Chapter 14

A global breakthrough in trade

International trade can be a powerful driver of economic growth and poverty reduction. It is not, however, a magic bullet for achieving development. The slogan "trade, not aid" is misguided, particularly in the poorest countries. Trade reforms are complementary to other development policies, especially scaled-up investments in infrastructure and human capital, macroeconomic stability, and institutional development.

As outlined in the Monterrey Consensus, an MDG-based international trade policy should focus on two overarching issues:

- Improving market access and terms of trade for the poorest countries.
- Improving supply-side competitiveness for low-income countries' exports through increased investments in infrastructure (roads, electricity, ports) and trade facilitation.

The second of these is often overlooked when discussing trade reforms in the context of the poorest countries. For many middle-income countries, basic infrastructure and productive capacities are in place so that market access issues pose the greatest challenge to increasing trade. Yet for many low-income countries, increased market access will provide only limited direct benefits, since there is often little agricultural surplus available to trade, a weak to nonexistent manufacturing base for export, and insufficient infrastructure to achieve competitiveness in nontraditional exports.

The poorest countries should pursue open trade and negotiate vigorously for greater market access in the high-income markets. But they should also emphasize, and receive, additional aid to overcome their supply-side production barriers. Overcoming the supply-side limitations will require significant investments in agricultural productivity (rural electricity, irrigation, soil nutrients, transport and storage facilities; see chapter 5), other key infrastructure

linked to trade (roads, ports, airports, telecommunications, electricity), and human capital (health, education, training).

The context of trade negotiations

Achieving more open and fair markets for the promotion of development is the mission of the multilateral trading system, which has evolved progressively since the end of World War II and delivered impressive results for many countries. Throughout most of its existence, however, the trading system has mainly served the interests of developed countries. Developing countries, sometimes by their own decision and other times by explicit exclusion dictated by richer countries, have not been influential in the system's design. Moreover, most of today's multilateral rules have emulated to a great extent the policies, the practices, and most important, the laws and regulations of only a few developed countries.

The system is thus unbalanced against the interests of developing countries. Balancing it will give developing countries greater economic growth potential, a major stake in developing multilateral trade rules and disciplines and in pursuing trade liberalization, and more effective capacity to expand trade and defeat poverty. That goal was the motivation underpinning the Doha Development Agenda Round of trade negotiations launched in November 2001, at least according to the rhetoric.

But this sense of purpose was short lived. With key deadlines missed and progress practically nil on every issue contained in the Doha Development Agenda, the WTO Ministerial of September 2003 in Cancun collapsed amid acrimony. There is no single explanation, but the developed countries' failure to lead by example was notable. WTO members have since made a courageous effort to revive the Round, but a lot more effort will be required. The 2004 Doha Work Programme framework, while necessary to prevent the collapse of the Round, is far from sufficient to sustain it.

The real work remains to be done, and a sense of urgency is required if the Round is to be completed by 2006 (UN Millennium Project 2005l). If this narrow window of opportunity is missed, it is hard to see how the Round can be completed in time to contribute to the achievement of the Millennium Development Goals by 2015. All members of the WTO must identify the core priorities of a real development round and make concrete political and financial commitments to achieving them.

A real development round is achievable but will require high-level political leadership—from both developed and developing countries—as part of a coherent policy approach to meeting the Goals. The year 2005 offers a rare opportunity to harness the momentum of the Goals to seek a major political consensus among heads of state, particularly in the lead-up to the September 2005 UN summit, to shape the multilateral trading system for the future. This grand vision would keep focused the eyes of negotiators at the Sixth WTO Ministerial Conference in Hong Kong (China) in December 2005.

Based on the work of the UN Millennium Project's Task Force on Trade, we recommend that leaders agree on two key guidelines for the future path of the trading system (UN Millennium Project 2005l). First, in a conveniently distant long term, such as by 2025, the multilateral trading system should deliver the total removal of barriers to all merchandise trade, a substantial and extensive liberalization of trade in services, and the universal enforcement of the principles of reciprocity and nondiscrimination in a way that supports attainment of the Millennium Development Goals. This target is ambitious but not impossible, with political leadership and appropriate support for adjustment. There is also a base to build on: APEC economies have already committed to free trade by 2010 for developed members and 2020 for developing members. Second, the most useful WTO would be focused on trade and be relieved of other global economic governance tasks, which can be better accomplished by other international instruments or entities.

Key areas under negotiation

In the Doha Round, the most important negotiation topics are likely to remain agriculture, nonagricultural market access, and services. Other important issues include contingent protection, standards, preferences, trade facilitation, intellectual property rights, and special and differential treatment.

Agriculture—the biggest and costliest aberration

The biggest and costliest aberration of the trading system is found in agriculture. Farm producers in rich countries receive support in excess of $250 billion, pushing their farmgate prices almost one-third higher than world prices (UN Millennium Project 2005l). Consumers in those countries pay for that protection through higher taxes and higher food prices. This is their choice. But it must be stressed that by so doing they also impose a heavy burden on other agricultural producers, particularly in developing countries. Agricultural protection in both developed and developing countries is most assuredly a contributor to poverty in a large number of poor countries.

That rich countries should lead farm liberalization is beyond question. They should deliver substantial liberalization under all three pillars of the agricultural negotiations. They should shift their farm policies to income support—helping the poor and small farmers in rich countries to adjust to more open farm markets. Export subsidies should be totally and definitively eliminated, as agreed in the Doha Development Agenda framework of August 2004. These should be removed by 2010. This will send a powerful signal to developing countries, which will follow suit with their own deeper market opening without the danger of export subsidies greatly distorting trade and competition. All countries should decouple all support payments to farmers by 2010 and cap all domestic support measures at 10 percent of the value of agricultural production (on a byproduct basis) by 2010 and at 5 percent by 2015.

Negotiations on farm trade liberalization should also broaden their focus beyond elimination of export subsidies to stress reductions in tariffs—themselves a powerful discipline on export subsidies—and reduction in domestic support. By 2015 no bound farm tariff should exceed 5 percent for OECD countries. Market access negotiations must address both the unacceptably high tariff peaks that remain in agriculture and tariff escalation, which continues to frustrate developing country efforts to move up the value chain. All nontariff barriers, including tariff rate quotas, should be removed by 2010.

Economic growth of the poorest countries depends crucially on a more dynamic agricultural sector. The fragility of these countries, however, suggests that, as a result of the Doha Round, they should reduce only their bound tariffs—since most of their applied tariffs are moderate—and their applied tariff peaks, which cost their poor consumers dearly without bringing public revenue. Additional complications for the poor countries that may be hurt by this liberalization, particularly the low-income food-importing countries that will pay higher import prices, should be dealt with by a substantial increase in international aid. The increased aid would serve partly to cover increased food import costs and partly to stimulate a new Twenty-first Century Green Revolution in food-insecure regions, especially in Sub-Saharan Africa. By 2015 no bound farm tariff should exceed 15 percent for the poorest countries and 10 percent for other developing countries.

Meanwhile the Green Box of minimally trade distorting subsidies should be maintained for the poorest countries—with clarifications or such marginal additions as support for diversification, transportation subsidies for farm products, consumption subsidies for domestic food aid, and public assistance for establishing farm cooperatives or institutions promoting marketing and quality control.

Nonagricultural market access—all countries should liberalize

Trade barriers in nonagricultural products, though not as severe as in farm products, continue to be significant and particularly detrimental to developing countries. For example, developing countries' exports to developed countries face tariffs that are, on average, four times higher than those faced by the exports of other developed countries. Developing countries' exports suffer from mega tariffs, tariff peaks, tariff escalation, and quotas imposed by rich countries on goods of great export potential. Developed countries should bind all tariffs on nonagricultural merchandise at zero by 2015, the target date for achieving the Millennium Development Goals. A midterm goal could be for no tariff higher than 5 percent by 2010.

Over the last few decades, developing countries have undertaken an unprecedented level of trade liberalization, both autonomously and in the context of multilateral and regional negotiations. They still suffer, however, from their own protection, which reduces not only their competitiveness in

world markets but also the enormous opportunities of increased trade among themselves. Developed countries bear a special responsibility to liberalize in the Doha Round, but developing countries should also do so because they are important markets for each other, including the poorest countries. While still less than full reciprocity, the poorest countries should nonetheless bind their tariffs at uniform and moderate rates in their own development interests. Ideally, developing countries should all be at zero tariffs by 2025. As soon as possible, these countries should bind all their tariffs in coherence with their applied rates. The poorest countries should also aim to bind all tariffs at a uniform and maximum rate. Adjustment costs should be economically and socially sustainable in developing countries—for example, by phasing in tariff reductions and providing international technical and financial assistance.

The Uruguay Round Agreement on Textiles and Clothing was supposed to phase out quotas progressively by January 1, 2005. But phaseouts have been heavily backloaded, with more than 50 percent of quotas—covering the most commercially valuable products—still to be removed (as of the end of 2004). Backloading has robbed developing countries of one of the major gains expected from the Uruguay Round and given rise to legitimate doubts about the willingness of the major importers to honor the agreement. It has also undermined any chance of gradual and orderly adjustment in the sector. The abrupt removal of the remaining quotas on January 1, 2005, will create adjustment problems for importers and exporters alike and is unleashing powerful protectionist forces in high-income countries. These must be effectively contained—for example, by restraining the proliferation of contingency protection measures. The correct answer lies not in pursuing protectionism by other means, but in providing adjustment support to small suppliers highly dependent on this sector through trade and development measures.

This has led some to call for an extension of quotas. But this would be a mistake. "Temporary" textile and clothing protection has persisted for 40 years; continuing protection is likely only to prolong and further distort the adjustment process. The difficult process of adjustment must be started now. Given the role that developed countries have played in creating the scale (if not the fact) of the adjustment challenge, they must now be prepared to contribute to its resolution by covering some of the costs of adjustment. Assistance could help developing countries to move into niche markets or up the value chain and to strengthen their networks of suppliers and clients to meet just-in-time production deadlines. Removal of trade barriers and domestic distortions by developing countries themselves would also help increase competitiveness. Tariff preferences may ease adjustment for some countries in the short term, although restrictive rules of origin will need to be addressed. More helpful and less distortionary temporary breathing space could be provided by all developed countries extending duty-free and quota-free access to all products from the poorest developing countries no later than January 1, 2006.

Services—a major source of gains for developing countries

Liberalization of trade in services, especially of so-called mode 4 (the temporary movement of people to supply services), has been recognized as a major source of gains for developing countries, capable of bringing more benefits to them than perhaps any other part of the Doha Agenda. Services liberalization promises real development gains in efficiency, in the growth potential of the economy, in the export of goods and other services, and in access to basic services to improve the lives of the poor. Done right, services negotiations offer developing countries an opportunity to act in their own economic interest and get paid for it. They also offer the opportunity to manage the world's mounting migration pressures in a much more orderly fashion.

But services gains are not automatic, and producing an outcome that supports development can be a challenge, given the need for regulation to address complex issues of market structure, market failures, and noneconomic objectives. Ensuring that services liberalization results in competition and increases access to services by the poor are key regulatory challenges, requiring increased research and assistance. But with appropriate care to the nature, pace, and sequencing of reform, adjustment—including that related to increased imports of labor-intensive services—can be managed.

The Doha Round must make progress on mode 4 as a high priority. Developing countries should seek to expand access for groups of interest to them (such as contractual service suppliers and intracorporate transferees) and improve the transparency and usability of existing access. Bilateral or plurilateral agreements could also be considered as an interim step. These cover a broader range of workers than mode 4 and provide scope to develop trust and complementary policies (for brain drain, remittance transfers, return, and recognition). Over time, recruitment of workers under these schemes could be opened on a most-favored nation (MFN) basis to any country that can implement the requirements. The WTO would be notified of agreements, and interested WTO members would have the opportunity to indicate their interest in joining or negotiating similar agreements. An MFN waiver would likely be necessary. Bilateral or regional agreements, while a potentially useful interim step, are no substitute in the longer term for bound multilateral commitments under the WTO. WTO commitments remain the best and most effective way to deliver gains to developing countries, and commercially meaningful market access commitments on mode 4 are essential to fulfill the development dimension of the services, and Doha, negotiations.

Contingent protection and standards—avoiding the costs and uncertainties of new barriers

Even if the access issues are addressed, it will be important to ensure that the hard-won gains are not eroded by other policies that recreate trade barriers or create transactions costs and uncertainty. Antidumping is a form of continent

protection used disproportionately against the exports of developing countries, with a severe chilling effect on their actual and potential trade—though some developing countries are now also becoming major users of antidumping measures. The Doha Round could help in several ways. The *de minimis* threshold below which developing country exports are immune from antidumping could be raised. Currently, as soon as imports from developing countries emerge from being insignificant, they are restricted by high antidumping barriers. National antidumping laws could also be required to treat all affected domestic interests—import-competing industries, consumers, and users—equally.

Meanwhile, developing countries should not be denied effective market access by their inability to meet ever more and ever higher OECD standards or market entry conditions. Exemptions are unlikely to help, serving only to brand developing country exports as inferior or unsafe and providing no incentive to raise national standards for the benefit of domestic consumers. Where standards are imposed by private buyers, there is even less scope for—or point in—seeking exemptions. Two things are essential if developing countries are not to be left behind: first, assistance to make effective use of the WTO disciplines for Technical Barriers to Trade and Sanitary and Phytosanitary Measures to ensure that standards are not abused for protectionist purposes, and, second, significant assistance to construct the institutional frameworks and infrastructure required to meet legitimate standards. Further, developing countries must be assisted to become more substantively involved in standard-setting processes, and those standard-setting activities themselves need to be oriented toward issues of greater interest to developing countries.

Preferences—to be replaced with equivalent development assistance

Rich countries have often used preferences to divide developing countries and promote their narrower regional, sectoral, and political objectives, often establishing complicated regulations that exclude exports from otherwise eligible countries. The poorest countries have frequently received limited benefits from preference schemes, in part because preferences do nothing to address their multiple supply-side constraints. Benefits are also often gained at the expense of other developing countries, and they are smaller than would be the case with either direct transfers or multilateral liberalization. But the price of preferences is continuing protection in rich countries. MFN liberalization—plus appropriate compensation for countries that may suffer adjustment problems—is likely to be a better path.

Some developing countries may confront possible large losses from preference erosion and will require concrete assistance. Given the history of preference programs, developed countries as a group should pay to replace preferences with equivalent official development assistance, which the recipient governments could use to fund adjustment costs. Making this deal operational should be an explicit part of the Doha Round. Any such assistance should

be seen as part of a broader effort needed to help poor countries build and strengthen their ability to use trade beneficially. Specifically in the context of a Doha deal, however, there is a need to accompany global commitments to implement far-reaching trade reforms on an MFN basis with a temporary program to transfer additional resources to developing countries, especially those that will experience preference-erosion losses.

Free trade agreements—imposing high transaction costs

Free trade agreements (FTAs) have a mixed record in achieving real liberalization, especially on the hardest nuts (agricultural subsidies or sensitive products). Benefits may be limited (or achieved at the expense of others) and costs can be high. Unlike at the WTO where developing countries can form effective coalitions, in FTAs they are at a disadvantage in resisting the inclusion of nontrade issues or erosion of their WTO rights (TRIPS+ on patents, especially pharmaceutical patents, and other WTO+ provisions). Multiple FTAs with differing rules of origin impose high transaction costs, particularly on small traders, and divert the limited negotiating resources of poor countries from the pursuit of multilateral liberalization.

Singapore issues—improved trade facilitation promises development gains

Three of the four Singapore issues (competition, investment, transparency in government procurement) have rightly been left off the Doha Round. None meet the three essential tests of whether rules on regulatory issues should be included in the WTO: Are they trade related? Are they in line with broader development priorities? And what is the specific value of a WTO agreement? These issues are not priorities for poor countries and could divert scarce resources from other issues with higher development payoffs. Even where there are development benefits, they may not be best pursued through a WTO agreement.

The remaining Singapore issue, trade facilitation to minimize bureaucratic procedures, promises trade and development gains, but a WTO agreement cannot be business as usual. It should not impose heavy obligations on developing countries and make light promises of assistance. The main value of a WTO agreement on trade facilitation would be as a mechanism for attracting and channeling international assistance. From a development perspective, the best model is one where implementation deadlines could be customized in negotiations with individual countries, with technical and financial assistance packages negotiated and customized as part of a package. A review process involving expert organizations and other developing countries with similar experiences could identify problems early, and negotiated extensions would be possible.

Trade-related intellectual property rights—differing needs by country

The inclusion of intellectual property rights in the WTO has been vigorously debated. Intellectual property laws require a very delicate balance of market

forces and public action—a balance unlikely to be the same for all countries. Unfortunately, TRIPS (trade-related aspects of intellectual property rights) obligations have tended to take too little account of levels of development and varying interests and priorities. This was manifestly true of TRIPS coverage of medicines, imposed without due regard for the possible adverse effects on public health. As a result, the TRIPS rules on access to essential medicines have had to be negotiated and renegotiated in a still-acrimonious environment. While the TRIPS Agreement has tried to mitigate the problems of one-size-fits-all by providing for differing implementation periods, countries acceding to the WTO may not even have access to these normal flexibilities.

The TRIPS Agreement does include areas of interest for many developing countries, though the balance of costs and benefits varies by country and according to issue. But the flexibility provided for implementation of TRIPS is still less than sufficient on paper, and even less so in practice. There is a clear case for revisiting more of the rules to examine their impact on developing countries and any additional flexibility required. This remains relevant for access to essential medicines.

Special and differential treatment—making it more effective and operational

All countries will enjoy significant long-term benefits from freer trade. But it is also clear that poorer countries have less capacity to benefit and many will need short-term adjustment support. Developing countries generally have a more limited ability to take advantage of new opportunities and to bear adjustment costs. Special and differential treatment makes sense—and should be made more effective and operational.

There is no compelling case for exemption for rules on traditional trade policies. Additional freedom to use bad policies promises few development gains, and risks harming other developing countries (through subsidy wars). For rules on domestic regulations requiring actual investment of resources, a cost-benefit analysis based on four factors should guide what special and differential treatment to grant and to whom: the extent to which the rules are related to trade (market access), the extent to which they are in line with broader development priorities, the costs of implementation, and the relative costs to others of nonimplementation. Assessments of costs and benefits will vary by issue and level of development of the country.

Where the costs are high and the trade and development benefits minimal, the issue should not be included in the WTO. Where the costs are high, and development benefits only a longer term priority, there is a strong case for extensive—but not eternal—flexibility. Where development benefits are greater or more immediate, a model that calibrates commitments with assistance and gives greater flexibility to countries to determine appropriate implementation periods is appropriate. Where WTO rules promise real and short-term trade

and development benefits, concrete technical and financial assistance should be assured—say, through mandatory commitments subject to review and linked to implementation requirements of developing countries.

A trading system limited only to agreements that are in the trade and development interests of all members to implement under the framework of binding multilateral trade rules should be accompanied by special and differential treatment that affords appropriately long and flexible conditions to adjust to trade liberalization and real and substantial aid for trade. Poor countries must be supported in generating the sources of revenue needed to compensate for losses incurred as a result of lowering import duties. They must also be supported in building the human and physical infrastructure they need to benefit from increased market opportunities and in adjusting to erosions of existing trade preferences stemming from multilateral negotiations.

An incremental and temporary "aid for trade fund" commensurate with the size of the task, or significantly ramped-up contributions through such existing channels as the Integrated Framework for Trade-Related Technical Assistance to Least Developed Countries, is needed to support countries in addressing adjustment costs associated with the implementation of a Doha reform agenda. A priority task for the development and trade communities could be the identification of new and existing channels though which this additional funding could most efficiently be made available for relevant, targeted projects in developing countries.

Coherence—adopting sound complementary policies and ramping up aid for trade

If trade liberalization is to contribute to economic growth, expanded trade, and poverty reduction, it must be coordinated with other policies at both the national and international levels. At the national level, policy coherence means adopting sound complementary policies to manage liberalization, as well as ensuring that trade policymaking is appropriately informed by expertise across a range of policy areas. Importantly, export competitiveness must not be pursued in a way that encourages discriminatory or coercive labor practices or adversely affects the natural environment—say, through unsustainable forestry or fisheries practices. At the international level, coherence calls for a significant ramping up of "aid for trade" by the development community (to negotiate, assess, and implement WTO agreements and to design and implement adjustment policies). It also calls for a clear and realistic view of the WTO's role in technical assistance. This assistance for deeper capacity building must be additional to, and not at the expense of, development aid. Trade liberalization requires international negotiations and international assistance, but its benefits and challenges remain fundamentally a question of domestic economic and policy reform. This is particularly important for the Least Developed Countries.

Promoting the export supply side in low-income countries

As indicated at the beginning of this chapter, the Monterrey Consensus called explicitly for market access issues to be complemented by an emphasis on overcoming supply-side constraints (UN 2002a). As the Consensus states:

> We invite multilateral and bilateral financial and development institutions to expand and coordinate their efforts, with increased resources, for gradually removing supply-side constraints; improve trade infrastructure; diversify export capacity and support an increase in the technological content of exports; strengthen institutional development and enhance overall productivity and competitiveness.…Special consideration should be given to Least Developed Countries, landlocked developing countries, small island developing states, African development, transit developing countries and countries with economies in transition (paragraph 36).

Supply-side constraints are most prominent in Least Developed Countries and other low-income countries, which are typically primary commodity exporters with high measures of export concentration. Most nonfuel commodity exporters are located in Sub-Saharan Africa, Latin America, and Central Asia. Many are caught in poverty traps. Low overall productivity and a high concentration of exports in a few primary commodities leave them subject both to frequent commodity price shocks and to a long-term terms-of-trade decline in some commodities.

Primary commodity exporters have tended to experience general economic stagnation over the past few decades. The UN Millennium Project Task Force on Poverty and Economic Development examined the growth performance of developing countries according to export composition (UN Millennium Project 2004a). Focusing attention on non-oil economies, and putting aside the special case of the postcommunist transition economies, the evidence shows that commodity exporters tended to stagnate while exporters of manufactures tended to grow. Among developing countries, only 19 of 41 primary commodity exporters experienced positive economic growth during 1980–98, while 23 of 24 manufactures exporters experienced positive economic growth over the same period. The commodity exporters had average GNP growth of 0.2 percent per person per year, compared with an average growth of 2.7 percent per person per year among the manufacturing exporters. Of course when commodities prices are high, the commodity exporters tend to grow faster, but they are then subject to sharp downturns when highly volatile commodity prices decline.

Export diversification, especially into nontraditional manufactures and services, is not easily achieved in low-income settings. Countries must have adequate infrastructure and human capital to support production and trade in nontraditional sectors. Low-income countries with small populations and with populations living far from sea coasts—and thus far from ports—are especially

Table 14.1

Economic growth rates by population size and location

	Small countries		Large countries	
	Number that grew in GDP per capita (PPP) 1980–98	Average growth in GDP per capita (PPP) 1980–98	Number that grew in GDP per capita (PPP) 1980–98	Average growth in GDP per capita (PPP) 1980–98
Inland populations	24 of 53	–0.2%	10 of 10	2.5%
Coastal populations	15 of 17	1.9%	3 of 4	3.2%

Note: Countries are defined as "small" if they had a population of less than 40 million in 1990 and "coastal" if more than 75 percent of their population lives less than 100 kilometers from the coast.

Source: Maddison 2001; Gallup, Sachs, and Mellinger 2003.

hindered. Since populations of Sub-Saharan countries tend to be both small and located inland, they face special difficulties in overcoming their lack of competitiveness in manufactures exports. Similarly, countries in Central Asia and the Andean region have tended to remain stuck in a few primary commodity exports.

Remote, small economies had a much harder time sustaining economic growth during 1980–98 than those that are either coastal or large (table 14.1). (We consider countries "small" if they had a population of less than 40 million in 1990 and "coastal" if more than 75 percent of their population lives less than 100 kilometers from the coast.) Countries that are both small and noncoastal, as are most countries in Sub-Saharan Africa, experienced negative economic growth in 1980–98. And among non-African small inland countries (with available data) 11 out of 20 grew in GDP per capita (PPP$) during 1980–98.

The implication of these figures is not that geographic barriers are insurmountable for trade and growth. Instead, countries with supply-side constraints (such as long distances from ports) require special supply-side attention. For landlocked and other relatively isolated economies, trade policy priorities need to include regional integration and donor-supported investments in transport infrastructure (trunk roads and ports) and communications infrastructure (mobile telephony and fiberoptic cables for Internet connectivity). We recommend that these investment and policy requirements be addressed as central issues within countries' MDG-based poverty reduction strategies.