

## **Developing Countries and the GATT/WTO**

Developing countries, by definition, are countries that are less advanced or matured in major areas such as technology and defence, and also have a low Human Development Index, which measures life expectancy, income and the quality of education. The General Agreement on Tariffs and Trade (GATT), which came into effect in January 1948 and transformed into the World Trade Organisation (WTO) in January 1995, was created to provide all members with a trade advantage by reducing tariffs and trade barriers. The relationship between GATT and developing countries has been distant, especially during the early years, with high doubts whether to become fully indulgent in the negotiations due to conflicts in preferences. Although trade can be viewed as somewhat harmful to developing countries, it is a very important factor for driving development, and GATT did have more of an influence within the more recent rounds.

**Outline the Prebisch/Singer thesis and explain its implications for developing countries. Is there any empirical support for the argument that trade is harmful for less developed countries?**

The Prebisch/Singer thesis proposes that there is a long term decline in the Terms of Trade (ToT) of developing countries; how much manufactured goods they can import with the amount of primary commodities they export. The ToT is given as a ratio  $P_x/P_m$  (price of exports/price of imports), so a decrease is either due to higher import prices or lower export prices. Although both economists are in consensus about the deterioration, they have differing views on the course of the effect. Prebisch takes a Keynesian approach to the matter. He explains that a rise in aggregate demand (AD) puts upward pressure on prices in booms, and a fall in aggregate supply (AS) puts downward pressure on prices in busts. The presence of labour unions and competitive producers in developed countries allows wage levels to be maintained during a bust, and increase with price levels in a boom, while the absence in developing countries means that wages are more susceptible to decline during upswings and downswings. As a result, the price of primary goods in the latter decrease in order to make it more affordable for the domestic residents. This in turn means export prices are cheaper, driving down the ToT as they would have to export more to obtain the same amount of imports. Singer however holds a more neoclassical view that “technological progress augments the demand for manufactured goods more than the demand for raw materials or food” (Hadass and Williamson, 2003; 633) due to income elasticities. Manufactured goods are considered normal or luxury goods, so they have a higher income elasticity of demand; as income increases, the demand for these goods increase. Technological progress creates more jobs, for example engineers, researchers, analysts which increases the income of individuals. Thus, the more technological progress, the higher the income and the more demand for manufactured goods. Whereas primary commodities

such as cotton, rubber and grain are necessities, they have a lower income elasticity of demand, therefore an increase in income will lead to a significantly smaller increase in demand. Furthermore, the high price elasticity of demand for manufactured goods means that as the demand increases, firms have the ability to increase the price to gain more profits, making imports more expensive for developing countries and resulting in a decline in the ToT.

The greatest argument for trade being harmful to developing countries is the impact on the balance of payments. Trade expands consumer choice as goods and services that are not available domestically can be imported. In the short term it is beneficial as consumers enjoy a better standard of living, however a long term increase in imports means there are more withdrawals which hinder economic growth. However, empirical evidence suggests that trade has been more beneficial to developing countries. It has contributed to the reduction in poverty and increased investment, “between 2000 and 2008, GDP per capita increased from \$325 to over \$625 in Least-Developed Countries.” (European Commission Report). Data also shows that, between 2000 and 2010, the GDP increase of G20 developing countries is 115%, proving that trade has helped them to catch up with developed countries. Of course other factors contribute to the growth of a country but trade has been shown to be more beneficial than harmful in the context of developing countries.

### **What alternative policies could developing countries adopt in order to foster their development? Which of these have been successful and why?**

Policies to foster development are often characterised into inward looking – protectionist policies, and outward looking – open minded policies that encourage trade. The most sought inward looking policy by developing countries was import substitution, a result of export pessimism derived from the Prebisch/Singer thesis. “Developing countries needed to foster industrial capacity both to reduce import dependence and to diversify away from traditional commodities” (Hoekman and Kostecki, 1995; 535). It was attempted through the imposition of high tariffs and low quotas on manufactured goods, as these were the most common imports of developing countries. Alternative domestic industries were created to produce the same goods, which in the long run benefited from economies of scale. It also created positive externalities of learning by doing, resulting in a more skilled workforce. The success of import substitution however varied depending on the nature of the developing country. Acharyya and Kar (2014) explain that countries in Africa, who relied mostly on agricultural goods, would benefit more than those belonging to the Asian and Latin American regions, which needed to import manufactured goods to support their leading stages of development. Thus, import substitution was “more likely to impede development and growth by encouraging inefficiencies” (Acharyya and Kar, 2014; 13-14). The lack of competition meant that there was little or no incentive for the firms to produce good quality products with minimal resources and at low costs. The policy should have

theoretically improved the balance of payments as it was designed to reduce the amount of imports, however in practice it was worsened as the government subsidised imports of capital goods for the creation of these alternative industries. The regulation and protection of these encouraged government intervention and gave them scope for corruption. Furthermore, the failure extends in regards to the concept of comparative advantage. Countries benefit from trade when they specialise in producing goods that have a lower opportunity cost and import those that don't; producing agricultural goods and importing manufactured goods. By establishing import substitution, developing countries deprive themselves of having a comparative advantage, as they are sharing their resources to inefficiently produce goods, thus not allowing the country to reach its potential growth.

Contrastingly, developing countries could adopt an outward looking policy of export promotion using International Commodity Agreements. The creation of buffer stocks and cartels were aimed to support and preserve prices of volatile primary goods, including sugar, coffee and tea, given the price inelasticity of demand of these goods presented by the Prebisch/Singer thesis. Buffer stocks require the government to purchase and stockpile excess crops when they are cheap, and selling them when prices increase. This ensures that there is constant supply and that farmers do not go out of business. The scheme generates economic rents for the government, which would aid the deficit of developing countries, or could be channelled back into the economy through government expenditure. However, the act of stockpiling goods such as grains is impractical as they cannot be properly preserved given they are perishable. Also, it requires large up-front costs to buy the excess supply, possibly resulting in borrowing and further worsening the balance of payments. Additionally, cartels were formed typically within developing countries that supplied oil, where they would scale back on production to achieve an agreed average price level above the market level. Although, this too proved to be a failure as high prices deterred consumers away and in search for cheaper alternatives such as natural gas. Cartels generally are hard to maintain, even in developed countries, as some members may have an incentive to deviate from the agreed prices and sell at a cheaper one to assume all of the demand.

A successful method of export promotion was economic integration. This is when countries belonging to the same region combine to form an economic and political union. Todaro and Smith (2009; 646) believe that "integration provides the opportunity for industries that have not yet been established... to take advantage of economies of large-scale production." The most commonly known example of economic integration is the European Union (EU), however a more relevant one amongst developing countries is the Association of South-East Asian Nations (ASEAN). Established in August 1967 "to accelerate economic growth, social progress and cultural development" (asean.org), ASEAN now has 10 members from the developing world, including Thailand, Malaysia and Indonesia. The ASEAN Free Trade Area later formed in 1992 produced a common effective preferential tariff, allowing goods to flow freely among countries in the union. What made the policy prosperous was its promotion of trade creation. Unlike import substitution, economic integration exploited the

theory of comparative advantage; countries would import low cost products from those in the region rather than use their own high cost products, thus focussing on producing goods that were low cost for themselves. As a result, ASEAN's real GDP growth between 2000 and 2013 was 5.1%, more than three times the growth of the UK, a developed country, whose was 1.5%. Although ASEAN consists of more than one country, it still reveals the effectiveness of economic integration between developing countries in bringing about development.

### **What political and economic factors led developing countries eventually to reach agreement in the negotiations of the GATT Uruguay round?**

The GATT Uruguay Round 1986-94, can be considered a breakthrough in terms of its deviation from the reciprocity nature of former rounds; the 'tit for tat' characteristic disallowed developing countries to benefit wholly from the GATT rounds, as they themselves had little to offer. This can be seen especially in relation to the preceding Kennedy Round, 1964-67, where tariffs for industrial goods were reduced by 50%; evidently advantageous for developed countries but rather insignificant for the developing. Journalist Chand (2015) supports this in an article on the issue; "developing countries remained unsatisfied by the Kennedy Round as their trading problems did not receive the attention and priority they deserved and as such they were not solved." Hence, the features of the Uruguay round that depict this paradigm shift, serve as both political and economic factors leading to the agreement. Hoekman and Kostecki ( 1995; 540) describe the round as "an important step towards ending the dichotomy that had characterised GATT for several decades."

A major export of developing countries is textiles, or apparel, which was hindered by the previous Multi-Fibre Arrangement (MFA) formed in the Tokyo Round, 1973-79. It involved the imposition of bilateral quotas, primarily enforced by the US and EU to protect their own domestic industries, detrimental to countries such as India whose textiles account for 11% of their total exports.<sup>1</sup> The Agreement on Textiles and Clothing (ATC) established in the Uruguay round was designed to phase out the MFA over a period of 10 years. By agreeing in the negotiations, developing countries including India, would be able to significantly boost their exports in textiles, as they would no longer be governed by quotas. The table below shows this increase from 2005 when the MFA officially ended, until 2011.

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<sup>1</sup> <http://www.ibef.org/industry/textiles.aspx>

**Fig 1. Fastest growing exporters of textiles  
(2005-2011, USD million, current)<sup>2</sup>**

Country	2005	2011	Percentage gain
<b>Egypt</b>	272	1,485	446%
<b>Viet Nam</b>	725	3,772.00	420%
<b>China</b>	41,050	94,411	130%
<b>Bangladesh</b>	705	1,590	125%
<b>India</b>	8,331	15,016	80%
<b>Turkey</b>	7,076	10,772	52%
<b>Malaysia</b>	1,356	2,036	50%
<b>Thailand</b>	2,764.00	4,072.00	52%
<b>Indonesia</b>	3,353	4,791	43%
<b>Pakistan</b>	7,087	9,082	28%
<b>WORLD TOTAL</b>	202,000	294,000	45%
<b>Swaziland</b>	174.8	85.4	-51%
<b>Togo</b>	0.28	4.1	1362%
<b>Zambia</b>	3.8	0.38	-90%

*Source: WTO database.*

With exports being a direct component of aggregate demand, a boost in textile exports of 446% in the case of Egypt, would undoubtedly contribute to the overall increase in net exports (given that it existed) and aid growth. Also, as the demand for textiles increases, more jobs will be created, leading to the reduction of unemployment and an increase in the standard of living; factors imperative for developing countries.

Agriculture is also deemed as a leading export for developing countries, though was not prevailing in the 1980s due to lack of financial support to farmers. Hence, improvements to policies within this sector as part of the Uruguay round further influenced their decision to agree in the negotiations. The main issue that was regarded was Anti-Dumping. This was to be achieved through reducing agricultural subsidies; grants given by the government to domestic farmers in order to aid the production of crops, and as a result achieving a more competitive price. As the subsidies were often provided within developed countries where governments could afford it, it drove out developing countries from selling their agriculture on the global market, and also encouraged imports of the commodity. The 1995 Agreement on Agriculture (AoA) required developed countries to reduce their agricultural subsidies by at least 36%, and limited the US and Europe to a \$380 billion annual spend on domestic support. As a result, statistics for 1993-1998, which encompasses the time of the agreement, reveal that agricultural exports have risen considerably amongst developing countries, from

\$120bn to \$167bn<sup>3</sup>. This allows developing countries to enter the global market and possibly gain a comparative advantage in agriculture.

The Uruguay round appealed economically to developing countries as it addressed the existing trading problems and clearly reflected their needs. By offering an alternative to the unsuccessful policy of import substitution and failed attempts at export promotion, the round provided the opportunity for them to increase exports in their dominant sectors, textiles and agriculture, and ultimately fuel development. Developing countries perhaps did not anticipate the scale of the success of the agreements made at the negotiations, but the fact that it was politically different from the previous rounds enticed them in hope of improving their economic positions.

The economic climate at the time of the Uruguay round also led developing countries into agreement, especially those belonging to the Latin American region.

**Fig 2. Foreign Debt of 30 Selected Developing Economies in 1982 (US\$'s in millions)<sup>4</sup>**

<i>Country</i>	<i>(1) Gross External Debt (US\$millions)</i>	<i>(2) Debt as a GNP</i>	<i>(3) % of 1982 Exports</i>	<i>(4) Interest as GNP</i>	<i>(5) % of Exports</i>	<i>(6) Long-Term claims of Private Banks (US\$millions)</i>
Algeria	\$17,641	34.7%	108.4%	2.9%	9.2%	\$4,439
Argentina	43,634	79.0	447.8	5.9	33.3	18,104
Bolivia	3,328	101.4	348.6	3.1	10.5	901
Brazil	92,961	34.6	405.3	4.0	47.1	57,605
Chile	17,315	68.7	333.9	8.3	40.5	12,100
Colombia	10,306	16.8	145.7	1.4	12.5	3,758
Costa Rica	3,646	157.1	306.3	14.8	28.9	1,190
Côte d'Ivoire	8,945	126.7	319.6	9.8	24.7	3,487
Ecuador	7,705	64.2	273.3	8.2	34.9	3,600
Egypt	29,526	121.1	422.8	4.3	15.1	923
India	27,438	12.6	190.2	0.0	0.3	1,800
Indonesia	25,133	24.4	108.6	1.6	7.0	6,848
Jamaica	2,846	97.6	219.9	6.5	14.6	467
Korea	37,330	48.4	125.3	4.9	12.8	11,346
Malaysia	13,354	37.5	70.2	1.2	2.2	7,589
Mexico	86,081	52.0	328.0	6.0	37.8	46,666
Morocco	12,536	83.4	422.0	5.1	25.9	2,744
Nigeria	12,954	12.4	89.6	1.1	8.3	5,531
Pakistan	11,638	35.1	339.6	1.0	9.2	624
Peru	10,712	37.8	229.1	3.7	22.2	3,061
Philippines	24,412	59.9	344.7	5.7	32.7	6,786
Sudan	7,218	101.1	823.5	5.3	43.5	1,276
Syria	6,187	43.6	241.0	0.9	4.9	0
Thailand	12,238	30.5	125.1	2.5	10.2	4,216
Turkey	19,716	36.2	238.7	3.0	19.7	4,873
Uruguay	2,647	27.9	79.7	1.7	4.8	1,276
Venezuela	32,158	32.9	145.7	1.2	5.5	14,800
Yugoslavia	19,900	30.3	126.9	2.6	11.0	12,004
Zaire	5,079	36.1	292.7	2.6	21.0	531
Zambia	3,689	99.9	332.0	5.1	17.0	132

<sup>3</sup> [https://www.wto.org/english/tratop\\_e/agric\\_e/negs\\_bkgnd14\\_devopcount\\_e.htm](https://www.wto.org/english/tratop_e/agric_e/negs_bkgnd14_devopcount_e.htm)

<sup>4</sup> Van den Berg, 2012

The 1980's debt crisis saw the inability of countries such as Mexico to repay amounts in excess of 50% of their GNP, owed to Western countries. Oil prices rocketed and given that the Latin Americans were net importers of the commodity, they experienced high import charges.<sup>5</sup> In conjunction with this, interest rates in the West were also on the rise, making payments more expensive for the Latin Americans, especially Mexico and Brazil who \$46,666m and \$57,605m respectively owed to private banks. Hoekman and Kostecky (1995; 539) hold the view that the crisis "highlighted the need to generate more foreign exchange and improve economic performance." Though the International Monetary Fund (IMF) offered aid, it was on the basis that the countries in crisis adopted export driven policies. Noting the success of countries such as South Korea and Taiwan, commonly known as NICs (New Industrialised Countries), who deviated from producing their own goods and fully immersed themselves in the market during the 1970s, it was of particular interest for other developing countries to follow suit, and coming to agreement in the Uruguay round was an opening for them to do just that. By becoming an active player in the global market and increasing trade through mediums such as the ATC and AoA, they would be able to improve their balance of payments position and eventually reduce their foreign exchange gap, progressing towards development.

GATT and WTO have made considerable efforts to work closely to include the preferences and needs of developing countries, and with that there has been significant improvement in their economic growth. The concept of comparative advantage is still very much relevant, but developing countries have been seen to adopt export promoting policies, and moving towards industrialisation.

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<sup>5</sup> <http://www.economicshelp.org/blog/glossary/debt-crisis-latin-america/>

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