Sida

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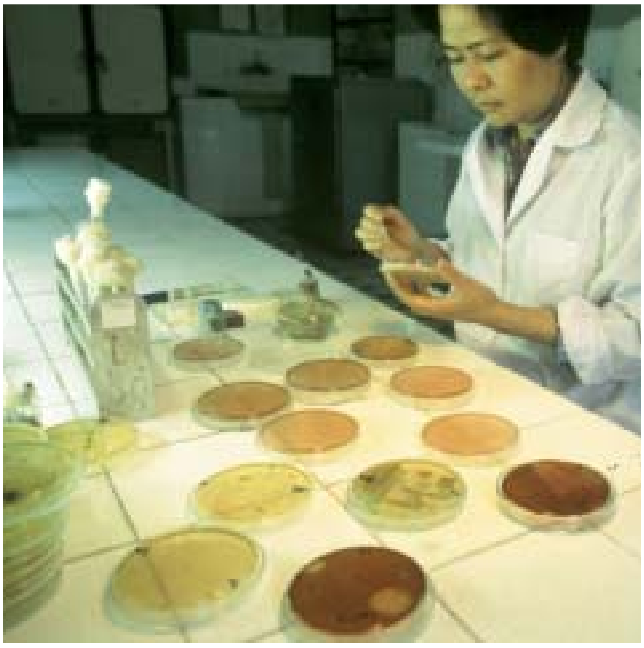
# Trade and Development – An Introduction



# Introduction

During the preparation of Sida's Policy for Trade-Related Development Cooperation, it became clear that it would be useful to have a document which could provide the reader with an introduction to the main issues of trade and development and their linkages.

This document aims to respond to that request with an overview of some of the main issues of trade and development and the role of development cooperation in this field. However, the intention is not to give a complete picture of all issues involved. The account of underlying factors, linkages and possible effects of different trade policies is by necessity of a simplified, summary nature. Furthermore, in light of its generalizations, neither will this document provide sufficient insights to give guidance to the implementation of particular trade-related development cooperation projects. An analysis of the sector and country-specific context will always be necessary.

In the process of developing Sida's Policy for Trade-Related Development Cooperation and this background document, Sida commissioned independent consultants to write trade briefs on various topics relating to trade and development. For a list of the topics and authors, see Annex I.

# Content

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# Summary

Enhanced trade is likely to lead to economic growth, and growth is in turn conducive to poverty reduction. There is a positive relationship between openness to trade, growth, and poverty alleviation although this correlation hides a complex set of linkages. Trade can be an important means in the fight against poverty, if trade reform is accompanied by complementary policies which ensure that the growth brought about by trade actually benefits the poor.

The simplified description of the issues surrounding trade and development in this document states that developing countries are active participants in international trade and that they increasingly trade with each other. The trade policies pursued by developing countries are therefore likely to affect both their own possibilities to engage in sustainable development, and those of other developing countries. Some developing countries face problems because they rely heavily on exports of primary commodities or agricultural products. Trade measures of developed countries are partly to blame for developing countries' difficulties in diversifying their exports out of a dependence on primary products. Nevertheless, a large number of developing countries today have significant exports of manufactured goods and services.

Careful attention needs to be paid to the poverty dimension of trade, and more generally, economic reform in developing countries. Trade liberalisation can lead to changes in the economic structure of rural areas where many poor people live, and may hurt poor groups in the short run. Trade liberalisation and other trade reforms may also lead to reduced government revenue to spend on programmes for the poor. It is therefore essential to sequence trade reform with other reforms, such as domestic tax reform, to ensure that resources are available to take measures of importance to the poor, for example in the areas of health and education.

Membership of the World Trade Organization (WTO) brings both opportunities and challenges. Among the advantages is the possibility to negotiate with almost 150 trading partners at the same time, predictable and increased market access in foreign markets, transparent rules in export markets, and a system for the settlement of trade disputes.

One disadvantage is that it is difficult for small trading nations to make their voices heard within the multilateral trading system. Another is that WTO membership means the acceptance of all rules and that their implementation often is costly for already constrained developing country budgets and requires human and institutional resources that are generally not available. Some of the rules are also most suited to the economic environment of developed countries.

Trade-related development cooperation does therefore have a role to play as it can enhance developing countries' possibilities to benefit from trade to pursue sustainable poverty-reducing development.

# 1. Trade and Development

The overarching goal of Sida's activities is to help create conditions that will enable poor people to improve there lives. Consequently, the way in which trade openness and trade reforms affect the poor should be one of the main determinants of the focus of Sida's trade support. This chapter looks into the relationship between trade and poverty and provides the analytical setting in which Sida's trade support should be framed.

## 1.1 Trade, Growth and Poverty Reduction

Most evidence indicates that openness to trade encourages growth. Economic growth is in turn likely to contribute to poverty alleviation as it expands overall income. However, the relationship between trade and poverty alleviation is complex and depends on a range of country-specific factors related to policy and institutions. The relation can usefully be divided into two interacting parts: the links between trade and growth on the one hand, and the links between growth and poverty reduction, on the other.

### Openness to trade encourages growth...

Openness to trade can promote economic growth in several ways. The classical argument for an open global trade regime is that trade permits countries to specialize in the production of the goods and services for which they have a comparative advantage. Each country can then use its resources more efficiently and so increase its income. Increased efficiency in production may also stem from what is called "economies of scale". Firms have fixed costs, and by producing both for the domestic and the international market they may increase their production and thereby lower their per unit costs.

Productivity growth (the ability to produce more with a given amount of production factors) can be enhanced by both imports and exports. Technological development is a crucial determinant of long-term productivity growth and openness to trade increases access to new ideas and the latest technologies. Furthermore, imports may increase productivity through increased competition, as domestic producers adapt to a more competitive environment.

Trade policy is closely related to institutional quality. The use of opaque barriers to limit imports increases the scope for arbitrariness in their application and may lead to corruption and rent-seeking. This is likely to hamper growth, as evidence indicates that institutional quality exerts a strong positive influence on aggregated income.[1]

Country studies have found that openness to trade affects economic growth positively.[2] But these findings have not been exempted from criticism.[3] Methodological aspects apart, the establishment of a causal link between an open trade regime and growth has been questioned, since trade liberalisation is often part of a wide-ranging reform programme, including macroeconomic stabilisation, structural reforms and other measures potentially conducive to growth.[4]

### ... and growth helps alleviate poverty

Several studies have shown that economic growth is an important factor in poverty reduction.[5] Economic growth increases income and consequently has the potential to alleviate poverty. Overemphasising income-based poverty, however, risks detracting attention from other aspects of a complex, multidimensional phenomenon. Poverty is not only lack of economic resources, but also deprivation of power, opportunities and security.[6] Nevertheless, income growth generates resources that are necessary to combat poverty in other dimensions as well. Poor people can spend more on health and education as income increases. In addition, government revenue, and thereby the funding of social welfare programmes that benefit the poor, is closely related to the level of income in the economy.[7, 8]

The extent to which growth is translated into reduced poverty depends on the initial distribution of income and the pattern of growth. The poverty-reducing effect of growth has been shown to be stronger in countries where initial inequality in income distribution is low than in countries with a more unequal distribution.[9] Growth may reduce poverty through various mechanisms: it can increase the demand for the output that poor people produce; it may expand the demand for poor people's productive resources (mainly unskilled labour); and it avails the government with more resources to spend on health, education and infrastructure, for example. Accordingly, the poverty-reducing impact of growth depends on in which sectors it takes place, on the government's inclination to prioritize pro-poor spending, and on the spending patterns in the economy.

### A complex, but positive relationship

In sum, the relationship between trade openness, growth and poverty reduction is complex, but positive, and determined by a wide range of country-specific factors. It should be noted that the poverty-reducing impact of trade reforms via growth is a long-term effect and that trade liberalisation may affect production and prices in ways that harm poor groups in the short run. Every trade reform package should therefore be carefully designed. The impact on the poor depends on the sequence of liberalisation measures, on the functioning of markets, and on complimentary public policies. These issues will be described in the following section.

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1 Rodrik and Subramanian (2003) have shown that the institutional quality has a strong, positive effect on income.

2 Dollar (1992), Sachs and Werner (1995), Edwards (1998) and a more recent paper by Dollar and Kraay (2001)

3 Rodríguez and Rodrik (1999)

4 McCulloch et al. (2001)

5 Gallup et al. (1998), Dollar and Kraay (2000) and Ravallion (2001). See also Klasen (2003) for further references.

6 Sida (2002)

7 Klasen (2003) points out that there are also causal linkages between income poverty and the majority of non-income measures of well-being.

8 Danielsson (2001) observes that this is not necessarily the case when growth is a result of structural adjustment programs that involve cuts in government spending.

9 Klasen (2003), Danielsson (2001)

## 1.2 Trade and the National Development Agenda – Complementary Policies to Trade Reform[10]

Trade liberalisation does not automatically generate growth and reduce poverty. The quality of available institutions and the types of policies pursued are among the factors that determine the impact of trade reforms on poverty. Trade reform changes the relative prices of tradable and non-tradable goods. These changes signal through the product, labour, and capital markets how the economy shall adjust to the reform. As adjustment takes time, some groups in society are likely to be adversely affected in the short run. Poor people are particularly vulnerable to such adverse effects as they often lack resources to cope with a temporary loss of job and income. Maximizing benefits from reform, minimizing adjustment costs, and devising arrangements to support adversely affected groups put high demands on government policy and institutions.

#### The importance of a participatory process

For trade reforms to be implemented as part of a wider policy package, they have to be integrated in national development agendas. The process through which Poverty Reduction Strategy Papers (PRSPs) are established offers a possibility for developing countries to design trade reform in conjunction with complementary policies.[11] It also provides the government with an opportunity to anchor trade reforms in society in a transparent and democratic manner. To create ownership of the national development strategy through a fully participatory and democratic process of elaboration, involving all groups in a society, is one of the key principles of the PRSP process.[12] However, this is equally important if trade reform is undertaken outside the PRSP process. Furthermore, because trade barriers tend to benefit specific groups, while the gains of trade reform are scattered among many and take time to materialize, it is often difficult to rally political support for reforms although they benefit society as a whole. An inclusive process in which trade issues are put into a broader context could help break up entrenched interests that block reforms. So far, however, the way in which trade has been mainstreamed in PRSPs has varied considerably between countries.[13]

#### Macroeconomic and exchange rate policies

A competitive real exchange rate and a stable macroeconomic environment are necessary for trade reforms to bear fruit. As explained earlier, trade reform works through changes in relative prices. A regime with high and variable inflation obscures the channelling of international price signals. Macroeconomic stability is thus a key complementary policy.

An overvalued exchange rate may severely increase the adjustment costs caused by trade liberalisation, since it discriminates against exports and puts the domestic industry at a competitive disadvantage in relation to imports. Exchange rate depreciation/devaluation at the beginning of major trade reforms can help the adjustment process. However, many developing countries have limited room for manoeuvre in this respect as they participate in currency zones or other types of fixed exchange rate regimes. Trade liberalisation may then have to proceed at a pace consistent with real exchange depreciation.

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[10] Unless otherwise indicated, this section draws on Michalopoulos (2004).

[11] See www.worldbank.org/poverty/strategies

[12] The other four core principles are: a results-oriented process, a multidimensional perspective of poverty, a partnership-oriented process, and a long-term perspective (www.worldbank.org/poverty/strategies).

[13] Hewitt and Gillson (2003)

### Fiscal revenue and the design of customs reform

A customs duty on merchandise imports is called a "tariff" in trade terminology. In many developing countries, tariffs are one of the main sources of government revenue, mainly because other forms of taxation (e.g. personal, corporate, goods and services) are not well established. Many developing countries consequently rely to a significant extent on border taxes to fund government expenditure. The threat of an adverse fiscal impact may fuel resistance to trade policy reform. However, the effect of trade liberalisation on government revenue is ambiguous.

If initial tariffs are high, they may generate little or no revenue in practice because high tariffs reduce demand for imported goods. In such a situation, reduction of tariffs to moderate levels may increase imports (and thus government revenue). The incentive to evade customs duties may also be reduced.[14] In other situations, tariff reductions might shrink government revenue.[15] If tariff rates are in the moderate to low range, further tariff reductions could result in a revenue loss.

Since many developing countries rely on quantitative restrictions and other non-tariff barriers, trade liberalisation does not necessarily mean cutting tariffs. If the reform programme involves eliminating quantitative import restrictions and converting them to tariff equivalents, then government revenue will rise. Reform of customs procedures, transport formalities and other regulations that hamper trade without generating revenue are examples of measures that may stimulate trade without decreasing government income. Studies show that such trade facilitation measures may have a large impact on trade.[16]

If trade liberalisation decreases government expenditures, the poor are likely to be negatively affected. Social expenditures may have to be cut in order for the government to maintain fiscal balance. Resulting macroeconomic instability may hit the poor hard as poor people have been shown to suffer more from inflation than the rich.[17] Furthermore, tariff cuts may in some cases have adverse redistributive effects for the poor. Tariffs are basically taxes on imported goods. Since the income share spent on imported goods tends to be higher among the urban middle class than among the rural poor, tariffs can have positive redistributive effects.[18] Tariff cuts diminish this effect.

For these reasons, trade reform may have to be complemented by a tax reform which creates an alternative tax base which increases tax revenue and thereby decreases the government's dependence on customs duties. The sequence of reforms should be designed so as to take the impact it has on the poor into account, by for example avoiding government revenue shortfalls.

### Competitive markets

Trade liberalisation may significantly increase competition in markets from which imports have previously been barred, but competitive markets do not always emerge despite trade reform and liberalisation. On the other hand, well-functioning markets are a condition for trade reforms to have the desired impact.

If markets work poorly, trade liberalisation and increased imports may not lead to increased competition and lower consumer prices and

[14] See McCulloch et al. (2001) for a discussion and further references.

[15] See Khattry and Rao (2002) and World Development Vol. 30 for a discussion.

[16] See Kommerskollegium and Sida (2002). See also section 2.2.

[17] Easterly and Fisher (1999)

[18] De Vylder et al. (2001)

producers may not fully benefit from the opportunities afforded by the export market. Markets may be distorted if some market actors are granted subsidies or other privileges, especially if these are state-owned enterprises designed to have exclusive privileges. Legal frameworks may be weak or poorly enforced and encourage the formation of monopolistic structures.[19] Domestic markets may be too small to allow for more than a few operators to profitably exist. If intermediaries have monopoly power, these may be the prime beneficiaries of trade liberalisation, pocketing what was previously collected as tariff revenue, instead of passing on the benefits of tariff cuts to consumers in the form of lower prices. The experience of liberalisation of agricultural policies in some African countries shows that there is a risk that the poor become negatively affected. Liberalisation of farm trade in Zambia and Zimbabwe resulted in the introduction of private monopolies to substitute for government-run marketing arrangements.[20] The negative impact was not caused by trade reform as such, but by the lack of appropriate complementary policies to ensure competition.

Export expansion has the potential to increase the incomes of poor people, but they often face great difficulties in transporting their products to foreign markets, in marketing their products abroad and obtaining export credits. Poorly working credit markets can be an important obstacle for the private sector to reap the benefits from trade reform and the same is true for limited availability and high prices on inputs (energy, business services, raw materials etc.) in general. Government policies, private initiatives and donor programmes designed to support micro-finance can alleviate the credit constraints on small and medium-sized enterprises (SMEs), as well as on small scale farmers. Public monopolies in the fuel, power and telecom sectors, or licensing restrictions on telecom or financial service providers, are examples of other factors that hamper private sector development and thereby obstruct export expansion. The sequencing of reforms is a particularly difficult issue when considering how to ensure well-functioning competitive markets, since causality runs from trade liberalisation to competitive markets as well as in the other direction.

#### Labour markets

The impact of trade liberalisation on employment in the import and export sectors depends on whether export firms can take advantage of the export possibilities created by increased market access to expand production, and on how well domestic firms face competition from imports (see the previous section). It also depends on how the labour markets function. If employment is lost in the import-competing sector, a smoothly working labour market permits laid-off workers to find jobs in the expanding export sector, with minimal adjustment costs. However, striking a balance between secure jobs and labour market mobility in legislation is difficult even in developed countries, and rigid labour market regulations may impede smooth adjustment. Furthermore, different sectors demand different skills. Education and training of workers therefore play an important role. This is especially true for poor people who often have limited access to education and training and may therefore face particular difficulties in finding new jobs.

Nonetheless, trade reform complemented by policies that increase labour mobility can generate jobs in the formal sector for workers previously em-

[19] Sida (2003)

[20] Michalopoulos (2004)

ployed in the informal sector. This can have a strong impact on poverty reduction since the poor are often concentrated in the informal sector.[21] As personal income thereby become formalised, it may also increase the tax base, with positive implications for government revenue and the possibilities to establish and maintain safety nets for the poor (see next page).

#### Infrastructure and transport

If the domestic industry lacks basic conditions for expanding production, trade liberalisation risks resulting in domestically produced goods being replaced by imported goods. High transport costs and deficient infrastructure for internal and international movement of goods and services make it difficult to engage in trade. Goods produced in rural areas, outside the capital or far from a seaport in a country with high internal transport costs have an obvious competitive disadvantage on the international market. In some Least-Developed Countries[22] (LDCs), poor transport systems and high transport costs make imported foodstuffs cheaper than locally produced food, as for example people in large cities close to ports may find imported goods to be cheaper than the domestically produced food which has to be transported on poor roads to the city.[23]

Investment and maintenance of infrastructure is costly and the budgets of developing countries constrained. However, internal policies concerning taxation of fuel, or government monopolies over air, river or rail transport services can influence at least a share of the transport costs. It is also likely that environmental considerations have to be made. Privatisation may be a

[21] Michalopoulos (2004)

[22] The WTO recognizes as LDCs those countries which have been designated as such by the United Nations (UN). There are currently 50 LDCs on the UN list, 32 of which have to date become WTO Members. Many of the WTO Agreements contain special provisions for the LDCs.

[23] De Vylder et al. (2001)

powerful tool for increasing efficiency in the provision of infrastructure, but establishing the necessary public regulatory framework and monitoring bodies for such reform requires resources and takes time.

### Safety nets

Establishing efficient social safety nets is one of the most important complementary policies for the poor. As previously pointed out, poor groups who are adversely affected by trade reform (for example poor workers in import competing activities) are often the least able to cope with lost revenue. They do not have the savings to manage a shortfall of income – no matter how transitory it may be – and often lack the voice to demand assistance. Against this backdrop, it is essential that the groups likely to be negatively affected by trade reforms are identified and safety nets put in place before trade reform is implemented. The policy options may range from establishing a general social safety net, to specific safety nets targeting those who would be most harmed by reform.

Establishing costly social safety nets in resource-strained countries is easier said than done. This underlines the need for integrating trade reforms in the national development agenda. If the design of trade reforms is based on an inclusive process where the poor have a voice, complementary policies that assist them in adjusting to liberalisation are more likely to be included. Nevertheless, the macroeconomic policy, the tax system, the competition policy, the labour markets, the infrastructure, and the large share of poor people in developing countries do not constitute the best preconditions for easy and successful liberalisation.

### Health and education

Education and health are both major determinants of the human capacity to engage in economic activity. Education is the key for creating, applying and spreading knowledge, which is a prime driving force behind economic development. Good health is a fundamental precondition for trade. Malnourishment and illness hinder people from participating in productive activities, the devastating consequences of which is seen in the wake of the HIV/AIDS epidemic in the poorest countries of the world.

Conversely, trade may have an important impact on education and health in multiple ways. For example, trade may increase access to new technologies and thereby enhance the scope for learning and increase incentives for investment in education. A disease may cross the border together with a traded good; tariff reductions may lead to lower prices for medical equipment; and international rules concerning patent protection may affect the availability of medicines and vaccines. More indirectly, economic growth spurred by trade may reduce poverty and increase standards of living, including better education and health.

Multilateral trading rules deal with various aspects of education and health (see also section 2.2). Both the TBT and SPS Agreements allow countries to restrain trade for health reasons (although they also require that such measures should not unnecessarily restrict trade). The TRIPS Agreement covers areas that are relevant to health, of which the issue of patent protection for pharmaceutical products is particularly critical to developing countries. The General Agreement on Trade in Services (GATS) agreement may also have implications for health and education. Successful trade liberalisation requires a careful analysis of these two-way linkages, particularly of their implications for the poor.

**Gender and Trade**

The multilateral trading system is gender neutral on the surface. However, the consequences of trade policies are different for women and men because women and men have different economic and social status. This means that trade, investment and competition policies do not affect women and men in the same way. Trade liberalisation has, for example, contributed to an overall increase in demand for women's labour, especially in the clothing, shoe, and processed food industries, where women often constitute the majority of the workforce. Changes in global trade regulations and patterns thus in many cases have a special impact on women. One example is the abolition of import quotas for textiles and garments in developed countries (see section 3.4). This may lead developed countries toreduce imports from countries like Bangladesh and Zimbabwe and leave a mainly female workforce unemployed. On the other hand, imports to developed countries from China and India may increase and lead to increased employment for women there instead.

Research in the area of trade and gender still has much to explore. It is important to enhance the availability of gender-specific data and create methods of analysis which bring out the gender nuances in the trading environment and thereby contribute to increased gender equality in the creation of multilateral trade rules.

# 2. Developing Countries in World Trade

## 2.1 Developing Countries in World Trade

With the trade and development perspective from the previous chapter in mind, this chapter aims to situate developing countries in a world trade perspective.

Today's global economic environment is dynamic, and its nature is changing rapidly. The growing importance of large multinational companies means that an increasing portion of world trade is taking place within these firms rather than between firms. Intra-industry trade is growing as well.[24] This makes the connection between foreign investment and trade stronger. Information technology has had far-reaching consequences for knowledge-sharing and information dissemination and is making it easier to trade internationally. The production of services is growing ever more important in developed as well as developing countries. The flow of capital across borders has increased rapidly, and the migration pressure is rising. These changes have had and will continue to have implications for the global trading environment.

The shift towards more open trade by developing countries has been reflected in fundamental changes in the role of developing countries in world trade. Developing country exports of manufactured goods have increased substantially, as have their exports of services.[25] The reliance on trade with other developing countries has also increased. However, it should be noted that the developing countries are a heterogeneous group, ranging from high-performing countries, e.g. China, to countries with less favourable conditions, such as the LDCs, small island economies and land-locked developing countries. Hence, the general picture for developing countries' trade performance is less positive when the LDCs or Sub-Saharan Africa are singled out.

Developing countries as a whole today constitute some 30% of world merchandise trade, compared to 23% in 1990. Between 1990 and 2000, developing country exports and imports expanded rapidly (more than 9% and 8%, respectively, per annum). The corresponding growth rate for world trade was about 6%.[26]

The growth performance in exports varies significantly among developing countries. In general, the fastest growing countries belong to the upper-middle-income and high-income developing economies.

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[24] OECD (2002)

[25] Martin (2003)

[26] UNCTAD (2003)

The exceptions are China and India, which experienced above-average export growth despite being low-income.[27] The exports of low-income countries, many of which are African, grew at a slower pace.[28] The export market shares of LDCs and low-income countries (excluding China) are small, compared to higher income countries, although the LDCs increased their share to 0.6% in 2001 (Table 1).[29] However, the increase in LDC exports was concentrated in 1999–2001 and was mainly due to oil exporting LDCs (Angola, Equatorial Guinea, Myanmar, Sudan and Yemen).

**Table 1. Developing countries' market share in world merchandise exports, by income group (% of total world merchandise trade, excluding intra-EU trade)**

| | 1990 | 1995 | 2001 |
|---|---|---|---|
| Least-developed (49) | 0.5 | 0.4 | 0.6 |
| Low-income (21) | 4.1 | 5.2 | 7.1 |
| Low-income without China | 2.3 | 2.3 | 2.7 |
| Lower-middle-income (44) | 6.1 | 5.5 | 7.1 |
| Upper-middle-income (31) | 9.8 | 11.0 | 12.9 |
| High-income (15) | 7.6 | 9.5 | 8.6 |

**Note:** LDCs are defined by a UN list of countries (while they were 49 in 2001, they are 50 today). The other categories are classified according to World Bank per capita income in 1998 as follows: low-income countries with per capita income less than $760 USD (except LDCs), lower-middle-income $760–3030 USD, upper-middle-income $3030–9360 USD, and high-income from $9360 USD.

**Source:** Adapted from Michalopoulos (2004)

In terms of value, the exports of 18 of the 49 LDCs were lower in 2001 than 1990, a reflection of their reliance on exports of commodities. Many developing countries, and the LDCs in particular, still face severe supply-side constraints. Some do not have the required human and physical resources, others are lacking basic infrastructure, producers might be unable to live up to the standards required by importing countries, or are simply unable to prove that the standards are met. These and other supply-side constraints prevent developing countries from increasing their share of manufactured goods and moving away from a dependence on exports of primary commodities. Attracting foreign investment may be one way to diversify production and obtain new technology. Since 1995, the inflow of foreign investment to developing countries has more than doubled ($240 billion USD in 2000). This may be compared with a fourfold increase in the world total inflow of foreign investment ($1,270 billion USD in 2000). However, it is mainly the high-income developing countries which have benefited from these flows.[30]

If one takes a regional view of the performance of developing countries' trade (Table 2), the fastest growing regions are East Asia, South Asia and Latin America. Asia as a whole constitutes the largest regional market among the developing regions, as far as both exports and imports are concerned. Although trade has expanded annually in sub-Saharan Africa and the transition economies, both regions have experienced a decline in their market shares between 1990 and 2000.

[27] During the 1990s, China's trade grew three times faster than world trade and rose by 30% between 2000 and 2002, when world trade stagnated. This exceptional development has put China in fourth place among the world's largest merchandise traders in 2002 (WTO Secretariat, 2003c).

[28] Michalopoulos (2004)

[29] Michalopoulos (2004)

[30] Kommerskollegium (2002a)

**Table 2. Developing countries' market share and growth of exports and imports, by region (%)**

| | Exports | | | | Imports | | | |
|---|---|---|---|---|---|---|---|---|
| | | | Change in market share | Average annual growth | | | Change in market share | Average annual growth |
| | 1990 | 2000 | 1990–2000 | 1990–2000 | 1990 | 2000 | 1990–2000 | 1990–2000 |
| Developed economies | 71.5 | 64.0 | -7.5 | 5.5 | 72.5 | 67.3 | -5.2 | 5.7 |
| Developing economies | 23.9 | 32.0 | 8.1 | 9.1 | 22.6 | 29.1 | 6.5 | 8.3 |
| of which: | | | | | | | | |
| Asia | 16.9 | 24.2 | 7.3 | 9.5 | 15.9 | 21.1 | 5.2 | 8.2 |
| East and South Asia | 13.0 | 20.0 | 7.3 | 10.3 | 12.9 | 18.0 | 5.1 | 8.7 |
| Latin America | 4.2 | 5.6 | 7.0 | 10.2 | 3.7 | 5.9 | 2.2 | 11.4 |
| Africa[a] | 2.3 | 1.8 | 1.4 | 3.5 | 2.4 | 1.6 | -0.8 | 3.2 |
| Sub-Saharan Africa[a] | 1.2 | 1.0 | -0.5 | 4.1 | 1.1 | 0.8 | -0.4 | 2.6 |
| Transition economies | 4.6 | 4.0 | -0.6 | 8.8 | 4.9 | 3.6 | -1.3 | 8.7 |

[a] Excluding South Africa.

**Source:** UNCTAD (2003).

The pattern of overall developing country exports has shifted from a reliance on natural resources and agricultural products to manufactured goods.[31] Developing countries' share in world manufactured exports has more than doubled since the 1980s.[32,33] Although the shares differ between countries, this change is true for all developing regions, and not just for high-performing countries, such as China and India.[34] Among the LDCs, it is primarily the exporters of textiles and garments (e.g. Bangladesh) that have taken part in this positive trend in manufactured goods.[35] Many of the poorest countries (mainly in Africa) are still dependent on commodities for their exports.[36] However, irrespective of the nature of exports (primary commodities or manufactures), LDC exports still tend to be highly concentrated in a few products.[37]

31 UNCTAD (2002a) notes that "… the evolution of a country's share in world trade is not always mirrored by changes in its share in world income." (p. 82), i.e. although the share of developing countries in both manufacturing trade and value added has increased, the share of some of these countries in world manufacturing income fell. This is explained by an increased import content (a consequence of the increased participation in import-dependent, labour-intensive, low value-added processes in international production networks, and trade liberalisation).

32 It should be noted that the spread of international production networks and growing intra-industry trade (trade with products from the same sector) tend to result in a double-counting of such goods. This may explain some of the rapid increase in trade in manufactured goods (UNCTAD, 2002a and 2003). Another explanation is that the cost structure and the previous pattern of protection in developing countries discriminated heavily against manufactured goods and agricultural processing (Martin, 2003). A third explanation is the relatively high rate of accumulation of human and physical capital in developing countries (Martin, 2001). This is in turn linked to the increased flows of foreign investment to developing countries.

33 World Bank (2000b)

34 The increase in the share of manufactured exports from developing countries is still valid when the figures are expressed in real values, i.e. corrected for price changes (World Bank, 2003).

35 It should be noted that the production of textiles and clothing is highly sensitive to the level of input costs, in particular labour costs. Production (machinery) readily shifts to countries where it is cheaper to produce clothing.

36 World Bank (2003)

37 UNCTAD (2002c)

World trade in fish has increased substantially during the last 20 years.[38] Developing countries' income from trade in fish has also increased during this period. In value terms, developing countries' net receipts from fish trade is greater than their receipts from other agricultural commodities such as coffee, bananas, rice and tea taken together.[39] The income generated from the export of fish is vital for the economies of Low Income Food Deficit Countries. In addition, fish is in many countries the main source of protein. It is therefore important that fish exports do not endanger food security and that trade rules and regulations enhance sustainable fisheries.

The direction of developing country exports has also changed substantially. The share of developing country exports to other developing countries (intra-developing country trade or 'south-south' trade) grew from 26% to 37% between 1980 and 1999.[40] This tendency is valid for all products, not just manufactured goods.[41] This is due in part to greater interdependence in production, for example as a result of regional trade agreements, but also to the importance of developing country products in the domestic consumption of other developing countries which has led to an overall increase in developing countries' share in global trade.

Another essential change in developing country trade is the increased importance of trade in services (e.g. tourism, transport services). At the beginning of the 1980s, commercial services exports constituted 6.5% of the total trade of low and middle-income developing countries. This grew to a share of 14% in the past two decades.[42] Since 1985, the value of developing country services exports has grown by a factor of four[43], to reach 23% of world services exports in 2001. The LDCs' share of world services exports was 0.4% in the same year.

## 2.2 Developing Country's Trade Policies and Practices

During the post-war period most developing countries were on the periphery of the trade policy negotiations under the General Agreement on Tariffs and Trade (GATT). Access to export markets was of limited interest to most developing countries and many followed import-substitution as a development strategy (Box 1). Developed countries focused more on liberalising access to each other's markets (e.g., Europe-North America) by reciprocity-based negotiations to reduce tariffs, than on tackling barriers in the distant, less familiar and less appealing markets of lower-income developing countries. Up until the Tokyo Round in the 1970s, non-tariff measures were not even addressed, and special and differential treatment was used by developing countries to justify more or less complete exemptions from commitments to liberalise.[44]

At the beginning of the 1980s many developing countries began to liberalise their trade regimes – sometimes on their own initiative, but most often as part of World Bank or IMF-sponsored programmes.[45]

[38] FAO and Royal Norwegian Ministry of Foreign Affairs (2004), page 4,5

[39] Ibid

[40] Developed countries still receive the main part of developing country exports, but the share decreased from 68% to 57% between 1980 and 1999 (Kommerskollegium, 2002a).

[41] Martin (2001)

[42] World Bank, World development indicators, http://www.worldbank.org

[43] Based on data from UNCTAD (2002b). The values have not been deflated. The data covers commercial services, which includes cross-border trade in services (GATS mode 1) and through movement of the consumer (GATS mode 2).

[44] Sally (2001)

[45] Sally (2000)

In the Uruguay Round, the last completed round of multilateral trade negotiations (1986–1994), developing countries participated more actively than ever before, and made commitments as full members of the World Trade Organisation (WTO).[46]

**Box 1. From import substitution to openness – the role of trade in development strategies**

Import substitution and its real effects on developing countries have been widely debated. This box aims to give a simplified description of the arguments for and against import substitution and its practical use. Import substitution was first adopted by countries in Latin America in the 1930s and 1940s as a strategy to promote economic development. The aim was to industrialise by replacing imports with domestically produced goods, sheltering domestic production with trade barriers. This protectionist trend was reinforced by the hypothesis of export pessimism put forward by Raul Prebisch and Hans Singer in the 1950s, which was endorsed by other developing countries.

One argument used to justify the introduction of trade barriers was the infant industry argument. Manufacturing industries in developing countries were said to need protection during the early stages of the learning process. A further argument for trade barriers was the belief that balance of payments difficulties could be addressed through trade controls. Consequently, the trade policy strategy of import substitution was characterised by highly protective trade measures.

It soon became evident that import substitution did not lead to the anticipated results. Lack of competition reduced the incentives of domestic industry to increase productivity and innovate. Many infant industries remained inefficient and failed to develop the ability to compete on the international market, or even nationally against imports, despite high levels of protection. This failure led to a re-consideration of the role of trade in development strategies. The evidence provided by comparative country studies also suggested that countries pursuing more open or outward-oriented trade policies enjoyed stronger growth in both exports and per capita income.

A more successful strategy seemed to be outward orientation of trade regimes. Various types of strategies have been and are being pursued successfully to expand trade, in particular exports. Korea, Taiwan and China have complex trade regimes, aimed at stimulating exports, while protecting against imports at the same time. Chile, Hong Kong and Singapore have maintained a neutral trade regime, open for both exports and imports. Other countries, such as Mauritius and El Salvador have established export-processing zones in otherwise protectionist trade regimes. The common denominator is the promotion of exports, while neutralising the negative effects of import protection on input costs. Since the 1980s, developing countries that are more open to global trade have become increasingly integrated in the world economy.

There has been a clear shift in the basic orientation of developing countries' trade policies, from closed to more open trade regimes, even if the degree of liberalisation, and how it has been implemented, differs markedly between countries and regions. Applied tariffs have been reduced, the tariff structure has been unified and simplified, the use of non-tariff barriers has been made the exception rather than the norm, and many services sectors have been liberalised, including through privatisation.[47]

[46] In principle, the same trade rules apply to all WTO Members. Special and differential treatment is granted to developing countries, and in particular to the LDCs, e.g. in the form of longer transition periods to full implementation of obligations. This is different from GATT 1947, which preceded the WTO, when GATT contracting parties could choose membership in the plurilateral agreements on non-tariff barriers ('GATT à la carte').

[47] Michalopoulos (2001)

**Customs duties/Tariffs**

The simple average applied tariff of developing countries declined from 32% in the early 1980s to 15.6% by the end of the 1990s. All developing regions have lowered their tariffs, although the greatest efforts have been made in South Asia, Latin America and East Asia. Tariff reductions have been more moderate in sub-Saharan Africa (although they have recently been significant in West Africa due to the establishment of customs unions), and small in the Middle East and North Africa.[48] Despite this downward trend, average tariffs in developing countries remain high compared to those in developed countries.[49] As the initial levels were high in South Asia, the average tariff is still more than 30% and well above 20% in the Middle East and North Africa.[50] The average tariff levels tend to vary inversely with the level of development: in general, the lower the income of a country, the higher the average tariff (noting that this may be a choice related to maintaining an important revenue stream for the state budget,[51] and that unweighted average tariffs do not necessarily reflect the real level of protection, which is influenced by for example particularly high tariffs on certain developing country exports, so called "tariff peaks").

Parts of the trade negotiations in the WTO are related to the "binding" of tariff levels. A tariff binding is a commitment not to increase a rate of duty above an agreed level. Once a rate of duty is bound, it may not be raised without compensating the affected parties, i.e. the countries exporting the product in question.[52] Based on the subset of developing countries for which such data are available, only 59% of their tariff lines are bound in the WTO.[53]

As a general rule, unbound tariffs create uncertainty and unpredictability for trading relations, since they can be raised whenever a country decides. The principal exception is where tariffs are unbound in the WTO, but subject to disciplines in another legal instrument, such as a regional trade agreement. In the presence of a bound tariff, the exporter knows in advance the level of the maximum tariff, which provides certainty in the treatment of the product in export markets.[54,55] The proportion of bound tariffs varies widely between regions. Countries in Latin America have bound almost all of their tariff lines, although at ceiling levels well above applied rates, while African and Asian countries have bound only a small share, but closer to applied rates.[56] For example, unbound tariff lines in Pakistan amount to about 63%[57] of all tariff lines and about 85% in Uganda.[58]

**Non-tariff barriers**

Non-tariff barriers include all trade barriers that are not customs duties, e.g. licensing, prohibitions, quotas, and minimum pricing. The frequency of non-tariff measures has decreased in all developing regions, with the exception of South Asia (Table 3).

48 World Bank (2001)

49 The average bound tariff for non-agricultural products is 3.8% in developed countries as a whole (www.wto.org). If only agricultural tariffs are considered, the average tariff level is about the same (roughly 40%) in developing and developed countries (Michalopoulos, 2001).

50 Average unweighted tariff rates 1996–98 (World Bank, 2001)

51 Michalopoulos (2001)

52 Goode (2003)

53 This figure is almost 100% in developed countries and transition economies, and nearly 100% for agricultural products only in all countries (Sally, 2000).

54 The upper limit is known since the bound tariff is the maximum tariff that may be applied. Lower tariffs may however be applied.

55 In Latin America, the bound levels are three times the level of applied tariffs, while in East Asia and East Europe they are twice as high (Sally, 2000).

56 Michalopoulos (2001)

57 WTO Secretariat (2001b) page 29

58 WTO Secretariat (2001c) page 34

**Table 3. Frequency of total core non-tariff measures for developing countries (%)**

| Region | 1989–94 | 1995–98 |
|---|---|---|
| East Asia and Pacific (7) | 30.1 | 16.3 |
| Latin America and the Caribbean (13) | 18.3 | 8.0 |
| Middle East and North Africa (4) | 43.8 | 16.6 |
| South Asia (4) | 57.0 | 58.3 |
| Sub-Saharan Africa (12) | 26.0 | 10.4 |

**Notes:** Average number of commodities subject to non-tariff measures as a percentage of total. Figures in parentheses are the number of countries in each region for which data are available.
Core measures are defined as those that involve various kinds of quantitative restrictions or price controls on imports.

**Source:** Michalopoulos (1999).

Before the WTO was established in 1995, non-tariff barriers were used frequently by a number of developing countries – covering more than 50% of imports in, for example, Bangladesh, Colombia, Egypt, Kenya, India, Indonesia and Malaysia.[59] Such measures are still being applied by a number of countries, although India and Korea have, for example, committed themselves to further liberalise these measures.[60]

**Other forms of protection**

There are still other measures which countries can use as barriers to imports. These are normally referred to as contingent protection or trade remedies and include antidumping measures, countervailing duties and safeguards.[61] These measures are, unlike most other non-tariff measures, permitted under the WTO, provided that the provisions of the relevant WTO agreement are observed when such measures are applied. Developed countries have long been intensive users of these types of protection, in particular of anti-dumping measures, and developing countries' use of these measures has increased in recent years, in particular among middle and high-income developing countries.[62] The target of these measures is mainly the exports coming from other developing countries.[63]

**Customs procedures, customs valuation and trade facilitation**

There is a wide range of procedures and formalities that governments and firms put in place to monitor and control the movement of goods in and out of a country. However, customs administrations in developing countries often lack resources and capacity, and exhibit weaknesses such as uncodified customs processes, poorly trained officials, a civil service system that does not provide appropriate remuneration and hence leads to corruption, and ineffective or nonexistent provisions for appeal of

59 Michalopoulos (2001)

60 Michalopoulos (2001)

61 Antidumping involves measures against imports found to be sold at below normal values and which injure or threaten to cause injury to the domestic industry. Antidumping measures are applied in the form of an additional tariff on imports or a price undertaking. Countervailing duties are measures taken to level out and/or counteract subsidies which directly or indirectly are granted to producers or exporters on the goods in the exporting country and which injure or threaten to cause injury to the domestic industry. The countervailing duty may take the form of an additional tariff on imports, or a price commitment by the exporting company. Safeguards may be introduced as a protection against sudden import surges, which distort the market.

62 Among the top 15 countries using antidumping measures, and initiating measures between 1995 and June 2002, are India, Argentina, South Africa, Brazil, Mexico, Indonesia, Peru and Egypt.

63 57% of the initiated antidumping investigations are directed towards developing countries, 31% towards developed countries, and the remainder towards transition economies.

customs decisions. Physical control systems may also be weak, making smuggling a significant problem.[64] Traders thus face problems such as disproportionate data requirements, excessive release and clearance time for goods, and poor co-ordination between customs and other authorities. In addition to hindering trade, such problems tend to restrain customs revenue collection and increase the scope for corruption. Estimations of the costs of trade procedures show that they vary widely across countries, but are nevertheless substantial, amounting to 2.5–15 percent of traded goods' value.[65] Improvements are therefore often needed in overall customs procedures.

WTO negotiations aiming at reducing the impact of import, export and trade procedures on trade flows were launched in July 2004. Measures aimed at reducing transaction costs related to trade and customs procedures are often termed "trade facilitation". Customs are a natural focal point for such reforms, but trade facilitation goes beyond customs reform, as it also relates to areas such as transparency in legislation, transport and payment systems. Therefore, a thorough analysis is often required to identify the main bottlenecks along the trade chain. For the same reason, effective trade facilitation requires dialogue between many different actors, within the government (e.g. Ministries of Trade, Transport and Finance and Customs) as well as within the business community (e.g. importers and exporters, banks and insurance companies). Active involvement of the business community is important also to ensure ownership and sustainability of reforms. Trade-related technical cooperation may play an important role to support trade facilitation, for various reasons: donors may avail developing countries' governments with financial means to carry out costly reforms; they can provide knowledge about international standards and procedures; and they can offer technical know-how on reforms.

An additional issue is the implementation of the WTO agreement on customs valuation. The agreement requires all WTO Members to use the actual transaction value as the standard basis for determining the customs value and thus the basis on which tariffs are applied (since they are generally expressed in ad valorem terms). As developing countries' customs administrations often lack the resources and the capacity to effectively implement the transaction value method[66], many developing countries, and in particular the majority of African countries, have recourse to preshipment inspection services (PSI) at the port of origin. The purpose of this specialised service, which is carried out by private enterprises, is to establish the customs value for use by customs administrations upon the subsequent importation at destination.[67, 68] Charges for such services are often required to be assumed by the importer in the form of an additional tax on imports.

**Technical regulations and standards, sanitary and phytosanitary measures**

In addition to other types of barriers to trade, technical regulations, national and international standards, guidelines or recommendations, which have been set to protect consumers, sometimes constitute real barriers to developing countries' exports. These types of non-tariff barriers are treated in two different WTO agreements. The Agreement on Technical Barriers to Trade

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64 Finger and Schuler (1999)

65 Kommerskollegium and SWEPRO (2002) pp. 12–14, OECD (2003)

66 Hoekman and Koestecki (2001), and Finger and Schuler (1999)

67 Preshipment inspection is a second best solution for countries with serious weaknesses in customs administration (Dutz, 2001).

68 Anson et al. (2002), Dutz (2001), Rege (2002) and WTO (2003d), page 3

(TBT) aims to ensure that regulations, standards, testing, and certification procedures do not create unnecessary obstacles to international trade. It contains rules that WTO members need to follow when they prepare, adopt and apply technical regulations and standards, including packaging, marking and labelling requirements, and procedures for assessment of conformity with technical regulations and standards. The Agreement on the Application of Sanitary and Phytosanitary Measures (SPS) relates to the protection of human, animal or plant life and health. Measures under this agreement are developed under Codex Alimentarius Commission, the International Office of Epizooties (OIE), and the relevant international and regional organisations operating within the framework of the International Plant Protection Convention (IPPC).

Developing countries, and in particular most LDCs, often lack the capacity to (a) establish national product regulations, including international standards; (b) assess the conformity of imported products, (c) ensure that products to be exported conform with the regulations in the export market, and (d) participate in the international standard-setting process (e.g., International Standardization Organisation (ISO), Codex Alimentarius, IPPC, OIE). This means that standards often are set without taking the situation in developing countries into account. Another effect is that potential exports from developing countries are refused as they do not meet, or can not be proven to meet, the regulations or standards in the import market. Furthermore, developing country consumers may face unsafe imported products which do not meet international standards and have an unacceptable quality.

Developing countries have highly diverse legislation in the TBT and SPS areas. A generalization would be to state that in Africa, the systems are either old, often based on colonial legal practices or, in many cases,

non-existent. New legislation is often introduced on an ad hoc basis, with important gaps in relation to the WTO Agreements on TBT and SPS. These problems are most acute in LDCs, while Latin American and Asian countries generally are more advanced in terms of both domestic legislation and the implementation of the WTO Agreements on TBT and SPS. Developing countries do often not cooperate sufficiently to harmonise technical regulations and SPS measures at the regional level. This lack of regional harmonization and co-ordination hinders free trade.

The need for trade-related development cooperation, especially at the regional level, is evident in this field. Training is needed to familiarise officials with standard setting and conformity assessment, as well as the benefits of product regulations for the development of exports. The concept of a national quality infrastructure, the need of quality products and consumer awareness are basic areas that have to be fulfilled to be a trading partner country. [69] Sweden is suited to provide technical assistance in the TBT and SPS field, as its quality awareness and consumer awareness are high and its authorities are open to provide this type of development cooperation.

**Measures affecting exports**

Developing countries themselves may also, for a variety of reasons, take actions which affect their exports. Some developing countries have measures in place designed to encourage non-traditional exports, i.e. of processed or manufactured goods.[70] Few countries grant export subsidies in the form of outright cash grants. This type of export promotion of a specific sector or enterprise is not only costly in terms of the subsidies to be provided, it also requires an informed decision about which sector or company to support. Trade administrations tend to be ill-equipped to make such decisions. Hence, it is not obvious that the benefits of export promotion through direct subsidies outweigh the costs for budget-constrained developing countries, compared to a more neutral trading regime. There are other measures that governments use more frequently to promote export development. These include subsidised export financing, providing insurance services, or providing favourable fiscal and customs treatment through export processing zones.

Exports may also be subject to restrictive measures in developing countries. In some cases, export restrictions may represent a costly effort to promote domestic processing of raw materials (e.g. an export ban on raw hides to promote leather manufacturing). In addition exports may be taxed for a variety of reasons, including an attempt to raise the price of the good in the export market by reducing supply, protecting the domestic processing industry by taxing exports of raw materials, enhancing domestic food security by taxing food exports, protecting finite natural resources by taxing them if exported, or simply as a way to raise government revenue. Other examples of similar policies include price controls or controls on how credits are allocated. Although developing countries have made efforts to liberalise these policies, trade-related domestic measures that inhibit the development of exports remain important.[71]

[69] Foss (2004)

[70] Michalopoulos (2001)

[71] World Bank (2001)

### Trade promotion

It is not only important for developing countries to have supply capacity; they must also be able to sell what they produce. However, export opportunities may sometimes be missed because of a lack of knowledge about the existence of foreign markets or because of a lack of contacts in foreign markets. Trade promotion is therefore an area where development cooperation can provide an impetus to strengthen developing countries competence and capacity to export. Private sector representatives and officials from developed countries with knowledge about their own markets can assist developing country exporters with information about market opportunities, quality requirements and how the market functions. Another type of useful assistance is initiatives enabling developing country exporters and their organisations to meet the business community in their potential export markets. The setting up of offices in developed countries to which developing country exporters can turn for all types of information regarding the market in question and for assistance with bureaucratic matters can also prove valuable. Assisting the business community build marketing expertise is yet another example of an area where help can be provided to potential developing country exporters.

### Services

The importance of services in overall economic activity has increased markedly in recent years (Box 2, on page 26, provides an explanation of the concepts). Services dominate the structure of developed economies (accounting for 70% of production and employing close to four-fifths of workers in OECD countries). Services are essential to most developing countries' economies as well and often constitute about 50% of their GDP (when government services are included). This is significantly more than the traditional sectors of agriculture and manufacturing.[72]

Although developed countries dominate trade and investment in services, the services sector also offer significant opportunities to developing countries. Many developing countries have a comparative advantage in supplying the types of services that require a significant amount of low-skilled labour, such as tourism. Other developing countries, such as India for example, benefit from a large and fairly well-educated work force which has been key to India's success in the computer engineering sector. This shows that trade in services can offer a way of diversifying an economy away from a dependence on primary products. Even developing countries with little comparative advantage in services have an interest in creating the preconditions for an efficient services sector, since a well-functioning service infrastructure, including finance, transport, telecommunications and energy, is vital to the long-term growth performance of the entire economy.

Despite the importance of services, trade in services is in some instances more protected than trade in goods.[73] Although many developing countries have autonomously removed barriers to investment in services (e.g. in telecommunications),[74] the level of developing countries' legally binding undertakings to open up their services sectors under the GATS is low compared to developed countries. On the other hand, developed countries have not done much in terms of legally binding undertakings under the GATS that would permit the mobility of labour from developing to developed countries.[75]

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[72] Sauvé (2004)

[73] See Kommerskollegium (2004) for references.

[74] Mattoo (1999)

[75] SOU (2001)

**Box 2. Services and trade in services at a glance**

The service sector ranges from traditional services such as transport, communications, finance, energy and tourism to new, dynamic areas such as wireless communications, software development, environmental, and educational services.

As opposed to goods, services are often intangible. In traditional trade, a product crosses the border. In services trade it is often the producer or the consumer who moves. The WTO agreement that covers trade in services, the General Agreement on Trade in Services (GATS), therefore defines trade in services according to how the service is supplied (so-called modes of supply). These are:

(i) *cross-border supply* – when a service crosses a national frontier, e.g. a long-distance phone call (similar to trade in goods);

(ii) *consumption abroad* – when the consumer travels to the territory of the service supplier, e.g. education or tourism;

(iii) *commercial presence* – involves the physical establishment in a foreign market, e.g. a subsidiary of a bank;

(iv) *movement of service suppliers* – the service provider moves temporarily to the country of consumption, e.g. an Asian doctor treating patients in Europe.

GATS covers in principle all international trade in services. The exception is publicly funded services such as governmental services that are not supplied commercially and do not compete with other suppliers, and, in the air transport sector, traffic rights and all services directly related to the exercise of such rights. The Agreement consists of two parts: a framework agreement laying down the fundamental principles and general obligations, and national schedules of specific liberalisation commitments made by WTO members. A voluntary approach to liberalisation commitments is applied. Members select the sectors, modes of supply, and the regulatory conditions in which specific market commitments are made. This makes GATS a flexible agreement.

**Source:** Sauvé (2004)

The GATS approach to liberalisation, which means that countries can choose in which sectors and to what extent they make legally binding undertakings to open their markets, and its emphasis on progressive liberalisation, help explain why the GATS is often described as the most "development-friendly" of all Uruguay Round agreements.[76] Just as for the binding of tariffs, services commitments made in the GATS are valuable for services traders since certainty of access is increased. However, the GATS still poses some challenges to developing countries. Critics are afraid that the GATS will inevitably bring all service sectors within its liberalising scope, and that governments will loose their sovereignty and ability to regulate public access, especially in areas that are vital to poverty reduction such as water, health and education. In addition, the request and offer process of the ongoing negotiations means that a certain pressure to liberalise is applied when developed countries make requests for market openings in developing countries. The effects of liberalisation of a certain sector will be different in different developing countries depending on how advanced they are in that particular sector. In spite of the exclusion of certain governmental services from the scope of the GATS, there are thus fears that negotiations will lead to reduced access to vital services for poor people if these sectors are left to private competition and complementary policies are not pursued.

[76] Sauvé (2004)

Reaping the benefits of trade in services demands not only liberalisation, but also a suitable domestic regulatory framework. The regulatory framework has to be put in place before the sector is opened up. Regulation is needed in many service sectors to address a variety of market failures, ranging from public monopolies in transportation and telecommunications to information asymmetries in the provision of professional services. Regulation may also be necessary to ensure universal access to education and health services.[77] Another criticism of the GATS is that while developing countries could benefit from the opening up of developed country markets for labour from developing countries, the design of the GATS is biased towards financial services, a sector which developed countries dominate.[78] One of the reasons for the current imbalance is that the GATS was based on the situation when it was negotiated, and which still exists, in which global markets for labour are far more restricted than global markets for financial services.[79]

There are several types of cooperation that can be envisaged in the services area.[80] They include providing developing countries with the capacity to determine their readiness to liberalise and their potential gains from liberalisation by others, and develop government-wide negotiating strategies (including the elaboration of offers and requests in the negotiations). Help can also be given to enable developing country service providers to take full advantage of the market access opportunities arising from regional and multilateral liberalisation efforts; strengthen the capacity of domestic regulatory agencies, notably by strengthening developing country participation in regional and global standard-setting initiatives; and enhance their capacity to design reforms that properly factor in the impacts of liberalisation on the poor and improve their access to essential services. It is important to ensure that developing countries are enabled to enhance their standards and qualifications for services so that they meet international requirements as well as remedy inadequacies in domestic regulation, as these can legitimise existing trade and investment barriers directed against developing country exports. In addition, a stocktaking exercise to consider national and cross-country experiences with services reform could help identify areas where reforms can be fast-tracked and those where uncertainties suggest greater precaution.

#### Intellectual property rights[81]

Ideas and knowledge are becoming ever more important parts of trade. They are contained in medicines, high technology products, artistic works such as music and films, brand named clothing, etc. Creators can be authorised to prevent others from using their innovations. These rights are intellectual property rights. Intellectual property rights are issued by governments to allow creators to protect their work for a limited duration. They include rights to produce, use, sell, license, and import the object of the right.

Intellectual property rights vary considerably around the world. The difference in protection and enforcement across countries increasingly became a source of friction as the intellectual property content of the goods traded increased. The Agreement on Trade-Related Intellectual Property Rights (TRIPS) came into force with the WTO in 1995. It establishes common international rules by requiring all WTO member

77 Sauvé (2004)

78 Oxfam (2002)

79 Oxfam (2002)

80 This paragraph is based on Sauvé (2004).

81 This section is based on CIPR (2002), Kommerskollegium (2004), and Maskus (2004).

countries to guarantee certain minimum standards of protection. These include patents, copyrights, trademarks, geographical indications, industrial designs, and the protection of trade secrets. The TRIPS Agreement also contains rules on how these rights shall be enforced.

The TRIPS Agreement may have profound implications for developing countries. Its effects will vary across countries or sectors depending inter alia on the country's level of development, technological capacity, market competition, effective governance, and social factors. Most developing countries have introduced or have modernised their intellectual property regimes in recent years.[82]

Intellectual property rights are intended to promote innovation, and innovation can benefit development. However, implementing the TRIPS Agreement involves costs.[83] New legislation often needs to be put in place, administered and enforced. There are also possible adjustment costs, e.g. displacement of workers in counterfeiting activities or higher prices for goods and technologies. The costs may be especially burdensome for the LDCs because of their limited resources. Governments' inclination to provide intellectual property protection normally depends on the country's level of development. Technologically advanced countries tend to have stronger protection in order to provide returns on investments in research and development, while poorer countries may wish to promote access to technologies and products through weaker protection.[84] However, all countries need to balance the promotion of innovation and the attempt to attract foreign investment through high

82 Kommerskollegium (2004)

83 See section 3.3 for a further discussion of the implementation costs.

84 In 1998, the high-income countries of the OECD accounted for 86% of total patent applications filed and 85% of scientific and technical journal articles published worldwide, earning over 97% of worldwide royalties and licence fees. In contrast, the LDCs earned 0.05%t of worldwide royalties and licence fees in the same year. (UNDP, 2003, page 207)

levels of protection against the desire to encourage public access to new technologies and products.

As the implications of intellectual property rights on a country's trade and development differ with the level of development, it is imperative to design the TRIPS rules to suit each country's particular situation. The TRIPS Agreement offers some flexibility. Developing countries were granted a transitional period to full implementation until January 2000. The transitional period for LDCs will end as of January 2006.[85] For pharmaceuticals, LDCs do not have to enforce the patent provisions of the TRIPS Agreement until 2016.

The TRIPS agreement is nevertheless one of the most criticised of the WTO agreements. One example of a much debated issue is developing countries' access to essential medicines (such as those against HIV/AIDS, malaria, and tuberculosis). The TRIPS Agreement requires countries to provide patents for new medicines. This is likely to raise the costs of medicines to consumers and/or Governments and may make them unaffordable for the poor. If a country has the production capacity, the TRIPS Agreement allows it to bypass the TRIPS requirements by issuing a compulsory licence (i.e. the patent holder must provide a local firm with the technology, under certain specified conditions). One restriction was that medicines produced under a compulsory licence were to be predominantly destined for the domestic market. This raised an obstacle to countries without domestic production capacity. Difficult negotiations to remedy that situation ended in a transitional solution in 2003. WTO Members then agreed to allow countries without domestic production capacity to import drugs produced under a compulsory licence. However, this procedure has so far never been used. One reason may be that they lack the capacity to change domestic legislation according to the new rules. Another may the stringency of its requirements.[86] It may also be an indication that developing countries, for political reasons, do not dare to use it. That compulsory licences are not used in practice may nevertheless not mean that they are of no use. The possibility that they may be used can be a sufficient reason for pharmaceutical companies to lower their prices.

A second set of issues of concern to developing countries is the relation between the TRIPS Agreement and the Convention on Biological Diversity. Developing countries fear that the TRIPS Agreement will negatively affect their biological diversity and access to and the benefit sharing of genetic resources, the protection of traditional knowledge, and farmers' right to save, exchange and replant their own seeds. A third issue of importance to developing countries is that the TRIPS Agreement provides some protection to geographical indications (a way of identifying certain qualities of a product based on its origin). A particularly high level of protection based on origin is given to wines and spirits. Some developing countries would wish to see this higher-level protection extended to agricultural produce and food (basmati rice and specialized oils for example) and textile and clothing designs, as it could offer added value and create market niches for their products.

The TRIPS Agreement offers some flexibility to achieve development goals. However, using this flexibility requires knowledge of the Agreement and how it may be adjusted to each country's prerequisites. Concrete measures that specify minimum standards have been suggested for the LDCs by

[85] Paragraph 66.1 of the TRIPS Agreement foresees a possibility for WTO Members to grant extensions of this period to LDCs which submit duly motivated requests.

[86] Bridges (2004)

the Commission on Intellectual Property Rights.[87] However, bilateral and regional trade agreements between developing and developed countries sometimes go beyond the provisions of the TRIPS Agreement to contain even stricter rules on intellectual property rights (often referred to as "TRIPS plus"). The inclusion of "TRIPS plus" provisions in regional trade agreements limits developing countries' possibility to take advantage of the flexibility offered under the TRIPS Agreement.

Because of the complexity of the TRIPS Agreement and its implications, it will take time before developing countries are able to administer and enforce intellectual property rights and effectively participate in international negotiations on trade-related intellectual property rights. Assistance is therefore needed to allow developing countries to build capacity in the TRIPS area and may include: measures which allow developing countries to build knowledge to analyse and implement legislative and regulatory changes; regional initiatives on e.g. patent standards; assistance to allow developing countries build an efficient and pro-development domestic intellectual property rights regime (which requires a holistic perspective as it needs to be supplemented by broader development policies); assistance which would allow developing countries to effectively administrate and enforce TRIPS provisions, and participate in further negotiations on trade-related intellectual property rights; and capacity building which enables developing countries to devise and implement complementary general policies that encourage competition and skills development.

### Trade and the Environment

Environmentalists and trade liberals are currently debating the environmental consequences of liberalised trade. More specifically, the issues debated have included the relationship between WTO rules and trade obligations set out in multilateral environmental agreements (MEAs). Moreover, discussions are taking place over the role fishery subsidies play in natural resource depletion, the benefits of accelerated liberalisation in forest product trade, the usefulness of eco-labelling, and the role, if any, of the precautionary principle in determining allowable imports. Unfortunately, even researchers only have a limited understanding of the role international trade plays in fostering economic growth and of how international trade and growth affect the environment.

Trade liberalisation may spur economic growth and increase production. A pure increase in the scale of economic activity is likely to raise pollution. However, economic growth is likely not only to increase, but also to change the pattern of production and consumption. Economic activity induced by trade could either lead a country to specialize in the production of relatively pollution-intensive goods, or lead it to production of relatively cleaner goods.[88]

The challenge of sustainable development is to foster economic growth while maintaining or improving environmental quality. This is likely to pose a particular challenge to developing countries. One theory, the pollution haven hypothesis, suggests that with trade liberalisation firms in pollution-intensive industries will move from their current location in the developed world to new low-cost locations in the developing world. Arguments for trade barriers against developing country exports are often based on this hypothesis. Although the limited empirical evidence suggests a fairly strong response by firms to differences in environmental regulation, regulatory differences do not seem to constitute the most significant determinant of trade flows.[89]

[87] Commission on Intellectual Property Rights, CIPR (2002)

[88] Taylor (2004)

Apart from the threat that liberalised trade may worsen environmental quality, there is also a risk that rising environmental concerns in the rest of the world may translate into reduced market access for developing country products. The Doha round of trade negotiations includes a discussion of the relationship between MEAs and the WTO. Many MEAs contain provisions for members to apply trade restrictions on countries both within the agreement and without.

Examples of cooperation linked to the environment that could increase developing countries' capacity to trade include support in building and maintaining systems of environmental monitoring in developing countries and capacity building to begin a process of environmental impact assessments of major policy changes or large industrial projects. More specifically linked to this policy, there is a need to strengthen developing countries' capacity to engage in the ongoing negotiations on trade and environment in the WTO. There is also a need to ensure coherence in Swedish and EU policy positions so that unfounded environmental concerns are not used as arguments for barriers to developing country exports.

## 2.3 Regional Trade Integration – Towards a Complex Network of Regional Trade Agreements[90]

Regional trade agreements can be viewed either as stepping-stones or as stumbling blocks towards multilateral integration. On the one hand, regional arrangements may serve as a laboratory for new trade issues not yet covered by WTO disciplines. There may also be possibilities for regional co-operation, e.g. on standardisation. On the other hand, regional trade integration with potentially unclear dividends may detract from global integration governed by non-discrimination.

The design and depth of integration vary between different regional trade agreements. They can either be preferential trade agreements, free trade areas, or customs unions (Box 3 on page 32).

[89] Taylor (2004)

[90] In the text the term regional trade agreements covers all trade agreements between two or more countries.

**Box 3. Different types of regional trade agreements**

*Preferential trade agreements*
A preferential agreement involves tariff reductions on trade between two or more countries. The coverage of products is often restricted. The preferences given may be one-sided or reciprocal.

*Free Trade Areas (FTA)*
In a free trade area, member countries abolish tariffs and other trade barriers on the trade flows between them. Each member country keeps its own trade regime towards non-member countries. Examples of free trade areas include NAFTA (North American Free Trade Area) and ECOWAS (Economic Community of West African States).

*Customs unions*
In a customs union, member countries remove tariffs and other trade barriers on trade between them and, in addition, establish a common commercial policy for trade relations with non-member countries. Examples of customs unions include the EU (European Union), MERCOSUR, WAEMU (West African Economic and Monetary Union) and SACU (Southern African Customs Union).

The sectoral coverage of regional trade agreements also varies widely, from simply including a particular range of industrial products, to coverage of services, or even the free movement of people and capital. An increasing number of regional trade agreements is characterised by deeper integration. It has been recognised that effective integration implies going beyond reducing tariffs and removing quotas, to addressing other barriers to trade and investment such as antidumping, national product standards, and competition policy. Regional trade agreements concluded recently also tend to be more open towards third countries than earlier agreements.

Nearly 180 regional trade agreements are currently in force. In addition, negotiations on further agreements are either under way or are being considered.[91] The number of regional trade agreements involving developing countries has also increased in recent years.[92, 93] Regional arrangements between developing countries constitute some 30–40% of the regional trade agreements in operation. In 2000, trade covered by regional agreements accounted for 43% of world merchandise trade. This figure may increase to more than 50% in 2005 if the agreements under negotiation are concluded and implemented.[94]

Why do countries wish to integrate regionally? The motives are both economic and political. The primary economic motive is to realise gains from trade in a larger market. Other economic motives include: lock-in of trade reforms; negotiation of trade liberalisation with a smaller group of countries; and attempting to develop a competitive industry by accessing a larger market, which is protected from imports from non-Member countries by trade barriers. A desire to achieve a larger coverage of trade issues is often cited as a reason for pursuing regional integration, particularly in the case of countries that already have made comprehensive WTO commitments on goods and services. Countries may consider that the multilateral approach is too

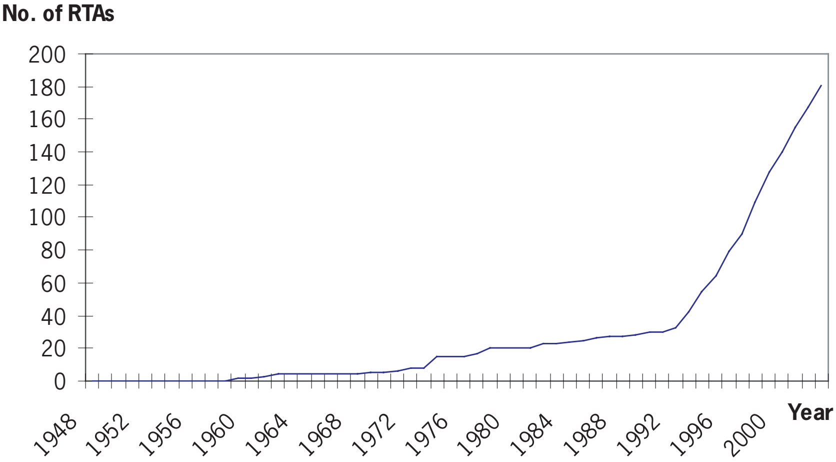
91 As of March 2003, the WTO lists 60 prospective free trade areas. See Appendix Table IB.5 in WTO Secretariat (2003a).

92 World Bank (2000a)

93 The EU has, for example, concluded several agreements with developing countries such as Mexico, South Africa and Chile, with some countries in North Africa and the Middle East (so-called Euro-Mediterranean), and is negotiating Economic Partnership Agreements with African, Carribbean and Pacific countries (WTO Secretariat, 2003a).

94 Measured as the share of preferential intra regional trade agreements' trade in world merchandise imports (WTO Secretariat, 2003a).

**Figure 1. Regional trade agreements (RTAs) in force, 1948–2002**




**Note:** Agreements notified to the WTO under the GATT, GATS and the Enabling Clause.

**Source:** WTO Secretariat (2003a).

time-consuming and view regional agreements as a faster track. Prevention of conflicts and increased security are often emphasised as political motives. Other political motives include enhanced bargaining power from regional unity, and regional co-operation.[95]

Before a country decides to enter into a regional arrangement, the economic implications need to be carefully analysed. (Box 4 on page 34) The positive effects of a regional trade agreement do not necessarily outweigh the negative ones.[96] Potential gains come from increased competition and reduced monopoly power as larger markets are created. Potential losses are trade diversion and the same short-term losses as for liberalisation in general.

The choice of partners is another important consideration. Research suggests that developing countries are likely to gain more in economic terms from a regional trade agreement with a developed country partner than with a developing country partner.[97] Regional integration between developing countries will often involve little trade creation. The problem lies in integrating with developing countries with a similar economic structure when the production patterns are undiversified.[98] Moreover, the benefits will probably be divided unevenly between partners, with the poorest country likely to gain less, as the more advanced country will often have a more mature production structure.

Measured by trade flows, regional integration does not appear to have taken place at the expense of global integration. Both trade within regional arrangements and these regions' trade with the rest of the world have increased.[99] However, it is impossible to know what the global trading system would have looked like in the absence of regional trade agreements.[100] Econometric studies suggest weak evidence of trade diversion, but the results are mixed.[101] It is therefore still too early to say what effects regionalism will have on the multilateral trading system.[102]

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95 WTO Secretariat (2003a)

96 As opposed to unilateral or multilateral liberalisation, when there is no economically inefficient trade diversion.

97 To a large extent summarised in World Bank (2000a).

98 This may not constitute a problem when developed countries integrate regionally, despite having similar economic structures, since the production structures and consumer patterns are more advanced and diversified and involve scope for intra-industry trade based consumers' demand for varieties.

99 World Bank (2000a). WTO Secretariat (2003a) also notes that the trade data do not show that trade is becoming more concentrated within regional trade agreements (p. 55).

100 Hoekman and Schiff (2002)

**Box 4. Trade effects of regional integration**

Three types of trade effects need to be taken into account when analysing the economic effects of regional integration: trade creation, trade diversion and transfers.

*Trade creation* occurs when more expensive domestic production is replaced by cheaper imports from a partner country and total trade increases.

*Trade diversion* is the result of low-cost imports from a third country being replaced by higher-cost imports from the partner country, made possible by preferential tariff treatment. Trade diversion will have negative effects on the welfare of third countries, since a less efficient producer from a partner country replaces the more efficient third country producer.

Aside from paying more for the imported good, the government loses its tariff revenue as the import is sourced within the region. Many developing countries depend on tariffs as a source of government revenue. Some African countries raise up to half of government revenue from trade taxes. The revenue is transferred as a competitive margin to producers in the partner country and in lower prices to consumers. The effect is called a *transfer.*

The overall economic effects of entering a regional arrangement will depend on the balance between trade creation, trade diversion and transfers. It is difficult to draw a general conclusion on the overall effect since the economic effects of each agreement are sensitive to the context and design of the agreement. Nevertheless, the negative effects can be minimised by reducing external trade barriers.

**Source:** World Bank (2000a).

The above discussion shows that the regional dimension of trade policy has become more important and will have implications for developing countries. The issues involved are complex and not made easier when regional trade agreements overlap. Developing countries often belong to several different regional trade agreements, especially in Africa. They will therefore have to manage different provisions with different countries within the same policy area. Swaziland, for example, is a member of three different regional trade agreements: COMESA, SADC and SACU. It is also in the process of negotiating a regional trade agreement with the EU called a regional Economic Partnership Agreement (EPA).

The EU has provided trade preferences since 1963 to a large number of developing countries in Africa, the Caribbean and the Pacific region (ACP). The EU is currently negotiating with six developing country regions, comprising 78 ACP countries, in order to replace the previous non-reciprocal agreements with reciprocal EPAs. The reasons given for the restructuring of the old agreements are that preference margins are bound to be eroded as multilateral trade liberalisation progresses, that the WTO waiver that was granted to the previous preferences is unlikely to be extended beyond 2007 (as the preferences are incompatible with WTO rules), and that beneficiary countries to a large extent have been unable to use the previous preferences.[103] Almost all other developed countries also provide trade preferences, of varying coverage, to developing countries.

Regional integration in the form of discriminatory trade preferences is controversial. A well-functioning multilateral trading system with low levels of protection and non-discriminatory and transparent trade

[101] World Bank (2000a)

[102] Schiff and Winters (2003)

[103] Trade between the ACP countries and the EU has remained important for the ACP, but marginal for the EU. Trade with the EU accounts for about 30% of ACP trade, while only about 3% of EU trade is with the ACP countries. In addition, about 65% of EU imports from the ACP countries consisted of raw materials, and just ten products made up nearly 60% of EU imports from the ACP.

practices is likely to best protect the interests of developing countries. Economic research show that the biggest share of the gains from trade liberalisation comes from dismantling domestic protection. This means that the ideal liberalisation strategy for a developing country, from an economic perspective, would be unilateralism first, followed by multilateralism, with regionalism in third place. In practice, most countries follow the reverse strategy.

With regionalism here to stay, developing countries are likely to be economically best served by partnerships with more advanced countries, even though this means that industrialized countries would be setting the agenda. At the same time, to minimize the losses associated with trade diversion, they should maintain low levels of protection towards non-partners. Deep integration agreements would normally be of most economic value for developing countries but are difficult to negotiate as they are complicated and demand initiated trade negotiators and political will.

Developing countries are active participants nowadays in international trade. They are not only exporting primary products and agricultural produce, but are increasingly engaged in manufacturing and services trade. The trade policies they pursue will affect their possibilities to engage in sustainable development, and the barriers they put up will not only bar imports from developed countries. Their import restrictions will also hurt other developing countries, as developing countries trade more with each other than ever before.

As many developing countries are members of regional trade agreements and of the WTO, they are not completely free to choose their own actions. They need to follow the rules of the multilateral trading system. In addition, being more integrated in trade means that the rules of the multilateral trading system and the trade policies pursued by others will have direct effects on developing countries' economies. The trade policy changes undertaken by developing countries can therefore not be considered in isolation. They always have to be seen in light of the changes in the global trading environment surrounding them. This will be discussed in the following chapter.

# 3. The Multilateral Trade Policy Context for Developing Countries

## 3.1 From the GATT to the WTO[104]

**GATT 1947**

The General Agreement on Tariffs and Trade (GATT), negotiated in 1946–47, entered into force on 1 January 1948. The GATT played a fundamental role in post-war economic development. It established for the first time a set of agreed rules for the contracting parties to follow in their trade with each other. Its objective of reducing tariffs and then non-tariff barriers to trade in goods was pursued through successive rounds of multilateral negotiations (Table 4).

**Table 4. Trade rounds**

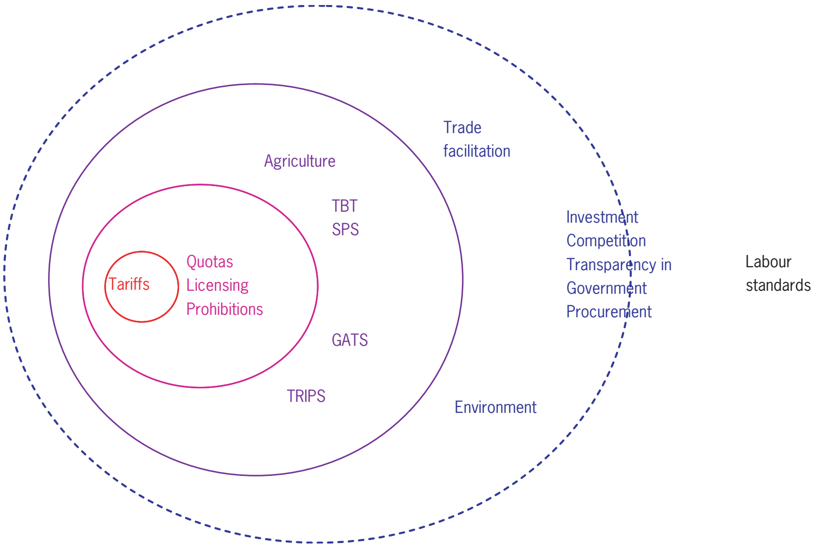
| Year | Name | Coverage | Partici-pants |
|---|---|---|---|
| 1947 | Geneva | Tariffs | 23 |
| 1949 | Annecy | Tariffs | 13 |
| 1951 | Torquay | Tariffs | 38 |
| 1956 | Geneva | Tariffs | 26 |
| 1960–61 | Dillon Round | Tariffs | 26 |
| 1964–67 | Kennedy Round | Tariffs, anti-dumping measures | 62 |
| 1973–49 | Tokyo Round | Tariffs, non-tariff measures,"framework" agreements (e.g. government procurement) | 102 |
| 1986–94 | Uruguay Round | Tariffs, non-tariff measures, rules, services, intellectual property, dispute settlement, textiles, agriculture, creation of the WTO, etc. | 123 |
| 2001– | The Doha Agenda | A broad work programme covering issues in the WTO, and new issues e.g. environment, investment, competition, transparency in government procurement, and trade facilitation | 147 |

**Source:** WTO Secretariat (2003b).

[104] This section is mainly based on WTO Secretariat (2003c).

The trade rules have evolved in accordance with the needs of the participants. From an initial focus on tariffs only, the multilateral trade rules expanded in the 1960s to encompass the use of anti-dumping measures, whose use was then rising, and later to other non-tariff measures (quotas, licensing, and prohibitions). From an initial focus on impediments to trade in goods, a sectoral expansion was made to trade in services through the GATS and to trade-related intellectual property rights (TRIPS) in the Uruguay Round.[105] In August 2004, WTO member countries decided to initiate negotiations on trade facilitation.[106] At the same time, they decided that three areas towards which developing countries had been sceptical, would not form part of the current negotiations. These were the relationship between trade and investment, the interaction between trade and competition policy, and transparency in government procurement.[107] The multilateral trading system has thus expanded over time, both in magnitude and breadth. The result of these efforts has been a more secure and open environment for trade, which is a key factor in raising growth and achieving prosperity among its participants.[108]

**Figure 2. The expansion of the multilateral trading system**




### WTO 1995

The WTO was founded on 1 January 1995, following the conclusion of the Uruguay Round. The WTO integrates all of the rules since GATT 1947 as one of its three pillars. The other two pillars are the GATS and the TRIPS Agreement (See section 2.2). The Dispute Settlement Understanding (DSU) and the Trade Policy Review Mechanism (TPRM) are other parts of the WTO which sustain respect by WTO Members for the rules of the current multilateral trading system.

Membership in the WTO is based on a single undertaking. This means that all WTO Members, developing countries included, must assume all the relevant obligations, whether in goods, services or intel-

105 Intellectual property rights are indirectly trade-related, and their protection affects the transfer of technology. The main motivation to include legal commitments in this area in the WTO was to protect the interests of rights holders by adding an enforcement dimension (via the dispute settlement mechanism) to the obligations arising from existing treaties of the World Intellectual Property Organisation (WIPO).

106 WTO (2004b), page 3. See also section 2.2.

107 Their inclusion could have implied large costs for the developing countries (see chapter 3.3).

108 During the first quarter century of the GATT's existence, growth in developed countries (the active participants in the GATT) averaged 5% while trade growth averaged 8%. This gap between trade and economic growth reflected the growing interdependence through trade in economic relations.

lectual property rights.[109] However, the WTO Agreements do contain a number of special and differential treatment provisions for developing countries. Although some of these provisions contain words without any practical implication, other special and differential treatment provisions do provide developing countries with special treatment by for example providing them with additional time to implement certain WTO obligations or complete exemptions. WTO rules demand the lowest level of commitment from the LDCs. This is different from the GATT, when countries had the choice of whether to sign up to the new agreements that extended the rules, such as the inclusion of anti-dumping and countervailing measures in the Tokyo Round (1973–79). Few developing countries then chose to sign up.

The WTO currently has 148 Members whose trade covers almost all of world trade.[110] The large majority of these are developing countries and 32 are LDCs according to the UN's classification (50 in total).[111] Although it might seem strange, WTO Members in principle chose for themselves if they shall be considered as developing or developed countries. There is therefore no agreed list of developed country WTO Members. However, some 20 WTO Members are likely to consider themselves as developed countries.[112]

Since the inception of the WTO, about 20 Members have joined which were not previously contracting parties to the GATT.[113] Only two of them are LDCs, Nepal and Cambodia. Another 30 countries are WTO observers[114] and most of them are engaged in accession. Nine of these are LDCs.[115]

## 3.2 Advantages of WTO Membership for Developing Countries

Why are countries flocking to join the WTO? The answer is simple: they expect that WTO membership confers important economic and political benefits that outweigh the costs, including the adjustment costs associated with the reforms often needed to qualify for membership.

WTO Membership involves several advantages of significant value to developing countries. Taken as a whole, the rights conferred by membership in principle provide access to markets of other WTO Members on the basis of non-discrimination, with permissible forms of protection limited to transparent tariffs, which in turn are constrained by bound ceilings. These ceilings can be the subject of further negotiation to achieve more open access. Furthermore, the system provides for transparency in the trade policies of other members and the rights are enforceable by the dispute settlement procedures. Stable and predictable access to the mar-

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[109] Two exceptions to the single undertaking in the WTO are the plurilateral agreements on civil aircraft and on government procurement. In the former case, membership is limited to countries with an aircraft industry, while in the latter case membership is confined to a small number of WTO Members willing to accept reciprocity-based access to procurement markets.

[110] As of 13 October 2004

[111] Office of the UN Representative for Least-Developed Countries. See http://www.un.org/special-rep/ohrlls/ldc/list.htm

[112] The European Union is a WTO Member in its own right as are each of its 25 Member States individually. This complex arrangement was decided as a result of the split competence within the EU over services issues. Because the Commission has responsibility for the Common Commercial Policy (CCP) of the EU, it intervenes on behalf of the EU in the WTO. Member States are however consulted.

[113] Albania, Armenia, Bulgaria, Cambodia, China, Croatia, Ecuador, Estonia, FYR Macedonia, Georgia, Jordan, Kyrgyz Republic, Lithuania, Latvia, Moldova, Mongolia, Nepal, Oman, Panama and Chinese Taipei

[114] Afghanistan, Algeria, Andorra, Azerbaijan, Bahamas, Belarus, Bhutan, Bosnia and Herzegovina, Cape Verde, Equatorial Guinea, Ethiopia, Iraq, Kazakhstan, Lao People's Democratic Republic, Lebanese Republic, Libya, Russian Federation, Samoa, Sao Tome and Principe, Saudi Arabia, Serbia and Montenegro, Seychelles, Sudan, Tajikistan, Tonga, Ukraine, Uzbekistan, Vanuatu, Viet Nam and Yemen

[115] Afghanistan, Bhutan, Cap Verde, Ethiopia, Lao People's Democratic Republic, Samoa, Sudan, Vanuatu, and Yemen

kets of other countries provides the basis for investment plans to be made and put into place by domestic enterprises.

The multilateral trading system also poses a number of challenges for developing countries. The implementation of its rules requires human and economic resources. Domestic reforms can sometimes be said to be carried out as the 'price' of membership.

#### Multilateral Negotiations

One important advantage that the multilateral trading system provides to small trading nations is that negotiations are carried out at the multilateral level in the WTO instead of at the bilateral level. A small developing country with a minuscule share of world trade would probably not have much to say in a negotiation with a much larger and more powerful partner, such as the European Union for example. Negotiation strength is gained when WTO Members with similar interests join forces.

A small trading nation would not have the resources to negotiate deals with 147 other countries either. Membership in the WTO automatically provides each Member with certain access to the markets of all the other Members (see below).

Negotiations within the WTO framework are carried out in rounds covering a large number of sectors. This can make it easier for governments to stem opposition from small, special interest groups at home as what is given in one area may be offset by gains in another area, arriving at the most beneficial outcome for the population at large. Nevertheless, in order to protect the poor and vulnerable segments of the population, governments may have to find ways to compensate the minority of people who will lose from any multilateral deal.

#### Non-discrimination and transparent protection: the bedrock of equal opportunity

A first advantage of WTO membership is non-discrimination, which ensures equality of opportunity for goods competing in the world market. This means that goods from developing countries will not be treated less favourably than products from a developed country.

Non-discrimination for trade in goods is embedded in the guiding principles of the WTO, called the most-favoured-nation and national treatment.[116] Most-favoured-nation treatment requires all WTO Members to provide equal treatment with respect to trade policy instruments applied at the border for products imported from different origins.[117] National treatment requires WTO Members not to differentiate between the imported and a domestically produced equivalent with regard to internal taxes or other regulations.

Another core principle of particular importance from an economic perspective is the ban on import and export quotas,[118] unless these are justified for health, safety, balance-of-payments or similar reasons. This principle ensures that protection, where it is applied, takes the form of a tariff. A tariff is both a more transparent instrument and does not require licensing for its administration. Tariffs provide governments with revenues, while licences for quotas usually are allocated by the Government, which creates scope for arbitrariness and corruption, and under-

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[116] Article I (most-favoured nation) and Article III (national treatment) of GATT 1994

[117] The two most significant exceptions are preferences granted under regional trade agreements (Article XXIV of GATT and the Enabling Clause), or in favour of developing countries under the Generalised System of Preferences (GSP) or other similar programmes in application of S&D.

[118] Article XI of GATT 1994

mines the equality of opportunity. This also means that it is the licence holder who collects the economic benefit that would otherwise have been collected as government revenue.

### Stable market access

A third advantage is the stable market access created by the concept of bindings. Individual country liberalisation commitments for goods and services are specified in schedules. These are referred to as bindings because they represent legally enforceable ceilings on the maximum levels of tariffs and on the restrictive nature of policies in the area of trade in services.[119] WTO Members are free to lower their barriers to trade in goods and services at any time, but cannot raise them when commitments apply without running the risk of a dispute settlement procedure (see below).

For developed country WTO Members, the legacy of eight completed rounds of tariff negotiations (mainly focussing on the trade between them) has led to a high coverage of the bindings (Table 5).

**Table 5. Bound tariffs, pre and post the Uruguay Round, percent**

| | Pre-Uruguay Round | Post-Uruguay Round |
|---|---|---|
| Developed countries | 78 | 99 |
| Developing countries | 21 | 73 |
| Transition economies | 73 | 98 |

**Source:** WTO Secretariat (2003b).

Developing countries were more or less exempted from commitments in earlier trade rounds. In the Uruguay Round, developing countries chose one of two approaches to tariff liberalisation commitments: (i) to either bind all or almost all of their tariff lines, but at ceiling levels well above actual applied rates; or (ii) to have a partial scope of bindings, but at ceiling rates close to or at actual applied rates. This approach demonstrates the value attached by trading partners in market access negotiations to the certainty provided by the bindings, equivalent to some degree to the benefit of reduced tariffs.

### Dispute settlement

A fourth advantage of WTO Membership for developing countries is the dispute settlement mechanism. According to the Secretariat, "dispute settlement is the central pillar of the multilateral trading system, and the WTO's unique contribution to the stability of the world economy."[120] The dispute settlement procedures allow WTO Members to challenge the WTO consistency of another Member's trade policy regime in areas covered by the WTO Agreements (Box 5). Access to the dispute settlement mechanism provides developing country members with greater possibilities than before to defend their trade interests. Developing countries, and in particular LDCs, nevertheless encounter significant costs in protecting their rights under the WTO. Although there is no direct fee to be paid to use the WTO dispute settlement mechanism, political, financial and legal resources are required to identify

[119] The concept of bindings is distinct from free trade. Indeed, a country may in practice have zero tariffs in place – which would constitute an entirely open trade region – but not have bound such treatment, in which case there would always be the possibility of tariffs being raised.

[120] WTO Secretariat (2003b), p. 55

WTO-illegal trade barriers and pursue them through a dispute settlement procedure.[121]

A forum for settling disputes also means that members are prevented from going outside the trade rules and having recourse to unilateral measures. Small trading nations, such as many developing countries, can in principle, and do in practice, win cases against WTO members with a much larger share of world trade. However, it is difficult for small WTO members to force compliance, should a large WTO Member fail to implement the ruling of a dispute settlement panel. Trade with the smaller WTO member may be of limited importance to the larger member and any threat from the smaller member may not be serious enough for the larger. It may even be the case that the imposition of trade restrictions against the larger member may actually harm the economy of the smaller member. The advantage of the WTO dispute settlement procedure is that any failure to comply with a ruling would undermine the system, and even the larger trading nations would stand to lose from such a situation.

**Box 5. WTO's dispute settlement mechanism**

The start of the process is the notification to the WTO of a dispute, which initiates a consultation phase. This phase, which involves discussions between the WTO Members involved, is often sufficient to secure a resolution. Two-thirds of all disputes do not go beyond this stage.

Should it be necessary to pursue the matter, a panel of specialists is appointed to rule on the matter. This ruling can be appealed to the Appellate Body whose subsequent ruling constitutes a definitive interpretation of the obligations of WTO Members under the agreements and hence becomes part of the WTO's jurisprudence. As such, the only recommendation that can be made by the WTO dispute settlement mechanism is to cease a WTO-inconsistency.

If this is not accomplished, the affected WTO Member may, as an ultimate resort, request the right to apply sanctions equivalent to the trade damage involved. The Dispute Settlement Body decides the matter by the 'consensus-but-one' rule, to ensure that the trading partner concerned cannot block the process. Note however that the sanctions remain subject to multilateral oversight to ensure that WTO Members retain control of the situation. As sanctions are negative for all concerned, the aim remains the resolution of the dispute by the removal of the WTO-inconsistent measure.

**Source:** Busch and Reinhardt (2004).

### 'Lock-in' of trade reforms

For the developing country member, the obligations of WTO membership enable domestic trade reforms to be 'locked-in'. Quantitative restrictions should be eliminated and replaced with tariffs. Tariffs should be bound to the largest extent possible to ensure stable and predictable market access. Domestic laws, regulations and other measures need to ensure national treatment for imported goods. Transparency should become the guiding principle of domestic laws and regulations, which also must be notified to the WTO to ensure that foreign exporters have access to full information. Non-tariff measures, if applied, should be subject to formal procedures to ensure due process for affected parties.

The advantage of 'locking-in' these trade reforms (many of which

[121] Busch and Reinhardt (2004). Note that an "Advisory Centre on WTO Law" was established in 2001 to provide legal advice to developing countries on WTO law, support them in WTO dispute settlement proceedings, and provide training in WTO law.

have already been implemented autonomously by a larger number of developing countries) is that it provides a strong signal that no reversal will occur. The result is a more favourable environment for investment, both for domestic entrepreneurs and for the purpose of attracting foreign investment. However, it is difficult to back-track once the reforms have been undertaken. It is therefore important to ensure that the policy changes reflect the wishes of the people.

#### Transparency

A final benefit of the multilateral trading system is that it increases the information available about other countries' trade policies and practices. WTO Members are not only required to follow the agreed rules. They also have notification obligations when policies are changed. All laws, rules and regulations pertaining to trade must be published and must be notified to the WTO. In addition, the WTO Trade Policy Review Mechanism provides regular opportunities to review other Members' trade policy and practices. Although of less obvious significance at first glance, these rules and mechanisms ensure that trade regimes are transparent and open to scrutiny, both by domestic interested parties, as well as trading partners and their exporters.

### 3.3 Challenges from a Developing Country Perspective

Notwithstanding the advantages associated with WTO membership, it also includes a number of challenges for developing countries. These vary from country to country. The main issues are to ensure effective participation in the WTO, negotiate improved market access for exports, and ensure that the rules are beneficial for development. The challenges at the domestic level involve securing adherence to WTO obligations, including the costs of implementing trade reforms and subsequent adherence to the rules. and the short-term costs of a more open trade regime.

Among the challenges of WTO membership, many developing countries include the difficulties they face in realising export-led development. That is, developing countries identify domestic supply constraints, including lack of an appropriate infrastructure (e.g. roads and transport networks), as barriers to taking advantage of the market access opportunities available to them. Hence the importance assigned to trade capacity building in development cooperation programmes.

#### Making your voice heard in a member-driven organisation

A significant challenge for most developing country members, especially the LDCs, is to make their voice heard in the WTO. The WTO is a member-driven organisation, where each Member counts as one; weights do not apply in relation to population, GDP, or share in world trade.

Presence in Geneva and an active and daily participation in meetings are required for developing countries to communicate their trade interests and concerns to partners and ensure that the system is favourable to them. Few developing countries can afford to maintain a significant delegation in Geneva. Brazil, China, India and Mexico are examples of active developing country WTO Members, but many LDCs have no representation whatsoever.[122] Even when developing countries have a Geneva-based mission, it generally consists of a small number of staff members with responsibilities stretching across the WTO and the UN system (e.g.

[122] In October 2001, 25 out of WTO's developing countries had no delegation in Geneva. Out of the 77 developing countries, which had a delegation in place, only 17 had a special presence for WTO activities and these were small (Kommerskollegium and Sida, 2002a).

WIPO, ILO and other Geneva-based UN bodies). In contrast, by virtue of their wealth in terms of financial and human resources, developed countries are often able to maintain a significant presence, and are able to participate effectively in regular WTO activities and negotiations.[123] Developing countries' inadequate resources make it impossible for them to be present at all important WTO-related meetings. This means that it often is difficult for them to influence the decisions taken in the WTO in an efficient way.

Coalition building can be an important tool for developing countries to ensure enhanced participation. The most important decisions in the WTO are taken by consensus. If decisions were based on voting, developing countries would constitute the overwhelming majority. But developing countries often have conflicting interests among themselves. It is therefore in practice most often sub-groups of developing country members that put forward joint proposals.[124] Under the consensus principle, a decision cannot be made if one or several members oppose the proposal, but it is rare that WTO Members openly oppose a proposed decision, since it is the practice of the multilateral trading system to ensure that proposed decisions that come up for approval face no opposition.

Besides the resource constraints which limit developing countries' possibilities to maintain presence in Geneva, political and institutional considerations may also hinder effective participation. Developing countries may, for example, be subject to pressure from developing countries, linking acceptance of certain decisions to benefits or threats in other areas (e.g. trade preferences or aid).[125]

### Costs of implementation

Another challenge for developing countries is the implementation of WTO obligations. Implementation typically involves a two-stage process of first altering the domestic regulatory framework to conform to obligations and, secondly, ensuring enforcement through institution-building. The difficulties faced, and the costs involved are, to a significant extent, country-specific and determined by the initial conditions.

The WTO agreements are often based on the existing institutional structures and procedures in OECD countries. To make the agreements work in developing countries, thorough reforms and reinforcements of institutions and governmental agencies are often required.[126] Implementation is likely to require considerable expenditure when institution-building for enforcement is involved. However, it is impossible to put a precise figure on the cost of implementing the WTO Agreements. One rough estimate of the purely administrative cost of implementing the WTO agreements for customs valuation, SPS and TRIPS is $130 million USD.[127] For several LDCs, this sum is larger than their yearly budget for their national development.

Customs valuation has proven to be a particularly difficult area for developing countries, despite the five-year transitional period they were granted until full implementation was required in 2000. There are several reasons for their implementation problems. The process of valuation

[123] A working day at the WTO normally means that there are at least two formal meetings going on in parallel, both in the morning and in the afternoon, not counting informal or bilateral meetings, or other WTO-related work.

[124] The LDC group, the African group, or small economies for example.

[125] Kwa (2003), South Centre (2001) and Jawara and Kwa (2003)

[126] Hoekman (2002)

[127] Finger and Schuler (2001)

that the WTO customs valuation agreement[128] prescribes presumes an administrative environment that does not exist in many of the poorest countries, as previously noted. Hence, the reform required goes beyond pure customs valuation reform.[129]

Apart from the need for overall reform, a specific implementation difficulty in the area of customs valuation is that developing countries must abandon the practice of setting minimum values. This practice artificially inflates customs values, and its elimination thus has a fiscal revenue implications. Even more significant is the fact that minimum values are most often set on domestically sensitive products, (i.e. those produced by domestic enterprises), and thus have a protective effect that would be lost if removed. Developing countries have complained that they are not equipped to apply measures of contingency protection, whose purpose is normally to respond to demands for protection by domestic enterprises allegedly injured by import competition.

With respect to other obligations on goods, most developing country WTO Members, and in particular those that were GATT contracting parties, did not face major difficulties in implementing the WTO obligations, as few were new. The practice of setting tariff commitments at ceiling levels meant that no developing country has in fact been required to reduce tariffs as a result of implementing WTO obligations (although many have done so autonomously).

The extension of the multilateral rules to encompass services and intellectual property rights posed new challenges to developing countries. Although the challenges are country-specific, they often involve building or adapting institutions.

Intellectual property regimes were not new for a significant number of developing countries as they had since long recognised the significance of intellectual property protection for attracting foreign investment and technology transfer. Many LDCs also had intellectual property regimes in place, although the regimes were of varying standards, and often a heritage from the colonial past.[130] The main implementation issue posed by the TRIPS Agreement has been the need to ensure that the existing regime is adjusted to the new requirements, that domestic administrative capacity is enhanced, and that economic operators gain capacity to enforce the rights. These are costly changes to undertake (See Table 6). In the cases where no intellectual property regimes were in place, drafting new legislation would involve additional costs of implementing the TRIPS Agreement. Even in the cases where domestic legislation may meet the requirements of the TRIPS Agreement, most developing countries have found its implementation to be a significant challenge given domestic resource constraints and lack of administrative, police and judicial capacity.[131] It may be questioned whether the costs of implementing the TRIPS Agreement is proportional to its benefits for many developing countries and LDCs. In this context it should be noted that today's developed countries did not have similar policies in place when they were at the stage of economic development where many developing countries currently are.

[128] The correct title is the "Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994".
[129] Finger and Schuler (1999)
[130] Kommerskollegium (2004)
[131] Kommerskollegium (2004) and (2002b), European Commission (2003)

**Table 6. Estimated costs of implementing the TRIPS Agreement**

| Country | Activity | Cost, millions USD |
|---|---|---|
| Brazil | Train staff administering IP rights | 4.0 |
| Indonesia | Improve IPR framework | 14.7 |
| Mexico | Agency to implement patent law | 32.1 |
| Chile | Establish IPR framework | 0.7–0.8 annually |
| Egypt | Train staff administering IPR | 1.8 |
| India | Modernise patent office | 5.9 |
| Tanzania | Draft laws, develop enforcement | 1–1.5 |
| Bangladesh | Draft laws, develop enforcement | 0.25 + 1.1 annually |

**Note:** IP is short for intellectual property, IPR is short for intellectual property rights.

**Source:** Finger and Schuler (1999).

### The short-term costs of a more open trade regime

Trade liberalisation is often associated with short-term costs for developing countries. These costs include a possible loss of government revenue when domestic tariffs are decreased. It may therefore be important to ensure that the tax base is broadened from a high dependence on tariff revenue before the tariff cuts take effect. Developing countries will also lose preferential margins when MFN tariffs are decreased in their export markets. Markets may then be lost to competing producers. This will involve costs (such as lost work opportunities for poor people) when developing countries' domestic production needs to adapt to the new trading environment. However, research shows that the number of developing countries that will be severely affected by the erosion of preferences is likely to be limited.[132] Solutions nevertheless have to be found to these short-term costs, even if they, at the same time, have to be considered in light of the long-term efficiency benefits.

As effective participation in the multilateral trading system requires both financial and human resources to surmount the challenges, it is an area where developing countries often wish to receive assistance. Examples of such general development cooperation include high quality education in the fields of economics and international trade, training relating to the multilateral trading system, including the content and functioning of the different WTO Agreements, trade negotiation skills, and analysis of the domestic economic and trade environment.

Appropriate trade-related development cooperation can nevertheless be difficult to provide. Each country has its own offensive trade interests. It may therefore be difficult to avoid that the donor's interests, rather than the recipient's, are reflected in the assistance. For trade-related development cooperation to be effective, it is therefore necessary that it is carried out in accordance with the desires of the developing country recipient, and may entail finding a 'neutral' provider. This can be difficult, as all governments and government-linked agencies are unlikely to be considered neutral, and the provider may have to be found among non-governmental organisations, research institutes, etc., although many of these are not neutral either, and many do not have the level of knowledge required.

[132] Alexandraki and Lankes (2004)

## 3.4 The Need for Liberalisation

As a result of implementing the commitments made during the Uruguay Round of trade negotiations (1986–94), developed countries tariffs are at historically low levels. Despite these reforms, developing countries exports of goods and services face a number of obstacles in developed countries' markets.

While the average bound tariff level for non-agricultural goods after the Uruguay Round is low (4% on average), bound tariffs remain high on goods in which most developing countries have a particular export interest, such as agricultural products, textiles and clothing, leather, shoes, rubber and fish.[133] Furthermore, tariff escalation (when tariffs increase by the value added of the good) hampers the diversification of developing countries' production, as it prevents them from increasing the share of processed products in their exports.[134] Textiles and clothing has been a sector with particular rules. The Multifibre Arrangement (MFA), which governed the sector from 1974 to 1994, meant that a large portion of textile and clothing exports from developing countries to industrial countries was subject to quotas under a special regime outside normal GATT rules.

The Agreement on Textiles and Clothing (ATC) (1995–2005) that superseded the MFA terminated on January 1, 2005, following a ten-year transition period of ATC implementation. This means that trade in textile and clothing products is no longer subject to quotas under a special regime outside normal WTO/GATT rules, but is now governed by the general rules and disciplines embodied in the multilateral trading system. As a result, some larger developing countries are likely to gain increased export opportunities, but it is also possible that some LDCs will lose market shares due to increased competition when their exports are no longer protected by quotas.

Agriculture plays a relatively important role in developing countries' economies, accounting for one quarter of their GDP and about half of their employment; by contrast, agriculture in OECD countries accounts for only around 2% of GDP and about 7% of employment.[135] With nearly three-quarters of the world's poor concentrated in rural areas, mainly in developing countries, and depending heavily on agriculture for their livelihoods, trade liberalisation in agriculture is important to the alleviation of poverty in many developing countries.

It is therefore a problem that agriculture is the most distorted sector in international trade. Rich countries often have high rates of protection against imports from developing countries and provide domestic support to their own agricultural production (such as producer subsidies and programmes to raise or guarantee agricultural prices or farmers' income) and even subsidize their exports. The domestic support and export subsidies provided by developed countries keep otherwise uncompetitive developed country farmers in business. Their produce floods the international markets and depresses world prices. Hardly any developing country can afford to pursue a similar policy. The solution seems simple.

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[133] Developing countries benefit from various kinds of preferential tariff access, e.g. the European Union's "Everything-but-Arms" initiative, the United States' African Growth and Opportunity Act (AGOA), the Generalised System of Preferences (GSP) granted by most developed countries. These initiatives provide preferential market access. However, the value of these preferences islimited by complex rules of origin, which require considerable administrative resources to be fulfilled. Moreover, the sectoral coverage of these preferences is tailored to the sensitivity of the developed countries' production, rather than being based on the export potential of developing countries. The preferences are also non-contractual, i.e. they may be withdrawn when the granting country so desires.

[134] WTO Secretariat (2001a)

[135] WTO Secretariat (2004a)

A complete liberalisation of agricultural trade and the abolishment of all forms of domestic support and export subsidies should then benefit developing countries.

The situation is unfortunately more complicated than it seems. One category of developing countries gains from the current situation with artificially low world market prices, and that is the net food-importing developing countries. Low prices on the world market means that the bill for food imports, and what consumes pay in these countries where imports are needed to cover consumption, can be kept relatively low. However, the drawback is that the low prices may discourage domestic production and thus contribute to keeping these countries in a situation where they depend on food imports. This already vulnerable group of net food-importing countries is likely to need special support if the prices of the agricultural goods they import would increase as a result of trade liberalisation. In addition, it is likely that the most advanced developing countries with the highest supply capacity, such as Brazil and China, would reap the largest gains from agricultural trade liberalisation.

The LDCs currently have more preferential access to several developed country markets than other more advanced developing countries, and is another group of vulnerable countries that may not be able to compete against the more advanced developing countries in a liberalised market. The same is true for some other preference-dependent developing countries, such as some small island nations. It is thus possible that these groups of vulnerable developing countries may not be able to export when faced with competition from more efficient advanced developing country producers. The result is likely to be lower domestic production, lost jobs in the agricultural sector and lower income for those who depend on the agricultural sector.

Trade in agriculture has effects on food security. The possibility to import contributes to food security as imports augment domestic supply to meet consumption needs when domestic production is insufficient, and thereby reduce supply variability. Trade should also contribute to food security as the possibility to export surplus supply may stimulate domestic production. However, liberalisation of agricultural trade can

also have negative effects on food security if agricultural production in already poor countries diminishes, as described above. Food imports are unfortunately unlikely to contribute substantially to food security for a majority of the poor in developing countries, as imported food is more likely to be consumed in larger cities than in remote poor villages, partly because of the transportation cost. Most of the world's food-insecure people are rural-based and rely on farm income and employment. Their adequate access to food is often only ensured if they produce food themselves for private consumption or if they, through agricultural labour, obtain the economic means to purchase food.

As the liberalisation of agricultural trade may have negative effects on some developing countries, the rules of the multilateral trading system contains some flexibility for agricultural production in poor rural areas of developing countries. The flexibility needed is unlikely to be in the form of permanent exemptions, but rather as transitional measures before the production has become internationally competitive or employment opportunities arise in other sectors of the economy.

The loopholes in the multilateral trading rules that allow for the use of agricultural export subsidies, which would not normally have been allowed for industrial products, date back to the GATT days. The WTO Agreement on Agriculture, which entered into force in 1995, requires all tariffs to be bound, and makes it difficult for WTO Members to raise them. However, the bindings were made at higher levels than the actual applied rates. They therefore only offered limited market access opportunities and lead to uncertainty in trade relations as the actual tariff may then still be increased. Transparency in agricultural trade is further impeded by specific rates as opposed to *ad valorem* tariffs.[136]

The WTO Agreement on Agriculture contains commitments to reduce, but not eliminate, domestic support. These commitments were implemented with minimal reductions in actual levels of domestic support. Furthermore, although export subsidies had to be cut back, their impact is still significant, and here again there is no commitment to eliminate their use (although new export subsidies cannot be introduced). In the specific area of cotton, for example, four West African LDCs that are the major producers have placed the issue of export subsidies on the agenda of the WTO.

In addition to the exports of unprocessed agricultural products, a number of developing countries, especially some LDCs, are heavily dependent on the export of primary commodities. It seems quite difficult for developing countries to diversify their production out of dependence of these exports. The current tariffs peaks and tariff escalation[137] create a difficult environment for developing countries that attempt to diversify their production. Tariff peaks and tariff escalation tend to be put in place to protect the domestic processing industry in developed countries. This discourages the development of a processing industry in the countries where the raw materials originate. Considering all the barriers that agricultural products from developing countries face in the market of the European Union, a reform of the EU's Common Agricultural Policy would improve many developing countries' possibilities to trade.

Trade in services should offer new possibilities for developing countries to use the advantage of having a large labour force to diversify their economies

[136] An ad valorem tariff is a customs duty levied as a fixed percentage of an item's value, while a specific tariff is a customs duty based on weight, quantity, or the physical characteristics of the imported item. 25 WTO Members have non ad valorem bindings on more than 50% of their agricultural tariff lines (WTO Secretariat, 2001).

[137] Tariff peaks are particularly high customs duties on selected products amidst otherwise relatively low customs duties. Tariff escalation is when tariffs increase with the value added of the good, i.e. low customs duties on raw materials, higher duties on semi-processed goods and the highest duties on finished products.

away from exporting raw materials. However, countless barriers still exist for services trade as well, especially in the area of labour mobility across countries. Clarifications, e.g. the relation to migration policy, and new market openings are needed to enhance the opportunities for developing countries to benefit from their abundant labour resources.

These barriers to developing country exports create imbalances in the international competitive situation. Developed countries have the opportunity and duty, in the ongoing negotiations, to ensure that trade policies do not counteract developing countries' possibilities to use trade as a means to develop.

As noted above, although the barriers to developing country exports have been reduced, they remain high in developed country markets. Considering that developing country barriers normally are even higher, and considering also the trend of increasing trade among developing countries, they would gain additional trade opportunities by lowering the barriers to each others' exports. However, if developed countries are serious about wanting to help create conditions that will enable poor people to improve their lives, there is much that can be done in the trade field, both in terms of developing countries' trade policies, and in terms of trade-related development cooperation.

# Abbreviations

| | |
|---|---|
| ACP | African, Caribbean and Pacific countries |
| ATC | Agreement on Textiles and Clothing |
| CCP | Common Commercial Policy |
| DSU | Dispute Settlement Understanding |
| DTIS | Diagnostic Trade Integration Studies |
| EPA | Economic Partnership Agreement |
| EU | European Union |
| FAO | Food and Agriculture Organization of the United Nations |
| GDP | Gross Domestic Product |
| GATS | General Agreement on Trade in Services |
| GATT | General Agreement on Tariffs and Trade |
| ILO | International Labour Organization |
| IMF | International Monetary Fund |
| IF | Integrated Framework for Trade-Related Technical Assistance to LDCs |
| IPPC | International Plant Protection Convention |
| IPR | Intellectual Property Right |
| ISO | International Standardization Organisation |
| ITC | International Trade Centre (UNCTAD/WTO) |
| LDC | Least-Developed Country |
| MEA | Multilateral Environmental Agreement |
| MFN | Most Favoured Nation |
| NAFTA | North American Free Trade Area |
| PRSP | Poverty Reduction Strategy Papers |
| PSD | Private Sector Development |
| PSI | Preshipment Inspection |
| OECD | Organisation of Economic Co-operation and Development |
| OIE | International Office of Epizooties |
| SME | Small and Medium-sized Enterprises |
| SACU | Southern African Customs Union |
| SPS | Sanitary and Phytosanitary Measures |

| | |
|---|---|
| TBT | Technical Barriers to Trade |
| TPRM | Trade Policy Review Mechanism |
| TRIPS | Trade-Related Intellectual Property Rights |
| UN | United Nations |
| UNCTAD | United Nations Conference on Trade and Development |
| UNDP | United Nations Development Programme |
| WAEMU | West African Economic and Monetary Union |
| WIPO | World Intellectual Property Rights Organization |
| WTO | World Trade Organization |

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# Annex 1

## List of Trade Briefs

Trade briefs is a Sida-sponsored publications series on trade and development issues. The briefs consist of three parts: a description of the content of the subject, the reasons why the subject is important from a development perspective and the issues raised in the debate, and the role of trade support. The purpose is to increase the general understanding on issues related to trade and development. The series commissioned for this document includes:

1. "Trade and poverty" by Constantine Michalopoulos
2. "TRIPS and development" by Keith Maskus
3. "Trade in agriculture, the WTO and developing countries" by Harry de Gorter
4. "The GATS and developing countries – at the service of development?" by Pierre Sauvé
5. "Standards as barriers to trade – and how technical assistance can help" by Digby Gascoine
6. "Trade, development and the environment" by Scott Taylor
7. "The WTO dispute settlement mechanism and developing countries" by Marc Busch and Eric Reinhardt

The views expressed in these trade briefs are those of the authors and do not necessarily represent those of Sida.

# Annex 2

## Trade Support Categories

The WTO/OECD database uses the concept of trade-related technical assistance and capacity-building for trade support. The following categories are included in the database:

### I. Trade Policy and Regulations

Dispute settlement
Customs valuation
Sanitary and phytosanitary measures (SPS)
Technical barriers to trade (TBT)
Trade-related intellectual property rights (TRIPs)
Trade-mainstreaming in PRSPs/development plans
Tariff negotiations – non-agricultural market access
Agriculture
Services
Rules
Trade and environment
Trade and investment
Trade and competition
Trade facilitation
Transparency and government procurement
Accession
Tariff reforms
Trade-related training education
Negotiation training
Regional trade agreements (RTAs)

### II. Trade Development

Trade promotion strategy: design and implementation
Market analysis and development
Business support services and institutions
Public-private sector networking
E-commerce
Trade finance

**Sources:** OECD (2004) and http://tcbdb.wto.org/trta.asp

*Halving poverty by 2015 is one of the greatest challenges of our time, requiring cooperation and sustainability. The partner countries are responsible for their own development. Sida provides resources and develops knowledge and expertise, making the world a richer place.*


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