



**WHY AND HOW DIFFERENTIATE DEVELOPING COUNTRIES IN
THE WTO?**

Theoretical Options and Negotiating Solutions

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“Trade for Development : the future of Special and Differential Treatment of
Developing Countries”

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Naturally, all views expressed are the authors' alone.

1 Introduction

The topic of differentiation amongst Developing Countries (DCs) in the WTO has become a totem for developed countries, and a taboo for developing ones. As in the classical Freudian scheme, the mythological origins of the totemic character have long been forgotten, but the sacred nature of the taboo prohibition stands enshrined beyond discussion.

How did it happen? The Doha Declaration extensively resort to the concept of “Special and Differential Treatment” (SDT) of the Developing countries but does not even spell the word “differentiation”.

Since the inception of the Doha Development Agenda (DDA), a North-South opposition embodied in two conflicting approaches of the SDT negotiating mandate.

Developed Countries promoted a crosscutting conceptual approach of SDT’s objectives, whereas Developing Countries tabled 88 specific proposals for re-consideration of the SDT provisions adopted during the Uruguay Round. Developed Countries would not agree with any specific proposal prior to global clarification of the scope and objectives of SDT. DCs would refuse giving up negotiating specifics against entering an open-ended horizontal discussion. In a classical WTO manner, procedural tricks were invented to bridge the gap. The 88 SDT requests were broke down into three baskets: one for measures deemed likely to raise consensus (most of them of low development impact); other for measures unlikely to obtain consensus ever; the last one for measures needing consideration in appropriate DDA sectorial negotiating committees. Yet the breakdown approach failed twice to deliver negotiating results, in Cancun (2003) and Geneva (2004).

Developed Countries increasingly asserted that they would not grant the same SDT concessions to all DCs, regardless of their economic size and diversity. In a nutshell, they claimed that “one size” of WTO rules “does not fit all” the diverse developing economies. Thus the issue of differentiation politically emerged. Developed Countries’ negotiators voiced their claim increasingly louder after the failure of the WTO Cancun Ministerial. US Trade Representative, Robert Zoellick, explicitly asked for differentiation in a letter to his WTO colleagues¹. EU Commissioner for External Trade, Peter Mandelson, later echoed and reinforced the argument in his first major address on trade and development². Both saw SDT negotiations and DCs’ differentiation as communicating vessels: an ambitious SDT regime may only be achieved at the condition of a better differentiation of beneficiaries. Less differentiation would mean less SDT.

Developing Countries unanimously rejected differentiation in principle. They acted consequently. Mexico and South Korea, both developing countries in the WTO and OECD members torpedoed OECD’s research initiative on countries’ economic calibration. India launched a major WTO dispute

¹ January 11, 2004

² Trade at the service of development. Lecture at the London School of Economics, February 4 2005

against the European “Drug-GSP”³, alleging discriminatory differentiation amongst DCs. In the run-up to the Geneva “July 2004 package” agreement relaunching the DDA negotiations, developing countries stonewalled all attempts for mentioning differentiation⁴. The “package” therefore ended-up with vague and faded language on SDT, without specific objectives and measures. From then on, SDT negotiations remain essentially deadlocked. All things remaining equal, chances are that this deadlock will last.

Against this political backdrop academic researches have been undertaken to help rationalize the totem and the taboo and identify possible ways forward in the negotiations. This paper reviews the literature on differentiation. It aims at taking stock of its main findings in order to contribute to designing achievable negotiating solutions. The paper’s main focus falls on differentiation under WTO SDT rules rather than market access preferential regimes. Section I outlines the legal and economic cases for more differentiation in the WTO. Section II reviews and assesses alternative theoretical options for DCs differentiation. Section III discusses the political economy of differentiation in the WTO context in order to suggest a way forward in the framework of the DDA negotiations.

2 Differentiation in Principle: Laying Out the Legal and Economic Cases

The legal WTO basis of SDT is the “Enabling Clause”⁵ inherited from the Tokyo Round (1973-1979). Under current WTO rules, the Developing Country’ status entitling to SDT benefits is merely obtained through self-declaration. Based on this mechanism, the WTO acknowledges 112 self-declared DCs out of 148 members. 32 of them bear LDC’s status providing access to extended SDT rights. The 80 remaining “pure” DCs’ legal group gathers countries as diverse in size, population, wealth and trade capacities, geographic and political conditions as, for instance, Nigeria, Saint Lucia and China. From such a blatant discrepancy between legal uniformity and economic diversity, one may infer that more legal fine-tuning may contribute to better operation of trade rules. Yet, is the intuitive case for differentiation strong enough to deserve official WTO consideration? The answer in the literature is boldly yes. The WTO system entails no insuperable legal provision opposing differentiation between DCs: on the contrary, it already resorts to legal differentiation. Moreover, there are good enough economic reasons for it, considering that the current SDT legal regime remains far from delivering development.

2.1 The Differentiation Principle in the WTO: Not Only Legally Based but Already Implemented

The content of special and differential treatment has evolved through the GATT and WTO history.

³ A special Generalized System of Preferences scheme providing trade incentives to countries engaged in combating drug production and trafficking.

⁴ ICTSD, February 2005. Doha Round Briefing Series, Special and Differential Treatment.

⁵ Differential and more favourable treatment reciprocity and fuller participation of developing countries, Decision of 28 November 1979

Prior to the Uruguay Round, developing countries received special and differential treatment (S&D) in six different areas. One from Article XVIII of GATT 1947 gave developing countries the right to protect infant industries and to use trade restrictions for balance-of-payments purposes. Another from three articles (XXXVI, XXXVII and XXXVIII) under Part IV of GATT 1964 that recognised the special needs of developing countries in the trading system and exempted them from making reciprocal tariff concessions. And four in the context of the 1979 framework agreement, commonly known as the Enabling Clause⁶.

Legal common sense suggests that the notion of “Special AND Differential” Treatment does not epitomize a merely pleonastic mantra but two different sources of legal meaning. A “special” treatment should automatically be “differential”: thus the question is how the two words relate to each other. From the Oxford English Dictionary, “differential” means “constituting or depending on a difference, differing or varying according to circumstances or relevant factors”: this suggests that a differential status should be grounded on objective facts. Under the provisions of the Enabling clause, the adjective “special” is exclusively associated with the category of Least Developed Countries (LDCs), be it for consideration of their “treatment”, “economic difficulties”, or “particular situation”. In contrast, the notion of “differential and more favorable” treatment applies to the broader category of the DCs⁷. Therefore, both the legal and linguistic contexts provide clues that objectively differentiating the treatment of DCs according to their level of development may be intrinsic to SDT.

Beyond contextual clues, various WTO rules and practices indicate that the system legally admits and implements differentiation amongst DCs.

First, the Enabling Clause explicitly asserts the dynamic and evolving nature of SDT. « The Enabling Clause, provides specific legal cover for the Generalised System of Preferences (GSP), for special and differential treatment under the Tokyo Round Codes, for regional arrangements among developing countries, and for special treatment in favour of the least developed countries »⁸. The title of the decision itself sets the twin objectives of “reciprocity and fuller participation of Developing Countries”: this suggests a causal linkage between increased trade participation of DCs and their progression toward reciprocal trade commitments. Paragraph 7 of the decision details the expectations toward DCs’: “their capacity to make contributions or negotiated concessions or take other mutually agreed action” will improve with their economic development; “and they would accordingly expect to participate more fully in the framework for rights and obligations”. Paragraph 9 of the Enabling clause eventually invites WTO members to “bear in mind” its ultimate goal and rationale, which is: “to meet the development needs of developing countries and the objectives of the GATT”, implying the

⁶ For a detailed review of the origin and evolution of S&D in the GATT/WTO, see OECD (2001), *The Development Dimensions of Trade*, OECD, Paris.

⁷ The UN also commonly refers to the global relation between developed and developing countries through the “common but differentiated responsibilities” in the Rio Agenda for sustainable development.

⁸ In Laird, Sam, Raed Safadi and Alessandro Turini, “The WTO and Development,” in Douglas Nelson (ed.). *The Political Economy of Policy Reforms*, Elsevier, 2004.

reciprocity of trade commitments. Thus, the principle of DCs graduation from SDT is embedded in its legal base.

Second, one major ambiguity from the Enabling Clause has been clarified by the WTO Dispute Settlement Appellate Body (AB). The Appellate Body acknowledged the principle of differentiation between DCs and precised its legal status and conditions in a 2004 ruling. India had disputed the European special GSP providing special trade preferences to DCs engaged in combating drug trafficking. India argued that such a DCs' differentiating regime was incompatible with the GATT (article I) non-discrimination principle. The AB ruling clarified two major points regarding the legal relation between the Most Favored Nation (MFN) provision and the Enabling clause. First, it established that the Enabling Clause constituted an exception to the GATT-MFN provision, and not a "Lex Specialis" creating an autonomous and equal legal regime. Second, the AB clearly laid out the conditions authorizing differentiation between DCs in preferential trade regimes: "we conclude that the term "non-discriminatory" (...) does not prohibit developed-country Members from granting different tariffs to products originating in different GSP beneficiaries, provided that such differential tariff treatment meets the remaining conditions in the Enabling Clause. In granting such differential tariff treatment, however, preference-granting countries are required, by virtue of the term "non-discriminatory", to ensure that identical treatment is available to all similarly-situated GSP beneficiaries, that is, to all GSP beneficiaries that have the "development, financial and trade needs" to which the treatment in question is intended to respond ».

Third, various WTO agreements have already established differentiated sub-categories of developing countries. The category of LDCs proceeds from the Enabling clause itself. The Uruguay Round also established new DCs' sub-categories eligible for specific SDT provisions. The Agreement on Subsidies and Countervailing Measures (SCM) recognized a specific sub-category of DCs (listed in its Annex VII)⁹ for countries with a GNP per capita inferior to 1000 USD per year¹⁰. These countries may use export subsidies for a product, as long as their exports remains below a threshold of global market share (3,25% of world exports of the product). The specific group of the Net Food-Importing Countries (NIFDC) was also established¹¹ in recognition of their particular food security needs, justifying corresponding SDT measures.

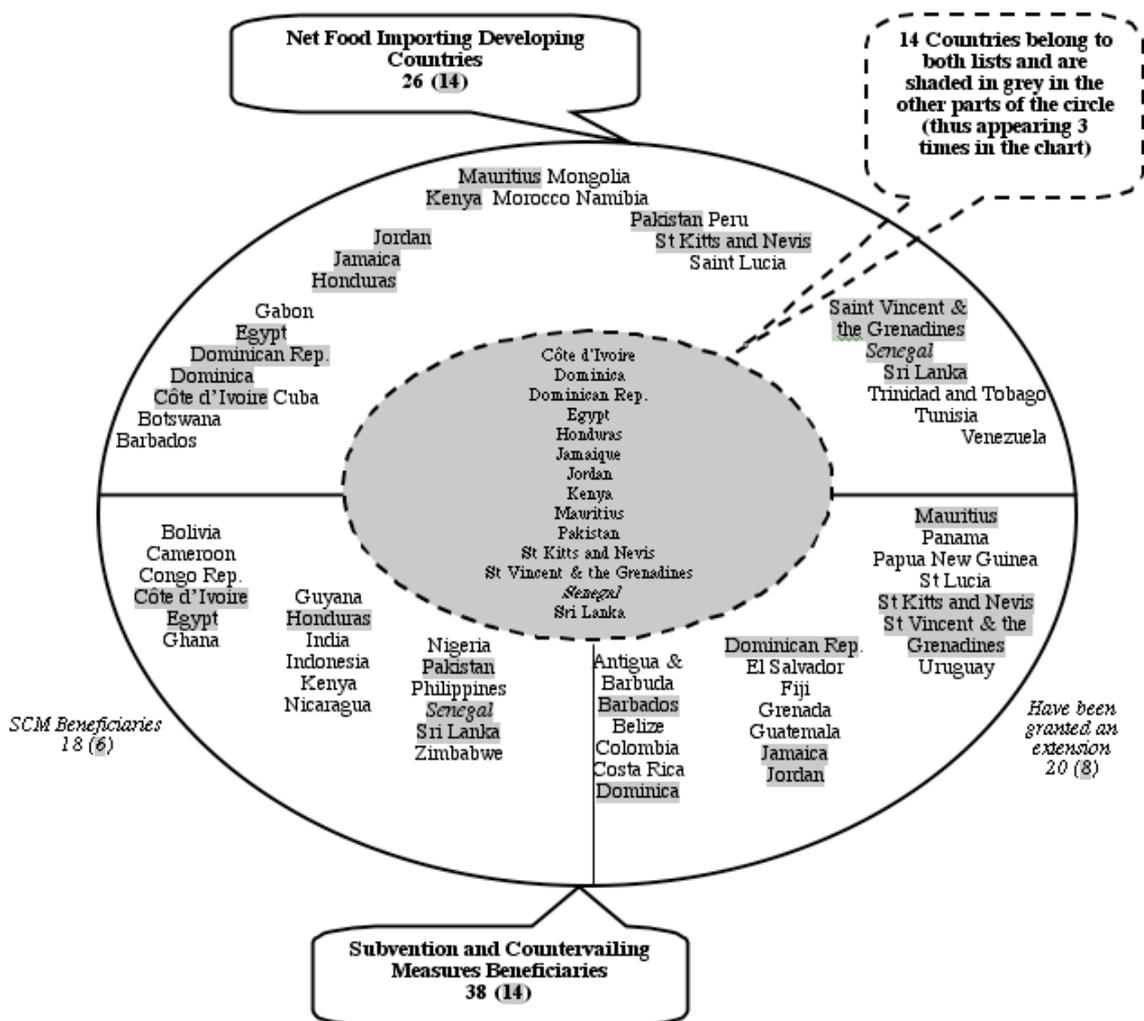
The following chart confronts both sub-categories of DCs under current WTO rules: it shows that only 14 states simultaneously belong to both categories. 24 states need only SCM and 12 states need NIFDCs. Others DCs are not considered in need of these particular SDT benefits.

⁹ Beyond this the SCM agreement also provides to "Members in the process of transformation from a centrally-planned into a market, free-enterprise economy" transitory flexibilities for exports subsidies.

¹⁰ This threshold has been adopted during the Uruguay Round Negotiations. No document is available on the roots of this figure, but some highlights about the methodology can be found on the WTO website. See in particular document G/SCM/38.

¹¹ Decisions adopted by the Trade Negotiations Committee on 15 December 1993 and 14 April 1994. Agriculture: measures

Chart 1: Differentiated WTO Sub-Categories for Food Security and Exports Subsidies SDT



Source: Authors, from WTO (2005), Keck & Low (2004). Except for Senegal (recently added to the list) LDCs are not taken into account in this chart since they automatically benefit from the measures at stake

Albeit not concluded yet, the DDA has already created another category of members under the framework of the TRIPS agreement. The decisions adopted in Doha (2001) and Geneva (2003)¹² recognize special rights to the category of “WTO members with insufficient or no pharmaceutical manufacturing capacities”. Furthermore, some higher-income developing countries have “voluntarily” accepted to exclude themselves from the benefit of the flexibilities introduced in the new intellectual property regime.

Fourth, while not legally created under WTO disciplines, several differentiated DCs groups are politically recognized in the WTO negotiations. Their special interests are expressed in several official documents. For instance, the Doha Ministerial Declaration creates a work program on “small – and vulnerable – economies”, albeit explicitly rejecting the creation of a new sub-category of members.

concerning the possible negative effect of the reform program for Net Food-Importing Countries and LDCs.

¹² Ministerial Declaration on the TRIPS agreement and public health, November 14 2001. Implementation of paragraph 6 of the Doha Declaration on the TRIPS Agreement and public health, Decision of the General Council August, 30 2003

Other DCs' groups assert particular economic interests in their negotiating stances: for instance, the Small Islands Developing States (SIDS), while not being defined through legal criteria (Encontre, 2004) act as a political category within the WTO and benefit from particular preferences in the developed countries' GSP schemes (Inama, 2004).

Far from preventing differentiation amongst developing countries, the WTO legal system pragmatically encourages it when needed.

2.2 The Economic Case for DC's Differentiation in the WTO: Improving the Development Impact of SDT

The economic case for better DCs' differentiation in the WTO is built upon three major arguments.

"One size does not fit all"

All International Economic Organizations (multilateral and bilateral) carrying a development mandates differentiate DCs according to their situations and development needs, in terms of economic vulnerability, trade development or poverty reduction. For instance, such kind of criteria determine eligibility for borrowing from the World Bank, based on per capita income, social indicators, creditworthiness, and economic and social policy performance. Furthermore, borrowing from the International Bank for Reconstruction and Development (IBRD) is at market terms, and borrowing from the International Development Association (IDA) is at concessional terms. Yet for "Small Islands States" the Bank mitigated the impact of its IDA cut-off threshold by granting special access to IDA resources for selected Islands States that would have graduated otherwise base on their per capita GDP¹³. This suggests that differentiation of countries sharing comparable conditions is relevant for the efficiency of development policies.

Table 1 superposes the WTO and other's DCs classifications to illustrate the difficulty of framing developing countries diversity under uniform SDT rules.

The claim that "one size does not fit all" in the WTO finds significant support in the literature.

Yet differentiation can not be considered itself a "silver bullet" for delivering economic development out of international trade. For instance, while most preferential market access schemes do implement some graduation mechanisms involving differentiation, mainstream economic analysis concludes that these schemes have delivered mixed or poor results for development¹⁴. Major obstacles to their economic efficiency stem from legal unpredictability of unilateral preferences, restrictiveness and complexity of preferential rules of origins, exemptions of sensitive products corresponding to major DCs exports interests and insufficient supply-side capacities.

Differentiation is more widely seen as an issue for improving the efficiency of SDT rules

¹³ "World Bank Support for Small States", Background Paper N°2, Submission by the world bank. UN Commission on sustainable development, twelfth session, April 2004.

¹⁴ Amongst many, see for instance: Michalopoulos (2002), Stevens (2002), Whalley (2002), Winters (1987), World Bank (2003).

provisions. Most empirical assessments tend to conclude that most SDT rules have proved poorly effective and operational as is also implicitly acknowledged in the Doha Declaration. Developed countries' "best effort" commitments from the Uruguay Round have not really been monitored and failed to materialize since they were not legally binding. Furthermore, several research works described in the forthcoming section II suggest that the existing WTO DCs' sub-categories do not fully reach their development targets. These authors specifically point at weak correlation between the granting of legal benefits from SDT measures and the actual development problems that they are meant to solve.

Trade Policy as a Second-Best Development Instrument

A significant body of literature concludes that, by itself, trade policy is not an efficient instrument to achieve such development objectives as: industrial and technological development, poverty reduction, food security, social development, support to farm incomes and rural activity. Bhagwati (2002) has long argued against the folly of trying to "kill two birds with one stone": market failures and imperfections should better be addressed directly through appropriate policies, than indirectly through trade policy distortions. Hoekman (2003), Keck and Low (2004), review the shortcomings of the "infant industry" argument for trade policy distortions. For them, the few success stories of strategic trade policies favoring industrial development are usually associated with other policy factors: institutional governance, investment in infrastructures and human capital, improvement in the tax system and market regulations. Rodrik *et al.* (2003) also argue that the quality of institutions holds the first role in the dynamics of growth and development.

However, Hoekman *et al.* (2003) recognize a specific case for the poorest countries endowed with low resources and institutional capacities. For these, trade policy instruments may offer a good second-best – if not unique - option to achieving their development objectives. Exemptions from WTO trade rules may also legitimately be preferred when and where their implementation would prove too resource intensive (as for intellectual property protection, competition rules or trade facilitation) and thus unsuited to local needs.

Therefore, the cost/benefits analysis of trade distorting policies in DCs supports the economic case for differentiation. SDT exemptions from trade rules should primarily benefit the most vulnerable countries deprived from alternatives to trade policy instruments. Technical assistance commitments and transition periods should also be grounded on a realistic assessment of rules implementation capacities.

Table 1: WTO Members and International Countries classifications

Table I: WTO Members and International Countries Classifications

Major Usual Categories of Countries Differentiated in the World: An Application to the 180 Members and Observers of the WTO

Code:			
Developed Country in the WTO (36)		<i>Small Islands Developing States (SIDS) (30)</i>	
LDC (32 WTO members and 11 WTO observers)		Land Locked Developing Countries (LLDCs) (31) * WTO Observers (32)	
Low Income (55) - (Income Per Capita: \$765 or less)			
Afghanistan *	Equatorial Guinea *	Mali	Senegal
Angola	Ethiopia *	Mauritania	Sierra Leone
Bangladesh	Gambia, The	Moldova, Rep.	<i>Solomon Islands</i>
Benin	Ghana	Mongolia	Sudan *
Bhutan *	Guinea	Mozambique	Tadjikistan *
Burkina Faso	<i>Guinea-Bissau</i>	Myanmar	Tanzania
Burundi	<i>Haiti</i>	Nepal	Togo
Cambodia	India	Nicaragua	Uganda
Cameroon	Kenya	Niger	Uzbekistan *
Central African Rep.	Kyrgyz Republic	Nigeria	Vietnam *
Chad	Lao PDR *	Pakistan	Yemen, Rep. *
Congo	Lesotho	<i>Papoua New Guinea</i>	Zambia
Congo, Dem. Rep	Madagascar	Rwanda	Zimbabwe
Côte d'Ivoire	Malawi	<i>Sao Tomé et Príncipe *</i>	
Upper Middle Income (33) - (Income Per Capita: \$3,036–9,385)			
<i>Antigua and Barbuda</i>	Gabon	Panama	
Argentina	<i>Grenada</i>	<u>Poland</u>	
<i>Barbados</i>	<u>Hungary</u>	Saudi Arabia *	
<i>Belize</i>	<u>Latvia</u>	<i>Seychelles *</i>	
Botswana	Lebanon *	<u>Slovak Republic</u>	
Chile	Libya *	<i>Saint-Kitts-et-Nevis</i>	
Costa Rica	<u>Lithuania</u>	<i>Sainte-Lucia</i>	
<i>Croatia</i>	Malaysia	<i>Saint-Vincent-and-the-Grenadines</i>	
<u>Czech Republic</u>	<i>Mauritius</i>	<i>Trinidad and Tobago</i>	
<i>Dominica</i>	<u>Mexico</u>	Uruguay	
<i>Estonia</i>	Oman	Venezuela, Bolivian Republic of	
High Income (40) - (Income Per Capita: \$9,386 or more)			
Andorra *	Hong Kong, China	<u>New Zealand</u>	
<u>Australia</u>	<u>Iceland</u>	<u>Norway</u>	
<u>Austria</u>	<u>Ireland</u>	<u>Portugal</u>	
<i>Bahamas, The *</i>	Israel	Qatar	
<i>Bahrain, Kingdom of</i>	<u>Italy</u>	Singapore	
<u>Belgium</u>	<u>Japan</u>	Slovenia	
Brunei Darussalam	<u>Korea, Rep.</u>	<u>Spain</u>	
<u>Canada</u>	Kuwait	<u>Sweden</u>	
Cyprus	<u>Liechtenstein</u>	<u>Switzerland</u>	
<u>Denmark</u>	<u>Luxembourg</u>	Chinese Taipei	
<u>Finland</u>	Macao, China	United Arab Emirates	
<u>France</u>	Malta	<u>United Kingdom</u>	
<u>Germany</u>	<u>Netherlands (for the Kingdom and...</u>	<u>United States</u>	
<u>Greece</u>	<i>...the Netherland Antilles)</i>		
Lower Middle Income (52) - (Income Per Capita: \$766–3,035)			
Albania	Djibouti	<i>Jamaica</i>	<i>Samoa *</i>
Algeria *	<i>Dominican Republic</i>	Jordan	Serbia *
Armenia	Ecuador	Kazakhstan *	South Africa
Azerbaïdjan *	Egypt, Arab Rep.	Macedonia, FYR	Sri Lanka
Belarus *	El Salvador	<i>Maldives</i>	<i>Suriname</i>
Bolivia	<i>Fiji</i>	Montenegro *	Swaziland
Bosnia and Herzegovina *	Georgia	Morocco	Thailande
Brazil	Guatemala	Namibia	<i>Tonga *</i>
<u>Bulgaria</u>	<i>Guyana</i>	Paraguay	Tunisia
<i>Cape Verde, rep. *</i>	Honduras	Peru	<u>Turkey</u>
China	Indonésia	Philippines	Turkmenistan
Colombia	Iran, Islamic Rep. *	Romania	Ukraine *
<i>Cuba</i>	Iraq *	Russian federation *	<i>Vanuatu *</i>

Sources: Authors, derived from the World Bank, WTO, OECD, UNCTAD, and Swedish Board of Agriculture.

Negative Externalities for Others

Stevens (2002), Page and Kleen (2005) consider SDT as a compromise between the public good resulting from predictable trade rules, and the costs of derogations granted to DCs. Exemptions from general trade rules inflict economic harms to others. The expected benefits of the additional “policy space” granted to DCs through SDT measures must be checked against their potential negative externalities for trading partners. Odds are great that the negative externalities from smallest trading powers will be negligible, whatever the importance of SDT rules exemptions. But important negative externalities are anticipated from granting the same SDT treatment to the poorest countries and the emerging trading powers. It is therefore unlikely that ambitious and efficient SDT provisions be agreed upon without further differentiating DCs. As discussed in Section III, this trade off lies at the heart of the political economy of current DDA negotiations on SDT.

3 Differentiation in Theory: Assessing WTO’ Options

Differentiation aims at grouping DCs more fairly and efficiently to achieve the first objective of SDT: development. Theoretical options for differentiation intellectually range from full uniformity (“one size fits all”) to case-by-case approach of individual country’s strategy (“each one its size”). In between, the literature suggests three types of approaches: country-based differentiation; rule-based differentiation; or an empirical mix of both.

3.1 Calibration and Graduation: the Country-Based Approaches

Country-based approaches aim at grouping countries sharing similar objective development situations, identified through geographic criteria or socio-economic indicators.

Geographic Criteria

A first possible geographic differentiation may rely on regional groupings. The UN system uses six world’s regions: Latin America and the Caribbean, Sub Saharan Africa, East Asia and the Pacific, Europe and Central Asia, Middle East and North Africa, and South Asia. Yet the diversity of countries’ development levels and trade situations within each region makes such a classification hardly relevant to the purpose of SDT in the WTO (Box 1).

A second approach considers geographic criteria independent from trade: relief, climate, natural resources, and exposition to natural disasters, etc. Countries’ vulnerability indexes can be elaborated by combining such criteria. The purpose of SDT measures would then be to compensate for natural handicaps of vulnerable countries where “geographic diseases” concentrate. Such a rationale has modestly been introduced into the WTO, for instance through the notion of “small and vulnerable economies” in the Doha mandate. Political action of the SIDSs (Small Islands Developing States) or the LLDCs (Landlocked Developing Countries) also provides examples of an effort toward geographic

classification.

Yet, the case for geographic differentiation in the WTO is weak. For instance, “smallness” is a vague and open-ended notion since it may characterize the size of a country’s territory, population or economy. Page and Kleen (2005) underline the lack of established correlation between unfavorable geographical conditions and poverty or economic performance. They point out that every single country may virtually exhibit at least one criterion of geographic vulnerability. Special trade measures thus can hardly provide a priori adapted answers to geographic diseases.

Socio-Economic Indicators

Unlike geographic criteria, socio-economic indicators can seize the dynamic of economic development. The World Bank, UNDP, UNCTAD, and OECD use classification matrixes based on economic (GNP per capita, vulnerability index), social (human development indexes) or institutional (governance, freedom index...) criteria. Trade related indicators are used in the UN definitions of LDCs, Low Income Food Deficit Countries and Transition Markets. The Food and Agriculture Organization (FAO) defines four categories of DCs based on their net trade agricultural position (Box 1).

However, most of these indicators do not specifically address the overall trade situation nor the integration of DCs in the global trading system : most of them would therefore be unsuited to the WTO context. The LDCs’ category is an understandable exception since these countries cumulate economic and social problems but hold a very small share of world trade. WTO members can reasonably accept the UN category as a good proxy for targeting a group of countries legitimately entitled to special trade measures, without imposing significant negative externalities on international trade.

Countries criteria could be technically adapted to the WTO by better weighting in trade characteristics. Developed Countries unilaterally developed such criteria for “graduating” countries out of their GSP schemes. The graduation is usually triggered by macro-economic and trade specific thresholds, combining country-based approaches (whole eligibility of a country to preferential programs) and product-based approaches (exclusion of a country’s sector/ product that has become internationally competitive).

Yet, elaborating cross-country criteria to create WTO new horizontal sub-categories of developing members is generally considered politically impossible, since major distributional consequences are anticipated. Keck and Low (2004) thus report that “a calibration exercise that has recently been undertaken by the OECD was put on the back burner by OECD members, supposedly because whatever statistical approach chosen, some developing countries were always grouped together with developed countries and others with LDCs.”

Box 1: Country-Based Approaches and Trade Criteria

The FAO establishes four trade-related categories of countries: Net Food Importing (NFIM - 105), Net Food Exporting (NFEX - 43), Net Agricultural Importing (NAIM - 85) and Net Agricultural Exporting (NAEX - 63). Confronting these categories with other possible classifications illustrates the difficulty of importing other organizations' criteria into the WTO.

Geographic criteria

Regions: East Asia and Pacific include NAEX, NFIM and NAIM countries. 75% of DCs in South Asia are NFIM and NAIM. Latin America and the Caribbean countries import food and agricultural products. All but three are SIDSs. In Europe and Central Asia, countries are net importer as well as net exporters. Middle East and North Africa countries are all NFIM and NAIM (except one). 60% of Sub Saharan African countries are net importers, and 40% are net exporters.

Geography: SIDSs and LLDCs claim recognition in the WTO. They suffer from several handicaps, usually are NFIM and NAIM, and considered food insecure countries. But the criteria they present are not sufficient to define new sub-categories. They may be treated more easily under the category of NFIDCs.

Socio-economic criteria

GDP per capita: UNCTAD, OECD and the World Bank classify low-income, middle-income and high-income countries. The thresholds differ from one organization to another.

Net Trade Position: the majority of DCs falls into NFIM and NAIM categories, half of them are low-incomes. 43% of DCs are NAEX, and more than half of them are low-income countries. One third of DCs is NFEX, spreading over different income categories. The UN defines another group: Low-Income Food Deficit Countries (LIFDCs - 58). They all belong to the Low Income countries category. Two third of the LIFDCs and all the LDCs are NFIM.

Human development: The UN Human Development Index classifies countries in low/middle/high human development groups. The criteria may be taken into account for SDT benefits, but is not sufficient alone.

Source: FAO, SBA, UNDP, WTO.

3.2 “Implicit Thresholds”: the Rule-Based Approaches

The second type of approach to differentiation aims at defining objective criteria for SDT eligibility, on an agreement-by-agreement basis. For Stevens (2002) these approaches are “based on the premise that eligible countries must share a set of “differences” that are directly related to the rules for which SDT is proposed”. For Hoekman *et al.* (2003) they “involve country-based criteria that are applied on an agreement-by-agreement basis to determine whether (when) agreements should be implemented”.

The starting point is thus opposite to countries' calibration. It starts from confronting WTO disciplines to the SDT stated objectives. The first step involves designing relevant criteria for the purpose of each specific SDT measures. The second step requires identification of the targeted group of countries corresponding to the final SDT objective. This approach intends to ensure that SDT measures are finely tuned to specific development needs, under diverse WTO disciplines. As for the country-based approaches, a graduation based on objective economic criteria is inherent to the system. But the graduation is not horizontal: a country may graduate from a specific SDT measure while remaining eligible to others.

Stevens (2002) and Keck & Low (2004) developed enlightening case studies of this “implicit threshold approach”. They illustrate how specific SDT provisions require specific eligibility criteria and countries' grouping to efficiently achieve their purpose.

Stevens analyzes how SDT measures in the WTO Agreement on Agriculture effectively articulate with the food security objectives recognized in the decision on LDCs and Net Food Importing

Developing Countries. He shows that countries actually benefiting from Agriculture SDT measures do not always correspond to countries in need (except for LDCs) according to objective food insecurity criteria.

Keck & Low apply a similar methodology to elaborate eligibility criteria for the benefit of SDT under Article 27.4 of the SCM Agreement¹⁵. They show that using Stevens' countries grouping for food security to determine eligibility to the SCM measure, would lead to the exclusion of 19 countries from the current WTO list of beneficiaries. Reciprocally, using the SCM Annex VII list to determine eligible SDT beneficiaries for food security reasons would exclude 19 objectively deserving countries. Only half of both countries' lists actually overlap. Chart 2 compares the WTO official NFIDCs list with the group of countries obtained with Stevens' Food Insecurity criteria.

Two conclusions arise. First, the more specific the thresholds are, the more SDT measures can effectively achieve their development target. Second, specific eligibility criteria to a particular SDT measure cannot be relevantly duplicated in another rule context.

Chart 2: Stevens' Methodology: Food Security and SDT in Agriculture

A country is deemed suffering from food insecurity when its food production does not ensure its population's needs and when it depends strongly on imports. **Stevens shows that the LDCs and NFIDCs categories that currently benefit SDT measures for food security are not appropriate.** Low GDP and reliance on food imports prove necessary but insufficient criteria of food insecurity. **Other WTO members should be eligible to the specific SDT measures, based on another set of objective food insecurity criteria.**

Stevens' methodology first identifies the WTO Agriculture rules that may adversely impact food security policies of WTO members (e.g. domestic subsidies). Second, he identifies countries potentially vulnerable to a tightening of the considered rule. To that end, he selects objective criteria reflecting food insecurity conditions.

- First, **the daily calories supply (DES):** the threshold is fixed at 2500 calories a day (or less). From this indicator we find that 12 out of 51 selected countries are neither LDCs nor NFIDCs WTO members. Conversely, some LDCs and NFIDCs carry calories supply above the 2500 calories threshold of food insecurity.

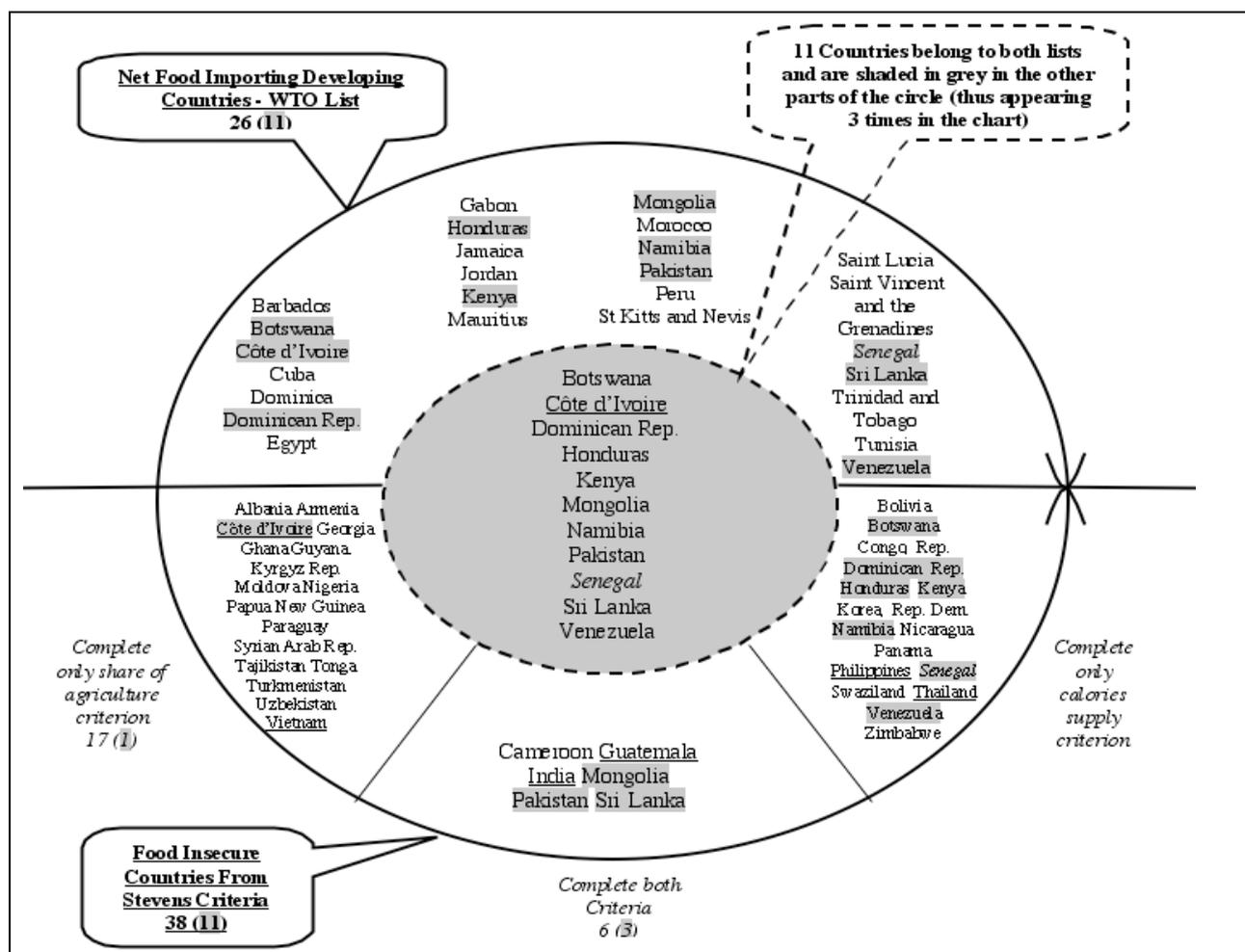
- **Second, agricultural dependence:** the criterion relates food insecurity to agricultural income and/or domestic production. Over 20% of GDP in agriculture make a country potentially prone to food insecurity. Combining this criterion with DES leads to selecting 77 countries. As almost all LDCs verify the criteria (except 14 of them for which no recent information on DES is provided) and as they are presumed to qualify for SDT in this case, we focus on DCs.

27 states belong neither to the LDC nor the NFIDC group; among them, 10 have a share of agriculture superior to 20%. Thus, as Stevens asserts, **"the LDC and NFIDC categories appear to overlap only partially with these other criteria of vulnerability"**. Only 11 countries on the 26 listed in the NFIDCs suffer from food insecurity (as defined by Stevens).

- **Third, trade vulnerability index** (share of agricultural exports in world agricultural exports) confirms that the existing WTO categories are not appropriate to target food security needs.

NB: the pie chart update Stevens' results with latest available statistics from his selected sources. Therefore the countries' list is here slightly different from his but his fundamental conclusions are still verified.

¹⁵ This provision allows selected countries to use certain types of export subsidies (see section I-1)



Source: Authors, from Stevens (2002), FAO (2005), World Bank Online Database on Development Indicators. The same remark than for Chart 1 applies here concerning LDCs and Senegal's status.

3.3 The “Rule of Thumb”: an Empirical Approach to Differentiation.

Some WTO regulatory disciplines may generate significant implementation costs and prove unsuited to particular DCs' situations, especially for low-income countries. According to Hoekman (2003), “countries may lack the scale needed for benefits to exceed implementation costs”. For these countries the domestic conditions must be improved before implementing the concerned WTO rules.

Hoekman *et al.* (2003) consider that SDT measures should be reserved to such cases. Hence they propose a “rule of thumb” approach by mixing “country-based” and “rule-based”. First, they identify a group of countries mostly in need: prima facie that group would include LDCs, the other low-incomes countries, and small economies with weak institutional capacities. This “LDC+” group would essentially be required to comply with the “core” WTO principles (non-discrimination, prohibition of quantitative restrictions, tariffs binding, and transparency). Countries in the group would be left an option for opting out of the “non-core” WTO disciplines, either because they require resource intensive implementation (such as TRIPS) or because they may hinder development priorities (such as public health or food security). A “right of appeal” would allow others DCs, excluded from the “LDC+” group, to make their case for selected SDT benefits. For these countries a “tailor made

approach” would be needed, based on regular audit and examination of their needs.

The “rule of thumb” thus suggests a bottom-up approach to SDT, essentially based on an income level criterion. Reserving SDT to the “LDC+” group would likely inflict minor harms to others WTO members, due to their limited economic size and trade capacities. Yet for other DCs, the approach would rely on a transparent peer-review of SDT measures effectively needed to support their development strategy. Such a process could be technically linked with the Trade Policy Review Mechanism and supported by technical assistance from international agencies¹⁶. Yet, its implementation in the WTO may prove difficult, time-consuming and costly. From that perspective, the “rule of thumb” differentiation would induce important legal uncertainty and significant transaction costs. Another critical issue with this approach would be delineating some « core WTO agreements » and others as “non-core”. Opponents consider these consequences as major drawbacks in the “rule of thumb” proposition making it impractical.

4 Differentiation in the DDA: Assembling the Negotiating Tool-Kit

4.1 The Political Economy of Differentiation in the WTO Context

All theoretical approaches to differentiation aim at improving the “development impact” of SDT rules.

Yet assessing their respective merits and feasibility requires consideration of the WTO “real world” political economy. Any valuable WTO discussion on differentiation should first and foremost focus on politically achievable options. To that end, four political economy parameters must be weighted in.

- *“Development impact” (SDT efficiency)*: the literature suggests that the development impact of SDT will be highly correlated with the accuracy of the economic indicators selected to proxy the reality of DCs’ trade situation and development needs. In a nutshell, fine-tuning through detailed differentiation indicators will improve the efficiency of SDT measures. From that perspective, the rule-based approaches are expected to deliver higher development results than the country-based approaches.

- *Distribution costs*. Country-based classifications would induce important horizontal distributional consequences compared to the current status quo, since some countries would immediately graduate out of SDT. As noted in Page and Kleen (2005) “even if indicators could be agreed, the fact that SDT represents a balance between a country’s needs and damage to others means that the boundary must be negotiated. In any definition of criteria, the choice of criteria will be influenced by countries’ knowledge of where they will fall”. Under a rule-based approach the distribution effects would be scattered by various specific agreement’s thresholds triggering-off graduation, thus harder to anticipate and measure.

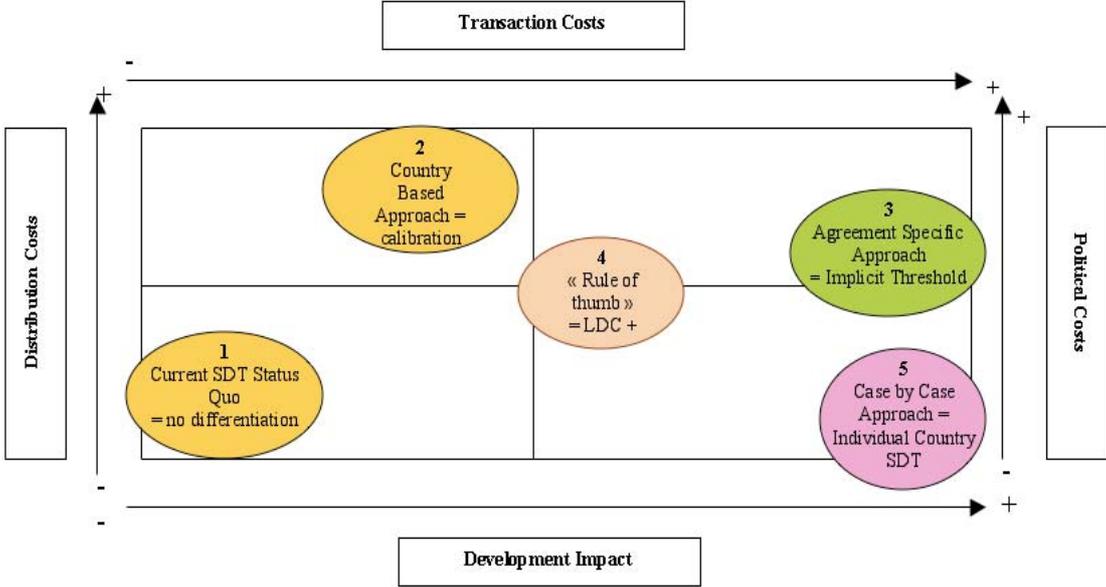
¹⁶ Enhancing and extending the Integrated Framework for LDCs may be an option to that end

- *Transaction costs.* All the proposed differentiation methodologies would generate important transaction costs in the WTO. A rule-based approach would mobilize a considerable amount of preparatory work and negotiating capital before achieving a political consensus on economic thresholds definitions for each WTO agreement or relevant SDT measure. A “rule of thumb” approach to SDT would minimize these transaction costs ex-ante but generate others ex-post due to the need for tailor-made decisions on SDT benefits for individual countries. The “right of appeal” would carry three hardly manageable risks: political deadlocks, legal unpredictability and possible discriminations between countries in a similar situation.

- *Political costs.* Due to uncertainties about their distribution impact, differentiation negotiating proposals stir major north-south, and south-south confrontations. The political economy of the “rule of thumb” essentially bets on the probability of reaching a WTO consensus for concentrating SDT on more vulnerable countries. The rule-based option bets on the possibility of moving the traditional lines of north-south confrontation by multiplying possibilities of trade-off: each DC may be eligible to SDT specific measures in the context of one agreement while not in another.

The following matrix shows how these parameters would intuitively combine.

Chart 3: Political Economy of Alternative Differentiation Approaches in the WTO



Source: Authors.

4.2 Principles for achieving differentiation in the DDA

Much political “rule of thumb” is certainly needed to draw a path to starting effective WTO negotiations on differentiation. Yet three principles may contribute to define the scope of a politically acceptable and technically manageable discussion.

Principle #1 - Confidence-Building: Differentiation Should be Exclusively Development Oriented

Developing Countries members of the WTO need to acknowledge that their individual development capacities and trade opportunities widely differ. To that end they must gain confidence that a WTO negotiation on differentiation would not lead to a dramatic upheaval of the current member's status, balances of commitments, and trade benefits. Hence DCs must receive clear assurances from developed countries.

First, differentiation should not primarily be considered as a negotiating tool for balancing trade concessions. Consequently, developed countries should clearly recognize that any discussion on DCs' differentiation must be driven by the sole consideration of its development impact. Yet, all WTO members should recognize that there is no global economic consensus on how best to achieve a positive development impact through recurring to SDT measures in international trade. For instance, the infant industries or food security arguments for maintaining trade protection in poor countries remain highly controversial. Recognizing such dissent may help considering that differentiated ways to development are needed under trade rules.

Second, developed countries should avoid upfront suggesting the design of new horizontal country-based criteria for differentiation. Focusing the differentiation debate on the creation of new horizontal categories of WTO DCs' members would not be politically acceptable due to the anticipation of major distribution costs. Nor would it be optimal for the development impact of SDT.

Third, WTO members should acknowledge that there is no "magic wand" for achieving a development friendly approach to differentiation. Workable options lie somewhere between the political (i.e. "rule of thumb / LDC+") and the legalistic (i.e. "implicit thresholds") approaches. Both carry important shortcomings and transaction costs that must be minimized. Hence a viable approach to differentiation will need to pragmatically combine a set of complementary options.

Principle #2 - Narrowing the Scope : Differentiation Should Focus on Selected Development Objectives.

The one and only objective of differentiation is to better tailor SDT rules to specific development stakes. Thus the scope of a possible negotiation on differentiation may shrink to manageable proportions by focusing selectively on its real development stakes.

First, market access must be distinguished from rules. As remarked by Stevens (2002), "achieving differentiation through national schedules presents either an unfeasibly large negotiating burden or substantial post-agreement risks". This consideration fully applies to negotiating differentiated SDT rules. However, there is no need for elaborating principles of differentiation for market access. In that field DCs' differentiation can be achieved through the national schedules of commitments. On a first level, horizontal provisions providing for "less than full reciprocity" in future DC's market access commitments can be agreed, without involving further DCs differentiation. Here, SDT provisions must be part of the market access formulas and flexibilities. Beyond these, a direct "request and offer"

negotiation between developed countries and major emerging economies could make room both for further market access differentiation amongst DCs and further market access concessions from developed countries to meet their priority interest. The results of such “requests and offers” going beyond the horizontally agreed market access formulas would be integrated in the individual schedules of commitments of the biggest economies. These additional concessions involving selected significant trading powers would then be bound and extended to all others WTO members on an MFN basis.

Second, authors remark that the purpose of SDT is not to compensate for lame rules, admittedly hindering development. In such cases there is no rationale for DCs’ differentiation: the bad rules should simply be renegotiated rather than tinkered with SDT. Such rationale underlies the negotiation of a TRIPS’ amendment to provide flexibilities for drug compulsory-licensing in case of health crisis.

Third, negotiating new criteria for differentiation is only relevant for “pure” trade policy rules that may constrain development strategies. Other trade commitments essentially return to building implementation capacities through development Aid and technical assistance. For these a *de facto* differentiation should merely proceed from an objective WTO and Aid Agencies’ assessment of individual country needs.

Fourth, the development stakes of differentiation do not involve every WTO rules. Four major development topics justifying DCs differentiation have really emerged with the DDA: food security (AOA), industrial policies (TRIMS and SCM), intellectual property, and trade facilitation and domestic regulatory capacities (SPS, TBT, Customs Valuation, Pre-shipment inspections, antidumping...). WTO members should therefore explicitly agree upon selected development stakes before entering a negotiation on DCs’ differentiation

Principle #3 - Sequencing the Political Trade-Off: Negotiating Modalities for Differentiation Should be Adopted as an Element of the DDA Conclusion

It is economically impossible to trade-off rules against market access. The value of rules must be judged on their legal merits and economic benefits. Market access concessions must balance reciprocal trade opportunities. Trying to trade-off rules against market access in the overall balance of commitments has proved a major hurdle to the whole progress of the DDA (Paugam 2003). It currently deadlocks the SDT negotiations.

Yet the trade-off is politically inescapable for WTO members. Since SDT can generate potential negative externalities for trade, developed countries try to proportionate their market access concessions to the harm that they anticipate. Resolving this mercantilist conundrum supposes the design of a new negotiating sequence embedding new incentives for WTO members to reach a successful conclusion.

First, the 88 SDT negotiating proposals may conceptually break down into two major categories :

one for provisions principally focusing on market access¹⁷, the other for provisions principally focusing on rules or technical assistance commitments. Since the first category directly impacts the overall balance of market access concessions, related provisions should be negotiated within the relevant market access negotiating bodies (Agriculture, NAMA, Services).

Second, a clear distinction must be drawn between the rules and market access dimensions of the negotiations. On the one hand, market access concessions – including the a.m category of market access SDT provisions - must reach their own satisfying balance in the North-South context (achieving DCs’ differentiation being here possible through adjustment of national schedules of commitments). On the other hand, the new SDT rules commitments (flexibilities, WTO procedural requirement, technical assistance), must be balanced with a better differentiation of beneficiaries. Once the two compromises are separately reached, a political trade-off between both may be considered.

Third, it must be acknowledged that the two dimensions of the negotiation may not progress at a similar pace.

Balancing market access concessions resort to classical GATT/WTO deal-making practices. Conversely, achieving principles for differentiation requires important technical analysis and preparatory works. An agreement on differentiation under SDT rules may not realistically be concluded simultaneously with market access commitments, without considerably delaying the conclusion of the DDA.

There is no strong reason why the principle of “single undertaking” in the DDA should be interpreted as “simultaneous conclusion of all agreements”. A sequenced phasing-in of the various DDA negotiating results could be envisioned while conforming to the legal framework of single undertaking.

- First, an overall agreement would need to be reached on market access liberalization (including market access related SDT provisions). Once fully agreed upon and detailed in the schedules of commitments, the implementation of the market access commitments could be split into two phases.

For developed countries, 50% of their market access commitments would be immediately and unconditionally implemented over the first phase (say 3 years). But the implementation of the remaining 50% of the commitments would remain conditionally triggered by the entry into force of a new WTO agreement on SDT, including DCs’ differentiation.

For developing countries, implementation of their market access commitments would be postponed to the end of a grace period corresponding to the first phase of developed countries implementation (3 years). By the end of the grace period DCs would unconditionally implement 50% of their own market access commitments. The implementation of the remaining 50% would also be conditionally triggered by the entry into force of the SDT agreement.

¹⁷ As for instance the proposal of extending a full duty and quota free market access to LDCs following the European Everything But Arms initiative.

- Second, an agreement would need to be reached for new SDT negotiating modalities, as part of the concluding results of the DDA. These modalities would explicitly assert the principle of DCs' differentiation according to the development needs.

In a nutshell: to conclude the Doha Round, new SDT rules and DCs differentiation should be left-over for further negotiations, under the single undertaking. In order to maintain incentives for WTO members to negotiate, it would simultaneously be decided that only half of the DDA market access commitments would enter into force as long as WTO members would fail in reaching an agreement on SDT and differentiation.

5 Conclusion

Our general conclusion from this overview is that DCs' differentiation in the WTO would be legally possible, economically desirable and technically workable in the framework of the DDA. The biggest challenge therefore remains turning the "big" political issue of differentiation into a rather technical one. To overcome currently entrenched north-south opposition the WTO needs to refer negotiators to one unique compass: the consideration of the potentially positive development impact of an improved DCs differentiation. Using this compass, the WTO members may start considering DCs differentiation coolly and in good faith. Yet it is true that both developed and developing WTO members share at least one common and undifferentiated feature: coolness and fairness hardly dominate their natural behaviors in trade negotiations.

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