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Great Leaps Forward and GATT Article XVIII

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Abstract

GATT Article XVIII provides developing countries with a mechanism to ask to be released from some WTO obligations when embarking on major attempts at developing their economies. These include increasing tariff protection beyond bound tariff levels, imposing quantitative restrictions, particularly to assist in managing balance of payments difficulties, and the use of subsidies. The ability to avail oneself of Article XVIII provisions is not, however, free as countries must inform the WTO membership of their intent to use the provisions, respond to requests for consultations and possibly negotiate compensation in good faith. Since 1955 when Article XVIII was amended, the use of its provisions has been very limited – many developing countries may perceive the requirements too onerous. More prosperous developing countries, however, are planning major initiatives – Great Leaps – to developed status and have the wherewithal to meet the constraints on using Article XVIII. Subsidies are the likely policy. These countries perceive opportunities in the technological disequilibrium of the current global economy with new industries and technologies awaiting investment.

Keywords: disequilibrium, GATT Article XVIII, Great Leap, subsidies, WTO

Introduction

Bounties upon exportation are … frequently petitioned for, and sometimes granted, to the produce of particular branches of domestic industry. By means of them, our merchants and manufacturers, it is pretended, will be enabled to sell their goods as cheap or cheaper than their rivals in the foreign market. A greater quantity, it is said, will thus be exported, and the balance of trade consequently turned more in favour of our own country. We cannot give our workmen a monopoly in the foreign, as we have done in the home market. We cannot force foreigners to buy their goods, as we have done our own countrymen. The next best expedient, it has been thought, therefore, is to pay them for buying. It is in this manner that the mercantile system proposes to enrich the whole country, and to put money into all our pockets, by means of the balance of trade.

Adam Smith
The Wealth of Nations, 1776, p. 405[1]

Meiji Japan (1868–1912) set itself the targets of political modernization, industrialization, military build-up, and correcting the unequal commercial treaties. All of these were eventually attained. In less than half a century after the forced opening of ports, it succeeded in vigorously importing Western systems and technology, transforming itself into a 'modern' state … In the economic arena, an industrial revolution in light manufacturing was achieved in the 1890s … Meiji Japan's emergence from an agro-based backward latecomer to one of the most advanced nations in the world was accompanied by a fast and broad absorption of Western technology and its local adjustments, and high-quality human capital which made this possible.

Kenichi Ohno
Meiji Japan. *How Nations Learn*, 2019, p. 85

… the observation that many developing countries are able to take advantage of either explicit or implicit exceptions in GATT so as to pursue almost at will any form of trade policy they wish. For example, the balance of payment rules of Article XII and XVIII of GATT give a claim of legitimacy to many measures implemented by developing countries, including quantitative restrictions, despite the nominal prohibitions in GATT against such measures.

John H. Jackson
The World Trading System, 1992, p. 277

The contracting parties recognize further that it may be necessary for those contracting parties, in order to implement programmes and policies of economic development designed to raise the general standard of living of their people, to take protective or other measures affecting imports, and that

> such measures are justified in so far as they facilitate the attainment of the objectives of this Agreement. …
>
> The contracting parties recognize finally that, with those additional facilities which are provided for in … this Article, the provisions of this Agreement would normally be sufficient to enable contracting parties to meet the requirements of their economic development. They agree, however, that there may be circumstances where no measure consistent with those provisions is practicable to permit a contracting party in the process of economic development to grant the governmental assistance required to promote the establishment of particular industries with a view to raising the general standard of living of its people. Special procedures are laid down in … this Article to deal with those cases.

Article XVIII of the General Agreement on Tariffs and Trade, 1947

The global economy is in, or on the cusp of, a major disequilibrium whereby there will be significant changes to the constitution of exiting industries and new industries coming into existence. Technological advances are the major driving force of these changes, but other factors are climate change, the evolution of workforces due to population dynamics and the rise of security concerns. The technological advances are spurred, to a considerable degree, by these other factors – the green transition, robotics, military drones. Much attention is given to the disruptions caused by technological-based disequilibrium (Kerr, 2022) but disequilibrium also creates opportunities. Developed countries are racing to identify, capitalize on and capture for themselves the expected benefits from these opportunities (Kerr, 2023). In the process they are often ignoring international trade laws as they provide massive subsidies and protection for the industries they wish to foster. In the process they are weaking the rules-based system of international law and its institutions such as the World Trade Organization (WTO). Developing countries, particularly those with considerable technical capacity also see opportunities in the current disequilibrium.

In January 2024 *The Economist* reported:

> By 2050 there will be a new crop of economic powers – if things go to plan. Narendra Modi, India’s prime minister wants his country’s GDP per person to surpass the World Bank’s high-income threshold three years before then. Indonesia’s leaders reckon that they have until the mid-century mark … to catch up with rich countries. The middle of the century is also the ultimate finale for many of Muhammad bin Salman’s “Vision 2030” reforms. Saudi Arabia’s crown prince wants to transform his country from an oil producer into a diversified economy. Other smaller countries, including Chile, Ethiopia and Malaysia, have schemes of their own.

It goes on to report:

> These vary widely, but all have something in common: breathtaking ambition. India's officials think that GDP growth of 8% a year will be required to meet Mr. Modi's goal – 1.5 percentage points more than the country has managed on average over the past three decades. Indonesia will need growth of 7% a year, up from an average of 4.6% over the same period. Saudi Arabia's non-oil economy will have to grow by 9% a year, up from an average of 2.8%. … Very few countries have maintained such growth for five years, let alone 30.

The Washington Consensus[2] upon which much economic development since the 1990s has been based, fostered much lower growth rates of approximately two percent. Those who are proposing more radical rates of economic transformation clearly have something else in mind – the model appears to be that of *Meiji* era Japan. Thus far, Japan is the only country to be considered to have moved from least developed to fully developed in three to four decades. Other countries in Europe, North America and the antipodes took much longer as have *Asian Tigers* such as Taiwan. South Korea, Hong Kong and Singapore. In the case of the *Asian Tigers*, arguably the process of transformation has not fully run its course although great progress has been made.

The globe is also littered with failed attempts to make the Great Leap to being developed. The Soviet Union strived to achieve such a goal between the late1920s to the 1960s but their command economy approach proved unsustainable (Gaisford et al., 2007). China, under the leadership of Mao Zedong initiated the *Great Leap Forward* in the mid-1950s. According to Jung and Chen (2019, p. 60) its objective was set out by Mao:

> Mao Zedong first expressed this idea clearly at the National Congress of the CPC in March 1955, where he proposed to catch up with or surpass the most powerful capitalist country in the world in a few decades. At the preparatory meeting for the Eighth National Congress of the CPC in August 1956, he affirmed, "We trail the United States by 60 years. We will surpass them in 50 or 60 years. This is a responsibility."... In November 1957, Mao led a delegation of the CPC to Moscow for a conference of representatives of the Communist Party and the Workers' Party of all countries. During the meeting, he changed his original rhetoric and proposed that China should take around 15 years to surpass Britain in steel and major industrial products.

This attempt at a Great Leap was a major disaster that engendered a major famine (Kerr, 2023a) and a decline in the economy.

Argentina was another country that caught up to the living standards of some European countries by the early decades of the 1900s. According to Salvatore (2004, p. 234):

> Scholars have presented "Golden Age" Argentina (1880–1914) as a case of successful export-led growth. Rapid growth in agricultural exports (primarily cereals and beef) translated into high rates of growth in per capita income. Argentina's remarkable economic performance during this period was attributed to its relative high levels of agricultural productivity, to the rapid expansion of basic resources (land, labor, and capital), and to wise economic policies: markets functioning almost without regulation and a monetary currency tied to the gold standard. Argentina was the case of a "frontier" economy that, with abundant land resources and the attraction of labor and capital from abroad, was able to grow in a rapid and sustained fashion.

The achievements of this leap did not prove sustainable (Salvatore, 2004).

The Japanese transformation remains the only example of a country that has made a rapid transition to developed status. Despite considerable research and study of Japan's successful movement from an agrarian/feudal economy to a modern industrial economy, it has not proved possible to replicate its success. It appears, however, that a number of developing countries are about to try.

Picking Winners

The fostering of this transition will be through the use of *industrial policy* whereby governments will pour resources into sectors it wants to become global leaders. This means *picking winners* – identifying the sectors where both a large economic impact and sustainable success can be expected. Experience suggests that governments have a poor record of *picking winners* (Davies and Kerr, 1997).

The spur for attempting a rapid transition is the current disequilibrium whereby the global economy is faced with a plethora new potential industries and a range of technologies which have the potential to underpin them. One of the factors that complicates the choices of developing countries is that developed countries are also wishing to take advantage of the opportunities presented by the current disequilibrium. They are also trying to capture the potential rewards from being industrial leaders though the mechanism of industrial policy. In their view, the market cannot be trusted to guarantee them the means to retain the lead associated with being a developed country. In the US, the Inflation Reduction Act, a signature policy of the administration of President Biden is the prime example of such industrial policy. It is targeted at transforming to a Green Economy in the US. Fostering the uptake of electronic vehicles receives particular emphasis.

In Canada, the government has mandated the end of new petrol-powered personal vehicle sales by 2035. It is also providing incentives for the installation of a large number of charging stations for electronic vehicles. This strategy is particularly ambitious given Canada's huge distances, low population density and sub-zero winter temperatures. In 2023 a Chinese car maker, *BYD*, sold more electric vehicles than the western flagship electronic vehicle maker, *Tesla*. The Chinese electronic vehicle industry has been the recipient of a range of subsidies and other incentives – which has led to the current success (*The Economist*, January, 13, 2024). It is a clear example of using *industrial policy* to challenge the lead of western economies in the race to take advantage of the opportunities provided by the current disequilibrium.

There are also examples of international cooperation in aid of garnering the expected benefits of the transition. The UK and the EU struck a deal to mutually halt the implementation of post-Brexit tariffs on electronic vehicles.

Much of the industrial policy of developed countries appears to not conform to World Trade Organization (WTO) commitments. The WTO has, however, been weakened over the last decade (Kerr, 2023b; Kerr, 2019), particularly by the indifference, and sometimes hostility, of the United States (Kerr, 2020; Kerr, 2018). While complaints have been registered at the WTO and formal disputes have been initiated, as the disputes mechanism of the WTO has been disabled, countries can ignore adverse Dispute Panel rulings. The refusal of the United States to cooperate in the appointment of new members to the Appellant body as existing members retired effectively means that the right of appeal to Dispute Panel decisions no longer exists – and the disputes mechanism is institutionally invalid – and thus can be ignored (Kerr, 2021). At the moment, this suites the countries in the race to garner the benefits of the opportunities the current technological disequilibrium present but this may not always be the case. Further, there is considerable pressure to break the log jam over the disputes mechanism – of course only after the presidential election in the United States in November 2024.

For developing countries with ambitions to make a Great Leap through the use of industrial policy, they might face strong WTO sanctioned trade actions brought by developed countries objecting to their use of large-scale subsidies. While they are making the Great Leap their economies will still be vulnerable to trade actions by developed countries. Their transitions, even if all goes well, will still take place over thirty to forty years. Thus, the question arises, are there provisions in the WTO that will allow developing countries to shelter their Great Leap fostering policies from threats from developed countries. Article XVIII may provide such shelter.

GATT Article XVIII and Policies to Foster a Great Leap

GATT Article XVIII was put into the GATT 1947 at the insistence negotiators from developing countries. It was designed as an escape valve for countries wishing to foster their economic development using economic tools such as tariffs and subsidies, and added later in 1955, quantitative restrictions on imports, whose use would violate normal commitments of GATT members. Article XVIII is arguably the most complicated of all the GATT articles. Developed countries, particularly the United States, did not want there to be loopholes in the agreement that would allow countries to circumvent their GATT commitments but had to grudgingly agree to the demands of negotiators from developing countries that their countries needed more policy leeway to foster economic development. The perceived primary rout to economic development at the time was based on import substitution development stemming from the popular work of Raúl Prebisch (Gerber, 2007). Developed countries, however, were not willing to grant countries claiming the exemptions provided in Article XVIII a *cart blanch* for their use – they attempted to restrict their use to a limited set of circumstances.

Article XVIII exemptions can only be claimed by developing countries. Two types of developing countries are identified in Article XVIII. The first is described in Section 4 (a):

> … the economy of which can only support low standards of living and is in the early stages of development, shall be free to deviate temporarily from the provisions of the other Articles of this Agreement ...

The second category is found in Section 4 (b):

> A contracting party, the economy of which is in the process of development, but which does not come within the scope of subparagraph (a) above, may submit applications to the CONTRACTING PARTIES …

Each category of developing countries has different requirements for it to access the provisions of Article XVIII.

The terms describing developing countries under Section 4 (a) are vague. What is a *low standard of living*? What is an *early stage of development*. Given their vagueness, countries about to attempt a Great Leap might argue that they fit within the definitions. This may be particularly relevant when the Great Leap is to bring the country up to developed country levels of economic development – the starting point may be a *low standard of living* relative to the end point of the Great Leap. Similarly, making the Great Leap suggests that a much later stage of development will be achieved relative to an *early stage of development*.

The explanatory notes to Article XVIII, if anything, provide broad interpretations of the terms in the agreement. For Paragraphs 1 and 4, Note 2 states:

> The phrase "in the early stages of development" is not meant to apply only to contracting parties which have just started their economic development, but also to contracting parties the economies of which are undergoing a process of industrialization to correct an excessive dependence on primary production.

For Paragraphs 2, 3, 7, 13 and 22

> The reference to the establishment of particular industries shall apply not only to the establishment of a new industry, but also to the establishment of a new branch of production in an existing industry and to the substantial transformation of an existing industry, and to the substantial expansion of an existing industry supplying a relatively small proportion of the domestic demand.

These definitions would appear to be broad enough to encompass the types of industries that would likely be included in any attempt at a Great Leap.

Article XVIII allow for three trade policy tools to be used by countries that qualify for and ask for exemptions. First, tariffs can be raised above *bound* levels. Second, quantitative measures can be used to provide protection from foreign competitors – in particular, if they can be justified on balance of payments difficulties. The latter was only added to GATT text after a review undertaken in 1954-1955. It seems these trade measures are not likely to be very important for a country attempting a Great Leap (Viju and Kerr, 2012). The third policy measure allowed for in Article XVIII is the use of subsidies. This appears to be the policy most likely to be used to foster a Great Leap.

According to Bhala (2002, p. 529)

> What Section C authorizes a developing country WTO Member to do is subsidize emerging industries. … Unlike Sections A and B, Section C empowers those countries to go a step further than protection through tariff and non-tariff barriers, respectively.
> It authorizes pro-active policies to promote the establishment of a particular industry.

Article XVIII also applies to developing countries that do not qualify as being only able to support low standards of living and is in the early stages of development. In other words, middle income developing countries. Countries contemplating a Great Leap are likely to be in this category.

According to Bhala (2002, p. 537):

> For this lot of somewhat better-off countries, ie, the 'middle-income developing countries, forgiveness cannot be granted under the terms of Sections A or B, ie, through a tariff or quantitative restriction implemented under those Sections, respectively. Transgressions

> against Sections A and B are tolerated for the less-well-off developing countries, but not for the middle-income Members. Rather, mercy for the latter group lies by referring to Section C, and following the overlay of Section D. That is, the middle-income Members are permitted only one forgivable type of transgression - governmental assistance, yet the transgression must be planned out in advance according to what Section D says.

Article XVIII lays out a number of steps a country must follow to invoke the provisions of the article. The General Assembly must be informed of the intent to use a subsidy and it must be planned out before – it is an *ex ante* not an *ex post* process. Other Members may ask for Consultations and Compensation if their domestic industries may be injured. The country must negotiate in *good faith* over compensation but a non-agreement on Compensation cannot stop the use of the subsidy forever. In the case of the Great Leaps currently contemplated, the idea is to capitalize on the current disequilibrium and establish new industries – where other members of the WTO will not likely have existing industries. Thus, Consultations and Compensation may not be issues. In the past Sri Lanka, Haiti, India and Cuba have been granted the use of Article XVIII measures while Indonesia and Malaysia gave notice but did not undergo the full consultation process (Bhata, 2002).

Hence, while there may be a number of hoops to jump through and hurdles to be crossed, once those activities are accomplished the subsidy can be put in place. According to Bhata (2022, p. 536):

> The 'bottom line' is that despite the rather complex language surrounding the procedural limitations, sooner or later, with more or less cajoling, a developing country WTO Member will be able to implement its proposed governmental assistance measure, possibly with "some modifications to it as a result of the consultation process. Most significantly, the legal fact is that the developing country will be released from its GATT obligations to the extent necessary to apply the measure.

Given that Great Leaps are projected to take place over thirty to forty years, spending the time to go through the processes and procedures specified in Article XVIII will not be an important constraint.

Conclusion

The global economy is in a period of technological innovation that has moved it from a state of relative equilibrium to one of disequilibrium. New industries show considerable promise and existing industries will be disrupted in some sectors. In Schumpeter's (1942) terms – a period of *creative destruction*. Disequilibrium provides opportunities and governments are attempting to have their countries capitalize on those opportunities to create (and capture) new industries.

While much of this activity is taking place in developed countries, developing countries – particularly those with considerable technical capacity and resources – can also see opportunities they might capitalize on – and make the Great Leap to developed status. To do this they must identify industries or projects that would contribute to accomplishing their Great Leap. Picking winners however, is far from easy and many attempts at Great Leaps have failed – sometimes with disastrous consequences.

Developing countries attempting a Great Leap do not need to be hampered by international institutions. Currently, making a Great Leap will be fostered by large scale subsidies. The WTO has rules that limit the use of subsidies. Exceptions are provided in GATT Article XVIII for developing countries to use subsidies to achieve development goals. Although, the use of Article XVIII provisions – including subsidies – has certain requirements these do not appear to be too onerous, particularly in the case of Great Leaps with horizons of thirty to forty years.

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Endnotes

[1] This quote is taken from a more accessible version of the *Wealth of Nations* that can be found at: https://www.rrojasdatabank.info/Wealth-Nations.pdf.
[2] First set out in 1989.