# Transforming Nations

## How the WTO Boosts Economies and Opens Societies

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Summary: The World Trade Organization has changed the world in the past decade by welcoming China and transforming national fortunes in Cambodia and Saudi Arabia. It provides the catalyst that political leaders need to reform.

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No visitor to Phnom Penh, Beijing, or Riyadh these days can fail to sense change, optimism, and new economic dynamism. Cambodia, China, and Saudi Arabia are on the move, and mostly for the better. Why? For one thing, because all three countries -- along with Croatia, Georgia, Taiwan, Vietnam, and many others -- have joined the World Trade Organization (WTO) in the past few years.

The power of the WTO to aid national transformation is easily forgotten. All too often, many developing countries measure their success in the WTO's Doha Round of trade negotiations by the extent to which they avoid obligations to open up their economies. And in polite conversations in Geneva, the potential of WTO disciplines to encourage radical market, institutional, and regulatory reform is a politically incorrect topic. It is the countries that have joined the WTO over the past decade that have drawn the most benefit from global trade rules. Older members, which did not need to negotiate their entry, have probably gained the least.

The WTO has changed the world in the past decade by welcoming China. And if it has changed national fortunes, in Cambodia and Saudi Arabia, for example, it is thanks to its accession procedures. Compared with the terms of bilateral free-trade areas, the terms of WTO membership amount to a revolution. The process is now lengthier than ever. China applied to the WTO's predecessor (the General Agreement on Tariffs and Trade, or GATT) in 1986 and joined the WTO in 2001, Cambodia applied in 1994 and joined in 2003, and Saudi Arabia joined in 2005 after 12 years of preparation and negotiation.

Why do governments put themselves through such trials to enter what was once tagged a rich man's club? The answer might simply be to get rich. This is trite, and it cannot explain the efforts by China or Saudi Arabia, where the opportunities for getting rich have long existed. In fact, a better explanation is that at a certain point political leaders understand that fundamental change is necessary, or unavoidable, and that it cannot be achieved without support from the outside. They need a catalyst; the WTO provides it. Change often means confronting vested interests, reducing the role of the state, reforming institutions, and taking on corruption. Change also means shaking up the private sector by encouraging competition, setting entrepreneurs free from government controls, and ensuring efficient and affordable services. In an era of broadening and deepening globalization, small or struggling economies thrive only in an environment that generates opportunity and supports entrepreneurship. Much of what the WTO does is, in fact, about helping achieve good or better governance.

Nowhere is the WTO's power to transform nations more evident than in its accession process. In the early years of the GATT, little was asked of new entrants; even the GATT's founding members remained knee-deep in high tariffs and quotas. They and other industrialized members did negotiate tariffs downward, lift nonagricultural import quotas, dispense with preferential treatment, and sign up for new agreements on nontariff measures. But most developing countries did nothing. From the 1960s onward, these states relied on their right to "special and differential treatment." It was only in the 1980s that more demanding terms began to be required for new members.

Things have been quite different with the WTO, which was formed in 1995. The WTO's accession terms have been so demanding that critics have called them unfair. The reforms necessary to meet WTO standards have been so deep that some countries have not made the grade -- and for most of the countries that have undergone the reforms, accession negotiations have lasted at least a decade. Today, a good number of developing countries in the WTO have undertaken more substantial and far-reaching commitments, especially regarding agriculture, than some of the organization's founding members. This may seem like a high price for them to pay, but is it such a bad thing? Have not the newcomers benefited? Is not the endless creation of exceptions for poor nations largely counterproductive? Dozens of middle-income WTO economies continue to lose opportunities thanks to a mindset that counts it as a success to concede nothing of practical import when it comes to trade. Meanwhile, Cambodia, China, and Saudi Arabia have changed dramatically -- and mostly for the better -- in the context of acceding to the WTO.

The fundamental value of WTO membership -- and the negotiations that precede it -- is an opportunity to establish an agenda and identify priorities for the candidate countries. Government ministers and officials and businesspeople in these countries have to consider issues of WTO compliance whenever they are tempted to slip back into the old ways. Broadly, the restraints imposed by the WTO push countries toward better governance. Above all, the global trade rules provide a cover for reformers. Policymakers can loudly decry the global trade rules when it suits them politically, but this system provides the support for doing the right thing when the political will to do the right thing exists.

The experiences of Cambodia, China, and Saudi Arabia should provide a lesson. They each have their detractors, and in some respects the critics may be right. But each of these three nations has changed dramatically in the context of WTO accession. So it is worth asking how, why, and to what effect? First and foremost, Cambodia, China, and Saudi Arabia all benefited from remarkable leadership as they sought their places in the global trade community. In each case, a vision of progress and a willingness to open up to the world in the economic arena seemed to override poor instincts and bad habits, even if not perfectly. Hun Sen, Deng Xiaoping, and King Abdullah were no champions of Western democratic ideals or free markets, but they saw WTO membership as essential to moving their nations forward.

No leader can personally pursue all the tortuous, detailed requirements of WTO membership. Hun Sen, Deng, and Abdullah were helped by talented junior ministers and officials who did the work on the ground in Geneva and -- what is often more important -- with the national and provincial authorities at home. But it was the guiding presence, commitment, and authority of national leaders that made it possible for Cambodia, China, and Saudi Arabia to overcome the inertia of domestic interests. These leaders' convictions overcame even the weight of precedent and ideology. Deng hardly had the neoliberal background conducive to pursuing such reform: he had served as the general secretary of the Chinese Communist Party from 1956 to 1967 and as the chair of the CCP's Central Military Commission from 1981 to 1989 -- an unlikely resumé for someone about to transform history's greatest monument to state control into the world's biggest potential market. Likewise, King Abdullah, the commander of Saudi Arabia's National Guard since 1962, was not the most obvious candidate to open up one of the world's most closed, inward-looking nations when he began to steer Saudia Arabia in 1995, after King Fahd was incapacitated by a stroke. And then there is Cambodia's prime minister, Hun Sen, a former Khmer Rouge field commander who defected to Vietnam as the horrors of Pol Pot's regime grew. When they invaded Cambodia in 1979, the Vietnamese installed their own government, which included Hun Sen. In 1993, when the country returned to multiparty rule, Hun Sen became Cambodia's co-prime minister. In 1998, he took over as the sole prime minister, and he continues today to oversee a political process that has seldom been exemplary. But like Deng and Abdullah, Hun Sen has developed, as much as events and traditions have permitted, a progressive vision for the future, promoting openness to the world, economic security, and the gradual reduction of poverty through integration into the global economy.

## CAMBODIA, INC.

Despite the Khmer Rouge's continued military activity on the Thai border, by the early 1990s Cambodia had nevertheless left behind its genocidal tragedy and embarked on a process of economic reform. Within a few years, a remarkable experiment in public-private dialogue had begun under Hun Sen's direct authority. It continues energetically today. Guided by the World Bank's International Finance Corporation, this dialogue has ensured the private sector's ability to influence policymaking, a development on which the future of the nation depends and without which no long-term alleviation of the country's poverty can be imagined.

Cambodia's application to join the WTO, filed in 1994, remained in abeyance in Geneva for five years. In the meantime, the Cambodians prepared for the eventual accession negotiations. Hun Sen's government simplified Cambodia's import tariff structure so that it had just four rates, and it reduced the average duty from a maximum of 35 percent to below 20 percent. As the negotiations proceeded, Cambodia made a series of farsighted and substantial commitments in the service sector to ensure that efficient, competitive services would be available to support industrial development and agriculture. Higher education and health services, for which the public sector had been unable to provide secure and adequate facilities, were opened up to the private sector. The government also made crucial concessions by opening up sectors such as banking and insurance, construction, professional services, and telecommunications.

Most of these moves were designed to attract foreign investment, generate competition for local providers, and bring better, more affordable products to the market. But it was clear that opening up the country's market alone would not suffice. The government's institutions and administrative practices and the regulatory environment needed to be beefed up as well. Thus, a legislative and regulatory agenda was put in place. It covered, among other things, investment law, privatization, contract law and the courts, new civil and criminal codes, competition law, and intellectual property protection. These legal improvements were buttressed by efforts to reform existing legal and financial institutions and improve the level of professionalism in the government. Cambodia has not met all of its commitments on time or in the manner in which other WTO members might have preferred. But it has moved slowly in the right direction, and this despite the political upheaval that followed the 2003 elections. Cambodia's WTO commitments are helping, and the results, although patchy, are beginning to show.

Cambodia's traditional lack of self-confidence about being in the shadow of the bordering economic powerhouses of China, Vietnam, and Thailand has begun to dissipate. Merchandise exports have boomed, led by a highly competitive apparel sector (one that was said to have been wiped out by Chinese competition after global quotas on Chinese textiles were removed in 2005). Merchandise exports grew from $284 million in 1993 to $1.4 billion in 2000 and then almost tripled between 2000 and 2006. Pay remains low in the garment factories, but wealth is being created, and it shows on the streets.

Services have thrived, and tourism is taking off; transportation and travel revenues have almost tripled since 2000. Foreign banks are either establishing local outposts or showing an interest in doing so, reversing the tendency before Cambodia's WTO accession to withdraw from the country. And the real estate market has taken off on the back of a healthy construction sector. The commitments that Cambodia made in order to join the WTO, including freezing all of its customs-duty ceilings, have created investor confidence. Doing business in Cambodia, although still problematic, is getting easier. Foreign direct investment flows rose from virtually zero in the early 1990s to around $180 million by 2000 and to around $500 million by 2006. The country has also been able to buy from its global trading partners as never before; merchandise imports in 2006 were ten times those in 1993 and more than twice those in 2000.

But the ultimate test of success in a country like Cambodia is the battle against poverty. So far, the results are uneven, with reason for both optimism and pessimism. The UN's Human Development Index shows Cambodia on an upward path. GDP per capita is growing. The World Bank's 2007 World Development Indicators shows that from 1995 to 2005 Cambodia did more than twice as well as other countries starting from a similar level of GDP per capita. And the International Monetary Fund was able to conclude that "strong macroeconomic policies have allowed Cambodia to achieve impressive growth and make inroads into poverty." On the other hand, the IMF recently observed that corruption in Cambodia remains endemic.

DESERT DIVERS

According to the World Bank, Saudi Arabia is now the 23rd-best location in the world and the single-best location in the Arab world for doing business. The recent focus on the relentless rise of oil prices has obscured the big economic changes taking place within the country, the world's second-most-prolific oil producer and its greatest holder of oil reserves.

Again, the WTO has had much to do with these changes. The concern, during a period of low oil prices, that the Saudi economy was too narrowly focused was a major factor in inspiring Riyadh to follow the WTO guidelines in opening up its economy. Since the early 1990s, large numbers of well-educated young Saudis had been growing disaffected because of a lack of employment opportunities; diversification in the economy was inevitable. Especially with Russia moving swiftly to be a big player in oil, gas, and related products, the oil sector itself needed to diversify, but it needed some predictable and secure trading conditions in the major markets to do so. Saudi Arabia's accession to the WTO also supported other goals of then Crown Prince Abdullah's administration: achieving balanced growth throughout the kingdom, strengthening the private sector, developing the country's infrastructure and human resources and thereby attracting new foreign investment, reaching social and economic integration among the Gulf Cooperation Council countries, and supporting economic cooperation with other countries.

The privatization program of the Saudi government eventually recorded in the final WTO terms in 2005 was remarkably ambitious. Among the areas designated for privatization by the government were water provision, sewage treatment, and desalination; telecommunications and postal services; railways, roads, seaports, and aviation; utilities in industrial cities; publicly owned companies, hotels, and sports clubs; education; health care; and agriculture. The government's commitment was profound, and it lasted even after 2002, when oil prices started to rise again.

Still, Saudi Arabia's accession to the WTO was not easy. For some years, Riyadh had difficulty in understanding and accepting the principles underlying the multilateral legal system. Whereas in the Arab world "My word is my bond" is a traditional approach to business, multilateralism, as practiced by a state in the context of WTO accession, requires explicit legislation and regulations, obligations and agreements, and the commitment of WTO member states to the principle that the terms of accession to the WTO are enforceable by all other members of the organization. Saudi Arabia's positions on Islamic banking, religious bans on certain imports, and the Arab boycott of Israel were all potential spoilers in the early phases of its accession negotiations. But none of them turned out to be a serious impediment, and the negotiations focused on transparency, opening markets, nondiscrimination, and fair-trading conditions.

The pace of talks between Saudi Arabia and the WTO accelerated after 2000. Preparations for its WTO accession brought about fundamental reforms in Saudi Arabia's tariff structure for imports. The simple average "most favored nation" rate for nonagricultural and nonfuel products was brought down from 12.2 percent in 1994 to 6.1 percent in 2004. Saudi Arabia took on about as many WTO commitments as other members of the trade body and some even more demanding than those applied to China. Saudi Arabia's service sector opened up for foreign suppliers and investors; its intellectual property law and enforcement became exemplary. The country diversified its exports: exports of nonfuel and nonmining products doubled in value between 1993 and 2000 and then grew tenfold between 2000 and 2005, to nearly $70 billion. Saudi imports have more than doubled since 2000. And the commercial services in the country are growing strongly, with transportation imports -- the operations of foreign-owned ships and foreign airlines flying into and out of Saudi Arabia -- doubling in the last eight years.

Saudi Arabia is increasingly attracting attention as a location for non-oil-related foreign investment. According to the UN Conference on Trade and Development, foreign direct investment in Saudi Arabia increased from $312 million in 1993 to $4.6 billion in 2005. According to the IMF, foreign direct investment (calculated on a very different basis) in Saudi Arabia increased by more than 50 percent from 2005 to 2006, to $18.3 billion. On the World Bank's "ease of doing business" index, Saudi Arabia has moved up ten places in the rankings, from 33rd place in 2007 to 23rd in 2008. According to the index's accompanying report, it took 14 procedures and 95 days in 2005 to launch a new business in Saudi Arabia; it is estimated that it will take 7 procedures and 15 days in 2008. This compares favorably with most developed countries. Meanwhile, the economy is diversifying; in October 2007, the IMF reported that although Saudi Arabia's GDP growth in 2006 had fallen to 4.3 percent, its GDP growth in non-oil sectors reached 6.3 percent that year.

The West will no doubt remain critical of some aspects of Saudi Arabia's social, political, and judicial systems. But these are being reformed, in part because of its WTO commitments. The notion of Saudi Arabia as a hermit kingdom, closed to the world, is an image from the past. Whether the changes induced by its entry into the WTO will ultimately change Saudi society cannot be known yet. Unarguably though, Saudi Arabia is becoming a different country.

## CHINESE MARATHON

China's economic success story hardly needs retelling; its trade performance remains stratospheric. Everybody is conscious of the relentless buildup of Chinese exports, and some countries are even trying to counter it through protectionist measures. But China's import performance is less discussed. China's merchandise purchases from the rest of the world have risen sharply and consistently, parallel to its exports -- from $53 billion in 1990 to almost $800 billion in 2006. Between 2000 and 2006, China's annual import growth was 23 percent; its annual export growth was 25 percent. And even if certain major economies are suffering from large structural trade deficits with it, China is not exporting at everyone else's expense. China's inward investment record is no less impressive. Average annual foreign direct investment in China was around $3 billion between 1986 and 1991; by 2006, it had reached $70 billion. Slowly, doing business in China is getting cheaper and easier.

And China is making progress in poverty eradication as well. According to the World Bank, China's per capita gross national income increased more than fivefold between 1990 and 2006, from $320 to $1,740. Although an extraordinarily large share of this increased national wealth is going into rather few pockets, poverty rates in the country are falling. The percentage of Chinese living on less than $1 a day fell from 33 percent in 1990 to below ten percent in 2005. Malnutrition rates are substantially down. Many people continue to struggle with poverty, especially in the countryside, but a huge and rapidly growing middle class is thriving. The number of cell-phone subscriptions grew from 11 per 100 in 2001 to 30 per 100 in 2005.

There can be little doubt that China's WTO accession inspired the dramatic changes that have occurred in the country. In September 1982, four years before Beijing requested to join the WTO, Deng told the 12th National Congress of the CCP that the country "must blaze a trail of its own, building socialism with Chinese characteristics. Socialist modernization is our basic line. To carry it out and make China prosperous, we must first carry out the policies of reform and opening to the outside world."

It turned out to be a long and difficult road. As a founding member of the GATT (it quit in 1950), China did not consider its WTO membership to require "accession"; rather, it was seeking to "resume its status." But its practical intention was never in doubt, and even when its economic reforms changed course and intensity over the years, China continually edged toward joining the WTO and opening up its economy. The memorandum that China presented to the GATT's contracting parties in 1987 openly admitted the failure of central planning: "Economic decision-making was overcentralized and regulation of the economy by state mandatory plans was overemphasized to the neglect of the role of market mechanisms. As a result, the enterprises were low in economic efficiency due to a lack of vitality, and the commodity economy could not be developed properly."

In 1987, China still saw itself as a low-income developing country (it had an average annual per capita income of $136 in the countryside and, according to the memorandum, "average annual [per capita] living expenses" of $256 in the cities), even though reforms had started in the rural areas in 1979 and in the urban economy after

1984. The memorandum spelled out some fundamental changes: "The equalitarian distribution system of 'everybody eating from the same big pot' is now being cast aside. For state organizations and institutions, the scale wage system is being replaced by a structured wage system in which staff members are paid according to the posts they hold. The restoration of the bonus system and the trial implementation of linking the total amount of wages and bonuses with productivity have greatly enhanced the productivity of the enterprises and the enthusiasm of the workers and staff." It stated further, "Reforms have been made in the irrational price system and the overcentralized price administration." Not that the break with the past was complete: central planning may have been abandoned, but, according to the document, the new system had to be a "planned commodity economy."

It was clear that China's trading regime had to be developed. Beijing had rationalized its heavy-handed regulatory and institutional practices, but much more would have to change to meet even the relatively loose demands of the GATT at the time. Most obviously, China's Byzantine tariff structure, with "minimum" and "general" duties ranging between three percent and 160 percent, was unlikely to survive the demands of the big GATT players. Additional problems were China's unwieldy licensing system for imports and exports, oppressive exchange controls, minimal intellectual property protection, unattractive investment laws, and dubious technical and health-inspection practices for imports.

Despite serious imperfections in the clarity of some concessions, the final accession deal that China signed with the WTO was a remarkable success. It was unprecedented in its depth and complexity. Today, China's WTO tariff structure is bound by an average rate of ten percent. The trade-weighted average of actually applied import duties is now under five percent. Transitional arrangements have bought China time to make additional adjustments, and China's biggest markets have demonstrated restraint in protecting industries experiencing difficulty. Consumers across the world have benefited. The demand from a thriving Chinese economy has created immense export opportunities for developing countries that supply agricultural commodities and raw materials. As a result of China's commitments to the WTO, overseas manufacturers and services providers have flooded into the country. Few can envision not being in the Chinese market in the decades to come.

Who could have imagined in 1986 that within 20 years two German companies would be contracted to build and operate a $145 million hospital in Shanghai? Or that by 2007 there would be around 1,200 auto-parts-manufacturing operations with overseas investment in China -- holding 50 percent of the market? Or that Volkswagen would export its Chinese-made cars to more than 80 countries? Notwithstanding the continuing counterfeiting problems, sales by the European luxury-goods-maker LVMH in China have recently been rising by 50 percent a year. Boeing expects China's airlines to spend $183 billion on new aircraft over the next two decades; it has already taken at least 57 orders for the new 787 Dreamliner (hundreds of earlier models are already in service in China). In 2006, according to official Chinese statistics, approximately 34 million Chinese tourists went abroad (including to Hong Kong and Macao), making China the largest outbound travel market in Asia. In just the first half of 2007, already over 38 million Chinese tourists had traveled abroad.

These are just a few examples of a story that would not have been possible without the painstaking efforts of successive Chinese leaders and officials in preparing the country for its WTO entry. In China, just as in Cambodia and Saudi Arabia, the WTO has made the crucial difference in transforming the leaders' vision into reality. Irrespective of what happens in the Doha Round of trade negotiations, political leaders around the world should be making better use of the WTO.

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