

Iraq's Accession to the World Trade Organization

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Executive Summary

Introduction

One of the most significant successes of the World Trade Organization in recent years has been the expansion of WTO Membership and the continued stream of applications of countries to accede to the WTO. Of the 43 countries that have applied to accede the WTO under Article XII since January 1st 1995, approximately one half are countries in the process of transition from a planned to a market economy. The WTO represents a powerful attraction for countries, seeking admission into the international community and treat their WTO membership as a 'stamp of approval' of their policies.

The purpose of this paper is to discuss the effects of WTO accession on economic indicators, and policy-making in Iraq. We shall do so by looking at the experience of those transition countries (both oil and non-oil exporting countries), which are already WTO members. We believe that this will offer a useful picture of the forces that ultimately shape the economic performance of these countries and in particular that it will show how economic performance has been affected by WTO accession. We will do this by taking annual data three years before and following accession to attempt to find a net positive impact of membership to the WTO.

Synopsis

In early 2004, Iraq applied for WTO membership. It was granted the WTO Observer status in February 2004. A working party to examine Iraq's accession to the WTO was established on December 13, 2004. A Chairperson for Iraq's Working Party is expected to be selected early 2005. Ministry of Trade (MOT) Order No. 2265 dated June 7, 2004 established a WTO National Committee (NC) headed by the Minister of Trade to (i) review national laws and regulations for their compatibility and consistency with WTO agreements; and (ii) prepare the Memorandum on Foreign Trade Regime (MFTR) and accession documents for full membership as soon as possible. The WTO is an intergovernmental organization aimed at gradual liberalization through reducing tariff barriers and eliminating non-tariff barriers to international trade in goods, facilitating trade in services, protecting intellectual property rights, harmonizing trade rules, and strengthening the rule of law.

Currently, more than 90% of world trade in goods and services is conducted among WTO members. To remain isolated from the activities of the WTO and to trade under different rules and principles from those applied by WTO member countries are likely to have serious negative economic consequences on Iraq's economy. Iraq has a responsibility to actively and openly consult with the private sector and the citizenry of Iraq as part of their WTO Accession process.

The World Trade Organization

The WTO is an international organization dealing with the global rules of trade between nations. Its main function is to ensure that trade flows as smoothly, predictably and freely as possible. The goal is a more prosperous, peaceful and accountable economic world. At the heart of the WTO system — known as the multilateral trading system — is the organization's agreement, negotiated and signed by a large majority of the world's trading nations, and ratified in their parliaments. These agreements are the legal ground-rules for international commerce. Essentially, they are contracts, guaranteeing member countries important trade rights. They also bind governments to keep their trade policies within agreed limits to everybody's benefit. The agreements were negotiated and signed by governments. But their purpose is to help producers of goods and services, exporters, and importers conduct their business.

The WTO's role is to provide the forum for negotiating liberalization. It also provides the rules for how liberalization can take place. The rules written into the agreements allow barriers to be lowered gradually so that domestic producers can adjust. They have special provisions that take into account the situations that developing countries face. They also spell out when and how governments can protect their domestic producers.

Benefits of Accession

Economists have identified different reasons why countries are interested in joining an international trade agreement. Firstly, there is strong evidence that trade opening – through the framework of WTO rules - has multiple economic benefits most notably in the form of increased foreign direct investment (FDI) by multinationals and foreign sources of capital. Owing to commitments to liberalize the market sectors to foreign investors, tariff reduction should lead to improved allocation of resources in Iraq, as resources will be induced to shift to sectors where they are more highly valued at world prices. According to analysis of FDI data¹ from the World Bank, the net effect of net inflows for oil exporting countries such as Saudi Arabia, Cote d'Ivoire and Columbia increased by 6.82%, 3.02% and 2.11%, respectively. A closer look at Saudi Arabia will highlight year-on-year growth in FDI as a percentage of GDP in the years following their accession in 2005. For a replication in Iraq, this would require an environment in which multinationals view the country as a market where investment can give them a global competitive advantage, as is the current case and can be seen in the Iraqi oil industry.

Secondly, tariff reduction would more readily permit Iraqi industries to access a wider range of high-quality, affordable inputs and an inflow of imported technology and capital they could not obtain in a closed economy. The additional transfer of soft capital, in the form of intangibles such as organisational and managerial skills and marketing networks, could be a catalyst for greater efficiency and productivity. This in turn could be a powerful stimulus for competition in the marketplace, which in the long term should contribute to GDP growth and an eventual expansion of the capital stock. The growth rate in GDP of transitional economies following accession has been significant. Morocco and Turkey both experienced a net change in growth rates of 4.11% and 3.08%, respectively. Nigeria, an oil exporting country saw an increase in rates of 1.22% with Egypt seeing a 1.07% change. Diverse and rapid export growth characterized the experience of all these countries, and appears crucial for sustained economic growth in Iraq.

¹ As a percentage of GDP.

WTO accession will contribute to progress in the domestic reform agenda in many dimensions, most notably on the credibility of government policies. Governments often face a 'credibility gap' in trying to convince foreign and regional investors about their commitments to particular policies. By framing the countries' concessions into legal commitments, the WTO Membership provides powerful guarantees of policy directions. Policy reforms supported by multilateral commitments are more credible, in particular because of the strategic interaction between the government and the private sector, which makes the agreement attractive. In this setting, Iraq can use international trade agreements to enhance the credibility of its policy choices reinforcing international confidence and cooperation in trade.

Furthermore, beyond its direct impact on efficiency through import liberalization, the most immediate effect of WTO Membership should be its indirect impact on efficiency through improved governance. Corruption and lack of transparency have large costs for economic development. There is strong evidence, based on cross-country comparisons, that higher levels of corruption are correlated with slower growth and lower levels of per capita income. Corruption is very costly and undermines well-functioning markets in five ways: as a tax, as a barrier to entry, it leads to a loss of government revenue, it disrupts the operation of markets, and it subverts the legitimacy of the state and its ability to provide institutions that support markets. Membership to the WTO should help reduce incentives for corruption by providing Iraq with some of the most powerful institutional checks and balances in the international economic sphere. Accession imposes changes both in institutions and policies. As discussed above, accession to the WTO provides, once fully implemented, a set of norms, which should contribute to the opening of the economy, enhance the transparency of policies, and promote the rule of law and the evolution of an independent judicial system. Theory and evidence suggest that openness reduces corruption. Binding market-access commitments, increased transparency, and market-based institutions should further reduce rent-seeking behavior and corruption. The adherence to internationally acceptable rules for international trade and FDI imposes stricter disciplines on governments and indirectly on firms. The saving from streamlining procedures could be 2–15% of the value of the goods traded, according to estimates by the Organization for Economic Cooperation and

Development (OECD). The Peterson Institute for International Economics estimates that it could add \$117.8 billion to the world economy (global GDP). The World Bank says that for every dollar of assistance provided to support trade facilitation reform in developing countries, there is a return of up to \$70 in economic benefits.

Accession should also help increase income levels and in turn reduce poverty through the effects of liberalised trade. Free trade enables countries to specialise in goods where they have a comparative advantage thus creating economies of scale and scope. This is especially true in industries with high fixed costs or capital intensive. On the one hand, economies of scale will ultimately lead to lower prices for consumers, which should translate into a lower cost of living and an increase in real income (purchasing power). On the other hand, with greater trade, imports provide Iraqi consumers with more choice — both more goods and services to choose from, and a wider range of qualities. The quality of locally produced goods also has the potential to improve because of the competition from imports. As a result markets can be introduced for previously untraded or unavailable goods resulting in a strong case for poverty alleviation. The WTO's own estimates for the impact of the 1994 Uruguay Round trade deal were between approximately \$109 billion and \$510 billion added to world income. More recent research has produced similar figures. Economists estimate that cutting trade barriers in agriculture, manufacturing and services by one third would boost the world economy by \$613 billion — equivalent to adding an economy the size of Canada to the world economy. In Europe, the EU Commission calculates that over 1989–93 EU incomes increased by 1.1–1.5% more than they would have done without the Single Market. Trade clearly boosts incomes and is a step on the right path to the redistribution of wealth and income between the rich and poor. Trade opening since 1945 has boosted US annual incomes by \$1 trillion, or \$9,000 per household, according to the US government. The European Union, which, through the creation of its single market undertook the third major liberalization at the turn of the century, says the gains from the wider variety of goods and services available to the average European consumer are in the range of €600 a year, in addition to the gains

from lower prices. According to analysis of Gini Index² data from the World Bank, the net impact of accession had a 4.35 point increase for Argentina and a 2.28 point increase for Cote d'Ivoire in just three years following accession despite a time lag existing in theory between accession and the positive benefits in the form of a reduction of poverty materialising.

Costs of Accession

Accession implies the adoption of WTO disciplines, and this poses a number of challenges for Iraq. Firstly, accession will affect the access of foreign multinational corporations into the country's domestic markets, and it is likely to facilitate the country's access to foreign markets. The challenge for Iraq is to ensure that its industries are sufficiently competitive in the face of foreign competition. This could bear a large private cost on the state and citizens in the short term however, if in the long term, these industries continue to be inefficient then the lack of protectionism will punish them and ensure a correction in the market i.e. more efficient firms will enter, assuming low barriers to entry. Secondly, accession will impose not only certain disciplines and rules but it will also require the establishment of those institutions and policies that are critical for the enforcement of these disciplines. One area of particular importance is "governance of public and private institutions which will be affected by the WTO accession. Finally, accession will also lead to various adjustment costs, and these can be divided into two groups - the government (public) financial costs of implementing the WTO disciplines and private costs of market adjustments due to changes in relative prices.

Additionally, accession to the WTO may potentially complicate the relations of Iraq with some of its existing trading partners. Problems have previously arisen as a result of conflicts between obligations imposed by regional agreements on the one hand and the WTO on the other. Regional trade arrangements may in turn complicate the country's negotiations for accession to the WTO, which

² Gini index measures the extent to which the distribution of income (or, in some cases, consumption expenditure) among individuals or households within an economy deviates from a perfectly equal distribution. A Lorenz curve plots the cumulative percentages of total income received against the cumulative number of recipients, starting with the poorest individual or household. The Gini index measures the area between the Lorenz curve and a hypothetical line of absolute equality, expressed as a percentage of the maximum area under the line. Thus a Gini index of 0 represents perfect equality, while an index of 100 implies perfect inequality.

specifies in Article XXIV of GATT the precise conditions under which preferential trade arrangements are acceptable in the WTO. Several examples of conflicts between the regional and multilateral integration processes involving transition countries have been documented. As noted above, regional integration projects may affect the country's negotiated terms of accession. The prospect of joining the EU, for instance, provides a strong incentive for a WTO acceding country to adopt a trade policy regime that is less open than that of the EU. The more open a country's trade policy and WTO commitments compared to that of the EU, the higher the compensation that the country concerned will have to pay to third countries upon the country's accession, and the higher the welfare cost of the adoption of the common external tariff to the new EU Member. This is presumably one of the main reasons why Estonia set its applied tariffs at zero but its bound rates are higher because of its prospective accession to the EU. Upon its accession to the EU, Estonia will thus have to replace its current free trade regime by the EU's common foreign trade policy. This will lead to an increase in tariffs and thus to a welfare loss. Estonians expect, however, that these trade diversion costs will be limited because a large share of Estonia's trade is already with the EU. Moreover, the level of EU protection on raw materials, the main import from non-EU members, is relatively low. Estonia will have to implement the EU's contingent protection measures including its anti-dumping rules but these are WTO consistent.

Implementation costs are a part of adjustment costs of WTO accession. Public costs, typically includes different types of costs resulting from the implementation of the WTO Agreements, noted above. The first important group includes costs that arise out of the harmonization of the country's policy instruments with those of the WTO. For example, under the GATT and the WTO Article XI, quotas must be replaced by tariff as the sole instrument of trade protection. The economic rationale for this rule is to replace administrative instruments of protection by price-based policy tools. This is a particularly important policy change for transition countries, which had traditionally relied on explicit and implicit quotas representing the governments' planning instruments. Thus, replacing the forbidden policy instruments and moving from administrative to market-based instruments will be a radical step. These switches of policy regimes can be complicated, disruptive as well as costly. The changes must

be handled carefully and only after thorough preparations. The second important group of adjustment of costs includes the costs of institutional changes. The implementation of the WTO agreements is not a simple matter of adopting new laws. For Iraq, it typically involves the setting up of new administrative capacities and substantial changes in technologies and new investment. The implementation of Article VII of GATT requires the establishment of administrative capacity, the training of customs officers, the learning of commercial practices, the development of risk analysis and audit systems.

Conclusion

WTO accession will benefit Iraq significantly from an economic, political and social perspective through economic growth, job creation, political stability as a by-product of good governance and increased income levels. Having said that, accession is likely to have different impacts on various layers of Iraqi society and on the economy. Although the benefits of accession far outweigh the costs in the long-term, the short-term costs are likely to be high enough to put the Iraqi government in sensitive situations in which they will be expected to respond in order to ease the burden of implementation of WTO Agreements and the costs of adjustment. The short-term effect could be detrimental to Iraqi industries. There may be an increase in unemployment even when trade is expanding; and this comes down to some countries being better at making the adjustment than others. This is partly because some countries have more effective adjustment policies and have more advanced legal, regulatory and physical infrastructure than others. Additionally, WTO agreements do not guarantee increased trade flows: they provide opportunities. Some countries are better placed than others to grasp those opportunities. Some need help and need to enhance their capacity to participate more effectively in the global marketplace. Trade also poses challenges as domestic producers face competition from imports. But the fact that there is additional income means that resources are available for the Iraqi government to redistribute the benefits from those who gain the most — for example to help companies and workers adapt by becoming more productive and competitive in what they were already doing, or by switching to new activities. Furthermore, accession often raises high

hopes while in reality it also represents heavy commitments and costly adjustments to new legal and institutional requirements. The economic transition of the kind undertaken by the former centrally planned economies is not an easy process and like all other transition countries, Iraq could face specific transition related problems. An assessment of the impact of WTO accession on institutional quality in the acceding countries is difficult and can only be estimated or inferred from business surveys. In addition, many other factors affect the quality of governance. Accession to the WTO is only one of many measures with effect on institutional quality and, most likely, its effect is conditional upon other policies. Moreover, the causality may go in both directions; a high level of institutional quality will facilitate the accession while the accession promotes good institutional quality. Also, it is not, of course, possible to trace the precise time pattern of the effect of accession. It is quite likely, for example, that the institutional quality may be affected long before the actual accession in view of the preparations that Iraq may want to undertake in the anticipation of the actual conditions required by the WTO Membership. Finally, while there is no simple one-to-one relationship between trade and poverty, the evidence seems to indicate that trade liberalization is generally a positive contributor to poverty alleviation—it allows people to exploit their productive potential, assists economic growth, curtails arbitrary policy interventions and helps to insulate against shocks. However, most trade reforms will create some losers (some even in the long run), and poverty may be exacerbated temporarily. The appropriate policy response in those cases is to alleviate the hardships and facilitate adjustments rather than abandon the reform process.

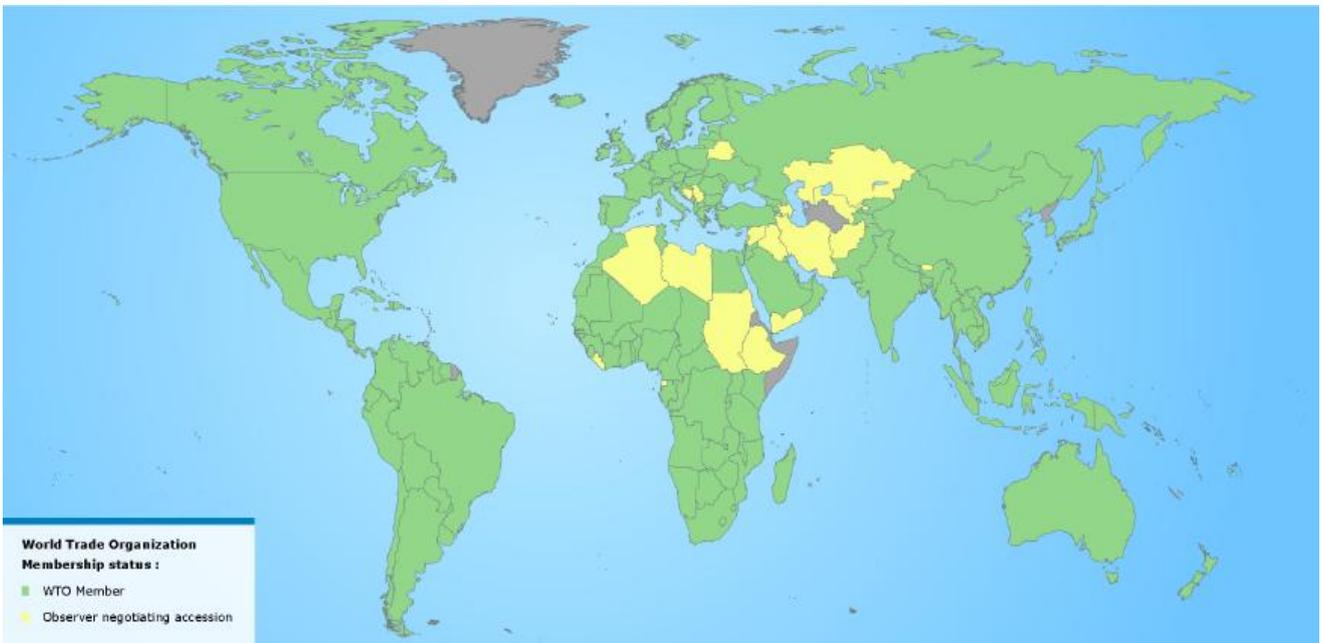


Figure 1. World map of WTO members and observers

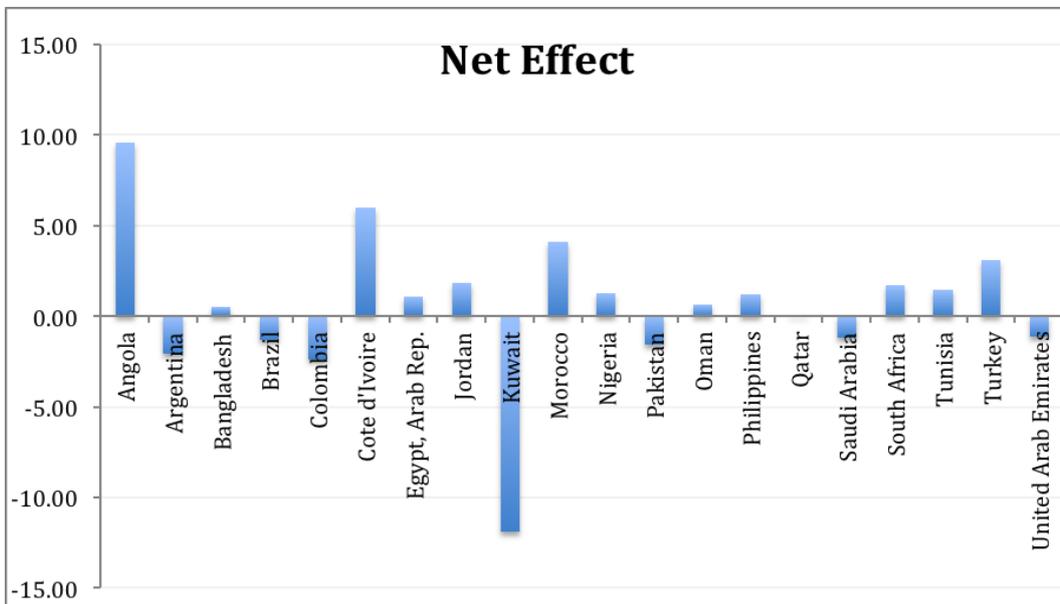


Figure 2. Net effect of WTO accession on GDP growth, Units: Percentage change

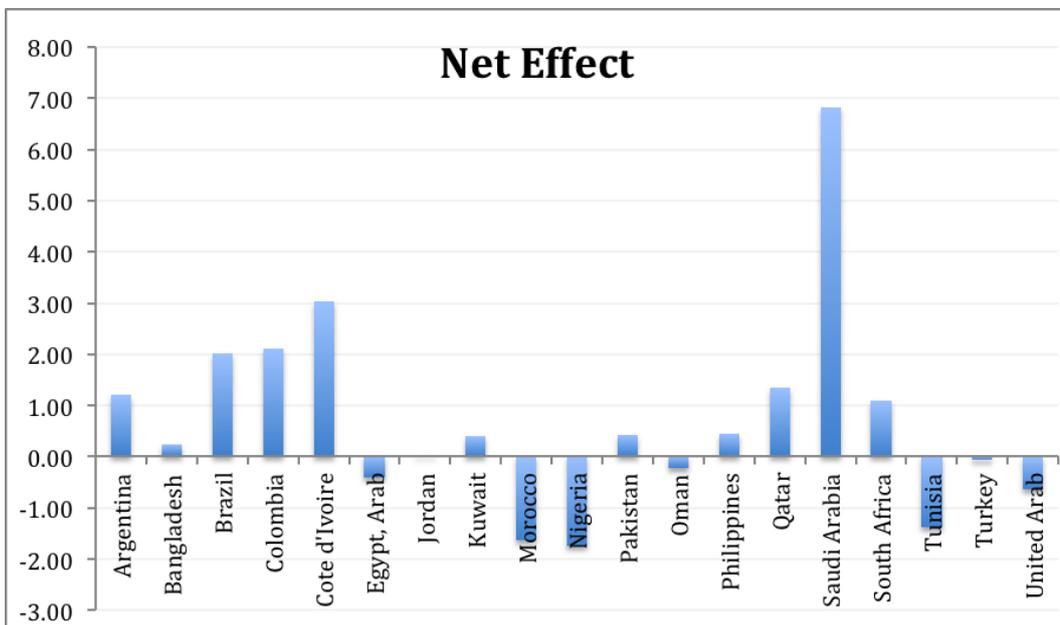


Figure 3. Net effect of accession on FDI, Units: Percentage of GDP