

Elements for a New Paradigm on Special and Differential Treatment

Special and Differential Treatment, The Multilateral Trading System and Economic Development in the 21st Century

Ajit Singh

Professor Economics, Cambridge University
Senior Fellow, Queens' College, Cambridge, CB3 9ET

Email: Ajit.singh@econ.cam.ac.uk

Fax: + 44 1223 740479

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I Introduction

The principle of “non-reciprocity” in international trade negotiations, together with the concept of Special and Differential Treatment (S&DT) for developing countries (DCs), were considered by the latter at the time to have been some of their important achievements in the 1950s and 1960s. Non-reciprocity indicated recognition by the international community that playing fields between developed and developing countries are not level.¹ In order to provide some kind of parity advanced countries (ACs) were urged to give access to their markets to DCs without requiring them to open their own markets to AC goods on a reciprocal basis.

The doctrine of S&DT is normally associated with the name of Dr Raul Prebisch, the first Secretary-General of UNCTAD, and with the establishment of UNCTAD itself in 1964 as an international organization.² S&DT was in keeping with the spirit of the age in that it was intended to promote the then widely favoured strategy of import substitution industrialization. The acceptance by ACs of these concepts of non-reciprocity and S&DT permitted DCs to pursue their economic development under protection whilst enjoying all the privileges and advantages of the multilateral trading system.

¹ Even large firms from DCs are severely handicapped when they compete with large AC firms, usually multinationals, many of whom have long been active in international trade and investment. DC firms are subject to infrastructural deficits, many missing or incomplete markets, lack of integration with the small and medium sized firms, and much higher costs of capital. It is important to note that atypical AC multinational’s average costs of production may be lower than those of a DC large firm not because the former enjoys economies of scale and scope, but because it is a monopolistic buyer and seller in many of its markets. Similarly, DC firms do not have brand names or marketing infrastructure and skills compared with the giant AC firms. To compensate for such structural deficits of DC firms – and there are myriad such deficits in other areas as well which also impinge on competitiveness – they were given the privilege of preferential access to AC markets without being asked for reciprocal access in DC markets.

² Many people identify the S&DT concept with the formulation of the General System of Preferences (GSPs) which was done at UNCTAD. However, the concept itself pre-dates GSPs.

S&DT was reaffirmed at the Tokyo meeting of GATT in 1973 and DCs took full advantage of it in the Tokyo Round of tariff cutting during 1974-79, i.e. they mostly did not cut their tariffs. However, in the 1980s, under the intellectual assault of neoliberalism, import substitution became a byword for inefficiency and consequently S&DT for DCs fell from favour both in the eyes of the international financial institutions and developing countries themselves. Nevertheless, for various reasons the S&DT principle was not abandoned in the subsequent multilateral trade negotiations. The 1986 Punta del Este ministerial declaration inaugurating the Uruguay Round again re-affirmed this principle in the following terms:

‘Contracting Parties agree that the principle of differential and more favorable treatment embodied in Part IV and other relevant provisions of the General Agreement ...applies to the negotiations ... [D]eveloped countries do not expect reciprocity for commitments made by them in trade negotiations to reduce or remove tariffs and other barriers to trade of developing countries (GATT,1986:7).’³

The S&DT principle is therefore deeply embedded in the WTO Agreements which came into being in 1994 at the end of the Uruguay Round. It has been given a further fillip by the DOHA ministerial meeting in 2001. Paragraph 44 of the ministerial declaration stated:

‘We reaffirm that provisions for special and differential treatment are an integral part of the WTO Agreements. We note the concerns expressed regarding their operation in addressing specific constraints faced by developing countries, particularly least-developed countries. In that connection, we also note that some Members have proposed a Framework Agreement on Special and Differential Treatment (WT/GC/W/442). We therefore agree that all special and differential treatment provisions shall be reviewed with a view to strengthening them and making them more precise, effective and operational. In this connection, we endorse the work programme on special and differential treatment set out in the Decision on Implementation-Related Issues and Concerns.’

³ Quoted in Hoeckman and Kostecki (2001). On the reasons for the reaffirmation of S&DT in the Uruguay round see further South Center (1999), Kessie (2000) and Fukasaku (2000). Tables 1-3 in Whalley (1999) provide an excellent account of the evolution of non-reciprocity and S&DT during the last four decades.

Paragraph 14 of the declaration also stipulated that:

‘Modalities for the further commitments, including provisions for special and differential treatment, shall be established no later than 31 March 2003.’⁴

In February 2002, the Trade Negotiating Committee of the WTO agreed that the mandate from paragraph 44 (referred to above) of the Doha Ministerial Declaration should be negotiated in the Committee on Trade and Development (CTD) in Special Sessions. CTD has, accordingly, met in such sessions but there has been a wide gulf and a deadlock between DCs and ACs. The deadline for completing these tasks has been repeatedly extended but there has been little progress in the negotiations. Serious commentators suggest that this deadlock threatens the entire negotiating process under the DOHA Round.⁵

The main purpose of this paper is to look afresh at the concept of S&DT and revisit its economic rationale in the current context of the world economy. Unlike many AC evaluations and studies which take a generally negative view of S&DT in terms of its benefits either to the DCs or to the multilateral trading system, this paper presents a rather different view. It acknowledges the failure of some current and previous approaches to S&DT but nevertheless it argues that the unqualified endorsement of S&DT by the ministers at Doha provides a basis for working towards realizing the inherent potential of S&DT for economic development. Specifically it is argued here that important impediments to economic development are represented by certain articles and clauses of the WTO Agreements themselves. It is a strange irony that apart from all the normal structural reasons for seeking special and differential treatment, parts of the Agreements now constitute an important additional reason for

⁴ Paragraph 44 of the Doha Ministerial Declaration is the main, central mandate on S&DT, but it is not the only one. It is reinforced by paragraph 12 of the Ministerial Decision on Implementation Issues that defines: (i) what the CTD has to do, i.e. the scope of the mandate; (ii) the place of the S&D issues in the single undertaking; and (iii) the crucial link between the S&D issue and the pending implementation issues. Another key element of the Doha mandate on S&D is contained in paragraph 50 of the Doha Ministerial Declaration, that sets the legal framework of the negotiation on S&D, i.e. it reiterates the legal (i.e. binding) value of the relevant WTO texts. The divergent interpretation of these three provisions altogether is what generates the obstacles in the current negotiations.

There are other "S&DT-like" mandates in the Doha texts, expressed in a variety of S&DT or "pro-development language: for instance, paragraphs 6 and 7 of the Declaration on TRIPS and Public Health; paragraphs 16, 19, 21, 24, 26, 27, 28, 29, 32, 33, 35, 36, 37, 38, 39, 40, 41, 42, 43, 51, plus the Decision on Implementation. I am grateful to Werner Corrales and Manuela Tortora for this point.

⁵ For a review of the progress on S&DT following the DOHA meeting see Tortora (2002), Mangeni (2002a&b), ICTSD.BRIDGES Weekly, Melamed (2003).

seeking S&DT for DCs. The paper suggests, however, that in order for it to meet the developmental needs of DCs, a fresh and broader conceptualization of S&DT would be required than is available under the current Agreements of the WTO. It is further argued that this new S&DT conceptualization would not only be of benefit to developing countries but would also serve the long-term interests of developed countries. Such S&DT architecture would be Pareto optimal in the present and prospective circumstances of the world economy.

Apart from its significance for developing countries, S&DT also provides an opportunity for the multilateral trading system to regain the necessary public legitimacy which it has evidently lost in the recent period (Ricupero 2000). For this to happen, the fresh thinking on these issues should aim to bring to the forefront the overarching environmental and developmental goals of the multilateral trading systems.

The *Agreement Establishing the World Trade Organization* states at the very outset:

The *Parties* to this Agreement,

‘Recognizing that their relations in the field of trade and economic endeavour should be conducted with a view to raising standards of living, ensuring full employment and a large and steadily growing volume of real income and effective demand, and expanding the production of and trade in goods, and services, while allowing for the optimal use of the world’s resources in accordance with the objective of sustainable development, seeking both to protect and preserve the environment and to enhance the means for doing so in a manner consistent with their respective needs and concerns at different levels of economic development. (WTO 1995:9)

The above passage may be regarded as being effectively the mission statement of the WTO. The restoration of public confidence of the civil society in the organization will only come if it is seen to be actively engaged in fulfilling its own laudable mission objectives.

This paper is in two parts. Part I discusses the analytical and policy issues which arise from examining S&DT provisions in WTO Agreements in the light of the Doha Declaration. This part of the paper is structured as follows. Section II provides a brief history and legal basis of S&DT provisions in multilateral trade agreements. Section III outlines the main issues which arise in examining the economic case for S&DT in

the contemporary international economy. In this and the following sections (IV-VIII) the claim that the best way to promote economic development is to integrate as quickly as possible with the multilateral trading system under the WTO Agreements is examined in some detail. The paper puts forward the concept of the optimal degree of openness of an economy from a developmental perspective and argues that this varies between countries. It is suggested in that context that the “single undertaking” requirement of the WTO Agreements is not very helpful. The evidence from the historical experience of East Asian countries, China, India, Latin America and Africa is analyzed to suggest the difficulties created by provisions of the WTO Agreements for economic development. Section VIII also examines *inter alia* the use of effectively S&DT measures by several advanced countries during the period of the Golden Age of 1950 to 1973. The advanced country examples illustrate the inherent potential of S&DT for economic development. Section IX sums up the main findings of Part I.

Part II (Sections X – XIV) considers issues of economic policy. It outlines alternative policy approaches to S&DT (Section X), and comments on the characteristics of a development friendly WTO regime (Section XI). Section XII provides a detailed analysis of the vexed issue of graduation and differentiation. It finds the North’s obsession with graduation and differentiation in relation to S&DT to be a mercantilist misconception with little economic justification. Section XIII considers the S&DT question within the broader context of the global economy and pays particular attention to the relationship between trade liberalization and financial liberalization. Section XIV concludes, outlining the main policy concerns of developing countries in relation to S&DT and the WTO Agreements.

II The Evolution of S&DT Provisions and their Legal Basis

Over the years, there has been a whole plethora of S&DT provisions intended to help developing countries to benefit from the multilateral trading system. WTO (2000) records that there are 145 such provisions spread across the different Multilateral Agreements: Multilateral Agreements on Trade in Goods; the General Agreement on Trade in Services; The Agreement on Trade-Related Aspects of Intellectual Property; the Understanding on Rules and Procedures Governing the Settlements of Disputes;

and various Ministerial Decisions. Of the 145 provisions, 107 were adopted at the conclusion of the Uruguay Round, and 22 apply to least-developed country Members only.

Whalley (1999) makes a useful distinction between S&DT provisions adopted before the Uruguay Round and those adopted subsequently. The former were crafted to provide market access for developing countries in advanced countries' markets on a preferential and non-reciprocal basis. The post -Uruguay Round S&DT measures have been of a different kind. Their main concern appears to be to assist developing countries in implementing the WTO disciplines. Thus, developing countries were offered extra time, technical assistance to enhance capacity, all in order to facilitate their adjustment into the new World Trading System. The WTO secretariat has developed a six-fold typology to classify the existing S&DT provisions.

- 1) provisions aimed at increasing the trade opportunities of developing country Members;
- 2) provisions under which WTO Members should safeguard the interests of developing country Members;
- 3) flexibility of commitments, of actions, and use of policy instruments;
- 4) transitional time periods;
- 5) technical assistance;
- 6) provisions relating to least-developed country Members.

GP and ICTSD (2003) suggest that these categories can be related to two development dimensions:

- i) Market access and fair competition in favour of developing countries;
- ii) "Spaces for development policies", i.e., extent to which S&DT measures enhance the capacity and the policy autonomy of developing countries in meeting their developmental needs and potential through trade.

Table 1 illustrates the nature of the relationship between the WTO Secretariat's classification of S&DT provisions and how these might translate into the two important channels above for achieving economic development.⁶

However, it is interesting to observe that the WTO's categorization of S&DT measures has an extremely important omission. There are no S&DT provisions here that would enable DCs to overcome the anti-developmental impact of several parts of the WTO Agreements themselves. It will be difficult to maintain that the TRIPS, the TRIMS, as well as several other elements of the Agreements normally have, *ceteris paribus*, a positive impact on economic development (see further below). These provisions clearly should not have been accepted by DCs at the time of their accession. As explained in later sections, the acceptance reflects the economic and political weaknesses of DCs in the "lost decade" of the 1980s. These anti-developmental features of WTO Agreements need to be re-negotiated and suitably amended if the Agreements are to serve the cause of development. The means by which this can be done would constitute a most important S&DT provision.

WTO Agreements contain not only provisions which are not conducive to developmental interest of DCs, but also contain a number of elements which can only be regarded as being S&DT in favor of ACs. Textile quotas and agricultural support schemes are obvious examples in this context. Less obvious are the provisions with respect to TRIPs and TRIMs. Restrictions on competition are accepted under the

TABLE 1: RELATIONSHIP BETWEEN S&DT PROVISIONS AND DIMENSIONS ACCORDING TO DEVELOPMENT CRITERIA

EXISTING S&DT PROVISIONS, ACCORDING TO WTO SECRETARIAT'S CLASSIFICATION	DIMENSION I: MARKET ACCESS AND TRADE FAIRNESS FOR DEVELOPING COUNTRIES	DIMENSION II. SPACE FOR DEVELOPMENT POLICIES			
		ENABLING FRAMEWORK FOR NATIONAL DEVELOPMENT POLICIES		FRAMEWORKS AND ACTIONS FOR COHERENT MULTILATERAL POLICIES	
		ACTIVE TRADE POLICIES	SUPPLY-SIDE ACTIVE POLICIES	POSITIVE INTERNATIONAL MEASURES	COHERENCE MULTILATERAL INSTITUTIONS

⁶ I am indebted to Mr Werner Corrales for this table.

<i>PROVISIONS AIMING AT INCREASING TRADE OPPORTUNITIES OF DEVELOPING COUNTRY MEMBERS</i>	X				
<i>PROVISIONS UNDER WHICH WTO MEMBERS SHOULD SAFEGUARD THE INTERESTS OF DEVELOPING COUNTRY MEMBERS</i>	X				
<i>FLEXIBILITY OF COMMITMENTS, OF ACTIONS, AND USE OF POLICY INSTRUMENTS</i>	X	X	X		
<i>TRANSITIONAL TIME PERIODS</i>	X	X	X		
<i>TECHNICAL ASSISTANCE</i>	X				
<i>PROVISIONS RELATED TO LDCs</i>	O	O	O		

TRIPs Agreement, for example, in order presumably to promote technical change and long-term economic growth. However, since most patents are held by AC corporations and individuals, the Agreement promotes the interest of developed rather than DCs.

Similarly, the notion of industrial policy is implicit in the Agreement on Subsidies and Countervailing Measures which does not prohibit government grants to private firms to promote R&D, or subsidies granted to disadvantaged regions, or those

relating to new environmental laws. This rule again favors industrial policy requirements of advanced countries; many of the subsidies of interest from the perspective of industrial policy in DCs are ruled out, for example, prohibited subsidies include those contingent on export performance, or those given for the use of domestic in preference to imported products.

Turning to the legal basis for the evolution of the S&DT provisions, at the beginning in 1947, Article XVIII of GATT was the only provision available for developing countries, for enhancing economic development. This was the infant industry protection clause. In 1954-55, this clause was modified to include XVIII:b on quantitative restrictions on imports in case of balance of payments difficulties encountered by developing countries. This provision was used by many developing countries until WTO agreements came into force in the 1990s. In 1965, a new Part IV was added to GATT, which introduced the concept of non-reciprocity for developing countries. One of the most important results of the Tokyo Round in the 1970s was a framework agreement on “differential and a more favorable treatment, reciprocity and fuller participation of the developing countries”. This is also known as the Enabling Clause, which provided a permanent legal basis for the GSP scheme.

One of the main difficulties in S&DT provisions in the WTO Agreements is that they are generally speaking voluntary and not legally binding. Part IV of GATT and most of the other S&DT measures in WTO Agreements are also voluntary and in the nature of “best endeavor” clauses. Kessie (2000) argues that “much of the WTO provisions dealing with S&D treatment could be said to be unenforceable, as they are expressed in the imprecise and hortatory language (p.15)”. This poses a challenge for the legal experts.⁷ The nature of other legal and related political challenges that will follow from the substantive analysis of this paper will become clear in the following sections.

Finally, it is important to note that a large number of regional trade agreements (RTAs) now exist side by side with the WTO Agreements. The former vary in their scope, in coverage and in their provision of S&DT for DCs in their jurisdiction. The most well known RTA is NAFTA (North American Free Trade Area comprising the

⁷ This paper is primarily concerned with underlying economic issues rather than with legal principles. However, for an interesting recent paper on legal issues concerned with S&DT see Mangeni 2002a.

U.S., Canada and Mexico), which has arguably more stringent disciplines for DCs than the WTO Agreements.⁸

III The economic rationale for S&DT in the contemporary international economy: the main issues.

A central analytical issue raised by the discussion so far of S&DT, the developmental objectives of the Doha Round as well as the Preamble paragraph of the WTO Agreements, is to what extent, if any, the multilateral trading system in its current form promotes or hinders economic development. The proponents of the WTO suggest that trade liberalization and integration into the world economy is the best way for DCs to achieve economic development, and this is exactly the path the multilateral trading system of the WTO has been following.

The WTO adherents, which includes not only the IFIs and other influential globalizers, normally support their case with the following kinds of subsidiary arguments:⁹

- The rate of growth of world trade has been twice the rate of production in the post-war period and that trade is therefore the engine of growth;
- The failure of the Soviet Union indicates that dirigiste policies are inappropriate;
- On the positive side, the experiences of Japan and East Asia indicate that export orientation, greater openness and integration with the world economy are the best means of achieving fast and equitable economic growth.

It is further suggested that developing countries would be better off abandoning S&DT altogether and integrating themselves quickly into the international economy. S&DT is regarded as being ineffective and, in any case, is likely to delay the necessary market-oriented pro-competition economic reforms that are necessary. Essentially, the basic development philosophy of the WTO consists of two main

⁸ On NAFTA and its implications for domestic policy autonomy in Mexico, see OXFAM (2002).

⁹ The classic reference here is Sachs and Warner(1995). For more recent studies see Prowse (2002) and Hoekman et.al (2003). See also Bhagwati and Srinivasan (1999) and Rodrik (1999).

elements: (a) trade liberalization and greater integration with the world economy; (b) increasing the role of the market and diminishing that of the state (as exemplified by TRIMS, abolition of state aid to subsidize industry, etc).

Thus, the case of the proponents of WTO and its current policies is multi-faceted and seemingly formidable. However, on close examination, it will be seen to be deeply flawed. The readers will recognize that the above line of reasoning is enshrined in the Washington Consensus which in recent years has lost much of its lustre and is being rapidly abandoned even by former adherents. (However, this issue is discussed further in Part II below.)

Nevertheless, in view of the hold of these arguments in influential circles in the WTO and elsewhere, these will be fully reviewed here in the light of the latest available research. It will be suggested that trade liberalization and globalization are far from being the best ways, let alone the only ways, of promoting economic development. From the perspective of economic development there is an optimal degree of openness for each country which does not necessarily coincide with either free trade or with free capital movements, and it is proposed that each country should have policy autonomy to choose its optimal level of openness. Indeed the intellectual case for suitable S&DT for countries at different levels of development and different circumstances is overwhelming. These propositions and proposals are systematically examined in the next three sections.

IV Liberal multilateral trading system and economic development: analytical considerations.¹⁰

The traditional case for free trade can best be put in terms of the two fundamental theorems of welfare economics. According to the first welfare theorem, a competitive equilibrium in the absence of externalities and non-satiation constitutes a Pareto optimum. The second theorem, which is more relevant for present purposes, states that any Pareto optimum can be realized as a competitive equilibrium in the presence of all-around convexity, provided suitable lump-sum transfers can be arranged among

¹⁰ This section draws on Chakravarty and Singh (1988).

the participants. Most of these assumptions are unrealistic in relation to the real world that does not always display all-around convexity and where externalities do matter.¹¹ Nevertheless, neo-classical economists suggest that such considerations do not destroy the case for free trade but only change the nature of the argument. Thus, Krugman (1987) concludes his classic defense of free trade in terms of modern theory as follows: "this is not the argument that free trade is optimal because markets are efficient. Instead it is a sadder but wiser argument for free trade as a rule of thumb in a world whose politics are as imperfect as its markets."

However, as Chakravarty and Singh (1988) suggest, the politics of a world of increasing returns to scale are more likely to make it gravitate towards 'managed' rather than free trade. Instead of either free trade or autarchy, this would be a world in between – one in which there were trade restrictions, government assistance to favoured industries and a plethora of special arrangements between countries, in other words, the messy real world. In place of all-around convexity, this real world is characterized by learning by doing (Arrow, 1962), dynamic economies and cumulative causation (Young, 1928; Kaldor 1978). This is, therefore, the world of second best and of multiple equilibria and the purpose of policy is to move from a bad to a good equilibrium. The gains from such policy intervention have, however, to be balanced against the losses from government failure and appropriate policy can therefore be prescribed only on a case-by-case basis (Ocampo and Taylor, 2000; Gomery and Baumol, 2000). Provided there is a mechanism for ensuring full employment of each nation's resources so that there are gains from trade to be realized, and if we abstract, for the moment, from the possibility of government failure, Chakravarty and Singh suggest that a policy of selective economic openness may be a source of great advantage for an economy for any one of the following reasons:¹²

¹¹ The traditional theory of comparative advantage assumes, *inter alia*, constant or decreasing returns to scale and full employment. There is, however, considerable evidence in the real world of increasing returns arising from the static, Kaldor's dynamic and Young's macro-economic economies of scale as well as of widespread externalities. The 'new' trade theory's response to these problems has been, as Ocampo and Taylor (2000) put it "to muffle the impact of scale economies by 'convexifying' assumptions". They note, for example the "Dixit and Stiglitz (1977) model of monopolistic competition in which firms' profitability gains from returns to scale are strictly limited by consumers' desires for product diversity."

¹² Such a mechanism, for example, existed in the "Golden Age" of the post-WWII era (1950-1973) when, under the aegis of a single hegemonic economic power, namely the U.S., European economies

- (a) it may enable a country to concentrate its relatively specialized resources in areas of production where the world demand is highly income and price elastic;
- (b) it may lead to diffusion of knowledge of a nature which can lead to considerable upgradation of the quality of local factors of production;
- (c) it may lead to sufficient competitive pressure to eliminate X-inefficiency;
- (d) trade may lead to changes in the distribution of income which can lead to a greater share of accumulation in national income;
- (e) trade may facilitate what Schumpeter stressed so much: an accelerated process of creative destruction.

In general, such trade openness works positively if the phenomenon of "learning" from contacts with the rest of the world are institutionalized through suitable adaptations on the policy side involving appropriate government interventions which make the domestic economy more responsive to change. This is a main lesson that emerges from the outstanding industrial success of East Asian economies during the second half of the 20th century as we shall see in the next section.¹³

To sum up, while neoclassical arguments for "free trade" suffer from serious conceptual and operational difficulties, there are indeed substantive benefits from selective trade or economic openness, which are more robust than the traditional neoclassical theory suggests. However, such benefits can be realized only in a world in which there is full employment in all trading nations, coupled with an appropriate set of domestic policies which go considerably beyond the limits of commercial policy as traditionally defined.

V Strategic versus close integration with the World Economy: The East Asian Experience

It used to be customary for International Financial Institutions (IFIs) and orthodox economists to ascribe East Asia's outstanding economic success during the last four

were able to maintain high levels of aggregate demand to ensure full employment (Glyn *et al.*, 1990; Singh, 1995a).

¹³ See further Freeman (1989); Chang (1994); Singh (1995b), Amsden (2001).

decades to (a) their close integration with the world economy; (b) competition and economic efficiency; (c) to government's market friendly approach which suggested that the government intervened in these countries sparingly, only to provide infrastructure and human capital for private enterprise to flourish. The export success of East Asian countries underlined their competitiveness. Overall, in the IFI's view, the experience of these countries is thought to show how orthodox economic policies can bring fast GDP growth.¹⁴

Recently, the IFIs have re-evaluated their analysis of East Asian success in the wake of the Asian crisis. Their new conclusion is that that the crisis was caused in part by too much government intervention in these economies and by the lack of competition which led to over investment, collapse of profits and ultimately to the crisis.¹⁵

The above version of the IFI's East Asian analysis is comprehensively rejected by independent scholars. The broad consensus view is that the governments in East Asian countries did not intervene reluctantly or sparingly but followed a vigorous industrial policy by which they attempted to change the vectors of prices and costs facing enterprises in the direction desired by the planners. The government intervened not only at the broad sectoral levels but also at the level of the individual firm, favoring companies which accepted its strategic plans. These interventions were normally carried out by the so-called administrative guidance rather than explicit legislation.¹⁶

To make the discussion more specific, the instruments of industrial and export promotion policies used either by Japan or by the Republic of Korea during their periods of rapid economic growth – the former country from 1950 to 1973 and the latter during the 1960s and the 1970s – can be summed up as follows:¹⁷

¹⁴ The classic references here are World Bank (1991,1993)

¹⁵ See IMF (1997); Summers(1998)

¹⁶ See Singh(1994,1997,1998); Amsden(1994); Lall(1995);Singh and Weisse(1999). For differing perspectives on the causes, consequences and remedies of the financial crisis in East Asian countries, see three recent collections of ararticles published by National Bureau of Economic Research: Feldstein (2002), Dooley and Frankel (2002), Edwards and Frankel (2002).

¹⁷ For information on Japan, see, among others, Okimoto (1989), Tsuru (1993); Caves and Uekusa (1976). For the Republic of Korea see Amsden (1989), Chang (1994); Singh (1998)

Export Promotion and import restriction:

- (ii) Import restrictions, both general and specific;
- (iii) Favours particular sectors for export promotion and in some cases particular firms for that purpose;
- (iv) Seeking compliance for subsidies given to exporters by means of export targets for specific firms (the Korean case);
- (v) Interest rate subsidies and the availability of credit and foreign exchange to favoured firms that meet export targets;
- (vi) General export promotion, in Japan through JETRO (Japan Export Trade Promotion Organization) and in the Republic of Korea via KOTRA (Korean Trade Promotion Organization);
- (vii) Provision of infrastructure, including human capital, in support of exports;
- (viii) Taxation relief on imported inputs and on R & D expenditures;
- (ix) Allowing favoured conglomerates to import capital goods and foreign technology and to raise cheaper finance on international markets.

Industrial policy measures

- (i) Lax enforcement of competition policy, including the extensive use of cartels;¹⁸
- (ii) Government creation and promotion of conglomerates (in the Republic of Korea);¹⁹
- (iii) Tax concessions to corporations to increase investment;
- (iv) Promotion of a close, long-term relationship between finance and industry which was critical to the implementation of the industrial policy;²⁰
- (v) Labour repression to ensure labour peace in a period of gigantic structural change (this applies to Korea rather than to Japan);²¹

¹⁸ See further Amsden and Singh (1994).

¹⁹ See Chang (1994).

²⁰ Johnson *et al.* (1989).

- (vi) Establishment of state industries to enhance industrial development (this again applies to the Republic of Korea rather than to Japan);
- (vii) Administrative guidance, used extensively in both countries.

Clearly, many of the above policies are *prima facie* in violation of the WTO Agreements, particularly in the areas of TRIMS, subsidies, and technology policy (TRIPS). It may, however, be argued that such policies had been implemented by many countries in Latin America as well but they have not been successful. This is clearly an important issue and will be taken up in Section VI below.

Table 2: Import-penetration in manufactures in advanced industrial countries: 1961-1979.

(Ratio of manufactured imports to GNP)

	1961	1965	1969	1973	1979
United States of America	1.5	2.1	3.4	4.0	4.5
United Kingdom	4.6	6.7	8.0	11.7	14.2
Rest of EEC (9)	6.1	7.6	10.1	13.0	15.8
Japan	1.8	1.5	2.2	3.0	2.4

Source: CEPG (1979)

Apart from industrial policy, it is important to emphasize, in the context of this paper, that the East Asian countries, contrary to the IFI view, did not have a close integration with the world economy. Rather, the degree of their integration can be regarded as being strategic but not close. Thus these countries had export-orientation but they extensively used selective as well as comprehensive import controls during the course

²¹ In the postwar period, Japan has cultivated an enterprise-based, in-house approach to labour unions, which has contributed to industrial peace. See further You and Chang (1993).

of industrialization. As Table 2 shows, as late as 1979 when Japan had been a member of OECD for nearly a decade and was therefore committed to more or less free trade, its manufactured imports as a proportion of GDP were just over two per cent. The corresponding imports of European countries were several orders of magnitude higher. Even the United States which, because of its continental size, has traditionally been relatively closed, had manufacturing imports nearly twice as high as those of Japan, relative to the respective GDPs in the two countries. Clearly, Japan was using informal methods of controlling imports even well after it had become a leading world exporter of a whole range of manufacture products including cars and electronic goods of various kinds.²² Similarly, South Korea afforded protection to its fledgling car industry for nearly three decades, to reach a stage where it too became a major exporter of cars.

East Asian countries' selective openness is indicated not just by their being open to exports but not imports; in a number of other relevant spheres also a similar policy was adopted. As is widely acknowledged both Korea and Japan during their high-growth phases discouraged foreign direct investment. This didn't mean that they were averse to technical change but rather that they thought that foreign direct investment was more expensive than licensing or other means of obtaining technology from abroad. So the two countries were more open to imports of technology through scientific and technical interchange and through licensing than through FDI.

The widely used policy of selective economic openness which the East Asian countries followed with spectacular results has been conceptualized by Chakravarty and Singh in the following terms. They suggest that economic openness is a multi-dimensional concept. A country can be open, or not so open, with respect to trade, to finance, to migration, to educational, scientific and cultural exchange. There is no economic theory that suggests that a country needs to be open in all dimensions at all times. A policy of strategic openness enables a nation to be open in areas where it is in its interest to do so. The optimal degree of economic openness will vary between

²² It is not unreasonable to infer informal import controls (possibly in the form of foreigners' access to the complex Japanese retail network) being a cause of slow growth of Japanese imports. The Japanese GDP growth was, if anything, faster than that in the competitor countries. This factor should have increased the rate of growth and the level of imports and not lowered it. For a fuller discussion of these issues see further Singh (1995b) and Johnson *et al.* (1989).

countries depending on their previous history, level of economic development, the size of the country, their institutional development and on the nature of its comparative and competitive advantage.

A striking feature of the WTO multilateral regime is that it does not generally permit the kind of diversity in international economic arrangements between countries which would be required if each country were to have its own optimal degree of openness. Under the “single undertaking” arrangement developing countries cannot opt out of some disciplines while accepting others: the Agreements as a whole have to be accepted by members. Although some concessions are given to developing countries under S&DT they tend to be grossly inadequate and basically the same rules apply to countries at widely different levels of economic development and with widely different capabilities. Such rules are *prima facie* unfair and unjust, and, as we shall see below, also anti-development.

VI Economic openness and the experience of China, India and other emerging countries.

Some of the fastest growing economies in the world for the last two decades have been the world’s most populous as well as amongst the world’s poorest countries, namely India and China. The IFIs regularly claim credit for this fast economic growth on the basis of the alleged openness of the two countries to the world economy. Openness is measured here in terms of the rate of growth of exports and imports. It is argued that the fast economic growth in the two countries is due to their high rate of growth of trade, and that in the case of China, is also caused by FDI of which China has been a major recipient.

There are, however, important difficulties with this line of reasoning. Firstly, it is not correct to infer openness from just the rate of growth of trade. This is because the growth of this variable does not just depend on import and export restrictions but also on the size of GDP and its rate of growth. Thus the causation could easily be the other way around: the faster the growth of GDP, the faster the growth of imports and exports.

Apart from the question of causation, to which we shall return soon in another context, the Indian and Chinese story does not support the claims of the IFIs and kindred globalisers in other respects as well. The Indian growth rate began to pick up in the 1980s whereas most of the “openness” reforms were not carried out until the early 1990s. Similarly, both China and India, despite their fast growth of exports and imports, continued to have extensive import controls and capital controls, not withstanding the liberalization which these countries have carried out over the last two decades. Thus, India still has one of the highest rates of average protection in the world. Similarly, China, while being the largest receiver of foreign direct investment among developing countries during the last decade, maintains a wide range of capital controls.²³ Table 3 provides information on the relative openness of capital account regimes in China, India and other selected DCs and ACs.

²³ See further Rodrik(2001)

Table 3. Financial Openness in Selected Developed and Developing Countries, 1977

<i>Country</i>	<i>Index^a</i>
<hr/>	
<i>Open^b</i>	
Argentina	1.78
Australia	1.77
Canada	1.92
Egypt	1.81
France	1.73
Japan	1.73
Mexico	1.69
Sweden	1.86
United Kingdom	1.86
United States	1.85
<i>Largely open^c</i>	
Croatia	1.54
Honduras	1.56
Philippines	1.59
Turkey	1.52
<i>Partially closed^d</i>	
Chile	1.43
China	1.37
Czech Republic	1.48
Ghana	1.43
Indonesia	1.46
Korea, Republic of	1.42
Mozambique	1.41
Russian Federation	1.43
South Africa	1.44
Thailand	1.46
<i>Largely closed^e</i>	
Brazil	1.19
Ethiopia	1.12
India	1.20
Malaysia	1.34
Pakistan	1.31

- a. The Financial Openness Index scoring draws on the methodology originally developed by Quinn and Inclan (1997), and is based on information contained in IMF, *Annual Report on Exchange Arrangements and Exchange Restrictions*, 1998.
- b. Open: Little or no regulation for outward or inward transactions, with a generally nondiscriminatory environment.
- c. Largely open: Some regulations are exercised on outward and inward transactions requiring documentary support but not governmental approval.
- d. Partially closed: Regulation with governmental approval required for outward and inward transactions and usually granted.
- e. Largely closed: Substantial restrictions, with governmental approval required but seldom granted for outward and inward transactions.

Source: Dailami, M. (2000) “Managing Risks of Global Financial Market Integration”, in *Managing Financial and Corporate Distress: Lessons from Asia*. Adams, C., R.E. Litan, and M.Pomerleano (eds.) Brookings Institutions Press, Washington, DC. pp. 458.

Apart from India and China, the case of Latin America is also relevant to the debate about the virtues of a free multilateral trading system versus those of selected economic openness, as well as to the broader discussion of the role of the state in the economy. The facts are that the Latin American countries from the end of the Second World War to 1980 generally followed dirigist and import substitution policies. However following the debt crisis in the 1980s they were persuaded by the international financial institutions (IFIS) to bring about a fundamental change and to adopt instead Washington Consensus policies of privatization, de-regulation, trade and financial liberalization²⁴. However these policies have not worked. The long-term trend rate of growth in Latin American countries during the last fifteen years is

²⁴ The IFIs ascribed the debt crisis to macro-economic mistakes of the Latin American governments and to their microeconomic inefficiencies, rent seeking and inappropriate resource allocation. The latter were thought to arise from import substitution and the pervasive role of the state in the economy. Singh 1993, Taylor 1988, and Fishlow 1991, strongly contested this thesis. They pointed out that the debt crisis was due to international economic forces over which developing countries had no control. It was noted that the financial contagion played a major role in the debt crisis. It was also observed that Brazil had a debt crisis even though it had better fundamentals than Korea and Korea did not have such a crisis. Williamson 1985 suggested that if Korea had been a Latin American country it too would have succumbed to the contagion.

half that these countries recorded during the bad old days of import substitution and interventionist industrial policy!. In the wake of the Latin American experience under the Washington Consensus policies it is widely acknowledged that the liberalization of trade and capital movements does not by itself lead to long-term economic growth.

An important lesson from the experience of the Latin American countries during dirigist period and the East Asian countries (examined earlier) is that since developing countries have incomplete and missing markets, the state can play an important role in coordinating investment activity of firms through a robust industrial policy. It can also help build the capabilities of domestic firms and enterprises until they are ready to compete in the world markets. Amsden (2001) however, suggests that state directed industrial policies have been successful only in those countries where the state has certain autonomy and has been able to set performance standards for the private sector in return for state aid. Many of the standards which developing countries have successfully used, for example, those relating to domestic content requirements and export targets have unfortunately been specifically prohibited under the WTO Agreements. These prohibitions add to the disadvantages of developing countries.

Finally and briefly we turn to African countries. Broadly speaking the experience of African countries who have followed the liberalization policies under structural adjustment, has been if anything even worse than that of Latin America. Many of these countries have long been under the IFI structural adjustment programmes but these have not led to sustainable long-term economic development.

VII Econometric evidence on trade liberalization and long-term economic growth.

There is a large literature which attempts to establish the nature of the causal relationship between trade liberalization and long-term economic growth. The literature is vast and highly contentious. However, it has been recently comprehensively reviewed by Rodriguez and Rodrik (1999). The two authors have analyzed some of the leading studies on the subject which have purported to show that trade liberalization causes long-term economic growth. Rodriguez and Rodrik's analysis indicates that the results of these studies are not at all robust and are indeed

quite shaky. One general fault they find in this research is that openness is not measured directly but by a number of proxies, many of which are quite unsuitable. Specifically, measuring the degree of openness by a variable such as black-market premium (see the study of Sachs and Warner (1995)) is not legitimate. Black-market premia reflect more the macro-economic disequilibria in the economy rather than how open the trade regime is.

Dollar and Kraay's (2000) influential study which purports to find a positive relationship between trade liberalization and economic growth is subject to some of the same limitations as Rodriguez and Rodrik found in the earlier studies they analyzed. Dollar and Kraay measure openness by the growth of exports and imports rather than by the country's commercial policy. India, in this analysis, comes out as a liberalizer even though, as noted earlier, it has the highest average rate of protection in the world.

Rodriguez and Rodrik's other relevant result in the context of this paper is that trade liberalization does not lead to convergence but rather to divergence between countries²⁵.

VIII The Experience of Advanced Countries in the Golden Age 1950 - 1973: S&DT on a Grand Scale.²⁶

In the debate on S&DT it is usually forgotten that European economic recovery and prosperity following the end of the Second World War depended to a large degree on what can only be called special and differential treatment accorded by the United States to Germany, Italy, Japan and other defeated as well as victor countries. The period 1950 to 1973 is rightly regarded as the Golden Age of world capitalism, for during this period the OECD economy grew at twice its historic trend rate over the last two centuries. Research suggests that an important element in this extraordinary epoch in economic history was the far-sighted international economic policies pursued by the United States. Analysis and evidence indicate that the United States,

²⁵ For other important contributions to the debate about the relationship between trade and economic growth see Bhagwati and Srinivasan(1999) and Rodrik(1999).

²⁶ For a further analysis of the issues raised in this section see Glyn *et al* (1990) and Kindleberger (1992).

confronted with the challenge of a triumphant Soviet Union at the end of the war, adopted for strategic reasons long-term economic policies designed to build up fast the economies of western countries so that they would not fall under Soviet influence. The net result was not only the Marshall Plan for Europe but also non-reciprocity in relation to U.S. trade with the other now advanced countries. As Spero (1977) notes:

In the short-term, it [the U.S.] dealt with its own huge balance-of-trade surplus and the European and Japanese deficits by foreign aid and military expenditures. In addition the United States abandoned the Bretton Woods goal of convertibility and encouraged European and Japanese trade protectionism and discrimination against the dollar. For example, the United States absorbed large volumes of Japanese exports while accepting Japanese restrictions against American exports. It supported the European Payments Union, an intra European clearing system which discriminated against the dollar. And it promoted European and Japanese exports to the United States...To encourage long-term adjustment, the United States promoted European and Japanese trade competitiveness. Policies for economic controls on the defeated Axis countries were scrapped. Aid to Europe and Japan was designed to rebuild productive and export capacity. In the long run it was expected that such European and Japanese recovery would benefit the United States by widening markets for American exports. (Spero (1977) p.37) (emphasis added).

The challenge for the international community today is whether the advanced countries are willing to follow enlightened long-term international economic policies similar to those pioneered by the United States in the Golden Age. These policies were evidently highly successful both for the U.S. and its allies and led ultimately to the demise of the Soviet Union. The important issue is whether advanced countries, not faced with a strategic threat from another superpower are willing voluntarily to sacrifice short-term and transient trade advantages for long-term economic policy that would benefit developing countries as well as themselves.

IX The Case for Special and differential Treatment for Developing Countries: A Summary.

The analysis of the previous sections has indicated that simply integrating developing countries with varying degrees of economic weaknesses in a multilateral world trading system is unlikely to lead by itself to economic development. Evidence from the developmental experience of various countries during the last half century or more, as well as economic analysis, suggest that the optimal degree of openness from the perspective of economic development varies between countries. Moreover, as Rodrik rightly argues, capitalism may be the only viable system in the world, but a wide variety of institutional arrangements are compatible with capitalism. To bring about sustainable economic development, developing countries need to have policy autonomy so that they can create their own institutions best suited to their needs. This type of choice is precisely what effectively becomes seriously circumscribed under the multilateral trading arrangements of the WTO.²⁷

Equally importantly, developing countries are unable to employ the variety of policy instruments used effectively as seen above by both developing and developed countries during the post world war II period to enhance their economic development. These notably include industrial policies employed in many Asian countries with outstanding results. These restrictions on government policy space under the WTO Agreements might not be regarded as a handicap if it is maintained that in most developing countries government failure is more important than market failure and so countries are better off in a regime where their governments cannot intervene. This may appear to be a plausible argument but one which flies in the face of evidence. Governments in China, India, Mexico, Brazil, Korea, Taiwan province of China, Malaysia and in many other developing countries have long overall records of successful government interventions, poverty reduction and economic development.²⁸ These countries have effective governments which are involved in carrying out myriad developmental tasks.

²⁷ Strictly speaking, WTO Agreements do not prohibit establishing new institutions as such. What they do is to place limitations on a country's policies and legal framework. The latter are compatible with some institutional arrangements and not with others which unnecessarily restricts many DC's policy autonomy and their ability to establish important development friendly institutions.

²⁸ See further Amsden (2001), for a discussion of why in some countries government interventions succeed and in other they do not .

At a developmental level the WTO Agreements have arguably been a colossal mistake. Rodrik is rightly scathing in his indictment:

The rules for admission into the world economy not only reflect little awareness of development priorities they are often completely unrelated to sensible economic principles. WTO rules on anti-dumping, subsidies and countervailing measures, agriculture, textiles, trade related investment measures (TRIMS) and trade related intellectual property rights (TRIPS) are utterly devoid of any economic rationale beyond the mercantilist interests of a narrow set of powerful groups in the advanced industrial countries. The developmental pay-off of most of these requirements is hard to see. Rodrik (2001) p.27.

Moreover, developing countries had to pay heavily for the privilege of joining this anti-development club. World Bank (2002) estimates that it costs a typical developing country \$US1.5 million in start up costs and \$US2 million in annual recurrent costs to implement a single WTO agreement, namely the TRIPs. These expenses are onerous for many developing countries.

Developing countries signed up to WTO agreements on which they were evidently not properly consulted. The implications of the Agreements for economic development were not spelled out. The euphoria of developing countries over the demand for the New International Economic Order in the 1970s had given way in the 1980s to a debt crisis in Latin America and Africa which reduced many of these countries to the status of being supplicants before the International Financial Institutions. The political weaknesses of developing countries were also noted earlier. These, plus the pressure from IFIs under the structural adjustment programs, obliged these countries to accept what many of them knew to be development unfriendly Agreements.

At a global level it is important to note that developing countries already suffer from an additional structural handicap compared with the pre-globalization period. In part as a consequence of trade liberalization and lowered tariffs on imported foreign

consumer goods, research indicates that developing countries are experiencing surges in imports. This results in their becoming balance of payments constrained at a systematically slower growth rate than used to be the case before.²⁹ To finance their current account deficits, countries often open up their capital account. This perhaps helps in the short term but over the medium term many countries have unhappy results with these capital accounts openings. (The latter issue is discussed further in section XIII.)

Significantly, the current account disequilibria of the kind outlined above can be rectified in other ways, without resorting to premature capital account liberalization and risking financial fragility. One important trade-as well as-development friendly way to do this would be to allow DCs again a balance of payments let-out clause (as in GATT) which would permit them to control directly the level and growth rate of their imports (including using quantitative controls if necessary). Permitting DCs this additional measure of economic autonomy would mean that the affected country does not necessarily have to reduce its level or its rate of growth of GDP, in order to reduce the level and the growth rates of imports. S&DT provisions of this kind in favour of DCs would thus benefit both the North and the South by reducing the costs of adjustments of temporary balance of payments disequilibria.

To sum up, in view of the evident anti-development bias of the many WTO Agreements, a very large degree of special and differential treatment would be needed to redress the balance. There is ample historical evidence, not least from developed countries themselves that a reasonably high and predictable degree of special and differential treatment can assist economic development. Such S&DT could also be in the long-term interest of developed countries as outlined below. This is in part because a prosperous developing world provides a greater market for advanced country goods which in turn leads to higher incomes and production in the North. This generates a greater demand for imports from the South, a positive feedback loop and a virtuous circle of cumulative causation and higher incomes in both North and South than would otherwise be the case. However, the resulting growth path is unstable, implying a fragility of the positive feedback loop. The latter could easily go

²⁹ See further UNCTAD (2000)

into reverse in a vicious circle if, for example, higher incomes in both regions lead to an increase in commodity prices, or there is a wage-price spiral in the labour markets in the North. To avoid this vicious circle, it will be necessary to establish long-term restraining institutions, both nationally (e.g. pay co-ordination policies) and internationally (e.g. commodity price stabilization policies) to deliver mutually supportive fast economic growth in both the North and the South, as occurred in the Golden Age.³⁰

PART II. POLICY ANALYSIS

X. Introduction: Alternative Policy Approaches to S & DT

The terms of paragraph 44 of Doha Ministerial Declaration on S&DT as well as other references to the latter provisions elsewhere in the Declaration can be interpreted in two diametrically opposite ways. The first interpretation would take the text at its face value and regard the fulsome endorsement of the S&DT and the mandate to rationalize and operationalize the concept as indicating a real desire on the part of ACs to make S&DT the cornerstone of a Doha Developmental Round. In short, this interpretation would suggest a genuine call for new thinking on S&DT issues to address the developmental concerns of emerging countries in the WTO system.

The second and opposite interpretation of the references to S&DT in the Doha Declaration, is to reject these as another cynical attempt by ACs to mislead DCs by putting before them the prospect of strengthened S&DT when they do not intend to do any thing other than to induce DCs to accept the full rigours of the WTO system, as well as to adopt the system of “graduation” which would be deeply divisive for DCs.

Although there is considerable past and present history to support the second interpretation, this paper takes the more optimistic first view so as to make a constructive contribution to the current North South discussions on these issues, which are taking place in Geneva and elsewhere. This broader and positive approach to S&DT provisions has also been implicitly called for by the heads of governments

³⁰ For a more comprehensive discussion of these issues see Kaldor’s (1976) classic paper, Singh (1995a) and Singh and Zammit (2000).

or states of non-aligned countries, who met in Kuala Lumpur recently. In relation to the current WTO negotiations the heads were “particularly concerned that major trading partners have yet again sought to place the question of S&DT for developing countries at a level less than at par with the other aspects of the negotiations.” They called for “immediate negotiations on the proposed Framework Agreement on Special and Differential Treatment for developing countries during the course of the present negotiations and reaffirmed that S&DT applies to all developing countries” (Koh 2003).

XI. Towards a Development Friendly WTO Regime

It would be useful to begin the policy analysis by considering first the most optimistic policy scenario from the perspective of DCs. In this hypothetical world ACs decide to act in an anti-mercantilist mode of the post World War II US economic policy described earlier. In this mode the anti-developmental aspects of TRIPS, TRIMS, subsidies, balance of payments’ provisions, as well as other relevant parts of WTO Agreements would be openly acknowledged and the DCs (but not the ACs) would be allowed to opt out of any of these components if this is desired. This may appear to be a huge change with respect to the current situation, but it is worth remembering that the hypothesized conditions represent in many ways no more than the GATT privileges and protections which were available to DC in the pre-Uruguay round period. During the 1960s and 1970s, as Hoekman et.al.(2003) put it, DC members were able to enjoy GATT on an à la carte basis. Further in this imagined development friendly world developing countries would have preferential access to advanced countries’ markets without being obliged to open their own markets in return. Thus, under the assumed circumstances, S&DT provisions in different areas help create an environment conducive to economic development: DCs are provided with the policy autonomy and the means and instruments for achieving their developmental priorities.

Would such a world, where S&DT takes what some would regard, this extreme form, necessarily harm economic development in developed countries? The theoretical answer in terms of neo-classical analysis is to suggest that such asymmetric integration of developing countries with the world economy would not prejudice economic growth and jobs in ACs. However, such a theoretical response is unlikely

to cut much ice with the advanced countries' policy makers who would say that although in principle trade is not a zero sum game, the presence of many advanced developing countries with low wages and poor working conditions provides unfair competition and threatens the survival of many of their industries. There can be sudden surges of imports from leading DCs which harm workers in ACs. Policy makers in ACs would go on to suggest that they maybe willing to provide some or all of these concessions to the Least Developed Countries but there has to be some progression, a "graduation" level, beyond which S&DT would no longer be appropriate. However, a contrary view is expressed in the NAM Declaration above, with the heads of governments or states of DCs reaffirming "that S&DT applies to all DCs". Hence the question of graduation is a major point of contention between ACs and DCs and it deserves careful examination.

XII. Graduation and Differentiation: a Mercantilist misconception

It was suggested by the analysis in Part I that the optimal degree of openness differs between countries, developing and developed, as well as within each of these country groups. In terms of the application of S&DT to DCs that would suggest a case by case approach to each country. This would however at the present stage of development of the multilateral trading system be extremely expensive in terms of either trust or in more orthodox financial terms of costs and is therefore likely to be impractical. Hence the South view that all DCs should benefit from S&DT and there should be no "graduation". The significant issue here, which may help towards a resolution of this controversy, concerns how much extra costs if any, would developed countries have to bear if the S&DT provisions were not confined to least developed countries but were given to all developing countries. Would the costs of greater universality of S&DT provisions be prohibitively high for developed countries?

In a recent important World Bank study (Hoekman *et al.*, 2003) on the S&DT controversy, the distinguished authors argue: "Defining (agreeing to) the criteria to determine eligibility for S&DT lies at the heart of the S&DT debate. The experience to date suggests that the depth of the differential treatment granted will be inversely related to the number of eligible countries. Eligibility for S&DT should be restricted to fewer WTO member countries than is currently the case under the self-declaration

approach that is used to identify developing countries.” The authors however, do not provide any economic justification for their advocacy of selection rather than universality in the granting of S&DT treatments to DCs. Yet, this issue is central to the dispute. For if the cost of universality were zero or negative or even a positive number which was small, it would be difficult to maintain a case for selectivity in favour of simply the Least Developed Countries and small number of other similar countries, as suggested by Hoekman et al., 2003. For if universality has no net economic cost to the ACs, their insistence on selectivity would be regarded by DCs as simply a political device to create divisions among their ranks.

It is therefore, important in relation to the “graduation” issue to estimate the net costs and benefits to ACs of the international trading system which up to now has been mainly working on a universalist criterion of self-declaration as a DC in relation to S&DT matters.³¹ There are no studies which directly compare a universalist S&DT regime with a selective one. There is nevertheless, a large body of analysis and indirect evidence which bears on the issue of the costs and benefits of the present trading system to ACs. The relevant parts of this literature³² concerns the effects of North South trade in manufacture on labour market outcomes (in terms of unemployment, wage dispersion and de-industrialization) in the North. This literature is highly contentious, albeit more in terms of methodology than with respect to the results. Until recently, the general empirical conclusion of this body of research was that the ACs manufacturing trade with DCs during the 1980s was responsible for about 20% of the observed wage dispersion in the US. It was also thought to contribute to de-industrialization and unemployment on a similar modest scale.³³ Most of the observed negative changes in the labour market outcomes in the North have been ascribed to technology.

Most researchers accept the view that the proximate cause of labour market outcomes in the North, is the fall in the demand for un-skilled labour which is ascribed to either

³¹ There are parts of WTO agreements in addition to S&DT, where a reference to least developed group is made but such references are few and far between. Generally speaking, statement in the text is correct that the main beneficiaries of S&DT are supposed to be DCs.

³² For recent review of this literature see Slaughter and Swagel (1997), Atkinson (1999, 2000, 2001), Singh (2003), Gottschalk and Smeeding (1997).

³³ However, Wood (1994) regards North-South manufacturing trade to be a major cause of the adverse labour market outcomes in the North. For alternative perspectives see the references cited in footnote 32. See also Singh’s (1995c) review of Wood.

trade or technology. Prof. Sir Tony Atkinson (1999, 2000, 2001) refers to this common view as the transatlantic consensus, since it provides a unified explanation for both unemployment in Western Europe and inequality in income distribution in the US. It does so by making the auxiliary assumption that labour markets in Western Europe are highly imperfect because of the welfare state, so that reduced demand for unskilled labour leads to unemployment rather than reduced wages. However in the US, the flexible labour market prevents unemployment at the expense of unfavourable changes in wage distribution.

Be that as it may, the most recent research on the subject which covers the data for the 1990s produces radically different conclusions. It suggests that neither trade nor technology can explain the observed changes, either in income distribution in the US or in unemployment in Europe. Macroeconomic factors, unionisation and variables such as social norms have been deemed to be more important than either trade or technology, in explaining the observed changes in the 1990s.

Equally significantly, empirical studies of the effects of trade and technology on AC labour markets, do not take into account changes in terms of trade, which are connected with the trade with the South and which have a highly positive effect on the welfare in the North. To illustrate, the large devaluations that occurred in the crisis affected Asian countries as a consequence of the acute macro-economic disturbances in the region in the 1997 to 2000, did not cause serious difficulties for US industry as was expected. Instead, improvements in terms of trade helped reduce inflation in the US which enabled the Federal Reserve to run the economy at a higher level of output and employment than would otherwise have been the case.

The above analysis suggests that, provided import surges can be controlled by multilaterally agreed safeguard measures, there are unlikely to be significant net economic costs to ACs of allowing a universalist S&DT regime in DCs. In view of this, it is not surprising that the DCs view the AC emphasis on graduation and differentiation as being politically motivated and designed to create further divisions among the DCs. Since there is a vast gap between countries in their relative political and economic strengths, more divisions among developing countries would further

reduce their bargaining power in a uni-polar world, and lead to even greater imbalances between the North and the South.

To sum up, the North's insistence on graduation and differentiation is a mercantilist misconception from which it needs to be weaned away, so that attention can be focused on the real and substantive issues of the kinds of S&DT which would best help emerging countries.

XIII Trade, Finance and the Global Economy

While the attention of developing country policy makers is concentrated on the WTO and the Doha Round, much of the relevant action is taking place elsewhere - in the financial sphere. There is unfortunately no reprieve for developing countries in that sphere either from the pursuit of short-term economic advantage and mercantilism of the ACs. In some ways the situation is worse. As noted in Part I, in view of the high propensity to import of emerging markets, relaxation of the import controls via trade liberalization has been closely connected with balance of payments difficulties. These difficulties oblige these countries to seek financial liberalization. The experience of developing countries with financial liberalization during the last decade has been catastrophic. A vast literature has explored the theoretical and empirical reasons for the financial crises that have invariably followed financial liberalization rather than consumption smoothing which text book theory would predict.³⁴

The Bretton Woods institutions were established following the end of World War II in order precisely to reduce such instability in the global and national economies. In practice, the International Monetary Fund has shown no stomach for disciplining its most powerful members whose macro-economic policies often do collateral damage in developing countries³⁵. Indeed, the Fund has effectively been used by leading industrial countries exclusively as a way of disciplining the Third World. Advanced countries, over nearly the last two decades (specifically since the Plaza Agreement of

³⁴ For a fuller discussion and recent reviews, see Singh (2002), Stiglitz (2000), Feldstein (2002). However, for a defense of capital account liberalization see Summers (2000) and Fischer (1997).

³⁵ For example, the interest rate shock of the late 1970s, which was a consequence of major changes in US monetary policy in 1979 under the then Chairman of the US Federal Reserve Paul Volker. This had devastating consequences for developing countries leading eventually to the 'lost' decade of the 1980s in Africa and Latin America. See further Fishlow (1991) and Singh (1993).

1985), have maintained the minimum degree of economic cooperation between themselves so as not to provoke price wars through competitive devaluations and deflations which characterized the 1930s. This has left developing countries increasingly at the mercy of highly unstable financial markets. Recent research indicates that developing countries suffer from much greater instability than developed countries, and further that this phenomenon is not due to greater labour market rigidities in developing countries (as economic theory would suggest), but rather it is due to the nature of the financial systems in developing countries as well as fluctuations in developing countries' terms of trade³⁶.

Hence, developing countries require a special and differential treatment not just at the WTO but also at the IMF. Until the Asian crisis, what they were getting instead at the IMF were strong exhortations to liberalize not just their current accounts but also their capital accounts. In 1997, the IMF attempted to change its Articles of Agreement to make capital account liberalization one of the main objectives of the organization. The Asian crisis brought some restraint and pull-back from these proposals. Professor Stiglitz(2000) Nobel Laureate and former Chief Economist of the World Bank, found striking “the zeal with which the International Monetary Fund (IMF) had requested an extension of its mandate to include capital market liberalization a short two years earlier at the Annual Meetings in Hong Kong. It should have been clear then, and it is certainly clear now, that the position was maintained either as a matter of ideology or of special interests, and not on the basis of careful analysis of theory, historical experience or a wealth of econometric studies. Indeed it has become increasingly clear that there is not only no case for capital market liberalization, but that there is a fairly compelling case against full liberalization” (page 1076).

It is therefore not surprising that although there has been an intellectual retreat from the Washington Consensus policies by the Fund and the Bank(as noted in Part I), in practice it is widely felt that these policies haven't fundamentally changed but have simply been given a new name (for example, poverty reduction strategy)³⁷. Similarly, it is disappointing that, notwithstanding all the pious references to S&DT in the Doha Declaration, the ground reality is that any such considerations are being blatantly

³⁶ See further Easterly, Islam and Stiglitz (2000).

³⁷ For a strong re-affirmation of the Washington consensus policies see Aninat (2003)

ignored in the negotiations on services modalities which have recently been agreed. WTO's press note of 10 March, 2003 reports the following decisions of the Council for Trade and Services in relation to liberalization of services in developing countries.

13. Pursuant to the objectives of the GATS, as stipulated in the Preamble, Article IV, and Article XIX:2, and in line with paragraph 2 of the Doha Ministerial Declaration, these modalities shall be used inter alia as a means of promoting the economic growth and development of developing countries and their increasing participation in trade in services.

14. In the application of these modalities, and in recognizing and granting credit pursuant to these modalities, Members shall take fully into account the flexibility provided for individual developing country Members under the provisions referred to in paragraph 13 above, as well as the level of development of developing country Members in relation to other Members. Special consideration shall be given to the least-developed country Members.

There is clearly no new concept of S&DT here. The juggernaut of precipitate liberalization rolls on regardless of the anti-developmental effects that such liberalization entails for developing countries as suggested by the analysis in Part I of this paper.

In endorsing S&DT in glowing terms, the Doha Ministerial Meeting provided the international community with an opportunity to make the concept of Special and Differential Treatment meaningful and use it as an instrument to correct the structural imbalances between developed and developing countries. However, as the example of services above shows, no such new thinking is actually permeating the normal WTO processes. Liberalization of trade, whether in goods or services, without any assessment of the developmental consequences of such liberalization still seems to be the order of the day. However, unlike the trade in goods, precipitate liberalization in the banking and financial sectors of services carries with it serious dangers to the

stability of the economy. Before a country undertakes such liberalization it requires a well functioning regulatory mechanism to provide prudent regulations. Alexander (2003) has argued that in the rush to liberalize the banking and financial services of the WTO, these elementary but exceptionally important requirements of prudential regulation are being ignored.

This last point has recently been forcefully argued by Bhagwati and Tarullo (2003). They refer specifically to the US government's recent RTA with Chile and Singapore. The Bush administration has insisted that the two countries will not be permitted to use capital controls against American firms. This, the reader will recall, is the exact opposite of the effective Special and Differential Treatment that the United States offered after the war to the European countries. These countries, within the framework of the European payments union were able to discriminate against the US dollar in favour of the local currency.

Bhagwati and Tarullo observe:

'Since the Asian financial crisis of 1997-98 the IMF has changed its thinking and acknowledged the need for careful policies that monitor and, in some cases, regulate capital flows.

Yet now, just as the world has become saner in these matters, the Bush administration has insisted that the free trade areas for Chile and Singapore include provisions penalizing them for the use of any controls on capital. This short-sighted view marks a discouraging triumph of ideology over experience and good sense.'

The two authors are worried that the Bush administration may use these two agreements (with Chile and Singapore) as templates for other trade agreements, possibly including the Doha round.

XIV Conclusion: S&DT and Economic Development

The unequivocal endorsement of S&DT at Doha gives the international community a fresh chance to change course, to put economic development at the heart of the agenda for the current and future evolution of the multilateral trading system. In operational terms this would indicate not only that internationally agreed poverty reduction goals are met, but that a movement towards convergence in income and productivity levels with rich countries is regarded as a legitimate objective which poor countries shall have the right, and be provided with the opportunity and the ability to pursue. Taking development goals seriously in this manner would require a new definition and a new conceptualization of S&DT than the narrow meaning given to it under the Uruguay Round and the WTO Agreements. This new conceptualization of S&DT should satisfy the following broad concerns of DCs.

- (a) There are parts of WTO Agreements which do not advance the cause of development and, arguably, restrict it. Reference here is to TRIMs, TRIPs, Subsidies and Countervailing Duties, Anti-dumping and other similar measures³⁸. These Agreements need to be re-negotiated and, if they cannot be satisfactorily amended developing countries should have the right to opt out of these. Indeed, what is being suggested here is that in terms of Hoekman et al(2003) developing countries should be allowed to indulge in the cardinal sin of participating in the multilateral trading system on the basis of 'GATT a la carte' as it were.
- (b) Not only is it necessary to recognize the imbalances and anti-development character of the existing WTO Agreements but, equally importantly it is essential to ensure that S&DT of DCs is made a part and parcel of the liberalization of Services and of other areas, as well as in the consideration of new disciplines (eg. the Singapore issues) on which negotiations are

³⁸ For fuller discussion of how the various parts of the WTO Agreements disadvantage developing countries and discourage development see Third World Network (2001), Oxfam (2002)

taking place now or are likely in the foreseeable future. Again if DCs concerns on these issues cannot be met within the framework of existing Agreements they should be permitted to opt out.

The achievement of (a) and (b) above depends on the ACs being weaned away from their insistence on graduation and differentiation, which this paper has argued is a mercantilist misconception. Indeed, this entire programme of putting development at the centre stage in WTO negotiations requires a sea change in the culture and conduct of such negotiations which at present appears to be steeped in narrow mercantilism rather than any long-term vision of a trading system which benefits both rich and poor countries. The AC negotiators should not forget that trade is not a zero sum game, and their countries themselves provide an outstanding example of the success of non-reciprocity in international trade and finance. As suggested in Part I of the paper in the golden Age 1950-73 the farsighted economic policies of the US which sought long-term objectives rather than short-term gains were spectacularly successful in building up most of Europe and Japan as show pieces of liberal capitalism.

The challenge ACs face today is whether they are willing to take a similar long term view in their trade and financial relationships with developing countries and whether or not they will be able to overcome the narrow mercantilist outlook which demands reciprocity. The ball is squarely in the court of the ACs as only they have the economic power to determine the world economic priorities and agenda.

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