in all its members having a stake in it. And this can come about if all the members have reasonable confidence that they will share in the benefits of the system. This will inspire and motivate them to strengthen the system. Right now, though, the developing countries have a feeling that the system merely serves the purpose of extracting concessions from them without their getting much in return. The system will remain unstable so long as a vast proportion of the membership remain dissatisfied with it.

A stable and smoothly functioning WTO is in the interest of both the developing and the developed countries. For the developing countries, the need lies in the factors enumerated earlier. And the developed countries too should be interested

since the WTO can be a good means for them to improve their prospects in the developing countries. This is important for them as they have only limited prospect of fast growth based on their own domestic economies. A near-static level of population and an annual rise in GDP of around 2% in the developed countries provide only a modest support base for the growth of their industry, services and trade. On the other hand, the developing countries, particularly those that are growing fast, provide them with big opportunities. And a multilateral system like the WTO can help them to avail themselves of these opportunities in a smooth way. If the multilateral system is emaciated or limping, it cannot be a good support for the economic operators of either the developing countries or the developed countries.

The negotiations in the system are currently characterized by an aggressive approach of the major developed countries in pursuing their agenda and stiff resistance from the developing countries against their unfair demands. Most of the time the majority of the developing countries appear sullen and rather withdrawn. But pushed to the wall, they bounce back with sudden vehemence, as was the case in Seattle and Cancun at the time of the Ministerial Conferences respectively in 1999 and 2003. Their frustration suddenly bursts out at times like a volcano.

A multilateral system cannot afford to ignore the interests and feelings of a large section of its membership. Otherwise, this will only go on adding strain to the system with no benefit to any party. What is needed is a constructive approach of partnership.

Some elements of reform

Following from what has been said above, the reform process should address the basic deficiencies and inadequacies. Some suggestions are given below.

It is important to modify and supplement the current instruments of liberalization, reciprocity and retaliation because they are too one-sided, as has been explained earlier. Liberalization of trade which generally provides direct benefit to the developed countries should be supplemented by other elements that could directly and effectively benefit the developing countries. In the limited context of international trade, these countries need to have higher production for export and enhance their benefits from export. For higher

production for export, they need: development of efficient productive capacity and of infrastructure as well as expansion of market opportunities. For enhancement of benefits from expanded production and trade, they need: expansion of domestic economic activity in production for trade, appropriate price for their exports and retention of higher value added in the country. Liberalization measures that benefit those having the productive capacity should be supplemented and balanced by measures that encourage and support the creation and enhancement of production capacity in other countries.

These elements will have to feature in the negotiations, some of them directly and others indirectly; but it is important to keep these basic needs and concerns in the forefront all the time, while formulating the agenda of negotiations, while negotiating and also while arriving at agreements on rights and obligations. The developing countries, which constitute the bulk of the WTO membership, have to be convinced that the outcomes of the negotiations will support these objectives and not hamper them. Insofar as relevant, there should be a combination of positive obligations on the part of the developed countries in support of these aims and also immunity for the developing countries from the rules that inhibit their achievement. This should be a serious, comprehensive and honest balance to the developing countries' obligations on liberalization of trade in goods and services.

Similarly, the mechanism of reciprocity has to be replaced/supplemented by some new mechanism. The provision of special and differential treatment of the developing countries, which has been much eroded from the stage of Part IV of the GATT to the Uruguay Round agreements, has proved to be of little use in balancing the adverse implication of using reciprocity as the basis for exchange of concessions between the developed and developing countries. Some new and innovative mechanism needs to be developed.

The tool of retaliation as the ultimate instrument of enforcement of rights and obligations may be supplemented by the principle and measure of joint action by the membership, particularly when the aggrieved party is a developing country and the offending party is a developed country. Other alternative or supplemental instruments may also be worked out, for example the requirement of payment of direct financial compensation in such cases.

In addition, a basic change is required in the decision-making process. The prevailing system of small group negotiations on important issues is adopted mainly for bringing in efficiency in the negotiating process. It is feared that the texts of agreements cannot be finalized in large meetings with the entire membership present and participating in deliberations. It is felt that there is a conflict between efficiency in negotiations and full and direct participation of members at all stages of the negotiations.

This problem has been well identified but there has not been much move towards bringing in formal solutions. Often some correctives have been applied in the form of occasional briefings of larger groups by the chairpersons of the particular negotiations or by the lead members of some interest groups. But this cannot be a substitute for a more formal and structured arrangement in which all members have the full satisfaction of effective participation. The problem must not remain ignored. Effective and vibrant participation of the members will bring strength to the system. It is necessary to evolve a system that balances the need for efficiency in negotiations with full and effective participation by the members in the negotiating process.

These are only some of the elements needing deep consideration while working on the reform of the system. The issues are too complex to be captured fully in these few illustrative points. Besides, the systemic problems in the current framework have dimensions that go beyond the developed-developing countries divide. Further, the nature of production and trade has undergone a fundamental change since the time the framework was originally created. Now a final product in its consumer-useable form is not always manufactured at one place; the manufacturing process is often spread across diverse units located in several countries. The support services too are dispersed often across the globe. Moreover, technology that is developing at incredible speed is adding new dimensions to the features of production and trade.

There may be many more issues and factors that will get into the agenda of reforms once the process starts.

Choice of forum

An important question is: what should be the forum in which this reform exercise is undertaken? A natural suggestion may be that it should be done in the WTO. But that may pose a problem. The objective is to have a basic and fundamental reform of the system, and the WTO, which is firmly embedded in its current groove, may not be the most appropriate institution for this purpose. And yet, it is necessary to involve the WTO fully in this process and utilize its vast experience in this area. The only other forum apart from the WTO that appears appropriate is the United Nations. Perhaps the process may be initiated and carried on in the UN with the support and involvement of the WTO.

How to begin?

Starting a process of basic and fundamental reform is often problematic. It needs massive effort and perseverance. The question is: who will take the lead and initiate the process? The major developed countries have often been the prime movers in the creation of new institutions or in fundamentally changing old institutions. But they are unlikely to be enthusiastic about such a change in the WTO as they are the main beneficiaries of the system in its current form. In fact, at least initially, they may not be enthusiastic about disturbing the status quo that has served them well so far.

Hence the lead has to come from the developing countries. A group of them, perhaps small in number in the beginning, may come together on this subject and enlarge the support base among the developing countries. Then they should approach the developed countries to seek their full involvement and participation. The exercise of reform can be comprehensive and effective only if it is a joint exercise of the developed and developing countries.

Bhagirath Lal Das was formerly Director of International Trade Programmes at the United Nations Conference on Trade and Development (UNCTAD) and India's Ambassador to the General Agreement on Tariffs and Trade (GATT) forum.