



The value of making commitments externally: Evidence from WTO accessions

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ABSTRACT

This paper studies the value of external commitment to policy reforms in the case of WTO/GATT accessions. The accessions often entail reforms that go beyond narrowly defined trade liberalization, and have to overcome fierce resistance in the acceding countries, as reflected in protracted negotiations. We study the growth and investment consequences of WTO/GATT accessions, with attention to a possible selection bias. We find that the accessions tend to raise income, but only for those countries that were subject to rigorous accession procedures. Policy commitments associated with the accessions were helpful, especially for countries with poor governance.

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"It is surprisingly hard to demonstrate convincingly that the GATT and the WTO have encouraged trade." Andrew Rose, American Economic Review, 2004.

"WTO accession provides a predictable business environment and gives a powerful guarantee to investors that there will be no policy reversals." Mamo Mihretu, advisor to the Ethiopian government on WTO accession, International Development Research Center, 2005.

1. Introduction

One way a country can acquire strong commitment to pro-growth policy reforms and convince investors that it has done so is by making the commitment a part of its international obligations. Examples of such external commitment include tariff reductions in a treaty that

governs the terms of a country's accession to the [World Trade Organization \(WTO\)](#), foregoing the right to impose capital controls in the future in a free trade agreement (FTA), a privatization scheme made as a part of the conditionality in a World Bank loan, or a tax reform plan made as a part of the conditionality in an International Monetary Fund (IMF) supported program. The value of such an external commitment is intuitive. While a government's unilateral announcement or implementation of a policy reform can be reversed or undone unilaterally, a policy reform embedded in an international treaty would involve a much higher cost of reversal. Non-fulfillment of an external commitment could trigger termination of loan disbursement from the World Bank or the IMF, or sanctions from the dispute settlement mechanism at the WTO or the FTA. In political economy terms, the benefits conferred by the multilateral organization (e.g., more secured access to foreign markets through the WTO, or loans from the IMF) can be used by the reform-minded government to buy political support from the originally anti-reform interest groups.

However, it is not a foregone conclusion that the value of such external commitment is positive. For example, some have accused IMF supported programs of having made some countries economically worse off, as they might advocate a rigid recipe of policy changes that may not be suitable for the countries (see, for example, views by [Feldstein, 1999](#); [Stiglitz, 2002](#)). A rigorous analysis by [Barro and Lee \(2005\)](#) that incorporates a clever strategy to model which countries receive IMF supported programs suggests that participation in IMF programs does not generally enhance a country's growth prospect

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and may have reduced it. So there is certainly room for the possibility of making external commitment to a wrong set of policies. This can be the case when the negotiating partners of the treaties do not necessarily have the country's best interest as their objective or simply misunderstand what is good for the country. Moreover, even if the commitments are good, there is a separate question of whether they can be enforced or sustained in the long run. In the case of IMF programs, the countries might reverse the prescribed reforms once the programs expire.

In this paper, we study the case of accessions to the WTO (or its predecessor, the General Agreement on Tariffs and Trade, GATT). Unlike policy commitments made in an IMF program, policy reforms mandated in an WTO accession agreement are legally binding as long as the country remains a member of the WTO. The accessions are sometimes reported with fanfare, as was the case for China in 2001. In recent years, the applicant countries are typically required by existing members to undertake a wide range of policy changes before membership can be granted and to promise to do more within a certain timeframe after the start of membership. The required policy changes typically go beyond a reduction in tariff rates, and can encompass termination of state monopoly, greater transparency in policy making process generally, reduction in restrictions on payment and foreign exchange arrangement, and better protection of intellectual property rights.² As the second quote at the beginning of the paper indicates, WTO accession is thought to make it less likely for governments to reverse market-oriented reforms. Many of these policy changes would have to overcome fierce resistance from anti-reform interest groups within the acceding countries. This is reflected in lengthy and often contentious negotiations between the acceding countries and the existing members. For example, for countries that acceded to the WTO during 1995–2001, the median time it took between the initial application and the final accession was 71 months. The view that WTO accession brings about pro-growth reforms even if they may be politically difficult can be summarized by a Chinese adage: beneficial medicine may be bitter in one's mouth.

This view, however, is not universally shared. Some think that the membership is completely irrelevant. For example, [Rose \(2004\)](#) reports that WTO/GATT member countries do not appear to trade any more than non-members do. As [Subramanian and Wei \(2007\)](#) point out, since most developing-country members of the GATT/WTO acceded to the trade body at a time when very few reforms were required of them, it is not difficult to understand the irrelevance results. If WTO membership does not even lead to a more open trade regime, then it is hard to see how it could deliver beneficial reforms in other ways. So, in this case, the medicine is neither bitter nor effective.

According to some, accession to the WTO may even mean making counterproductive external commitments. The policy changes demanded by existing members of the WTO/GATT might narrow the “policy space,” and force the acceding countries to choose inferior policies that they otherwise would not have chosen. In a book entitled, “Behind the Scenes at the WTO: the Real World of International Trade Negotiations,” the authors Fatoumata Jawara and Aileen Kwa suggested that WTO negotiations place the interests of powerful developed countries ahead of everyone else and often coerce developing countries into signing something that they profoundly disagree with. By this view, the medicine is not only bitter but also poisonous.

In the first four decades of the GATT, developing countries were not asked to do much reform if they wanted to join the club. Indeed, many of them retained very high bound tariff rates even after becoming GATT members. However, the Uruguay Round of the GATT negotia-

tions signifies a drastic change. One objective of the Uruguay Round was to bridge the gap between the developed and developing countries in terms of their degree of liberalization and obligations. New acceding countries are subject to much more stringent accession requirements. For instance, under the old GATT rules, an existing member might be able to invoke nonapplication only on the condition that it had never entered bilateral negotiations with the acceding country; however, under the new WTO regime, an existing member could opt to not extend its WTO-related benefits to the new member even after they had held bilateral negotiations. For example, the United States had invoked the nonapplication clause against the Kyrgyz Republic, Mongolia, and Georgia, even after it had held bilateral negotiations with them. The United States would not have been allowed to exercise nonapplication in such a situation in the GATT era ([Drabek and Bacchetta, 2004](#)). Such threat of ex-post nonapplication potentially strengthens the leverage of existing members over an acceding country during the bilateral negotiations, and thus enable them to extract more concessions from the new member.

[Subramanian and Wei \(2007\)](#) document that these new (i.e., post-Uruguay) members tend to be systematically more open than old developing country members of the GATT. On average, new developing country members of the WTO/GATT trade about 30% more than the old developing members. Thus, accessions to the WTO/GATT after the Uruguay Round offer an opportunity to empirically study the value to a country of making policy commitments externally.

Specifically, in this paper we investigate whether and how WTO/GATT accession between 1990 and 2001 alters a country's growth trajectories. The empirical method we employ is in spirit a difference-in-differences strategy: comparing the change in the growth rate of the acceding countries before and after accessions with the change in the growth rate of nonacceding developing countries. Our results show that, relative to other developing countries, countries that became WTO members did generally grow faster than before, and the increments in their ratios of investment to GDP were greater as well.³

Any good economist would instinctively ask whether there is any endogeneity bias in this result. Specifically, is it possible that only countries that would pursue pro-growth, open-trade policies anyway would apply for GATT/WTO membership? Researchers might find a positive association between accession and an increase in the growth rate even though the former may not cause the latter. In some sense, we are just as happy with the possible result that reforms designed to promote trade openness rather than WTO accession per se have increased growth. In this scenario, application for GATT/WTO membership is simply a demonstration of a government's resolve to switch to a more open trade regime. Our exercise can be seen simply as a new angle to check the consequence of trade reforms for growth.

We, however, document a number of patterns in the data that enhance our confidence that the WTO commitments may causally improve investment climate and help to raise the growth rate. Besides implementing a Heckman procedure that explicitly models the selection issue, we also make use of a number of economic and

² More examples of reform conditions in recent accession cases that have implications outside trade are given in Table 10 of the NBER working paper version.

³ We choose to leave developed countries out of our analysis. About half of the developed countries were cofounders of the GATT. A majority of the remaining ones had joined the GATT by mid-1950s. We do not want to make developed countries to be part of the control group (when the treatment group consists of developing countries) as we wish to compare the like with the like. We do not want to make the developed countries to be the treatment group since it is not possible to construct a meaningful control group that consists of other developed countries. An interesting paper by [Staiger and Tabellini \(1999\)](#) shows that developed countries did gain policy commitment by embedding policy reforms as part of the “concessions” made in the Tokyo Round of the GATT negotiation.

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