

Policy challenges for developing economies under the WTO

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Key to symbols used in tables

- n.a. not applicable
- .. not available
- zero
- . insignificant

Abbreviations

ADB	Asian Development Bank
BOT	Bank of Thailand
FDI	foreign direct investment
IMF	International Monetary Funds
NEER	Nominal effective exchange rate
REER	Real effective exchange rate

Economic development involves a transformation from traditional to modern, which can raise per capita income and improve quality of life. Engagement in international trade tends to hasten this transformation, however it does not fully ensure successful economic development. As well as undertaking trade reform through WTO agreements, developing countries need to create and implement complementary domestic policies. This paper examines Thailand, in order to identify challenges faced by developing countries in this respect, and makes recommendations about how to minimise the undesirable consequences of trade liberalisation.

Protectionism and WTO negotiations

Both industrial and developing countries use tariff and non-tariff barriers to protect their economies from foreign competition. After eight rounds of trade negotiations, tariff rates on manufactures have been brought down to their current low level. A study by Hertel and Martin (2000) shows that tariff walls for agricultural products remain higher than for manufactured products (Table 1). This is true for both high-income and low-income countries. Degree of agricultural production remains high in developing countries, who are understandably reluctant to negotiate for the reduction of agricultural tariff rates, however this is also true for industrial countries, who have much to gain from agricultural trade negotiations. In 1995, the total implied value of tariff on imported agricultural products collected by industrial countries was \$53 billion, compared to \$34 billion collected by developing countries. Despite obvious efficiency gains, special-interest groups with powerful lobbying machines still hamper negotiations. Since tariff revenues are predominantly raised from imports of manufactured goods, developing countries have a lot more to lose than industrial countries. In 1995, the total implied value of tariffs on imported manufactured goods collected by developing countries was \$160 billion, while that collected by industrial countries was \$39 billion. These figures imply that the road to agricultural trade liberalisation will be long and rough.

Industrial countries can usually afford price distortions in their economies, but developing countries tend to be constrained by their tax capacity. The tariff revenues developing countries obtain from manufactured goods tend to be higher than those they obtain from agricultural products, because developing countries are net importers of manufactured goods. Since they are food producing countries, they have good reason to be afraid of competition from more efficient farmers in industrial countries. Furthermore, production and export subsidies in industrial countries tend to be much higher than developing countries can afford.

As comparative advantage shifts towards skilled labour intensive products, competition between domestic and foreign manufacturers becomes more intense. According to Martin and Ianchovichina (2001), the number of anti-dumping initiations taken against China, Korea and Taiwan between 1995 and 1996 was 137, 75 and 47 respectively. For the European Union and the United States, the number was 179 and 66. Measured as an index of initiations per dollar value of exports, the severity of anti-dumping measures can be seen from Table 2, where the index of 100 corresponds to anti-dumping measures taken against Japan.

Table 1 **Average tariffs and implied tariffs in industrial and developing countries, 1995**

	Importing region	Exporting region
Manufactures		
Industrial	0.8 (\$16b)	10.9 (\$93b)
Developing	3.4 (\$23b)	12.8 (\$57b)
Agricultural		
Industrial	15.9 (\$37b)	21.5 (\$20b)
Developing	15.1 (\$16b)	18.3 (\$14b)

Source: Hertel, T.W. and Martin, W., 2000. 'Liberalizing agriculture and manufactures in a millennium round: implications for developing countries', *The World Economy*, 23:455–69.

Table 2 **Anti-dumping initiations against rich and poor countries, 1995–99**

	Number	Initiations per exports*
India	38	1079
China	137	776
Indonesia	36	691
Korea	75	564
Thailand	30	509
Taiwan	47	386
European Union	179	106
United States	66	105
Japan	44	100
Australia	3	56

Note: * Exports in \$US, Japan = 100

Source: Martin, W. and Ianchovichina, E., 2001. 'Implications of China's accession to the World Trade Organization for China and the WTO', *The World Economy*, 24(9):1,205–19.

Economic recession has usually been followed by increased protectionism, as the history of US trade policy attests, and the global slowdown of 2001 would have significantly encouraged the use and abuse of anti-dumping measures. Clearly, anti-dumping measures are now widely accepted as tools of domestic protection, and the WTO must endeavour to abolish them, since they can actually become enemies to growth and development. The majority of anti-dumping initiations have been taken not to counteract predatory behaviour but to hamper competition from more efficient foreign exporters.

The WTO dispute settlement process must be made fairer. According to Hoekman and Mavroidis (2000), developing countries are underrepresented in dispute settlement. Between April 1994 and March 1999, the great majority of cases involved the United States and the European Union (Table 3).

Developing countries are obviously at a disadvantage in dispute settlement. Stiglitz (2000) argues that the principles of fairness and comprehensiveness in trade negotiations must be upheld if developing countries are to return to the negotiating tables. Otherwise, proponents of inward-oriented policies would declare relations between industrial and developing countries to be exploitative and conflicting. A comprehensive approach to negotiations implies that many different aspects of policy reform are considered simultaneously. Athukorala (2000) has suggested that the WTO should coordinate with

Table 3 **WTO dispute settlement (number of cases), April 1994–March 1999**

	Complainant	Respondent
United States	54	30
European Union	43	26
India	8	12
Japan	7	12
Thailand	4	1
Australia	2	6
Philippines	2	2
Korea	2	10
Malaysia	1	1
Indonesia	1	4
Sri Lanka	1	0

Source: Hoekman, B.M. and Mavroidis, P.C., 2000. 'WTO dispute settlement, transparency and surveillance', *The World Economy*, 23:527–42.

other international financial development institutions, which could provide loans to be used to relieve the high adjustment costs of agricultural reform.

Trade reform and development: the case of Thailand

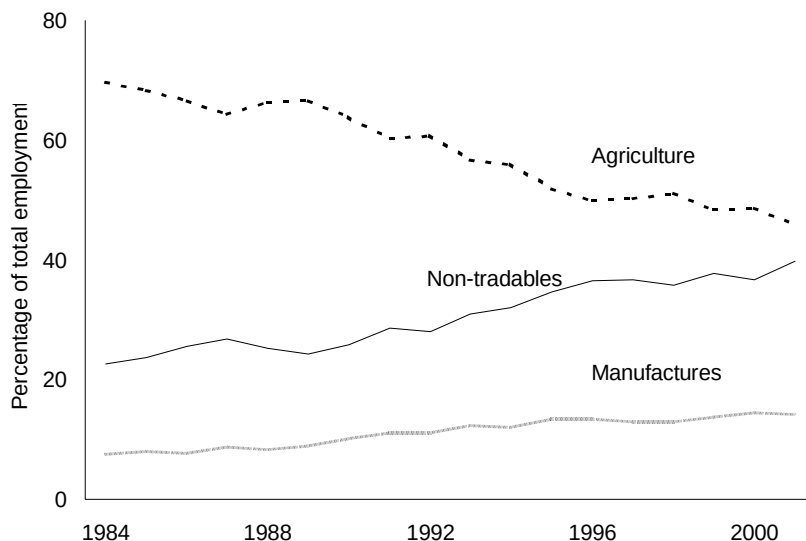
Thailand's economic development during the period 1970–2000 can be used to identify the salient features of the intricate nexus between trade and development. Since 1970, Thailand has undergone a gradual transformation from a predominantly agricultural economy to one whose growth is led mainly by manufactured exports (Figure 1).

In the early 1980s, rising manufacturing output exceeded falling agricultural output. The structure of exports followed a similar pattern of change (Figure 2). This is a stylised scenario that has occurred in many developing countries during the early stages of economic development. The greater the degree of a country's involvement in the global economy, the faster its structural changes in output, trade and employment. The crossover points for shares of agriculture and manufacturing in output, export and employment are indicators of the degree of economic development. Korea and Taiwan reached these crossover points long before Thailand, and both countries were able to benefit from market access to industrial countries. At the same time, these two countries implemented domestic policies that enabled them to exploit their comparative advantages.

It should be noted that countries' comparative advantages are changing, reflecting changing endowment and rising costs of production. Thailand has lost its comparative advantage in primary commodities to other less-developed developing countries, however its comparative advantage has shifted towards high value added agricultural products. Since profitability dictates the movement of resources among sectors (Figure 3), the manufacturing sector is not able to generate as much employment as the non-traded sector, which has attracted capital inflows and domestic credit extension in response to higher relative product prices. Although many agricultural labourers have migrated into the non-traded sector, the majority remain in agriculture.

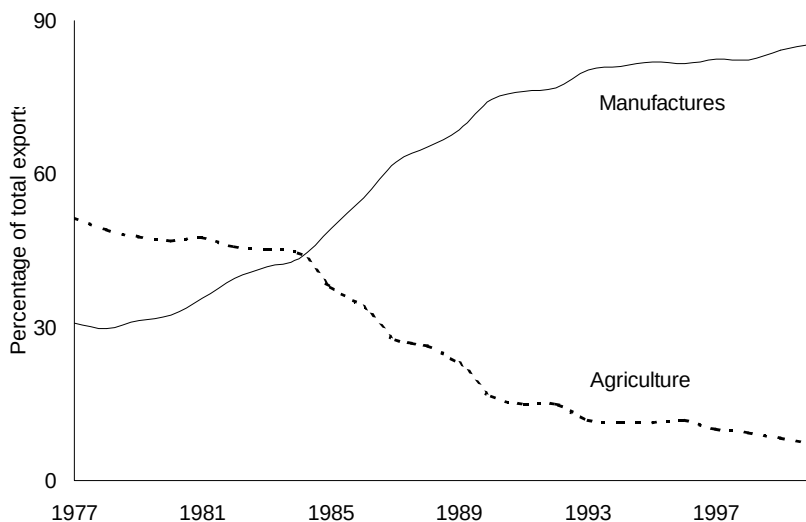
The employment structure in Thailand differs greatly from the employment structures in Taiwan and South Korea. Given similar per capita income, the South Korean and

Figure 1 **Structural output changes in the Thai economy, 1984–2001**



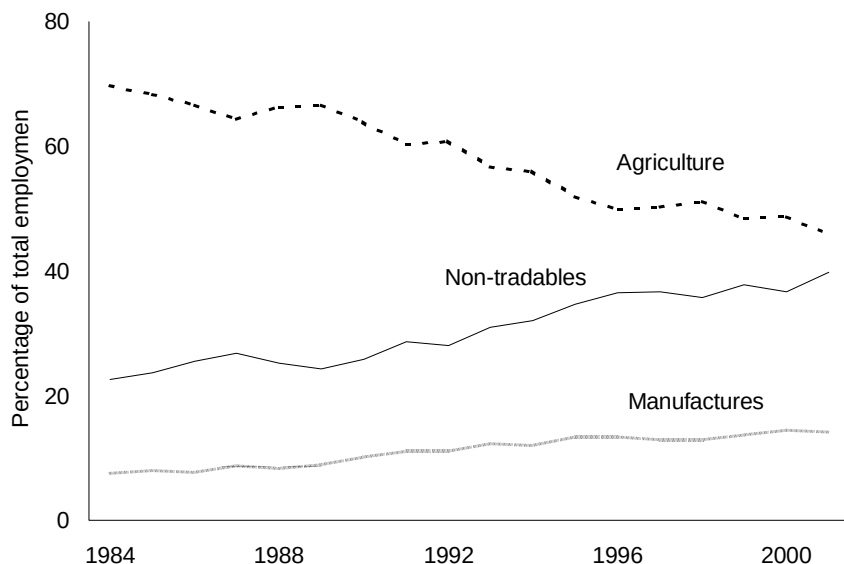
Source: Bank of Thailand, n.d. *Quarterly Bulletin*, Various issues, The Economic Research Department, Bank of Thailand, Bangkok, Available online at http://www.bot.or.th/bothomepage/databank/ArticlesAndPublications/quarter_report_e.htm.

Figure 2 **The rising importance of Thailand's manufactures exports, 1977–2000**



Source: Bank of Thailand, n.d. *Quarterly Bulletin*, Various issues, The Economic Research Department, Bank of Thailand, Bangkok, Available online at http://www.bot.or.th/bothomepage/databank/ArticlesAndPublications/quarter_report_e.htm.

Figure 3 Shifts in Thailand's employment structure, 1984–2001



Source: For 1972–93, Asian Development Bank, 1996. *Key Indicators of Developing Asian and Pacific Countries*, Vol. XXVII, Asian Development Bank, Manila; for 1993–99, National Statistical Office of Thailand, 2001. *Labour Force Survey, Table 9: Number of Employed Persons by Industry and Sex, 1989–2000*, Social Statistics Division, National Statistical Office of Thailand, Bangkok. Available online at <http://www.nso.go.th/eng/stat/lfstab9.html>.

Taiwanese industrial sectors have been able to absorb more labour than the industrial sector in Thailand. If agricultural sector productivity remains low, loss of comparative advantage may become a problem, leading to unemployment, migration, poverty and increased income disparities. According to Warr (2000), protection in the Thai agricultural sector remains at a higher level than protection in the manufacturing sector, which has undergone drastic tariff reform since 1994. It is possible that the low productivity of the Thai agricultural sector was caused by its high level of protection and lack of competition from outsiders.

The manufacturing sector's capacity to pull labour from the agricultural sector is constrained by the level of export demand. If foreign direct investment (FDI) employs capital-intensive technology, the employment effects of capital flows will be minimal, and productivity differential among sectors will not improve income distribution. The reason labour-saving technology is used predominantly in the manufacturing sector has to do with the exchange rate and industrial promotion policy. Again, trade reform in the manufacturing sector can lead to impressive growth in exports and output, but other complementary policies must be implemented simultaneously in order to avoid unintended and undesirable outcomes.

Since 1970, Thailand has followed outward-oriented policies. Figure 4 shows the negative relationship between the average tariff rate and trade intensity value—the ratio of the combined values of exports and imports to GDP—the latter rising from 26 per cent in

1970 to 120 per cent in 2000. As Warr (2000) observes, Thailand has continued to adhere to the principles of trade liberalisation even after the 1997 currency crisis. Gradual reform was evident in the gradual decline of the average tariff rate since 1970, and a sharp cut in the average tariff rate occurred in the early 1970s, with mild stagnation in the late 1970s. It is expected that the average tax rate will be even lower after 2005, when tariff protection in 'normal tract' industries is eliminated.

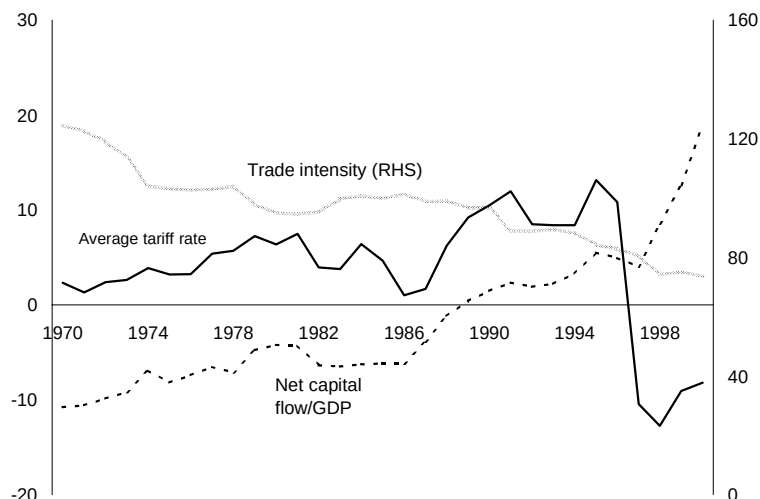
One of Thailand's great policy mistakes was the premature liberalisation of the capital account in the early 1990s. Huge and rapid capital inflows created unsustainable booms and, together with weak financial institutions and inadequate financial supervision, the subsequent collapse of the fixed exchange rate economy. Figure 4 exhibits the degree of openness in the capital account as measured by the ratio of net capital flow to GDP. Rapid capital inflows actually became capital flight immediately after the poor export performance of 1996. A high degree of dependency on world trade and world capital markets can bring rapid growth but at the same time can have extreme negative effects during global recession.

Export dependency and vulnerability

If a country's economy is driven mainly by exports, the share of exports in its GDP will be very high, an acceptable situation as long as external conditions are favourable. In fact, between 1970 and 1995, Southeast Asian countries rapidly raised their per capita income by penetrating markets in developed countries, and these countries' rapid rebound in 1999–2000 was due to robust growth in the United States. In 2001, however, Thailand experienced a growth rate of 1.5 per cent, or one-third of the 2000 growth rate, mainly because of the 2001 slump in the US economy, which had repercussions for the growth rate of the rest of the world. The ratio of Thailand's exports and services to GDP was 60 per cent, compared with less than 25 per cent for China. China's relatively low level of dependence on exports helped it moderate the decline in its growth rate from 8 to 7.3 per cent in 2001. Meanwhile small countries with large export shares in their GDP such as Hong Kong and Singapore suffered severely. Thus, increased globalisation through trade reform can lead to high levels of vulnerability to external shocks, and pro-trade countries must realise that the global economy is not immune to fluctuations in the output of major producers.

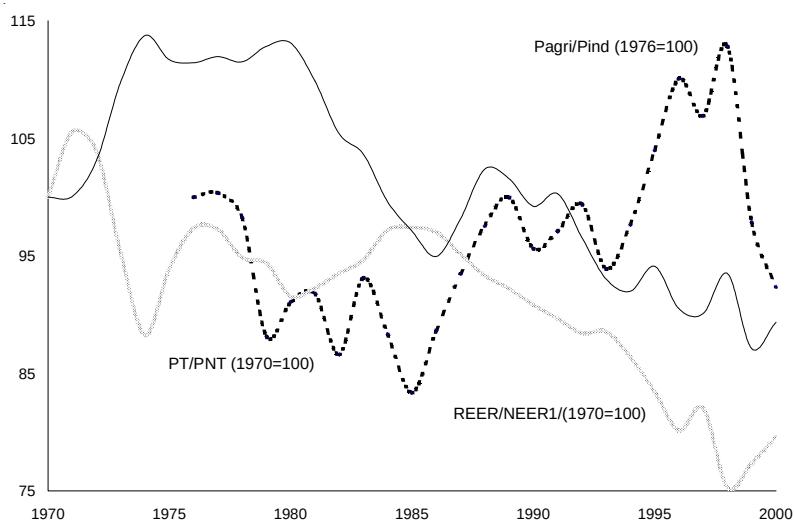
China's accession to the WTO will increase its dependence on exports in the long run, however new WTO members can use their domestic policies to lessen the impact of external shocks. Protection of the domestic economy from global slowdown depends partly on the implementation of fiscal expansion policies, which are limited by public debt levels. The ability of the Thai government to engineer recovery is limited because its public debt is around 60 per cent of GDP, whereas China's is only 30 per cent of GDP. Thus, China can employ public spending to cushion the fall in export demand. Other countries that are subject to IMF conditionality or the Economic Union's requirement to keep budget deficit at a certain percentage of GDP will not be able to maintain the same level of aggregate demand in the face of export shortfalls. Financial discipline and fiscal prudence are therefore required to set a maximum level of public debt.

Figure 4 Degree of openness and average tariff rate, 1970–2000



Source: Author's calculations based on Bank of Thailand, n.d. *Quarterly Bulletin*, Various issues, The Economic Research Department, Bank of Thailand, Bangkok, Available online at http://www.bot.or.th/bothomepage/databank/ArticlesAndPublications/quarter_report_e.htm.

Figure 5 Effective exchange rates, relative producer prices of agriculture and industry, and relative prices of tradable and non-tradable goods, 1970–2000



Note: ¹ Nominal Effective Exchange Rate (NEER) is based on the annual average exchange rate between the baht and the currencies of Thailand's major trading partners. The currency weight is based on each country's average aggregate trade share (1985–2000) and the shares as Japan 35.5, U.S 31.3, Singapore 14.3, Malaysia 7.1, Germany 6.3 and U.K 5.4. Real Effective Exchange Rate (REER) is an adjustment to domestic versus foreign GDP deflators.

Source: International Monetary Fund (IMF), n.d. *International Financial Statistics*, Statistics Department, IMF, Washington DC, Available online to subscribers at <http://ifs.apdi.net/imf/>; and Bank of Thailand, n.d. *Quarterly Bulletin*, Various issues, The Economic Research Department, Bank of Thailand, Bangkok, Available online at http://www.bot.or.th/bothomepage/databank/ArticlesAndPublications/quarter_report_e.htm.

Loss of tariff revenue after trade reform

Because low per capita income and inefficient tax administration in developing countries tend to hamper direct taxation, these countries derive most of their tax revenues from trade and indirect taxes. Compared to income taxes, trade taxes are particularly important for low-income countries on account of their lower collection costs and lesser susceptibility to tax evasion. Taxes on agricultural exports and manufactured imports are vital to the fiscal health of low-income developing countries. Trade liberalisation entails losses in revenue and can significantly reduce budgetary funds allocated to the building of infrastructure. This is why gradual reform is preferable to a big-bang approach. As Huang et al. (2000) have pointed out, since 1980 China has reformed its agricultural sector gradually. As a result, China's accession to the WTO has not caused great disruption and has had only a modest impact on output and rural incomes. Following this example, other developing countries should not have to fear the possibility of a renminbi devaluation.

When labour migrates to the manufacturing and service sectors, the structure of taxation generally evolves towards greater reliance on direct taxes. Thus, developing countries need to find alternatives to trade taxes, such as value-added taxes. Fear of tariff revenue loss may be unfounded, since revenue from corporate income taxes can offset the decline in customs revenues, provided trade actually enhances growth. Export taxes are instruments of inward-oriented development strategy, which gives unequal incentives to domestic and foreign product supply. In addition, export taxes tend to have a strong redistributive effect, with people working in the agricultural sector and living below the poverty line generally the most affected. To sum up, developing countries need to overhaul their tax systems so as to prevent volatile trade volumes from affecting their finances.

Declining terms of trade and income distribution

The increased efficiency of production and consumption and improved terms of trade involved in trade reform can give rise to significant welfare gains, however the terms of trade may move in favour of the manufactures exporting countries as opposed to agricultural product exporting countries. In Thailand, for example, between 1993 and 1996, the terms of trade between agricultural products and manufactures improved, and income inequality was reduced to its lowest-ever level. Since labour's share in agriculture remained very large, however, deteriorating terms of trade in agriculture after 1996 led to increased income inequality. The implication of worsening terms of trade is therefore quite clear: they can profoundly affect income inequality.

Furthermore, declining terms of trade have a negative impact on the balance of trade and can hamper poverty eradication. In the face of falling agricultural export prices, developing countries might form cartels in order to shore up their agricultural export prices. Some Southeast Asian countries have substantial shares in world trade of rubber, rice and coffee, and are therefore tempted to form cartels for these products. It is worth mentioning, however, that cartels have their own inherent problems, for example production control and monitoring. In the short run, when export demand is low, cartels can temporarily reverse price declines, however if substitutes are developed then the cartels might lose their markets permanently.

Trade and capital account liberalisation can contribute to positive growth and poverty alleviation in developing countries, however the impact on income distribution can be both positive and negative. If labour is paid for the value of its marginal product, capital control liberalisation can raise the marginal productivity of labour in capital-intensive sectors. Income distribution can be worsened if distribution of capital goods is skewed towards modern sectors, where labour productivity is high because of a high ratio of capital to labour, achieved through FDI and credit concentration. Unequal distribution of money and physical capital due to capital liberalisation can increase income inequality. Furthermore, if the price of non-traded goods rises relative to that of traded goods because of Dutch disease, then income disparity between workers in the non-traded sector and traded sector can widen. Labour migration, urban poverty and political instability can complicate development in countries that suddenly open themselves up to foreign capital.

In 1989, the top–bottom ratio of the national income of the richest 20 per cent of countries to that of the poorest 20 per cent was 59, indicating great inequality. Different measures of income inequality also point to increasing income inequality among nations, and Wade (2001) argues that global organisations like the World Bank and the WTO should seriously address the issue. Developing countries need to be aware that ushering a national economy into the global economy does not automatically reduce national income inequality, nor is it certain that open-door policies to trade and foreign investment will enable developing countries to bring their living standards up to the level of those of industrial countries.

Parallel policy preparation

To prevent unintended and undesirable outcomes of trade liberalisation, developing countries must create new economic policies in keeping with the changing economic environment. The lesson from the 1997 currency crisis in Thailand is that the fixed exchange rate regime is incompatible with a world of high capital mobility. The fixed exchange rate or currency board can produce price stability for periods, as in the case of Argentina between 1991 and 2001, but it cannot work indefinitely in a volatile environment of international trade and investment. Developing countries need to gradually adjust their exchange rates to reflect differentials between domestic and foreign inflation rates. Figure 5 shows how overvaluation of the baht began in 1985 and continued up until the crisis in 1997. There is thus reason to doubt the sustainability of remaining fixed exchange rate economies like China and Hong Kong. A flexible exchange rate can mitigate the impact of external shocks, and a gradual shift from a fixed to a flexible exchange rate regime as in the case of Australia in the 1980s would incur lower adjustment costs than Thailand's sudden jump into the float currency.

According to the WTO, Southeast Asian nations have nothing to fear from China's accession (Supachai and Clifford 2002). The main reasons for Southeast Asian businessmen to fear China's accession to the WTO are the low costs of Chinese labour-intensive production, the end of textile quotas, and the possible diversion of FDI away from Southeast Asia towards China. In order to assuage this fear, Supachai and Clifford (2002) cite a study that shows a positive correlation between FDI in China and FDI in Southeast Asia. It should be noted, however, that such a positive correlation can result

from a scale effect due to enlarged world capital fund portfolios. Distribution of FDI flow depends very much on relative rates of return in different regions. Because of the shift in the production structure of manufactures exports from labour-intensive to skilled labour-intensive products, FDI flows these days are attracted not by low wage rates as in the 1970s, but largely by pools of skilled labour (Noorbakhsh et al. 2001). Since FDI now flows to places where human capital is abundant, developing countries wanting to attract FDI must increase public spending on human capital and education.

Conclusion

Negotiations to reduce trade barriers in agriculture will prove more difficult than those to reduce tariff barriers in manufactures. Anti-dumping measures have too often been used as disguised protection. The WTO dispute settlement process is not likely to succeed unless both developing and industrial countries adhere to the principle of fairness. Trade liberalisation through WTO commitments can significantly alter developing countries' production and employment structures, and developing countries will undoubtedly encounter problems of job destruction in sectors with comparative disadvantage. Although export-led growth can reduce poverty, it can also increase income inequality. In addition, integration into the global economy can heighten vulnerability to negative external shocks. Developing countries must create new macroeconomic policies in anticipation of the adverse consequences of trade liberalisation.

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