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# Asia-Pacific Research and Training Network on Trade

## The role of developing countries in global economic governance

*By Peter Lloyd*

No. 117/August 2012

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# The role of developing countries in global economic governance

*Peter Lloyd*

## **Abstract**

The paper reviews critically the arguments concerning greater voice for developing countries in global governance. It supports the arguments for greater voice but argues that greater voice brings with it greater responsibilities in terms of the actions and commitments from developing countries. The two main illustrations are the multilateral trade negotiations in the WTO and the negotiations concerning climate change in the UN. In both case, it is argued, developing countries must assume greater responsibilities if these negotiations are to be concluded. This can be done in a way which yields net benefits to the developing countries themselves.

**Key Words:** global economic governance, developing countries, WTO, UNFCCC

**JEL Code:** F13

## Introduction

It is commonly argued that developing countries should be given a greater role in the multilateral organisations that are responsible for the management and regulation of the world economy. This view has been made most frequently in relation to the Washington Consensus organisations, the International Monetary Fund (IMF) and World Bank, but it has also been made in relation to the World Trade Organisation (WTO), United Nations (UN), Bank for International Settlements (BIS), and the Group of Twenty 20 (G-20). At Yekaterinburg in June 2009, after their first summit meeting, the large emerging economies in the BRIC group (Brazil, Russian Federation<sup>1</sup>, India, China) called for establishment of an equitable, democratic and multipolar world order. The particular demands for a greater role differ among the organisations because they each function differently in terms of their voting rights and modus operandi. The common element is a call for a greater say in the decision-making, a greater “voice”, in these organisations.

There are two strands behind this argument. One is the long-standing view among some developing countries or advocates on their behalf that these organisations have not taken sufficient account of the interests of this group of countries, and conversely that they have pursued to an excessive degree the interests of the major developed countries, particularly those of the USA and EU. The second strand is that the developing countries as a group have become substantially more important in the world economy as measured by the relative size of their GDPs, the value of their international trade in goods and services, and other dimensions of their participation in the production and investment activities of the world economy.

This paper reviews these arguments critically. The main theme is that developing countries should indeed be given a greater role in all of these organisations but that greater voice carries with it a greater responsibility in terms of the actions and commitments from developing countries.

Section 2 examines the changing place of the developing countries in the world economy while Section 3 looks at the place of developing countries in world governance in three multilateral organisations; the IMF where the case for greater participation has been most debated, the World Bank and G-20. Sections 4 and 5 then consider the WTO and the United Nations Framework Convention on Climate Change (UNFCCC) respectively. This paper focuses on these two institutions because the current negotiations being held in these two organisations, relating to world trade market access and other trade and trade-related issues and to the mitigation and adaptation to global climate change respectively, are the two most important negotiations relating to world governance to take place for at least twenty years. Moreover, they affect all developing countries. Both sets of negotiations have made little progress over many years. Section 6 sums up.

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<sup>1</sup> The classification of Russian Federation is troublesome. The UN does not consider Russian Federation a developing country and in the UNFCCC it is an Annex I (developed) country. But the IMF classifies it in the group of developing and emerging economies.

## 1. The changing place of developing countries in the world economy

Table 1 shows the share of all developing countries as a group in global GDP. It reports GDP measured in current prices and at nominal (market) exchange rates and GDP measured at purchasing power parity rates. The figures are reported for the decadal years 1980, 1990, 2000 and 2010. Developing countries are taken to be all emerging and developing countries, that is, all countries except the “advanced economies”, as classified by the IMF.

These figures show clearly the steady growth in the importance of developing countries in global production in the last two decades. This holds for both series. The share of developing countries is considerably greater when GDP is measured at purchasing power parity rates because goods and services prices are consistently lower in developing countries when converted at market exchange rates. In terms of GDP measured at PPP rates, China is now the second largest economy in the world and India is the fourth largest.

As a consequence of the more rapid growth of developing countries, there has been a significant convergence of income levels between the poorer and the richer countries in the world.<sup>2</sup> This is a new and very desirable feature of the world economy. If convergence continues, it will increase further the relative importance of developing countries in the world economy.

For the important group of large emerging economies comprising Brazil, China, India and Russian Federation this rapid growth has been projected to continue. Goldman Sachs coined the term BRIC in 2001 for this group of countries. In a later set of forecasts, Goldman Sachs (2007) has projected BRIC GDPs (in constant dollars and at nominal exchange rates<sup>3</sup>) to 2050. Their projections show a very rapid increase in their share of global GDP. China is projected to become the world’s largest economy by 2030 and to be almost twice the size of the US economy in 2050. India may catch up with the US by about 2050. Collectively, the BRIC countries are projected to be as large in aggregate output as the G-7 group of major advanced economies by 2035. While these projections may not of course be realised, they are widely regarded as plausible. They imply that these countries will be come much more important in all commodity and asset markets.

Table 1 shows that the rapid growth of output from the developing countries has been accompanied by a growing share of world trade in goods and services in the last two decades. Indeed, in 2010, China is the largest goods exporter in the world and the second largest importer (after the USA, WTO, 2011, Appendix Table I). Output growth is also reflected in their growing share of global emission flows. Sections 4 and 5 respectively draw upon these changes in world trade and emission flows. Similarly, developing countries have become much more important in world asset markets. In some markets, they account for more than 50 per cent of global total assets; for example, in foreign exchange reserves and assets held by sovereign debt funds. This dimension is relevant to some aspects of the debate about reforming the international monetary system.

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<sup>2</sup> For general discussion, see Estevadeordal and Taylor, 2008 and Spence, 2011.

<sup>3</sup> Measuring GDP at PPP exchange rates would increase the relative size of the BRIC economies but it would also lower the future growth rate as the prices of non-tradeables increase in these economies.



## 2. The voice of developing countries in world governance

This section reviews the voice of developing countries in three multilateral organisations, the IMF, the World Bank Group and the G-20.

The most specific demands of developing countries and their advocates are those relating to the IMF and the World Bank. Developing country members of the IMF and World Bank have long complained about conditionality of loans granted. Loan conditions have been used to drive borrowers towards a more open and less regulated policy stance.

This dissatisfaction reached a peak with opposition to the “Washington Consensus” view of the IMF and World Bank during the 1990s. While the term is sometimes treated inaccurately<sup>4</sup> as synonymous with market fundamentalism, it embraced a package of disciplined macroeconomic policies, the use of markets accompanied by privatization and deregulation, and liberalisation of trade in goods and capital.

Developing countries subject to IMF and World Bank loan conditions and prescriptions did not have a uniform view of the policies they wanted to follow. Their views and policy preferences varied with the countries and the circumstances. What they wanted in general was much greater flexibility in reform policies, including the ability to follow policies outside the Washington Consensus such as restrictions on short-term capital movements and state-owned public utilities and price controls, and the freedom to decide for themselves. One of the most contentious cases was the Argentinian crisis of 1999-2002. The World Bank imposed financial and fiscal austerity which led to the crash of the Argentinian bond market and a severe financial crisis. In the Asian Crisis of 1997-98, Asian borrowers complained that the Fund misdiagnosed the nature of the crisis and prescribed inappropriate contractionary fiscal and exchange rate policies and freedom of capital movements.

These concerns over IMF policy prescriptions led to concerns over the under-representation of developing countries in the governance of the Fund. Under-representation of developing countries in the quotas and voting power of the IMF has been recognised for a long time. A Member’s quota determines its obligations to provide financial resources to the IMF for it to lend to other members, and it is the principal variable determining its borrowing rights and SDRs. The original quotas were determined by a formula which weights five variables: GDP at current market prices, foreign exchange reserves, current account payments, current account receipts and a variability measure of current receipts. The IMF has a weighted voting system. A Member’s voting power depends on its quota. Each Member has one vote for every SDR 100,000 of its quota plus a small number of “basic votes” which is equal for all Members.

Quotas can be adjusted at any time. Under Article III of the IMF, the Board of Governors is required to conduct a general quota review every five years. Any change requires an 85 per cent majority of total voting power. The Board is free to choose its method of adjustment of quotas. When it has made adjustments, it has generally ignored the quota formula, preferring instead to increase Members’ quotas by a common percentage or to make ad hoc adjustments to the quotas of some members.

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<sup>4</sup> John Williamson coined the term in 1989. In Williamson (2004) he sets out the history and interpretations of the term. The Washington Consensus is now considered dead, having been replaced by a broader and more flexible set of views on development and macroeconomic policies in these institutions.

The outcome of this process is that there is still a large amount of inertia in the distribution of quotas and voting power. Adjustments to quotas and therefore also to voting power have failed to keep up with the rapid growth of developing countries as a group in the last two decades. To take one important group of developing countries, in 2008 the five BRICS countries<sup>5</sup> collectively after the last 2008 amendment of quotas and voting shares have 11.53 per cent of the quota and 10.67 per cent of the voting power in the IMF (IMF, 2011). By contrast, they have 15.6 per cent of the world GDP at current prices (as at 2010).<sup>6</sup>

Governance reform has received much more attention in the last eight years. As part of the 12<sup>th</sup> general review of quotas, which was completed in 2003, the IMF appointed a group of outside experts to a Quota Formula Review Group. The Group recommended a simple mean formula. In this there are only two variables, GDP calculated at market prices and nominal exchange rates and a measure of variability of current receipts and long-term capital flows, with a weight of two thirds and one third respectively (Cooper and Truman, 2007). However, the IMF Board did not accept the formula. In 2006 and 2008 the quotas and voting power were adjusted by a small amount in favour of some developing countries. In November 2010, the IMF agreed to wide-ranging governance reforms to reflect the increasing importance of emerging market economies. It even posted on its website a series of video clips by prominent academics, NGO representatives and government officials discussing why the IMF needed to change.

One of the contentious issues in recent discussions of quota revision is whether country GDP should be measured using nominal exchange rates or purchasing power parity rates. Measuring GDP at PPP gives a more accurate measure of the real output size. When GDP is calculated at purchasing power parity, the BRICS countries have (as at 2010) 25.7 per cent of the world GDP. While GDP should not be the sole metric to determine quota rights and voting power, this disparity reflects a major understatement of the developing countries' quotas and voting power in the IMF.

At its Summit in April 2009, the G-20 called for more reform of the IMF resources, lending and governance as part of an overhaul of the global financial architecture. It called for the IMF to complete the next reform of its quotas by January 2011. In November 2010 the Board of Governors of the IMF agreed to a package of governance reforms, including a major realignment of quota shares. Another comprehensive review of the quota formula will be completed by January 2013 and the 15<sup>th</sup> general review of quotas will be completed by January 2014.

Dissatisfaction with the quotas and voting power has not been the only complaint made by developing countries. Decision-making is carried out mainly at the level of the Executive Board. The Board has 24 Directors or "chairs", five of whom are appointed and the rest elected by regional groups. The Managing Director acts as Chairperson. Currently, 11 of the 25 are from the developed countries, including all appointed Directors. The composition of the Executive Board too has enshrined the power of the large developed countries. The Board has agreed to a restructuring to make all chairs

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<sup>5</sup> South Africa was added to the group at the end of 2010.

<sup>6</sup> All figures of GDP at market or PPP exchange rates have been calculated from data taken from the IMF's World Economic Outlook Database.

elected by the member countries. It is expected this will increase the representation of emerging market economies and other developing countries.

The record of governance in the World Bank closely parallels that of the IMF and will be considered only briefly. A country joining the World Bank must first join the IMF. The quota assigned by the IMF is used to determine the number of shares a member of the Bank holds in the Bank's capital stock. Each member country is allocated one vote for each share it holds in the Bank's capital stock plus 250 votes. Consequently, the distribution of voting power in the World Bank over the life of the organisation has tracked very closely that in the IMF.

Following the lead of the Fund, the Bank began reforming its governance in 2008. This includes, for the first time, developing a new formula for shareholdings specifically to reflect the needs and mandate of the World Bank. In 2010 it moved to increase the voting share of developing and Transition Countries in the International Bank for Reconstruction and Development to 47 per cent and ultimately to more than 50 per cent. There are similar changes in the other organisations of the World Bank Group.

There has been dissatisfaction too over the selection of the heads of the IMF and World Bank. All of the 11 Managing Directors of the IMF since its inception have been appointed from an advanced European member country, five of them from France. Similarly, all of the 12 Presidents of the World Bank Group (formerly the World Bank) have been US citizens. This convention stems from an agreement between the US and Europeans when the IMF and the World Bank were created in the Bretton Woods Agreement of 1944. At the time of the appointment of the last IMF Managing Director in 2011 there was a push from several developing country Members for the appointee to come from an emerging market economy and two candidates from developing countries were on the short list. It would be a mistake, however, to replace one geographic basis of selection by another. The sole criterion for the selection of the head should surely be to find the person best able to provide leadership and direction of this important multilateral institution.

Although it was set up in 1999, the G-20 expanded its activities substantially after the onset of the Global Financial Crisis. It has quickly come to be regarded as the major forum for discussion of developments in the world economy. Whereas its predecessor, the G-7, had no developing country members and the G-8 had only the Russian Federation, all five BRICS countries plus Indonesia, Argentina, Mexico and Turkey are members of the G-20. This is widely regarded, in developing countries as well as developed countries, as an important step forward for greater voice of developing countries. Yet, the G-20 has no powers to regulate any aspects of the world economy; it can only recommend to other organisations that reforms or changes be made. It has no voting procedures and no constitution or charter of rights and responsibilities.

Comparing the voice of developing countries in the three multilateral organisations reviewed above in this section with the changing place of developing countries in the world economy reviewed in the previous section, it is evident that those changes which have occurred in the world governance have lagged seriously behind the growth in the economic importance of developing countries. However, after years of talk, the developing countries are now making large gains in achieving greater voice in the multilateral organisations reviewed in this section and will make more in the next few years.

### 3. The WTO - Doha Development Round negotiations

Governance in the two multilateral organisations reviewed in this section and the next, the WTO and the UNFCCC respectively, has also been a big issue. However, it has played out differently, partly because of the different nature of these organisations and partly because of their different histories. Unlike the World Bank and the IMF, the WTO and the UNFCCC are member-driven and make decisions by consensus. They are member-driven in that decisions relating to their work agenda and to changes in their rules are taken by representatives of the governments of the member countries. In the WTO this procedure is sometimes described as “bottom-up”. It contrasts strongly with the top-down procedures of the IMF and World Bank. Consensus is defined in Article IX of the 1994 Marrakesh Agreement, which established the WTO, as no dissent. An agreement on any decision by its governing bodies, the General Council and the Ministerial Conferences, is reached if no member formally objects. This followed the consensus rule in its predecessor organisation, the GATT.

With this member-driven and consensus-based mode the issues relating to voice that have been so troubling in the IMF and the World Bank do not arise in the WTO in the same way. Yet, in the current round of negotiations, developing countries members have complained that their interests have not been sufficiently recognised.<sup>7</sup> Historically, it is also true that seven of the eight Directors-General of the GATT and the WTO up to the present have been from developed countries. However, five of these have been from smaller Country Members (two from Switzerland, one each from Ireland, Italy and New Zealand), and one has been from a developing country, Thailand.

There has been a concern over the trade problems of developing countries in the GATT/WTO from the outset. This concern was formally recognised with the introduction of Part IV of the GATT in 1966. This part emphasised the need to improve market access for the exports of developing countries to the country members. Importantly, Article XXXVI, paragraph 8 stated that “The developed contracting parties do not expect reciprocity for commitments made by them in trade negotiations to reduce or remove tariffs and other barriers to the trade of less-developed contracting parties.” These provisions were extended in the Enabling Clause in 1979. The full name of the Enabling Clause is The Decision on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of developing countries. It is commonly known as Special and Differential Treatment, or SDT. This clause authorised the introduction of the Generalised System of Preferences and other non-reciprocal preference schemes introduced by developed countries to give improved market access to developing country exports into these countries. These preferences became and still are an important feature of market access in the world economy. In later rounds, particularly the last, the Uruguay Round, many provisions in favour of developing countries and others in favour of least developed countries were introduced into individual agreements and the general agreements concluding each round. These take the form of fewer obligations and differing rules.<sup>8</sup>

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<sup>7</sup> One may note that the same issues of voice arise in regional (=sub-global) organisations and agreements. One important example is the free trade areas negotiated between the African, Caribbean and Pacific countries on the one hand and the EU.

<sup>8</sup> For an introduction to these provisions, see WTO, 1999, Part Five “developing countries in the WTO System” and Hoekman and Mavroidis, 2007, chapter 6.

This increasing focus on trade issues concerning developing countries has been boosted by accession of a large number of new developing country Members to the GATT and the WTO. At the time the GATT began operation in 1947, there were 23 Contracting Parties of whom 13 are now classified as developing countries. The latter included the BRICS nations Brazil, India, China and South Africa but not Russian Federation. At the time the WTO was established in 1994, there were 128 Members. Since the 2011 Ministerial Conference there have been 156 Members. All 28 non-GATT countries newly acceding to the WTO were developing countries (including China and Taiwan Province of China,<sup>9</sup> and Russian Federation). Developing countries now comprise two thirds of the members and another 26 are currently negotiating accession. The G-90 group is a most important coalition in the negotiations.

The current round of negotiations was expressly intended to benefit the trade of developing countries. Hence, it became known as the Doha Development Round. The agenda for this round was laid out in the Doha Declaration (WTO, 2001). The Declaration provides for Special and Differential Treatment for developing country members. There are several elements. One is trade facilitation for the exports of developing country Members. Another is Aid for Trade. But the main element relates to market access for exports of goods and services.

For non-agricultural products market access, or NAMA in the jargon of the WTO, Paragraph 16 states:

*“The negotiation shall take into account the special needs and interests of developing and least developed country participants, including through less than full reciprocity in reduction commitments” (WTO, 2001).*

There is similar wording in the paragraphs relating to market access for agricultural goods and for services. There are supplementary provisions for least developed countries. The most notable is that, in Paragraph 42 of the Doha Declaration, the Members committed themselves to the *“objective of duty-free, quota-free market access for products originating from LDCs.”*

The current state of the market access negotiations for agricultural goods and for industrial goods are still based on the draft modalities set out in the revised Chairpersons' texts of December 2008 (WTO, 2010a and b).

For agricultural market access, there are separate modalities for each of the three areas of trade measures, or “pillars” as they are known - market access (tariffs and other border measures), domestic support and export competition. With regard to tariffs, the proposed cuts for developed countries are arranged in tiers, with higher percentage cuts for higher tariff rates. With regard to domestic support, there is also a tiered formula with different cuts for products in different boxes. With regard to the third area of export competition, export subsidies would be eliminated by the end of 2013, half of this by the end of 2010. For developing country Members, the cuts in each tier of the tariffs and in the Amber (trade-distorting) Box for domestic support would be two-thirds of the cuts made by country members and those without Amber Box reduction commitments would not have to

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<sup>9</sup> China was one of the original signatories to the GATT but, following the Communist victory over the Kuomintang, China withdrew from the GATT in 1949. It had, therefore, to apply for accession to the WTO.

cut overall distorting support. Least developed countries and some smaller recently-acceded members (but excluding China and Taiwan Province of China) would not have to make any reduction commitments in most of the parameters of the two pillars. The group of small vulnerable developing economies got additional concessions. When combined there are 70 Members in these three groups receiving special group treatment over and above the general differential treatment for developing countries.<sup>10</sup> All developing countries as a group would also be able to make smaller cuts in some circumstances.

In contrast to agriculture, the negotiations on NAMA are centred on tariffs. Here, they chose to use the Swiss formula which automatically gives a higher percentage cut the higher the tariff rate (expressed in ad valorem terms). The extent of all cuts depends on the coefficient of the formula. The coefficient is in fact the maximum tariff rate after the cuts have been carried out. For developed country Members, there is a proposed coefficient of 8, meaning that all (bound) tariff rates would be below 8 per cent in these countries. For developing country Members, the coefficient is in the range of 20 to 25, meaning that maximum rates would be somewhere below 20 or 25 per cent in these countries. Again there are exemptions or weaker commitments under a number of provisions but, unlike agriculture, there is also provision for deeper tariff reductions, possibly to zero, in a number of sectors. Least developed country and some smaller recently-acceded Members would not have to make any tariff reduction commitments, small and vulnerable economies have reduced reduction obligations and, as in the agriculture sector, there were additional concessions for developing country Members under various flexibility provisions.

Thus, all least developed countries, most small vulnerable economies and many recently-acceded members would be required to make very few reduction commitments in the agriculture and NAMA commodity groups. For developing countries outside these three groups “less than full reciprocity” has evolved during the Doha Development Round to mean they too should make small commitments. This is more important because of the larger size of the trade and GDP of these countries. That is, “*less than full reciprocity*” means something between virtually zero for a large number of countries and a maximum of two-thirds, with the average across all developing countries being a *little* reciprocity.

These draft modalities have not been accepted by Members. There are still huge disagreements between different groups of countries. The US in particular insists that the developing country members generally and the large emerging market economies in particular must make much greater reduction commitments in their own trade barriers to imports of goods and services.

There are many areas of disagreement in the WTO negotiations besides those relating to reduction commitments and in some Members are divided along the lines of developing or developed country status. This applies to the Trade-related Intellectual Property (TRIPS) and service area negotiations. Another area which is particularly divisive from the point of view of developing countries is trade and the environment. Some developed countries would like to strengthen their ability to restrict imports of goods such as tropical hardwoods. Some developed countries, particularly the USA,

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<sup>10</sup> A list of the countries which are in each WTO group may be found in “Groups in the negotiations” on the WTO website [www.wto.org](http://www.wto.org). There are 31 LDCs, 20 small vulnerable economies and 19 recently-acceded Members. Mongolia is a member of both the LDC and the recently-acceded groups.

would also like to introduce rules relating to minimum labour standards, though this is outside the Work Programme of the Doha Development Round.

In May 2011, it was decided that the package could not be completed in 2011, the deadline which the Trade Negotiations Committee had set earlier in the year. Instead the Members would aim to complete by December 2011 Plan B, a mini-package focusing on reforms that would benefit the least developed country members. In July, the TNC abandoned this goal too. At the December 2011 Ministerial Conference no decision was taken concerning the future of the negotiations.

The gap between the developing and developed countries with respect to commitment demands and offers is only one of many divisions among members that have made the negotiations difficult. Improving market access to the agricultural markets of the major developed countries is another major obstacle that divides developed countries.<sup>11</sup> Yet, at the 2011 Ministerial Conference, the conference chair, listed the balance of contributions and responsibilities between the emerging and the advanced economies as the “key question” in the impasse (International Centre for Trade and Sustainable Development, 2012, p. 18). Reducing substantially the gap between the developing and developed country reduction commitment offers and requests is a necessary condition for completion of the round.

#### 4. UNFCCC – climate change negotiations

The UNFCCC was set up in 1992. Its objective is to devise binding rules and a mechanism that will stabilise the stock of greenhouse gases (GHGs) that increase global air and water temperatures by absorbing infrared radiation from the sun. In the UNFCCC, negotiations have proceeded in a series of annual Conferences of the Parties (COPs).

The negotiations cover three general areas: climate change mitigation, adaptation, and technology transfer and finance. Of these three mitigation, that is, the reduction of annual emissions of GHGs, is the core of the negotiations.

COP-3 in 1997 produced the Kyoto Protocol as an attachment to the UNFCCC. The Protocol is a binding international agreement. It has been signed and ratified by 193 nations and came into force on February 2005. Importantly, the US has signed but not ratified the Agreement and it is, therefore, not bound by the Protocol. Under the Kyoto Protocol, climate change mitigation is to be achieved by setting national targets for annual gas emissions which will reduce aggregate global flows of greenhouse gases and eventually stabilise the stock.

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<sup>11</sup> Some have blamed the impasse on the very large number of countries negotiating and the very large agenda. Some have even blamed the member-driven consensus-based modus operandi. The Director-General of the WTO himself, after the crucial July 2008 failure to reach agreement, outlined the negotiation problems of the WTO in the following terms:

*“Three principal constraints today represent a challenge to our work: the first is the bottom-up approach, under which members must themselves always take the lead in tabling negotiating proposals and compromise solutions; the second is the concept of a “single undertaking”, which implies that in a round of negotiations with 20 different topics, nothing is agreed until all is agreed; and the third is the decision-taking by consensus, which is reasonably close to unanimity.” (Lamy, 2008).*

The UNFCCC too is a member-driven consensus-based multilateral organisation. The UNFCCC and, under it the Kyoto Protocol, divides the parties into two groups; Annex I countries, the developed countries, and the non-Annex I countries, the developing countries.<sup>12</sup> These emission reduction targets are to be set initially for Annex I countries only. Annex I signatories committed themselves to reduce their collective GHGs by 5.2 per cent from the benchmark 1990 level by 2012. Each of the countries sets its own target. Developing countries, or strictly the non-Annex I countries, have no emission restrictions but were to make general commitments to reduce their GHGs. The Protocol allows for several “flexible mechanisms” to allow Annex I countries to meet their GHG emission targets by purchasing GHG emission reduction credits from other Annex I and non-Annex I countries. These mechanisms include emissions trading, the Clean Development Mechanism (CDM) and joint implementation.

COP-15 in Copenhagen made a big effort to conclude a binding agreement but it failed to do so. It did, however, produce the Copenhagen Accord. Paragraph 4 of the Accord stated that Annex I countries were to submit new quantified economy-wide emission targets for 2020 to the secretariat. The commitments of the current 42 Annex I countries (including the United States) range widely from 5 per cent to 40 per cent emission reduction by 2020, with most in the range of 15-30 per cent (UNFCCC, 2010a). But the base years differ and almost all of the commitments are conditional on other countries setting up a comprehensive global agreement or taking sufficient action. Paragraph 5 stated that non-Annex I countries were to submit plans for mitigation by 2020 to the Secretariat by 31 January 2010, also known as NAMAs (Nationally Appropriate Mitigation Action plans). They too did so (UNFCCC, 2010b). These agreements are known as the Cancún Agreements.

The reduction commitments of the developing countries differ from those of the developed countries in two respects. First, in contrast to the targets of the Annex I countries, the non-Annex I country mitigation actions are framed in terms of reductions in emissions intensity (emissions per unit of GDP) or relative to business-as-usual scenarios: for example, the China plan is for a 40-45 reduction in emissions intensity and the India plan is for 20-25 per cent reduction in emissions intensity by 2020. Second, the commitments of the developing countries are “plans as nationally appropriate”. Plans are not mandatory.

A comparison of the Cancún Agreements commitments of Annex I and non-Annex I countries is not straightforward because of the former being expressed in terms of reductions of the total flows and the latter in terms of reductions in emissions intensity per unit of GDP or from a business-as-usual base. Total emissions are equal to the emissions intensity per unit of GDP multiplied by the GDP. Hence, the rate of change in the total emissions flow over time is the sum of the rate of change (decrease) in emissions intensity plus the rate of change (increase) in the size of the GDP. Jotzo (2010) has standardised these different target forms by showing the reductions relative to a common base year and using common forms of the targets. If one looks at emissions intensity, the commitments of the Annex I and the non-Annex I countries are remarkably similar (Jotzo, 2010, Figure 4). The reductions in emissions intensity planned by China and India are a significant policy commitment. However, their cumulative percentage

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<sup>12</sup> There is a third group, Annex II countries. These are a sub-group of developed countries who contribute to costs of developing countries.



growth of GDP by 2020 is expected to be considerably greater than the planned reduction in emissions intensity per unit of GDP in percentage terms. Consequently, if these post-Copenhagen commitments were implemented, their total emissions will increase substantially (Jotzo, 2010, Figure 1). This would occur at a time when Annex I countries are all expected to reduce total emissions.

This differential treatment of developed and developing (or Annex I and non-Annex I) countries derives from the Framework Convention. This Convention laid down the principle of “*common but differentiated responsibilities*” for developing country parties. In the Kyoto Protocol, this principle was interpreted as requiring no specific emission reduction commitments from developing countries. At the Copenhagen Conference this principle was modified in the Accord, in which non-Annex I countries were asked to make mitigation plans as nationally appropriate.

The “common but differentiated responsibilities” principle is based on arguments that the largest share of historical cumulative emissions of greenhouse gases originated in the developed countries, that per capita emissions flows in developing countries are currently low, and the share of global emission flows originating in developing countries will rise to meet their pressing development needs.

This principle has set off a fierce debate about which countries should carry the burden of emissions reductions. The Kyoto Protocol interpreted “common but differentiated responsibilities” to mean that all the heavy lifting should be done by developed countries alone. This is effectively differentiated responsibilities with little in common. This distribution of the burden of adjustment was not acceptable to the US at the Copenhagen Conference and is not now acceptable to some other Annex I countries, especially as China has replaced the US as the largest emitter and India is the third largest emitter.

The UNFCCC Parties have been searching for some middle interpretation which would give non-Annex I countries lower but real emissions reduction commitments.

At the conclusion of COP-17 in Durban South Africa, the Conference released a set of documents collectively called the Durban Platform. Agreement was reached by all parties to develop a new legal instrument, applicable to all parties. Work on this is to begin in the first half of 2012; the new treaty is to be completed by 2015 and is to come into effect by 2020. In the interim and after intense negotiations, the Kyoto Protocol has been extended into a second commitment period from 1 January 2013 but only the EU and some other small developed countries made new commitments. Together these were 38 of the 44 Annex I countries and they account for only about 17 per cent of global emissions. The others, including US, Canada, Japan and Russian Federation, refused to make a new commitment. Compared with the commitments made by Annex I countries under the first commitment period, there are some steps forward and one big step backward. It is not clear where the negotiations will head.

## **5. Greater voice brings greater responsibility**

In both the WTO Doha Development Round and the UNFCCC Conferences, the differences in the views of the developing and the developed groups of countries have become the main issues that have thwarted progress in the negotiations. The differential

treatment of developing countries stem from the principles of “less than full reciprocity” in the WTO and “common but differentiated responsibilities” in the UNFCCC. These principles have become unworkable. They need to be reassessed in the light of the changes in the relative position of developing countries in the world economy, which were noted in Section 2, and the changes in economic policy analysis that have taken place since the doctrines were devised more than two decades ago.

Since the doctrine of Special and Differential Treatment was devised in 1979, the developing countries as a group have become much more important in the world’s commodity markets, as noted in Table 1. Moreover, the developing countries made much smaller reductions than developed countries in trade barriers under the previous GATT rounds of multilateral trade negotiations. Consequently, in the NAMA product group, trade barriers in developing countries are much higher on average than those in developed countries. For the agricultural products groups, trade barriers in the developing countries are less than those in the developed countries (see Table 2). However, they are rising on average whereas they are falling in the developed countries. These changes in the position of the developing countries in the global economy have increased the importance of access to their markets, for exports from other developing countries and from developed countries alike.

The notion of “less than full reciprocity” has been ambiguous in the history of the GATT/ WTO. It conflicts with the notion of reciprocity which has been central to the operation of the GATT/WTO. Moreover, “less than full reciprocity” was never intended to create a fundamental division in reciprocity obligations between developed and developing countries. The Articles of the WTO, unlike the UNFCCC, do not divide members into categories. Special and Differential Treatment to developing countries has been granted by means of exceptions to the rules, often temporary, and by longer transition periods. However, the interpretation of the less than full reciprocity during the Doha Round negotiations has, in effect, divided the members of the organisation into two classes.

Developing countries should, in my view, increase their commitment to reduce their own trade barriers for several reasons. First, the deadlock in WTO negotiations in relation to market access for industrial and agricultural goods is unlikely to break unless developing countries increase their commitments to reduce their own border barriers to trade in goods. Spokespersons’ for the larger developing countries act as if the economies of their countries were small in the sense of international trade theory, that is, their actions do not significantly affect the economies of other countries. This is patently not true of the larger emerging economies such as China, India and Brazil. In many markets, China is the largest single buyer or seller.

An example of the effects of hardline views adopted by some developing countries was the breakdown of WTO negotiations in July 2008. These negotiations were at that time close to concluding a deal. The particular issue on which they founded was the insistence of some developing countries, notably India, on a special safeguard mechanism for agriculture which would have allowed them to impose temporary tariffs in the event of an import surge or a border price fall in so-called special products. This mechanism was widely regarded among the developed countries as unnecessary and potentially quite trade-restricting.

Moreover, the concessions relating to lower reduction commitments given to developing Country Members and sub-groups of them under various terms have contributed greatly to making the negotiations of mind-boggling complexity. The texts of the agriculture and NAMA 2008 drafts each run to more than 100 densely-packed pages. The WTO has had to prepare for its own Members documents such as “The December 2008 NAMA Modalities Text Made Simple”. Much greater simplicity in the patterns of offers would greatly facilitate the negotiations. This in turn requires simpler rules with many fewer exceptions for groups of countries.

The second reason why developed countries should increase their reductions in their own trade barriers is that this would also benefit the developing countries themselves. Standard theory of the gains from trade applies to all countries and indicates strongly that developing countries would gain from greater cuts in their own barriers to trade. Simulations done at the World Bank during the current negotiations using a computable general equilibrium model show that proposed WTO scenarios would benefit developing countries to a greater extent in relation to their GDPs than the rest of the world (see Anderson, Martin, and van der Mensbrugge, 2006). Moreover, these gains would come more from cuts in their own border restrictions than from improved export market access.

Today many developing country Members point to Article XVIII of GATT 1947 as the justification for maintaining higher market access barriers and “less than full reciprocity” for developing country commitment offers.<sup>13</sup> This article permits Members in the “early stages of development” to use tariff protection to establish new industries. At the time of writing of the GATT articles in the 1940s, there was a general belief by economists in the “infant industry” argument for protection. It is now discredited. Contemporary economists believe that, if there is particular failure in a market for capital or innovation or whatever, this should be addressed in that market and not used to justify product protection from all foreign competitors in the traded goods markets; see, for example, Baldwin (1969). Empirical studies show that trade liberalisation accelerates the rate of growth of liberalising economies. (See Lloyd, 2011 and references therein). Estevadeordal and Taylor (2008) estimate that growth acceleration in countries that have liberalised their goods trade has raised their rate of growth of GDP by 1 percentage point per year. These growth gains are ongoing, unlike the standard gains from trade which are once-only gains.

Indeed, far from assisting developing country members, the “less than full reciprocity” interpretation of Special and Differential Treatment has imposed a severe barrier to developing country gains from trade liberalisation and it would, in its present form in the draft modalities, lower their growth rates. The WTO does not do developing countries a favour when it interprets Special and Differential Treatment as Less than Full Reciprocity. Moreover, one unintended effect of Special and Differential Treatment has been the reluctance by the beneficiaries of this treatment to support reductions in MFN tariffs because of the consequential erosion of their preferences.

This does not mean that the Doha Development Round should not do more to assist developing country members; it should do so. However, it would assist their

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<sup>13</sup> A referee has suggested that “less than full reciprocity” may be a rational bargaining strategy for developing countries. This does not seem the case. Historically, the doctrine arose because of a long-standing view in the GATT that more should be done to increase market access for developing country exports. In all rounds prior to the Doha round developing countries (and smaller developed countries) were allowed to undertake significantly less market-opening commitments than the larger developed countries.

growth of trade and real output much more if Special and Differential Treatment were to take the form of special measures to open up the markets to exports from developing country Members plus longer transition periods and Aid for Trade.

The developing countries must offer more reciprocity. One option is to have one single parameter for reduction commitments for developed countries and one single parameter for developing countries, with no further variations for sub-groups of developing countries and no additional flexibilities. In agriculture, it could be, say two-thirds, and in NAMA a roughly equivalent difference in the Swiss formula coefficients. Such a change would lead to much larger gains from trade and higher growth rates in developing countries than the present interpretation of less than full reciprocity, and it would drastically simplify the negotiations. The theory and empirical research of trade and growth indicate that the best parameter is 100 per cent, that is, no differential treatment in relation to reduction commitments. However, this is not consistent with the Less than Full Reciprocity in the Doha Declaration. With hindsight, it is evident that the Doha Declaration is, in this respect, based on a false premise.

Another option is to have one parameter apply to developed countries and large emerging economies. The case for amending special and differential treatment is strongest for the group of large emerging economies. All of this reasoning applies to less developed countries too but these economies are much less important in the world economy. They and small vulnerable economies do, however, require special consideration in terms of assistance to make adjustments to border barriers.

If the developing countries were to increase their reduction commitments, the developed countries would have to deliver on other measures to assist developing country exports as a quid pro quo in a new package; these would include reductions in barriers to trade for cotton exporters and EBA for all least developed Member countries and other measures such as reducing the effects of cascading tariffs.

The history of developing country commitments to reduce emission levels parallels that in the WTO in broad terms. Over time the demands for developing countries to increase their emission reductions have increased. The Cancún Agreements reached at COP-15 and formalised at COP-16 saw the introduction of “plans as nationally appropriate” for these countries. The Durban Platform at COP-17 calls for an increased ambition with regard to mitigation efforts and for “the highest possible mitigation efforts by all parties” (UNFCCC, 2011). It is not clear what this implies for developing country Parties. The US and some other developed countries want developing countries such as China and India to make binding commitments in the same way as developed countries. India resisted this. In Durban China backed India but indicated it was willing to consider a treaty with a binding commitment after 2020.

Despite some change in the willingness of developing countries to consider stronger emission reduction commitments, their willingness has lagged behind their changing position in the global carbon situation. At the time the UNFCCC was drawn up, developing countries were small emitters. This situation has changed drastically. Table 3 shows the figures for annual emission flows in 2010. China and India are now the largest and third largest emitters and other developing countries such as Brazil and Indonesia are substantial emitters on the world scale. Moreover, the rate of growth of emissions is much higher in developing countries than it is in developed countries. If recent trends

continue, developing countries will account for more than 50 per cent of global annual emissions within a few years.

There are areas of disagreement between developed and developing countries other than those related to emission reductions. Two areas which have divided Parties along the lines of developed or developing country status are the issue of verification of emission reductions and border tax adjustments applied by those countries which introduce a tax or emission trading mechanism. The latter are now included in “response measures”. Some developing countries have been strongly opposed to verification and border tax adjustments.

In my view the doctrine of “common but differentiated responsibilities” needs to be amended, as with the doctrine of “less than full reciprocity” in the WTO. This doctrine is founded on the view that historically developed countries have been responsible for the bulk of the increase in the stock of GHGs since the Industrial Revolution. In Durban India opposed an international agreement that would be binding on India on these grounds: “[It is] as an attempt to shift the burden of the entire climate change problem on to countries that have not caused it.” (Indian Environment Minister, 2011). Houghton (2008) questions the historical accuracy of this generalisation. He constructs a database of net carbon flows resulting from changes in land use (such as harvesting of forest products and clearing for agriculture) on an annual basis from 1850 to 2005, roughly the industrialisation period.<sup>14</sup> According to these estimates, the developing country areas of the world have been responsible for some 45 per cent of the total CO<sub>2</sub> emissions due to land use changes since 1850. Many of the smaller countries that are now classified as developed countries contributed little to the historic accumulation of GHGs: for example, Denmark, Finland and New Zealand. In any case, it is not fair to hold the contemporary residents of developed countries responsible for the actions of their ancestors who were totally ignorant of the GHG emissions resulting from their economic activities.

Developing countries should, in my view, make emission reduction commitments in the same way as developed countries. They should also abandon their opposition to border tax adjustments (provided they do no more than establish a fair playing field) and accept verification.

They should make these changes in their policy stance for several reasons. First, as with the WTO negotiations, a binding agreement is unlikely to be achieved unless they do so. Circumstances have changed greatly since the Kyoto Protocol was devised. China and India are now the largest and third largest emitters of GHGs. Developed countries are not going to accept commitments which see them reduce their emission levels while these two countries continue to increase their emission levels rapidly. Without a binding agreement, there is little prospect of preventing global warming that will harm developing countries. Some, such as the small island states and Bangladesh, Egypt and Vietnam are expected to be harmed greatly if sea levels rise significantly. At the Durban Conference of the Parties these countries pressed China and India to agree to binding commitments to reduce emissions.

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<sup>14</sup> This takes account not only of the initial removal and oxidation of the carbon in the vegetation but also subsequent regrowth and changes in soil carbon. It does not take into account of the emissions due to the use of fossil fuels and other sources.

Second, developing countries stand to derive benefits from a binding agreement apart from the primary benefits of avoiding the costs of global warming. If a mechanism can be devised to reduce emissions from deforestation, there will be large environmental gains from the preservation of forest areas, especially those in the Amazon and other tropical areas. Then there are the benefits of the distribution of \$100 billion from the Green Climate Fund and other adaptation and technology transfers.

The option of having developed countries plus the subset of developing countries which are large emerging countries having the same emission reduction commitments, with other developing countries having lesser commitments, is not appropriate in this case. The nature of the policy coordination problem is that all countries contribute to global aggregate emissions. Exempting some countries increases the burden on other countries and requires a higher carbon price.

Emission reduction commitments on the part of developing countries would not require them to move immediately to the same levels of reduction as developed countries. In per capita terms, the emission levels of developing and developed countries should converge over some specified time period, with the emission levels rising in the developing countries and falling in developed countries (at agreed rates) to eventual equality. Such convergence requires agreement on an emissions time path for all nations.<sup>15</sup> Posing reduction commitments in per capita terms rather than total emission terms also allows developing countries to accommodate population growth.<sup>16</sup> Emissions convergence should be done in a way which does not slow down, substantially at least, the convergence of per capita incomes noted in Section 2.

If established, a global cap-and-trade system would permit the costs of each nation to be separated from the question of who pays for them. Some of the costs of emission reduction in developing countries could be borne by developed countries. There could be large net purchases by developed (Annex I) countries from developing (non-Annex I) countries of emission reduction credits under the Clean Development Mechanism and other mechanisms.

In both the WTO and the UNFCCC negotiations, developing countries will be persuaded to make greater reduction commitments and other actions only if these nations see gains in doing so. Developing countries need to re-examine the gains from their participation in these multilateral negotiations.

I have focussed on the need for a change in developing country views as a part of their seeking greater voice in multilateral organisations. This does not attach the blame for the failure of the negotiations to developing countries. Equally developed countries too need to re-examine the gains to them from their participation. In the WTO, developed countries should increase their offers of market access and changes in the rules in ways which will benefit developing countries. This is especially true of agriculture, where the barriers to imports in developed countries are particularly high (see Table 2) and are a severe restraint on the trade of many developing countries with comparative advantage in

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<sup>15</sup> One particular path of “contraction and convergence” has been proposed by the Global Commons Institute (2000).

<sup>16</sup> Total emissions are the production of emissions per capita multiplied by population. Hence, the rate of growth of total emissions is the sum of the rates of growth of emissions intensity and of income minus the rate of growth of population.

these commodities. Similarly, developed countries need to re-examine their gains from greater GHG emission reductions. In short, both groups of countries must move towards the middle of the negotiation gap currently separating them.

Similarly, there is a need for developing (and) Countries to continually assess their responsibilities in other multilateral organisations and debates. One example is the debate raging around China's refusal to revalue the fixed Renmenbi significantly. In foreign exchange markets China is far from a small country, its exchange rate policy has a major effect on global foreign exchange and commodity and asset markets.

There is plenty of scope for bargains in multilateral organisations. The voice of all nations should be heard but each has a responsibility to reassess its actions and policy commitments in the light of changes in the relative positions of economies in the world economy and changes in economic policy analysis.

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## Annexes

**Annex Table 1: Developing countries in the world economy**

	Percent			
	1980	1990	2000	2010
GDP at current prices	23.8	20.4	20.3	34.2
GDP (Purchasing power parity)	31.0	30.8	37.2	47.9
Imports of goods & services	22.9	16.9	22.6	n.a.
Exports of goods & services	25.4	16.3	23.9	36.4

*Source:* Calculated from IMF, World Economic Outlook Database, September 2011.

**Annex Table 2: Average levels of trade restrictions**

	NAMA	Agriculture	Average Trade Reduction Index
	Average Applied Tariff Rate	Average Applied Tariff Rate	
Developed countries	(Nov. 2001)	(Nov. 2001)	(all Measures)
US	1.4	1.3	16
EU	1.5	6	n.a.
Japan	0.9	10.4	163
7 sample countries	1.4	5.5	n.a.
All high-income countries			58
Developing countries	(Nov. 2001)	(Nov. 2001)	(all Measures)
China	3.5	9.6	8
India	7.8	60.2	27
Brazil	7	4.1	7
All sample countries	4.4	12	n.a.
All developing countries			<u>22</u>

*Sources:*

Column (2): Average applied tariff rates: Hufbauer, Schott & Wong (2010, Table 2.4)

Column (3) Average applied tariff rates: Hufbauer, Schott & Wong (2010, Table 2.1)

Column (4): Agriculture average trade reduction index: Lloyd, Croser, & Anderson (2009, Table 11.7, 11.3)

Calculated from data in the World Bank database on distortions of agricultural trade. This covers the three pillars of trade restrictions – tariffs, subsidies and assistance to exporters.

The commodity group here is all covered tradable farm products in 2000 - 04.

No EU average is available as the figures are calculated for individual EU countries.

**Annex Table 3. Fossil fuel CO2 emissions growth in 2010**

<b>Country/Group</b>	<b>Emissions (PgC)</b>	<b>Growth Rate 2010</b>
Global	9.14	5.9
<b>Non-Annex I</b>	3.57	7.6
China	2.24	10.4
India	0.56	9.4
South Korea	0.15	9.2
Brazil	0.11	11.6
Indonesia	0.13	7.9
Saudi Arabia	0.13	7.3
<b>Annex I</b>	5.02	3.4
USA	1.44	4.1
Russian Federation	0.46	5.8
EU-27	1.01	2.2
Japan	0.31	6.8
Germany	0.21	4.0

*Source:* Global Carbon Project (2010)

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