

3

Other systemic issues

Coherence

For trade to contribute to poverty reduction, several elements need to work together in synergy: better national development strategies that integrate trade as a key component; increased and effective international financial and technical assistance for developing production and trade capacities; and a more enabling international trade environment. Improvements in the international trade regime will have an impact on poverty only if countries have sound policies and receive the necessary assistance to build the productive capacity to take advantage of new opportunities (UNCTAD and ICTSD 2004). The previous chapters have discussed the ways in which the international trade regime could be more supportive of developing countries; this chapter focuses on the other two elements: national strategies and international technical and financial assistance.

Against this backdrop, a “coherent” approach in the context of trade and the Millennium Development Goals has three interlinked dimensions. First, at the national level, coherence means the adoption of sound complementary policies by national governments where necessary to manage liberalization, as well as ensuring that trade policymaking is appropriately informed by expertise across a range of policy areas. It means integrating trade policy into national development plans and ensuring that trade policy is subject to public debate including all relevant stakeholders. Second, at the international level, coherence calls for a significant ramping-up of “aid for trade” by the development community and for a clear and realistic view on the WTO’s role in technical assistance. Third, coherence means a mutually supportive relationship between trade and other policies at the national and international levels with a view to achieving the Goals. Clearly, while the three are all linked, policy coherence at the national level is the key to creating the conditions for the effectiveness of all other actions.

Policy coherence at the national level

Trade liberalization can require a range of complementary policies to ensure that gains for the economy and society as a whole are realized and the needs of the most vulnerable groups addressed. While liberalization results in overall gains in terms of economic growth and wealth creation, it does not by itself address the ultimate distribution of those gains. The immediate effects of trade liberalization can also vary among different groups—those in import-competing sectors may suffer adjustment costs in the face of increased competition, while those in export sectors may experience gains from new opportunities. Governments need to make choices about whether and how adjustment assistance may be offered to those who suffer losses, and how the gains from growth may be distributed—or redistributed—within a society. Such choices can be crucial in determining the outcomes of trade liberalization for particular groups and for the economy as a whole.

Complementary policies for the poor

One of the most important complementary policies for the poor is an efficient social safety net. Trade liberalization will have some impact upon those poor households that may be incapable of sustaining even short periods with adverse adjustment costs because they do not have the savings. The policy choices broadly defined are: general social safety nets, safety nets targeted to those who are harmed by the trade reform, and selective limitation of the reforms or intervention in markets for the purpose of limiting the impact of market reforms on the poor.

In terms of the third option, a fundamental problem in using government interventions to limit market reforms ostensibly for the benefit of the poor is that these interventions are subject to political lobbying. The poor typically lack political power, so that political intervention in market processes will typically result in outcomes that are even worse for the poor. Indeed, a variety of efforts are under way in many countries to replace parastatals and similar bodies with more efficient private sector entities.¹ In the poorest developing countries, such alternatives may not be a viable option, however. Complementary actions may be called for, such as improving and reducing the cost of education to poor households.

Regarding the second option, specialized safety nets linked to trade reform have a spotty history. In practice it is difficult to distinguish workers who are harmed due to trade reform from those who are harmed due to normal turnover or displacement in an economy. Fundamentally, it is morally difficult to justify safety-net programs to poor people who are harmed due to trade reform, and to deny assistance to other poor people who suffer equivalent harm from fluctuations such as technological displacement or price changes due to domestic demand shifts. Consequently, it is best to employ general, countrywide safety nets to deal with problems linked to trade reform, rather than to establish special safety net programs for trade related problems. As the main need for the poor during a difficult transition period is likely to be food,

one approach is a time-limited food subsidy and distribution program. Given that targeting of food subsidies is difficult, an untargeted subsidy on “inferior” goods may be a better approach.

This leaves the first option: provision of a general social safety net. Direct income support tends to be the most efficient type of social safety net, provided it can be administratively arranged. A problem is that it is very hard to identify who actually needs the money and even harder to get it to all those who need it. One approach is to provide a money payment to all households initially, subsequently narrow this to middle and low-income families, and finally give it only to low-income families. Because distinguishing the poor from the non-poor may be difficult, workfare programs may be more generally applicable, and have been proven effective under various circumstances, as individuals can self-identify for these programs.

Some poor countries may not be able to afford a full-fledged safety net. This implies that development aid has an important role to play in supporting the operation of such safety nets, as is discussed further below. In terms of the design of trade policy reform, it also strengthens the need for up-front analysis of where the poor are located in terms of production (income) and consumption, assessing which groups may be seriously detrimentally affected, and determining what types of complementary reforms would best offset these potential losses.

Identifying the national interest

Research efforts at the national level should aim to ensure that trade policy decisions, including WTO negotiating positions, are based on sound analysis of the costs and benefits of different options for the domestic economy. This assessment has become all the more important in the context of WTO rules subject to binding dispute settlement, and all the more complex as trade rules move further into domestic regulatory areas. Evaluating and understanding the implications of alternative rules is not straightforward, especially when it comes to the regulatory, “behind the border” policies—such as food safety or product standards, labeling requirements, and regulations for all the services sectors, from financial markets to auditing services, to conditions for building new large retail shops—that are increasingly the subject of multilateral discussions. Too often deliberations in the WTO are not informed by economic analysis or a good understanding of the costs and benefits of specific proposals or rules, or how these costs and benefits are distributed across or within countries. This is another form of policy coherence, namely coherence between analysis of what makes sense in terms of trade policy reform for development and negotiating positions and dynamics in Geneva.

The role of domestic institutions is crucial because trade policy raises domestic issues, and vice-versa. In some countries, domestic universities or independent think tanks conduct much of the needed research and policy analysis. In other countries, government agencies undertake this analysis. For

instance, the Australian Productivity Commission conducts public inquiries and research into a broad range of economic and social issues, including trade and industry assistance. Recent reviews have focused on, for example, assistance to the automotive and textile industries, as well as barriers to trade in services in the Asia-Pacific region. The role of the Productivity Commission has been instrumental in turning Australia from a protectionist country in the 1960s to a free-trade-minded country today.

Well informed domestic debates are particularly critical for a number of the poorest developing countries, where assessing the impact of existing or possible policy choices in the context of negotiations remains a major challenge. International organizations, nongovernmental organizations (NGOs), and others in the development community can do much to assess the costs and benefits for individual countries of various liberalization scenarios. International organizations—such as UNCTAD, the World Bank, and OECD—and local and international NGOs fill part of the gap, but their supply falls short of demand, in particular for country-specific analyses. Moreover, they do not address the crucial (and in all countries difficult) problem of the extent to which these debates effectively feed into the policymaking process. The best way forward is likely to involve leveraging the expertise of international organizations and international NGOs to help countries develop such research capacity at the national level. Strengthening and expanding existing linkages and networks between international organizations and local NGOs and researchers could be an important starting point.

More generally, greater efforts should be made to support developing countries at the national level in efforts to involve a wider range of national stakeholders in the debate about trade policy and assessment of different policy options. This is essential to ensure that assessments of policy options are grounded in local realities and that realistic and sustainable positions that reflect the views of a range of constituents are adopted.

In addition to greater involvement of local NGOs, business in developing countries could usefully be assisted to become better organized and better able to promote their interests in national policy debates. Business groups are vital in identifying offensive interests—governments may not always be aware of which companies are exporting what and to which markets, or indeed of the types of problems being encountered (such as on standards). Equally, the small and medium-size enterprises that account for the bulk of businesses in developing countries may benefit particularly from the certainties provided by international trade rules. Increasing the capacity of business to communicate export interests to governments is also critical to balancing the (generally more organized) voice of the protectionist lobbies.

Finally, better efforts are also needed at the national level to explain the gains from trade and trade rules. The survival of the WTO depends on the willingness of the Members to undertake necessary reform at the national

level. The case for reform and the role of the rules-based multilateral trading system in supporting that has to be explained and defended at the national level. Increasing the profile and informed debate about trade issues in the media will be a critical element in building support for policy positions and reforms at home.

Achieving whole-of-government positions

Complex trade agreements intersecting with a wide range of domestic regulatory issues also place new demands on coordination within government at the national level. Trade negotiations are no longer the exclusive domain of trade ministries; at some point almost all government agencies will be called on to feed into the assessment of policy options, the development of “whole of government” negotiating positions, or the design of appropriate complementary policies. Most important, responsibility for actually implementing commitments is likely to fall to government agencies beyond those responsible for trade.

But coordination is no easy task. Many government agencies have limited knowledge of—or often interest in—trade agreements or negotiations, even where their own areas of responsibility might be involved. Overburdened and underresourced agencies with heavy domestic responsibilities may legitimately view trade negotiations as a lower priority. A survey of countries’ preparations for the GATS negotiations revealed that, while many countries had some sort of mechanism for intragovernmental coordination in place, attracting interest from other agencies was often a major challenge. Even where agencies were engaged, considerable time, effort, and resources needed to be devoted to explaining the issues and providing information about the trading system. Developing countries with limited administrative resources faced particular obstacles in pursuing and servicing the coordination process (OECD 2003d). Further, where other agencies are motivated to be engaged in the negotiations, this can be due to regulatory capture (where the agency’s strong links with the domestic industry for which it has regulatory responsibility lead it to view their interests as being the national interest).

Lack of policy coherence poses real risks in terms of inappropriate WTO commitments, or failure to implement those commitments. By contrast, the gains from sound policy coordination are large, and include:

- Early involvement by relevant agencies assists in government understanding of the various policy options and maximizes the knowledge of both the current situation and alternative approaches taken by other countries. Similarly, involving regulatory agencies in the negotiations helps them to establish their own international networks, fostering dialogue and encouraging the development of regulatory cooperation to address cross-border issues.
- Experience suggests that ministries with responsibility for particular sectors or issues are less resistant to the development of trade rules if

they are involved in the discussions and negotiations from an early stage.

- Involvement of other agencies also assists with the implementation of WTO commitments by ensuring that liberalization is underpinned by necessary and appropriate regulation; and by generating both awareness of the potential impacts and prior planning of programs and strategies to manage those impacts.
- Coordination can also assist in the identification of areas where trade liberalization can contribute to other national policy goals. For example, improving access to higher education might be achieved by allowing foreign universities to establish in the country; access to health care might be served by promoting health tourism and using the proceeds to cross-subsidize the national system; or, more generally, importation of food might lower the costs of basic items for poor consumers.
- Coordination can also help to identify and promote policy “win-wins.” A number of these have been identified in trade and environment—for instance, trade disciplines on environmentally harmful subsidies (in agriculture or energy services) or through trade in environmental goods and services.
- Coordination is also important for avoiding contradictory policy, such as pursuing curbs on greenhouse gases while subsidizing the extraction of coal.

Policy coherence at the international level

International policy coherence refers not simply to the provision of international assistance to help countries participate in the trading system and to integrate into the world economy. It also refers to the need for such assistance to be better coordinated among key donors and international organizations.

This international level is not unrelated to coordination at the national level. One reason for the post-Uruguay Round difficulties with implementation is that commitments by OECD countries to provide assistance were made without the involvement of their aid agencies (who actually have responsibility for disbursing funds). Equally, to the extent that aid is demand-driven, developing countries must also nominate trade-related assistance as a priority for bilateral aid programs. Donors have indicated that, while they planned to put more emphasis on trade in their bilateral country programs, the outcome would depend on the priorities of the partner country (WTO/OECD 2003).

Current aid for trade

In recent times, and in response to the Doha Agenda, most donors have increased both the quantity and value of their Trade-Related Technical Assistance and Capacity Building (TRTA/CB) (WTO/OECD 2003) (box 12.1). Given this increase, donor coordination is all the more important, and some

Box 12.1**Trade-related technical assistance and capacity building**

a. Australia, Belgium, Canada, Denmark, EC, Finland, France, Germany, Ireland, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, the United Kingdom, the United States, plus 16 international organizations including APEC, FAO, IMF, ITC, OECD, UNCTAD, UNDP, UNIDO, WTO, and World Bank.

b. Trade policy and regulations: effective participation in negotiations, analysis, and implementation of multilateral trade agreements; trade policy mainstreaming and technical standards; trade facilitation, including tariff structures and customs regimes; support to regional trade agreements and human resources development in trade. Trade development: business development and activities aimed at improving the business climate; access to trade finance; and trade promotion in the productive sectors, including at the institutional and enterprise level. All aid to infrastructure is deemed to assist international trading.

Source: WTO/OECD 2003.

The Doha Development Agenda Trade Capacity-Building Data Base, launched in November 2002, contains information from 39 bilateral donors and multilateral agencies^a on three categories of assistance: trade policy and regulations (participation in the trading system), trade development (business climate and trade promotion), and infrastructure.^b

On average, some 3,500 trade-related technical assistance and capacity-building activities were committed in 2001 and 2002, almost equally distributed in number between trade policy (\$719 million) and trade development (\$1,408 million). Some 1,900 activities were committed for infrastructure (\$8,144 million—not all directed at trade).

Most commitments under trade policy went to trade facilitation (mostly Africa), regional trade agreements (mostly Asia), technical standards (mostly regional), and aid to integrate trade into development plans (mostly Asia). For activities related to WTO negotiations, most assistance went to competition and environment. Under trade development, most were business support services, trade finance activities, and trade promotion and market development.

Since 2001, 177 developing countries have received some assistance in trade policy and 163 in trade development, with the number of activities per recipient ranging from 1 to 260. Five countries (China, Indonesia, Thailand, Uganda, and Viet Nam) received more than 150 activities. Africa received more than one-third of total infrastructure activities and 31 percent of trade development but only 21 percent of trade policy and regulations. Asia received one-third of trade policy activities but only a quarter of trade development and infrastructure.

Commitments to trade-related technical assistance and capacity-building activities constitute 4.8 percent of total aid, on a par with population programs and more than basic education or basic health. Multilateral programs remained the main channel for such activities, but some large donors also run substantial bilateral programs.

initiatives have been taken. The WTO and OECD secretariats have combined to create a Doha Development Agenda Trade Capacity-Building Data Base (TCBDB), which aims to help the development and trade policy communities to achieve higher degrees of coordination and coherence, avoid duplication, share information, and monitor the implementation of commitments in the Doha Agenda. The TCBDB enables donors to view the multiplicity of programs (national and regional) already available and to identify gaps.

Another important initiative has been the Integrated Framework for Trade-Related Technical Assistance to LDCs (IF). A partnership between the International Trade Centre, UNCTAD, WTO, UNDP, World Bank, and IMF, it aims to take a coordinated approach to identifying and prioritizing trade-related assistance needs in LDCs, as well as projects for donor funding. It also aims to mainstream trade into national poverty reduction and development strategies. The IF is now on a more stable footing, having had a few false starts, but more effort is still required to achieve the kind of cooperation between donors and organizations that the IF was supposed to engender. Turf protection and other priorities of international organizations have been an

issue, as has a lack of willingness of major donors to act through the IF and not their own channels.

Finally, there is also considerable scope to deepen the treatment of trade and trade-related policies in the Poverty Reduction Strategy Papers (PRSPs) prepared by developing country authorities, with input from the IMF and World Bank, as well as donors and NGOs, which set out policy and donor priorities for many of the poorest developing countries. Links could also be made between the domestic PRSPs and, where available, the studies conducted for the IF.

The role of the WTO

Whereas the GATT was essentially conceived as a contract between the parties, with an interim secretariat to support it, the WTO is an organization with 148 Members. This change of status has given rise to many new and conflicting expectations.

On one hand, the WTO is strongly member-driven. The WTO as such does little—as evidenced by the relatively small size of the organization (500 employees, compared with 2,000 for the OECD). The media and others often use expressions such as “the WTO requires,” but this is completely misleading. WTO obligations are owed not to the organization, but to the Members, and the organization undertakes no independent monitoring of its Members’ implementation of their obligations. That is, commitments are owed to other WTO Members, and only other Members can claim that those commitments are not being met and initiate a dispute. Even notification obligations are owed to other Members—specifically, to the bodies (such as the Council for Trade in Services) that those Members constitute. In other words, the WTO is merely the channel.

On the other hand, the new status of the organization, and the greater reach of its rules, bring new factors into play. Unlike much of the GATT, WTO obligations apply to all developing countries and those obligations were (and are increasingly) linked in negotiations to the provision of assistance for their implementation. The perception thus became that “WTO obligations” should be accompanied by “WTO assistance” with implementation. As became rapidly apparent—from TRIPS to customs valuation—this is a task that the organization is ill-equipped to undertake. The WTO’s role on technical assistance will continue to evolve, but the following principles might serve as useful “rules of thumb”:

- *Focus on what the WTO Secretariat can and cannot do.* The main form of assistance that the WTO Secretariat can provide is to explain the legal requirements of WTO agreements. Even for this limited task, demand greatly outstrips the capacity of the Secretariat to deliver. There is a need to increase resources to some extent (as already took place pursuant to the Doha Agenda) but also to outsource more—using local consultants

can both be cheaper and have a useful flow-on effect in helping to establish local networks. The challenge is to maintain quality control.

- *Manage expectations about what assistance the WTO can provide.* This is not assistance to trade—the WTO does not fund the development of new ports or roads—nor even all the assistance that is required to meet the obligations of agreements (the WTO does not fund the creation of national SPS standards bodies). It is limited to explaining what the agreements require and providing advice on the range of ways in which Members might be consistent with their commitments. Other organizations and forums exist to provide countries with advice about development policy, organizations that come accompanied by funding to implement those policies.
- *Improve cooperation and coherence with other organizations.* The WTO needs to share with others the burden of helping countries identify options for reform and draw on those with greater experience on the practical solutions—such as WIPO on intellectual property, and the WCO on customs reform and trade facilitation. This should be part of an ongoing loop—input from these organizations should also inform Members’ deliberations of what obligations they should negotiate in the first place, as well as how to implement them.

Looking ahead

While trade policies create market access opportunities for developing countries, increased aid must be forthcoming if developing countries are to be able to benefit from these opportunities. A major constraint limiting export growth in many small and low-income countries is a lack of supply capacity and a high-cost business environment. Firms in these low-income countries may also find it difficult to deal with regulatory requirements such as health and safety standards that apply in export markets. Development assistance can play an important role in helping to build the institutional and trade capacity needed to benefit from increased trade and better access to markets. As noted above, this assistance must go beyond the implementation of trade agreement rules narrowly defined and focus on supply capacity more broadly, as well as addressing adjustment costs associated with reforms (including with others’ reforms, as in the case of those countries that will experience losses from preference erosion).

More aid for trade. Clearly, significantly stepped-up funding is required. Donors should create an international “aid for trade fund” to assist developing countries to benefit from and undertake trade reforms. The size of the fund should reflect the scale and importance of the task at hand.

Mobilizing such funding should be feasible as the aggregate (global) gains from trade are much greater than the aggregate losses associated with restructuring. The problem is that in practice the compensation (transfers) that is

called for often does not occur domestically, and barely occurs at all internationally, as reflected in low official development assistance (ODA) levels—\$69 billion in 2003—relative to the estimates of the net income gains associated with past multilateral rounds (in the \$200–\$500 billion range), the magnitude of total support to farmers in OECD countries (currently some \$350 billion), or the potential gains from further global liberalization (upward of \$500 billion, especially if services trade is included).²

There are various ways in which such redistribution could be realized (Hoekman 2004). For instance, it could be through a small consumption tax on the goods whose prices will be falling as a result of the implementation of negotiated multilateral liberalization commitments. However, administrative convenience and collection costs considerations might make a small uniform levy on imports whose tariffs are being cut more feasible. To give a sense of the orders of magnitude involved, a 0.25 percent levy on imports of OECD countries would be equivalent to more than \$12 billion (total OECD imports are some \$5 trillion). However, as much of trade into OECD countries is duty free, and it is not desirable to re-impose duties on such trade, any such levy should be restricted to currently dutiable imports where tariffs are subject to reduction commitments. An option here would be to agree to allocate a certain share of currently collected revenue to low-income countries. As tariffs are gradually lowered following a Doha Round negotiated outcome, the total revenue available would automatically decline over time, which is appropriate given that the motivation is to facilitate adjustment.

Indeed, it is important that there be general acceptance that any such levy not be an additional tax, but be explicitly based on the recognition that any process of multilateral liberalization will create losers as well as winners. Despite the well known case for and potential feasibility of compensating losers, in practice this often does not occur. A small reduction in the price gains/benefits that will accrue to consumers as a result of liberalization is one practical means of redistributing some of the gains from trade reform to those who gain less or may lose.

A key challenge will be to ensure that these additional funds are used most effectively, including within the existing structures and mechanisms for “aid for trade.” There are a variety of potential channels where this additional funding could usefully be absorbed—notably the Integrated Framework—and ensuring coordination and cooperation with existing initiatives will be an important task for the trade and development communities. A priority task could be the identification of new and existing channels through which this additional funding could most efficiently be made available for relevant, targeted projects in developing countries.

In terms of the types of activities to which such increased international assistance could be devoted, four main areas can be identified: assistance for trade policymaking and participation in negotiations; for implementation of

WTO agreements; to manage the costs of adjustment; and to participate in trade itself. Under each of these headings, some work is already under way (see box 12.1), although amounts remain small compared with what is needed, and there is considerable scope to scale up activities.

A few additional words of caution are required, however. First, care must be taken to ensure that additional assistance to participate in WTO negotiations does not reflect OECD priorities more than those of developing countries—as, for instance, has been the case with the focus on competition and environment, and the scarcity of assistance to help developing countries address anti-dumping complaints. Second, in regulatory areas, vigilance is necessary in the face of the risk that OECD assistance may be used to create regulatory “spheres of influence”—that is, OECD countries might seek to propagate their own regulatory systems in developing countries (however inappropriate they may be for the country concerned). While this may be legitimately motivated by the belief that their approach is the best, it can also be used to create a critical mass of countries that share their approach for the purpose of new rule-making negotiations in the WTO. Third, additional assistance should aim at maximizing the benefits for, and building genuine local capacity in, developing countries—goals that cannot be achieved where aid is conditional on the use of inputs from the donor (so-called “tied aid”).

Finally, additional assistance will also be most effective where developing countries also create supportive conditions for trade and investment as part of their national development strategies (UNCTAD 2003c). Trade liberalization requires international negotiations and international assistance, but its benefits and challenges remain fundamentally a question of domestic economic and policy reform.

Aid to assist trade policymaking at the national level and participation in WTO negotiations. As noted above, international organizations can play an important role in assisting countries in identifying their interests in negotiations and in assessing the impact of various policy choices, in particular in relation to the poor. This analysis can be specific to the negotiations—as in the assessments of different tariff reduction formulas (see chapter 3), or more generally related to liberalization, with or without WTO commitments (such as efficient regulatory policy for energy liberalization). Much analysis is, and should be, devoted to seeking insights for the current negotiations from assessments of the impact, including that on the most vulnerable groups, of Uruguay Round agreements. This can be important both in overcoming short-term resistance to change and in learning from past mistakes. As noted above, however, international organizations are a complement to domestic research capacity, not a substitute; their efforts should ultimately aim at developing local capacity for analysis.

Exchanges among countries on their experiences with liberalization and policy reform are also valuable, either bilaterally or regionally (for example,

APEC combines research projects with intergovernmental dialogue on services and regulatory reform). International organizations can also serve as a forum for the exchange of views, with the additional benefit of subjecting their research to the “reality check” of policymaker input.

Finally, programs run by international organizations, NGOs, or bilateral donors can help developing country trade negotiators to participate in WTO negotiations. These courses, of which the best known is the WTO Trade Policy Training Course, normally cover the specifics of individual agreements, as well as insights into the negotiating process.

Aid to assist with implementation of WTO agreements. This has been the focus of much international assistance, and rightly so. Initially this assistance focused on explaining the legal provisions and requirements of the new agreements. However, what was required to implement WTO agreements went well beyond this. The new agreements required not only new laws, but new institutions, with trained staff and enforcement capacity. The involvement of other international organizations with expertise—and resources—has proved critical (such as WIPO on intellectual property and the WCO on rules of origin and customs valuation). But WTO Members greatly underestimated what would be required to implement the new agreements, and more time and far more resources than anticipated are required. Some additional key areas for assistance include institutions, infrastructure, and human resources for Technical Barriers to Trade (TBT) and Sanitary and Phytosanitary Measures (SPS) (the Standards and Trade Development Facility is a positive development—see chapter 6); and assistance to develop and implement regulatory frameworks in services (chapter 4).

Aid to manage adjustment from liberalization. This report has highlighted many areas where international assistance—often financial assistance—will be required to help countries operate the complementary policies needed for successful trade liberalization. These include assistance to operate social safety nets (chapter 12); assistance with the funding for universal service mechanisms targeting poor consumers in liberalized services markets (chapter 4); assistance with reform of the tax system to help compensate governments for loss of tariff revenue (chapter 5); assistance with land reform, education of farmers, and research and technology in agriculture (chapter 3); and compensation mechanisms to address concerns about preference erosion—given that estimates to date indicate that the amounts involved may not be enormous, this should be feasible (chapter 7).

The IMF’s Trade Integration Mechanism (TIM), approved by the IMF Board in April 2004, is designed to help mitigate adjustment costs of liberalization for developing countries. It is intended to address not only preference erosion but also developing country concerns that multilateral trade liberalization

might temporarily affect their balance of payments. That is, the TIM will also cover cases such as balance of payments shortfalls as a result of ATC quota integration and the possible impact on net food-importing developing countries of higher foods import prices. The TIM is not a new facility but operates through existing IMF facilities. A further suggestion is for compensation by developed countries for loss of agricultural preferences to be covered by the Green Box (chapter 3). Addressing this issue would do much to ease the concerns of the recipient countries and remove an important roadblock in the negotiations.

The magnitude of adjustment shocks and the associated costs are of course a function of the magnitude of the underlying policy changes. Insofar as a developing country does little to open its own markets, and the Doha Round outcome is not very ambitious, by definition there will be little in the way of adjustment costs—or potential net gains for that matter. However, even an ambitious Doha Round may have only limited benefits for many of the poorest countries without assistance to better integrate them into the world economy (see below).

Aid to participate in trade. Finally, increased assistance is required to address the supply-side constraints on poor countries, affecting their ability to take advantage of new market access opportunities. Such assistance could include, for example, support for measures to improve the investment climate and raise productivity in agriculture. In many cases, assistance may also be required to tackle transaction costs and institutional weaknesses obstructing trade and develop the necessary infrastructure (as in relation to transportation of goods for export). Here, liberalization may increase capacity (as in telecommunications and financial services—chapter 4), though assistance may still be needed in creating a sound regulatory environment to underpin this liberalization. Finally, assistance may be necessary to improve the performance of institutions for trade (such as customs reform—chapter 9).

Additional assistance will be necessary to help developing country exporters meet health or other technical standards in key export markets. This should include assistance to increase developing country participation in relevant international standard-setting bodies, to ensure that international standards take account of their interests and to promote the development of standards in their products (chapter 6).

Other policy coherence for development

While beyond the immediate scope of this study, a critical area for attention is the relationship between trade, debt, and finance and how the level of external debt affects developing countries' participation in international trade. The creation of a WTO Working Group on Trade, Debt, and Finance is an important step in encouraging greater coherence between the WTO and the Bretton Woods institutions. Developed countries need to take greater account of

the full range of policies and circumstances affecting the ability of developing countries to participate in world trade, particularly in assessing the actual or potential impacts of WTO obligations.

More generally, in the globalized economy, ever more domestic policies have international effects. Consideration of the potential impact of domestic policies on developing countries must become an automatic part of the policy-making process in developed countries. From the impact of domestic standards for goods and services on the potential trade opportunities of developing countries, to the impact of agricultural, financial, and aid policies, if developed countries are serious about their commitment to achieving the Millennium Development Goals by 2015, a more comprehensive approach to ensuring the consistency of the whole range of their domestic policies with this objective will need to be taken.

Policy coherence in practice: trade and environment

Coherence between trade and environment policy has been on the international agenda for some years.³ The first “trade and” issue to be included in the WTO, the trade and environment work program has aimed at identifying the synergies and areas of potential tension between these two key national policies aimed at international problems and with international ramifications. Considerable work has been undertaken by a wide range of international organizations, NGOs, and researchers to identify the linkages and synergies between trade and environment policies, including the scope for “win-win-win” outcomes (for environment, development, and trade) from the removal of environmentally harmful—and trade-distorting—subsidies in agriculture, fisheries, and energy (box 12.2). In agriculture, for instance, trade-distorting domestic support policies encourage environmentally harmful agricultural practices, such as intensive farming, including high use of fertilizers and pesticides. The result is resource degradation and environmental stress. Furthermore, trade-distorting support, including export subsidies, can have negative environmental effects in third countries, particularly developing countries.

The relationship between WTO rules and trade obligations in multilateral environmental agreements. A key aspect of policy coherence with regard to trade and environment is also on the negotiating agenda of the Doha Round. The Doha Agenda mandates negotiations, without prejudging their outcome, on the relationship between existing WTO rules and specific trade obligations in multilateral environmental agreements (MEAs) (the other major issues mandated for negotiations—environmental services and goods—are dealt with in chapters 4 and 5, respectively). At issue is whether WTO rules and specific trade obligations under MEAs are always compatible and, if not, which takes precedence. Some careful limits are placed on the negotiations, however. They shall not “prejudice the WTO rights of any Member that is not a party to

Box 12.2
Win-win-win
scenarios? Fishery
subsidies

The current WTO negotiations on fisheries subsidies could set an important precedent in an area where trade and conservation objectives intersect (see box 1.6). Subsidies to marine capture fisheries, which have been estimated to be at least \$15 billion a year worldwide, are believed by a number of countries to be contributing to overcapacity and overfishing, putting enormous strain on fishing stocks already threatened by the destruction of coastal habitats and the pollution of the seas. Developing country exporters of fisheries products compete not only against the highly subsidized fleets of developed countries—some subsidies also support distant-water fishing by developed country fleets in the exclusive economic zones of developing countries, which may stunt the development of their own fishing fleets and exports.

Not all the money spent by governments in support of their fishing industries is harmful. Indeed, a not insignificant proportion of it is used to fund research, monitoring, and enforcement—activities that are vital for ensuring the effective management of a vital natural food resource. The focus of the current negotiations, therefore, is on crafting effective disciplines that will prohibit or discourage subsidies that are capacity-enhancing or effort-enhancing, while allowing space for governments to spend money on protecting their fishery resources and encouraging structural adjustment, such as through decommissioning vessels and retraining displaced workers.

How to provide developing countries with special and differential treatment remains one of the thornier issues. Some developing countries would like to maintain or even increase employment in their fishing industries, especially in the small-scale and artisanal segments, and feel that subsidies are necessary to accomplish that goal. Other developing countries, speaking from experience, warn that subsidizing the expansion of fishing capacity risks overshooting the target of maximum sustainable yield. It is apparently a risk that some countries would nonetheless prefer having the option to take.

the MEA in question,” nor “add or diminish the rights and obligations” of any WTO Member under existing WTO agreements, in particular the SPS Agreement. That is, the negotiations do not include discussion of the situation where there is a conflict between WTO Members when one is not a party to the MEA in question, the more likely source of possible tensions.

There are currently approximately 200 multilateral environmental agreements in operation, of which only 20 contain specific trade provisions. These include, for example, the Montreal Protocol for the protection of the ozone layer, which applies restrictions on the production, consumption, and export of aerosols containing chlorofluorocarbons (CFCs); the Basel Convention, which controls trade or transportation of hazardous waste across international borders; and the Convention on International Trade in Endangered Species. To date, no measure affecting trade taken under an environmental agreement has been challenged in the GATT-WTO system.

Given the cautious pace of discussions in the WTO to date (where much time has been devoted to coming to a common understanding on the scope of the mandate), and the fact that this issue has rightly not been a priority for developing country resources in the Doha Round, it would be premature to advocate any particular outcome as being in the interests of all developing

countries. Two general points could be made, however. First, improved coordination between trade and environment officials at the national level is the key to a more mutually supportive trade and environment relationship and is the best way to limit the potential for future problems. But this is not easily achieved: divisions within governments on several trade and environment issues appear to be as great as between governments. But trade and environment is an area that demands true policy coherence and whole-of-government positions, rather than replays of battles between different ministries and interest groups at the international level and among international organizations.

Second, developing countries have an interest in ensuring that trade measures are seen as part of a package of measures in MEAs and not taken out of context. Trade measures play a certain role in such a package and contribute as such to the overall effectiveness and efficiency of the package. Developing countries have a key interest in supportive measures—such as financial and technical assistance, training, transfer of technology, and so on—that generally contribute to reducing adjustment costs in developing countries to meet MEA objectives. Developing countries also have an interest in ensuring that trade measures do not pursue one-size-fits-all approaches, but are customized to the specific situation in different country groups. Finally, developing countries need to emphasize the interrelationship between flexibility in MEA trade measures and the size and effectiveness of supportive measures. In short, the more rigid a trade measure in a MEA, the higher the need for supportive measures and their flexibility in application for developing countries.

The Doha Agenda also mandates work programs to explore the effect of environmental measures on market access (see chapter 6), TRIPS, and environmental labeling, with recommendations to be made to the WTO Ministerial Conference on future action, including the desirability of negotiations.

TRIPS and the Convention on Biological Diversity. Discussions on TRIPS have focused on the relationship between the TRIPS Agreement and the Convention on Biological Diversity (CBD), including the protection of traditional knowledge. Developing countries have a particular interest in the CBD, as the vast majority of global biodiversity and traditional knowledge lies within their territories. They also wish to make full use of these resources for their long-term sustainable development.

Article 16(5) of the CBD recognizes that patents and other intellectual property rights may have an influence on the CBD implementation and requests parties to cooperate in this regard to ensure that such rights are supportive of and do not run counter to the objectives of the Convention. The TRIPS Agreement makes no mention of the CBD or its principles.

The type of knowledge protected under the TRIPS Agreement (patents, trademarks, copyright, and so on) is predominantly held in developed countries. Some 95 percent of patents are in developed countries, and a large proportion

of the 5 percent in developing countries is held by developed country companies. Developing countries are, on the other hand, well endowed with traditional knowledge. The nature of this knowledge—for example, it is often held collectively, passed down orally from generation to generation—makes much if not most of it difficult to protect using the conventional IPR instruments required by the TRIPS Agreement. Thus there exists an imbalance, whereby the knowledge predominant in developed countries is protected, whereas that predominant in developing countries is not.

Moreover, there are concerns that the genetic resources and traditional knowledge of developing countries are often used commercially and patented in developed countries with little or no benefit to the owners of genetic resources (the sovereign states, as per the CBD) or traditional knowledge, and without their prior informed consent. With the TRIPS Agreement being implemented by more WTO Members, there are concerns that this situation will only be exacerbated, to the detriment of developing countries and the holders of traditional knowledge.

To this end, developing countries have sought to amend the TRIPS Agreement so that applications for patents relating to biological materials or to traditional knowledge shall provide, as a condition to acquiring patent rights: disclosure of the source and country of origin of the biological resource and of the traditional knowledge used in the invention; evidence of prior informed consent through approval of authorities under the relevant national regimes; and evidence of fair and equitable benefit sharing under the national regime of the country of origin. This would provide a legally binding defensive protection against “bad patents” based on misappropriation of genetic resources and traditional knowledge, and facilitate benefit sharing. But it would not prevent genetic resources or traditional knowledge being inappropriately acquired, used commercially, but just not patented. There is therefore also a need for positive protection, such as national *sui generis* systems for the protection of traditional knowledge, traditional knowledge registries, and databases. There have also been many calls from the developing world for an international framework, which would recognize protection of traditional knowledge at the national and regional levels.

Ecolabeling. Ecolabeling could represent a potentially attractive way to provide consumers with information about the environmental impact of purchased products, as well as provide producers in developing countries with market access, and possibly a price premium, for products that are environmentally friendly (as products from organic agriculture or certified sustainably managed forests). While there is still no evidence of changes in trade flows arising from ecolabeling programs, there are a number of concerns (noted in chapter 6) related to the costs of compliance and compliance assessment; the appropriateness and comparability of the information provided to consumers; and

the potential use of ecolabels based on a life-cycle approach, which would take account of non-product-related process and production methods (see also chapter 5 with regard to environmental goods). Particular attention needs to be paid to this issue, because mandatory ecolabels based on non-product-related process and production methods could undermine what is perceived to be a competitive advantage of developing countries. In addition, this approach may open the backdoor for consideration of the precautionary measures that go beyond the current approach in the SPS Agreement, which require that precautionary measures be: temporary and subject to review in the light of new scientific evidence; based on scientific evidence; and subject to a risk assessment (Article 5).

Ecolabeling is currently being discussed in the WTO, but the debate has not progressed much. Given that the majority of ecolabeling schemes are voluntary, and that there is no obligation to notify voluntary labeling schemes to the WTO, progress on this issue may be beneficial to developing countries, because as long as ecolabels remain outside the scope of WTO agreements they can lead to inappropriate discrimination (see chapter 6). At a minimum, developing countries should demand greater transparency in the establishment and application of such schemes.

Box 12.3

Did we say policy coherence?

- Total aid from OECD countries amounts to around \$69 billion a year, but total OECD spending on agricultural subsidies is \$300 billion a year. In 2001 net flows of ODA to LDCs would have been doubled if 14 percent of the 2001 value of the fiscal support for OECD producers had been redirected in aid to LDCs (UNCTAD 2004b).
- Aid programs encourage crop diversification in developing countries, but preference programs encourage specialization.
- Aid includes assistance to help countries upgrade their production capacity and increase their value added, but tariff escalation discourages further processing.
- Trade preferences are granted to help developing countries to integrate into the global trading system, but they create incentives for them to oppose further liberalization of global trade.
- Developed countries promote intra-developing country trade, but the rules of origin in their own preferential agreements with developing countries discourage it by preventing sourcing of inputs from other developing countries on a global basis or by requiring use of developed country fabric.
- Developed countries have long promoted the idea that developing countries have export interests in services, as well as the possibilities of making use of information and communication technology for development. But some have responded to increased outsourcing to developing countries (a services export).

Free trade agreements

The proliferation of preferential trade agreements poses major challenges both for the multilateral trading system and for trade. It has led to the creation of a tangled web of differential treatment, adding complexity and uncertainty to trade, and to the development of different trade rules under different agreements—rules that may not be in the interests of developing countries.

Virtually all WTO Members are party to one or more free trade agreements (FTAs). More than 170 FTAs are currently in force; an additional 70 are estimated to be operational though not yet notified to the WTO. The WTO estimates that, by the end of 2005, if FTAs reportedly planned or already under negotiation are concluded, the total number of FTAs in force might well approach 300. Developing countries are involved in 149 agreements (76 notified to the WTO, 34 concluded but not notified, and 39 under negotiation), of which 76 are intra-developing country agreements (27 notified to the WTO, 26 concluded but not notified, and 23 under negotiation) (Schott 2003).

Do free trade agreements confer benefits?

Notwithstanding their popularity, FTAs are often tools of geopolitics (or domestic public relations and marketing) rather than economics. They have a mixed record in terms of the extent of real liberalization achieved, particularly in sensitive sectors and once the impact of sometimes restrictive rules of origin are taken into account. Developing countries negotiating FTAs often have limited bargaining power and, unlike in the multilateral setting, have limited ability to form coalitions to take on more powerful trading partners—Cancún is a timely reminder of the importance of coalitions in defending and promoting developing country interests. Some developing countries may find themselves excluded from FTAs altogether, as they offer limited economic or geopolitical benefits to trading partners.

Even where parties to the FTA benefit in terms of significant market access gains, it is often at the expense of nonparties to the agreement—that is, there is trade diversion from other efficient suppliers, many of which may also be developing countries. There are also costs to the countries in the FTA: under trade diversion, the importing country ends up paying more for imports, with money that was initially going to the government as tariff revenue now accruing to producers in the partner countries. Part of this extra cost is a simple transfer from the taxpayers in the importing partner to producers in the exporting partner, but because the real cost of imports has risen (the partner is less efficient than “outside” producers), real resources are also wasted by trade diversion. When all the commodities covered by the FTA are considered together, if trade diversion predominates, the FTA can reduce the welfare of some or all of the member countries.

Further, from a political economy point of view, FTAs that are trade diverting are likely to encounter less resistance from domestic industry than those that are trade creating. The reason is simple. Trade creation occurs when domestic production is replaced by cheaper imports from partner countries. While beneficial for the economy as a whole, it damages domestic producers, which will oppose the agreement or request exceptions. On the other hand, trade diversion means that imports from the rest of the world are replaced by imports from the partner country, and this is less damaging for the domestic industry.

Additionally, FTAs do not address some of the biggest problems in world trade, notably agricultural subsidies. In the case of agriculture, FTAs can be especially damaging—either agriculture is excluded entirely from the agreement, significantly reducing the value of such agreements to countries for which this is a key export interest, or only the market access dimension is covered. This creates the iniquitous situation where some parties to FTAs progressively open their markets to the agricultural produce of other parties, but without means of addressing in parallel the enormous subsidies on those products. Such agreements can serve less to liberalize trade than to legitimize dumping (as happened to Mexico under NAFTA and as threatens to happen to other FTA partners in the absence of significant progress on agricultural subsidies at the multilateral level).

Where FTAs go beyond the multilateral system, this is not necessarily good news. In FTAs, developing countries are more likely to be confronted with provisions on nontrade issues that they have combined with others to resist at the multilateral level—such as those related to adherence to labor standards. More recently, concerns have arisen that FTAs negotiated by the U.S. have the effect of extending patent protection for pharmaceuticals beyond that required by the TRIPS Agreement, perhaps undermining countries’ ability to make use of compulsory licensing provisions to ensure access to medicines (box 13.1).

Regardless of the nature of the FTA, there are also dangers in terms of the costs—including opportunity costs—they impose. Multiple FTAs with differing rules of origin impose high transaction costs, particularly on small

Box 13.1
Examples of
TRIPS-plus
provisions in free
trade agreements

Source: Oxfam International 2003, 2004b; Vivas-Eugui 2003; Drahos 2004.

Extension of patent protection beyond the 20 years required under TRIPS: Patent terms should be extended to compensate patent holders for any unreasonable delays in the granting of the patent or unreasonable curtailment of the patent term as a result of the marketing approval process. There are no such requirements under TRIPS, so the effective period of protection under TRIPS is usually less than 20 years.

Limits on parallel imports: The patent holder is permitted to restrict the possibility of parallel imports in the market. TRIPS is silent on parallel importation.

Test data protection: Test data of patent owners must be protected for at least 5 years for pharmaceutical products (10 years for agricultural chemicals) from the date of approval of the patent, delaying the marketing approval of generic drugs. Should this requirement continue to apply even where a compulsory license has been issued, it would effectively prevent the use of such licenses, since the delay and costs would be too great. TRIPS requires only protection of such data against “unfair commercial use.”

Compulsory licensing: The grounds on which compulsory licenses can be issued are more restrictive than in TRIPS, or requirements for compensation to the right holder may be higher than required by TRIPS.

Marketing approval and the life of the patent: The patent owner must be notified of the request for marketing approval and of the identity of the applicant; patent holders are claimed to use frivolous lawsuits to unnecessarily delay marketing approval for generics. TRIPS permits generic producers to seek regulatory approval during the life of the patent with no conditions.

traders. For small countries with limited trade negotiating capacity, FTAs can also divert scarce resources from the pursuit of multilateral liberalization. While some argue that FTAs stimulate global trade negotiations, much of the evidence shows that advances in multilateral trade negotiations have led—not followed—the formation of trade blocs.¹ Equally, the perception that trade blocs make global liberalization easier to achieve because they reduce the number of negotiating parties is open to question because blocs may find it just as difficult to achieve internal agreement, while their size can make it easier for them to resist global pressures to liberalize (as in the case of EU agriculture). Even where such agreements may lead to multilateral liberalization, this also involves costs—in encouraging temporary trade diversion, FTAs encourage the temporary growth of some industries, and the adjustment costs of entry and exit can be particularly high for developing countries (Stiglitz and Charlton 2004).

Intra-developing country free trade agreements

However, given the importance of trade among developing countries—by some estimates, 40 percent of all developing country trade (Stiglitz and Charlton 2004)—are there benefits to intra-developing country FTAs? Some argue that where domestic firms have weak technological and productive capacities and the global economic context is characterized by systemic biases and asymmetries,

regional arrangements may well provide the most supportive environment in which to pursue national development strategies (UNCTAD 2002). These studies note that FTAs among developing countries (such as AFTA and Mercosur) tend to be less restrictive to nonmembers than those between developed and developing countries—in the latter case, developing country members tend to gain considerable advantage over other developing countries in access to developed country markets (Mexico under NAFTA), though this advantage can be eroded when new FTAs are signed by the developed country in question (as best illustrated by the “pyramid of preferences” that the EU tried to create during the 1970s). This can alter the distribution of market shares among developing countries, and the outcome is not always favorable to the poorer countries (UNCTAD 2002).

One could also argue that FTAs could solve inherited political problems. For instance, countries in Africa that have inherited inappropriate borders might not be readily able to negotiate them away, but they may be able to render them less important by negotiating the free movement of goods, services, and people. Single markets of this nature might be more attractive to foreign investors and could facilitate the creation of cost-saving regional regulatory frameworks and institutions. However, the question remains whether these offsetting benefits could counterbalance the above problems of trade diversion.

However, others have cast doubt on the gains from intra-developing country FTAs. They argue that an intra-developing country FTA among small economies that provides preferential access to its member states but keeps its external trade policy with respect to the rest of the world unchanged is likely to lower welfare for the bloc as a whole (Panagariya 1997; Schiff and Winters 2002, 2003). The argument is that, as it is likely that members of intra-developing country FTAs will continue to import from excluded countries, prices cannot fall for homogeneous goods because domestic prices continue to be equal to world prices plus the tariff on imports from the rest of the world. And since prices are unchanged, output, consumption, and imports are unchanged as well. Since total imports do not increase, there can be no trade creation. However, imports from other member countries increase at the expense of cheaper imports from excluded countries—and this trade diversion lowers the welfare of the bloc as a whole (Schiff and Winters 2003).

Additionally, the less developed members are likely to lose more. More developed members usually have a trade surplus with the less developed members, and trade diversion from the rest of the world to the partner country results in a transfer of tariff revenues from the poorer to the more developed countries, equivalent to a worsening of the terms of trade for the poorer member countries. Losses may also result from agglomeration effects, whereby industry tends to leave the smaller and poorer members and agglomerate in the more developed ones once trade barriers between them are removed. The best way to ensure that intra-developing country FTAs are beneficial is thus for member countries to liberalize their trade regimes with respect to the rest of the world (Schiff and Winters 2003).

The Dispute Settlement Understanding

While getting the rules right is important, so is enforcement. The crux of this issue is the ability of developing countries to use WTO dispute settlement mechanisms in instances where they perceive that partners have not been abiding by the terms of an agreement. Suggestions have been made by observers that there may be a potential bias against developing countries in the dispute settlement system due to their resource constraints and lack of retaliatory power. A number of proposals to address such possible biases are discussed below.

Who uses the system?

During 1995–2002, 305 bilateral disputes were brought to the WTO, entailing more than 1,800 “grievances”—specific allegations of violation of a WTO provision. Developing countries brought 124 of the 305 disputes, or about one-third (appendix 8). Most of these countries were middle-income economies; low-income countries (with a per capita income below \$800) were plaintiffs in only 18 cases and respondents only 21 times—and much of this reflected the activities of India. That said, many of those developing countries using the system have done so successfully, including against much larger and better resourced trading partners (Ecuador and the EU, and Costa Rica and the U.S. are two such instances). In sum, while some developing countries have been relatively active users of the system, with some success, LDCs did not participate at all, never acting as a complainant or respondent. Well over half the WTO membership does not participate in WTO dispute settlement.

Developing countries accounted for about one-third of complaints under both the GATT and the WTO. However, the share of cases against developing countries rose from 8 percent to 37 percent, suggesting that the shift to the WTO—with the associated expansion of disciplines on developing countries—has given rise to a significant increase in the probability of confronting dispute

settlement. However, the evidence for “bias” is not particularly strong once one controls for the fact that disputes should be correlated with the number of incompatible measures a country’s exporters encounter and the volume of trade. It is nonetheless striking that many developing countries have not participated in WTO dispute settlement.

Why has developing country participation been limited?

In part this simply reflects the manifold challenges that arise at various levels. A first necessary condition to defending rights through the WTO is information that a WTO provision may have been violated by a partner government. A second is to convince the government to bring the case forward—enterprises do not have access to the WTO (that is, they have no legal standing). A third is that the expected payoff to bringing a case is positive. This will depend in part on the remedy that is available and the likelihood that the trading partner will implement the proposed remedy, which in turn depends on an implicit cost-benefit analysis that will be a function of facing (and imposing) retaliation in the case of noncompliance. That the incentives to participate revolve around expected net payoffs has, for good (and bad) reasons, involved large OECD countries—in particular the EU and the U.S.—more rapidly in dispute settlement than the other WTO Members.

The problem of asymmetric enforcement ability

There are “asymmetric” incentives for countries to deviate from the WTO, as the ultimate threat that can be made against a Member that does not comply with a panel recommendation is retaliation. Small countries cannot credibly threaten this because raising import barriers will have little impact on the target market while being costly in welfare terms. Thus, pressure to comply with panel rulings is largely moral in nature. In practice, the system has worked rather well, in that recourse to retaliation has rarely been required to enforce multilateral dispute settlement decisions. This reflects the repeated nature of WTO interactions and the resulting value that governments attach to maintaining a good reputation. Nonetheless, asymmetry in enforcement ability can affect incentives to use the system. The classic recommendation to address this asymmetry problem is to change the rules so that nonimplementation of panel recommendations would be punished by withdrawal of market access commitments by all WTO Members. Suggestions to this effect have always been resisted.

A basic problem with retaliation is that it involves raising barriers to trade, which is generally detrimental to the interests of the country that does so, and to world welfare more generally. The power of retaliation may also be captured by protectionist interests in an importing country. A superior approach would be to strengthen compensation provisions. Developing countries have proposed, for example, that WTO panels should be authorized to recommend

payment of financial compensation in cases where a developing country loses its trade in a product as a result of actions by a developed country that are inconsistent with WTO norms. Such suggestions have a long history. Mexico recently suggested allowing countries that have won a dispute but where implementation has not occurred to auction off the resulting retaliation rights.

While compensation or fines would be less distorting than trade sanctions, they may not be very effective in inducing compliance, as the costs would be dispersed over all taxpayers. Other options should therefore be considered, including stronger surveillance mechanisms and greater opportunities for interested parties to bring cases in national forums. Whatever is done, it is important to halt the emerging trend toward escalating retaliation and the use of trade sanctions.

Compensation may be worth revisiting, however, as a possible solution to cases where it is clear that a Member will not (has no intention to) comply with an adverse ruling. At present there are a couple of instances where large Members have chosen to absorb the cost of retaliation on an ongoing basis rather than to bring the nonconforming measure into compliance with their obligations. This has been the case, and other cases are likely to arise in the future, when the noncompliant Member assesses that the political cost of implementation is too high.

This situation is undesirable for several reasons. First, retaliation harms all WTO Members and global welfare, and instituting protection is not a long-term solution (the whole idea of retaliation is to force prompt compliance). In situations of prolonged noncompliance, the WTO dispute settlement system begins to serve the function of legitimizing trade wars, rather than opening markets. This point is particularly resented by sectors that, while not involved in the original complaint, bear the cost of retaliation (companies in these sectors often legitimately argue that it is not they that are refusing to comply). Second, prolonged noncompliance undermines the credibility of the system, the delicate balance that keeps all Members agreeing to play by the rules because they need others to do so. Given that prolonged noncompliance is generally an option only for larger Members whose economies can bear the cost of retaliation, it also adds to perceptions that the system is biased against smaller players. Third, noncompliance creates incentives for the noncompliant party to bring other difficult and contentious disputes into the system, rather than address them through negotiation, in order to create bargaining chips, in the hope that noncompliance by the other party will eventually “cancel out” its own.

All these do considerable harm to the trading system. However, it can be argued that equal—or greater—harm could be done were the noncompliant party to comply with a ruling that was politically or socially unacceptable to most of the populace. This could undermine public support for the trading system in a more fundamental and, in the longer term, more deeply damaging way.

In this situation, it may be better to accept that the noncompliant party has no intention of complying in the foreseeable future and to make a virtue of necessity. That is, after a period (say, two years) of bearing retaliation, the noncomplying Member would be automatically (unless WTO Members agree by consensus to waive the requirement) required to offer compensation to other Members in the form of additional market opening in other areas, to the equivalent value of the retaliation.

While the noncomplying Member would be able to choose the areas in which it offered the compensatory market access, it could be obliged to give serious consideration to the requests of the original parties (and perhaps third parties) to the dispute. Such compensation would in no way imply that the original Member was now in compliance: the compensatory market access would stay in place for as long as the noncomplying measure remained in force. If the value of the access increased over time, this would obviously alter the cost-benefit analysis of the noncompliant party and may encourage ultimate compliance in the longer term.

It could be argued that this undermines the rules-based system, by essentially allowing Members to buy their way out of their obligations. This is a valid criticism. However, it must be pointed out that it is attempting to deal with something that is already happening; as noted above, it attempts to salvage something positive for the system from the reality on the ground.

Main conclusions and recommendations

Main conclusions

Trade openness can be a powerful driver of economic growth, which is indispensable to reduce poverty and foster development. Trade, however, is not a silver bullet for achieving development. There is no way around the other institutional, macroeconomic, and microeconomic conditions that, along with well designed social policies, must also be met to attain development. Yet it is very likely that if developed countries opened their markets significantly more to developing countries and developing countries also became more open, poverty would fall faster worldwide, including in most of the poorest countries, provided the needed complementary policies were in place.

Achieving more open and fair markets for the promotion of development is the mission of the multilateral trading system. This system has evolved progressively since the end of the Second World War and has delivered impressive results for many countries, particularly those now fully industrialized.

Throughout most of its existence, however, the trading system has mainly served the interests of developed countries. Sometimes by their own decision and other times by explicit exclusion dictated by richer countries, developing countries have not been influential in the design of the multilateral trading system. Moreover, most of the existing multilateral rules, through respective rounds, emulated to a great extent the policies, the practices, and most important, the laws and regulations of a few developed countries.

The system is thus unbalanced against the interests of developing countries. Balancing the system will give developing countries greater economic growth potential, a major stake in developing multilateral trade rules and disciplines and in pursuing trade liberalization, and a more effective capacity to expand trade and defeat poverty.

That goal was the *raison d'être* of the Doha Development Agenda (DDA) 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 DDA, the WTO Ministerial of September 2003 collapsed amid acrimony. There is no single reason to explain this; however the failure of the U.S., the EU, and Japan to lead by example is a major one.

WTO Members have since made a courageous effort to revive the Doha Round, but a lot more 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 Doha Round is to be completed by the end of 2006 or very early 2007 at the latest. If this narrow window of opportunity is missed, it is hard to see how the round can be completed in time to contribute to achieving the Millennium Development Goals by 2015.

All WTO Members must identify the core priorities of a real development round and make concrete political and financial commitment to achieving them. What must be done in the Doha Round and beyond?

Agriculture—the biggest and costliest aberration

The biggest and most costly aberration of the trading system is to be found in agriculture. Farm producers in rich countries receive support in excess of \$250 billion, thanks to which their farmgate prices are almost one-third higher than world prices. Consumers in those countries pay for that protection through higher taxes and higher food prices. It's their choice, but it must be stressed that by doing so 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 cause of poverty in 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 adjust to more open farm markets. Export subsidies should be totally and definitively eliminated, as agreed in the DDA framework of August 2004. This will send a powerful signal to developing countries, which will follow suit with their own deeper market opening without the danger of trade and competition being greatly distorted by export subsidies. 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. Market access negotiations must address

both the unacceptably high tariffs, which remain in agriculture, and tariff escalation, which continues to frustrate developing country efforts to move up the value chain.

The growth of the poorest countries depends crucially on a more dynamic farm sector—coming from increased domestic production for import substitution and/or exports. 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 also their applied tariff peaks, which cost their poor consumers dearly without bringing public revenue. Additional complications for the few poor countries that may be hurt by this modest liberalization could be dealt with by a substantial increase in international aid—to provide the necessary means for a new wave of Green Revolutions and to ensure adequate food security.

Nonagricultural market access—developing countries should also liberalize

Although not as severe as in farm products, trade barriers in nonagricultural 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 tariff peaks, tariff escalation, and quotas imposed by rich countries on goods of great export potential. While over the last few decades developing countries have undertaken an unprecedented level of trade liberalization, both on an autonomous basis and in the context of multilateral and regional negotiations, they still suffer, of course, from their own protection, which not only reduces their competitiveness in world markets but also cancels enormous opportunities of increased trade among themselves.

While developed countries bear a special responsibility to liberalize in this Round, developing countries should also do so—in their own interests and because they are important markets for each other and for the poorest countries. While this would still be less than full reciprocity, the poorest countries should nonetheless bind their tariffs at uniform and moderate rates in their own development interests. 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 (ATC) mandated the progressive phasing out of quotas by January 1, 2005. But phase-outs were heavily backloaded, with more than 50 percent of quotas—covering the most commercially valuable products—left to be removed on the final deadline of January 1 2005. This backloading robbed developing countries of one of the major gains expected from the Uruguay Round and gave rise to legitimate doubts about the willingness of the major importers to honor the agreement. It

also undermined any chance of gradual and orderly adjustment in the sector; the abrupt removal of the remaining quotas on January 1, 2005, may create adjustment problems for importers and exporters alike, and is likely to unleash powerful protectionist forces. 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 the poorest countries and 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 been around for 40 years; continued protection is likely only to prolong and further distort the adjustment process. Addicts always promise that they will quit tomorrow—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 costs. Assistance could help developing countries move into niche markets or up the value chain and 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, though 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 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 Round. Services liberalization promises real development gains—in terms of the efficiency and growth potential of the economy as a whole, the export of goods and other services, and 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.

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—and will require increased assistance and regulatory creativity. 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.

A serious “Development Round” must make progress on mode 4. 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 (such as on brain drain, remittance transfer, 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. Agreements would be notified to the WTO, and WTO Members would have the opportunity to indicate their interest in joining or negotiating similar agreements. An MFN waiver would likely be necessary. While a potentially useful interim step, bilateral or regional agreements are no substitute over 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.

Keeping markets open—avoiding new barriers, added costs, and uncertainties

Hard-won gains in market access in agricultural and nonagricultural products are increasingly eroded by other policies that recreate trade barriers and/or create transaction costs and uncertainty.

Antidumping is 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 can be restricted by high antidumping barriers. Additionally, national antidumping laws could be required to treat all affected domestic interests—import-competing industries, consumers, and users—equally.

Many developing countries are being 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: assistance to make effective use of the Technical Barriers to Trade (TBT) and Sanitary and Phytosanitary Measures (SPS) disciplines to ensure

that standards are not abused for protectionist purposes; and 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—liberalization on a most favored nation basis and appropriate compensation are a better way

Rich countries have 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 often received limited benefits from preference schemes, because preferences do nothing to address their multiple supply-side constraints. Benefits are also often at the expense of other developing countries, and 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.

While preference erosion is generally less than often thought, some countries may confront possible large losses and will require concrete assistance. Given the history of preference programs, developed countries as a group should pay. They should replace preferences with equivalent development assistance, which could be used by the recipient governments to fund adjustment costs. Operationalizing this deal should be an explicit part of the Doha Round. Any such assistance should be seen as part of a broader effort that is needed to help poor countries build and strengthen their ability to use trade beneficially. However, specifically in the context of a Doha deal, 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—limited benefits, high costs

Likewise, free trade agreements have a mixed record in achieving real liberalization, especially on the hardest nuts (such as agricultural subsidies or sensitive products). Benefits may be limited (or achieved at the expense of others) but costs can be high. Unlike at the WTO where developing countries can form effective coalitions, in free trade agreements (FTAs) they are at a disadvantage in resisting the inclusion of nontrade issues or erosion of their WTO rights (such as 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—trade facilitation promises gains but cannot be business as usual

Three out of the four so-called Singapore issues (competition, investment, transparency in government procurement) have rightly been left off the Doha Round. None meets the 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.

Trade facilitation 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 (along the lines of GATS precommitments), with technical and financial assistance 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. Flexibility on dispute settlement could be provided by a Peace Clause.

Trade-related intellectual property rights—could be revisited

Should intellectual property rights have been included in the WTO? From an economic point of view, probably not, because they require a very delicate balance of market forces and public action—a balance unlikely to be the same for all countries. TRIPS obligations also tend to be “one size fits all,” taking no account of levels of development and varying interests and priorities. While the agreement tries to mitigate this to some extent by providing for differing implementation periods, countries acceding to the WTO may not even have access to these normal flexibilities.

That said, the TRIPS Agreement is not without areas of actual or potential interest for developing countries (although the balance of costs and benefits will vary among developing countries and according to the issue), nor is it without some flexibility in its provisions. However, the flexibility provided for implementation of TRIPS seems yet insufficient on paper, and even more so in practice, and the assistance provided is clearly inadequate. There is a clear case for revisiting more of the rules to determine their impact on developing

countries and any additional flexibility required. In other cases, the agreement provides for flexibility, but certain WTO Members—the U.S. on drugs, the EU on geographical indications—are trying to narrow unacceptably the scope of that flexibility.

Special and differential treatment—making it more effective and operational

While it is clear that developing countries benefit from freer trade, it is equally clear that their capacity to do so is different from that of developed countries. 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 (such as 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 the level of development of the country concerned.

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 warranted. Where WTO rules promise real and short-term trade and development benefits, concrete technical and financial assistance should be ensured—say, through mandatory commitments subject to review and linked to the implementation requirements of 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 the adoption of sound complementary policies by national governments to manage liberalization, as well as ensuring that trade policymaking is appropriately informed by expertise across a range of policy areas. 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) and for a clear and realistic view of the WTO's role in technical assistance. This assistance for increasingly 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.

Main recommendations

A real development round is achievable but will require some enlightened, albeit self-interested, leadership on the part of the major players in both developed and developing countries. Providing this leadership is not within the realm of trade negotiators' capacities. Political leadership must be generated at a higher level, perhaps not even at the ministerial level but at the head of government level as part of a coherent policy approach—economic, political, and social—to meeting the development challenge.

The year 2005 offers a rare opportunity to harness the broader momentum of the “2000 plus 5” high-level review of the Millennium Summit to seek a major political consensus among the heads of government of a group of 20 or so countries on the Doha Development Round and other crucial topics for achieving the Goals.

Heads of state can agree on the major strategic criteria to shape the multilateral trading system for the future. This grand vision would keep the eyes of negotiators preparing for the Sixth WTO Ministerial Conference, in Hong Kong (China) in December 2005, on the prize of a real development round and the contribution it could make to achieving the Goals.

In this context it is recommended that leaders agree on the following ideals for the future path of the trading system:

- In a conveniently distant long term (2025) the multilateral trading system must 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 will and appropriate support for adjustment. And there is a base to build on; Asia-Pacific Economic Cooperation (APEC) economies have already committed to free trade by 2010 for developed Members and 2020 for developing Members.
- The most useful WTO would be one focused solely on trade and relieved of other global economic governance tasks, which could be better accomplished by other international instruments or entities.

Consistent with these criteria, more medium-term targets could be adopted. Greatly increased international technical and financial support for reform and adjustment by developing countries will be needed to ensure the achievement

of those targets; in the absence of such assistance, more flexibility would be required. But given the potential benefits, it is in all countries' interests for substantial assistance to be forthcoming to underpin the following targets:

- By 2015, no bound farm tariff should exceed 5 percent for OECD countries, 10 percent for developing countries, and 15 percent for the poorest countries. All nontariff barriers, including tariff-rate quotas, should be removed by 2010.
- As soon as possible and no later than 2010, all export subsidies should be abolished, with comparable disciplines on similar instruments.
- Domestic support (such as price support, direct production subsidies) must be made both less trade-distorting (decoupled from production) and subject to an overall, significantly lower limit. 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 by-product basis) by 2010 and at 5 percent by 2015. The Green Box (of minimally trade-distorting subsidies) should be maintained for the poorest countries—with clarifications or marginal additions such as support for diversification, transportation subsidies for farm products, consumption subsidies for domestic food aid, public assistance for establishing farm cooperatives, or institutions for promoting marketing and quality control.
- Developed countries should bind all tariffs on nonagricultural merchandise at zero by 2015, the target date for achieving the Millennium Development Goals. A mid-term target could be for no tariff higher than 5 percent by 2010. 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 moderate rate.
- Duty-free and quota-free access for all exports from the poorest countries should be extended by all developed countries no later than January 1, 2006.
- The liberalization of mode 4 of the GATS (temporary movement of labor to provide services) should be adopted as a high-priority item on the international agenda, considering its potential benefits for both developing and developed countries as well as the need to manage in a more orderly fashion the mounting migration pressures in the world. Developing countries' liberalization to foreign direct investment must be matched by developed countries' liberalization to foreign labor.
- The traditional approach to special and differential treatment must be revised away from the present, and for the most part counterproductive, system of exemptions from obligations and complex webs of discriminatory preferences. 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, 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.

- A 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, is needed to support countries in addressing adjustment costs associated with the implementation of a Doha reform agenda. Such funding must be additional to current aid flows (and could be financed out of the tariff revenue that is presently collected by OECD and higher income developing countries on imports that will be subject to Doha reduction commitments). A priority task for the development and trade communities could be the identification of new and existing channels through which this additional funding could most efficiently be made available for relevant, targeted projects in developing countries.