Trading our Way Out of the Financial Crisis: The Need for WTO Reform

By Kevin P. Gallagher and Timothy A. Wise | March 4, 2009

In the context of the deepening global crisis that is pushing millions more women, children, and men into poverty in developing countries, development should be the centerpiece of reforming the global financial architecture. Pressing to conclude a World Trade Organization (WTO) deal based on the current proposals in Geneva would be counterproductive. This Policy Brief offers five policies toward reforming global trade that will enable economic development and stimulate global demand during the crisis.

Soldiers guard the entrance to the Doha Sheraton in Qatar, the mainvenue for the WTO Doha meetings.
Photo: AP Photo/Kamran Jebreili.

Many developing countries have spent scarce resources to build human capital and technological capabilities in the manufacturing, services, and agricultural sectors of their domestic economies. In the wake of the current economic crisis, massive devaluations in currencies, along with the loss of credit, can wipe out domestic firms and put the real economy into a tailspin. Without care, these losses can be irreversible because the domestic firms are often replaced or taken over by foreign firms or import shocks. Losing such firms not only throws people out of work, it represents a long-term setback to dynamic development.

Ensuring that years of development policy are not swallowed up by foreign capital during tough times is among the utmost priorities in the developing world in the wake of the crisis. Some developing countries are equipped with reserves and stabilization funds that can be used to ensure that the domestic economy does not become hollowed out. Many more ran dangerously high budget and current account deficits that make preservation and recovery impossible.

The WTO, as it currently stands, provides some levers to help facilitate this process. Under current WTO rules nations can put in place capital controls, use safeguard mechanisms when faced with unjustified floods in imports or investment, subsidize credit to domestic firms, and stimulate the domestic economy through government procurement programs.

Rushing to a new WTO deal could strip many developing countries of these tools, and leave them little in return. Many of the proposals being discussed in Geneva would end up giving private capital greater freedom from government regulation. Instead, what is needed to weather the storm from the current crisis is precisely more careful regulation.

In July of 2008, rich countries pressed the poor to drastically reduce applied tariff rates in manufacturing and agriculture and virtually eliminate the use of safeguard mechanisms that would suspend such cuts during crises. According to the United Nations, such cuts would cost the developing world approximately $63 billion in lost government revenue. Tariff revenue comprises over 20% of many developing country government budgets—budgets that are now straining to counteract the crisis.

Alongside those costs, the gains projected for the WTO Doha Round deal were limited at best. Studies by the World Bank and other institutions estimated benefits for the developing world that could only be called paltry. Under the World Bank's "likely Doha" modeling projections, global gains for 2015 are just $96 billion, with only $16 billion going to the developing world. The developing country benefits are 0.16% of GDP. In per capita terms, that amounts to $3.13 per year, or less than a penny per day per person for those living in developing countries.[1]

The elements of a WTO deal have been in place for a while: modest cuts in agricultural tariffs and subsidies by developed countries in return for modest cuts in manufacturing and services barriers in the developing world.[2] The developed world's refusal to grant poorer nations sufficient exceptions to such cuts so they have the "policy space" to build competitive national industries and protect their economies from unfair or unequal competition is ultimately what doomed the negotiations.

Indeed, one of the deal breakers when the talks collapsed in July was a developing country demand for a "special safeguard mechanism"—the right for developing country governments to raise tariffs in the event of sudden or large increases in imports that threaten to undermine domestic producers. The measure is exactly the kind of policy space that the poorest countries have sought from this so-called development round. The United States negotiators refused, and India, backed by a large number of developing countries, walked away from the table.[3]

The Way Forward

The organizing principle for revived global trade negotiations needs to be a recognition that the world economy consists of nations at widely differing levels of development. Developing countries need the policy space to retain, adapt, and evolve the kinds of government measures that have been proven to work for development in the West and in other developing countries.

Any negotiation that claims to take development seriously must recognize these fundamental asymmetries and address them. To restart negotiations on a pro-development foundation, policy space should be guaranteed in five areas:

First, nations should preserve the space under current WTO law to place capital controls, use safeguard mechanisms when faced with surges in imports or investment, subsidize credit to domestic firms, and stimulate the domestic economy through government procurement programs.

Second, developing nations need to be part of a coordinated global response to the crisis. At least $1 trillion in new capital needs to be infused into the developing world to preserve currencies, for coordinated stimulus packages, and to cover the costs of adjustment such as tariff losses and job retraining in sectors where tariffs are cut. The IMF's (International Monetary Fund) Trade Integration Mechanism and Short-term Liquidity Facility can help. However, the IMF will need to double its budget through issuing more Special Drawing Rights.

Third, in agriculture, the United States and Europe should agree to honor WTO rulings that have found their subsidies for cotton and sugar to be in violation of existing trade rules that forbid exporting products at subsidized prices. This would give a tangible boost to farmers in West Africa and Latin America and send a strong signal to developing countries that developed nations are willing to honor existing WTO rules.

What's more, the WTO should take seriously the proposals made by many African nations to tame highly concentrated global commodities markets, dominated by

Five Recommendations for Preserving Policy Space for Developing Countries in the World Trade Organization to Confront the Global Economic Crisis

1) The WTO must preserve current rules that allow nations to employ capital controls and safeguard mechanisms, subsidize credit to domestic firms, and stimulate the domestic economy through government procurement programs.
2) Developing nation needs must be integrated into a global response to the crisis.
3) The United States and Europe should comply with rulings against subsidized agricultural exports, allow exemptions for "special products" and use of "special safeguard mechanisms," and permit regulation of global commodities.
4) The WTO principle of "special and differentiated treatment" should be re-enshrined for poorer nations in manufacturing sectors.
5) There should be an immediate moratorium on North-South preferential trade agreements.

agribusinesses that suck most of the value out of these value chains. Rich nations should also grant poorer countries extensive rights to exempt staples of their local economy such as corn, rice, and wheat—so-called "special products"—from tariff cuts, and allow them to raise duties when imports surge—the "special safeguard mechanism" the United States would not agree to in July.

Fourth, for manufacturing, the longstanding WTO principle of "special and differentiated treatment" should be re-enshrined for poorer nations. Developed nations should roll back patent laws that impede poorer nations from manufacturing cheaper generic drugs and allow selective industrial policy so governments can diversify their economies. What worked for the United States, China, and South Korea must not be prohibited by the WTO.

Finally, there should be a moratorium on North-South preferential trade agreements. These deals exploit the asymmetric nature of bargaining power between developed and developing nations, divert trade away from nations with true comparative advantages, and curtail the ability of developing countries to deploy effective policies for development.

According to UN trade statistics, in 2006 58% of all trade from the EU, Japan, and the United States was destined from or destined to the developing world. Granting developing countries the policy space for equitable growth will be key to stimulating global demand and getting us out of the crisis.

End Notes

[1] New research by the Carnegie Endowment for International Peace using similar modeling exercises puts the potential gains to developing countries at $21.5 billion. See Sandra Polaski, "Winners and Losers: Impact of the Doha Round on Developing Countries" (Washington, DC: Carnegie Endowment for International Peace, 2006), Figures 3.1-3.8.

[2] Specifically, the United States and other developed nations would have cut applied agricultural tariffs from 15% on average to 11%. On agriculture, the United States offered to cut its trade-distorting subsidies to $14.5 billion (well above current levels). Regarding manufacturing tariff reductions, developed country members agreed to apply an across-the-board "Swiss formula" coefficient (the lower the coefficient the deeper the cut) of 7 to 9 and developing countries agreed to three different ranges between 19 and 26 (the lower the coefficient the more exceptions each country can enjoy). Finally, many developing countries agreed in principle to liberalize their financial service sectors.

[3] India proposed that if imports rise above 115% over a base period, developing nations should be allowed to impose safeguards that are 25-30% over its bound duties on products taking zero cut. The Bush administration, however, refused to come down below a 140% trigger, a level India and other countries argued would make the mechanism virtually useless in most circumstances.

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