

THE MULTILATERAL TRADE REGIME: A GLOBAL PUBLIC GOOD FOR ALL?

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“[Like] putting a rabbit and a tiger in the same cage.”

—A Sri Lankan activist, when asked about
free trade between developing and industrial countries

International trade continues to be a defining feature of national development policies. But the breakdown of the World Trade Organization (WTO) ministerial conference in Seattle, Washington (United States), in 1999 and the difficulties (if not near failure) of the conference in Doha, Qatar, in 2001 highlight the strained relations among WTO members—at times polarized by a divide between industrial and developing countries.¹ Both critics (see, for example, Rodrik 2001; Third World Network 2001; OXFAM International 2002) and supporters (see, for example, Srinivasan and Bhagwati 1999; Ben-David 2001; Greenaway, Morgan, and Wright 2002) of international trade do not see trade itself as the problem. All agree that trade has the potential to benefit developing countries. But disagreements arise on the structure of arrangements for multilateral trade.

This chapter responds to this problem by reviewing the multilateral trade regime through the lens of the global public goods concept. The analysis suggests that the trade regime is a global public good in form but not substance. The regime is largely public in consumption, but the distribution of its net benefits is skewed in favor of industrial countries. Correcting this imbalance would not only be good for developing countries, it would also enhance the functioning and stability of the trade regime—benefiting industrial countries.

The first section of the chapter examines the evolution of the multilateral trade regime since 1947. During that time the trade regime has taken on the form of a global public good. Yet the regime’s increasing publicness has generated tensions between various groups of states as well as other stakeholders—notably in

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terms of questions about its fairness. The main issue is whether and to what extent all countries derive a net benefit from trade rules and mechanisms. The evidence presented in the second section indicates problems of fairness. Relative to industrial countries, developing countries—and especially the least developed countries—derive smaller benefits and incur higher costs from the trade regime. The third section proposes reforms that could correct this situation, making the multilateral trade regime a global public good in form and substance. The overarching reform is to recast trade negotiations and rules in a way that recognizes the primacy of national development policies and provides flexible support for developing countries. More specific reforms are suggested to make this approach operational. The conclusion presents the chapter's main messages.

THE MULTILATERAL TRADE REGIME: FROM CLUB GOOD TO GLOBAL PUBLIC GOOD

International regimes are often composed of rules and of organizational mechanisms to facilitate the negotiation and implementation of those rules. Today's multilateral trade regime is governed by the WTO, which was established in 1995 as the successor to the General Agreement on Tariffs and Trade (GATT). The GATT was created in 1947 but for nearly five decades functioned without a formal organizational arrangement.² Current multilateral trade rules are composed primarily of the GATT, the agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), the General Agreement on Trade in Services (GATS), and the Dispute Settlement Understanding (DSU).³ The WTO's main organizational elements include the Ministerial Conference, General Council, Dispute Settlement Body and Appellate Body, and Trade Policy Review Body (see Blackhurst 1998; Ruggie 1998; and Woolcock 1999).

An analysis of the regime fittingly begins with a description of its evolution over time. The analysis in this section covers both the "GATT period" and the "GATT/WTO" period. The discussion shows how membership in the regime has increased and become more diverse and how the issues covered by the regime have continuously widened.⁴

The trade regime from 1947 to today

The evolutions of the two international market systems—for trade and finance—are strikingly similar. In 1944, 45 countries created the International Monetary Fund (IMF) and World Bank, together known as the Bretton Woods institutions. Today these two institutions have 183 members and form the cornerstone of the international financial architecture. Similarly, the multilateral trade regime began in 1947 with 23 parties to the Protocol of Provisional Application of the GATT.⁵ If the 1947 GATT is considered a club, then club membership and club rules have changed dramatically since its inception.

Club membership. In 1948 the 23 original parties to the GATT accounted for 60 percent of world merchandise trade. By 1994, coupled with new trade agreements from the Uruguay Round of negotiations, the number of contracting parties had quintupled. Today the WTO has 144 member countries that account for more than 90 percent of world merchandise exports and imports.⁶

Membership has become far more diverse. More than 70 percent of WTO members are developing countries, yet more than 80 percent of world merchandise exports come from just 30 countries—indicating wide disparities in trading capacity (World Bank 2001, p. 21). In 1992 the dispersion in per capita GDP (measured by the coefficient of variation) for a sample of GATT member countries was 0.92, up from 0.61 for a sample in 1950 (figure 1). With the accession of about 40 developing countries since 1992 and the pending accession of 27 more, this pattern of highly differentiated trading capacities will likely become more pronounced.⁷

Club rules. The scope and depth of the original GATT were quite minimal, dealing only with some provisional rules and giving member countries the flexibility to select sectors for liberalization. But the eight rounds of negotiations over the GATT's more than 50-year history have covered increasingly larger volumes and more aspects (such as dispute settlement, technical barriers, and so on) of international trade. The 1947 GATT was eventually replaced by the expanded 1994 GATT.⁸ At the 1994 ministerial conference in Marrakech it was decided that the 1994 GATT, the TRIPS agreement, and the GATS would form the core legal

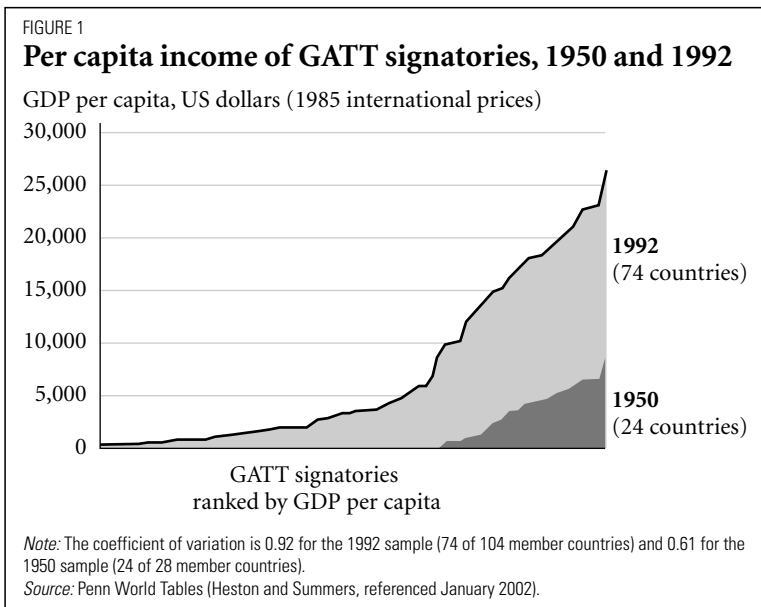


TABLE 1

Issues addressed by multilateral trade negotiations, 1947–present

Issue	First five rounds 1947–61 ^a	Kennedy Round, 1963–67 (62 countries)	Tokyo Round, 1973–79 (102 countries)	Uruguay Round, 1986–94 (123 countries)	World Trade Organization, 2002–present (144 countries) ^b
Tariffs	•	•	•	•	•
Customs duties		•	•	•	•
Antidumping		•	•	•	•
Agriculture		•	•	•	•
Subsidies and countervailing duties		•	•	•	•
Technical barriers to trade			•	•	•
Import licensing			•	•	•
Public procurement			•	•	•
Safeguards			•	•	•
GATT articles			•	•	•
Dispute settlement			•	•	•
Code on civil aircraft (subsidies)			•	•	•
Rules of origin				•	•
Preshipment inspection				•	•
Textiles and clothing				•	•

GATT functions	•	•
WTO (organizational issues)	•	•
Investment	•	•
TRIPS	•	•
Services	•	•
<hr/>		
Industrial tariffs		•
Regional trade agreements		•
Trade and the environment		•
Capacity building		•
Implementation issues ^c		•
“Singapore issues” ^d		?
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a. The first five rounds were the Geneva Round, 1947 (23 countries); Annecy Round, 1948 (13 countries); Torquay Round, 1950 (38 countries); Geneva Round, 1956 (26 countries); and Dillon Round, 1960–61 (26 countries).

b. As of January 2002.

c. Include, among other issues, further liberalization of textiles and agriculture (see http://www.wto.org/english/tratop_e/devel_e/d5prop_e.htm).

d. Include investment and public procurement (both of which were also covered by the Uruguay Round), competition policy, and trade facilitation. No formal decision has been made to start negotiations on these issues.

Source: Woolcock 1999, table 1.1; WTO 1999; <http://www.wto.org>.

ground rules for international commerce, facilitated by GATT's successor, the WTO. Under the single undertaking introduced in the Uruguay Round, member countries are to adhere to nearly these same rules. The next round of negotiations will cover even more aspects of international trade, further expanding this set of rules (table 1).

The Uruguay Round signaled a paradigm shift in the nature and structure of the trade regime. From being a minimalist set of agreements on reducing tariffs and nontariff barriers on traded goods, the regime grew to encompass both border and domestic issues for trade in both goods and services. The expanded GATT, together with the GATS, TRIPS agreement, and DSU, are now administered by the WTO, a full-fledged international organization with a mandate and vested authority to monitor and regulate specific trade matters. These changes have introduced a level of determinacy in the trade regime that was not present in the 1947 GATT.

Is the multilateral trade regime a global public good?

These changes in the scope and membership of the multilateral trade regime make it a global public good in form. The regime is available to a large group of member countries, and it has strong properties of nonrivalrous consumption and nonexcludable benefits.

In terms of nonrivalry, having more countries join the trade regime does not detract from the benefits to existing members. Common, established rules for trade can benefit all consumers and producers across countries and over time. In fact, having more members makes the regime's rules more valuable, increasing their legitimacy and credibility. This is especially important for the work of WTO units such as the Trade Policy Review Body and Dispute Settlement and Appellate bodies.

In terms of nonexcludability, there are two dimensions to consider: publicness of consumption and nonexclusivity (that is, potential openness to all countries). A number of WTO benefits are nonexcludable, with high publicness of consumption. For example, because the multilateral trade regime promotes a rule-based framework, it restrains inefficient protectionism and minimizes the probability of costly trade wars, both of which could disrupt international trade. The absence (or minimization) of these disruptions benefits all countries, members and nonmembers alike. Moreover, because the regime has a large (and growing) membership and covers a large (and growing) portion of international trade, its impact is likely to be significant and felt across all countries and regions. The regime's benefits (and costs) are available for the global public to consume—to some extent whether they choose to or not.

Furthermore, as more countries join, the portion of the market governed by the regime becomes larger and more diverse. Hence there are also benefits from network externalities and greater product variety (Funke and Ruhwedel 2001; Hummels and Klenow 2002; Rutherford and Tarr 2002). As a result better, cheaper

products are enjoyed by more consumers. But perhaps most important, trade provides many countries with important development and growth benefits.⁹ For all these reasons the rules of the club emphasize the expansion and nonexclusivity of membership, as long as new members accept existing rules.¹⁰

Tensions about trade between and within countries

Despite its properties as a global public good in form, the trade regime has started to see tensions arise on two main fronts. At the international level the dispersed development levels of member countries indicate varying capacities to combine participating in international trade with pursuing effective national development policies. There is growing concern in developing countries about the “bounced check” of the Uruguay Round, because industrial country markets continue to be highly protected—despite promises of greater access (Vajpayee 2001). Developing countries also often see themselves as “rule takers,” importing burdensome standards and regulations (such as the TRIPS agreement) that may not be compatible with their development policies (see Finger and Schuler 2001; Helleiner 2001; Ostry 2002; and Rodrik 2001).

Pressures have also increased within countries. There is growing awareness of the “social cost comparative advantage” of developing countries. As a result issues such as pollution-intensive manufacturing, unsustainable harvesting of natural resources, and child labor have resulted in a backlash (primarily in industrial countries) against “ecodumping” and “social dumping” (Birdsall and Lawrence 1999, pp. 132–42). Furthermore, the proliferation of nonstate actors in both industrial and developing countries has helped push for a broader agenda and more participatory trade negotiations. The increasing spread of democratic norms within countries has also created demand for their application at the international level, because many observers perceive the problems of globalization as stemming partly from this “democratic deficit.” This issue has become even more important with the WTO’s continued expansion into areas with a direct impact on domestic policymaking and lawmaking (see Helleiner 2001; Kennedy and Southwick 2002; Scholte, O’Brien, and Williams 1999; and Third World Network 2001).

Production of the multilateral trade regime—like production of all global public goods—requires national and international inputs, and the tensions above indicate that some of these inputs may be in jeopardy. Examples of national inputs for the trade regime include domestic trade policy reform, institutional capacity building, and provision of trade adjustment assistance and safety nets. International inputs include the 1994 GATT and other trade agreements as well as the WTO’s ministerial conferences and Dispute Settlement and Appellate bodies. How the international inputs are shaped (and to begin with, their existence or absence) critically determines, by supporting or hindering, each country’s capacity to provide national inputs. If a country’s welfare gains from trade are small or shrinking—due in no small measure to the structure of international trade agree-

BOX 1

DEVELOPMENT REQUIRES MORE THAN FREE TRADE

The move toward freer international trade has its roots in David Ricardo's classical theory of comparative advantage, which is driven by inherent differences in countries' capacity—and hence cost—to produce different products and services. But much has changed since Ricardo's 1817 world of Portuguese wine and British clothing. Today's trade patterns reveal that comparative advantage, on which specialization in production and trade is based, can no longer be taken as a given. Beyond inherent differences in factor endowments, possible sources of comparative advantage now include increasing returns to scale, product differentiation, and technological differences. Enhancing comparative advantage in retainable industries—those with high startup costs, making small-scale entry difficult—can lead to more gains from trade and robust economic development. In retainable industries, market forces tend to bolster the status quo, suggesting the need for active government support of domestic industries. This also implies that some protection may be required to nurture and develop comparative advantage in these industries.

Source: Antweiler and Trefler 2002; Dollar 1993; Gomory and Baumol 2000; Hummels and Levinsohn 1993; Leamer 1993; Tybout 1993.

ments, as shown in the next section—it faces an added constraint on its social, economic, and institutional adjustments related to trade. This point has not been adequately considered as the trade regime has expanded and evolved into a global public good, causing it to come under severe stress.¹¹

IS THE MULTILATERAL TRADE REGIME FAIR?

As with all goods, private and public, the multilateral trade regime is valuable only to the extent that it generates utility for its providers and users. Growing concern about its welfare effects on the different actors and stakeholders in trade is perhaps the unifying theme behind all the current tensions related to the regime. Developing countries in particular have reason to reevaluate the regime, taking into account the trade and development nexus that national and international policymakers have repeatedly emphasized.

Development and growth require more than just free trade—a costly lesson for many developing countries that have liberalized trade yet failed to reap its potential benefits (box 1). Making matters worse, these countries often face import-led consumption booms, appreciating real exchange rates (due to capital inflows), social dislocation, rising income inequality (between workers in export sectors and the rest of the population), and even deindustrialization (see

Wood 1995; Taylor 2001; and UNCTAD various years). Several fundamental questions have been raised about the multilateral trade regime: Do all countries benefit from trade? Is the trade regime balanced in terms of benefits and costs? Is the regime fair?

This section provides some preliminary answers to these questions. It first proposes some notions of fairness, then uses these to assess, in a tentative way, the fairness of the multilateral trade regime. Two aspects of the regime are examined. The first is whether and to what extent the projected outcomes of major Uruguay Round agreements benefit all regime members. The second is whether the regime addresses the main concerns of all country groups or whether it suffers gaps.

Measures of fairness

As Albin (in this volume) points out, the notion of fairness remains contested. Still, three aspects of fairness seem useful for evaluating the trade regime:

- *Neutrality.* Pareto efficiency is achieved if no individual can be made better off without making another individual worse off. If this notion of efficiency is recast as a notion of fairness, one could argue that the trade regime is fair in this limited sense—if it does not make any country worse off when it makes some countries better off. This minimalist or neutral notion of fairness requires, at the least, that the regime do no harm. Fairness, in this sense, would require that each country be at least as well off with the trade regime as it would be without it.
- *Net benefit for all.* One welfare-maximizing approach is to achieve the greatest good for all. Under this notion of fairness the multilateral trade regime (or its expansion) is fair if all member countries derive positive net benefits. In fact, if industrial countries were to benefit immensely from the regime through larger and faster-growing gains from trade (and leave behind developing countries in the process), the regime would still be fair in this sense if all countries were better off relative to the “no trade regime” scenario.
- *Maximin rule.* If the rules of the trade regime were chosen to maximize the gains to the least well-off member countries, the Rawlsian notion of fairness as process would obtain.¹² From the point of view of developing countries, particularly the least developed ones, fairness could reasonably mean nothing less than increasing net benefits from the trade regime—or alternatively, growth and development.

With these fairness measures, the chosen trade regime could be one that simply does not harm the progress of developing countries, implying a minimalist approach. Yet WTO policy statements suggest that the international community has chosen a more active approach to development. Under the WTO Articles of Agreement (WTO 1994, p. 9) all member countries recognize that “there is need for positive efforts designed to ensure that developing countries, and especially the least developed among them, secure a share in the growth in international

trade commensurate with the needs of their economic development” (see Bhagwati 1998; Kapstein 1999; and Shafaeddin 2000 for other discussions of fair trade). The next step is to evaluate the net benefits from specific agreements in the Uruguay Round—the building blocks of the trade regime.¹³

Projected effects of Uruguay Round agreements

The Uruguay Round negotiations, in essence, was intended to give developing countries increased access to the protected agricultural, textiles, and manufacturing markets of industrial countries—in exchange for introducing agreements on investments, intellectual property rights, and trade in services, which primarily benefited industrial countries through increased rents and market access (see Ostry 2002). Measuring the cross-country distribution of the gains from this bargain would be a considerable task, requiring a cost-benefit examination of all the agreements. To keep the task manageable, the analysis here compares the welfare gains from all the agreements that were supposed to benefit developing countries (that is, the agreements requiring agricultural, textiles, and manufacturing reforms) with the costs of just one agreement that primarily interested some industrial countries (the agreement on TRIPS). The analysis shows that the projected net benefit is negative for developing countries (see McCalman 1999 for a similar analysis).

The likely cost for developing countries of the TRIPS agreement. Although the full implications of the TRIPS agreement—in terms of access to technology, transfers of rents, and changes in prices of patented products—will not be apparent for some time, some estimates of potential outcomes are available. If the TRIPS agreement were fully implemented, annual net rent transfers to the five main technology-creating countries (France, Germany, Japan, the United Kingdom, and the United States) alone would be about \$38 billion in 2000 dollars (World Bank 2001, table 5.1).

What developing countries might gain in agriculture, textiles, and manufacturing. Harrison, Rutherford, and Tarr (1996) present one of the few disaggregated studies of the welfare impact of the Uruguay Round across regions. In their base (constant returns to scale) model they project that complete implementation of agricultural, textiles, and manufacturing reforms in both developing and industrial countries (based on the trade agreements negotiated) would provide developing countries with annual welfare gains of about \$18 billion in 1992 dollars, or about \$22 billion in 2000 dollars (table 2). Using a static increasing returns to scale model, developing countries’ annual projected gains are about \$24 billion, while under a steady-state increasing returns to scale model they are about \$68 billion (in 2000 dollars).¹⁴

Net gains for developing countries. Assuming that full implementation of the TRIPS agreement would cost developing countries \$38 billion (excluding the additional costs of price increases and implementation), a back-of-the-envelope calculation shows that under the base model the Uruguay Round causes a net annual loss of \$16 billion for developing countries. Under the static increasing returns to scale model, developing countries stand to lose about \$14 billion, while under the steady-state model they stand to gain \$30 billion (see table 2).

TABLE 2

Projected annual effects of full implementation of trade-related agriculture, textiles, and manufacturing reforms agreed to under the Uruguay Round

(billions of U.S. dollars)

Region/country group	Base model		Static increasing returns to scale model		Steady-state increasing returns to scale model	
	1992 dollars		1992 dollars		1992 dollars	
Sub-Saharan Africa	-0.4		-0.3		-0.7	
Middle East and North Africa	-0.4		-0.3		1.5	
Eastern Europe and former Soviet Union	-0.4		-0.2		1.2	
South Asia	3.3		3.7		6.7	
	1992	2000	1992	2000	1992	2000
	dollars	dollars	dollars	dollars	dollars	dollars
World	92.9	114.0	96.0	117.9	170.6	209.5
Industrial countries	75.2	92.4	76.6	94.1	115.4	141.7
Developing countries	17.7	21.6	19.4	23.8	55.2	67.8
	2000 dollars		2000 dollars		2000 dollars	
Effect of Uruguay Round on developing countries	21.6		23.8		67.8	
Cost of TRIPS agreement	38.0		38.0		38.0	
Net effect on developing countries	-16.4		-14.2		29.8	

Note: Calculations for 2000 data assume an average U.S. inflation rate of 2.6 percent.

Source: World Bank 2001; Harrison, Rutherford, and Tarr 1996, tables 8.2, 8.6, and 8.7.

Harrison, Rutherford, and Tarr (1996) also forecast some scenarios for developing regions in which Sub-Saharan Africa, the Middle East and North Africa, and Eastern Europe and the former Soviet Union would lose out even without the TRIPS agreement. Sub-Saharan Africa suffers losses in all three models, ranging from \$0.3–0.7 billion in 1992 dollars. The authors attribute some of these losses to worsened terms of trade for net food importers and to inefficient developing country producers (of textiles and clothing) losing market share. If these countries had to comply with the TRIPS agreement under these conditions, there would be little reason to expect any net benefits.¹⁵

In analyzing these results, several points are worth noting. First, industrial countries' annual gains—ranging from \$92–142 billion in 2000 dollars—may be misleading under the common mercantilist notion of “concessions” because most of the gains are due to reductions in these countries' protectionist measures. Second, the gains of developing countries (without the TRIPS agreement) range from about a quarter (under the base and static models) to half (under the steady-state model) those of industrial countries—reasonably high given that developing countries accounted for only about a quarter of global trade at the time of the Uruguay Round. Third, these simple country groups mask the fact that a small group of developing countries receive most of the gains. Of the \$17.7 billion a year that developing countries gain in the base model, \$4.6 billion goes to the Republic of Korea, while China, Indonesia, Malaysia, the Philippines, Singapore, and Thailand together gain about \$8.6 billion. Finally, net rent transfers from developing countries could be lower since some industrial countries could also be net importers of technology. Further research is required to ascertain the exact cost of the TRIPS agreement for the developing world.

Still, it is clear that some developing countries, such as those in Sub-Saharan Africa, are projected to receive negative net benefits from agricultural, textiles, and manufacturing reforms. In addition to their rent transfers, Sub-Saharan countries will also likely be more adversely affected by the TRIPS agreement, given the HIV/AIDS epidemic in that region.¹⁶ And as the base and static models show, developing countries as a group could lose out in the short run, using the preliminary figure on net rent transfers.

These numbers are not conclusive by any means and are quite sensitive to modeling assumptions and revisions in implementation schedules. For instance, for most developing countries implementation of the TRIPS agreement has already been delayed until 2006 (and until 2016 for the least developed countries). In addition, liberalization of industrial countries' agriculture and textiles sectors has fallen short of expectations (World Bank 2001).¹⁷ Still, these figures are useful indicators that the current multilateral trade regime, largely formed during the Uruguay Round, likely fails the neutrality (minimalist) measure of fairness. Its projected effects appear to be loaded against developing countries. (See Perroni 1998 and World Bank 2001 for an overview of other modeling results.)

TABLE 3

Variance in the growth rates of terms of trade, by region and country group, 1980–97

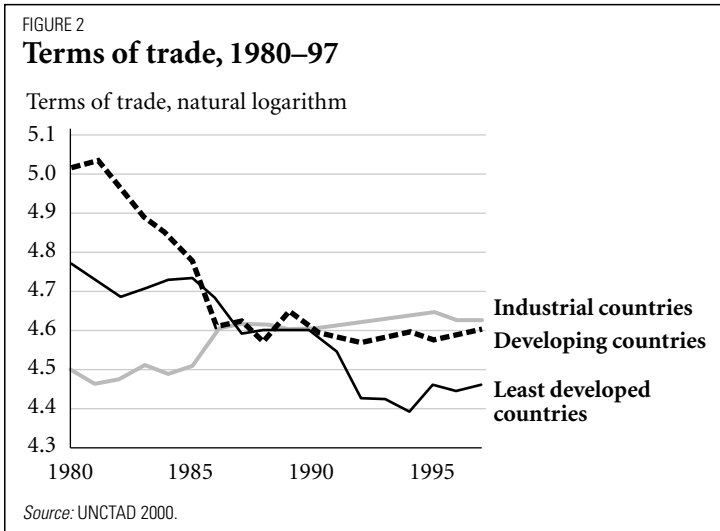
Variance	Region/country group
0.0308	West Asia
0.0299	Major petroleum exporters
0.0204	Oceania
0.0199	North Africa
0.0083	Africa
0.0038	Asia
0.0034	Other Africa
0.0030	All developing countries
0.0030	Non-major petroleum exporters, major exporters of manufactures
0.0028	Americas: non-major petroleum exporters, non-major exporters of manufactures
0.0026	Other Asia
0.0026	Other Asia: non-major petroleum exporters, non-major exporters of manufactures
0.0025	All heavily indebted countries
0.0022	Americas
0.0021	Non-major petroleum exporters, non-major exporters of manufactures
0.0021	All least developed countries
0.0018	West Asia: non-major petroleum exporters, non-major exporters of manufactures
0.0015	Non-major petroleum exporters
0.0014	Africa: non-major petroleum exporters, non-major exporters of manufactures
0.0008	All industrial countries

Note: Except for the last row, all regions and country groups refer to developing countries. Countries may belong to more than one country group.

Source: UNCTAD 2000.

Protection against trade shocks: a gap in the regime

The pattern of a country's terms of trade is a good indicator of its welfare gains from trade over time. Many developing countries' terms of trade—and hence their gains from trade—are volatile and shrinking, not necessarily because of faulty development policies but more likely because of international trade patterns beyond their control. For instance, developing countries in West Asia,¹⁸ Oceania, and Africa, as well as major petroleum exporters, are exposed to more trade shocks—as implied by the relatively high variance in the growth rates of their terms of trade (table 3).¹⁹ This fact, coupled with their growing trade as a share of GDP and in the context of low per capita incomes, leaves these countries extremely vulnerable. This vulnerability was evident in the aftermath of the 1997–98 finan-



cial crisis on the Asian countries and the effects of the commodity terms of trade shocks on the African countries in the late 1990s (UNCTAD, *Trade and Development Report 1999*).

The vulnerability of developing countries is even clearer from the direction of their terms of trade over time. Since the mid-1980s industrial countries' terms of trade have improved dramatically (figure 2). As a result developing countries—specifically the least developed countries—have seen their terms of trade decline, shrinking their gains from trade.

Are developing countries as likely to face such terms of trade shocks inside the trade regime as they would outside it? That is, does the trade regime pass the neutrality notion of fairness? (Recall that this notion of fairness requires that the country be at least as well off with the regime as without it.) While the counterfactual is difficult to ascertain, it is reasonable to expect terms of trade shocks to be just as prevalent without the trade regime as long as these countries remain exporters of primary products. In this sense the trade regime passes the minimal fairness condition of neutrality.

Over time, however, unabated terms of trade decline and volatility shrink developing countries' gains from trade and weaken their development prospects (UNCTAD, *Trade and Development Report 1999*)—violating the two other notions of fairness defined above. If the multilateral trade regime is intended to promote development and ensure conditions under which all member countries share in the benefits of international trade, one could reasonably argue that the regime should include mechanisms—such as international trade agreements or financing facilities—that help developing countries deal with terms of trade shocks more effectively. Such issues have not been dealt with effectively in trade

negotiations and can be seen as gaps in the regime. (See Conceição in this volume for more empirical data on the adverse effects of terms of trade shocks, particularly on developing countries.)

Hence the evidence indicates that the multilateral trade regime is imbalanced in terms of its benefits and costs. Judging from the main agreements under the Uruguay Round, the trade regime appears to fail even the minimal neutrality notion of fairness. That these imbalances have not been corrected indicates underprovision of this global public good (box 2).

The vulnerability of developing countries to terms of trade shocks—coupled with the lack of adequate mechanisms to respond to such shocks—also indicates underprovision of the trade regime as a global public good. Under these conditions the trade regime passes the minimal neutrality notion of fairness but probably fails the two others. To the extent that developing countries' development concerns are not adequately reflected in the design of the trade regime (and its underlying decisionmaking process), this is also proof of malprovision.

MAKING THE TRADE REGIME A GLOBAL PUBLIC GOOD IN FORM AND SUBSTANCE

These imbalances show that the multilateral trade regime is fast advancing as a global public good in form (due to its increased membership and broader scope) but is lagging in substance (due to the imbalanced welfare gains from trade). This explains why developing countries advocate a fair trade regime. But why would all countries necessarily want to pursue a fair regime?

BOX 2

WHY DID DEVELOPING COUNTRIES JOIN THE WORLD TRADE ORGANIZATION?

Beyond the concessions (such as longer timetables to implement reforms) and the promised support (for example, for capacity building and technology transfers) that come with WTO membership, many developing countries have based their development strategies on outward-oriented trade policies—part of a broader approach heavily promoted by the World Bank and International Monetary Fund. And the multilateral trade regime, however flawed, is likely preferable to unilateral actions by industrial countries. Nevertheless, developing countries probably overestimated the improved market access and underestimated the compliance and implementation costs resulting from the Uruguay Round.

Source: Finger and Schuler 2001; Ostry 2002; Taylor 2001.

Beyond the policy statements by WTO member countries seeking to promote development through trade—on which developing countries can legitimately anchor their demands for a fair trade regime—the regime requires *ex ante* and *ex post* fairness in order to be stable. *Ex ante* fairness in processes and procedures (trade negotiations, dispute settlements, and so on) is needed because it underpins trade-related reforms, which are key national inputs for this global public good. For instance, if a proposed agreement on competition policy would affect policymaking (and lawmaking) in developing countries, those countries should have a say on how (and whether) it is drafted. Such participation would make for a better agreement (if one is drafted), since all possible policy options are more likely to be considered, and would bolster each country's commitment to the reforms needed for that agreement.

Ex post fairness in outcomes is also important because defection is always a possibility. Evidence of this comes from the past experiences of Brazil and South Africa—and the more recent experiences of Canada and the United States—with the TRIPS agreement, as well as the growing disappointment in trade outcomes from the Uruguay Round.²⁰ As noted, trade outcomes (that is, welfare gains) largely determine each country's capacity to provide inputs for this global public good. Imbalanced outcomes can therefore jeopardize these inputs. Thus the trade regime should be reevaluated over time, in light of emerging information on the gains from and development impact of trade.

Appropriate provision of this global public good requires a better balance between constructing a free trade regime and a fair trade regime, with a fair regime promoting a more equitable distribution of the gains from trade, including those that directly bolster development policies. To bring this about, two areas of reform have already received significant treatment in the literature: the need to rebalance the results of the Uruguay Round, primarily through liberalization of agriculture and textiles markets in industrial countries (Finger and Schuknecht 2001; Hertel and Martin 2001; Ostry 2002), and the need to bolster developing country participation in the WTO (Helleiner 2001; Shafaeddin 2000; Third World Network 2001). The first reform responds to the underprovision of this global public good, while the second responds to its malprovision at the decisionmaking stage. (See Chasek and Rajamani in this volume for a discussion of developing country strategies to enhance their bargaining power and the effectiveness of their participation.)

However, through the lens of global public goods these reforms alone will likely prove insufficient. Even with the liberalization of agriculture and textiles markets, many developing countries may still be left out—if not harmed outright, as shown earlier. Furthermore, the bargaining framework is a limited vehicle from which to construct a more development-oriented trade regime. Improved bargaining capacity for developing countries does little to change this fact (Mendoza and Bahadur forthcoming).²¹ Appropriate recognition of the basic flaws in the

bargaining framework is missing in much of the trade discourse; yet some economists—notably Helleiner (2001) and Rodrik (2001)—have begun to hint at this by calling for the primacy of development goals in viewing trade issues, instead of the other way around.

The following recommendations on safeguards, additional foreign aid, and Rawlsian policies are presented to elicit further discussion. To facilitate a clear outline of policy options, each reform is linked to one of the fairness notions established earlier. What surfaces is a hierarchy of reforms that progressively bring about a fairer multilateral trade regime.

Safeguards: minimizing the negative impact of trade on development

Perhaps the first building block toward a fair trade regime would be to establish safeguards to help protect particularly vulnerable countries from adverse impacts from international trade. This move would ensure the minimal notion of fairness discussed earlier: neutrality. In essence, this responds to the declining net benefits from trade by limiting the “cost” side.

To illustrate, think of the trade regime as a national public highway used by both car drivers and bicyclists. Providing space for a bike path would protect bikers from being run over by cars. Some of the special and differential treatment clauses in WTO agreements—such as lower obligations and more flexible implementation timetables for developing countries—can be seen as serving this purpose. The GATT also includes language on economic development and infant industry protection that enables developing countries to opt out of many provisions (see Article XVIII on Special and Differential Treatment and GATT Part IV on Trade and Development). But both types of protections have proven inadequate. (See Birdsall and Lawrence 1999 and Michalopoulos 2000 for discussions of special and differential treatment issues.) The proposal by Rodrik (2001) to recast the Agreement on Safeguards (pursuant to Article XIX of GATT 1994) into a broader Agreement on Development and Social Safeguards could be a more effective “bike path” for developing countries and should be studied further.

Income transfers: ensuring net benefits for all

The process of specialization in the Ricardian world is supposed to produce an optimal collective outcome as world production increases well beyond autarkic levels. But in the real world this process is far from automatic and painless, generating social costs that are much higher among developing countries. Their benefits from trade are also likely to be smaller, due to their various capacity constraints mentioned earlier. Indeed, some least developed countries were projected to lose out, on balance, from the Uruguay Round.

With national public goods, winners normally compensate losers so that welfare levels increase for all. Ensuring gains from trade for all member countries—the second notion of fairness identified above—is therefore a similar concern.

Within each country, adjustment assistance programs (such as trade adjustment assistance and the National Emergency Grants programs in the United States) serve this purpose of ensuring that adversely affected sectors also gain, by enhancing the competitiveness of those sectors or facilitating the adjustment of individuals in those sectors to transfer to other, more competitive sectors. But in the international context of trade, there is no such income transfer arrangement across countries, and the closest—and imperfect—equivalent is foreign aid.

As a means to build capacity for better interface with the multilateral trade regime, foreign aid could help increase developing countries' gains from trade in the long run, and so should not be readily discounted. In the short run an additional justification for income transfers could be to temporarily assist and partly compensate commodity exporters for the decline in their export earnings. Cheaper commodities, after all, amount to a net welfare transfer from commodity exporters to commodity importers. The failure of commodity export boards in the 1960s and 1970s, the ineffectiveness of IMF lending facilities (such as the Compensatory Financing Facility), and the limitations of other market-based approaches—such as the commodity price insurance proposed by the International Task Force on Commodity Risk Management in Developing Countries²² and the fair trade movement²³—underscore the need to explore this income transfer option. Such an arrangement departs from the traditional motivation for aid, and so should not crowd out existing aid. This income transfer can be thought of as a sort of compensation for agreeing to more international trade integration, which has declining and more volatile commodity prices as inevitable features.

While helpful, foreign aid and safeguards for developing countries still constitute a relatively neutral stance on growth and development. If increased participation in the multilateral trade regime is intended to promote the development of the least developed member countries, a more active stance is required. The objective is not just to protect the bicyclists in the short run, but also to ensure that they eventually become car drivers in the long run—responding to the net benefits issue by boosting the “benefit” side.

Rawlsian policies: ensuring development

The development of comparative advantage—that is, developing supply capacity (Shafaeddin 1994) and nurturing retainable industries (Gomory and Baumol 2000)—is one of the primary challenges for developing countries, particularly the least developed ones, that hope to eventually diversify out of commodity exports.²⁴ Such strategies would enable them to permanently respond to terms of trade shocks, increase their gains from trade, and, most important, generate more robust growth.

Such development strategies are difficult enough without giving up policy maneuverability in the context of the trade regime. Rawlsian measures that preserve—and even enhance—policy maneuverability could therefore be under-

taken. One such measure would be continuing the Generalized System of Preferences (GSP), of which the EU Everything but Arms initiative is a good example. Expected to increase the revenues of least developed countries by 10 percent and trade from Sub-Saharan Africa by 14 percent (World Bank 2001, p. 162), this initiative will be an important first step in supporting developing countries' transition from "bike" to "car."²⁵

More generally, the key to a development-oriented approach would lie primarily in ensuring sufficient policy maneuverability for developing countries to generate innovative development policies and foster the initial conditions for robust development that are not likely to occur under *laissez-faire* approaches and that ultimately are more crucial than trade liberalization alone (see Gomory and Baumol 2000; Hausmann and Rodrik 2002; and Rodrik 1999).²⁶ This approach is not unreasonable, as industrial countries enjoyed considerable maneuverability in their earlier stages of development (see Chang 2002 for a detailed historical discussion on this point). And even with their higher development levels today, these countries have occasionally reclaimed policy maneuverability. For example, after several cases of anthrax were reported in the United States in the fall of 2001, Canada and the United States considered compulsory licensing of the generic equivalent of Cipro, the antibiotic. If industrial countries sometimes require policy maneuverability, shouldn't developing countries be granted the same leverage—if not more?

To operationalize this Rawlsian approach, a trade and development review mechanism could be incorporated into the multilateral trade regime. Additional pro-development policies that enhance policy maneuverability could also be pursued.

A trade and development review council. Preserving policy maneuverability is admittedly a somewhat vague notion. *Ex ante*, it would be difficult to tell which agreements (and which of their aspects) would hamper development policies. Experience from the TRIPS agreement and the way it constrained policy responses to HIV/AIDS showed that the development impact of some agreements could become evident only over time. How would policy maneuverability be legitimately reclaimed as such?

One solution would be to create a trade and development review council in the WTO to allow developing countries, individually or collectively, to make the case for possible reforms in the trade regime. Such a review mechanism could help assess the impact of trade-related issues that now plague developing countries (such as terms of trade shocks) and facilitate policy responses. Thus it could prove invaluable in enabling member countries to fill in gaps in the regime that may not have been covered during negotiations. Such a facility could also enable member countries to fine-tune the trade rules, in order to more appropriately take account of specific country conditions.²⁷

More important, this demand-driven review mechanism could facilitate an immediate response to trade-related development crises.²⁸ Certainly, any proposal brought to this member-constituted panel for peer review would need to be agreed to by all WTO members, under a transparent and participatory process. Hence it could also serve the important function of providing a safety valve for the multilateral trade regime. Whether the facility responds in the context of the trade regime (as it probably would with terms of trade shocks) or whether it calls on other international organizations for a more coordinated effort (as it might with labor or environmental issues), its key advantage would be that development and trade concerns would be adequately and appropriately deliberated based on their merits.²⁹

Additional pro-development policies. The WTO discipline could prove useful from a political economy vantage point if it binds developing country governments to sound and consistent development strategies. But in the absence of such strategies, this same discipline would amount to nothing more than a self-inflicted constraint on policy maneuverability, amplified by internationally binding agreements. Immediately bringing all these countries within the expanding discipline of the WTO could therefore prove detrimental to their development, particularly if the tail (trade policy) starts wagging the dog (development policy).

It is in this light that further expansion of the trade regime into “beyond-border issues” (such as “Singapore issues” and labor standards) must be slowed and reviewed more carefully. Instead, development policies can be bolstered by certain measures in the WTO, including but not limited to the following proposals:

- Subsidies implemented by developing countries are part of their arsenal of development tools, and should not be removed nor limited.
- The transfer of technology provisions under the TRIPS agreement (articles 7, 8, and 66.2) need to be operationalized to improve developing country access to needed technologies (Third World Network 2001).

CONCLUSION

As Sandmo (in this volume) explains, an extension of the public goods concept in the international setting reveals that efficiency and equity cannot simply be disentangled. Perhaps for no global public good is this truer than the multilateral trade regime. Trade is inherently redistributive, as specialization triggers intra- as well as international adjustment by consumers and producers. Throughout this process, developing countries increasingly find themselves caught between shrinking gains from trade and decreasing policy maneuverability—a combination that is anathema to robust development.

The WTO meetings in Seattle and Doha and the growing backlash against globalization indicate that the future of the trade regime rests on a more equitable

distribution of gains from trade between and within countries. For developing countries the development impact of trade is a primary concern. Hence the provision of this global public good is more properly seen as striking a better balance between a free trade regime and a fair trade regime. Bargaining and negotiations are inherently poor vehicles for accomplishing such a task. A combination of a more balanced trade negotiations process and more development-focused policies and mechanisms in the WTO may be more effective. Certainly, opt-out clauses are needed to protect developing country gains, and additional foreign aid can be used to help build capacity in developing countries (as well as partly compensate them for the costs related to this regime).

But these policies alone might not be enough. To reconcile WTO member countries' proclamations on trade and development with the realities of international trade, Rawlsian policies that actively advance development need to be investigated. Perhaps as a start, industrial and developing country policymakers should reexamine the totality and the components of the multilateral trade regime under the fairness notions introduced earlier, to determine which level of fairness is in effect—and more important, which level they are willing to pursue. If such reforms are not accomplished, expectations for the trade and development nexus—as well as optimistic forecasts on the integration of international goods and services markets—need to be ratcheted downward, if only to defuse some of the tensions on the trade regime.

“Trade theory is not a guarantee of Santa Claus gains for all. Its classical and neoclassical versions do preclude *losses for all*. Still, the winds of economic history can warm some and freeze others with no regard for *distributive justice*” (Samuelson 2001, p. 1209). The stability of the multilateral trade regime will hinge on a more balanced distribution of benefits from this global public good. Ultimately, only a regime that promotes both free and fair trade will endure.

NOTES

1. Though trade talks in Doha were scheduled to conclude on 13 November 2001, “green room” meetings were held well into that night to hammer out an agreement (Reddy 2001).

2. That is, the GATT is a set of rules, with no institutional foundation, applied on a provisional basis. The WTO is a permanent institution with a permanent framework and its own secretariat. (<http://www.wto.org>)

3. These rules form the core of the multilateral trade regime. Other parts of the regime include the agreement on trade policy reviews and agreements on plurilateral trade (such as those on civil aircraft and government procurement) not signed by all WTO members (<http://www.wto.org>).

4. The discussion in this chapter focuses on the multilateral trade regime as embodied by the WTO. Other analysts refer to this as the “multilateral trading sys-

tem” or the “WTO trade regime.” Note that the multilateral trade regime does not cover every aspect of international trade, nor does it cover regional trade agreements. Although regional trade agreements are important, they are beyond the scope of this chapter. Throughout the chapter, the term *trade regime* refers to the multilateral trade regime.

5. The 1947 GATT followed directly from the unsuccessful attempt to establish an international trade organization at the UN Conference on Trade and Employment held in Havana, Cuba, in 1947.

6. Technically, some members are customs territories, but for brevity this chapter refers to all members as countries.

7. Comparable data from the Penn World Tables (Heston and Summers, referenced January 2002) end in 1992. The author’s calculation of 1999 per capita GDP data (in purchasing power parity terms) from the World Bank (Data and Statistics, referenced January 2002) for 122 WTO members resulted in a coefficient of variation of 1.02.

8. GATT is an international agreement on trade in goods as well as an ad hoc international agency created later to support the agreement. It was never ratified in the parliaments of its contracting parties; and it contained no provision for the creation of an organization. GATT no longer exists as an agency—it was replaced by the WTO, a more formal international organization, after the Uruguay Round. The WTO has an expanded mandate that includes reviewing trade policies and a stronger role in settling trade disputes (see http://www.wto.org/english/res_e/doload_e/tif.pdf).

9. “The multilateral trading system...has contributed significantly to economic growth, development and employment throughout the past fifty years. We are determined...to maintain the process of reform and liberalization of trade policies, thus ensuring that the system plays its full part in promoting recovery, growth and development” (Doha Ministerial Declaration, 20 November 2001, p. 1; see http://www.wto.org/english/thewto_e/minist_e/min01_e/mindecl_e.htm).

10. At the micro level the regime is nonexcludable among member countries’ producers and consumers, all of whom share in its benefits and costs to varying degrees. At the international level the regime is made conditionally nonexclusive for nonmember countries, because the terms of accession can be considered membership fees. But nonmembers are actively being encouraged to join, particularly by the Group of Eight (G-8) countries and by the World Bank and International Monetary Fund. For instance, the accessions of Mexico and Morocco were supported with World Bank lending (Hoekman and Kostecki 1995, p. 52).

11. Trade agreements reflect the commitment of member countries to WTO rules and their intention to subject themselves to WTO discipline. National policies implemented in light of these agreements (whether because the policies were required by the agreements or were affected nonetheless) are important inputs for the trade regime. In a way national and international inputs cannot be disentangled. International rules are useful only to the extent that they are complied with in light of national policies.

12. According to philosopher John Rawls (1999), the principles of justice as fairness are those that would be selected from a detached viewpoint. Rawls argues that individuals are risk averse and that, if they were not certain about their position in society, they would opt for a welfare criterion that departs from perfect equality only if the worst-off individual under an unequal utility distribution would be better off than under equality.

13. Adverse outcomes from trade may also result from bad policies or from purely exogenous factors (such as weather) unrelated to the trade regime. Hence it is important to distinguish the rules and institutions of the game (the trade regime) from the game itself (trade).

14. Harrison, Rutherford, and Tarr (1996) quantify the impact of the Uruguay Round based on four reforms: reduced tariffs on manufactured products, tariffication of nontariff barriers in agriculture as well as binding commitments to reduce agricultural protection, reduced export and production subsidies in agriculture, and elimination of voluntary export restraints and the Multifibre Agreement. Their base model is a comparative static model based on constant returns to scale. Their static increasing returns to scale model introduces scale economies at the plant or firm level across several sectors. Their steady-state increasing returns to scale model accounts for dynamic gains from trade due to scale economies, in the presence of imperfect competition. Unlike other studies, theirs bases counterfactual simulations on actual reform commitments, and their more disaggregated model offers better insight into regional effects.

15. In addition, Page and Davenport (1994) argue that exporters of primary goods would not only lose the preferential terms on their few nontraditional primary and manufacturing exports, they would also lose any possible future preferences to help them break into foreign markets. This trend has been reversed somewhat with the renewed discussion on special and differential treatment and the Cotonou waiver, successfully negotiated by the 78 African, Caribbean, and Pacific countries as a deal breaker at the WTO conference in Doha.

16. A year's supply of patented HIV/AIDS antiretroviral drugs costs \$10,000–12,000 in industrial countries, while their generic versions sell for \$350 in developing countries. Once the TRIPS agreement is implemented, patents are expected to increase drug prices in some developing countries by 12–68 percent (see World Bank 2001; Fink 2000; Watal 2000; Lanjouw 1997; and Subramanian 1995). In addition, the administrative costs of developing a patent system that complies with the agreement—that is, the costs of setting up the system, training personnel, and creating the capacity to manage records—could cost between \$250,000 and \$1.2 million per country (UNCTAD 1996). Finger and Schuler (2001) provide much higher estimates of broader Uruguay Round compliance costs: \$150 million a country.

17. The Uruguay Round Agreement on Agriculture left broad margins for continued subsidies, while much of the liberalization due to the Agreement on Textiles and Clothing (ATC) has been slowed and back-loaded.

18. West Asian countries include Bahrain, Cyprus, and Jordan, among others. For a complete list of countries in each region, see UNCTAD (2000, pp. 2–8).

19. This discussion refers to the “net barter” terms of trade, defined as the ratio of the export unit value index to the import unit value index.

20. Potentially violating the TRIPS agreement, Brazil and South Africa explored options to manufacture cheaper versions of HIV/AIDS drugs.

21. Mendoza and Bahadur (forthcoming) argue that the bargaining framework is inherently unequal (given unequal bargainers) and usually characterized by coercion, incentives to overload the negotiating agenda, and flawed agreements in the context of cross-bargaining.

22. The task force’s proposal focuses on price risk, though not income protection; alleviates short-term price fluctuations but not declining price trends; and covers only some commodities (<http://www.itf-commrisk.org/>)

23. This refers to efforts by organizations such as the Max Havelaar Foundation, Cafedirect, and Kuapa Kokoo (a Ghanaian cocoa cooperative) to develop a niche in the commodity market that ensures minimum prices for producers. But these organizations’ purchases are quite minimal (Cowe 2002).

24. On this point the debate has also begun to shift in focus from terms of trade between primary commodities and manufactures to relative movements in the prices of manufactures exported by developing relative to industrial countries. See UNCTAD’s *Trade and Development Report 2002* for a discussion.

25. In its present form this initiative is still limited—with some critics referring to it as “everything but farms.”

26. In addition, Jones (2000) argues that in the presence of factor mobility (such as capital flows), a comparison of government policies will have a first-order effect on where that factor locates itself. Government interventions, such as subsidies, may be welfare enhancing even in competitive settings (p. 140). Moreover, Wood and Ridao-Cano (1999) provide evidence that more openness might actually widen country differences in skill stocks, increasing divergence in per capita incomes.

27. This proposal differs from the existing WTO Committee on Trade and Development, which discusses and monitors trade agreements rather than filling gaps in WTO rules. Focusing broadly on improving the governance of the WTO, Ostry (2001) makes a similar proposal to establish a policy forum or executive committee that would study and foster comprehensive structural reform. In the same vein, Helleiner (2001) advocates an immediate independent review of the content, implementation, and development consequences of existing trade agreements.

28. Decisions made for individual countries could also be seen as setting precedents.

29. There are obviously many more issues to consider for this proposal to differ from the current process. One key issue for further discussion would be how to strike the appropriate balance between a technocratic approach (as in the dispute settlement process) and a more democratic (bargaining) approach. But discussing and facilitating policies on trade and development issues outside normal trade negotiations would be a welcome change in and of itself. In the longer term this review facility could

decouple the most pressing development issues from traditional trade negotiations, preventing legitimate development-related issues from being treated as bargaining chips.

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