The Development Round of Trade Negotiations
In The Aftermath of Cancun

A report for the Commonwealth Secretariat prepared by

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Executive Summary:

The development focus of the Doha Round emerged from a renewed spirit of collective responsibility for the challenges faced by poor countries, and also as a response to the perceived inequities generated by previous rounds of trade negotiations. Unfortunately, in the years since it was launched, the Doha Round has not delivered on its development mandate in several important respects. First, there has been little progress on the issues of interest to developing countries (especially agriculture, labor mobility, and labor-intensive manufactures and services). Second, the new issues on the agenda, the so-called ‘Singapore Issues’, primarily reflect the interests of the advanced industrial countries and have been strongly opposed by many developing countries. Third, the domestic and bilateral actions of several OECD countries have led to questions about their commitment to the multilateral development agenda. Finally, there has been only limited reform to the culture and procedures of the WTO.

This report presents an alternative way forward for the Doha Round based on social justice and economic analysis. The first part of the report proposes an alternative agenda for the Round. It suggests principles that should motivate the negotiations and identifies priority initiatives which would deliver significant gains to developing countries and increase global efficiency. It also recommends institutional reforms necessary to make global trade negotiations more effective and inclusive.

The primary principle of the Doha Round must be to ensure that the agreements promote development in poor countries. To make this principle operational, the WTO needs to foster a culture of robust economic analysis to identify pro-development proposals and promote them to the top of the agenda. In practice this means establishing a source of impartial and publicly available analysis of the effects of different initiatives on different countries and groups within countries. This should be a core responsibility of an expanded WTO Secretariat. Based on this analysis, any agreement that differentially hurts developing countries or provides disproportionate benefits to developed countries should be presumptively viewed as unfair and regarded as being against the spirit of the Development Round.

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1 See the US Farm Bill of 2002 (Farm Security and Rural Investment Act 2002) which increases domestic support to agricultural producers and the European Commission’s Luxembourg reform of the common agricultural policy which did little to cut the total level of European agricultural support.
The agreements must enshrine both *de jure* and *de facto* fairness. This means ensuring that developing countries are not prevented from unlocking the benefits of free trade because of a lack of institutional capacity. In this regard, developing countries will require special assistance to enable them to participate equally in the WTO.

The principle of fairness should also be sensitive to countries’ initial conditions. Special and differential treatment is needed to recognize that adjustment to new trading rules involves particularly high costs for developing countries whose institutions are weakest and whose populations are most vulnerable. Prescriptive multilateral agreements must not be allowed to run roughshod over national strategies to deal with idiosyncratic development problems.

This report presents pro-development priorities that should form the core of the Doha Round agreements. Primary attention should be given to market access for goods produced by developing countries. There is an urgent need to reduce protection on labor-intensive manufactures (textiles and food processing), agricultural goods, and unskilled services (maritime and construction services). Priority should also be given to the development of schemes to increase labor mobility – particularly the facilitation of temporary migration for unskilled workers. As tariff barriers have come down, developed countries have increasingly resorted to non-tariff barriers; these need to be circumscribed.

Significant change in the outcomes of multilateral trade agreements must be supported by institutional reforms. A fair agreement is unlikely to be produced through an unfair process. In particular, greater transparency and openness is required to create a more inclusive bargaining process and put an end to the infamous ‘green room’ negotiations.

The Report makes clear that there is a huge discrepancy between the Development Round trade agenda, both as it was formulated at Doha and as it has evolved since, and a *true* Development Round agenda, that would reflect the interests and concerns of the developing world. Such an agenda would promote growth in developing countries and work to reduce the huge disparity that separates them from the more advanced industrial countries.

Part 2 of this report considers some of the issues associated with the adjustment process to a new trade regime. In one sense these adjustment costs can be thought of as the price to be paid for the benefits of multilateral trade liberalization. It is these adjustment costs together with the trade benefits that determine the net effect of trade reform for each country. The Doha Round has placed renewed emphasis on the importance of sharing the *benefits* of trade reform fairly among developed and developing countries. However there has been less attention to the distribution of adjustment costs among countries. The fact that implementation and adjustment costs are likely to be larger in
developing countries, unemployment rates are likely to be higher, safety nets weaker, and risk markets poor are all facts that have to be taken into account in trade negotiations. For the some of the smallest and poorest states, the adjustment costs of trade liberalization may significantly outweigh the benefits available.

If the Development Round is to bring widespread benefits to people living in developing countries - and if there is to be widespread support for the continuing agenda for trade reform and liberalization - the developed world must make a stronger commitment than it has provided in the past to giving assistance to the developing world. Assistance is required not only to help bear the often large costs associated with trade reform, but also to enable developing countries to avail themselves of the new opportunities provided by a more integrated global economy.
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1 Introduction

In the aftermath of the failure of Cancun, there is a need to reassess the direction of global trade negotiations. In Doha, the nations of the world agreed to a new round of trade negotiations, which would redress some of the imbalances of the past, imbalances which it was widely felt had benefited the advanced industrial countries at the expense of developing countries. There was, in fact, some basis for the complaints of the developing countries, both in terms of the manner in which trade negotiations had been conducted in the past and in terms of the outcomes. Many of the participants in the Cancun meeting felt that Europe and the United States had reneged on the promises that had been made at Doha, emblemized by the lack of progress in agriculture.

There were mutual recriminations about who was to blame for the failure. There was even disagreement about who would suffer the most. The United States and Europe were quick to assert that it was the developing countries who were the ultimate losers. But many developing countries had taken the view that no agreement was better than a bad agreement, and that the Doha round was rushing headlong (if any trade agreement can be described as “rushing”) into

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2 Of particular concern was the lack of transparency (including “green room negotiations, in which only a few chosen countries from the developing world engaged in negotiations with the United States and Europe) and the disadvantageous position the developing countries had in these negotiations, simply because of the complexity of the negotiations and their limited staffs. See for example the open letter, dated 6 November 1999, sent by 11 developing countries to the WTO chairman Ambassador Ali Mchumo of Tanzania, expressing their concern over the lack of transparency in the WTO Green room process.

3 A widely quoted World Bank study estimated that Sub-Saharan Africa was actually worse off as a result of the terms of trade effects generated by the Uruguay Round of trade negotiations. The United Nations Development Programme estimates that under the WTO regime, in the period 1995 to 2004, the 48 least developed countries will actually be worse off by $600 million a year, with sub-Saharan Africa actually worse off by $1.2 billion. The UN Development Programme also says that 70% of the gains of the Uruguay Round will go to developed countries, with most of the rest going to a relatively few large export-oriented developing countries. UNDP HDR [1997]. Similar concerns are raised about the “allowed” trade restrictions. Textiles remain the one major area of quotas, and those these are supposed to end in 2005, there is concern that the developed countries will either not fulfill their commitments (a ten year transition period was provided, to facilitate “adjustment,” but little adjustment occurred in the first eight years); or they will replace the quotas with extremely high tariffs; or they will use safeguards or other non-tariff barriers. While it is often emphasized that average tariffs of developing countries remain higher than those of developed countries, it is also true that developed countries average tariffs against developing countries are higher than their average tariffs against developing countries, even taking into account existing preferences.

one which, rather than redressing the imbalances of the past, would actually make them worse off. Though some progress had been made in addressing the concerns about the manner in which the negotiations were conducted, the failure to address these concerns fully generated the further worry that the developing countries would, somehow, be strong-armed in the end into an agreement that was disadvantageous to them. There were also threats, especially by the United States, that it would effectively abandon the multilateral approach, taking up a bilateral approach. It differentiated between the “can do” countries and others, and suggested that the “can do” countries would benefit from a series of bilateral agreements.6

This paper takes a step back from these disputes. It attempts to support progress in the current round by asking, what should a Development Round of trade negotiations look like? What would an agreement that was based on principles of economic analysis and social justice—not on economic power and special interests—look like? Our analysis concludes that the agenda would look markedly different from that which has been at the center of discussions for the past two years, and that the fears of the developing countries that the Doha round of trade negotiations (were the demands of the developed countries acceded to) would disadvantage them were in fact justified.

Section 2 of this paper addresses the need for a Development Round. It examines some elements of the experience of developing countries in previous trade negotiations and briefly reviews some of the potential gains available from further liberalization. Section 3 is a brief review of the Doha round so far, and the extent to which it has lived up to the expectations of developing countries.

Most of this paper is what is sometimes called “blue sky” analysis: it approaches the issues from a fresh start, relatively unencumbered by concerns of politics and what has happened in the recent past. Section 4 outlines the principles of a Development Round of trade negotiations. Section 5 details the priorities of a Development Round of trade negotiations in the context of today’s international setting and section 6 considers several issues of particular interest to developing countries.

Finally section 7 takes a brief look at some institutional reforms that might facilitate a more transparent and democratic negotiating process, and one which might more likely result in agreements that were both fair and in the general interests of the world.

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5 Most notable in this regard was the request by a number of developing countries that the Cancun draft be prepared on the basis of views and inputs at open-ended consultations, and where there was no consensus, to clearly indicate the differing positions or views. The proposal was rejected by a coalition of developed countries.

6 The smaller developing countries recognized that in these bilateral discussions their bargaining position was even weaker than it was in the multilateral setting. Several of the bilateral trade agreements made since Cancun have shown that these worries were justified. On the other hand, the United States has not succeeded in a bilateral trade agreement with any major developing country.
2 The Need for a Development Round

2.1 Redressing past imbalances

In June 1993 the Uruguay Round (UR) was finally brought to a close. Part of the impetus for members to conclude the round was the promise of large welfare gains that had been projected by many researchers. In 1992-1993, the World Bank, the Organization for Economic Cooperation and Development, and various other institutions made projections of welfare gains in the order of $200 billion a year. A large share of the gains was predicted to accrue to developing countries. In hindsight these estimates – particularly in relation to developing countries – were over-optimistic. It has since been estimated that 70% of the gains from the Uruguay Round will go to developed countries, with most of the rest going to a relatively few large export-oriented developing countries. Indeed many of the poorest countries in the world would actually be worse off as a result of the round. In the first six years of the Uruguay round (1995-2001), the 48 least developed countries will actually be worse off by some $600 million a year, with sub-Saharan Africa worse off by $1.2 billion. (UNDP HDR [1997], p. 82).

One reason was that the modeled scenarios were not fully reflected in actual events. Several reforms, which were significant sources of predicted gains, did not proceed as had been hoped early in the negotiations. For example, the Agreement on Textiles and Clothing (ATC) was structured to significantly

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8 The gain to developing countries was estimated at up to 90 billion dollars, or roughly one third of the $200bn total gain predicted at the time (OECD 1993).

9 The models themselves also make assumptions that may not be fully appropriate for less developed countries. See Charlton and Stiglitz [2004].
Backload liberalization;\textsuperscript{10} the ability of tariff-rate quotas (TRQs) to liberalize agricultural market access was overestimated; and the costs of implementation were almost completely ignored.

In addition the Uruguay Round agenda reflected, in large part, the priorities of developed countries. Market access gains for example were concentrated in areas of interest to developed countries and there was only marginal progress on the priorities of developing countries (particularly in agriculture and textiles). The result of this regressive asymmetry was that after the implementation of Uruguay Round commitments, the average OECD tariff on imports from developing countries is four times higher than on imports originating in the OECD (Laird 2002). Domestic protection (particularly agricultural subsidies) is also much higher in developed countries, amounting to more than US$300bn in 2002. The impact of this protection is particularly regressive since producers in the poorest developing countries are the most affected by OECD policies. Only 4 per cent of the exports of developed countries are subsidized by another WTO member, but 6.4 per cent of the exports of middle income countries are subsidized. By contrast, a much larger share (29.4 per cent) of the exports of the poorest countries (not including China and India) are subsidized by another WTO member.\textsuperscript{11}

As well as receiving a small share of the gains from the Uruguay Round, developing countries accepted a remarkable range of obligations and responsibilities. New trade rules and domestic disciplines were introduced, but they too reflected the priorities and needs of developed countries more than developing countries (e.g., subsidies were permitted for agriculture, but not industrial products). Many of the rules acted to constrain the policy options (such as industrial policies) of developing countries, in some cases prohibiting the use of instruments that had been used by developed countries at comparable stages of their development. Many of the new obligations imposed significant burdens on developing countries. In return the least developed countries were promised financial assistance with implementation costs and extensions of preferential market access schemes. The common feature of these commitments is that they were non-binding on developed countries. As a consequence developing countries found themselves at the mercy of the goodwill of developed countries. As Finger and Schuler (2000) aptly note: “the developing countries took a bound commitments to implement in exchange for unbound commitment of assistance”. Insufficient attention has subsequently been paid to the enormous demands upon developing countries in implementing the outcome from the Uruguay Round. Agreements related to intellectual property, customs

\textsuperscript{10} The developed countries were given a decade to remove their textiles quota; many thought the extra time would allow them a smoother adjustment process. In practice, little if any adjustment has occurred. Only the day of reckoning was postponed.

\textsuperscript{11} These may underestimate the relative effects of subsidies if developing countries’ exports are more concentrated in those agricultural products which attract subsidies.
valuation, technical barriers to trade and agricultural food safety have been particular targets of criticism in this regard.\textsuperscript{12}

### 2.2 Unfinished business

The 1994 Agreement on Agriculture defined a framework in which agricultural protection could be negotiated in the WTO, but it did not deliver significant benefits to developing countries. Martin and Winters (1995) note that the Agreement on Agriculture achieved “little in terms of immediate market opening.” Indeed the level of OECD farm protection was not noticeably reduced. In 1986-88 transfers were equivalent to 51 percent of all OECD farm production, and fourteen years later, after the implementation of Uruguay commitments, they still account for 48 per cent of all farm production - roughly US$320 billion (OECD, 2003). Trade-distorting measures of industrialized nations displace the agricultural exports of developing countries. By suppressing world prices, these policies have a direct effect on farm incomes.\textsuperscript{13} Moreover, there may be dynamic effects when investment is suppressed in countries whose trade is affected by OECD support.\textsuperscript{14}

In non-agricultural goods, there is also scope for further liberalization. The significant liberalization of manufacturing tariffs in developed countries over the last two decades might suggest that there is little to gain from further negotiations on industrial products. However if this is true to some extent for developed countries, it is certainly not the case for developing countries. While average developed country tariff rates are low, they maintain high barriers to many of the goods exported most intensively by developing countries. When weighted by import volumes, developing countries face average manufacturing tariffs of 3.4 per cent on their exports to developed countries, more than four times higher than the average rate faced by goods from developed countries, 0.8 per cent (Hertel and Martin, 2000). Moreover aggregate data hides the

\textsuperscript{12}Many developing countries have been unable to meet their Uruguay Round obligations because of these high costs. By January 2000, up to 90 of the WTOs 109 developing country members were in violation of the SPS, customs valuation, and TRIPs agreements. Estimates of the cost of compliance to the Uruguay agreements vary widely depending on the quality of the existing systems and the strength of institutions in each country. Hungary spent more than $40 million to upgrade the level of sanitation of its slaughterhouses alone. Mexico spent more than $30 million to upgrade intellectual property laws. Finger (2000) suggests that for many of the least developed countries in the WTO compliance with these agreements is a less attractive investment than expenditure on basic development goals such as education.

\textsuperscript{13}Estimates of the downward impact on world prices caused by OECD domestic support are between 3.5-5\% for many agricultural commodities including wheat & other coarse grains and oilseeds (Dimararan et al. (2003)).

\textsuperscript{14}Diao, Diaz-Bonilla, and Robinson (2003) report that protectionism and subsidies by industrialized nations cost developing countries about US$24 billion annually in lost agricultural and agro-industrial income. Latin America and the Caribbean lose about US$8.3 billion in annual income from agriculture, Asia loses some US$6.6 billion, and sub-Saharan Africa, close to US$2 billion. Their estimates do not include dynamic effects.
existence of tariff peaks. In the United States, post-Uruguay-Round tariff rates on more than half of textile and clothing imports are between 15 and 35 per cent, while in Japan 22 per cent of textile imports face tariffs of 10-15 per cent (UNCTAD 1996). Similarly in the processed food sector, Canadian, Japanese and EU tariffs on fully processed food are 42, 65 and 24 per cent respectively. By contrast, the least processed products face tariffs of 3, 35, and 15 per cent in these countries (World Bank 2002). Such tariff escalation serves to discourage the development of food processing in LDC’s since the effective tariff rate on “value added” in food processing is very high. Tariff escalation and tariff peaks are manifestly unfair and have a particularly pernicious effect on development by restricting industrial diversification in the poorest countries.

After the Uruguay Round, there was also a widely held view that the TRIPS agreement needed to be reviewed, particularly in its application to public health and bio-piracy. Article 71.1 of TRIPS provided for a review of the implementation of the TRIPS Agreement after year 2000, and for possible reviews "in the light of any relevant new developments which might warrant modification or amendment". Many developing countries felt that the Agreement as it stood primarily reflected IPRs protection suitable for developed countries, but which largely disregarded important factors in developing countries.

International rules for intellectual property rights have potentially huge public health effects and global distributional consequences. Unbalanced rules—and there is a concern that present rules are unbalanced—can impede efforts to close the north-south ‘knowledge gap’. Additionally the WTO also has the responsibility to protect indigenous knowledge. While there have been a few dramatic bio-piracy cases, the full impact of expanded patentability remains uncertain. Patent laws need to be changed so that the onus of proof reversed and companies should give an undertaking that the patent they are seeking is not based on traditional wisdom.

Finally, the Uruguay Round imposed strong restrictions on developing countries’ use of industrial policies—policies that had arguably played an important role both in the development of Western economies in an earlier century and more recently in the East Asian Miracle. But they allowed developed countries to continue to use non-tariff barriers to exclude goods of the developing countries. Developing countries needed more freedom to use industrial policies, and more protection from the abuses by developed countries

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15 In May, 1995 the US Patent Office granted to the University of Mississippi Medical Center a patent [#5,401,504] for "Use of Turmeric in Wound Healing.“ The United States Patent and Trademark Office (USPTO) revoked the patent after dozens of references to the procedure were found in Indian texts.
16 For a discussion see, eg. Chang (2002).
of dumping duties, countervailing duties, safeguard measures, and phyto-sanitary conditions.

2.3 New areas of importance

Services represent an increasingly large share of GDP and trade in both developed and developing countries. With manufacturing dwindling to 14% of U.S. GDP, it was natural for the U.S. to shift the focus of trade liberalization to services.18 Indeed, the irony was that increasingly, it seemed as if the trade agreements of the past, centered around manufacturing, would, in the future, be of greater benefit to China than to any other country.

But the Uruguay Round focused on the liberalization of those service industries of primary interest to firms in OECD countries (like financial services). There was significantly less attention given to low-skilled labor intensive services in which developing countries have a comparative advantage.19 Developing countries have increased their exports of services by more than four times since 1990, despite the large trade barriers facing many of their most promising industries such as construction, shipping services, and health services (OECD 2002). In these industries developing countries have legitimate and substantial interest in the outcome of a new round of liberalization.20

Some of the areas of service sector liberalization that were advanced in the Uruguay Round may well have disadvantaged the developing countries. Financial market liberalization, for instance, may have weakened domestic financial firms, reducing the already scant supply of credit available to domestic small and medium sized enterprises.

This agenda of “new issues” and “unfinished business” is markedly different from the agenda of the Doha round. The new “Singapore issues”21 all centered

18 Additionally, given the apparent barriers to service trade, there might be large gains from liberalization. (See Brown, Deardorff and Stern, 2002. They estimate of the global gains from service liberalization are as high as $400bn. However these estimates may overstate the benefits from liberalization if many of these barriers are exogenous and not related to economic policy.)
19 More than one quarter of the world’s top 40 service exporters in 2002 were developing countries. Twelve developing countries
20 As we discuss in the next section, these labor intensive services are not the ones that have been given priority in the Doha Round so far.
21 These centered around (i) government procurement; (ii) trade facilitation; (iii) competition; and (iv) investment. The names, however, are somewhat misleading. Competition did focus, for instance, on anti-trust. The developing countries had already expressed their hostility to the initiative by the OECD for a multilateral investment agreement. There was no reason to believe that the WTO provided a venue in which an agreement acceptable to the developing countries could be worked out. In any case, it was clear that this was an initiative of the developed countries, not of the developing countries. Similarly, while developed countries hoped to have greater access to government procurement in developing countries,
around concerns of the developed countries. There was one, competition policy, which in principle could have been of benefit to the developing countries—had dumping duties been brought into the discussion. But the developed countries were adamantly opposed.

there was little hope that developing countries could make much inroad in procurement by developed countries, especially in the central area of defense. This too was a developed country agenda item.
3  Doha’s Development Record So Far

Despite the expressions of goodwill at Doha, progress on the Development Round has been slow. Part of the problem is that, while the interests of different developing countries differ, the evolving agenda itself was not really designed to reflect the real concerns of developing countries. Throughout 2002 and 2003 it became apparent that many developing countries felt that the Doha Round was moving in the wrong direction on many key issues. They felt that the new round offers them few immediate benefits but carries the risk of additional obligations. As a consequence developing countries walked away from the Cancun Ministerial in September 2003.

Up to that point, Doha had achieved little progress on most of the critical development issues. One of the key disappointments has been agricultural reform, which many developing countries\(^{22}\) and NGOs\(^{23}\) viewed as the primary objective of the round. The March 2003 deadline for agreement on agricultural modalities was missed. When the US and EC finally presented a joint paper on agriculture modalities in August, the framework was widely criticized by developing countries, correctly in our judgment, for ignoring their interests.\(^{24}\) On the key issues of market access, domestic support, and export subsidies the text was perceived to fall short of the level of ambition of the Doha mandate; indeed, in some respects, what was offered was a step backward.\(^{25}\)

At the same time, agricultural initiatives within OECD countries seemed to be undermining multilateral efforts. The U.S. Farm Bill in 2002 increased the level

\(^{22}\) Section 7 of 6\(^{th}\) June 2003 Communication from Argentina, Bolivia, Botswana, Brazil, Chile, China, Colombia, Cuba, Dominican Republic, Ecuador, El Salvador, Gabon, Guatemala, Honduras, India, Malaysia, Mexico, Morocco, Nicaragua, Pakistan, Paraguay, Peru, Thailand, Uruguay, Venezuela and Zimbabwe, (TN/C/W/13), makes it clear that “Reform of agricultural trade is of central importance for many developing countries” and is “an essential ingredient of the negotiation and its outcome.” (original emphasis.)

\(^{23}\) Oxfam (2000) argues that “agriculture is the key to unlocking the Doha development agenda, and without constructive steps on this issue, the broader negotiations cannot really restart.”

\(^{24}\) See the statements by Indian Ambassador K.M. Chandrasekhar, Brazil’s Ambassador, Luis Felipe de Seixas Correa, and China’s Ambassador Sun Zhenyu.

\(^{25}\) On domestic support, no specific figures were given for reducing most trade distorting support. The text potentially widened the scope for the use of blue box support – a step backwards in terms of liberalization. Also the text did not focus on trade distorting elements of the Green Box measures. See the critical response by Kenyan Ambassador Ms. Amina Chawahir Mohamed who said that “the EC-US text falls short of our expectations and as such we find it difficult to accept it as a basis of our further work”.
of support to U.S. farmers and strengthened the link between subsidies and production decisions. One year later, the EC’s 2003 Luxembourg reform of the common agricultural policy (CAP) was also disappointing. The EC reform shifts support from the ‘Blue Box’ (production limiting) to the ‘Green Box’ (deemed to be less trade-distorting). However the level of producer support will remain virtually constant – projected to fall from 57 per cent to 56 per cent (OECD 2004). Moreover the reform has little impact on export subsidies or import barriers. Both of these initiatives fell far short of expectations and signaled the limited commitment of the US and EC to agricultural reform. Consequently both plans had a depressing effect on the mood of multilateral agricultural negotiations.

After the Uruguay round, there was a clear understanding that there would be further liberalization of agriculture. There is now a strong sense that the United States has reneged on that commitment; whether the huge increase in agricultural subsidies is an explicit violation of earlier agreements is of less importance than that it represents a violation of the spirit of the agreement (or at least was taken as the spirit of the agreement by the developing countries.) Just as the agreement has to be viewed as a whole, so too, a Development Round agreement has to be viewed in the context of the unbalanced agreements that preceded it.

In addition to their disappointment on agriculture, developing countries are skeptical about the effects of the new items on the agenda. There is significant opposition from developing countries to the Singapore Issues. In the space of a month from early June 2003, 77 developing countries, including over half the WTO membership, made public statements urging that the Singapore Issues not be included as part of the Doha Round. Since these issues are not priorities for developing countries, their emerging centrality in the agenda is an incongruous feature of the ‘development’ round.

Several developing countries see the Singapore issues as incursions into their national sovereignty that are not justified by the benefits they bring. Multilateral

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26 The U.S. Farm Security and Rural Investment Act (FSRIA) of May 2002 has a value of about $190 billion over the next 10 years, about $83 billion more than under previous programs. It sets target prices which are lower than the pre 1996 levels, but the total effective support is larger because average world commodity prices have declined and the range of commodities included in FSIRA is larger than in the 1996 FAIR Act. That act was intended to phase out farm subsidies, but even before the passage of FSRIA had achieved additional support through emergency measures.

27 It provides counter cyclical payments (CCPs) to U.S. farmers which respond negatively to the world prices. This type of measures has allowed the U.S. to dump its farm surplus on world markets. For example, the U.S. exports corn at prices 20 percent below the cost of production, and wheat at 46 percent below cost. See Cassel (2002).

28 The recent preliminary WTO ruling against American cotton subsidies (based on a complaint from Brazil) has lent support to the critics. America claimed, remarkably, that their subsidies did not adversely affect other cotton exporting countries. Such claims clearly undermine the credibility of the position of the developed countries.

regulatory disciplines hold the specter of repeating the worst elements of Uruguay by restricting the options for individual governments to pursue development policies based on their own national priorities and problems.

In addition there are concerns that the initiatives based on the Singapore issues may impose a large burden on the administrative capacity of developing countries. There are significant costs associated with both the creation and enforcement of new regimes in competition policy, investment regulations, and trade and customs procedures. Many developing countries have been unable to meet their Uruguay Round obligations because of these high costs.

Another area where achievements have lagged behind rhetoric is in the delivery of non-reciprocal trade preferences. Recently there have been a number of initiatives in OECD countries to further discriminate in favour of LDCs. Most notable among these are the EU’s Everything But Arms (EBA) initiative and the US’s African Growth and Opportunity Act (AGOA). The EU has argued that the EBA will “significantly enhance export opportunities and hence potential income and growth” for LDCs (CEC 2002). However analysis of preferential schemes on LDC exports shows only limited impact. Brenton (2003) concludes that trade in goods given preferences for the first time under the EBA in 2001, amounted to just two hundredths of one per cent of LDC exports to the EU in 2001. Even earlier preferences were not focused on goods exported by LDC’s: up to 50 per cent of the exports of non-ACP countries to the EC did not receive preferential access and paid the MFN tariff [Brenton, 2003]. Overall, the impact of these schemes has not yet been very significant, with the exception of African apparel exports to the U.S. under AGOA [World Bank, 2003].

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30 Finger (2000) estimated the implementation of three of the Uruguay Round’s six agreements that required regulatory change (customs reform, intellectual property rights, and sanitary and phytosanitary (SPS) measures). His analysis suggests that the average cost of restructuring domestic regulations in the 12 developing countries considered could be as much as $150 million. In eight of these countries this figure is larger than the entire annual development budget.

31 By January 2000, up to 90 of the WTOs 109 developing country members were in violation of the SPS, customs valuation, and TRIPs agreements.

32 Part of the reason the EBA has had such a limited effect is that almost all EC imports from LDCs (more than 99 percent in 2001) were already eligible for preferences under other schemes (Brenton 2003). In 2001 the EBA initiative granted duty-Free access to imports of all products from the least developed countries (except arms and munitions). Total exports from these LDCs to the EU increased by 9.6 per cent in 2001. However in practice, the EBA was only relevant to the remaining 919 products (of the EU’s 10,200 tariff lines) which had not previously been granted duty free status under either the GSP or Cononou Agreement. Of these 919 products, imports from LDCs were recorded in just 80 products in 2001. Brenton (2003) notes that total exports of these products actually fell from 3.5 million euros in 2000 to 2.9 million euros in 2001. Moreover trade in these goods in 2001 amounted to just two-hundredths of one per cent of the total value of LDC exports to the EU. Thus it appears that the direct impact of the EBA initiative has not been significant in the short term and given the small size of trade in affected products, is not likely to be large in the medium term.

33 Moreover, beginning in 2008, cotton textile producers will have to use American cotton, further limiting the benefits of AGOA.
There was also little or no progress on other items that are of concern to developing countries, from non-tariff barriers like dumping duties to bio-piracy.

In summary the agenda for the ‘Development Round’ has evolved disappointingly for developing countries. It has done little to address their concerns in agriculture and it has done little to address problems posed by non-tariff barriers. It has not prioritized a developing country service sector agenda and there were no reforms in basic procedures.

In addition, the proposed agenda’s new issues could have made life worse for developing countries. The U.S. wanted capital market liberalization as part of investment agreement, even though weight of evidence was that capital market liberalization did not promote growth but did lead to more instability. Under competition policy, rather than creating a true competitive environment—hindering use of dumping duties as protectionist devices—there was fear of restricting development and socially oriented preferences.

In the South, of course, there is a tendency to see the actions as coordinated, driven by economic interests in the North. While they may see more coordination than actually occurs, the impacts are often closely akin to what they would be if they were coordinated. The high interest rates, tax policies, and trade liberalization policies demanded by the IMF do exacerbate the adverse effects on developing countries of whatever trade liberalization measures they agree to within the WTO. The two cannot be seen in isolation.
4 Principles of a Development Round

We begin with an analysis of the principles that should underlay a development round of trade negotiations. It seems self-evident that:

1. *Any agreement should be assessed in terms of its impact on development; items with a negative effect on development should not be on the agenda.*
2. *Any agreement should be fair.*
3. *Any agreement should be fairly arrived at.*
4. *The agenda should be limited to trade-related and development-friendly issues.*

While these principles may be widely agreed to, there may be important differences both about the meaning of terms and about how to respond to conflicts among the principles.

4.1 Any agreement should be assessed in terms of its impact on development

Any agreement should be carefully designed to promote, not hinder, development. There is surprisingly little economic analysis of the precise consequences of various potential trade agreements on participant countries. Where analytical studies have been done, they have not penetrated into the core of negotiations and do not seem to play a central role in setting the agenda. The absence of this type of analysis raises the question of what is driving the prioritization of trade issues on the WTO agenda, other than a mélangé of prevailing orthodoxies and the momentum of special interest groups?

The WTO Secretariat should be responsible for producing a *general equilibrium incidence* analysis, analogous to what is conducted when taxes are imposed, attempting to assess how different countries are affected by different proposals. Publicly available analysis would benefit developing countries, many of whom are at an information disadvantage relative to developed countries. Publicly available information would also be an important source for consumers who are less equipped to lobby for favorable outcomes than producer groups.
Analysis based on general equilibrium models must be sensitive to the fact that different developing countries are likely to be affected differently, and different groups within developing countries are likely to be affected in different ways. Thus, eliminating developed country agricultural subsidies is likely to benefit grain exporters, but hurt grain importers. It is likely to benefit grain producers, and hurt grain consumers. What is particularly problematic is that within developing countries, the grain producers are among the poorest, so they are the ones most likely to benefit, even if the country as a whole is a grain importer, so the country as a whole loses. Moreover, within most developing countries, there are limited mechanisms of redistribution, so that it does not suffice to assess what happens on average.

The results of general equilibrium models are sensitive to their assumptions. Much of the analysis of the impacts (including, for instance judgments about whether particular types of agricultural subsidies are trade distorting) relies on a particular model of the economy, the neo-classical model, which assumes full employment of resources, perfect competition, perfect information, and well functioning markets, assumptions which are of questionable validity for any country, but which are particularly problematic for developing countries.

Most of the tools used to analyze general equilibrium effects of trade liberalization are static models. They describe the movement from one ‘steady state’ to another but do not incorporate the costs associated with transition or the consequences for economies which are initially out of steady state. For example the models typically assume that there is full employment. Trade liberalization measures are good for a country because it enables resources to be redirected from low productivity protected sectors to more productive sectors as the economy specializes in its areas of comparative advantage. Under full employment, developing countries would unambiguously benefit from trade liberalization measures, were it not for terms of trade effects (changes in relative prices.) Most of the studies that assess the impact on developing countries cited in the Appendix thus focus principally on these terms of trade effects.

But with unemployment, trade liberalization may simply move workers from low productivity protected sectors into unemployment. This lowers the country’s national income and increases poverty. There can be multiplier effects, so that the total impact is far greater than the direct effect. Much of the opposition to trade liberalization arises because of the perceived effects on unemployment. In more developed countries, monetary and fiscal policy should, in principal, enable the country to maintain close to full employment. As the advocates of trade liberalization repeatedly emphasize, the objective of trade liberalization is not to create jobs, but to increase standards of living by allowing countries to specialize in areas of comparative advantage. But in many developing countries, with persistent unemployment—with unemployment rates
sometimes in excess of 20%—it is evident that monetary and fiscal polices are unable to maintain the economy at full employment. While the standard neoclassical models typically employed to assess trade impacts do not identify the impact of trade liberalization on the equilibrium level of unemployment—by assumption there is none—even if trade liberalization had no impact on the equilibrium level of unemployment, it may take the economy considerable time to adjust, and the costs of adjustments—lost income and increased poverty—may be considerable.

Another important assumption made in most of the analyses is that there is no uncertainty, no risk. But changes in trade regimes affect countries’ exposure to risk. In the absence of good insurance markets, there can be first order welfare effects arising from this increased exposure to risk. For instance, with a quota, those who compete with imports know precisely how much will be imported, and therefore, if there is relatively little domestic volatility, they will face relative little price uncertainty. But with the tarrification of quotas, countries are exposed to considerably greater volatility.

It is important that any incidence analysis take into account other pre-existing distortions. For instance, tax policies (often advocated by international institutions), which effectively tax the informal sector less than the formal sector, already distort production in favor of the informal sector. In this context, trade regimes which lower the international price of agricultural goods, typically produced by the informal sector, have a larger adverse effect than would be the case if tax policy were more neutral.

It is also important that any incidence analysis be based on an assessment of the global general equilibrium impacts, which takes into account the effects of a change in a trade regime on global relative prices. For instance, if a single small country were to subsidize cotton, it would have a relatively small effect on the global price of cotton. But if a large producer—the United States—subsidizes cotton, it has an effect on the international price of cotton.

The fact that implementation and adjustment costs are likely to be larger in developing countries, unemployment rates are likely to be higher, safety nets weaker, and risk markets poor are all features of developing countries that have to be taken into account in conducting a relative incidence analysis. If trade

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34 In 2001 average unemployment rates reached 14.4 per cent in Africa; 12.6 per cent in transition economies; and 10 per cent in Latin America. Such statistics, however, often under represent the true level of unemployment, for instance, the prevalent high levels of disguised unemployment.
35 See for instance the papers cited in the appendix, especially contributions by Hertel (1997), Anderson et al. (2000)
36 For instance, Dasgupta and Stiglitz [1977] show that the change from quotas to tariffs may expose countries to much greater risk. Newbery and Stiglitz [1984] show that the adverse effects from increased exposure to risk may be so greater that everyone in both countries may be worse off.
37 The incidence, in this case, depends on the extent to which there are disturbances in the domestic markets, and the extent to which the external disturbances are correlated with the domestic disturbance.
liberalization has a large effect on inequality, then governments may be required to strengthen their redistributive welfare system. Larger taxes generate increased deadweight loss, which reduces the efficiency gains from liberalization.

Large adjustment costs imply not only that the process of liberalization should be conducted gradually, but also that there should not be oscillations. Bilateral agreements on the way to a multilateral agreement may be particularly offensive, when there are important elements of trade diversion. The greater adjustment costs in developing countries may mean either that the net benefit (net of the adjustment costs into and out of the sector having temporary preferential treatment) may be small and/or that there will, in fact, be relatively little benefit, as expansion into that sector may be limited, as investors recognize its short term nature.

Finally, it is of first order importance to distinguish between provisions which should, in principle, make a country better off on its own, almost regardless of the circumstances, provisions which might or might not make a country better off, on its own, and provisions which essentially are redistributive in nature, with the gains to one side being largely offset by losses to the other. We have argued that many of the trade liberalization measures would, in a world of full employment, make a country better off, on its own. In this world, the question is often posed: why is there any need for a trade agreement? Trade agreements are used only as a bargaining weapon; the threat of not opening up one’s own market (which has a cost) is used to force the opening up of the foreigner’s markets.

Note that many of the arguments that are currently used in favor of certain provisions of proposed trade agreements contend that they are good for the developing countries. To the extent that such arguments are correct, of course, it implies that there is no need for a trade agreement, other than the political economy argument, that it is only by bringing the pressure from the gainers from trade liberalization that one can overcome the resistance of the losers in a world in which compensations are typically not made. Moreover, to the extent that such arguments are correct, it implies that (apart from global terms of trade effects) the issue of fairness only pertains to the distribution of relative gains (relative costs and benefits) since every country benefits. It also means that any country could unilaterally increase its gains simply by lowering its trade barriers further, thereby expanding trade. To be sure, some of the opposition against trade liberalization comes from those who would be hurt by it, especially special interests who benefit from protection; but some opposition may arise because particular countries may be adversely affected as a whole.

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38 This includes not only trade liberalization, but also investor protections. Investor protections will attract more investment. But if that is the case, then countries would have an incentive to undertake such actions on their own. There are some legitimate worries, spelled out below: excessive investor protection may compromise general welfare concerns, e.g. about safety or the environment.
These cases need to be distinguished from intellectual property rights, where stronger IPO protections may increase the incomes of those in the more advanced industrial countries at the expense of those in the less advanced industrial countries. Here, the issue is primarily redistributive, and is accordingly fundamentally different from those that arise in connection with trade liberalization.\textsuperscript{39} Again, the developed countries make a self-serving argument that stronger IPO protections will (a) induce more research; or (b) induce more investment in intellectual property intensive industries. There is relatively little evidence that the incremental profits generated in developing countries, for most goods, has much impact on research. This is certainly the case for most drugs, where the overwhelming bulk of the profits are generated by sales in the North; the drug companies do little research related to illnesses the primary incidence of which is in the South. In many areas, such as soft drinks, trade secrets, not patents, have been the basis of expansion into the South. In any case, again, if it were true that stronger intellectual property protections led to faster growth, countries interested in enhancing growth would on their own provide such stronger protection.\textsuperscript{40}

4.2 Any agreement should be fair.

This is perhaps the principle which is most difficult, but also one that is perhaps the most important. Underlying conflicts about perceptions of fairness is the fact that because the circumstances of the different countries are different, any agreement that applies “fairly” or “uniformly” to all countries may still have large differential effects. This is why we have emphasized (under point 1) the importance of an incidence analysis, an assessment of the differential effects on different countries. Any agreement that differentially hurts developing countries more or benefits the developed countries more (say, as measured by the net gains as a percentage of GDP) should be presumptively viewed as unfair. Indeed, it should be essential that any reform be progressive, i.e. that a larger share of the benefits accrues to the poorer countries. This was almost surely not true of the Uruguay round.

There is one key difficulty in interpreting this requirement. Many of the costs of, say, agricultural subsidies are borne by the developed countries. Not only are there huge budgetary costs associated with the subsidies, but the subsidies distort production, and thus there is a deadweight loss associated with these

\textsuperscript{39} See, e.g. Bhagwati [2002] who argues, accordingly, that intellectual property should never have been part of trade negotiations.

\textsuperscript{40} In the case of intellectual property, there is a concern about free rider problems, given the public good nature of research. There is, accordingly, a need for collective action—including possibly collection action related to the protection of intellectual property. On the other hand, because of the public good nature of knowledge, providing free access to such knowledge to the developing countries is one of the efficient, low cost ways by which developed countries can provide assistance to developing countries.
subsidies. Thus, were developed countries to eliminate their subsidies, the
developed countries (as a whole) would be among the main beneficiaries. Thus,
a refinement of the above criterion would look at the benefits granted others; in
competitive markets, it would be reflected in the general equilibrium terms of
trade effects received by producers or paid by consumers; in non-competitive
markets (or markets with quota restrictions) it would be the value of access
granted.

One particular aspect of this should be emphasized: in trade disputes, _both de
jure_ and _de facto_ the more developed countries are in a better position to
prevail. Thus, the costs to a developing country to attacking a claim of
intellectual property by a Western company in a case involving bio-piracy\(^41\)
may be very high; in practice the developing country is at a disadvantageous
position in any process entailing resort to complicated and expensive legal
proceedings.

More generally, the WTO dispute system favors rich countries with the
resources to use it effectively for their own interests. The EC, Japan and the US
were complainants in almost half (143 of 305) of all bilateral disputes in the
WTO Dispute Settlement system between 1995 and 2002. By contrast the 49
members classified by the UN as Less Developed Countries did not bring a
single challenge in that period.\(^42\)

There is a long history within developed countries of those in positions of power
using the legal system to maintain their privileges. More recently, many
developed countries have tried to come to terms with the resulting inequities by
providing public legal assistance. Typically, because of the relatively low pay
of those employed to provide such assistance, this can go only a little way in
redressing the imbalance. But at a minimum, the developed countries should
provide assistance to the less developed countries in helping create a more level
playing field. This is one of the proposals taken up in Part 2.

By the same token, even were a developing country to prevail in a WTO
tribunal against the United States or Europe, the enforcement system is
asymmetric, and consequently unfair. The sanction for violating a WTO
agreement is the imposition of duties. If Ecuador, say, were to impose duties on
goods that it imports from the United States, it would have a negligible effect on
the American producer; while if the United States were to impose a duty on
goods produced by Ecuador, the economic impact is more likely to be
devastating. In practice, the WTO system has no effective way of enforcing an
unfair trade action, the main impact of which is on small developing countries.

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\(^41\) Bio-piracy is the attempt by a Northern firm to patent a traditional food or medicine from a developing
country, in order to capture the intellectual property rents. The developing countries may be forced to pay
for what they view as rightfully theirs. See below for a more extensive discussion.

Countries’ CEPR.
When, of course, a major industrial country takes a global action—such as the U.S. imposition of tariffs on steel—then there can be a global response, and this can induce a response (as we have seen.)

But the other side of “fairness” is the initial condition. Currently, developing countries have higher tariffs than do developed countries. The United States might claim that it is only fair that developing countries cut their tariffs proportionately; this would entail a greater amount of tariff reduction by the developing countries—and accordingly the costs to the developing countries might be greater. But the developing countries also point out that at the very least the principle of progressivity should rule out adverse discrimination against developing countries. Yet, currently, the developed countries impose higher tariffs against the developing countries than they do against the developed countries, even taking into account the so-called ‘preferences’.

Balancing these concerns are those dealing with historical inequities. If a country’s relative weakness in part is due to a colonial heritage, or more pertinently, to earlier unfair trade agreements (e.g. that resulting from the Opium War in the nineteenth century in China), to what extent does fairness and equity demand that current agreements reflect these past injustices? Trade negotiators from the North would like to pretend that such inequities never occurred. Those from the South might argue that one cannot separate events today from the historical context.

The nature of trade agreements is, of course, that not every provision in the agreement is viewed to be “fair.” Some are intended to give more to one party, the other to another; it is the package as a whole which should be viewed as fair. But each trade agreement is forward looking; there are implicit and explicit understandings about the direction of future agreements. After the Uruguay round, there was a clear understanding that there would be further liberalization of agriculture, and there was a presumption that the textile quotas would not simply be replaced by high tariffs, but that this market too would open. In the case of agriculture, there is a strong sense that the United States has reneged on that commitment; whether the huge increase in agricultural subsidies is an explicit violation of earlier agreements is of less importance than that it represents a violation of the spirit of the agreement (or what should have been the spirit of the agreement, or at least was taken as the spirit of the agreement by the developing countries.) Just as the agreement has to be viewed as a whole, so too, a Development Round agreement has to be viewed in the context of the unbalanced agreements that preceded it.

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43 For manufactured goods average tariff rates are 1.5 per cent for developed countries and 11.5 per cent for developing countries. For agriculture, average tariff rates are 15.6 per cent for developed countries and 20.1 for developing countries (Hertel and Martin 2000).
4.2.1 Fairness between foreign and domestic producers

While most of the discussion of this paper concerns the “fairness” among countries, there is a related issue: fairness between domestic and foreign producers. One of the purposes of trade liberalization is to ensure that foreign producers are treated “fairly.” But again, there are questions: what does that mean? Foreign producers and domestic producers are often inherently in different situations. The foreign producer (in the case of a developing country) may have greater access to capital. He almost surely has greater access to international technology. Much of the debate about protection concerns “leveling the playing field,” correcting these initial inequities.

Most of the economics literature eschews the “fairness” vocabulary in favor of the efficiency language. Protecting domestic firms is inefficient; the country would be better off if it did not. But for reasons hinted at in the previous subsection, these arguments are contentious. There may be important learning benefits from protection. And while economists have typically argued in favor of open subsidies, and/or government loan programs, rather than the hidden subsidies protection provides, direct subsidies may, for a variety of reasons, be difficult or impossible to implement. In a second best world, some protection may be efficient.44

Thus, there is contentiousness in both the efficiency and the fairness arguments. But what cannot be justified in either terms are developed country non-tariff barriers, such as dumping, which treat developing country producers disadvantageously relative to their own, subjecting them, for instance, to a far higher standard for what amounts to predatory behavior than they subject their own firms.45

By the same token, it is hard to justify demanding developing countries to provide foreign firms with greater protections than provided domestic firms. While there is some debate about the validity, or abuse, of the infant industry argument, there is no argument for protection of the “grown up industry.”

So too, America has found it desirable to impose lending requiring on its banks, to ensure that they provide capital to underserved communities through the Community Reinvestment Act. Such measures recognize that there is role for government in encouraging particular sectors of the economy. It seems unfair (and inefficient) to preclude developing countries undertaking analogous measures.

44 For a historical argument, see Chang, Ha-Joon (2002). More recent theoretical analysis includes that of Dasgupta and Stiglitz [1985].
45 For instance, the U.S. anti-trust laws impose a very high standard for predatory pricing, much higher than is employed in the U.S. fair trade laws which pertain to the actions of foreign firms. Indeed, it has been argued that using the US domestic standard, few foreign firms would ever be found guilty of dumping, but using the dumping standard, most American firms could be found guilty.
4.2.2 Other problems in the interpretation of fairness

One of the most difficult issues is how to treat policy failures within each of the countries. Suppose that it is true (as asserted earlier) that the Uruguay round in fact differentially benefited the United States. But suppose the imbalance could have been reduced if only the developing countries reformed their economies. They might, for instance, have been able to benefit more from the reduction in tariffs on manufacturing, if only they had invested more in infrastructure, so that they could have attracted more manufacturing.

By the same token, to what extent should the international trading regime be blamed for inequities which arise, in part, because of how other parts of the international system operate? Suppose, for instance, that a “fair” trade negotiation occurs within the WTO, but that after the trade negotiations are over, the developing country has to turn to the IMF for assistance; and that the IMF imposes as a condition for assistance further trade liberalization. Viewing the two negotiations together, as a package, clearly the developing country may have given far more than it got within the trade package, but of course, it got, in addition, some foreign assistance. (Admittedly, in the case of many of the bail-outs, the primary beneficiary of the bail-outs may be banks in the more advanced industrial countries.) But even apart from these demands that are put on developing countries, the United States makes demands on other countries (section 301 and super 301 actions46), to which they often feel compelled to accede. Thus, even if the trade agreements that were reached were fair, what happens afterwards upsets the balance; the inequities are all the greater when the initial trade agreement is unfair.

Similarly, when international institutions encourage tax policies which have the effect of distorting production towards the informal sector, it implies, as noted above, that the West’s subsidies of agriculture have a greater adverse effect on the developing countries than they otherwise would have had. In talking about the inequities of the trade regime, should we assess its fairness, coming on top of distortions imposed or encouraged by the North, or in terms of what the incidence would have been, had a more neutral tax system been imposed? Should we view the two actions together, assessing the incidence of the two policies in conjunction, or should we only assess the fairness of the trading regime itself?

By the same token, when countervailing duties are imposed against a developing country which has “subsidized” interest payments, by bringing them down from the usurious levels insisted upon by the IMF, to levels still slightly higher than in international capital markets, is this unfair? Should the

46 Super 301 authority - which expired in 1997 but was re-instituted in January 1999 - enables the USTR to identify the most significant unfair trade practices facing U.S. exports and to focus U.S. resources on eliminating those practices.
government only be viewed as undoing a distortion? The problems are exacerbated by demands (included in the recent bilateral trade agreements between the United States and Chile and the United States and Singapore) for capital market liberalization. Capital market liberalization increases economic volatility\(^{47}\), and the increased economic volatility increases the risk premium that investors demand,\(^{48}\) effectively increasing the interest rate charged. It seems unfair to force upon the developing countries provisions which effectively increase the interest rate they have to pay, and then when the government tries to undo the consequences, to have a countervailing duty slapped upon them.

In the South, of course, there is a tendency to see the actions as coordinated, driven by economic interests in the North. While they may see more coordination than actually occurs, the impacts are often closely akin to what they would be if they were coordinated. The high interest rates, tax policies, and trade liberalization policies demanded by the IMF do exacerbate the adverse effects on developing countries of whatever trade liberalization measures they agree to within the WTO. The two cannot be seen in isolation. This provides the basis of one of the important recommendations that we make below.

With such disparate views of fairness, it is no wonder that the South may feel that a trade agreement proposal is grossly unfair, and yet the North might feel no pangs of conscience. Some might conclude that, as a result, we should simply drop the criterion of equity among the desiderata of a Development Round agreement. That would be a mistake. In a democracy, any trade agreement must be freely entered into, and the citizens of the country must be persuaded that the agreement is essentially *fair*. Moreover, there are several widely accepted philosophical frameworks—in particular that of Rawls\(^{49}\)—which are widely accepted, and that at least provide some guidance for thinking about whether any agreement is fair.

### 4.3 Any agreement should be fairly arrived at

This is often referred to as *procedural justice.* It becomes an important complement to the kind of fairness discussed in the preceding section when there is some ambiguity about what should be meant by “outcome fairness.”

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47 See, for instance, Prasad *et al.*, the report of the IPD task force on capital market liberalization (2004), and Stiglitz [1999, 2001, 2004]

48 See Stiglitz [2003]

49 John Rawls [1971], *A Theory of Justice.* He emphasizes that we should assess whether (in the current context) a particular change in the trade regime would be generally agreed to, *behind a veil of ignorance*, in which the participants in the discussion did not know whether they were to be born in a less developed or a more developed country. For alternative frameworks (which in the current context would arrive at quite similar views) see A. K Sen [1999] *Development as Freedom.*
Procedural fairness focuses on the openness and transparency of the negotiation process, and the manner in which the discussions are conducted. There is now a large literature which establishes that setting the agenda may have a large effect on the outcome; hence having voice in the setting of the agenda is essential. The agenda in previous trade negotiations has been unbalanced; issues of benefit to the developed countries have been at the center of the discussion; issues like liberalization of unskilled labor intensive services have been off the agenda, while liberalization of skilled labor intensive services have been on the agenda.

Transparency is essential because it enables more voices to be heard in the negotiating process and limits abuses by the powerful. This is particularly important for developing countries, because of the limited size of their negotiating teams. Of particular concern is the lack of transparency of the ‘green room’ negotiations, in which only a few chosen countries from the developing world engaged in negotiations with the United States and Europe. The ‘green room’ process limits outside scrutiny and places the developing countries in a disadvantaged position because of the complexity of the negotiations and their limited staffs.\(^{50}\) Procedural fairness needs to deal with the asymmetry of power and the asymmetry of information among WTO members. While the effect of power disparities are difficult to reduce, informational disadvantage can be remedied.\(^{51}\)

The processes for adjudicating disputes too often lack the protections that we have come to expect in modern democracy. Under NAFTA, for instance, there is not an appellate process that affords the same guarantees for the public interest that arises is issues concerning investor protection domestically.

Indeed, the very distinction between the manner in which international rules are arrived at and the manner in which domestic rules are determined reflects the lack of democratic guarantees. Within a country, we have parliamentary processes. These processes involve negotiations, but they are not just a negotiation between interested parties. We do not have business and labor negotiating labor legislation, for instance, though in the deliberation, the views of both are listened to carefully. At the international level, we have no analogous parliamentary body. We have a “negotiation.” In the past, the terms of the negotiation have largely been set by the United States and Europe. The negotiators mandate is to get the best deal for their country, using whatever tactics they can employ, whether it be threats, promises, secret meetings, etc. This contrasts markedly with at least the language used in parliamentary

\(^{50}\) See for example the open letter, dated 6 November 1999, sent by 11 developing countries to the WTO chairman Ambassador Ali Mchumo of Tanzania, expressing their concern over the lack of transparency in the WTO Green room process.

\(^{51}\) Both increased transparency and the provision of (impact assessment) information discussed in section 4.1 reduce information asymmetries.
processes, in which the objective is to find a set of rules and regulations which are fair and efficient. The participants in the discussions, while mindful of the interests of those they represent, defend their positions in terms of principle, and look for principled solutions, reflecting social justice and solidarity.

4.4 The policy space should be interpreted conservatively

Defining the policy space appropriate for attention within the WTO is a difficult task. There has been a tendency to expand the WTO’s agenda to include all manner of international problems from intellectual property rights to protection for foreign investors. The international community has found that bringing formerly intractable international issues within the ambit of trade provides both a convenient negotiating forum and a ready mechanism for enforcement of agreements. If the only test of inclusion in the agenda is that a policy must affect trade flows, then the boundaries of WTO activity are very hard to define because almost all international problems can be linked to trade flows in some way. In this regard, policymakers have literally employed the prefix “trade related aspects of” to pragmatically expand the WTO’s mandate into a growing number of issues.

However the growth of the WTO’s policy space comes at a price. First developing countries have limited capacity to analyze and negotiate over a large range of issues. Second the experience of the Singapore issues suggests that larger agendas burden the negotiations. Third, the expansion creates room for developed countries to use their superior bargaining power in trade negotiations to exploit developing countries over a larger range of issues. For instance when the agenda was extended to competition policy, the issues relevant to the foreign business interests of developed countries became the main focus of negotiations while insufficient attention was given to key areas of concern for developing countries, such as rules against predation and the development of global anti-trust enforcement. Similarly the focus of intellectual property negotiations has been determined by the pharmaceutical industry in the industrialized world. Almost inevitably, they determination of these issues will reflect the consequences of the exercise of power.

For these reasons a ‘principle of conservatism’ needs to be introduced to guide the growth of the WTO’s mandate. Further issues should only be included in the agenda of a development round if they score highly on three criteria: (i) the relevance of the issue to trade flows, (ii) its development friendliness, and (iii) the existence of a rationale for collective action.

This third element reflects a general presumption in favor of national sovereignty. There is no reason to force nations to undertake certain actions
unless their actions have effects on the trade of others, which require collective action to resolve. There are areas in which a trade agreement is absolutely essential. These include an international rule of law (procedures) for dealing with trade disputes and/or agreements to prevent beggar-thy-neighbor trade policies. There are areas in which international agreements would be beneficial to manage cross-border externalities or global public goods.\textsuperscript{52} But modern trade agreements have been extended into areas which intrude into national sovereignty with no justification based on the need for collective action and without clearly identified and fairly distributed global benefits.\textsuperscript{53} The presumption of consumer sovereignty is based on the premise that society should only interfere with individual choices when those choices have consequences for others, when there is a need for collective action, and the same is true in trade.

### 4.5 Some Implications

The above principles have some immediate implications for the \textit{structure} and \textit{design} of any development round agreement and process, several of which we have already touched upon. Among the more important are the following

1. \textit{The scope of the agreements should be relatively limited, with first priority going to areas where collective action is absolutely required.}
   i. There is a need to revisit TRIPS
   ii. Few, if any, of the Singapore issues meet this criterion
   iii. There should be restrictions on \textit{investment competition}; this is more important than negotiating over \textit{investment protections}

2. \textit{The priorities for trade liberalization should reflect the development concerns of the poorer countries.}
   i. There is a need to revisit the sectoral priorities (agricultural versus services; labor versus capital)
   ii. There is a need to revisit the priorities within sectors (unskilled service intensive sectors versus skilled service intensive sectors)
   iii. There is a need to revisit the use of non-tariff barriers (dumping, safeguards, and countervailing duties)
   iv. There is a need to revisit the issue of subsidies
      (i) Are some of the so-called non distorting agricultural subsidies really distorting

\textsuperscript{52} For a discussion of the concept of global public goods, see Kaul et al. [2003]. See also Stiglitz [1994, 1995]
\textsuperscript{53} Trade agreements might also be useful as a mechanism for governments to overcome domestic political opposition to trade reform.
(ii) Are there some prohibited subsidies which should be allowed for developing countries
v. There is a need to revisit the issue of how countries respond to crises
vi. There is a need to analyze trade policy within the context of the broader international context.
5  Priorities for a Development Round

5.1  The Context

As developing countries enter the trade negotiations, the natural question to ask is *what agreement would make the most difference for them.* What should they be trying to get? There is a corresponding question: what is it that they could *give,* which is of most benefit to the developed countries, and which is of the least cost (or perhaps even of benefit) to themselves at the same time. The developed countries natural response may to demand a *quid pro quo.* But such a demand would be to look at the current negotiation outside of its historical context. The developed countries got the lion’s share of the benefits out of previous trade negotiations. Accordingly, they *ought* to be willing to accept a smaller share of the benefits out of the current trade negotiations.\(^5\)\(^4\) Ironically, the demands of the advanced industrial countries at Cancun, had they been accepted by the developing countries, arguably would have resulted in a new trade agreement where once again the lion’s share of the benefits would have gone to the developed world.

With little progress on the issues of concern to developing countries—non-tariff barriers, intellectual property, migration, unskilled intensive services, and agriculture—and new demands in areas of dubious benefit to the developing countries, it was hard to see how the developing countries would benefit significantly.\(^5\)\(^5\) Actually, even within manufacturing, there is scope for gains to the developing countries. What matters is not just the *average* tariff rate\(^5\)\(^6\), but the structure of tariffs. Escalating tariffs, where there are higher tariffs on more processed goods than on less processed goods, inhibit the ability of developing

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\(^5\) The problem, of course, is that political globalization has not kept pace with economic globalization: issues of international trade agreements are seldom looked at through the same kind of lens that we look at domestic legislation. We do not demand that the poor give up an amount commensurate with what they get. Rather, we talk about social justice and equity.

\(^5\) Anderson (2001) compares the benefits of developed country liberalization on developing countries with the benefits of developing country liberalization on developed countries. As a proportion of GDP in each group the benefits to developing countries of the former exceed the benefits to developed countries from the latter by a factor of 6. Given this imbalance in payoffs it is not surprising that developed countries are in such a strong bargaining position.

\(^6\) Average tariff rates—when weighted by the amount of trade—may be particularly misleading, since high tariffs lead to little trade, and accordingly such high tariffs may be given little weight in the computation of the average, even though they have a very distortive effect.
countries developing manufacturing capacities, especially in areas which might represent a natural comparative advantage, such as food processing or textiles.

The salient fact is that average developed country tariffs (notwithstanding important tariff peaks on agriculture and key labor intensive goods and services) are already very low, so that developing countries have relatively little to benefit even were these to be completely eliminated.\textsuperscript{57} The large reductions in tariffs by developing countries would have put large strains on these countries. Were they at full employment, a strong argument could be made that they would, nonetheless, benefit, if they were given enough time and resources to adjust. But that the speed of adjustment that was likely to be demanded, and the absence of adequate resources to facilitate the adjustment, meant that developing countries might be significantly worse off.

There is an important asymmetry of power in the negotiations: what developing countries do in opening up their markets to developed countries has a much smaller impact on the developed countries than the converse, what the developed countries do in opening up their markets to the developing world. In short, the developed countries themselves gain from liberalizing their own markets, because they are able to adjust, and the disturbances posed to them by the developing countries are small; the developing countries are in a far more disadvantageous position; they will need assistance in making the required adjustments, and they should be given a longer time within which to adjust.

Accordingly, at the center of a development round of trade should be an expansion of Europe’s Everything but Arms initiative. The developed countries should

(i) All agree to follow Europe’s lead
(ii) Should extend the initiative to middle income countries; and
(iii) Should extend the initiative to eliminate agricultural subsidies.
(iv) Make sure that technical provisions—like rules of origin—do not undermine the promise of market opening.\textsuperscript{58}

In short, reciprocity should not be the central feature of these negotiations, as they have been in the past.\textsuperscript{59}

\textsuperscript{57} Average tariff rates on industrial goods imported into the OECD countries fell from around 40 per cent in 1950 to 1.5 per cent in 1998 (Hertel (2000). In spite of these low average rates, there are tariff peaks, many of which adversely hurt developing countries, so that, provided these are addressed, developing countries do have something to gain.

\textsuperscript{58} In the discussion below we note the initially extremely small impact of the Everything But Arms initiative—with the rules of origin providing one of the explanations. Countries can only receive the preferential treatment of exports if a large fraction of the value added originates in the country.

\textsuperscript{59} There are two arguments sometimes put forward by those that advocate reciprocity, even after recognizing the asymmetric position of developed and less developed countries. The first is a political economy argument. It is argued that without some reciprocity, the North is unlikely to make any concessions to developing countries. We do not address that issue here. The question posed to us was what would be on the agenda of a true development round? What would a global trade regime that promoted developed look like? Still, we note that developed countries voluntarily provide assistance
There is one other aspect of the context in which trade negotiations are currently occurring. What distinguishes developed from less developed countries is not only the extent and nature of market imperfections, but also factor endowments. Developing countries are intensive in unskilled labor; their greatest shortage is probably in the ownership of physical capital. Developing countries are disproportionately in the tropics and, currently, are more engaged in the export of commodities, including natural resources. Thus, they differ in the products that they export and import, which is why decisions about which goods and services to liberalize, which for which there should be restrictions on subsidies, can make a great deal of difference for the general equilibrium incidence.

Finally, we should note the dramatic transformation of the global economy. In the nineteenth century, what are the advanced industrial economies transformed themselves from agriculture into manufacturing. Today, only 14% of employment and output in the United States is in manufacturing, and the fraction in Europe is not much higher. Now, they are transforming themselves from manufacturing economies into service and knowledge economies. Meanwhile, the developing world itself is divided into several groups: subsistence agriculture (much of Africa); export agriculture (Brazil and Argentina); and those breaking out of agriculture and becoming increasingly centered on manufacturing. For the agricultural exporters, of course, the failure to liberalize trade in agriculture and to remove subsidies has been particularly costly.

There is, as a result, a fundamental tension in current trade negotiations. The developed countries want to protect their declining industries and to gain market

(unilaterally) to developing countries, partly because they believe it is the morally right thing to do, partly because they believe political stability may be enhanced by strengthening developing countries. It seems strange to argue for unilateral assistance, which in many cases only partially compensates for the damage done by unfair trade agreements. The second is a paternalistic argument: developing countries need economic reforms, like trade liberalization; but special interests within developing countries make such reforms difficult. Only by insisting on them through multilateral trade agreements (or through conditionality on assistance) can such reforms occur. There is a large literature explaining why such conditionality undermines democratic processes and, in any case, is not likely to produce genuine reform.


61 FAO (2003)

62 Developed countries share of world trade in manufactures has fallen from 90 per cent in 1970 to 72 percent in 2000 (World Bank 2002).

63 But note that most of the progress in trade negotiations during the past half century have focused around liberalization of manufacturing (other than textiles)—the goods that are of diminishing importance to the advanced industrial countries but of increasing importance to middle income developing countries. There is a certain irony: while the United States and Europe may have thought that they were negotiating trade agreements that were of most benefit to themselves, in fact they negotiation a global trading regime that, if it is fairly implemented (and setting the non-tariff barriers aside) is likely in the future to be of most benefit to China and other middle income developing countries.
access for their expanding industries. But their declining industries are declining largely because of competitive pressures from the developing countries. Hence, the sectors that they are most interested in protecting are precisely the sectors that are of the greatest concern to the developing world. It is not as if America is mostly concerned with protecting itself against Europe, or vice versa (though there is some element of that.) And the sectors that are declining are, by the same token, those in which there are the lowest wage workers. Hence protection elicits concerns about equity and social justice within the developed countries—a particularly narrow vision which is out of sync with economic globalization.

At the same time, by demanding market access for the sectors which are growing, the developed countries hope to catapult the advantage that they already have—the first mover advantage—into a longer term advantage. For that very reason, were such a strategy accepted, it would inhibit the development transformation of the poorer countries, making it all the more difficult for them to move from traditional products into becoming effective competitors with the more developed countries.

It is also because the advanced industrial countries are intuitively aware of these difficulties that non-tariff barriers have assumed increasing importance. Having negotiated away tariffs, this is their one remaining protectionist instrument.

### 5.2 Market access priorities

The general argument in favor of trade liberalization is that it allows the expansion of the size of markets, allowing the global economy to take further advantage of the economies of scale (the argument Adam Smith put forward more than 200 years ago), and it enhances global efficiency in production and exchange. The factor price equalization theorem stipulates conditions under which trade in goods and services leads to full global efficiency, substituting for the free mobility of factors. Those conditions are highly restrictive, and over the past several decades, discussions have moved from liberalization of trade to allowing for the mobility of capital, though not of labor. As noted earlier, the standard argument that trade liberalization necessarily makes all countries better off (though not necessarily all individuals within each country) is predicated on a set of assumptions that is not satisfied in most developing countries: full employment, perfect competition, and perfect capital and risk markets.
5.2.1 Labor mobility and unskilled labor intensive services

The General Agreement on Trade in Services (GATS) recognizes four modes of service delivery. The temporary movement of natural persons (Mode 4) has received by far the smallest attention in terms of the volume of scheduled concessions. Yet differences in factor payments across countries provide evidence that factor movements would substantially increase global productivity. If factor payments equal marginal products, then the largest discrepancies are associated with the payments to unskilled labor, then to skilled labor, and lastly to capital. Accordingly, agreements that provide for the mobility of unskilled labor would do most to increase global efficiency.

Nor has there been enough attention given to proposals to facilitate remittances. Governments have a role to play in maximizing both the value of remittances and their impact on development. Efforts to formalize the structure of remittance flow (much of which currently moves through informal channels) could make it easier, safer, and cheaper to transfer funds. For example, governments could ensure migrants have access to secure and low cost financial services and regulate remittance-handling intermediaries to prevent malpractices. As well as increasing the flow of remittances, remittance policies can improve the development impact of remittances at the receiving end. For example, micro-finance and micro-enterprise support initiatives have encouraged remittance-receiving clients (especially small businesses) to access credit and savings accounts. Finally, the further development of remittance-backed bonds could help liquidity constrained developing countries to use future flows of remittances to raise external finance relatively cheaply.

Yet despite the tremendous development potential of this reform, the limited progress that has been made in this area has been largely associated with the intra-corporate movement of skilled personnel – an issue of interest to developed countries. Thus far Mode 4 has not progressed in a way that allows developing countries to use their comparative advantage in low and medium skill labor-intensive services. Nor has there been enough attention given to

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64 They may not, and the disparity between factor payments and the value of marginal products may differ across countries, if the degree of market imperfections differs.

65 For an example initiative in this area see the case of the financial institution PRODEM in Bolivia which focuses on the promotion of savings and the offer of new financial services to remittance receivers. See UNDP (2003) Worker Remittance as an Instrument for Development, Comparative Research – UNDP El Salvador. A number of best practice scenarios from Latin America and Asia were presented and documented in the November 2000 ILO conference in Geneva on “Making the best of Globalization: Migrant Worker Remittances and Micro-Finance.”

66 In 2001, Banco do Brasil issued $300 million worth of bonds through Merrill Lynch using the future yen remittances from Brazilian workers in Japan as collateral. The terms of these bonds were more favourable than those available on sovereign issues (with a BBB+ Standard and Poors rating compared to BB- on Brazil’s sovereign foreign currency rating). For a review of securitization of remittance flows see Ketkar, Suhas and Dilip Ratha (2000) Development Financing During a Crisis: Securitization of Future Receivables, mimeo, Economic Policy and Prospects Group, The World Bank, Washington DC.
proposals to facilitate remittances. Governments have a role to play in maximizing both the value of remittances and their impact on development. For example, governments could ensure migrants have access to secure and low cost financial services and regulate remittance-handling intermediaries to prevent malpractices. The development of new financial instruments like remittance-backed bonds and the facilitation of transfers from migrants using employer's payroll deduction schemes would also increase the ease with which remittances flow to developing countries.

As well as facilitating the movement of natural persons (mode 4), there is scope for liberalization of other service industries of importance to developing countries. Services account for, on average, 50 per cent of developing countries’ GDP, but developing countries account for only 25 per cent of the world’s services exports. While the last decade has seen considerable liberalization of high skill services, there has been less progress in those unskilled-labor-intensive services of interest to developing countries.

A large portion of benefits from services liberalization derive, not from seeking better market access abroad, but from the increased competitiveness and efficiency of the domestic market. However in addition to these ‘efficiency gains’ developing countries have important export interests in further services liberalization (OECD 2004). Many developing countries have capitalized on their comparative advantage in low-skill services to develop competitive and highly specialized industries. Examples are maritime services including port services and the shipping industry; construction services; back office services including data processing and call centers.

5.2.2 Agriculture

Section 2.2 highlighted the persistently high levels of agricultural protection in the OECD. 67 Yet agriculture is crucial to developing countries. It represents almost 40 per cent of their GDP, 35 per cent of exports, and 70 per cent of employment.

Because agriculture is such an important part of both national economic development and daily livelihoods in developing countries, agricultural reform must proceed carefully. Agricultural liberalization presents developing countries with the benefits of increased market access, but also the (potential) costs of higher prices for domestic consumers. The fundamental point is that consumers benefit from lower prices that result from large agricultural subsidies, and producers lose. The net effect of wide-ranging agricultural reform varies across developing countries depending on the composition of their exports and imports.

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67 Total OECD spending on agricultural subsidies is more than US$300 bn per year. This is almost six times the total aid from OECD countries to all developing countries (US$50-60 bn per year).
of different commodities, and the price sensitivity of those commodities to liberalization. The potential for losses highlights the need for a more fine grained approach, which would differentiate among crops and countries.

The WTO should focus on liberalizing those commodities which have the largest positive effect on producers and the smallest adverse consumption effects. One important determinant of the net effect of this kind of reform is the level of protection for each commodity and the consequent impact of liberalization on prices. Tariffs are particularly high in the feed grains, dairy, and food grains sectors, while dairy products, meat, and livestock are the worlds most subsidized exports. Producer payments are highest for grains and oilseed sectors and lowest for meat, livestock and dairy (Hertel et al. 2000).

Another important determinant of the welfare effects of liberalization is the agricultural trade balance across countries. There is a division between temperate products (program crops and livestock) where developing countries are largely net importers and developed countries are largely net exporters, and tropical products for which developing countries are largely net exporters. Most developing countries are net importers of program crops, which are precisely the commodities that have the highest domestic support and stand to experience the largest price increases. It is therefore not surprising that most studies predict that most developing countries are worse off as a result of the terms of trade effects following this kind of reform. Indeed Dimaranan, Hertel and Keeney (2003) find that gains accrue primarily to developed countries in the Cairns group as well as the two largest developing country exporters, Argentina and Brazil. These countries are the strongest advocates for the existing agricultural reform agenda. Still, it is possible that, as producer prices increase, some developing countries will switch from being net importers to net exporters.

Moreover, western production subsidies may have large adverse distributional effects in developing countries. Producers lose, as consumers gain; the producers are typically poor farmers, often far worse off than the urban net consumers. Given the limited capacity of developing countries to effect redistributions, there can be a significant welfare loss from such adverse distributional impacts.

The existence of net losses for developing countries in some areas of reform should not imply that no reform is required – rather it suggests that a selective approach is needed. The most important subsidies to eliminate would be those where the consumption benefits are small relative to the production costs. Developing countries should focus their attention of the elimination of tariffs

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68 This includes Mexico, ‘Rest of South America’ (a regional average which excludes Argentina and Brazil), China, Indonesia, Korea, ‘Rest of South Asia’ (a regional average which excludes India), Tanzania, Zambia, ‘Rest of Sub Saharan Africa’ (a regional average which excludes Tanzania and Zambia), and the average of the Middle East and North African Countries. Brazil, India, Argentina and Vietnam are net exporters (Dimaranan, Hertel and Keeney, 2003).
and quotas on tropical products, processed foods, and other commodities which they export or for which they have high export elasticities with respect to price. Elimination of cotton subsidies would raise producer prices for cotton, but have a small effect on standards of living in developing countries as a result of the small increase in the price of cloth. Similarly, subsidies for crops which are disproportionately consumed by the wealthy will have the least adverse distributional effects. Soy beans, for instance, may largely go into the production of animals (beef and chicken).

Furthermore, the potential adverse effects of agricultural liberalization on large segments of society suggest the importance of a gradual approach, allowing urban workers time to adjust. It would also be desirable for developed countries to give some of the money they previously expended on subsidies to assist the developing countries in the transition.

The WTO makes a clear distinction between explicit export subsidies and other forms of domestic subsidies, yet both types of payment can increase production and exports and depress world prices. Since, domestic subsidies are treated more permissively in the WTO several OECD countries have reduced their export subsidies and increased their direct domestic support payments to comply with their WTO commitments. In the US and EU, the annual values of export subsidies for cereals and beef declined by US$4.1 billion between the base period and 1998 and 1999. In the same period, domestic support in the form of exempt direct payments for those commodities rose by an estimated US$18.9 billion a year in the European Union alone (ABARE 2001). However, the trade effects of various types of domestic subsidies are often understated. While the impact of export support on developing countries per dollar of subsidy is greater than production-based support, the difference is small if the elasticity of demand is small, which is the case for many agricultural commodities. Even non-production based support (‘decoupled’ payments primarily in the ‘green box’), have an impact on output and prices. These payments advantage OECD producers by providing them with cheap (or free) credit to potentially use for investment and expansion of production. The distinction between trade distorting subsidies and non-trade distorting subsidies is based on a particular economic model, in which capital markets are perfect. Then, trade-distorting subsidies are subsidies which change the marginal return to production or which reduce the marginal cost of production. Thus, generalized income supports, in this view, are not production distorting, nor are payments to keep land fallow. But both of these may, in fact, be production distorting, if, for instance, farmers face credit constraints. Then, in effect, the subsidies provide additional finance, which allows farmers to expand production.

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69 The WTO classifies domestic subsidies according to their distortionary effect on trade: amber (directly trade-distorting); blue (indirectly trade-distorting production payments); green (non-trade distorting).
5.2.3 Liberalization of industrial goods

While average developed country tariff rates are low, developed countries maintain high barriers to many of the goods exported most intensively by developing countries. When weighted by import volumes, developing countries face average manufacturing tariffs of 3.4 per cent on their exports to developed countries, more than four times higher than the average rate faced by goods from developed countries, 0.8 per cent (Hertel and Martin, 2000).\(^7\)

Moreover aggregate data hides the existence of tariff peaks (discussed in section 2.2). OECD tariffs are particularly high for goods of importance to poor countries such as low skill manufactures (especially textiles) and processed foods. Such tariff peaks have a particularly harmful effect on development by restricting industrial diversification in the poorest countries.

A second reason that developing countries should be pushing to have industrial tariffs prioritized in the Doha Agenda is that barriers to south-south trade are quite high. The average import-weighted tariff on the exports of manufactured goods from developing countries to developing countries is 12.8 per cent (Hertel and Martin, 2000). Anderson et. al (2000) estimate that the welfare gains to developing countries derived from the liberalisation of trade in manufactures by other developing countries is $US31bn.

5.2.4 Non-tariff barriers

Developing countries have repeatedly found that as they make inroads into a market in the United States or Europe, they are slapped with dumping duties or face some other form of non-tariff barrier. Though ostensibly the Uruguay Round marked the end of the so-called voluntary export restraint, the United States has talked about reinstating such restraints against China. The effect of these non-tariff barriers is far greater than indicated by the actual duties imposed. The fear that they will be imposed has a chilling effect on development: it increases the risk associated with investing in an export oriented industry, which is particularly important in economies already facing high interest rates. Often, initially high duties are imposed, only to be revised down substantially; but the initially high duties suffice to drive the exporting firm out of business. Some solution to the problems posed by non-tariff barriers should be high on the agenda of any development round.

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\(^7\) The distortion is even larger if one recognizes that the quantities imported are reduced as a result of the high tariff barriers. (In the measure cited, a prohibitive tariff would have no weight in the measure, since there would be no imports.)
There are four important categories of non-tariff barriers. Dumping duties, which are imposed when a country (allegedly) sells products below costs, countervailing duties, which can be imposed when a country subsidizes a commodity, safeguards, which can be imposed temporarily when a country faces a surge of imports, and restrictions to maintain food safety or avoid, say, an infestation of fruit flies. The advanced industrial countries have used all of these at times to restrict imports from developing countries, when they have achieved a degree of competitiveness which allows them to enter the markets of the developed countries. Many of these measures are described as ensuring “fair trade,” but from the perspective of developing countries, they ensure “unfair trade.” They are evidence of the hypocrisy of the North. Increasingly, however, developing countries are using such measures against each other and against the advanced industrial countries, and in that sense they represent a hidden threat to a trade liberalization regime.

There has been a large increase in the number of antidumping claims.71 Part of the problem with the schemes is how they have been implemented. Consider, for example, America’s use of dumping duties. The accused must respond in a short period of time to a long demand for information (in English), and when the accused is unable to do so, the U.S. government acts on the “best information available,” usually the information which has been provided by the American company trying to keep out its rivals. High initial duties are imposed, which regularly get revised downward, when better information becomes available. But meanwhile, long term damage has been done, as American buyers will not purchase the commodity, given the uncertainty about the level of tariffs they may have to pay.72 America’s provisions for dumping duties (and in some cases countervailing duties) for China and some of the former Communist countries have been particularly egregious. In the “surrogate country methodology” which is used to assess the cost of production (the benchmark against which charges of dumping are assessed) costs of production are compared with those of a “similar” country. In one instance, the United States used Canada as the country most similar to Poland; not surprisingly, it was found that the costs of production were high, justifying a high dumping duty.73

President Bush’s action in imposing steel tariffs exemplifies the inequities associated with safeguards, a particular form of non-tariff barrier. With safeguard measures, one does not have to even show that the developing country has done anything wrong; in some cases, one does not even have to show that the developing country’s exports are at the center of the industry’s problems. All that one has to show is that the industry faces a problem—sales or profitability are declining, and that the “surge” of imports contributed to the

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71 There were 2,063 dumping cases initiated between 1995 and 2002. The three most common initiators were the U.S. (279), India (273), and the EC (255). See Finger and Zlate (2003).
73 See Economic Report of the President
problems. But if the United States, the richest country in the world, a country with low unemployment and a relatively good safety net, says that it needs to resort to safeguards to protect an industry which has long been in decline, then how much more convincing is the need for most developing countries—with high unemployment and often no safety net—to impose safeguards.

There are three reforms that would make a great deal of difference. The first is to recognize the principle of national treatment: in addressing problems of unfair trade, the legal framework should be the same for domestic firms as it is for foreign firms. In the case of dumping, for instance, firms are charged with selling below cost. To an economist, the natural question is, why would a firm ever sell below marginal cost (and what is the relevant economic concept)? The answer is to try to drive out rivals, to establish a monopoly or dominant position in a market, that would enable it later on to sell at a high price, well above costs. Thus, American anti-trust law, in assessing whether predatory pricing (the equivalent in a domestic context of dumping) has occurred attempts to assess whether price is below the relevant cost, and whether there is evidence of the likelihood that the accused will recoup his loses. As a result of this high standard, few cases of predatory pricing have been successfully prosecuted. Subjecting foreign firms to the same standard would ensure that dumping charges were being used to preserve competition, not to reduce the threat of foreign competition. (The double standard is highlighted by the fact that if American firms were subject to the standard used in dumping case, a large fraction of American firms would be found guilty of dumping.)

The second is to create a new international tribunal as the first “court.” Today, when, for instance, the United States accuses firms of a foreign country of dumping, it acts as prosecutor, judge, and jury. Though the process is governed by a “rule of law,” in the sense that there were well defined procedures, the process often works in a highly unfair way. There is a costly and lengthy WTO process, which can, and has, been used to rectify gross abuses, as in the case of the U.S. imposed steel tariffs. But it would be far better if the original decision was taken out of the hands of the country and put into a specialized international tribunal.

The third is that the implementation legislation and practices of the countries should be reviewed to ascertain whether it is fair and non-discriminatory, both de jure and de facto, and is in conformity with widely accepted economic principles. An example already referred to is the use of BIA (best information available). Almost all economists agree that the relevant cost concept for

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74 This is governed by Article XIX of GATT 1994 which deals with "Emergency Actions on Imports of Particular Products", and also by the Agreement on Safeguards. To quote the appellate body in the US Steel case: "Together, Article XIX and the Agreement on Safeguards confirm the right of WTO members to apply safeguard measures when, as a result of unforeseen developments and of the effect of obligations incurred, including tariff concessions, a product is being imported in such increased quantities and under such conditions as to cause or threaten to cause serious injury to the domestic industry that produces like or directly competitive products."
judging dumping is *marginal* not average costs, yet the legislation in many
countries uses average costs; this means that dumping charges are often
sustained in cyclical industries, in downturns, where marginal costs are
considerably below average costs.\footnote{Moreover, dumping is sometime found in competitive industries, in which no rational firm would ever
engage in predatory pricing, since there is no way it could establish the monopoly power required for it to recoup the losses it makes when it sells below marginal cost.}

The determination of whether subsidies have been provided is another example
which has been subject to considerable contention. A development round
should clarify this, in ways which ensure that governments may undertake
industrial policies to promote nascent industries. This is particularly important
because the *form* of subsidy in the United States—research in the defense
industry, the benefits of which spill over to civilian uses—is markedly different
form that in the developing world. Allowing one, but not the other, creates an
uneven playing field. Similarly, the IMF often forces developing countries to
have high interest rates, well above the “market rate”; lending money at more
reasonable rates should not be viewed as a subsidy.

A third example concerns the sale of privatized assets, particularly in the former
socialist economies. Assume that the original investment was subsidized, but
the government privatizes the industry through a competitive auction. Such an
auction should extinguish the subsidy: the new investor pays, in effect, fair
market value for the asset. In a way, one can look at the privatization as a
bankruptcy/restructuring proceeding. When a firm goes bankrupt, its assets are
sold in an auction. The acquiring firm is not viewed as having received a
subsidy. The socialist economies can be viewed as a large bankrupt enterprise,
the assets of which are now being disposed. On the other hand, when the
government effectively gives away the asset, then the subsidy is clearly not
exinguished. (A side-benefit of a rule that distinguishes between the two kinds
of privatizations is that it would encourage more honest privatizations.)

While the argument for safeguard measures is persuasive, they have been
widely abused, especially by the developed countries. If the richest country of
the world, the United States, with a strong safety net, relatively high
employment level, etc. has to resort to safeguard measures to protect itself
against a surge of imports, how much more justified are developing countries in
imposing such measures. Indeed, it is hard to conceive of many important
liberalization measures, against which safeguard protections could not
justifiably be invoked by developing countries. This highlights again the need
to set clearer standards *at the international level*. For instance, for a safeguard
measure to be imposed, not only should the country show that there is “injury,”
but that it is substantial, entailing a loss, say, of at least 1% of the jobs in the
country, and that the burden on the country’s social safety net is such that it
would be hard pressed to absorb it. The threshold standard should be lower in
developing countries. Such a reform would ensure that the safeguard measures
only be used in cases where trade disturbances imposed significant adjustment burdens.

5.3 Priorities in non-market access issues

5.3.1 Restrictions on tax and incentive competition to attract investors

One arena in which an international agreement might be of immense benefit to developing countries concerns their competition for investment through concessionary tax rates and financial subsidies. The main beneficiary of that competition is international business and often countries suffer large fiscal losses without commensurate gains to either their domestic economy or to the efficiency of the location of international production. If authorities were to embark on cross-country (or cross-jurisdiction) policy action, there are essentially three options, representing three levels of ambition with regards to the objectives being pursued. In ascending order these are: i) transparency-enhancing obligations on firms and countries; ii) co-operation between jurisdictions; and iii) the putting in place of enforceable international rules.

Just as international agreements circumscribe subsidies in general, there should be a strong proscription on firm specific competition. The spirit of the WTO’s Agreement on Subsidies and Countervailing Measures (SCM) could be extended to new rules limiting investment competition. Under the SCM, subsidies are actionable if they can be shown to cause adverse trade effects. One of the adverse effects triggering actionability under Part III is: “serious prejudice to the interests of another member” – a principle which could be analogously applied to the incentive instruments used in investment competition.

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78 OECD countries adopted a similar approach in their efforts to identify and reduce “harmful tax competition” (OECD 1998). While the OECD’s mandate here covers mainly general tax rates rather than specific incentives, the criteria used to determine “harmful” tax policies is instructive for investment incentives. Two of the criteria cover transparency and discrimination between foreign and domestic firms. The European Commission’s 1999 “Code of Conduct (Business Taxation)” has taken a similar approach.
79 Three alternative frameworks could regulate incentives with reference to either their i) size (capping the total financial benefit available); ii) use (e.g. specifying geographical areas or sectors in which they are allowed/prohibited); and iii) instrument (proscribing instruments perceived to be particularly harmful).
The European Union (which has been operating state aid guidelines now for several decades) provides an example of how rules might be developed. Although grants & subsidies to foreign direct investors are not explicitly targeted by Commission policy, in practice they are one of the main forms of state aid regulated by it. The definition of state aid clearly encompasses traditional instruments of investment attraction. Indeed the European Commission classifies state aid as including i) grants to firms; ii) loans and guarantees; iii) tax exemptions; and iv) infrastructure projects benefiting identifiable end-users. These payments are regulated by the European Commission, which claims some success in reducing subsidies in the EU.\footnote{See Charlton (2003) for a discussion of the EU’s state aid regulations as applied to foreign investment incentives.}

5.3.2 Anti-corruption policies

One particularly insidious interaction between foreign firms and developing countries is the rampant corruption: it is often less expensive to bribe government officials to obtain, say, a concession, than to pay the full market price. International non-bribery agreements (such as America’s Foreign Corrupt Practices Act) should be made part of an international agreement. There should be full disclosure of all payments made to foreign companies (publish where you pay). There should be an agreement that only disclosed payments will be tax deductible; but even stronger enforcement measures should be undertaken.

Secret bank accounts facilitate corruption, by providing a safe haven for funds stolen from a country. This greatly adversely affects developing countries. There should be an international agreement proscribing bank secrecy (the importance of which has recently been recognized in the case of terrorism.) This too can easily be enforced. No bank should be allowed to deal with any bank in a country which does not conform to the agreed upon transparency standards. Any country that does not enforce such a sanction can be sued (e.g. under provisions similar to those discussed above under fair competition.)

5.3.3 Anti civil strife policies and pro-environment policies

Trade agreements have largely been designed to expand the scope of trade, on the premise that trade is beneficial. Trade policy has become controversial because there are some notable instances where that does not seem to be the
case. The most obvious are the trading in arms, especially small arms, the trafficking in diamonds and other minerals which help finance the purchase of arms, and the narcotics trade. It has become well accepted that countries that export drugs have a responsibility for containing the sale of those drugs. This perspective has been pushed by the advanced industrial countries; as they have come to the view of their inability to control consumption and the demand side, they have put increasing responsibility on the supply side. The same principle should hold for arms trade—it may be far easier to control the sale of arms than the purchase.

In its appellate decision in the shrimp-turtle case, the WTO recognized the importance of global environmental concerns. This decision needs to be strengthened and its scope extended, most importantly to recognize that allowing the firms within a country to take advantage of a global economic resource, to deplete that resource unduly, to excessively harm that resource, is an unfair trade practice and should be subject to sanctions. The failure to impose charges for the use of global environmental resources (including the atmosphere) of course encourages such abusive practices. Some developing counties risk being very adversely affected by global warming, even if some temperate advanced industrial countries will not be so adversely affected.

5.3.4 Responding to crises: from beggar-thy-neighbor to help-thy-neighbor

One of the original motivations for international trade agreements was the fear of the kinds of beggar-thy-neighbor policies which marked the Great Depression. Nonetheless, even within the WTO, there are provisions (almost never invoked) that allow countries to take emergency measures. The issue is important because given the unstable global financial and economic system, country after country has faced a crisis in recent years; by one reckoning there have been a hundred crises in the last three decades. Rather than resorting to beggar-thy-neighbor policies, it would be far better than encouraging countries to return to protectionist measures in the event of a crisis to encourage other countries to take special measures to open up their markets. For instance, in the Argentine crisis, if countries provided special access to Argentinean beef or wine, it might have modulated the downturn and facilitated a quicker restoration of the economy. An international panel within the WTO should assess whether there is a crisis exists which might benefit from special trade opening measures, and how those “help thy neighbor” policies might be implemented.
5.3.5 Trade implementation and environment facility

The developing countries are at a marked disadvantage, not only in negotiating fair trade agreements, but also in implementation. We noted one aspect of this earlier: there difficulty in mounting challenges to bio-piracy actions under TRIPS.

Some developed and many less developed countries have marked subsidies to the use of energy, which has adverse effects on the global environment. The costs of global warming are likely to be particularly severe to some developing countries, such as Bangladesh. The international community has recognized the need to assist developing countries face the incremental costs associated with implementing environmentally sound technologies, and that should include adjustment assistance to help developing countries bear the costs of eliminating subsidies to (fossil fuel) energy.

5.4 What should not be on the agenda?

The preceding is a partial list of some of the items that should have a high priority in any round of trade negotiations that pretends to call itself a development round. Many of the items listed have received little or no attention. Equally remarkable are the several items (especially within the so-called Singapore issues) that are on the table. Some of these would almost surely impede development. The fact that the United States and Europe put such items on the agenda and continued to push them so long within the so-called Development Round is worrisome: Were they merely bargaining chips? Was there no real comprehension about what should be meant by a Development Round?

5.4.1 Investor Agreement

Developed countries have put considerable efforts in expanding investor rights. As we noted earlier, facilitating the free mobility of capital is far less important for global economic efficiency or for the developing countries themselves than facilitating the movement of labor, particularly that of unskilled workers.

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81 United Nations Environment Programme (UNEP) estimates that the costs of global warming may exceed $300 billion annually. These costs stem from more frequent natural disasters, loss of land as a result of rising sea levels and damage to fishing stocks, agriculture and water supplies. In some low lying states such as the Maldives, the Marshall Islands and the Federated States of Micronesia, losses linked to climate change could, by 2050, exceed 10 per cent of Gross Domestic Product (UNEP 2001)
Indeed, there is a strong case the capital market liberalization may actually lower global economic efficiency.\textsuperscript{82}

Moreover, as we have also noted, to the extent that there is validity to the argument that improved investor protections will attract more capital, each country can do that on its own. Each developing country does not have to rely on an international agreement. But it is only through international negotiations that free labor mobility can be achieved.\textsuperscript{83} There is, accordingly, a far stronger argument for focusing on the “rights of labor” than on the “rights of capital.”

Equally troublesome is that arguably, some of the items that were on the agenda would actually have an adverse effect on the well-being of developing countries. The United States put the issue of capital market liberalization on the table, and has in fact insisted on such provisions in bilateral agreements (e.g. with Chile and Singapore.) There is mounting evidence that full mobility of short term speculative capital (hot money) would actually increase economic instability, increasing in turn poverty. There is little evidence that it enhances economic growth. Indeed, the instability which it generates may well impede investment and growth. The problems of Latin America in recent years, and of East Asia at the end of the last decade, can be directly traced to capital market liberalization.

The problem with many investor protections is that other rights have been compromised in the attempt to enhance the rights of investors. Such investor rights are not costless. But those whose rights are being compromised do not have a seat at the table (see the discussion of Institutional reforms in Section V). For instance, Chapter 11 of NAFTA granted investor rights which compromised the rights of government to provide for the general welfare, through health, safety, and environmental regulations. Recent decisions suggest that the right of a community to protect itself against toxic wastes may be compromised.

There are already mechanisms for the protection of investors against expropriation, both internationally (MIGA, the Multilateral Investment Guarantee Agency) and on the part of many of the investing countries (Overseas Private Investment Corporation, OPIC, in the United States.) There has not been a convincing case made that these are inadequate, or, if they are, that they cannot be strengthened. The new investor protections go beyond the concern for expropriation, to the granting of additional rights to investors.

\textsuperscript{82} See, e.g. J. E. Stiglitz [2000, 2004] and the forthcoming IPD task force report on Capital Market Liberalization (Oxford University Press, forthcoming.)

\textsuperscript{83} The distinction is perhaps not quite as strong as it has sometimes been put. Allowing immigration of labor will benefit both the recipient and sending country; but there are likely to be groups that are directly adversely affected in the recipient country, who will be vocal, and often politically effective, in their opposition. On the other hand, investors seldom oppose capital market liberalization, as they focus on the consequences of the lowering of the cost of capital. Of course, entrenched industry may resist the entry of competitors in their line of business.
5.4.2 Intellectual property rights

Had such a provision been part of the Uruguay Round, it is doubtful whether the TRIPS agreement would have passed muster. Clearly, the provisions relating to compulsory licensing of drugs had an enormously adverse effect on many of the poorest in the developing countries.

While there have been a few dramatic bio-piracy cases, the full impact remains uncertain. Yet, because of the huge inequities which it suggests, it has taken on symbolic value, and accordingly, it is difficult to conceive of a fair trade agreement that does not address the issues.

The argument of Bhagwati and others that intellectual property should not be included in a trade agreement are sufficiently compelling that in fact there should be a complete roll back of TRIPS. The issues should be switched to another international forum (WIPO).

Whether within the WTO or this alternative forum, a new intellectual property regime needs to be created which balances more carefully the interests, e.g. of users in both developed and less developed countries (including researchers, for whom knowledge is one of the most important inputs) and producers of knowledge. This should be reflected in all the provisions, including the tests of novelty, as well as the breadth and scope of the patent. There should be a stronger presumption for narrowly defined patents, and the issue of patents for business practices as well as other recent extensions of patent coverage should be examined and agreed to within an international process that is centered in the scientific community, not the trade ministers. There should also be sensitivity to the disadvantageous positions of developing countries in pursuing legal recourse. (The issue of intellectual property rights is discussed further in section 6 below.)

84 One famous case involved a Texas company attempting to patent Basmati rice. In that case, India challenged the patent and prevailed.
85 Patents could not, for instance, be granted for traditional medicines or goods, or slight variants of those traditional medicines, when the usefulness of those commodities has already been recognized within the developing country.
86 There is already in motion a backlash among the more technologically advanced of the less developed countries. Brazil is pushing for open source software, and China may adopt its own telecommunications standards, which will enable it to avoid paying high royalties for the use of technology based on other standards. An unbalanced intellectual property regime can contribute to overall global inefficiency in the use and production of knowledge.
5.4.3 Other services

In the list of priorities, we emphasized earlier the opening up of markets to unskilled labor intensive services and the movement of unskilled labor (sometimes in support of such services.) Earlier rounds of trade liberalization focused on, for instance, financial services, the benefits of which are arguable. The standard argument is that more efficient financial service intermediation lowers the cost of doing business and thus promotes economic growth. It is pro-development. But a closer look at the record reveals a more mixed picture. In at least some developing countries there are concerns that the purchase of local banks by foreign banks has reduced the flow of credit to domestic small and medium sized enterprises, and thus impeded economic growth. (There is a long history of such concerns, evidenced in the United States, for instance, by restrictions on interstate banking, intended to prevent New York and other money center banks from buying up other banks, thereby impeding regional, and especially rural, development.) The agreements on financial services should be reexamined, to ascertain whether there is sufficient protection for developing countries. In particular, the right of developing countries to impose lending requirements (analogous to those in the United States in the Community Reinvestment Act) to force more lending to underserved populations should be explicitly recognized.

5.4.4 Other regulatory interventions

Developing countries worry that new trade agreements will create new barriers to the entry of their goods into developed country markets (impeding their development). They worry about blue-tariffs (impediments based on labor standards) and green tariffs (impediments based on environmental standards.)

Standard economic theory suggests that, with a couple of exceptions noted below, weak standards do not necessarily improve a country’s competitiveness, and therefore the issue of standards should not, in general, be embraced within a trade agreement. In standard theory, in a competitive market, any costly provision (such as improved working conditions) simply gets reflected in the wage paid. Such restrictions affect the form of compensation, but not the overall level of compensation. In general, there is no reason that the international community should intrude into the forms of compensation.

There are three basic exceptions to these principals. The first is when the global community is affected (a principle which has already been recognized in the appellate decision in the shrimp/turtle case, in the area of environment and
The international community has a right to take actions to address global public goods and externalities, and among the most important of these is the global environment. Trade policy should recognize, as we have noted earlier, that not forcing firms to pay the true social costs of their environmental damage is a form of subsidy, which countries should have the right to take action against. Since developing countries as a whole are more likely to be adversely affected by global warming than, say, the United States, using trade policy to force compliance by the advanced industrial countries with the Kyoto Protocol could well be considered an important part of a pro-development trade agenda.

The second is related—matters of human rights. Clearly, when individuals are forced to provide labor services (e.g. when they are prisoners) or allowed to use child labor, costs of production may be lowered. As a global community, we do not want to provide economic incentives for such behaviors; on the contrary, we want to discourage it. By the same token, when governments have seized land of indigenous peoples, and provides the fruits of that land to others at discounted prices (even if those prices are above its cost of acquisition), then that should be viewed as an unfair subsidy. Countervailing duties against minerals and lumber produced in many countries would be justified by such a provision.

The third, which too may be related, concerns circumstances in which countries can take actions which affect unfairly costs of production. The most notable example of this is restrictions on collective bargaining and the right to take collective action. The bargaining relationship between workers and firms is one sided, and firms can use their economic power to drive down wages and labor costs, making their products more competitive than they otherwise would be.

In all of these cases, some argue that since these are not matters of trade (though the first clearly constitutes a trade-distorting subsidy) it is preferable to address these problems through other channels. Without prejudging the validity of this argument, the fact of the matter is that there are few other channels. Today, in the absence of alternatives, trade sanctions are one of the few ways that the international community can enforce its will, and though resort to such measures should be carefully circumscribed, the instances enumerated are among those in which sanctions may arguably be justified.

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87 The United States requires domestic shrimpers to use protective technology called Turtle Excluder Devices, which are a kind of trap door by which turtles can escape from shrimp nets. In 1989, Congress essentially banned importation of shrimp caught by foreign shrimpers who don't use Turtle Excluder Devices.

88 This is because the developing countries, on average, are already in warmer climates.

89 It is important that the decision about whether a trade sanction is to be imposed be taken by the international community; otherwise special interests within a country may well try to disguise protectionism behind a cloak of environmentalism or labor rights.
On the other hand, there are a host of other regulatory interventions which may adversely affect foreign businesses, sometimes differentially so, but whose primary motivation is to enhance economic development. We referred to one earlier—restrictions on banks that require that they lend certain minimal amounts to small and medium sized domestic enterprises and to other underserved communities. It is a legitimate role for government to undertake such actions. The United States, Japan, and many other countries did so in their earlier stages of development—and continue to do so. Because foreign banks may not be in a position to screen among such loan applicants as well as domestic banks, such regulations may have a differentially adverse effect on foreign banks.

By the same token, governments may decide that affirmative action programs are desirable for social purposes, and require that all employers hire workers from certain disadvantaged groups. These restrictions might, conceivably, impose greater costs on foreign firms, who are used to hiring Western educated individuals, but they reflect a legitimate aspiration of governments to create a more equal society.

5.4.5 Exchange rate manipulation

The United States has recently leveled charges of exchange rate manipulation against China. Global financial markets have exhibited enormous instability. Volatility of exchange rates presents a particular problem for developing country. Markets are thin, and thus subject to both more volatility and manipulability. Government intervention is, accordingly, often viewed to be desirable. There are a variety of mechanisms by which the government can affect the exchange rate, and there are a variety of policies which the government undertakes which affect the exchange rate indirectly. Bad economic policies (large deficits) for instance may lead to a devaluation of the currency, whether that is the intent of the policy or not. Given the large adverse consequences of trade deficits, there should be a presumption that countries that have only a moderate trade surplus are not engaged in exchange rate manipulation. The complexities involved suggest that there should be a high threshold test for taking action in the event of an accusation of exchange rate manipulation, and that, at the very least, only multilateral trade surpluses, not bilateral trade deficits, should be presented as evidence of such manipulation.
6 Special Issues

6.1 Special and Differential Treatment and the Development Box

There is now general agreement that the different circumstances that developing countries are in warrants special and differential treatment. This is necessary if there is to be any trade agreement that goes much beyond current arrangements, and yet promotes the development of the poorest countries in the world.

There are at least two approaches to special and differential treatment. The first lifts the “single undertaking”, allowing countries to decide which of the provisions they wish to sign up to. Many developing countries fear, however, that eliminating the single undertaking will lead to a divide and conquer strategy, in which a few countries sign up to the “higher standards,” putting pressure on the others to do so.

That is why the alternative approach of generalized rules embodying differential treatment is preferred. Thus, for instance, developing countries should be given a longer adjustment period. They should be given greater latitude in providing subsidies, especially for new technology. If non-tariff barriers are retained, the developing countries should receive differential treatment.

A variant of this proposal would divide the WTOs agenda into two or more schedules. The core market access agenda and those elements which would not function in the presence of a free-rider problem would remain subject to the ‘single undertaking’. This agenda would embody generalized SDT for developing countries. A second schedule would include peripheral trade issues for which the free-rider is less significant and where most of the gains from liberalization are captured domestically. Countries could choose to opt-out of any or all of the elements of this schedule depending on whether the proposals are consistent with their other national development policies.

Such differential treatment would facilitate the design of trade agreements which are more likely to promote economic development. A blanket proscription against government subsidies to technology (industrial policies) is likely to have an adverse effect on developing countries, and indeed, it is likely in practice to be unfair; the United States conducts its industrial policy largely through the military, which supports a wide variety of technological developments that eventually have important civilian applications. And it is
hard to conceive of a trade agreement that would prohibit the transfer of such technologies.

Thus, each provision of a trade agreement should be assessed for its impact on development, and designed, employing where necessary, provisions for special and differential treatment, to ensure that development is enhanced. Moreover, the totality of the trade agreement should be assessed, to ensure that a fair share of the benefits (the net incidence) accrues to developing countries.

6.2 Intellectual property issues

Recent debates about intellectual property need to be put into context. Intellectual property provides innovators with a temporary monopoly power. Monopoly power always results in an economic inefficiency. There is accordingly a high cost of granting even a temporary monopoly power. But the benefit is that by doing so, greater motivation is provided for inventive activity. The dynamic gains, it is hoped, exceed the static losses.

Much of the most important innovative activity is outside the realm of intellectual property. Behind the inventions associated with atomic energy or lasers were basic discoveries in physics. Behind the computer were basic discoveries in mathematics. The basic research which underlies practical innovation in almost all arenas occurs in universities and government research laboratories, and few of the discoveries are protected by intellectual property.

In many cases, it is neither desirable nor practical for this to happen. Often the applications which give market value to the discovery occur years after the original discovery (beyond the normal patent life.) Ideas give rise to other ideas, and there is no way to ascertain which ideas proved instrumental in the creation of follow-on ideas.

Most important, it should be recognized that material reward provides little of the motivation for much of this intellectual activity. To be sure, it could not occur without financial support. The salaries of the researchers have to be paid, and if the financial support is woefully inadequate, many would-be researchers will divert their attentions to other areas. Yet there is little evidence that stronger intellectual property protection would generate a greater flow of basic ideas.

Knowledge is a public good, and this is especially true for the fruits of basic research, which is why governments have an important responsibility for its support. Intellectual property protection thus constitutes only a part—and not the most important part—of what may be called our knowledge and research system. Providing greater support to this one part of the system may actually
harm other parts of the system, and impede the progress of science. Note that the system under which basic research is conducted is a very open one, in which ideas freely move around, and in which in fact scientists put considerable effort into disseminating their ideas and encouraging others to use them. In many ways, this is the opposite of the premises underlying intellectual property, which seeks to circumscribe the use of knowledge, limiting it only to those who are willing and able to pay.

Thus, the intellectual property regime must balance concerns about incentives for research with the costs of the inefficiencies associated with monopoly power; it must balance the interests of some producers of knowledge, with the interests of other producers of knowledge, of consumers, and of society more generally.

Since knowledge is the most important input into research, better intellectual property protection may actually impede the research process. Much of the effort in patenting is directed at trying to maintain monopoly power, ensuring that others will not invent around the patent. Some of the value of each patent entails “enclosing” what was previously public knowledge.

The intellectual property provisions of the Uruguay Round (TRIPs) were unbalanced. No where was the lack of balance more in evidence that in TRIPS treatment of medicines, and there remain concerns even about the agreement that was reached in the run up to Cancun. Compulsory licensing should be extended to any drug that is lifesaving or which controls diseases with serious effects on health. Even if malaria or dysentery were not life saving to some people, they enervate millions of people in the developing world, impeding their productivity and lowering their living standards. There may not be an “emergency” or crisis, as there is in the case of AIDs, but it is still of critical importance to the developing world.

The revenues lost to the pharmaceuticals as a result of such compulsory licensing are likely to be miniscule, relative to the revenues generated by the exercise of monopoly power in the more advanced industrial countries, and therefore are likely to have a negligible effect on the development of drugs. The cost to the developing countries of failure to provide drugs at affordable prices is enormous.\(^9\)

The disparity between price and marginal cost of production can be viewed as a tax, used to finance research. Basic principles of equity question the levying of this tax on some of the poorest people in the world. If the international

\(^9\) The right of a government to demand compulsory licensing has been recognized even by the United States, the staunchest defender of intellectual property rights; when it was worried about anthrax, it forced the compulsory licensing of Ciprio. The only issue is, under what conditions should such compulsory licensing be allowed. A development round would have provided answers that more directly addressed the concerns of the developing countries.
community believes that there is a need to provide greater incentives for research for the development of medicines, then they should do so directly, through funding of research either within the public or private sector, not by levying a tax on the poor. One proposal has it that each country should make a contribution to research, the magnitude of which would be based on their income, and the form of which would be of their own choosing. The contribution, for instance, could be in the form of direct expenditures on research, licensing fees, or the implicit taxes paid to holders of patents.

There are other issues which affect developing countries access to life saving medicines at affordable prices. One concern is the ease with which generic drugs are able to get established, and how quickly they can enter a market at the expiration of a patent. In some of its bilateral trade agreements, the United States has been working to make it more difficult. If there is to be an intellectual property agreement within a development round, it should enshrine principles facilitating the rapid entry of generics.

The problems posed by bio-piracy are equally serious. While as noted earlier, when contested in court, some of the claims of Western firms may not be sustained, it is costly for developing countries to mount the legal challenge. One proposal is that there be a change in the presumptions associated with patenting, say, traditional medicines, with the party applying having to show that there was not recognition of its medicinal properties, with the adjudication occurring in an international tribunal, and with the legal expenses of the developing country being divided between the applicant and the developing country in proportion to the ratio of the income per capita.

6.3 Competition Issues

Competition was supposed to be one of the Singapore issues, but the discussions on competition have devolved more into ensuring fair competitive access of developed countries into developing country markets, than into ensuring that markets are really competitive, and that developing countries have fair access to developed country markets.

Ensuring Competition. Today, many companies operate across boundaries. Competition policy in one country can affect others. The United States and Europe have increasingly come to recognize this. The United States instituted an action against Japan, claiming anti-competitive practices in Japan, which the Japanese government had not stopped, had unfairly discriminated against Kodak. Europe took actions against Honeywell on anti-trust grounds, and the American government complained that its standards were too high. The EU is considering taking actions against Microsoft; even though American courts have
found Microsoft guilty of violations of anti-trust laws, there is widespread concern that the remedies were insufficient.

The concerns are two sided: there is a worry that the anti-trust laws will be applied in a discriminatory way, to hurt foreign companies; and that anti-trust actions will fail to take account of anti-competitive effects in developing country. Ideally, there should be harmonization of anti-trust laws at the highest standard. Strong competition advocates worry, however, that harmonization will occur at the standard of the least common denominator, and an international agreement will legitimate such lower standards.

Given these difficulties, initial steps would include insisting on national (non-discriminatory treatment); this would entail either eliminating dumping duties, or revising anti-trust legislation, to apply the same standards to foreign and domestic firms.

A second reform would require that national authorities look carefully at anti-competitive effects outside their own jurisdiction. Not only should domestic anti-trust regulators look at competitive effects abroad, but foreign consumers should have the right to take actions in foreign courts against corporations that abuse their market power. Cross border class action suits should be sanctioned, allowing consumers in multiple jurisdictions to band together to impose, for instance, treble damages, with judgments enforceable in the jurisdiction of the home country.

Thirdly, consumers and governments in all countries should be able to take actions (including class action suits) against international cartels, including those cartels in which governments are a party or have sanctioned the cartel. (While some developing countries may lose from such an action, the benefits received by others would almost surely outweigh the losses. For instance, oil producers may be worse off, but oil consumers would be better off.)

*Ensuring fair access.* Here, the concern of developed countries is that restrictions imposed by developing countries (such as affirmative action or preferences for small and medium sized enterprises) have a differential effect on multinationals. But a development round should recognize the legitimate role of such restrictions as social and developmental policy tools, and there should be a high burden of proof imposed on any challenge to such restrictions, to establish that there is no legitimate social or developmental objective of the restriction or that those objectives could not be practicably achieved in a significantly less trade-distorting way. At the same time, developed country regulations and practices which have an adverse effect on firms from

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91 Fink, Matoo and Rathindran (2001) suggest that the GATS should require domestic competition law to consider the effect of collusive agreements on foreign markets. (The relevance of this point goes, of course, well beyond the service sector.)

92 E.g. without significant adverse effects on other groups. The alternative should be “Pareto Superior”. 
developing countries (e.g. high licensing fees) should be held to a much higher standard.

6.4 Regional and Bi-lateral Trade Agreements and South-South Trade

With the collapse of the Doha Round, the United States threatened to pursue a set of bilateral and regional trade agreements. Such agreements are against the spirit of the multilateral trading system, which has been based on most-favored nation principles. Moreover, developing countries may be even more disadvantaged in one on one bargaining with the United States; a series of such agreements may leave many developing countries worse off than they would be, even with another unfair multilateral agreement. While in principal, such agreements are only WTO consistent if there is limited trade diversion, in practice, little attention has been paid to this requirement. The argument that these regional agreements are useful as a step towards improved multilateral agreements is also suspect. The kind of multilateral agreement to which they may lead may be more unbalanced than one which would be directly entered into, without the more circuitous route. More to the point, there is a high cost to the round-about approach. For to the extent that there is temporary trade diversion, some industries are being temporarily encouraged, only to be later discouraged. Adjustment costs are typically high in developed countries; there may be significant costs of entry and exit, and with a scarcity of capital, the burden on developing countries may be particularly large.

In the next section, we proposed institutional reforms that address these issues. But there is another arena in which trade agreements which fall short of full multinational agreements may be desirable, and those entail reducing the restrictions on South-South trade. South-South trade makes up some 40% of developing country trade. Developing countries have much higher tariff levels than developed countries. This suggests there are considerable gains available from liberalization of south-south trade.

How then should WTO agreements manage the trade-off between the need to protect domestic markets from competition from developed countries, while not hindering trade between developing countries? One solution might be to allow developing countries to offer preferential market access deals to each other in the same way that the EU’s EBA initiative offers free access to developing countries only. Such a provision would have one further advantage: preferential treatment by some developed countries (most notably the U.S.) is based on political conditionality; it is a “gift” that is constantly in threat of being taken risk, and this induced risk limits the value of the gift. Moreover, the granting of such preferences becomes a lever with which developed countries can extract other concessions from developing countries. A South-South agreement would
likely focus more exclusively on trade issue, and would not suffer from these “abuses.”
7    Institutional Reforms

7.1    Procedures

There is widespread dissatisfaction with the way that trade agreements are made, partly stemming from a belief that current procedures put developing countries at a disadvantage. This is particularly important, given the increasing role that such trade agreements have in our societies. They define a wide set of rights and obligations. Yet they are arrived at in a manner that is distinctly different from the way that other kinds of legislation are adopted. The terms are often negotiated behind closed doors, with little public debate about specific provisions. The legislative process is often truncated. The result is agreements, like Chapter 11 of the NAFTA agreement or the TRIPS agreement, which contain provisions which would never have been accepted by a democratic parliament with open discussion in a deliberative process.

The hallmark of earlier trade agreements is that they were conducted in secret, with many of the terms not fully disclosed until the end of the negotiations, and then governments faced an “all or nothing” choice. Because they could have no effect on the outcome, parliamentarians had little incentive to understand the intricacies. Given the extent to which trade issues overlap with other issues, including those touching on the environment, it is important that the procedural reforms move deliberations about trade issues to make them more like other deliberative processes—including more open deliberation.

Trade has become too important to be left to trade ministers alone. Part of the deliberative process must entail the active involvement of others (meeting together, not just through the trade ministers.) Thus when intellectual property matters are being discussed (if they are to be discussed at all), the Science Ministers must be involved. When trade policy affects the environment, there must be some mechanisms for the environmental ministers’ voice to be heard. They would insist, for instance, that provisions be inserted that prevent a race to the bottom, that low environmental standards (e.g. associated with allowing the pollution of the world’s atmosphere) be viewed as a form of subsidy to be prohibited.

We emphasized in Section 3 that the fairness of the international regime is to be judged not only in terms of the outcomes, but also in terms of the processes. There is now a large literature documenting the deficiencies in the procedures.\(^{[93]}\)

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\(^{[93]}\) On participation see Blackhurst, Lyakurwa, and Oyejide [2000]; on transparency see Francois [2001]; on representation see Winters [2001]
and for reasons already noted, these procedural deficiencies disadvantage developing countries. That is why procedural reforms – particularly relating to transparency and representation – should have a high priority.

The developed countries should continue the kind of support they have provided to help the developing countries participate more effectively in these deliberations. Trade negotiations involve complex issues, including economic issues in which even the experts are not in agreement. Meaningful participation in these discussions requires understanding these complexities, knowing the full import of each of the provisions, how it might affect countries differently in quite different situations.

7.2 Structures and representation

As the number of WTO members has grown, and the demands for a more inclusive bargaining process have increased, the current system appears to many as increasingly unwieldy. It is not the intent of this paper to provide a detailed analysis of alternative proposals for institutional reform, but rather to highlight its importance, and to emphasize why such reforms should in fact be viewed as a priority in current discussions.

It is apparent that the opening up of the WTO to so many members makes negotiations cumbersome and difficult. This has been used as an excuse for the secretive processes in which, somehow, a selected group of countries are chosen to negotiate with the United States, EU, and Japan in the “Green Room.” The arbitrary and capriciousness nature of the Green Room procedures needs to be replaced. In other areas of democratic decision making, especially those based on consensual processes (as in principle) trade negotiations are supposed to be, the principle of representativeness is well accepted: a small group of countries is chosen to reflect the various interests and constituencies—say the largest trading countries, United States, EU, Japan, China; a representative or two of the middle income countries, say Brazil and one other country; a couple if representatives of the least developed countries; a representative of the Cairns group, etc. Each would then consult with those that they are representing on a regular basis. An open and transparent process would ensure that the views and voices of all are heard.

Another requirement is a new body within the WTO responsible for assessing the impacts of proposed trade provisions on development and developing countries and also assess ‘trade diversion’ vs. ‘trade creation’ affects of bilateral and regional agreements. Its objective would be to look objectively at the consequences of alternative proposals for all the countries of the world, recognizing that economic science is not at a stage where there is agreement about the “right” model. Thus, the body might attempt to assess the impact of
the allegedly non-trade distorting agricultural subsidies in a world in which there are capital constraints.

Other functions of an expanded WTO secretariat might include an independent body to assess countries in crisis ant to adjudicate and approve the imposition of trade restrictions (‘safeguard measures’) and to investigate dumping charges, countervailing duties, and phyto-sanitary conditions.

There is a need to address the scope of technical assistance and the capacity of the WTO to adequately provide it within existing structures. Helping low income countries strengthen their institutional capacity to permit them to meet WTO agreements will require not only technical assistance but also significant financial assistance. The costs of implementation of WTO commitments are very substantial. 94

While a limited assistance program may assist developing countries to implement reform, technical assistance is not sufficient to deal with the economy-wide adjustment costs associated with structural change. These costs, which generate domestic opposition to trade liberalization, are no less important barriers to progress than the lack of institutional capacity.

In addition, lack of institutional capacity has the effect of limiting the access of developing countries to justice within the dispute system. Developing countries are disadvantaged in complex and expensive legal proceedings. An expansion of existing legal assistance schemes will be an important prerequisite for institutional fairness.

The bulk of technical assistance has fallen on international organizations. Both the World Bank and the WTO have increased their technical co-operation activities. However as much as 90 per cent of financing for these activities is provided by trust funds provided by two or three bilateral donors, while the WTO itself has typically allocated for technical co-operation activities less than one per cent of its total annual budget – less than half a million US dollars, Michalopoulos (2000). 95

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8 A “practical” agenda

The agenda set forth may not be readily accepted by the developed countries, if they maintain the frame of mind that has prevailed in the past, where each country attempts to extract the most out of the trade negotiations, given its bargaining power. Given the weak bargaining power of the developing countries, they have, not surprisingly, not fared well.

But the world is fast changing. There is widespread recognition of the inequities associated with past agreements, and that makes it increasingly impossible for at least those countries with democratic governments to sign onto another unfair agreement. Even in the developed countries, there is widespread recognition of these inequities, and an almost embarrassment at the extent to which trade agreements are shaped by special interests. The protests in Seattle and at the other international meetings around the world are evidence of the dissatisfaction with globalization as it has been practice.

The developing countries have also recognized that if they stand together, there can be no new agreement that does not address their concerns. As we argued in the introduction, the kind of agreement that the developed countries were asking for—at least as part of their bargaining position—would arguably have put new demands on the developing countries, without offering them much in return. There is increasing sentiment that no agreement is better than a bad agreement.

The concern about terrorism combined with the resolve of the international community to reduce poverty—the Millennium Development Goals—has put on new spotlight on the plight of the developing countries. While poverty may not cause terrorism, poverty and despair provide fertile feeding grounds. As aid levels have declined (in real terms, especially relative to the needs) many of the developed countries talk about the importance of trade. But what is needed for the developing countries is access to the markets of the developed countries; this is what they cannot do on their own; this is where an international agreement—to pursue a common international concern—would be of value.

A practical agenda for a development round would focus on what measures would improve the plight of the developing countries. It would postpone any discussion of new demands until after the problems and imbalances of previous rounds have been addressed. From the list of suggestions in the previous two sections, the following constitutes a “minimal” list, which should be the basis of a development round of negotiations:

1. Special and differential treatment
Trade negotiations must begin from the premise that the less developed countries are deserving of special and differential treatment, both because they have been disadvantaged in the past, and because of the differences in their current circumstances. This will entail a movement away from the principles of reciprocity and bargaining which have underlay most trade negotiations thus far. It will entail unilateral concessions by the developed countries, both to redress the imbalances of the past and to further the development of the poorest countries of the world. The costs to the developed countries of such concessions is likely to be low, the benefits to the developing countries enormous.

2. Institutional reforms
   a. Greater transparency and openness in process; no green room negotiations
   b. The creation of a representative “trade council” with partially rotation membership for negotiation of key issues
   c. The establishment of international tribunals to adjudicate in the first instance accusations of dumping and other unfair trade practices
   d. The establishment of international tribunals to adjudicate in the first instance claims of intellectual property involving indigenous products
   e. The creation of a permanent advisory body to help the developing countries bargain more effectively for their own interests
   f. The creation of an independent evaluation unit, which would assess the incidence and development impact of alternative proposals as well as evaluate the extent to which any bilateral or regional trade agreement diverts trade.
   g. The right of the WTO secretariat on its own to initiate cases. (Developing countries may feel uneasy about initiating cases against large powerful countries, partly out of fear, for instance, that foreign assistance be reduced.)

3. Regional and bilateral trade agreements
   These trade agreements undermine the multilateral trade system. The argument that they are an important stepping stone towards a multilateral system is unpersuasive. Indeed they impose costs on the developing countries, as they continually adjust to ever changing artificially created advantages. Moreover, the process of “divide and conquer” may lead to an outcome which is more to the disadvantage of the developing countries.
   a. There should be strict enforcement of restrictions already in place on regional and bilateral trade agreements, intended to ensure that the benefits of such agreements arise mainly from trade creation rather than trade diversion
   b. The independent body described in 1. should evaluate each proposed trade agreement in these terms
c. The use of political conditionality in trade agreements, other than a commitment to democratic processes, should be prohibited

4. Investor issues
   a. An agreement among all countries that they would not compete for companies by providing tax concessions or special infrastructure benefits, enforced both by private rights to action and by trade sanctions
   b. An agreement by all countries concerning transparency for all payments to governments (especially for mineral, oil, and other resource royalties), and an agreement by the capital exporting countries that they would not allow deductibility of any payments not so published.
   c. A universal foreign corrupt practices act
   d. An elimination of bank secrecy, not only for terrorism, but also for tax evasion and corruption
   e. A recognition of the right of countries to impose regulations on companies for health, safety, or the environment, or for the advancement of disadvantaged groups.
   f. A recognition of the right of countries to subsidize domestic firms, on a temporary basis, to promote the development of new industries

5. Agriculture
   a. The recognition of the right of countries to impose countervailing duties against agricultural subsidies, regardless of the form those subsidies take
   b. A reexamination of the distinction between trade distorting and non-trade distorting subsidies, with a heavier burden placed on those claiming that particular forms of subsidy are not trade distorting. (Explicit attention should be paid to the consequences in the more realistic situations, e.g. when there are capital constraints.)
   c. A commitment to the phasing out of preferential treatments granted exporters from one set of countries to another; while special and differential treatment for developing countries as a whole is beneficial, when directed at particular countries, it gives rise to trade diversion rather than trade creation.
   d. A commitment by developed countries to the elimination of all production and export subsidies on commodities the consumption of which is primarily in the developed world over the next five years. Other agricultural subsidies would be eliminated over the next ten years. Included in production subsidies are subsidies to fertilizer, capital, water, and energy. The developed countries should divert some of the money saved in subsidies to helping consumers in the developing countries who are adversely affected by the increased prices.

6. Manufactured goods
   a. The rapid elimination of all tariffs on all manufactured goods from low income countries
b. The reduction of tariffs and other trade barriers on textiles to a level not exceeding the current average level of tariffs on all other commodities, followed by a phase out of all tariffs on textiles.

7. Services
a. The recognition of the right of developing countries to restrict foreign banking, and in particular to impose lending requirements, particularly for small and medium sized enterprises
b. The recognition of the right of developing countries to impose domestic reinvestment restrictions on funds raised within the developing country
c. The reduction in restrictions by developed countries on unskilled-labor intensive services (like construction and transportation services). As part of the liberalization of these services, temporary migration of individuals will be allowed.
d. The rights of temporary migrants are to be fully recognized. This includes rights of their children to education, rights to health care services, and civil rights.
e. An agreement that there should be no restrictions on off-shore contracting of internet services
f. An agreement that further negotiations for liberalization of services in skilled intensive areas will be put on hold until the imbalance of previous rounds of negotiations have been fully redressed

8. Non-tariff barriers
a. There should be an agreement that there should be a single standard governing unfair trade practices for developed and less developed countries; the standards should reflect those employed in anti-trust laws. There are two approaches that could be taken:
   i. National treatment: each country could be allowed to set its own standard, but the standard would have to be non-discriminatory
   ii. A single standard for the world would be negotiated.
b. Procedural reforms outlined in 2c would ensure fairer treatment of developing countries
c. Dumping: Whatever approach is taken, it would entail using economically relevant cost concepts (marginal not average costs); eschewing discriminatory procedures (like best information available); and eliminating the use of the surrogate country method for allegedly non-market economies
96
d. Countervailing duties: Privatization in competitive auctions will have deemed to have extinguished a subsidy; the provision of credit at LIBOR plus rates will not be deemed a subsidy, even if such rates are substantially below interest rates prevailing in the country. Providing

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96 In the surrogate country method, dumping duties are imposed, not by comparing price with actual costs, but with the costs in a “similar” market economy. The methodology has often been implemented in a totally distorted one; in one case, Canada was judged as the country most “similar” to Poland.
energy and water (or other commodities) at prices that do not reflect environmental impacts will be deemed a subsidy.

e. Safeguards: Developed countries should face higher threshold impacts before safeguard measures can be resorted to.

9. Intellectual Property
a. The provisions of TRIPS will be re-examined, with a view to
b. Ensuring access not only to life saving medicines, but also to medicines that have impacts on the many debilitating diseases in developing countries
c. Advancing the interests of developing countries in acquiring new technology, to close the “knowledge gap,” that separates them from the more developed countries
d. Preventing bio-piracy

10. Competition issues
a. National treatment of domestic and foreign producers in competition law (effectively, the elimination of dumping duties)
b. The recognition of the right of governments to enact special provisions for disadvantaged groups and small and medium sized enterprises
c. Anti-trust action against international cartels (including those in which governments are a party, and including provisions for class actions)
d. Anti-trust authorities to recognize the impacts of mergers and anti-competitive actions outside the country
e. Those adversely affect by a merger or other anti-competitive action have the right to take actions (including class action suits) in foreign courts


APPENDIX 1:

A survey of estimates of the potential costs and gains from the liberalisation of trade and factor flows
1 Introduction

The “Doha Development Agenda” of November 2001 puts poverty-reducing economic growth at the centre of the WTO’s considerations.

If the development focus of the Doha Round is to be a meaningful operating principle, then the overriding task of the Round must be to ensure that the liberalisation agreements promote development in poor countries.

In practise this means prioritising reforms which yield the largest benefits to developing countries; helping governments move towards good trade policies; and dealing effectively with the implementation constraints faced by poor members.

This report attempts to support that task by reviewing the potential benefits and costs of liberalisation across various trade and factor flows.

This analysis is a crucial first step to ensure that priority is given to those elements of the agenda that deliver the largest gains to developing countries.

A thorough survey of the empirical literature on the gains from various WTO proposals has not been done. Time does not permit this to be a thorough analysis, but it is a brief survey of the effects of different liberalisation programs on global welfare. The bulk of useful regional-level empirical studies use computable general equilibrium (CGE) models. Such studies are based on a simple model of the entire economy that, as the name suggests, are developed in a computable form. These models enable us to observe the effects of various liberalisation experiments on trade volumes, prices, and incomes. Simulations can separately determine the effects of reform on different sectors and on different countries and regions. CGE models have several limitations. They require a large amount of data (to estimate accurately all the demand and supply functions which underlie them) and rely on a few crude assumptions. Most importantly, they do not incorporate key features of developing countries, such as the high level of
unemployment. Most assume away the problems posed by uncertainty; but the absence of risk markets makes risk of central concern in developing countries. Most assume perfect competition, while markets in developing countries may be highly non-competitive. We present these models not because we believe that they provide accurate assessments of the costs and benefits of trade liberalization, but because they call attention to some of the key issues—and because they have become a point of reference.

Where possible, the specific effects of reform on Commonwealth developing countries has been included. However the empirical evidence in this regard is thin and most global CGE studies do not disaggregate the effects on small countries beyond the regional level.

This appendix analyses the potential gains and costs from liberalisation in four areas: agricultural trade; services; the temporary movement of natural persons; and manufactured goods trade.

To some extent the results of the survey give cause for a re-evaluation of the current focus of negotiations. The estimated welfare gains from those negotiating areas which consume considerable attention are estimated to yield smaller benefits than other reforms on which there has been less focus, and less progress.

Three conclusions which we believe are relatively robust emerge from the empirical survey below.

- Liberalisation of labor markets – in particular allowing an increased quota of workers from developing countries to work temporarily in developed countries – offers large welfare gains.

- There are significant gains to be realised from the reductions in tariff barriers to south-south trade. In both agriculture and manufacturing the gains to developing countries from liberalisation of trade between themselves are estimated to be greater than those from liberalisation of trade with the OECD. (This may both because tariff barriers between developing countries are higher—implying greater benefits from reductions—and because of the extensive use of non-tariff barriers by developed countries.)

- There is considerable evidence that poorly implemented liberalisation especially in the service sector, can have
negative effects for the poor. Carefully managed implementation, effective regulation, and substantial assistance will be necessary part of any reform agenda.

The literature surveyed identifies ambiguous effects of agricultural and investment liberalization on developing countries. The reason for the ambiguity will be detailed in the discussion below.
2 Agriculture

2.1 Introduction

In the Doha Ministerial Declaration, WTO members committed themselves to reform of the main instruments of agricultural protection including “substantial improvements in market access; reductions of, with a view to phasing out, all forms of export subsidies; and substantial reductions in trade-distorting domestic support.” They also agreed that “special and differential treatment of developing countries shall be an integral part of all elements of the negotiations.”

This vision combines wide-ranging reform of the distorted agricultural trade policies of developed countries, and gradual liberalisation in developing countries.

This background note surveys the (at times thin) empirical evidence on the potential costs and benefits associated with the kind of reform envisioned by the Doha declaration. It focuses specifically on the welfare effects of liberalisation for developing countries.

Developing countries face the benefits of increased market access and the (potential) costs of higher prices for domestic consumers. The fundamental point is that consumers benefit from lower prices that result from large agricultural subsidies, and producers lose. The net effect of wide-ranging agricultural reform varies across developing countries depending on the composition of their exports and imports of different commodities, and the price sensitivity of those commodities to liberalisation. As a result, the conclusions of the empirical evidence give cause for caution.

A reform agenda which maximises the welfare of developing countries must also recognise the specific effects of different protection instruments on different commodities.

Furthermore, developed countries have a large number of instruments by which they can redistribute income and alleviate poverty. In less developed countries, by contrast, the set of instruments is far more circumscribed. Since
Agriculture producers are among the poorest people in developing countries, increasing the prices they receive may be one of the few instruments for alleviating rural poverty. But such policies are, at the same time, likely to increase urban poverty. Tariffs on imports (especially when they countervail subsidies by more advanced industrial countries), with some of the proceeds use to provide targeted food subsidies may accordingly increase welfare.

Reform should focus on maximising market access benefits and identifying ways of offsetting the terms of trade impact on consumers. This requires (i) a rapid elimination of the most damaging protection instruments: export and production subsidies on commodities that compete with developing countries and which are not consumed extensively by developing countries, or in which the effect of liberalization on prices paid by consumers in developing countries is likely to be small; (ii) increased market access, particularly for the goods exported by developing countries; (iii) a gradual reduction of production subsidies on sensitive commodities (those imported by developing countries with, say, substantial negative price effects on poverty); (iv) assistance for the poorest countries.1

2.2 Patterns of protection and trade

While average manufacturing tariffs fell have fallen significantly in recent decades, agricultural protection has remained stubbornly high. The average level of agricultural producer support in OECD countries ranges from less than 5 per cent of gross farm receipts in Australia to 20 per cent in the US and 35 per cent in the EU (figure 2.1). Developing countries face high tariff barriers on many of their agricultural exports – the average tariff on agricultural goods exported to developed countries was 15.1 per cent in 2000 (Hertel et al 2000).2

Table 2.1 shows the (projected) levels of farm support in 2005 after the Uruguay Round agreements are fully implemented (Hertel et al. 2000). Tariffs are particularly high in the feed grains, dairy, and food grains sectors.

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1 The nature of the assistance is discussed more fully in Part II

2 There are also large non-tariff barriers for some commodities, e.g. sugar quotas.
Column 2 shows that dairy products are the world’s most subsidised exports followed by meat and livestock. Producer payments are highest for grains and oilseed sectors and lowest for meat, livestock and dairy (column 3).

Figure 2.1 Agricultural producer support
(% of value of gross farm receipts)

Source: Anderson (2003)

*Average* levels of subsidies (or protection) do not necessarily provide a good indicator of how distorted the market is. For instance, most cotton production may be totally unsubsidised, but America provides large subsidies, which has a substantial *marginal* effect. The price effect of large subsidies to even a limited group can be quite large, given the inelasticity of demand for agricultural goods.

Table 2.1: Average Protection
This table shows the average protection (per cent ad valorem) for food and agriculture by sector. The figures are worldwide averages in 2005. Subsidy equivalents are aggregated across all regions and divided by exports at domestic market prices.

<table>
<thead>
<tr>
<th></th>
<th>Import Tariff</th>
<th>Export Subsidy</th>
<th>Production Subsidy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Food grains</td>
<td>23</td>
<td>1</td>
<td>6</td>
</tr>
<tr>
<td>Feed grains</td>
<td>97</td>
<td>4</td>
<td>11</td>
</tr>
<tr>
<td>Oil seeds</td>
<td>4</td>
<td>0</td>
<td>9</td>
</tr>
<tr>
<td>Meat &amp; livestock</td>
<td>17</td>
<td>8</td>
<td>2</td>
</tr>
<tr>
<td>Dairy</td>
<td>23</td>
<td>27</td>
<td>2</td>
</tr>
</tbody>
</table>
Table 2.2 shows the average tariffs on agricultural goods by importing and exporting region. Developing countries face even higher tariffs on exports to other developing countries (18.3 per cent) than on exports to developed countries (15.1 per cent).

A second important determinant of the welfare effects of liberalisation is the agricultural trade balance across countries. Table 2.3 (from Dimaranan, Hertel and Keeney, 2003) reports the average trade specialization indices for several countries and regions over the course of three decades. These indices give a measure of the trend of agricultural trade balances through time. The value of the index ranges from -1 for a country that imports and does not export a particular commodity, to +1 for a country which only exports.

Table 2.3 shows a division between temperate products (program crops and livestock) where developing countries are largely net importers and developed countries are largely net exporters, and tropical products for which developing countries are largely net exporters. Many of the most developed countries – including the EU, US, Australia and New Zealand – have increased their food trade balance over the last 30 years. Most of the developing countries – Sub Saharan Africa, Latin America (excluding Argentina and Brazil), Indonesia, Mexico, Middle East and North Africa – have actually become more dependent on imports in program crops and meat/livestock.
Table 2.3 Trade Specialization Indices
This table reports trade specialization indices. The index is calculated as (X-M)/(X+M) where X is exports and M is imports for each country. A country that only exports has an index value 1. A country that only imports has an index value –1. The program commodities referred to in this section are composed of paddy rice, wheat, cereal grains, oilseeds, raw sugar, processed rice, and refined sugar. Livestock and meat includes livestock, wool, animal products, meat, dairy. Other includes vegetables and fruits, plant-based fibers, other crops, vegetable oils and fats, other processed food.

<table>
<thead>
<tr>
<th>Year</th>
<th>Program Commodities</th>
<th>Livestock &amp; Meat Products</th>
<th>Other Agr and Food</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1965-75</td>
<td>76-85</td>
<td>86-98</td>
</tr>
<tr>
<td>Aus/NZ</td>
<td>0.95</td>
<td>0.97</td>
<td>0.94</td>
</tr>
<tr>
<td>Japan</td>
<td>-0.94</td>
<td>-0.96</td>
<td>-1.00</td>
</tr>
<tr>
<td>Korea</td>
<td>-0.90</td>
<td>-0.82</td>
<td>-0.90</td>
</tr>
<tr>
<td>USA</td>
<td>0.59</td>
<td>0.78</td>
<td>0.81</td>
</tr>
<tr>
<td>Canada</td>
<td>0.55</td>
<td>0.72</td>
<td>0.76</td>
</tr>
<tr>
<td>Mexico</td>
<td>0.19</td>
<td>-0.87</td>
<td>-0.83</td>
</tr>
<tr>
<td>EU15</td>
<td>-0.74</td>
<td>-0.56</td>
<td>-0.27</td>
</tr>
<tr>
<td>EFTA</td>
<td>-0.91</td>
<td>-0.89</td>
<td>-0.76</td>
</tr>
<tr>
<td>CEU</td>
<td>-0.51</td>
<td>-0.71</td>
<td>0.03</td>
</tr>
<tr>
<td>Turkey</td>
<td>-0.54</td>
<td>0.25</td>
<td>-0.51</td>
</tr>
<tr>
<td>China</td>
<td>-0.17</td>
<td>-0.55</td>
<td>-0.18</td>
</tr>
<tr>
<td>Indonesia</td>
<td>-0.57</td>
<td>-0.88</td>
<td>-0.88</td>
</tr>
<tr>
<td>Vietnam</td>
<td>n.a.</td>
<td>-0.37</td>
<td>0.85</td>
</tr>
<tr>
<td>ASEAN4</td>
<td>0.58</td>
<td>0.49</td>
<td>0.20</td>
</tr>
<tr>
<td>India</td>
<td>-0.58</td>
<td>-0.15</td>
<td>0.43</td>
</tr>
<tr>
<td>RSoAsia</td>
<td>-0.59</td>
<td>-0.16</td>
<td>-0.40</td>
</tr>
<tr>
<td>Argentina</td>
<td>0.97</td>
<td>0.99</td>
<td>0.96</td>
</tr>
<tr>
<td>Brazil</td>
<td>0.58</td>
<td>0.15</td>
<td>0.29</td>
</tr>
<tr>
<td>RLatAm</td>
<td>0.36</td>
<td>0.07</td>
<td>-0.08</td>
</tr>
<tr>
<td>FSU</td>
<td>n.a.</td>
<td>n.a.</td>
<td>-0.63</td>
</tr>
<tr>
<td>MENA</td>
<td>-0.91</td>
<td>-0.97</td>
<td>-0.94</td>
</tr>
<tr>
<td>Tanzania</td>
<td>n.a.</td>
<td>n.a.</td>
<td>-0.40</td>
</tr>
<tr>
<td>Zambia</td>
<td>-0.35</td>
<td>-0.40</td>
<td>-0.40</td>
</tr>
<tr>
<td>R_SSA</td>
<td>0.39</td>
<td>-0.13</td>
<td>-0.17</td>
</tr>
<tr>
<td>ROW</td>
<td>-0.10</td>
<td>-0.43</td>
<td>-0.66</td>
</tr>
</tbody>
</table>

Source: Dimaranan et al. (2003)

Table 2.4 gives an indication of developing countries trading relationship with the developed world. It shows developing countries exports to, and imports from, OECD countries as a share of each countries total. As a group, the OECD countries are big exporters of commodities to countries like China, India and the rest of South Asia (RSoAsia) and the Middle East and North Africa (MENA). These countries are likely to be affected by liberalisation which alters the price of OECD exports. Indonesia, Sub Saharan Africa and China also rely on the OECD countries as export markets for most of their products.
For countries like these which are heavily integrated into OECD markets, liberalisation brings risks and rewards. Producers gain from greater market access, while consumers may lose through higher prices. These effects are discussed in more detail in the next section. However, table 2.3 gives us some indication of their relative importance across countries: many developing countries are net importers of most commodities.

Table 2.4. Share of Developing Country Trade with OECD, 1997
This table reports the percentage of several developing countries’ exports and imports which are traded with the OECD. The program are composed of paddy rice, wheat, cereal grains, oilseeds, raw sugar, processed rice, and refined sugar. Livestock and meat includes livestock, wool, animal products, meat, dairy. Other includes vegetables and fruits, plant-based fibers, other crops, vegetable oils and fats, other processed food.

<table>
<thead>
<tr>
<th>Program Commodities</th>
<th>Livestock and Meat</th>
<th>Other Agr and Food</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exports</td>
<td>Imports</td>
<td>Exports</td>
</tr>
<tr>
<td>China</td>
<td>52</td>
<td>76</td>
</tr>
<tr>
<td>Indonesia</td>
<td>78</td>
<td>58</td>
</tr>
<tr>
<td>Vietnam</td>
<td>13</td>
<td>56</td>
</tr>
<tr>
<td>ASEAN4</td>
<td>40</td>
<td>48</td>
</tr>
<tr>
<td>India</td>
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<td>R_SSA</td>
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<tr>
<td>ROW</td>
<td>62</td>
<td>73</td>
</tr>
</tbody>
</table>


These results, however, have to be taken with some caution. They reflect the pattern of trade flows that result given the highly distorted trade regime. Many developing countries simply cannot compete against the huge subsidies, say, to dairy; if these subsidies were not there, they would become exporters rather than importers.

Moreover, agricultural markets are global markets, and so even if developing country A imports wheat from developing country B, the price it pays is greatly affected by the subsidies provided by the developed world or by trade barriers they might impose against the imports of the commodity.
2.3 Effects of liberalisation

The (national) real income effects of liberalisation are dominated by two factors: (i) the change in allocative efficiency, and (ii) the change in terms of trade (TOT).

Gains from allocative efficiency are realised when market distortions are removed, permitting the economy to reallocate its resources to the most productive use. These benefits accrue largely to the liberalising region itself. They are partially reflected in the huge budgetary savings that accrue to the government of the liberalizing country.

The terms of trade effect comes from changes in a country’s export prices relative to its import prices. The impact of global liberalisation on national terms of trade is usefully decomposed by McDougall (1993) into three separate effects — the world price effect, the export price effect and the import price effect.

Export and import restrictions mean that there is a wedge between the international price and the price that may be received by producers or paid by consumers in each country. A country with an export subsidy faces a higher producer and consumer price than the world price. A country with a production subsidy faces a higher producer price (inclusive of the subsidy) but the consumer price is the world price. A country with an import quota or tariff faces both a higher consumer and producer price. Full liberalization entails eliminating all of these restrictions. Since there are huge subsidies to the production of temperate agriculture products, the world price of these crops would go up. The consumer price would go up less in the EU, which has an export subsidy, than in the United States. Developing countries that protect agriculture would see consumer and producer prices go down relative to the

3 Consumer prices could even fall.
world price, but since the world price has gone up, the net effect is ambiguous.

Making matters more complicated are cross commodity movements. Not all agricultural crops are equally subsidized. The elimination of subsidies would lead to a reallocation of resources within the agricultural sector. It is possible, for instance, that with the elimination of the dairy subsidy, the output of beef cattle could rise, and thus that the price of beef might fall, even though the consumer price of milk products might rise. In general, vegetables are less subsidized than grains, and hence there would be a shift away from grains towards vegetables. Shipping costs are, however, less for grains than for vegetables, and vegetable markets tend to be localized. Thus, even if vegetable prices in developed countries fall, it will have little impact on developing countries.

For a few crops, like sugar, there are quotas. The elimination of the quota would lower producer and consumer prices in the developed countries imposing quotas, and raise international producer and consumer prices. The overall impact on developing countries depends on who receives the quota rents. Even when the rent goes to those in developing countries, it does not seep down to producers.

Differences between production and export subsidies are often exaggerated. A production subsidy of $t_p$ percent in an economy producing $x_p$ raises output by approximately $t_p \frac{\epsilon}{\epsilon+1}$, where $\epsilon$ is the elasticity of supply. The output impact per dollar of subsidy is $t_p \frac{\epsilon}{\epsilon+1} p_x \frac{1}{\epsilon+1}$, and the impact on exports is $\frac{\epsilon}{\epsilon+1} p_x \frac{1}{\epsilon+1}$, where $\epsilon$ is the ratio of exports to total production. On the other hand, an export subsidy raises both the production price and the consumption price, so that output is increased and consumption reduced. The impact on exports is thus $\frac{\epsilon}{\epsilon+1} p_x \frac{1}{\epsilon+1} + (1/\epsilon - 1) \frac{\epsilon}{\epsilon+1} p_c$, where $c$ is consumption. While the impact on developing countries per dollar of subsidy is greater, the difference is small, if the elasticity of demand is small, which is the case for many agricultural commodities.

It is important to recognize that among the “consumers” of agriculture goods is agro-business. While the higher price discourages direct consumption, it also discourages agro-business, shifting it to other countries, including developing countries. Thus, while there remains a presumption that export subsidies are worse than production subsidies for developing countries, there is some question not only about the magnitude, but even about the sign.
2.4 Other impacts of reform on developing countries

There are several concerns about the effects of agricultural liberalisation on developing countries. The effects of Uruguay round liberalisation were expressed at the Marrakech Meeting, where the Ministerial Decision on “Measures Concerning the Possible Negative effects of the Reform Program on Least Developed and Net Food-Importing Developing Countries” addressed the need to provide adversely affected countries with assistance.

(i) Poverty and income distribution

The effect of liberalisation on poverty is difficult to determine, largely for the same reasons that we noted that there was an ambiguity in the impact on developing countries as a whole: consumers lose while producers gain. One problem is that the limited resources of small farmers could prevent them from taking advantage of liberalised markets unless credit facilities are improved.

One of the most significant effects of liberalisation on the poor is felt through changes in the price of food. Andersson et al. (2000) model a general equilibrium framework and find that full liberalisation of OECD farm policies would have a large effect on the volume of international food trade (a 50 per cent increase) but only a small effect on prices (a 5 per cent increase on average). Beghin et al. (2003) find that the price rise is larger for some commodities. However it does not include the effects of reform to non-farm trade and so may misstate the effect in a multisector agreement. But even in this study, the expected price increases are not large – the smallest increases (about 4-6 per cent) are in the wheat, rice, and coarse grains sectors. The effect price increases on poverty is hard to generalise across developing countries and within countries. This is because the relationship between liberalisation and poverty depends on the shares of household income from different factors (land, labor, capital) – the prices of which will change. The size of these changes depends on factor substitutability, factor intensities and factor mobility. The impact of price changes on welfare depends on the relative shares of different goods in the production bundle. Additionally liberalisation could have effects on net transfers including increased welfare,
remittances from distant relatives or changed taxation levels (Anderson 2003).

Despite these difficulties, Anderson (2003) argues that since most of the poorest people are net sellers of food (or at least sellers of agricultural labor) liberalisation would reduce poverty. Increases in the price of food would stimulate production and increase the demand for unskilled farm labor. Because unemployment (both open and disguised) is chronic in developing countries, this in itself would have enormous benefits.

(ii) Food self-sufficiency

Some fear that cuts to protection by OECD countries will lead to unaffordably high international food import bills (Sharma, Konondreas, and Greenfield, 1996).

Table 2.5 shows the proportion of the population that is undernourished in several developing countries (Anderson 2003). The last two columns show the value of food imports as a percentage of total exports and total agricultural exports. Interestingly however, net food importer status (greater than 100 per cent in the last column) is not highly correlated with the FAO’s category ‘Low income food deficit country’ (LIFDC). Botswana, Jamaica and Peru are all net importers but are not classified as food deficient. Also the Cote d’Ivoire, Malawi and Kenya all import less than 20 per cent of their export volume, but are classified as food deficient.

An additional concern is that the liberalisation of agricultural trade would prevent countries from managing external price shocks. However, Zwart and Blandford (1989) argue that liberalisation could lead to less volatile food prices since trade can even out surpluses and deficits across countries with heterogenous production shocks.

But governments may want to intervene to stabilize either producer or consumer prices, especially in developing countries where means for risk absorption are limited. Thus, initiatives at agriculture liberalization should leave scope for developing countries to implement such stabilization schemes.
(iii) Preferential agreements

A final concern is that many of the least developed countries already receive preferential access to OECD country markets. Some of the beneficiaries of these agreements are concerned that their advantages might be eroded under a broader multilateral agreement.

However there are several reasons why multilateralism should be preferred. First preferential agreements harm those countries that are not in the agreement, including many who are very poor. Borrell (1999) discusses this point in the context of the banana dispute of the 1990s in which
one study showed that for every dollar of benefit to producers of bananas in ACP countries, the regime harmed non-ACP developing country producers by a similar amount and reduced the welfare of EU consumers by 13 dollars. This type of scheme does not seem to be a very efficient means of assisting banana producers in ACP countries, who could be directly compensated by gains from removing the preference.

Second, if developing countries only sell part of their production in preferential markets, then they are selling the rest of their output at lower than normal prices because of the depressing effect of OECD protection on prices in the rest of the international market.

2.5 Empirical review

The empirical results below come largely from CGE (computable general equilibrium models).

(i) Total benefits

Hertel et al. (2000) reports simulation results from a reduction from a 40 per cent liberalisation of all types of protection (including production and export subsidies). The real income impacts of these changes are dominated by efficiency and terms of trade effects.

There are significant gains from increases in allocative efficiency. The first column in table 2.6 reports the efficiency gains as a share of food and agricultural value added. Large gains accrue to countries with the most distorted policies, such as Europe, US and Japan. In Western Europe the efficiency gains from liberalisation amount to more than 8 per cent of the entire sector’s value added.

Hertel et al. (2000) add these efficiency gains to the terms of trade effects to calculate a measure of welfare gains, the ‘equivalent variation’ (EV) – which represents the amount of money that would make consumers equally well off had there been no liberalisation. The second column in table 2.6 shows the ratio of efficiency gains to total gain (EV). Where this is greater (less) than 100 per cent the terms of trade effects are negative (positive). For example, India experiences a terms of trade loss. Sub Saharan Africa, Brazil and Latin America experience a terms of trade gain because they are net exporters of food.
The total global welfare increase from a 40 per cent liberalisation of agricultural protection is $70 bn in this study. The distribution of these gains across countries is regressive. By far the largest absolute gains (column 4, table 2.6) accrue to developed countries. Western Europe and Japan who benefit from the reduction in their own subsidies. However, column 3 shows a measure of relative welfare which accounts for the importance of food in GDP in each region. Although the benefits of liberalisation to Western Europe are large, the food sector only represents 5 per cent of GDP. The third column in table 2.6 shows the total gain (EV) as a proportion of expenditure on food in that region. This is one way of representing the benefits of liberalisation relative to the importance of agriculture in the economy. On this category, the largest gains are realised in Other South Asia (non-India), Rest of the World (ROW), and Other Southeast Asia (non-Indonesia), the Other NICs and then Western Europe (Hertel et al. 2000).

For comparison, Table 2.7 shows the results of a second CGE study by Anderson et al. (2000). They estimate that the total welfare gain from the liberalisation of all (i.e. 100 per cent) of agricultural protection is $164 bn. The Anderson study reports the impact of liberalisation by different regions on other regions. It concludes that the farm policies of the OECD countries – after the Uruguay reforms have been accounted for – reduce welfare in developing countries by $11.6 bn. This is a small number in comparison to the gains realised by developing countries as a result of liberalisation in other developing countries ($31.4 bn), and the gains realised by developed countries as a result of their own liberalisation ($110.5 bn). It is also a small number in comparison to the gains predicted from liberalisation in the temporary movement of natural persons. The reason many developing countries do not gain more is not difficult to understand given the structure of these models. Their gains from more efficient resource allocation are offset by an adverse change in the region’s terms of trade.

Moreover, these models simply add up the gains and losses; no note is made of the fact that rural producers may be far poorer than the average person in society; or that those who buy imported food (say wheat) are far richer than

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4 This study is roughly consistent with Hertel et al. (2000) whose predicted $70bn gain was based on a 40 per cent reduction of barriers.
those who live off locally grown crops, like millet. Nor does it take into account any multiplier effects, e.g. the losses in income to producers may have a larger effect on GDP than corresponding gains in income to consumers (e.g. because of differences in marginal propensities to consume.) With unemployment rampant in most developing countries, aggregate demand is often a constraining variable. Nor do these models take into account the impacts of credit constraints: higher prices allow poor rural farmers to buy more fertilizer and higher quality seed, thus providing a further boost to their income. The higher incomes, in turn, may allow other forms of high return investment—including temporary migration into higher paying urban areas. Finally, there is considerable evidence that at very low incomes, productivity depends on nutrition, and the higher incomes accordingly will have a direct impact on agricultural productivity, another effect not incorporated into these models.

(ii) Effect of different instruments

For further comparison, we look at studies which focus on the effects of specific protection mechanisms.

Dimararan et al. (2003) examine the effect of domestic support (not including market access restrictions) in industrialised countries on developing countries. The terms of trade effect dominates welfare outcomes in their simulations, leading them to conclude that a cut in OECD production subsidies would lead to welfare losses in most developing regions. The first column in table 2.9 reports the average world price impacts of cutting domestic support in all industrialised countries for all agricultural commodities by 50 per cent. The table shows that domestic support has the largest effect on price for program crops (wheat, corn, barley, rice) and ruminant livestock (beef). Sugar and dairy, which are mainly protected by tariffs, show small price declines and land and labor shifts out of program crops. The remaining columns in table 2.9 decompose the world price effects by type of domestic instrument: output subsidies, intermediate input subsidies, land based payments, and capital subsidies (including livestock based payments).

The welfare impacts of domestic support reduction arise from allocative efficiency, output stimulus, and terms of trade effects (table 2.10). The two largest agricultural exporters, Argentina and Brazil, gain considerably in each of these categories. For these countries the terms of trade effects are large and positive. However for most developing
In developing countries the terms of trade effects are negative and exceed the allocative efficiency gains. A 50 per cent reduction in OECD domestic support results in a decline in aggregate developing country welfare of $357.3 mn.

Turning our attention to another experiment in partial liberalisation, Hertel et al. (2000) analyse the effect of reductions in border protection (leaving production subsidies unchanged). They report that, not surprisingly, the global gains from this partial liberalisation are smaller than when liberalisation also includes production subsidies: $59 bn rather than $70 bn (table 2.7). However, the additional benefit from including production subsidies accrues entirely to developed countries which reap allocative efficiency gains. Western Europe alone gains an additional $9 bn when production subsidies are included. By contrast, many developing countries are worse off when production subsidies are liberalised because of the terms of trade effect. The Middle East and North Africa and Sub Saharan African countries outside the customs union are significantly worse off as a result of the reduction in production subsidies (table 2.10).

2.6 Conclusion - Analysis of empirical results

The quantitative studies above indicate that the effect of agricultural liberalisation on developing countries is complex. Competing efficiency and price effects have different effects across heterogenous countries.

For the reasons explained earlier, these results should not be taken too seriously. The underlying assumptions of the computable general models do not provide a good description of the economies of developing countries. The results are highly sensitive to assumptions about elasticities and cross elasticities of supply and demand.

Still, there are three lessons that emerge from these admitted highly restrictive studies. The first is that in the process of liberalization, many developing countries will find themselves worse off, and this will be especially so for urban workers. But these adverse effects can be mitigated by adjustment assistance from the more developed countries which at the same time leaves the more advanced industrial countries better off. This is because of the large allocative
inefficiencies associated with the distorted patterns of production.

The second is that a true development round has to go well beyond agriculture. It must include agriculture: it is too important to some of the developing countries; there can be no principled trade agreement without including agriculture; and, not surprisingly, as a consequence, it has taken on enormous symbolic value.

Thirdly the potential for losses does not suggest that multilateral reform should be abandoned. Instead it suggests that to share benefits among all countries, reform must accommodate differences across countries. The case for liberalization is particularly strong for those commodities, like cotton, the elimination of the subsidies for which would have little direct bearing on the standard of living of those in developing countries.

The empirical results surveyed above indicate that uniform elimination of all agricultural protection, would result in negative terms of trade shocks for developing countries and sharp declines in farm incomes in Europe and North America. The latter are in a position to bear the costs; the former may not be. A reform agenda must carefully discriminate between liberalisation instruments. Such an agenda would have three key components.

First, a significant reduction in border protection in developed countries (particularly the EU), including tariff cuts and the elimination of export subsidies. Tariffs on the goods produced primarily by developing countries as well as those consumed primarily in developed countries should be reduced most rapidly. For example the elimination of US and EU quotas and tariffs on sugar and tropical products would increase the price received by developing world producers but only have a small effect on consumer prices in developing countries.

Second, domestic production support for price-sensitive necessities that are widely consumed in developing countries should be reduced gradually, with some of the savings in developed country subsidy budgets being directed at ameliorating the adjustment costs of those in the developing world.. Many developing countries in North Africa, Sub Saharan Africa and Latin America (not Brazil, Argentina or Mexico) rely on imports of subsidised grains and oilseeds from OECD producers. The empirical evidence reviewed above suggests that these countries are particularly
exposed to agricultural reforms which might increase the price of some commodities.

Third, domestic support should be shifted from market price support to alternative payment systems. Reinstrumentation of protection in OECD countries towards the least trade-distorting instruments (such as land based payments) is one possible means of compensating OECD farmers while minimising the impact on developing world consumers. But for reasons stated in the main body of this report, many of the so-called non-trade distorting subsidies do in fact lead to increased production, and too much has been made of the distinction between export subsidies and production subsidies.

This type of program is similar to the thrust of the OECD in its “Positive Reform Agenda” for agriculture (OECD 2002) and supported by a series of recent research contributions.5

A more complete agenda is described in Section V of the main report.

5 Rae and Strutt (2002) compare the welfare gains of liberalisation in border measures and domestic support in a CGE framework. They find that improved market access generates far greater trade and welfare gains than reductions in domestic support. They conclude that the WTO should focus primarily on achieving reductions in border restrictions and deprioritise the elimination of domestic support. Hoeckman, Ng and Olarrea (2002) focus on the effect of OECD agricultural reform on developing countries. They reach the same conclusion that developing countries interests are better suited through tariff cuts rather than domestic support. It is still the case, however, that the elimination of domestic subsidies for certain commodities (like cotton) is likely to have a small effect on consumers in developing country, and a large benefit to producers. There are other crops for which this is also likely to be true. The critical distortion differs markedly across commodities, and their results are highly dependent on assumptions concerning demand and supply elasticities, and therefore the results may differ markedly across commodities. In the case of sugar, it is trade restrictions which dominate; in the case of wheat, it is almost surely production and export subsidies which dominate.
Table 2.6. Change in World Trade Volume
This table shows the change in world trade resulting from a 40 per cent reduction in protection across 3 sectors: Agriculture, manufactured goods, services. AgrMkt40 excludes reductions in production subsidies whereas Agr40 covers all forms of protection. Figures are percentage changes.

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<th>Item</th>
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Table 2.7 Welfare and Efficiency Gains due to 40% Liberalization in Agriculture: 2005
The first column reports the efficiency changes as a share of food and agricultural value added. AgrMkt40 excludes reductions in production subsidies whereas Agr40 covers all forms of protection.

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</table>

Source: Hertel et al. (2000) Table 8, page 27

Table 2.8: Welfare Gains (Anderson et al. 2001)
Sectoral and regional contributions to the economic welfare gains from completely removing trade barriers globally, post-Uruguay Round, 2005

<table>
<thead>
<tr>
<th>Liberalizing Region</th>
<th>Benefiting Region</th>
<th>Agriculture and Food</th>
<th>Other Primary</th>
<th>Textiles &amp; Clothing</th>
<th>Other Manufacturers</th>
<th>Total</th>
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<td>9.0</td>
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<td>14.2</td>
<td>139.7</td>
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<td>High Income</td>
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<td>14.1</td>
<td>55.3</td>
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Source Anderson et al. (2001)
### Table 2.9 Change in Average World Prices due to Comprehensive OECD Domestic Support

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<th>Commodity</th>
<th>World price change</th>
<th>Contribution by Tax/Subsidy to World Price Change</th>
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<td>Int.Input</td>
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<td>srvc</td>
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Source: Dimaranan et al. (2003) Table 10, page 30.

### Table 2.10 Developing Region Welfare Changes: Domestic Support Reform in $ millions

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<th>Equivalent Variation</th>
<th>Terms of Trade Components Region</th>
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3 Services

3.1 Introduction

This section analyses the potential gains from the liberalisation of services.

Services represent an increasingly large share of GDP in both developed and developing countries—but a much larger share in developed countries. Indeed, the area of focus of trade negotiations during the past fifty years, manufacturing, is increasingly becoming the province of developing countries. It is natural, then, that the developed countries like the United States would shift their focus towards liberalization of services.

The bulk of the empirical studies surveyed below suggest that the liberalisation of services could yield significant welfare gains—much larger than the gains from agricultural or manufactured goods. The estimates of global gains are as high as $400bn. The estimates are large because protection levels are high in the service sector, and services make up are a large (and growing) share of world trade. Additionally services are key inputs into the production of almost all goods.

The enthusiasm in the cross-country empirical literature is tempered by negative experiences at the national level. Opening up markets has been accompanied at times by a reduction in competition, and an increase in prices, in the case of financial services, there are even allegations that the supply of credit to medium and small domestic enterprises has been reduced. Financial and capital market liberalization has been associated with greater instability, not higher levels of economic growth. These adverse

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6 For example, privatisation of utilities – such as South Africa’s experience of granting its newly privatised telecommunications utility Telekom a 5 year monopoly – can lead to inefficient services (OECD 2002). Similarly the poor regulation of financial sectors across South East Asia contributed to instability prior to the crises of the late 1990s. Poor electricity deregulation has led to problems in many countries.
consequences help, in turn, to explain the unhappiness that many countries have about efforts to force further opening up of the service sector.

It is easy to explain the discrepancy between the “models” and the outcomes. It is partly that, as deficient as the models used to analyze the consequences of agricultural liberalization are, those in the area of services are far worse. They model trade in services in exactly the same manner that they model trade in goods, and thus the models have all the problems we noted earlier. But in addition, there are several further problems. There are some formal barriers to trade: the United States does not allow coastal shipping by ships of another nationality. There are restrictions on media ownership. Foreigners may not buy spectrum, and if they cannot buy spectrum, they cannot provide broadcasting services except by selling services to Americans who own stations. But many of the barriers to trade are more subtle, and are typically hard to quantify. Because the estimates of the government created trade barriers are unreliable, so are the resulting estimates of the benefits that would accrue from eliminating them. Worse still, debates about liberalization in services do not center around discussions of lowering the effective barrier from say 40% to 20%; rather, they center around particular measures, such as privatization, elimination of particular regulations, etc. In each of these cases, the ramifications of the particular measure extend well beyond the impacts on trade; in many cases, these are incidental. Inevitably, then, debates about service sector liberalization devolve into fundamental debates about national economic and social policy. Should the media, for instance, be controlled by a few rich, foreign firms, who are able to use their wealth to control the flow of information to the citizenry? This is an issue which is fundamental to the functioning of democracy, and should not be relegated to trade negotiators to settle. (At the same time, we should recognize that there are certain service sector liberalizations which are little different in their impact than a standard trade liberalization; such is the case for construction and maritime services—areas which were not included in the Uruguay negotiations, and which are of some concern to developing countries.)

Part of the reason that the standard models are unpersuasive arises from the fact that they fail to take account of the highly differentiated nature of services, and the large “local information” content. There are other ways in which trade in services are obviously different from trade in goods. For the most part, services have to be consumed at the point of
production. In the case of haircuts, the point is obvious. But the same is true for retail sales, hotels, electricity. Thus, the issue of the trade in services in inextricably linked (as already noted) to the movement of capital and labor. Without these, there can be little trade in services.

But movements of labor and capital introduce a host of other considerations, quite different from those associated with trade in goods. The issues of labor—which are of vital concern to developing countries—are dealt with in the next section. The central issue of concern for capital flows are investor protections. What the investors would like, of course, is a world without regulation or taxation, but that would compromise the general well being of the developing world. Indeed, most of the failures of liberalization have been because of a failure to put into place an adequate regulatory environment (including one which ensures competition.)

Economic theory, of course, says that, under certain idealized circumstances (e.g. constant returns to scale) full global efficiency can be gained either through the free mobility of capital or the free mobility of labor. But in the general case, equating the marginal returns to capital will not suffice to equate the marginal returns to labor.

What do international firms provide when they provide services? Why might an American company have a competitive advantage in financial services over a domestic company? Presumably, this relates to knowledge and information, e.g. about how to organize the provision of the services.

There are, in fact, a variety of ways by which such services are sold, besides direct investment. Hotels and restaurants issue franchises, which have been enormously popular. Firms may contract out management services.

Of increasing concern in recent years in the United States is the problem of “contracting out” services through the internet. This is one area in which production of a service can occur at a place different from that where the service is consumed. Such services are, in many ways, very much like traded goods. It is of importance to developing countries that this nascent industry not be impaired, by the creation of new trade barriers by the developed countries.

Impact on poverty. A further concern is that many service sector liberalizations increase poverty, by increasing prices of essential services or reduce access for the poor. Private
Services

firms may be less willing to engage in cross-subsidisation of market segments in poor and rural areas. Even if liberalisation leads to lower average costs through increased competitiveness and efficiency, prices for some end-users may rise. Mosely (1999) estimates that the impact of financial liberalisation on access to rural credit in four African countries – Uganda, Kenya, Malawi and Lesotho. The study found that liberalisation expanded credit where it was accompanied by innovative reforms with regulation focused on rural access and poverty reduction. However merely privatising government micro-credit agencies had a negative effect on rural areas, as witnessed by the consequences of reform in Malawi.

Impact on communities and cultural identity. There is also a concern that some service sector liberalizations, even if they increase economic welfare, narrowly defined, have an adverse effect on community life. Each individual in the community values having the local store; the local store owner, like other local businessmen, provide essential services for the community. But these are services that are not “priced.” It pays each consumer to buy the goods for the lowest price. Walmart is thus able to drive out of business the local store. But there are fundamental questions: is the community better off, with the local businessman replaced by a hired manager, that is rotated in and out of the community in three years time?

3.2 Patterns of trade and protection

Services sectors account for half of GDP in developing countries (60 per cent in developed countries) and are some of the fastest growing industries in many economies. The performance of the services sector is critical to growth. For example, the strength of a countries financial sector is a determinant of growth (Levine 1997, Carlin and Mayer 2003). Well-managed and well-regulated banks lead to an efficient transformation of savings to investment, ensuring an appropriate allocation of resources. Similarly, efficient business services reduce transactions costs and telecommunications capabilities are an important prerequisite for development in many sectors.

(i) Modes of supply
The GATS framework provides for 4 modes of service delivery:

- **Mode one:** *cross-border supply*, which is analogous to trade in goods; arises when a service crosses a national frontier, for example, the purchase of software or insurance by a consumer from a supplier located abroad.

- **Mode two:** *consumption abroad*; occurs when the consumer travels to the territory of service supplier, for example, to purchase tourism, education, or health services.

- **Mode three:** *commercial presence*; involves foreign direct investment, for example, when a foreign bank or telecommunications firm establishes a branch or subsidiary in the territory of a country. Figure 3.1 indicates that the stock of service sector FDI in developing countries is small relative to OECD countries. However as the right-hand panel indicates, service sector FDI is growing more rapidly in developing countries, with the exception of Sub-Saharan Africa.

**Figure 3.1 FDI in services**

Source: OECD (2002)
• Mode four: movement of individuals; occurs when independent service providers or employees of a multinational firm temporarily move to another country. This mode will be discussed separately in another section.

These four elements of the General Agreement on Trade in Services (GATS) encompass the movement of both capital and labor for services provision. This broad approach enables countries to bargain to exploit their comparative advantage. For example developing countries might exchange greater market access for capital for more fluid movement of unskilled workers to developed countries. Figure 3.2 shows that the existing commitments have been lopsided, with the development of mode 4 proceeding most slowly.

Figure 3.2 Full and partial market access commitments under GATS

The upper part of each bar represents partial commitments, the lower part full commitments. DC = Developed countries; LDC = Developing and transition economies; AC = Accessing countries

Source: OECD (2002)

(ii) Protection
International service transactions remain heavily protected in many countries. Table 3.1 estimates the tariff equivalent protection levels for the construction services, business and finance, trade and transport, and government services sectors across various countries and regions. These are taken from estimates by Francois (1999). The estimates are based on predictions of the level of bilateral services trade with the US. Discrepancies between the actual level of bilateral trade (from US trade data) and the predicted level are assumed to result from protection. The estimates for the trade and transport, and the government services sectors are taken from Hoekman (1995).

Table 3.1 indicates that impediments to trade are quite high in trade and transport, government services and construction and that barriers to trade in services are much larger than barriers to trade in manufactures and extraction industries. Findlay and McGuire (2003) report that impediments to international services tend to fall as income rises, except in some professional service activities. This is indicated in figure 3.3.

Table 3.1 Average Rates of Protection
This table reports estimated levels of average protection by region and sector in 2005. In services these are tariff equivalent rates. For example in China, the figures below suggest that import prices in the construction industry must be 41 per cent above their free trade level to explain the relatively low share of imports in this market.

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<th>Region</th>
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<th>Manufactures</th>
<th>Services</th>
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<td>Trade &amp; Transport</td>
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</tr>
<tr>
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<td>20</td>
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<tr>
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<td>OthSSA</td>
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</tr>
<tr>
<td>ROW</td>
<td>76</td>
<td>33</td>
<td>46</td>
</tr>
</tbody>
</table>

One has to be careful, however, about interpreting this data, which refers primarily to mode 1 impediments. There are some service sectors—like haircuts—that are typically small businesses. Without mode 4 liberalization, there is likely to be little cross border sales of these services, even though standard economic theory would suggest that there would be large gains to trade. Services are highly individualized, often requiring large amounts of localized information. Thus, even with no artificially created barriers, individuals in one country may prefer to deal with those from their own community; and those from their own community may be able to provide the services that individuals want. Local banks may have a competitive advantage in knowing who are good borrowers (an advantage which may more than offset the problem of correlated risk.) Large multinationals, geared to providing services to those in advanced industrial countries, may find it difficult to provide the services demanded in poor developing countries. In short, there are reasons to believe that even apart from artificially created barriers to trade in services, such trade might be more limited than trade in manufactured goods. In that case, even though the service sector is today larger than the manufacturing sector in developed countries, potential gains from trade, and the reductions of trade barriers, may be more limited.

Moreover, one has to distinguish protection from the legitimate role of government in imposing regulations that promote a variety of concerns of general interests, even when such regulations have the effect of discouraging foreign firms. For instance, affirmative action requirements might have the effect of discouraging foreign firms, yet it is a legitimate objective of government policy to advance the economic well being of the disadvantaged.

Figure 3.3 Service sector openness by region: financial services and telecommunications

The openness index for telecommunications captures the degree of competition, restrictions on ownership and the existence of an independent regulator (ITU-World Bank database for 1998). The index for financial services captures the restrictions on new entry, foreign ownership and capital mobility (IMF’s Annual Report on Exchange Arrangements and Exchange Restrictions).
3.3 Potential gains and costs of liberalisation for developing countries

Inefficient service industries operate like a tax on an economy. Since services are essential production inputs for most goods, the price and quality of services provided to other producers have major impacts on the whole economy. This is particularly true in key service industries such as telecommunications, transport, energy and finance.

For this reason the majority of gains from effectively managed reform accrue to the liberalizing region itself. Domestic firms benefit from access to services at lower prices; consumers gain; employees in most service industries earn higher wages than in manufacturing (OECD 2002).

This poses two questions: First, if the benefits of liberalization are so great to the country liberalizing, why does one need to include such liberalizations within a trade agreement? Won’t countries have an incentive to do that on their own. The answer traditionally put forward is that it is part of the political economy of trade liberalization: one gives up something of value to the other side (refusing at the same time to do something that would be of even greater value to oneself) in order to extract a concession out of the other side. The problem with this argument, in the
context of services, is that typically the advanced industrial country *as a whole* has relatively little to gain, though particular firms in the developed country may gain a large amount. Thus, in the area of services, one is pandering to special interests. Pandering to special interests in not only bad economic policy, it is dangerous; because after the foreign firm comes in, the company continues to put pressure on its government to put pressure on the foreign government to pass legislation or regulations that are to its benefits, to renegotiate concessions, when they prove unprofitable, not to abrogate a contract, even when there is clear evidence that the contract was only entered into because of corruption.

The reason that particular firms have much to gain, though not necessarily countries as a whole, is associated with the very reason that there are gains to trade in services: these arise not out of the standard differences associated with differences in factor supplies (after all, most of the production actually occurs in the purchasing country) but out of differential information and knowledge, including organizational capacity. If that information is widespread within a society, it is more likely that that information can easily flow abroad, especially so in our highly interconnected global economy. Walmart, Toys-R-Us, AIG have certain strengths that may not (or, in some cases, may) be easily imitated. When hard bargaining by the U.S. allowed Toys-R-Us to open up in Japan, Japanese children benefited from the cheaper toys, as did Chinese workers, as China's sales of toys increased. But America benefited only to the extent that Toys-R-us profits increased. American jobs were essentially unaffected.

The second, related issue is why *should* these liberalizations be part of an international trade agreement. Such agreements should focus on areas where there is a *global public good* being provided, e.g. through the setting of standards or where there are global externalities.

3.4 Review of empirical results

(i) Methodology
For agricultural and manufacturing, most models report results dominated by two main effects – allocative efficiency gains and changes in terms of trade.

For services liberalisation, movements of capital across borders generate additional effects. Firstly, foreign direct investment inflows and outflows can lead to an expansion or contraction in the capital stock located within a region. Changes in capital endowments affect national output, but since the capital is still owned by foreigners, the effect on GNP is less than on GDP.

A second effect on income works through the rents earned on foreign direct investments. Rents are created by barriers to services trade which fall during liberalisation. It is conceivable that service sector liberalization could increase GDP but lower GNP, as domestic providers of services lose their rents, foreign firms capture rents associated with their superior knowledge and information, and the gains to others from the more efficient provision of services are less than the losses in domestic rents.

(ii) Modelling results

Unlike in agriculture, the modelling, which focuses on the benefits resulting from assumed gains in the efficiency of the provision of services, suggests that the main beneficiaries of reform in terms of both absolute and relative (% GDP) welfare gains are the developing countries.

Dee and Hanslow (2000) use a CGE model called FTAP, to report that the total global gain from liberalising all post-Uruguay trade restrictions on services is $130 bn.\(^7\) This amounts to half the total gain ($260bn) from total post-Uruguay liberalisation – with the other half being made up of gains from agriculture ($50bn) and manufactures ($80bn). These are the projected gains in real income about 10 years after the liberalisation has occurred. They include the gains from increased trade and more efficient resource allocation.

In a similar exercise by Hertel (1999), world welfare gains were predicted to me smaller than those in Dee and Hanslow (2000). Hertel predicts that the gains from liberalisation in agriculture, manufactures, and services are 164bn, $130bn and $55bn respectively. This variation is

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\(^7\) Welfare gains are reported in standard CGE ‘real income’ terms. Real income is a measure of national income deflated by an index of national prices.
largely accounted for by differences in modelling assumptions. In agriculture, Hertel assumes no effective Uruguay liberalisation post-1995, leaving much more to be done and more gains to be realised. In manufactures, the difference is largely accounted for by differences in the base year (Dee and Hanslow use 1995; Hertel uses 2005). Applying the 2005 base to the FTAP model makes up 90 per cent of the difference. In the service sector, Hertel models only liberalisation in the construction and business services sector. He also does not include liberalisation of FDI.

Brown, Deardorff and Stern (2002) use a CGE model to calculate the welfare effects of a 33 per cent reduction to barriers in the service sector. Table 3.2 shows that they expect global welfare to rise by $413bn. All of the countries listed experience welfare gains as well as increases in real wages and returns to capital. Developed countries experience large welfare gains – $142bn for the EU, $131.4bn for the US, and $57.9 for Japan. However developing countries also large, and in many cases larger relative shares of the benefits. Brown, Deardorff and Stern (2002) note that their results - which are dependent on the accuracy of the size of barriers they estimated indirectly from trade flow data – show that the liberalisation of services is likely to yield significantly larger gains than other reforms.

Hertel, Anderson, Francois and Martin (2000) also compare the gains from services liberalisation to agriculture and manufactures. They report that a 40 per cent cut in protection in the business services and construction sectors yield a $22bn gain. Their estimates of the potential gains in the trade and transport sectors are $332bn. The trade and transport sectors represent a large share of global trade in services and have significant flow on benefits to other sectors of the economy. Table 3.3 shows the wide distribution of these gains across developed and developing countries.

Verikos and Zhang (2001) analyse the sectoral impacts of liberalisation in financial and communication services. They estimate the gain from each sector is $24bn. In both sectors, the majority of the gains come from removing restrictions that discriminate against foreign firms.

(iii) Distribution of gains across countries

These gains are not of course divided equally across all countries. In Dee and Hanslow’s analysis, their $133bn gain accrues disproportionately to developing countries. The
service sectors in many developing countries are projected to expand as their relatively large barriers to entry are removed. For example, the service sector in China (which captures a large part of the welfare gains) is projected to increase by a third when its large barriers to entry are removed. This is predicated, of course, on the assumption that China cannot obtain the requisite knowledge and information to improve its service sector without opening itself more fully, an assumption which is increasingly looking dubious.

Dee and Hanslow report results for only a small number of commonwealth developing countries. The gain to Malaysia from global service sector liberalisation is $1bn – equivalent to 0.7 per cent of GDP. The gains to the ‘rest of the world’ which includes smaller developing countries is $23bn or 0.8 per cent of GDP. Australia, China, Mexico, Chile and Indonesia all gain more from tertiary liberalisation than from primary and secondary combined.

### 3.5 Conclusions

Service sector liberalisation has the potential to deliver large welfare gains to developed and developing countries. But the results of attempts to estimate these benefits need to be taken with even more caution than results in agriculture and manufacturing. The localized nature of the services and the information that leads to success in its provisions means that the elimination of government imposed barriers may not necessarily lead to as much increase in trade as these models predict, and the gains in efficiency may be partially offset as rents are transferred from domestic to foreign producers. Some worry that financial service sector liberalization may even lead to a reduction in national output, as the supply of credit to domestic small and medium size enterprises is reduced. Empirical work estimating these effects is limited, and most of the CGE models simply proceeds by assuming that the production and sales of services is little different than those of agriculture and manufactured goods. Thus to the litany of qualifications to the use of CGE models noted earlier, the additional ones noted here mean that the results need to be taken with circumspection.

Since a large part of the gains from reform in the services sector accrue to domestic policy reforms, it is not obvious why international negotiations are necessary to achieve
desirable outcomes. If the main gains could be achieved unilaterally, then what is the utility of multilateral negotiations? Matoo (2002) observes that many developing countries are in a situation where their ability to implement reform is hindered by opposition from domestic lobbies. In this context, it may be useful for some countries to undertake reforms in the context of the momentum of broad international negotiations.

There are however other areas where co-ordinated reciprocity could yield significant gains in the context of multilateral negotiations. On one hand developing countries have a number of developed country market access interests, particularly in the area of access to labour markets (GATS Mode 4), but also in construction and back-office business services. This suggests the prospect for a deal based on access to labour markets in exchange for a developed country demand such as greater commercial presence by foreign service providers in developing countries (Matoo 2002). But the shape of earlier service sector negotiations undermined this rationale; financial sector liberalization, for instance, preceded liberalization in construction and other service sectors that were of interest to developing countries.

Moreover there are several cases in which international cooperation may be valuable. One example is competition policy: a permissible merger in one jurisdiction may have a detrimental effect on competition in a smaller foreign jurisdiction. Fink, Matoo and Rathindran (2001) suggest that the GATS should require domestic competition law to consider the effect of collusive agreements on foreign markets. Second they suggest the foreign consumers should have the right to take actions in foreign courts against corporations that abuse their market power.
This table shows the effects of a 33% reduction in barriers to service trade on imports, exports, terms of trade, welfare, real wages and the return to capital.

<table>
<thead>
<tr>
<th>Country</th>
<th>Imports (Millions)</th>
<th>Exports (Millions)</th>
<th>Terms of trade (Percent)</th>
<th>Welfare (Percent)</th>
<th>Welfare (Millions)</th>
<th>Real Wage (Percent)</th>
<th>Return to Capital (Percent)</th>
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<tr>
<td>Australia&amp;NewZealand</td>
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<td>1.050</td>
<td>5379.6</td>
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<td>0.811</td>
<td>5910.4</td>
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<td>0.316</td>
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<td>EuropeanUnionandEFTA</td>
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<td>1.295</td>
<td>142003.2</td>
<td>0.553</td>
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<td>57875.1</td>
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<td>131426.8</td>
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<td>0.534</td>
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<td>5643.1</td>
<td>5.638</td>
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<td>2470.8</td>
<td>4.821</td>
<td>3.972</td>
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<td>5227.2</td>
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<td>130621.8</td>
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<td></td>
<td>413695.4</td>
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</table>

Source: Brown, Deardorff, Stern (2002), table 4
Table 3.3 Welfare and Efficiency Gains
The first column reports the efficiency changes due to a 40% liberalization in agriculture as a share of food and agricultural value added. The second column reports the efficiency gain as a proportion of the total gain in terms of equivalent variation (EV)– where this is larger than 100, the terms of trade effect is negative. Column 3 reports the EV as a proportion of total expenditure. Columns 5-8 report the EV for 5 different sector liberalization experiments.

<table>
<thead>
<tr>
<th>Region</th>
<th>Agr/$VA</th>
<th>Eff/EV</th>
<th>EV/Exp</th>
<th>Agr40</th>
<th>AgrMkt40</th>
<th>Manuf40</th>
<th>BusFinSvces</th>
<th>T&amp;Tsvces</th>
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</tbody>
</table>

Source: Hertel et al. (2000) Table 8, page 27
4 Temporary migration

4.1 Introduction

The GATS recognises four modes of service delivery. The temporary movement of natural persons (TMNP) is known as Mode 4. It is by far the smallest in terms of trade flows and the volume of scheduled concessions recorded under the GATS (figure 3.2).

The limited commitments that have been made refer to high-skill personnel – business executives etc. – whose mobility is closely linked to foreign direct investment and is an issue of interest to business lobbies in developed countries. Thus far Mode 4 has not progressed in a way that allows developing countries to use their comparative advantage in low and medium skill labor-intensive services.

The empirical studies surveyed below suggest that an expanded Mode 4 could generate enormous welfare gains. The temporary movement of less skilled workers from developing countries (where they are in oversupply) to developed countries (where they are relatively undersupplied) is estimated to increase world welfare by hundreds of billions of dollars, even if the scale of the labor flow was modest.

4.2 Potential gains and costs from liberalisation

The movement of natural persons is usefully divided into three categories.

(i) Flows from Developed to Developing

This category represents highly skilled technical or managerial workers who work in developing countries either providing specialised services such as consulting and legal advice or fulfilling senior management roles in foreign-owned firms. This is a widespread practise which aids the
management of multinational firms and supplies useful skills to firms in developing countries.

(ii) Skilled flows from developing to developed

The emigration of skilled workers from developing countries is actively encouraged by developed countries and provides clear gains to them. Over 30 per cent of all doctors and nurses in the British health care system were born outside the UK. The same is true for more than 12 per cent of academic staff in British Universities.

From the perspective of developing countries, this flow is better known as the ‘brain drain’. The loss of skilled local workers deprives the country of the various economic and non-economic spillovers. The brain drain reduces total output, diminishes the competence of domestic high skill sectors, and erodes the tax base. To the extent that these skilled workers are complementary with other factors of production, such as unskilled labor, the emigration of these skilled workers leads to lower incomes for these other factors. Desai et al. (2001) point out that the one million Indians living in the United States account for just 0.1 per cent of India’s population but earned the equivalent of 10 per cent of India’s national income.

On the other hand, the temporary emigration of skilled persons can benefit developing countries in several important ways. First, the possibility of temporary migration for skilled workers may increase the returns to education in the source country, inducing more investment in human capital. Commander Kangasniemi and Winters (2002) argue that this leads to an increase in skilled workers in the domestic economy (even taking account of those that migrate out) which partly offsets the direct effects of the brain drain.

Second, remittances from workers in developed countries back to their families are an additional benefit of migration (Massey et al. 1998). Remittances are an economically significant transfer for LDCs. In 2002, the Inter-American Development Bank reported $32bn in remittances sent to the countries of Latin America and the Caribbean. This was far greater than total ODI and only slightly less than foreign direct investment (Ellerman 2003). (Though impressive in size, it is worth being circumspect about the potential for remittances to generate sustained development. Martin and Straubhaar (2001) argue that income from remittances is potentially less valuable than income from newly
established local enterprises, or export earnings because the domestic spillovers may be smaller.)

Additionally there is evidence that national diasporas are an important source of growth. For example, the 50 million Chinese living abroad have been remarkably beneficial to the Chinese economy. They are a source of business experience, network connections, and capital.

(iii) Unskilled flows from developing to developed

The movement of unskilled workers to developed countries offers the greatest gain because it is associated with the largest difference between factor prices and the largest scope for movement, measured as number of willing people. It is also however the subject of the greatest concern in developed countries.

Developed countries experience benefits and costs from unskilled migration. Foreign workers are an important source of labor in developed countries. London’s catering industry depends on migrants for 70 per cent of its labor force and a large proportion of seasonal agricultural workers are foreign (Home Office 2000).

Opposition to unskilled labor flows comes from the fear that foreigners displace local workers and contribute to unemployment. A study by the British Home Office (2000) examines the widely held perception that immigration is detrimental to native workers. It concludes that unskilled workers often fill jobs in low paid and insecure industries. In many cases these are jobs that native workers are unwilling to accept. In these jobs, foreign workers are filling labor market gaps rather than displacing native workers. Where migrants move in to industries with unfilled vacancies, their presence has little effect on either employment or wages of domestic workers.

Even in industries where migrants are competing with domestic workers, the effect is not much different than the impact of labor-intensive imports of foreign goods on domestic manufacturing.

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8 Such concerns are, of course, not consistent with the CGE models, which typically are based on full employment.
4.3 Empirical review

In an early study, Hamilton and Whalley (1984) suggest that if labour were free to move between countries sufficiently to equalise wages around the world, world output would rise by more than 150 per cent.  

Even using the more conservative assumption that part of the cross-country difference in wages reflects productivity differences which persist irrespective of location – e.g. health and education – the gains are large. Winters, Walmsley, Wang and Grynberg (2002) assume that workers from poor countries are naturally only one third as productive as workers in developed countries. They estimate the gain from full labor mobility to be 70 per cent of world GDP.

Obviously full labor mobility is an extreme and impractical assumption. Winters (2000) estimates that even relatively modest increase in labor mobility would increase world welfare by $300 bn. This study assumes that fifty million additional workers from developing countries be permitted to work in developed countries. Winters assumes that when workers move from a low to a high wage country, they make up one quarter of the wage gap, i.e. three quarters of observed wage gaps are due to persistent differences in productivity.

These rough estimates have been subsequently corroborated by Winters et al. (2002) using a general equilibrium model. They find that if developed countries allowed temporary workers from developing countries to increase their workforces by 3 per cent (8 million skilled and 8.4 million unskilled), world welfare would increase by over $150 bn. Winters et al (2002) use the GTAP model and database developed by Hertel (1997). They assume that temporary workers make up half the productivity differences between their home country and their host country when they move.

The initial residents of developing countries (which are labor exporting) gain most from the increase in migration. Their share of the total gain is approximately $80bn, more than developed countries and a significantly larger fraction of their income. The largest part of this increase accrues to

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9 Assumes an elasticity of substitution between factors of 1.
Temporary migration

accrues to temporary migrants themselves. In several developing countries Winters et al. (2002) find that the remaining residents of developing countries generally experience a loss in welfare. Despite increases in remittances and an improvement in their terms of trade (as the fall in GDP reduces the supply of their goods), the decrease in labor supply leads to a fall in the return to other factors which outweighs these gains.\textsuperscript{10} However for many commonwealth countries including India, South Asia and South Africa, the welfare of permanent residents increases. For these underdeveloped countries, the increase in remittances outweighs the decline in labour and capital income. Remittance income increases the demand for domestic goods and allows the real wages of both skilled and unskilled workers to rise. The welfare of permanent residents in India and the rest of South Asia increases by $16 billion and $350 million respectively. In South Africa, the welfare of permanent residents increases by $82 million, while the welfare of temporary migrants increases by $4.4 billion.

4.4 Conclusion

The substantial benefits estimated to be available to developing countries from the liberalisation of temporary migration for the unskilled—related to the huge differences in wages in developed and less developed countries—suggest that this is a promising area of reform. The global efficiency gains too are probably an order of magnitude greater than those associated with capital market liberalization, which has been the subject of so much attention. Unskilled workers in developed countries have, not surprisingly, been worried about the effect of the migration of unskilled labor on their wages, and have so far been effective in limiting the extent of migration. (On the other hand, business interests in developed countries have been successful in allowing migration of skilled workers; this may be partially because unskilled workers have thought that such workers are complements, and thus they too will benefit. But such skilled labor migration is of

\textsuperscript{10} This result obviously is based on the assumption that the migrants are not unemployed unskilled workers, or that there is not an equilibrium level of unemployment.
ambiguous benefit to the developing world.) Winters et al. (2002) suggest that one possible way forward is to include existing foreign worker schemes under the GATS by scheduling them and subsequently extending them. Many countries already have short-term foreign worker schemes for low skilled jobs in agriculture, tourism and construction.

A second approach is to focus on subcontracting schemes in future Mode 4 negotiations. Restricting the movement of people to existing employees of incorporated firms avoids many of the problems of mobility for individual workers (but also limits the scope of benefits). The pre-employment guarantee ensures that the workers will arrive with a job and increases the likelihood of their return after completion of the project. Where firms are responsible for their staff, they can provide housing, health and insurance, etc. These services may reduce the costs of mobility for some workers.

However there are also many disadvantages associated with sub-contracting. First, many service transactions are not appropriate for sub contracting. Limiting mobility to transactions that are suitable for provision by sub contractors obviously diminishes the potential gains from liberalisation of migration.

In spite of the huge barriers that developed countries have imposed to the movement of unskilled labor, the economic forces leading to such migration is so large that large amounts still occurs, in spite of the barriers, and the developing countries have received large benefits, e.g. as a result of remittances. The developing countries have an interest in facilitating the flow of these remittances and in improving the rights and living conditions of the migrants (many of whom are illegal.) These issues would be high on an agenda for a development round of trade negotiations centered around the concerns of the developing countries.
5 Manufacturing

5.1 Introduction

The Doha Ministerial Conference agreed to launch tariff-cutting negotiations on all non-agricultural products. The aim is to “reduce, or as appropriate eliminate tariffs, including the reduction or elimination of tariff peaks, high tariffs, and tariff escalation, as well as non-tariff barriers, in particular on products of export interest to developing countries.”

Significant progress on tariff reduction has been made in several sectors. The empirical evidence below suggests that this reform has been accompanied by an increase in the share of manufactured goods in world trade and in the share of manufactured goods in developing country exports.

However, several studies suggest that the potential gains from the Doha Round might be larger than those realised as a consequence of Uruguay Round reform. This may be because the Uruguay Round was tilted against developing countries.

The reduction in tariffs peaks on goods of interest to developing countries and the reduction in protection on south-south trade are promising areas for reform.

5.2 Patterns of trade and protection

While the average rate of agricultural protection in OECD countries has risen in the last 3 decades, manufacturing protection levels have fallen. Average tariffs on industrial goods imported into the OECD countries fell from around 40 per cent in 1950 to 1.5 per cent in 1998 (Hertel 2000).

Figure 5.1 shows that there has been over the same period a shift in the composition of global export towards manufactured products, while the share of agricultural products has fallen.
This trend is particularly strong in developing countries. Figure 5.2 shows that in the last 40 years, the share of agriculture in total developing country exports has fallen from 45 per cent to less than 10 per cent, while the share of manufactures has risen from 23 per cent to 79 per cent.
(i) South-North Trade

Despite their export shift from agriculture to manufactures (figure 5.2 above) and their increasing share of the world trade in manufactures (figure 5.3 below), developing countries as a group are still net importers of manufactured goods and net exporters of agricultural goods.

Figure 5.3 Developing countries share of world trade

![Graph showing developing countries share of world trade]


Figure 5.4 shows that developing countries have succeeded in increasing the quantity of manufactured goods they provide to major developed economies. However even in the last period reported (1995) the shares were low, ranging from just over 3 per cent in Japan to under 7 per cent in North America.

Figure 5.4 Selected developed country imports from all developing countries (% of consumption)

![Bar chart showing selected developed country imports]

Source: UNCTAD (1996)
Aggregate data hides the existence of tariff peaks, which may restrict access to developing countries products. For example, in the processed food sector, Canadian, Japanese and EU tariffs on fully processed food are 42, 65 and 24 per cent respectively. By contrast, the least processed products face tariffs of 3, 35, and 15 per cent in the same countries. Partly because of these trade restrictions, the penetration of developing country processed food has been limited (World Bank 2002).

(ii) South-South Trade

Notwithstanding tariff peaks, developing countries goods are subject to much higher barriers in other developing countries than in OECD countries. Table 5.1 shows that developing countries face average manufacturing tariffs of 12.8 per cent in other developing countries but just 3.4 per cent in developed countries.

Table 5.1 Average manufacturing tariff rates
This table reports the average tariff rates faced by high and low income countries on their own and each other’s goods.

<table>
<thead>
<tr>
<th>Exporting region</th>
<th>Importing region</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>High-income</td>
</tr>
<tr>
<td>countries</td>
<td>countries</td>
</tr>
<tr>
<td>High-income</td>
<td>0.8</td>
</tr>
<tr>
<td>Developing</td>
<td>3.4</td>
</tr>
<tr>
<td>World</td>
<td>1.5</td>
</tr>
</tbody>
</table>

*Source: Hertel and Martin, 2000*

Figure 5.5  Average MFN tariff on manufactures (1995 & 2005)

Source: Hertel (2000)
Figure 5.5 shows the average MFN tariff on manufacturing by importer in 1995 and 2005 (Hertel 2000). The highest tariffs are in developing countries, particularly India, China and Other South East Asia.

5.3 Empirical review

Brown, Deardorff and Stern (2002) use a CGE simulation model to test the effects of trade liberalisation in manufactures. In their model domestic consumers respond to reductions in protection by purchasing more imported goods. Industrial sectors in each country expand or contract depending on whether their protection is reduced by more or less than in other countries. Countries with larger than average tariff reductions experience a real depreciation of their currency to maintain a constant trade balance. Welfare in their model is determined by the effect of these changes on allocative efficiency and each country’s terms of trade. The authors also incorporate non-tariff barriers. These generate rents to the preferred exporters, which are lost upon elimination. Thus the effect of liberalisation may not be positive for all exporters.

Brown, Deardorff and Stern (2002) initially apply their model to the Uruguay Agreement on manufactures. They estimate the welfare gains resulting from a scenario in which all countries reduce their tariffs as per the Agreement. Table 5.2 shows that global welfare increases by $56.5 bn and the gains are shared across all countries. The largest welfare increases in absolute terms accrue to the European Union ($17.4 bn), however large relative gains – expressed as a share of GDP – accrue to the Rest of South Asia, the Philippines, and Malaysia.

Brown, Deardorff and Stern (2002) follow this simulation with an estimation of the welfare gains available in the Doha Round (table 5.3). They present the results of a 33 per cent reduction in post Uruguay Round tariffs. They estimate that the potential gains from the Doha Round ($163.4bn from a 33 per cent reduction) are significantly larger than those realised in the Uruguay Round (table 5.2). In particular, most developing countries gain significantly more

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11 This is the kind of effect which is often ignored in popular discussions of trade liberalization, but is absolutely essential when attempting to appraise the true (general equilibrium) effects.
as a share of GDP than they did in the Uruguay round. The authors suggest that this may be because the Uruguay round was tilted against developing countries.

Hertel et al. (2000) use the GTAP model of global trade to make similar estimates about the welfare gains from a 40 per cent liberalisation of post Uruguay tariffs on manufactures. They find that the global gain is in the region of $70bn, roughly the same size as the gains they predict from agriculture. Table 5.4 shows that developing countries get a much larger proportion of the gains from liberalisation of manufacturing trade than they do from agriculture. With the exception of Sub Saharan Africa, all developing countries gain more from the reduction of manufacturing tariffs.

A third study, Hertel (2000) using the same GTAP model, estimates that the benefits of full (100 per cent) reduction in post Uruguay manufacturing tariffs is a global gain of $130bn. Again, the author predicts that a large share of this will accrue to developing countries. Figure 5.6 shows the developing country share of the gains from reform in three different sectors (and combined reform). Manufacturing is the sector most benefited within developing countries (who gain over 70 per cent of the welfare and efficiency dividend). This persistent result in the literature is derived from the fact that developing countries have the highest tariffs on manufacturing goods and thus receive the largest gains from removing the distortions. The studies do not separately analyse “consumer benefits” (access to goods at lower prices) and “producer benefits” (the creation of new jobs as a result of access to markets abroad). Another implication of the analysis is that the realisation of these allocative efficiency gains will entail significant adjustment costs – a theme we revisit in appendix 2.

![Figure 5.6 The share of liberalisation gains accruing to developing countries across three sectors](image.png)
Table 5.2
This table shows simulation results from the Uruguay reductions in manufactures.

<table>
<thead>
<tr>
<th>Change in Imports (Millions)</th>
<th>Exports (Millions)</th>
<th>Terms of Trade (Percent)</th>
<th>Welfare (Millions)</th>
<th>Real Wage (Percent)</th>
<th>Return to Capital (Percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia&amp;NewZealand</td>
<td>2848.0</td>
<td>2527.6</td>
<td>0.347</td>
<td>0.327</td>
<td>1674.8</td>
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<tr>
<td>Canada</td>
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<td>1354.5</td>
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<td>0.127</td>
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<tr>
<td>EuropeanUnionandEFTA</td>
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<td>15358.5</td>
<td>0.145</td>
<td>0.159</td>
<td>17405.6</td>
</tr>
<tr>
<td>Japan</td>
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<td>UnitedStates</td>
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<td>0.123</td>
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</tr>
<tr>
<td>India</td>
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<td>3628.9</td>
<td>-2.099</td>
<td>0.446</td>
<td>1875.4</td>
</tr>
<tr>
<td>SriLanka</td>
<td>98.8</td>
<td>106.3</td>
<td>-0.193</td>
<td>0.558</td>
<td>93.0</td>
</tr>
<tr>
<td>RestofSouthAsia</td>
<td>3454.8</td>
<td>4820.1</td>
<td>-7.541</td>
<td>2.025</td>
<td>2366.5</td>
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<tr>
<td>China</td>
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<td>0.456</td>
<td>0.305</td>
<td>2762.2</td>
</tr>
<tr>
<td>HongKong</td>
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<td>480.1</td>
<td>0.254</td>
<td>0.360</td>
<td>464.1</td>
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<td>0.422</td>
<td>2403.3</td>
</tr>
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<td>626.0</td>
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<td>0.423</td>
<td>0.022</td>
<td>377.1</td>
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<td>Total</td>
<td>71616.2</td>
<td>71876.4</td>
<td></td>
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</table>

Source: Brown, Deardorff and Stern (2002)
Table 5.3 Doha Welfare gains
This table shows simulation results from a 33 per cent reduction in post Uruguay tariffs on manufactures.

<table>
<thead>
<tr>
<th>Change in Imports</th>
<th>Change in Exports</th>
<th>Terms of Trade</th>
<th>Welfare</th>
<th>Real Wage</th>
<th>Return to Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Millions)</td>
<td>(Millions)</td>
<td>(Percent)</td>
<td>(Percent)</td>
<td>(Millions)</td>
<td>(Percent)</td>
</tr>
<tr>
<td>Australia &amp; New Zealand</td>
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<td>0.358</td>
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<td>0.696</td>
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<td>Rest of South Asia</td>
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<td>0.364</td>
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<td>1558.6</td>
<td>-0.335</td>
<td>0.827</td>
<td>1740.3</td>
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<td>Central Europe</td>
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<td>4366.4</td>
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<td>0.734</td>
<td>2724.2</td>
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<td>Central &amp; South America</td>
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<td>131880.0</td>
<td>163441.4</td>
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<td></td>
</tr>
</tbody>
</table>

Source: Brown, Deardorff and Stern (2002)
Table 5.4. Welfare and Efficiency Gains due to 40% Liberalization in Agriculture and manufacturing: 2005
Both columns report the benefits of reform in terms of equivalent variation.

<table>
<thead>
<tr>
<th>Region</th>
<th>Agriculture</th>
<th>Manufacturing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Namerica</td>
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<td>3310</td>
</tr>
<tr>
<td>Weurope</td>
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Source: Hertel et al. (2000) Table 8, page 27
6 Preliminary conclusions

The purpose of the empirical survey above is to suggest a prioritisation of trade issues that will benefit developing countries.

When negotiating parties lobby at the WTO, it is assumed that they do so in their own self-interest. In the case of developing countries and their advocates, it is not always clear what evidence they are using to determine how different reforms will affect them.

The CGE results presented in this note are certainly not perfectly reliable estimates of the welfare effects of various WTO proposals – indeed the estimates vary quite widely between different studies. However they draw attention to the wide range of global effects of WTO proposals.

The results of the empirical survey presented in this note suggest a different prioritisation to the current hierarchy of market access issues receiving attention in the WTO.

The evidence presented above suggests that an alternative market access liberalisation agenda might focus on labor market access for unskilled workers, unskilled labor services, market access for agricultural goods exported by developing countries, and tariff peaks for manufactured goods. The empirical work has paid less attention to the non-market access issues, like competition policy, but, as we noted in the text, here too the agenda that was being pursued, e.g. in the Singapore issues, is markedly different from that which reflects the interests and concerns of the developing world.
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APPENDIX 2:

Regulatory Harmonisation: The Singapore Issues
1 Introduction

The inclusion of a domestic regulatory agenda in WTO negotiations represents a departure from the traditional ‘market access’ focus of the GATT rounds. The national regulations embodied in the ‘Singapore issues’ have become more prominent as the liberalisation of traditional trade protection instruments has highlighted the trade impact of remaining differences in national regulatory regimes.

Efforts to harmonise national regulation have commenced in competition law, FDI policy, transparency in government procurement, and trade facilitation. It has been argued that these issues are not priorities for low-income countries and should not form part of a so-called ‘development round’. In particular, there is significant opposition from developing countries. In the space of a month from early June 2003, 77 developing countries, including over half the WTO membership, made public statements urging that new negotiations should not be launched as part of the Doha Round.¹

Several developing countries see the Singapore issues as incursions into their national sovereignty that are not justified by the benefits they bring. Multilateral regulatory disciplines hold the spectre of preventing individual governments from pursuing development policies based on their own national priorities and problems.

In addition there are concerns that the initiatives based on the Singapore issues may impose a large burden on the administrative capacity of developing countries. There are significant costs associated with both the creation and enforcement of new regimes in competition policy, investment regulations, and trade and customs procedures. Moreover the required institutional capacity and human expertise may not be available in developing countries. In OECD countries these critical inputs developed gradually over a long period of time. These considerations suggest that the payoff to requiring WTO members to implement

rapidly the Singapore proposals may not be large relative to its costs. Moreover it suggests that any reform will require significant technical assistance from developed countries.

Finally there is broad concern that the Doha agenda may be overloaded. The Doha Round has an ambitious work program involving multilateral negotiations on many issues. The inclusion of complex and controversial issues may slow progress on more fruitful initiatives.

As the debate on the Singapore issues evolved, two other issues became more apparent. The first is that many of the Singapore issues involved a detailed knowledge of complex public policy issues that went well beyond the competence of trade ministers to negotiate. The outcomes, accordingly, might not be good even for the developed countries. There was a resonance with what had happened in the intellectual property negotiations (TRIPS) in the Uruguay Round, where both the Council of Economic Advisers and the Office of Science and Technology Policy raised serious concerns, to which the U.S. Trade Representatives paid little attention in the negotiations. The issues that were being debated under “Competition” did not attempt to unify treatment of predatory pricing between domestic and foreign firms, a natural part of any attempt at developing a uniform competition code. The United States put on the agenda in the discussion of Investment highly controversial issues involving capital market liberalization, which almost contemporaneously, the IMF had revisited, raising questions about the potential economic benefits and costs.

This brings us to the second concern: some of the proposals would have actually been adverse to the development of the developing countries. They went against the entire spirit of the Development Round. Such was the case, for instance, with proposals for full capital market liberalization.

In the context of these concerns, we consider four criteria for prioritizing an issue in the current round of negotiations.

- Is WTO justified by returns to international collective action that are higher than returns to unilateral action, i.e., are there spill-overs or externalities which justify multilateralism?
- Are the benefits of the initiative large relative to other proposals? Are the benefits shared between developing and developed countries?
- Are the costs of implementation small relative to the benefits of the initiative?

- To what extent do multilateral commitments impede national development strategies?

Using these criteria, this appendix analyses the merits of including the Singapore issues in the Doha Development Round. The merits are certainly not uniform across the four issues or even across the different initiatives within each issue.

Significantly more work needs to be done to quantify the potential benefits and costs flowing from the Singapore issues. Indeed the paucity of authoritative studies in this area is in itself a reason to advocate caution. Therefore the conclusions of this appendix are preliminary.

Nonetheless the empirical survey below suggests that the current focus of the WTO’s regulatory harmonisation agenda is misdirected in some areas.

- In the competition and investment arenas, the WTO should move away from imposing uniformity on manifestly different countries and focus its attention on areas where externalities generate returns to multilateralism.

  In investment policy, reducing the ‘race to the bottom’ incentive war would be a useful initiative.

  Similarly, competition policy initiatives should include anti-trust action against cartels which raise prices for developing countries, and a mechanism for analysing the global effects of merger decisions in developed countries.

- In government procurement and trade facilitation, progress should be made through national efforts aided by technical assistance, rather than through imposing additional obligations in the WTO.
2 Investment

At the Singapore WTO Ministerial meeting in 1996, members agreed to form a working group to study the relationship between trade and investment. Since then, some developed countries have attempted to move towards a negotiated investment agreement within the WTO.

The proponents of such an agreement seek internationally binding rules that would minimise the conditions and regulations on foreign investors entering or operating in host countries and to grant them national treatment. This would involve the removal of performance requirements and the adoption of a range of investor rights.

However most developing countries were reluctant to agree to this because several believed that an investment regime was inappropriate within a trade organisation. Others had concerns about the loss of autonomy over investment policy and the consequent limitations on industrial policy options. Also there were broadly expressed concerns that an investment agreement would divert time and human resources from other vital work in the WTO.

2.1 Potential benefits and costs from an investment agreement

The fundamental premise of the argument in favor of a multilateral investment agreement is that it will increase investment flows to developing countries. An agreement which improves investor protections may stimulate domestic investment and alleviate the concerns of foreign investors.

However there are several reasons to be cautious about the responsiveness of investment to new multilateral protections. First, the current absence of multilateral investment disciplines and the failure of previous attempts to establish them (such as the OECD’s ill-fated Multilateral Agreement on Investment, MAI) has not deterred foreign investment. Foreign direct investment has grown rapidly over the last decade, outpacing both trade and output growth.

Additionally, the absence of a multilateral agreement has not prevented substantial unilateral liberalisation of
investment regimes. UNCTAD reports that between 1991 and 2001, a total of 1,393 changes were made to national investment regulations. More than 90 per cent of these were liberalising changes. Figure 1 shows that in 2001, over 200 regulatory changes were made in 71 countries, only 6 per cent of which were restrictive changes. In this environment there does not seem to be a compelling rationale to force national governments to adopt a uniform multilateral agreement. Idiosyncratic national regimes are sensitive to national development proprieties and can be tailored to existing institutional arrangements to minimise implementation costs.

Figure 1. Liberalisation of investment regimes

![Graph showing liberalisation and restrictive changes to investment regulations]


A third reason for caution comes from the historical experience of investment treaties in generating increased investment flows. Bilateral investment treaties (BITs) surged in the 1990s to more than 2,000 in 2001. There has been significant activity between developing countries, which accounted for 42 per cent of new BITs in 2001 (UNCTAD 2002). BITs proscribe a range of investment protections that often go further than many of the realistic proposals before the WTO. Yet there is not much evidence that the signing of bilateral investment treaties increases the flow of investment. UNCTAD’s (1998) study found no relationship between the level of FDI and the number of BITs signed by host countries. A more comprehensive study by Hallward-Driemeier (2002) looked at the bilateral flows of OECD countries to 31 developing countries over 20 years. After accounting for trends, they found little evidence that BITs
increased investment to developing countries. More research need to be done on the effects of investment treaties on investment volume, but the existing evidence suggests that the benefits of additional treaties may be small.

Fourthly, the most serious concern, nationalization of foreign investments, has already been addressed at both the national and international level, though national and multilateral agencies (MIGA, the Multilateral Investment Guarantee Association, is part of the World Bank Group) providing guarantees against such confiscations of property. Going beyond this entails difficult to make judgments about what are “legitimate” and illegitimate restrictions. Most fundamentally, each country has an incentive to develop an investment regime balancing provisions which might serve to attract more foreign investment with those protecting against potential adverse effects on the citizenry. International agreements might help developing countries provide assurances that they will abide by their commitments, which is what MIGA in effect does. But they should not dictate how each country should make that balance.

Figure 2. Bilateral investment treaties

A further difficulty is that in providing further protections, even bilateral agreements negotiated by trade ministers often go too far, intruding on national sovereignty in unacceptable ways. The problem is that it often takes years
before the full import is discovered, by which time the possibility of revising the treaty has become difficult and tendentious. The infamous Chapter 11 of NAFTA provides a compelling case in point, where foreign investors were given more rights than domestics (e.g. for compensation for changes in costs or profitability as a result of even fully justified regulations, in what are called regulatory takings). This is arguably having an adverse effect in the development of important regulations in areas like the environment and consumer protection. (The Clinton Administration was opposing attempts to provide such compensation in domestic legislation, even as its trade negotiators were putting such a provision into NAFTA, without seeking prior approval either of the Cabinet, the National Economic Council, or Congress. Once such provisions are put into an agreement, it is hard to take them out.) Even judicial protections, such as punitive damages, have come under question.

The attempt to impose restrictions on capital market liberalization illustrates the dangers of these non-trade related investment agreements. (Trade related capital flows are already covered within current IMF agreements.) There is compelling evidence that full liberalization has little effect on economic growth, but exposes countries to increased instability, a fact recognized even by the IMF in its recent Board paper.²

For these reasons, the current direction of WTO negotiations on investment disciplines seems to offer few advantages to developing countries. An international agreement on investment rules of the type currently being proposed is ultimately designed to maximise foreign investors rights whilst minimising the authority of governments in developing countries. Instead the WTO should focus on improving the investment environment in ways which strengthens the bargaining position of governments vis-a-vis foreign investors rather than weakening it.

2.2 Priorities

One area in which there is clear cause for multilateral action is the reduction of ‘beggar-thy-neighbor’ investment

² See also the forthcoming IPD volume on Capital Market Liberalization and Macroeconomic Stability (Oxford University Press)
incentive competition for foreign investment. Since the mid-1980s, the efforts of national and sub-national levels of government to attract direct investment to their jurisdictions have increased considerably (Charlton 2003).

Political pressure on governments to be seen as ‘job winners’ push policy makers to play a race-to-the-bottom game. Oxfam (2000) estimates that developing countries lose $35 billion per year due to a competitive pressure to reduce corporate tax rates combined with the transfer of profits out of developing countries to low-tax environments.

The potential negative consequences of investment competition are particularly acute in developing nations. The risk of “overbidding” is exacerbated by institutional weaknesses, poor cost-benefit analysis and in some cases, corruption. Moreover, the potential consequences of excessively generous incentives might be increased in those developing nations whose fiscal positions are already weak.

Agreements to limit the size of incentives seems to be the most obvious approach to pursue within a multilateral framework. The European Union provides a good example of the kind of approach to policy co-ordination that might benefit developing countries. The EU has been operating state aid guidelines now for several decades. Although grants to foreign direct investment are not explicitly targeted by Commission policy, in practice they are one of the main forms of state aid regulated by it. The EU takes the general view that state aid is incompatible with the common market. The definition of state aid clearly encompasses traditional instruments of investment attraction. Indeed the European Commission classifies state aid as including i) grants to firms; ii) loans and guarantees; iii) tax exemptions; and iv) infrastructure projects benefiting identifiable end-users. The European Commission claims some success in reducing subsidies in the EU. There is evidence that the Commission has used its guidelines to effectively restrict incentives in some areas. For example, before the introduction of guidelines for the support of SMEs, it was not rare to find state-aid grants of as much as 20 per cent of an investment project. Under the new framework, the fixed maximums are 7.5 per cent (medium-sized enterprises) and 15 per cent (small enterprises).³

³ An example from the Czech Republic provides an illustration of how the Commission uses its power in practice. The Czech Republic planned to offer subsidies to the Volkswagen unit Skoda for an engine plant at Mlada Boleslav. After a year of negotiations with the EU, the
3 Competition policy

Strong competition policy backed by clearly enforced laws is beneficial to developing countries and should be encouraged in international forums. There is a clear worry that the benefits of a liberal trade regime would be undermined by domestic or international monopolies and cartels. Liberalization might largely simply transfer rents that had been accruing to the government to private sector monopolies, and not lead to lower consumer prices. However competition policy disciplines as envisaged by the proponents of a WTO agreement may impinge on the ability of each country to choose a competition policy model which is suitable for its own development priorities, and the proposals under discussion do not address the most important concerns of developing countries. What is required is a paradigm to view competition from a development perspective. What is needed is to ensure that developing country producers receive even handed treatment with domestic producers (which they currently do not), and to ensure that developing country consumers can be protected from non-competitive actions by global anti-trust action, including anti-trust actions centered in the developed countries. National competition law and policy should complement other national development objectives (such as industrial development). Moreover it should not hinder government efforts to minimise adjustment costs resulting from structural change generated by WTO driven liberalisation in other areas. Some sensitive industrial sectors may require protection from advanced foreign firms for the time it takes to create local capacity. Moreover, it needs to be recognized that the legal frameworks that have been developed in the advanced industrial countries to promote competition are costly to administer. Early on, there was an awareness of the risk of politicization of competition policy, providing one of the rationale for private enforcement actions. There is some reason to believe that those fears have been justified, and when incorporated within a trade regime, there is often more a concern for the promotion of the interests of the country’s government agreed to slash tax breaks and grants that if was offering to Skoda from $120 million to $22 million.
corporations, than on the well-being of consumers. Thus, a failure of a country’s firms to do well in a market will be blamed on anti-competitive actions; but the attempt by a foreign government to protect its citizens from anti-competitive practices of one’s own company will be viewed with suspicions. But because of their costs, private enforcement actions are often not feasible for those harmed in developing countries.

For these reasons, some of the conventional models of competition which operate in developed countries may not be appropriate for a developing country. In the discussion below, we identify some policies that might redress the imbalance.

### 3.1 Potential gains and costs

The theoretical benefits from the maintenance of competition are clear. Indeed, the benefits that are associated with free markets are only enjoyed if those markets are competitive. As we suggested before, trade liberalization and privatization will only deliver on their promised benefits in a competitive environment. But imperfections in competition are pervasive, especially in developing countries whether markets are often small. There is an abiding concern that a large multinational can use its economic power to become dominant in certain markets in developing countries—these companies often have sales that exceed the GDP of the economy.

While the case for strong competition policy is clear, there is regrettably only a small amount of evidence on the welfare effects of competition policy agreements. Kee and Hoekman (2002) investigate the impact of competition law on estimated industry mark-ups over cost. They use time series panel data from 28 industries in 42 countries. They conclude that antitrust legislation has no individual impact on the size of mark-ups. By contrast they conclude that imports and lower entry barriers (which anti-trust policies can lead to) are associated with a larger payoff, a result supported by several studies (Djankov et. al, 2002; Hoekman, Kee and Olarreaga, 2001; Vandenbussche, 2000).

By contrast, Clarke and Evenett (2003) show that in Latin America, Asia and Western Europe, jurisdictions that did not enforce their cartel laws suffered greater overcharges than those nations that actively enforced their cartel laws.
New competition regimes are associated with significant implementation costs. Competition law is technical and requires institutional skills and resources that are in short supply in many developing countries. In addition, competition law enforcement is expensive. OECD and national sources indicate that the annual budget of the antitrust office in OECD countries is in the $15-50 million plus range. For developing countries with enforcement agencies, the budgets are lower but still significant (Hoekman and Mavroidis 2002).4

3.2 Priorities

Discussions under “competition” center around two issues: preventing monopolization and anti-competitive practices; and preventing governments from acting in ways which give an “unfair” competitive advantage to their firms, either by imposing requirements on foreign firms or by subsidizing their own firms.

Under the first rubric, preventing monopolization and anti-competitive practices, there are two important reforms. The first is the adoption of a single standard for predatory anti-competitive behaviour between domestic and foreign firms. There is a large literature5 on the cost of dumping laws, and on their inequities (including those associated with the manner in which they are implemented).

Another priority should be to protect purchasers in developing countries from paying excessively high prices as a result of monopolies and especially international cartels. National competition policy may ignore collusion by domestic firms to raise prices in export markets since there is no harm to those within the country. Moreover, developing countries without the resources to effectively enforce competition policy on international firms may suffer from international cartels. There is a small amount of (mainly informal) evidence on the effects of international cartels on developing countries. Levenstein, Oswald and Suslow (2002) analyse 16 goods whose supply was found to

4 For example, the costs of antitrust offices are large in Mexico ($14m), Poland ($4.1m), Argentina ($1.4m), Hungary ($2m).

be internationally cartelised by American or European firms. They found that in 1997 developing countries' purchased $36.4bn of goods from a set of 10 industries that had seen a price fixing conspiracy in the 1990s. This amounts to 2.9 per cent of developing countries total imports which may have been subject to collusive price fixing by firms from developed countries. It has been estimated that cartels in developed countries have cost consumers in developing countries up to $7bn in the 1990s. Some of the worst offending cartels have been found in the international maritime transport industry. Such cartels are often approved by national competition authorities but have been found to lead to higher prices for consumers. Fink et al. (2001) estimates that collusive practices in the maritime transport industry have cost consumers in the US alone up to $2.1bn. If developing countries were to save the same proportion of their shipping costs the savings would be $2.3bn.

Figure 3. Imports affected by cartels

Total imports of 12 products where cartels have been proved to exist. (US$bn)

In the mid-1990s, as Russia moved from communism to a market economy, one of the few goods that it could easily sell internationally was aluminium, but its attempts to enter Western markets were hampered as American aluminium companies put pressure on the United States to create an international aluminium cartel that would strictly limit the extent to which they could enter Western markets and which would thereby maintain international prices at high levels. This is a case in which both Russia and consumers around the world were injured. But those affected had no recourse to anti-trust laws, especially since governments were involved in the very creation of the cartel.

Almost undoubtedly, the most important international cartel is OPEC, which attempts to control the price of oil. Though several OPEC members are developing countries, most of those in the developing world live in countries which are net importers of oil, and therefore are worse off as a result of the oil cartel.

This suggests there might be potential gains from multilateral action to ban export cartels, including those in which governments are a party.

A key issue is how developing countries can respond to anti-competitive actions, including export cartels. No small developing country could force the break up of a cartel; each would find it expensive to bring a court case, and even if it could bring such a case in its own jurisdiction, enforcement of a judgment would be difficult. One option would be to allow governments of detrimentally affected countries to use the court system of OECD countries to prosecute offending firms. Further, adversely affected parties (including governments acting on behalf of citizens) should be allowed to be a plaintiff in civil actions in the courts of the advanced industrial countries, and there should be a provision for class action suits, with flexible standards for class certification, which would in particular encourage purchasers of products in foreign countries to be able to join in with each other and with other purchasers in the advanced industrial countries. Given the limited resources of developing countries and the high costs of suits, assistance from OECD countries would be desirable. Hoekman and Mavroidis (2002) suggest the creation of a ‘special prosecutor’ within the WTO with authority to bring cases in the relevant jurisdiction on behalf of developing country consumers.

Merger policy is another area in which national competition policies may have international spillover effects. The
concern is that nationalistic approval criteria may allow mergers between domestic firms even when the global welfare effect is negative, so long as the welfare benefits within the country are positive. If these firms have a larger combined market share in some smaller foreign markets than they do in the domestic market, a merger may be domestically acceptable but globally undesirable.

Both from the perspective of developed and less developed countries, we worry about attempts to harmonize national competition policies, for in doing so, there is a real risk that the “least common denominator” will be accepted, that is, one which will provide the least protection for consumers. Even a movement towards a common framework, a common framework which inevitably would be close to a “least common denominator,” would risk not recognizing the differential circumstances of the developing countries and encouraging governments to move towards this low standard. This is especially the case because corporate interests tend to be far better represented in trade negotiations than consumer interests.

It would be better to use the discussion of Competition issues within the WTO to encourage countries to develop high competition standards, and to recognize some of the ways that countries may legitimately do so. For instance, the United States has, on several occasions, recognized that concerns about competition “trump” intellectual property; standard intellectual property protections, which give temporary monopoly power, have been circumscribed, when they lead to excessive monopolization of particular markets. This is a principle which should more universally be recognized; it should be made explicitly clear that such actions are not a violation of TRIPs. As a second example, per se rules may be easier and less costly to enforce than “rule of reason” judgments, requiring the careful balancing of costs and benefits of certain potentially anti-competitive practices. Strong “per se” rules (such as limiting the share of the country’s market that any firm may have) should be allowed, even if they have the effect of limiting entry by international firms (for whom, say, entry into a market would only be worthwhile if they had a dominant position.)

On the second rubric, actions taken to give a competitive advantage to one’s own firms (or competitive disadvantage to foreign firms), the development concerns should be given priority, and actions which have arguably a development objective should be allowed, at least on a medium term basis, even if they put foreign firms at a disadvantage. Inevitably, firms from developing and
developed countries are in different circumstances; each has some advantages over the others. Firms from advanced industrial countries often have access to lower cost of capital and to government financed research, especially by-products of the huge expenditures on defence. Local firms may have more local knowledge, and that may give them a competitive advantage. Inevitably, there will be some ambiguity in what is meant by “levelling the playing field.” But approaching the issue from the development perspective provides some guidance into what kinds of policies should be allowed by developing countries. Developing countries should be allowed to provide capital to domestic firms at “reasonable terms,” which may be significantly below the very high interest rates that are imposed on them as a condition of IMF loans, or which they feel they have to have to prevent a currency crisis. Imposing “community reinvestment act” lending requirements on banks, to lend a certain fraction of their money to particular groups, e.g. underserved minorities, or small or medium size domestic enterprises, is a legitimate restriction. Giving preferences to small and medium sized enterprises for government contracts (see below) should also be legitimate, even if in doing so, multinational firms are in effect discriminated against. At the same time, the standards for judging whether the provision of infrastructure which, in the first instance, may be directed at a particular enterprise, is a subsidy or not should be looked at from different perspectives for a developing country than for a developed country. While advanced industrial countries have long been critical of local content requirements, such requirements may in fact facilitate developmental objectives.

4 Government Procurement

Government purchases of goods and services are a significant fraction of world GDP. Recent analysis by the OECD indicates that total central government expenditures of OECD countries was almost $2 trillion in 1998. In developing countries this figure was $0.3 trillion – equal to six times the total annual multilateral and bilateral aid currently given to developing countries (Evenett 2003).

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6 This figure excludes military expenditure and the payment of state employees.
In an attempt to harness this part of the international economy, several WTO members signed the ‘plurilateral’ (only binding to those members that choose to sign) Agreement on Government Procurement (GPA) at the Uruguay Round in 1994. One of the GPA’s primary long term objectives is to ensure that government decisions to purchase goods and services do not depend on the location of production or the affiliation of the supplier.

Many developed countries, principally the US and the EU would like to see the GPA develop into a multilateral agreement which in the first stage draws all members into an agreement on transparency; and in the second stage extends the scope to due process and national treatment for foreign firms.

4.1 Potential benefits and costs

Estimates of the value of a broad multilateral procurement agreement (encompassing both transparency and non-discrimination) depend on the size of the government procurement market, the size of preference margins extended to domestic suppliers, and the general equilibrium gains and losses derived from the elimination of these preferences.

As described above, government procurement accounts for an average of about 10-15 per cent of GDP for developed countries and as much as 20 per cent of GDP for developing countries. National domestic preference margins are estimated by analysing either national policies or the price wedges that explain government purchasing choices. Francois, Palmeter and Nelson (1997) estimate the margin of preference for OECD countries to be in the 13-50 per cent range.

However the proportion of government purchases whose price is inflated by preferential treatment may not be large. In a procurement auction, preferences only raise prices when domestic bidders are not the lowest but are within the preference margin, or when the domestic bidders are the lowest but there is only one of them (in which case the domestic bidder raises its sell price to the lowest foreign price plus the preference margin). However in other circumstances a preferential procurement policy may actually reduce procurement costs. McAfee and McMillan (1989) show that preferential polices can cause foreign
suppliers to reduce their sell price so as to bid under the domestic firms receiving preferences.

Government procurement policies have important economic and social roles in developing countries which would be curtailed if governments were mandated to observe national treatment principles. The level of expenditure, and the attempt to direct the expenditure to locally produced materials, is a major macroeconomic instrument, especially during recessionary periods, to counter economic downturn (Kohr 2003). If the foreign share increases, there would be a leakage in government attempts to boost the economy through increased spending during a downturn.

Additionally procurement policies might be used to boost domestic industries or encourage development in specific sectors of national interest. Social objectives could also be advanced by preferences for specific groups or communities, especially those that are under-represented in economic standing.

Finally, while developed countries (and especially, particular firms within developed countries) have much to gain from gaining access to government procurement in developing countries, it is not likely that the gains are fully reciprocal. Even the EU has had difficulty making inroads into U.S. government defence procurement. Furthermore, the consequences of procurement liberalization will inevitably depend on liberalization of services and labor flows. If the U.S. government decides to subcontract meal services in the army, will it allow a foreign firm to provide the service? Almost surely, security concerns will demand that the firm be an American firm. But since defence is a larger fraction of expenditures for America, it means that a larger fraction of government procurement will be exempt. Some communities in the United States have moved towards contracting out a range of public services, including schools and prisons. It is unlikely that foreign firms have equal access.

In the context of the important government objectives achieved by procurement policy and the lack of any externalities to justify international action, it seems important that developing countries retain their autonomy over this area of policy.\(^7\)

\(^7\) Moreover, it will be difficult to implement any procurement policy in a way which would widely be acceptable. A large fraction of American expenditures are for defense, and it will almost surely claim a defense
5 Trade facilitation

Trade facilitation initiatives hold out the promise of increasing trade and efficiency by reducing onerous trade-related costs. Such costs include: regulatory compliance costs; charges for trade-related services; procedural delays; lack of predictability; and lost business opportunities (Lucenti 2003).

The benefits of improving trade facilitation include: increasing trade in goods and services; promoting competition which can spur productivity gains as well as lower prices; enhancing efficiency in both the state sector and the private sector; improving the business environment and so encouraging foreign direct investment ("FDI"); and increasing participation of small- and medium-sized enterprises ("SMEs") in international trade.

The empirical evidence below suggests that many of these benefits may be economically significant but are associated with large implementation costs. Rather than imposing new obligations within the WTO, progress on trade facilitation should be achieved through national efforts aided by technical assistance.

5.1 Potential benefits and costs

Few studies have been done that explicitly examine the potential gains from trade facilitation. There are dramatic anecdotal stories: Costa Rica’s commitment to trade facilitation was arguably critical in its getting the large Intel plant. Modern manufacturing has increasingly relied on exception. Much of government procurement is for services, but the provision of such services requires the temporary movement of natural persons. Contract specification can often be used to give local firms a preference; ascertaining whether the contract specification was “reasonable” will be extremely tendentious.

The Doha Declaration (para 27) states that until the Fifth Ministerial the WTO Council for Trade in Goods shall review and as appropriate clarify and improve relevant aspects of Articles V, VIII and X of GATT 1994 and identify the trade facilitation needs and priorities of Members, particularly developing and least developed countries. [Article V is on freedom of transit, Article VIII is on fees and formalities connected with import and export, and Article X is on publication and administration of trade regulations.]
just-in-time inventory methods, and these cannot operate if there are costly delays at borders.

Moreover the studies presented below differ in terms of the scope of trade facilitation considered and the breadth of countries and commodities analysed. This makes their results difficult to compare meaningfully. However the results below do highlight the magnitude of potential gains from trade facilitation.

Ernst and Whinney (1987) surveyed EC business costs for the European Commission. The customs compliance costs associated with intra EC trade were estimated to be 1.5 per cent of the total value of trade between member countries.

The US National Committee on International Documentation (US NCITD) analysed the benefits of trade facilitation in a 1971 study, subsequently updated in the 1990s by Raven (1996). These studies found that the costs of documentation and compliance with export and import regulations (at both ends of the transaction) represented more than 7.5 per cent of the total value of US shipments.

A study by the Swedish Trade Procedures Council (SWEPRO) in 1995 used data from companies and government sources to estimate the cost of compliance with Swedish trade procedures. It concluded that these costs could be as much as 4 per cent of the value of imports and exports.

More recently, a study by Wilson et al. (2003) used a computable general equilibrium framework to estimate gains from trade facilitation. They estimated the effect of bringing the below average APEC members halfway to the APEC average in four key areas of trade facilitation (administrative transparency, e-commerce, logistics, standards harmonisation). They estimate this type of facilitation would increase APEC trade by $280bn.

A similar study by Wilson, Mann and Otsuki (2003) compares the relative benefits from trade facilitation with those from traditional market access initiatives. They estimate that a reduction of all tariffs to zero from an APEC average of 6.5 per cent would create a gain of $27.8bn. By comparison they find that the improvement in trade facilitation necessary to achieve the same gains is small. Relatively minor improvements in port efficiency, customs procedures and e-business usage deliver similar sized gains.
The brief survey above suggests that there is a wide span of estimations regarding the costs of trade procedures, ranging from 1.5-7.5 per cent of the value of trade flows.

The implementation costs associated with realizing gains from trade facilitation are also significant. Administrative changes are associated with obvious costs to both governments (the creation of new systems and enforcement of new regulations) and business (compliance). For developing countries, a large part of the costs to government should be borne by technical assistance from developing countries.

The costs of trade facilitation depends on the type of reform proposed. For example, the World Bank assisted Tunisia in its program of streamlining and modernising its customs procedures. The total value of World Bank loans to Tunisia for this purpose was $35m in 1999. Similarly the World Bank lent $38m to Poland for upgrading physical and managerial infrastructure of its port facilities. In some cases, streamlining procedures will both facilitate trade and save the government money.

Developing countries should put forward the view that improvements in trade facilitation should be made through national efforts aided by technical assistance, rather than through imposing additional obligations in the WTO. If the consideration of the problems in these areas results in some solutions, these should, at best, be adopted only as guiding principles or as flexible best-endeavour provisions, not enforceable through the dispute settlement process (Das 2002).

The discussion here, as elsewhere, focuses more on the concerns of developed countries in gaining access to developing countries, than on what should have been the concern of the Development Round, i.e., developing countries gaining access to developed countries’ markets. Of intense concern in the last few years are America’s visa restrictions. Such restrictions may or may not be justified by legitimate concerns for security, however it is certainly true that the existence of these security concerns illustrates that the developed countries often put non-trade concerns over trade concerns—but often criticize developing countries when they attempt to do the same. But the inability to send businessmen to America to market their goods and the long delays and high costs (especially in time) in obtaining a visa

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is clearly an important impediment to trade. This is an issue that would be high on a development oriented agenda for trade facilitation. The fact that it has not been on the agenda at all is just another illustration of the gap between what has been attempted to be sold as a development round agenda and an agenda that would truly promote the interests of the developing world.
6 References

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