

“The division of labour among nations is that some specialize in winning and others in losing.”

Eduardo Galeano ¹

Hypocrisy and double standards are not strong foundations for a rules-based multilateral system

“Until the lions have their historians”, declares an African proverb, “tales of hunting will always glorify the hunter.” The same is true of tales about international trade. For globalization enthusiasts the rapid expansion of world trade over the past two decades has been an unmitigated blessing, notably for the world’s poor. Reality is more prosaic. Greater trade does offer enormous opportunities for human development. Under the right conditions it has potential for reducing poverty, narrowing inequality and overcoming economic injustice. For many of the world’s poorest countries, and for millions of poor people, these conditions have yet to be created.

Improved multilateral cooperation on trade is vital if the international community is to achieve the Millennium Development Goals (MDGs) and wider development objectives. International trade rules and national trade policies need to be aligned with a commitment to poverty reduction. The starting point should be a recognition that greater openness to trade, like economic growth, is not an end in itself: it is a means to expanding human capabilities. Indicators for increased openness—such as export growth and rising trade to GDP ratios—are important, but they are not proxies for human development.

Trade is at the heart of the interdependence that binds countries together. That interdependence has contributed to some highly visible human development advances, enabling millions of people to escape poverty and share in the prosperity generated by globalization. Yet many millions more have been left behind. The costs and benefits of trade have been unevenly distributed across and within countries, perpetuating a pattern of globalization that builds prosperity for some amid mass poverty and deepening inequality for others.

The rules of the game are at the heart of the problem. Developed country governments

seldom waste an opportunity to emphasize the virtues of open markets, level playing fields and free trade, especially in their prescriptions for poor countries. Yet the same governments maintain a formidable array of protectionist barriers against developing countries. They also spend billions of dollars on agricultural subsidies. Such policies skew the benefits of globalization in favour of rich countries, while denying millions of people in developing countries a chance to share in the benefits of trade. Hypocrisy and double standards are not strong foundations for a rules-based multilateral system geared towards human development.

The Doha Round of World Trade Organization (WTO) negotiations provides an opportunity to change the rules of the game. That opportunity has so far been wasted. Launched in 2001, Doha was billed as a “development round”. Rich countries promised practical measures to achieve a fairer distribution of benefits from globalization. Four years later, nothing of substance has been achieved. Trade barriers remain intact, agricultural subsidies have been increased, and rich countries have aggressively pursued rules on investment, services and intellectual property that threaten to reinforce

Living standards in rich and poor countries alike depend increasingly on trade

global inequalities. Meanwhile, issues of vital interest to many of the poorest developing countries—notably the protracted decline in commodity prices—scarcely figure on the international trade agenda.

Delivering on the promise of a development round will not address all of the human development problems raised by international trade. Even the best rules will not overcome the systemic disadvantages linked to low income, poverty and inequalities in education and health. Nor will such rules address the structural inequalities within countries that prevent the poor from capturing a fair share of the prosperity generated by trade. However, failure to align multilateral trade rules with a commitment to human development will have grave consequences. Most immediately, it will undermine prospects for accelerated progress towards the MDGs. Failure at the Doha Round would damage the credibility and legitimacy of the rules-based trading system itself, with grave consequences for

the future of multilateralism. At a time when shared security and shared prosperity depend increasingly on rules-based multilateralism, the costs of failure will extend far beyond the trading system.

The first section of this chapter provides an overview of developments in the international trading system under globalization. It challenges the argument that economic integration through trade is leading to convergence and identifies some of the conditions under which trade can help—or hinder—human development. The second section looks at how the current trading system is rigged in favour of rich countries. The third section addresses issues beyond the multilateral rules that lock poor countries out of world trade, including the protracted crisis in commodity markets and the increasingly important role of supermarkets as gatekeepers to western markets. The final section sets out an agenda for turning the current round of trade negotiations into a true development round.

An interdependent world

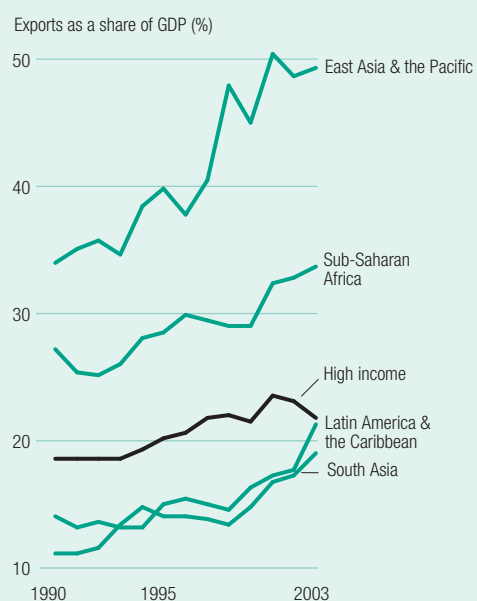
Deep global integration through trade is not unprecedented. At the end of the nineteenth century cross-border flows of goods, capital and information created a powerful dynamic for global integration. Far more than today, people as well as goods and investment flowed across borders: in the four decades up to the First World War 36 million people left Europe, helping alleviate poverty and narrowing global income inequalities.² The globalized world of the early twentieth century was shattered by the First World War and the Great Depression. The revival of global integration began in earnest about 25 years ago, with international trade and finance creating the impetus. Since then there have been major shifts in trade patterns, though continuity has been as important as change.

Trade and global living standards

Trade has been one of the most powerful motors driving global integration. Over the past decade the value of world exports has almost doubled, to \$9 trillion in 2003.³ Global production has grown more slowly, so that the share of exports in global GDP and in the income of most countries and regions has been growing (figure 4.1). Exports now account for more than one-quarter of world income and more than one-third of income in Sub-Saharan Africa.

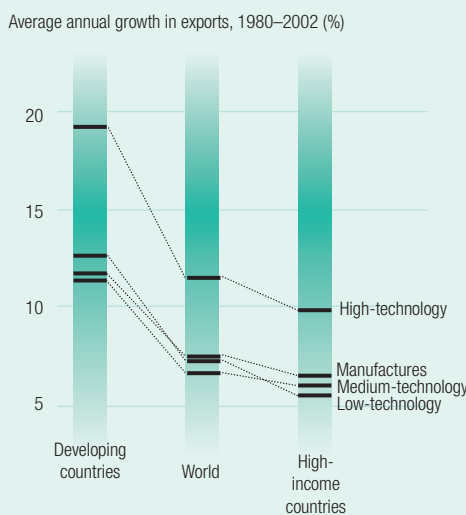
Interdependence is the corollary of rising exports. Living standards in rich and poor countries alike depend increasingly on trade. Behind the complicated economics, globalization produces one outcome that is very straightforward: the prosperity of any one country in the global

Figure 4.1 Exports are rising as a share of income



Source: World Bank 2005f.

Figure 4.2 Growth of world manufactured exports



Source: UNIDO 2004.

trading system is increasingly dependent on the prosperity of others. It is true that the interdependence is asymmetric: developing countries remain more dependent on industrial countries as export markets than industrial countries are on developing countries. But in the globalized world of the early twenty-first century all countries' fortunes are becoming inextricably linked.

Deepening interdependence has gone together with a change in the structure of world trade. Manufacturing exports have been the catalyst for integration, led by trade in high-technology products (such as electronics and computer equipment) and medium-technology products (such as automobile parts; figure 4.2). Trade in commercial services has also been increasing and now represents one-quarter of world trade. Meanwhile, the share of agriculture and primary commodities in the value of world trade has been in steady decline, falling from 15% to 10% since 1980.⁴ Patterns of trade have also been changing. One of the most important developments has been the rapid growth of trade between developing countries.⁵ More than 40% of developing country exports are now destined for other developing countries.

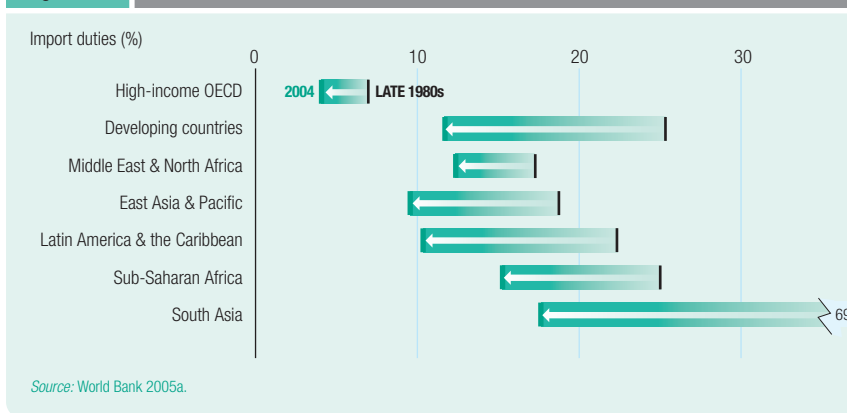
Developing countries have been expanding their share of world markets. Collectively,

they accounted for about one-quarter of global manufactured exports in 2003, double the share in 1980. In value terms manufactured goods account for 80% of developing country exports. Export growth in developing countries has outstripped growth in industrial countries across all technology sectors—but most spectacularly in high technology. Only in agriculture, an area in which developing countries have an obvious comparative advantage, have industrial countries avoided losing market share—a testimony to the power of protectionism and agricultural subsidies.

Policy change and new technologies have combined to create the conditions for increased trade. Import barriers and restrictions on foreign investment have fallen across the world, especially in developing countries. Tariffs have been cut, tariff schedules simplified and non-tariff barriers rolled back. The average tariff in developing countries has fallen from 25% in the late 1980s to 11% today, with most of the liberalization having been carried out on a unilateral basis (figure 4.3).⁶ At the same time falling transport costs, cheaper communications and new information technologies have opened up new frontiers.

One of the defining features of contemporary globalization has been the development of worldwide production systems. When the

Figure 4.3 Tariffs are falling



first Model T rolled off the Ford assembly line in Detroit in 1908, it was a genuinely national car assembled under one roof. One hundred years later the United States accounts for only about one-third of value added in domestically produced cars. As in other sectors of manufacturing the production of goods that previously took place in one location has been broken down into discrete parts, with components and products assembled in networks that span many countries.⁷

Consider the Microsoft Xbox—a high-technology game console containing cutting-edge technology. Manufacturing is outsourced to a Taiwanese company. The Intel processors are sourced from any of 11 production sites, including China, Costa Rica, Malaysia and the Philippines. Graphics processors are manufactured by a US company at a plant in Taiwan Province of China. The hard drive is assembled in China from components produced in Ireland. The DVD-ROM is manufactured in Indonesia. Final assembly has recently been moved from Mexico to China.⁸

The Xbox is a microcosm of what is happening under globalization. In computer electronics regional hubs based in East Asia dominate global networks. It has been estimated that two-thirds of computer components marketed in the United States have passed through the Chinese city of Dongguan, in some cases more than once.⁹ “National” cars are a thing of the past. General Motors sources gearboxes assembled in Mexico, radiator caps from plants in Chennai, India, and upholstery from suppliers in Indonesia, using materials imported from China.

The fragmentation of production has been accompanied by wider changes. Some services that previously could be provided only domestically can now be traded internationally. Western companies now outsource not just software services but also data management, information services and insurance claims. The vertiginous growth of India’s information technology and business outsourcing sectors is one result. Research, as well as data management and technical service provision, is also being outsourced. General Electric now operates one of the world’s largest aerospace research laboratories in Bangalore, India, having followed companies like Intel and Texas Instruments in relocating research facilities.

The limits to convergence

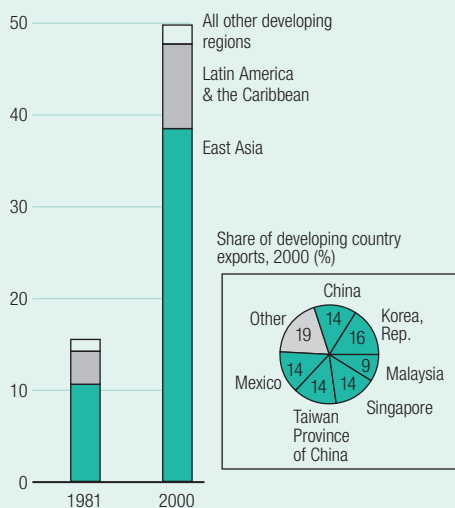
One of the prevailing myths of globalization is that increased trade has been the catalyst for a new era of convergence. Expanded trade, so the argument runs, is narrowing the income gap between rich and poor countries, with the developing world gaining from access to new technologies and new markets. Like most myths, this one combines some elements of truth with a hefty dose of exaggeration. Some countries are catching up, albeit from a low base. But successful integration is the exception rather than the rule—and trade is a driver of global inequality as well as prosperity. For the majority of countries the globalization story is one of divergence and marginalization.

Success in world trade depends increasingly on entry into higher value-added markets for manufactured goods. Most of the increase in developing world market share in manufactured goods can be traced to one region—East Asia—and to a small cluster of countries (figure 4.4). Since 1980 East Asia has more than doubled its share of world manufactured exports, to 18% of the total. China has been doubling its share of world trade roughly every five years. China now supplies one-fifth of the world’s clothing exports and one-third of the world’s mobile phones, and it is the world’s largest exporter of domestic appliances, toys and computer electronics. Mexico has also been increasing its world market share. However, the very visible

Figure 4.4 Export success is highly concentrated

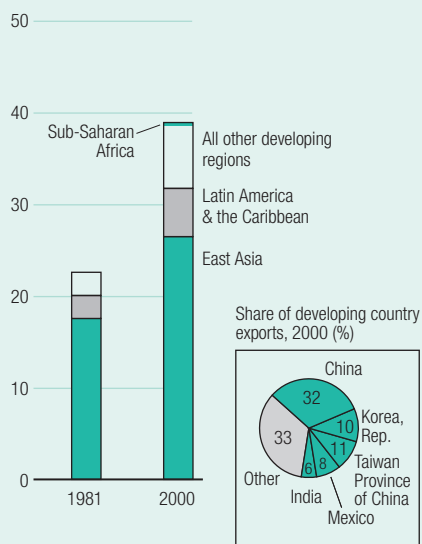
High- and medium-technology exports

Share of world exports (%)



Low-technology exports

Share of world exports (%)



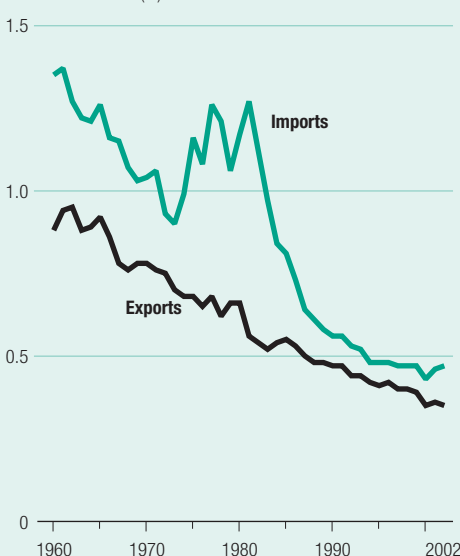
Source: Calculated on the basis of data on exports from UNIDO 2004.

presence of a group of dynamic developing country exporters can create a misleading impression. Just seven developing countries account for more than 70% of low-technology exports and 80% of high-technology exports.¹⁰

As these figures suggest, there are limits to convergence. Much of the developing world has little more than a toehold in manufacturing export markets. Excluding Mexico, Latin America's presence in world manufacturing export markets is limited and shrinking from a low

Figure 4.5 Sub-Saharan Africa's falling share of world trade

Share of world total (%)



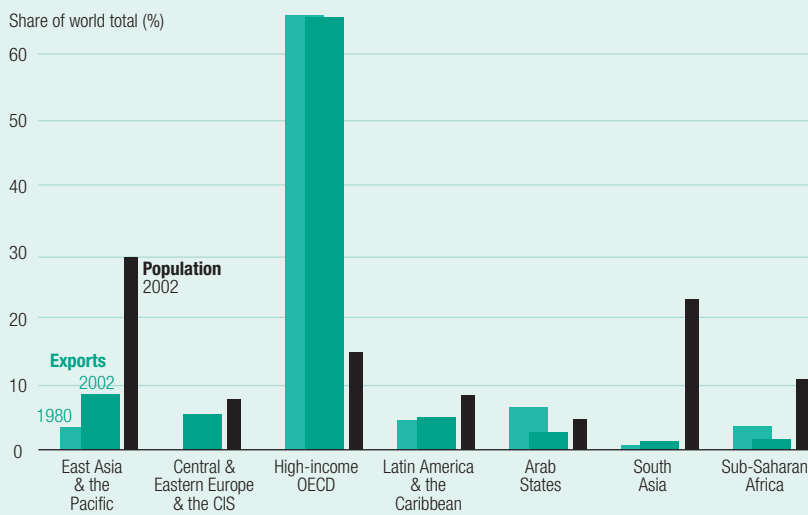
Source: World Bank 2005f.

base. Mexico now accounts for more than one-half of the region's manufactured exports. South Asia's share of world exports is rising from a low base, led by India's export growth. Meanwhile, the growth of international trade has done little to slow the marginalization of Sub-Saharan Africa. While trade has risen as a share of GDP—from 40% to 55% since 1990—the region's share (excluding South Africa) of world exports has fallen to 0.3% (figure 4.5). Today, the share of world exports of Sub-Saharan Africa, with 689 million people, is less than one-half that of Belgium, with 10 million people.

Sub-Saharan Africa graphically demonstrates how losses from trade can outweigh the benefits associated with aid and debt relief. If Africa enjoyed the same share of world exports today as it did in 1980, its exports today would be some \$119 billion higher (in constant 2000 dollars). That is equivalent to about five times aid flows and budget savings from debt service relief provided by high-income countries in 2002.

These limits to convergence through global integration are striking. After more than two decades of rapid trade growth, high-income countries representing 15% of the world's population still account for two-thirds of world exports—a modest decline from the position

Figure 4.6 World exports: rich countries still dominate



Source: Calculated on the basis of data on exports and population from World Bank 2005f.

Figure 4.7 Manufacturing value added: shifting shares in the developing world



Source: UNIDO 2004.

in 1980 (figure 4.6). Evidence of convergence is even less impressive based on current market shares. India may be one of the world's fastest growing export economies, with exports rising at more than 10% a year since 1990, but it still accounts for just 0.7% of world exports.

World export market shares give only a partial picture of the extent of divergence in world trade. The ability of countries to convert export success into rising incomes—and so into improved living standards and poverty reduction—depends not just on the volume of production and export, but also on value added—a measure of wealth created. It is value added through manufacturing production that has the biggest bearing on the distribution of global income and the benefits of trade. The bad news from a global distribution perspective is that the balance of power in world manufacturing has barely changed after 25 years of global integration.

Over 1980–2000 manufacturing value added in developing countries increased at more than 5% a year—twice the rate in industrial countries.¹¹ But almost the entire increase was recorded in East Asia, and industrial countries still account for more than 70% of manufacturing value added worldwide.

Contrasts between East Asia and Latin America demonstrate that export growth and export success are very different concepts. In manufacturing value added Latin America has

been losing market share relative to East Asia (figure 4.7). Even Mexico, Latin America's most dynamic exporter, has been losing market share relative to East Asia and, more spectacularly, relative to China.¹² The explanation: Mexico is a low value-added producer of high value-added, high-technology products. Much of the export growth has been built on the simple assembly and re-export of imported products in maquiladora plants, with limited technological upgrading.¹³ At a lower level of technology the Mexican model of high export growth and low value added is characteristic of a larger group of countries. Garment exporters such as Bangladesh, Honduras and Nicaragua fit into this category.

Global integration through trade has been marked by elements of continuity as well as change. Agriculture may be shrinking as a share of world trade, but many poor countries remain heavily dependent on agricultural exports. More than 50 developing countries depend on agriculture for at least one-quarter of their export earnings. These countries are on the downward escalator. They are exporting products that account for a diminishing share of world trade and income, with attendant implications for their position in global distribution. The regional share for agricultural exports is highest for Latin America (29%, excluding Mexico) and Sub-Saharan Africa (16%).

Many of these countries, especially in Sub-Saharan Africa, depend on a very narrow range of commodities for which world prices have been declining steeply. Between 1997 and 2001 the combined price index for all commodities fell by 53% in real terms.¹⁴ This means that African exporters had to double export volumes to maintain incomes at constant levels (see later in this chapter). It is not only commodity-dependent exporters that have faced declining terms of trade. The purchasing power of manufactured exports from developing countries has fallen by 10% since the mid-1990s, with labour-intensive exports facing the biggest decline.¹⁵

Why do these trends towards convergence and divergence matter for human development? One reason is that international trade has an increasingly important bearing on the distribution of global income. As the share of trade in world

GDP rises, the share of countries in world trade will strongly affect their standing in the global distribution of income. Another reason that distribution trends matter is that success—and failure—in trade is cumulative. Exports are important not just—or even mainly—as a source of income but also as a means of financing imports of the new technologies needed to generate growth, productivity and employment and to improve living standards and maintain competitiveness in world markets. Thus trade marginalization can translate into technological marginalization, with impacts on global income distribution and poverty. Avoiding marginalization implies entry into more dynamic, higher value-added markets. And that demands the development of diversified manufacturing systems capable of adapting new technologies and adding value locally.¹⁶

Trade and human development

The idea that participation in trade enhances human welfare is as old as modern economics. From different perspectives, Adam Smith, David Ricardo, John Stuart Mill and Karl Marx all argued that specialization through trade would increase productivity, economic growth and living standards. Many of their insights remain valid. But the pathways between trade and human development are complex—and there are no simple blueprints for successful integration into global markets.

Trade policy represents one of the last frontiers of old-style development thinking. In other areas most policy-makers accept in principle that economic growth and consumption are not ends in themselves but means to advance human development. In trade the logic of development is inverted. Success is typically measured in terms of export growth, changes in trade to GDP ratios and the speed at which import barriers are falling. As Dani Rodrik has written: “Trade has become the lens through which development is perceived, rather than the other way round.”¹⁷

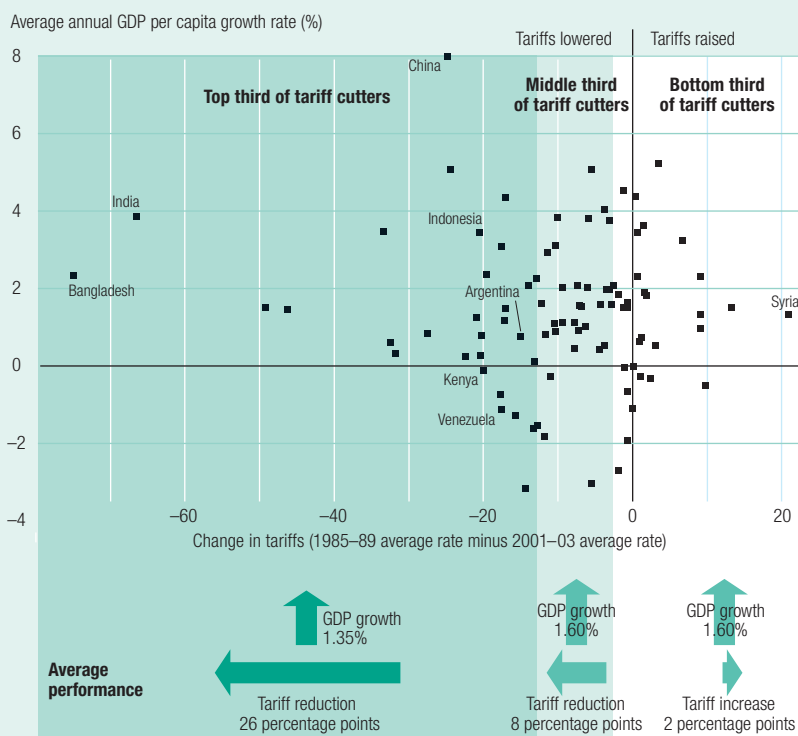
The idea that openness to trade is inherently good for both growth and human development now enjoys almost universal support. Translated into policy terms, this belief has led to an emphasis on the merits of rapid import liberalization as

the key to successful integration into global markets. When countries such as Cambodia and Viet Nam join the WTO, they are required as a condition of entry to implement deep cuts in tariffs on agriculture and manufacturing, as though this were a test of their trade policy credentials.

Such approaches are unjustified. The evidence to support the proposition that import liberalization is automatically good for growth is weak—almost as weak as the opposite proposition that protectionism is good for growth (figure 4.8 and box 4.1). While properly sequenced and gradual import liberalization can foster gains in productivity, successful trade liberalization and deepening integration are often outcomes of sustained high growth, with countries lowering tariffs as they grow richer. This was true both for rich economies during their industrial development and for successful integrators in the developing world: China, India, the Republic of Korea and Taiwan Province of China started lowering tariffs progressively after the reforms that generated economic take-off.

None of this detracts from the obvious benefits of participation in trade. At a household

Figure 4.8 Lowering tariffs is no magic bullet for growth



Source: Samman 2005a.

The idea that openness is good for growth and human development is deeply ingrained. Developing country governments are frequently pressed to liberalize imports, in some cases as conditions for aid or loans and in almost all cases as a requirement for joining the WTO. Does the evidence support the prescription?

One widely cited research exercise proceeds by dividing countries into globalizers and non-globalizers on the basis of the rate of growth in their trade to GDP ratio.¹ It then asks which group grows fastest. The answer that emerges is globalizers, by a ratio of 3:1—a huge margin. Because these countries have also cut their tariffs more deeply, the implication drawn is that import liberalization is good for growth. The same exercise argues that growth is distribution neutral on average, in that the poor share in growth in direct proportion to their current income levels. Openness is thus found to be good for growth and good for the poor.

Running the same exercise to look at the relationship between import liberalization and growth reveals a very different picture, however. Cross-country comparisons show that economic growth is positively associated with export growth, though the effects work in both directions: export growth is as much a consequence as a cause of higher income growth. The relationship between import liberalization and growth is less well defined. Unlike the trade to GDP ratio, which is an indicator of economic outcomes, import liberalization is a policy indi-

cator. Figure 4.8 in the main text summarizes data on the relationship between that indicator, as measured by the percentage change in (unweighted) tariffs, and growth for 92 countries over the period 1985–89 to 2001–03. Clustering countries into three groups on the basis of the depth of their tariff cuts reveals no significant growth differential.

What emerges instead is a diversity of outcomes, highlighting the importance of the interaction between trade policy measures and other variables. Brazil and Peru are more impressive tariff cutters than China and other countries in East Asia, but they perform considerably less impressively on growth. India has combined deep tariff cuts with an improved growth performance in the 1990s. However, the higher growth path predates import liberalization by a decade, and tariffs remain relatively high. In other cases—such as Kenya and Nicaragua—rapid market opening has been associated with stagnation or economic decline.

None of this makes a case for protectionism. There is no evidence that higher tariffs are good for growth. However, the diversity of outcomes associated with import liberalization suggests that the links to growth are more complex than is sometimes argued. In practice, the relationship between trade and growth is determined by a complex array of domestic and external factors. Cross-country evidence provides little foundation for the use of loan conditions or world trade rules to promote rapid liberalization.

1. Dollar and Kraay 2001a, b.

Source: Samman 2005b; Dollar and Kraay 2001a, b.

level exports can provide an important source of income and employment to poor people. In Bangladesh the growth of garment exports since 1990 has created about 1.8 million jobs, more than 90% of them for women.¹⁸ Increased incomes in the garment sector have lowered poverty and contributed to improvements in health and education indicators. When Viet Nam liberalized rice marketing, it gave domestic producers access to global markets, with important gains for living standards and human development indicators.¹⁹ In both cases the broad-based income and employment effects generated by exports provided an impetus for human development.

Beyond the household some of the most important benefits of trade derive from imports of capital goods that are cheaper than those available domestically. Exports of labour-intensive manufactured products in the 1960s and 1970s enabled the Republic of Korea and Taiwan Province of China to import and adapt the technologies needed to diversify their manufacturing

sectors, raise productivity and enter higher value-added areas of world trade.²⁰ Similarly, export growth, allied to foreign investment, has financed the import of technologies that have enabled Chinese firms to compete successfully in local and international markets.

Like any technological change, restructuring or reform affecting national markets, greater openness to trade can give rise to dislocation and adjustment costs. Participation in trade can produce losers as well as winners. From a human development perspective the challenge is to take advantage of new opportunities presented by trade while ensuring that the benefits are widely distributed and that vulnerable populations are protected from the costs. The six elements discussed below are among the key requirements.

Developing an active industrial and technology policy

Success in global markets depends increasingly on the development of industrial capabilities. In

a knowledge-based global economy cheap labour and exports of primary commodities or simple assembled goods are insufficient to support rising living standards. Climbing the value chain depends on managing the processes of adapting and improving new technologies. This is an area in which market failure is widespread. Free markets may not give the right signals for investment in new technologies when there are high and unpredictable learning costs. Moreover, firms in developing countries face such structural disadvantages as lack of information, weak capital markets and poor support institutions.

Most successful examples of integration into global markets have involved government action to overcome market failure.²¹ The governments of the Republic of Korea and Taiwan Province of China, among the first generation of East Asian “tigers”, created incentive for the development of local technological capacity by restricting imports, encouraging reverse engineering of imported technologies and regulating foreign investment. China followed a broadly similar path. Foreign investors in the automobile and electronics sectors have been required to transfer new technologies, train domestic workers and use local inputs. Government procurement has been used to create incentives. To qualify for government contracts, foreign software manufacturers have to transfer core technologies to China, invest a minimum proportion of their revenues in the country and

meet 50% of development costs for eligible software products.

Managing openness

If openness, as measured by the ratio of trade to GDP, were an indicator of human development progress, Latin America would be an unmitigated success story. The region has led the world in trade liberalization. However, outcomes have been disappointing. After a decade of falling incomes in the 1980s economic growth per capita in the 1990s was just over 1%.²² Greater openness in Mexico has been associated with negligible reductions in poverty and high levels of inequality. Rapid import liberalization in agriculture has further marginalized the rural poor in particular, in part due to high levels of initial inequality. The contrast with Viet Nam is striking. From far lower levels of average income, openness in Viet Nam has contributed to accelerated human development (box 4.2). Viet Nam has succeeded partly because its export success has been built on domestic reforms that have generated economic growth with equity and partly because it has not pursued greater openness through rapid import liberalization. More important, Viet Nam built integration into global markets on strong human development foundations.

These contrasting cases underline the importance of viewing trade policy, especially import liberalization, as an integral part of

Box 4.2

Viet Nam and Mexico—a tale of two globalizers

Both Viet Nam and Mexico are in the premier division of new globalizing countries, as measured by standard economic indicators. Measured on human development indicators, they are in different leagues. Deeper participation in trade has sustained rapid advances in Viet Nam. In Mexico export “success” has gone hand in hand with limited progress in human development (see table).

Viet Nam. Since introducing market reforms at the end of the 1980s, Viet Nam has sustained growth rates in excess of 5% a year—one of the highest in the world. Participation in trade has been critical, providing producers with access to new markets and new technologies. Imports and exports have been rising at more than 20% a year since the early 1990s, with the share of exports in GDP doubling.

Human development advances have accompanied this trade success. During the 1990s income poverty levels fell from 58% to 28%, life expectancy increased by six years, and child mortality was cut in half. Inequality has risen, but from a low base. The Gini coefficient increased from 35.7 at the start of the 1990s to 37 at the end of the decade—still one of the lowest in the world. The country’s HDI ranking today is 16 places above its wealth ranking. The factors behind Viet Nam’s success include:

- *Prior investments in human development.* Before economic take-off Viet Nam had high levels of income poverty, but other indicators (school enrolment, literacy, life expectancy) were far higher than the average for countries at a similar income level.

(continued on next page)

Global integration and human development: some do it better than others

Country	Exports of goods and services (% of GDP)			GDP per capita (2002 PPP US\$)			Extreme poverty rate (%)				Income share of the poorest 20% of population (%)		Gini coefficient	
	1990	2003	Average annual growth 1990–2003 (%)	1990	2003	Average annual growth 1990–2003 (%)	National extreme poverty line ^a (%)		International extreme poverty line (%)		1990	2002	1990	2002
							1990	2002	1990	2002				
Viet Nam	36.0	59.7	20.2	1,282	2,490	5.9	30.0	15.0	60.0	37.0	..	7.5	35.7 ^b	37.0
Mexico	18.6	28.4	11.4	7,973	9,168	1.4	22.5 ^c	20.3 ^d	15.8	9.9	..	3.1	50.3 ^c	54.6 ^d

.. Not available.

a. Comparisons should not be made across countries because national poverty lines vary considerably.

b. Data are for 1993.

c. Data are for 1992.

d. Data are for 2000.

Source: Exports data, indicator table 16; GDP per capita data, indicator table 14; national extreme poverty data, Mexico, Secretaría de Desarrollo Social 2005 and UN Viet Nam 2002; international extreme poverty data for Mexico, World Bank 2005d, for Viet Nam, UN Viet Nam 2002; poorest 20% of population's income and Gini coefficient data, indicator table 15.

- *Broad-based, inclusive growth.* Export growth was driven by millions of smallholder producers. Economic reform started with liberalization of agricultural markets. Restrictions on rice exports were relaxed, constraints on imports of fertilizer were lifted, and land tenure rights were extended. Rising prices and falling input costs led to rapidly rising income for smallholders. Agricultural wages, domestic trade and local demand all rose.
- *A commitment to equity.* Viet Nam collects about 16% of GDP in revenue—a high share for a low-income country. As a result, the government was able to distribute the benefits of trade more widely through spending on social and economic infrastructure.
- *Gradual liberalization.* Higher growth and export promotion pre-dated import liberalization. Quantitative restrictions were reduced beginning in the mid-1990s, but mean tariffs remained at about 15%. Capital markets remained closed, insulating Viet Nam from the impact of the East Asian financial crisis.
- *Market diversification.* At the end of the 1980s Viet Nam relied almost exclusively on exports of oil to Japan and Singapore. During the 1990s policies promoted diversification of exports (manufactured goods now account for about one-third of the total) and export markets.
- *A high degree of initial inequality.* Mexico has one of the highest Gini coefficients in the world—and it has risen slightly over the past decade. The poorest 10% of the population account for one-quarter of the share of national income of their counterparts in Viet Nam. The role of the government in developing the social and economic infrastructure for broad-based growth has been constrained by weak revenue collection. Mexico has an average income five times the level of Viet Nam but a lower tax revenue to GDP ratio of 13%, which is comparable to Uganda.
- *Rapid liberalization.* Under the North American Free Trade Agreement Mexico has been one of the developing world's most rapidly liberalizing economies. In some sectors import liberalization has compounded poverty. Imports of subsidized maize from the United States have increased sixfold since liberalization started in 1994, contributing to a 70% decline in real proceeds for Mexico's millions of maize farmers. Agricultural export growth has been concentrated in large irrigated commercial farms, while small farmers have had to adjust to increased import competition.
- *Weak industrial policy.* Export data pointing to a high-technology boom are misleading. Half of Mexico's exports originate in the maquiladora zone, where production is dominated by simple assembly and re-export of imported components. Export activity is associated with limited local value added and minimal skills and technology transfer. Dependence on a low-wage, low-skill export sector has left Mexico highly exposed to competition from lower wage economies such as China. Employment has fallen by 180,000 since 2001 alone.
- *Power imbalances in labour markets.* Despite sustained productivity increases real wages have not risen with rapid export growth, partly because of the concentration of export activity in low value-added sectors. Weak collective bargaining rights and unemployment pressures are contributing factors. Another is wage inequality linked to the feminization of the work force: on average, women's wages are 11% lower than men's.

Source: Viet Nam 2004; IMF 2003b; Audley and others 2003; Oxfam International 2003b.

national poverty reduction strategies rather than as a standalone enterprise. That said, import liberalization can have positive benefits for economic growth and human development. Since 1990 India has reduced its average tariff from more than 80% to 20%, enabling firms to obtain the imports needed to sustain an increasingly dynamic growth process. One of the problems in India may be that import liberalization has not gone far enough in some areas. Tariffs on inputs for manufacturing are far higher than the world average, hindering the competitiveness of products that rely on imported inputs.²³

Tackling inequality

Participation in trade can exacerbate inequality as poor people absorb the adjustment costs of increased competition from imports, while people with assets and market power take advantage of opportunities provided by exports.

Rapid export growth is not a panacea for poverty. The surge in textile and apparel exports from Madagascar since the late 1990s has created a large number of jobs, but predominantly for skilled workers. The result: rising inequality and a modest impact on poverty. Increased exports of high value-added fruit and vegetables from countries like Kenya and Zambia have been concentrated in large, capital-intensive farms with weak links to the rest of the economy. Similarly, in Brazil, the world's fourth largest agricultural exporter, large commercial farms and agribusiness firms dominate the \$20 billion export market: just four or fewer firms account for more than 40% of exports of soy, orange juice, poultry and beef. The other face of Brazilian agriculture is scarred by mass poverty. More than 10 million people in rural areas live below the poverty line, most of them smallholder farmers or landless labourers.²⁴ Guatemala, another export "success story", is a human development laggard (box 4.3).

Box 4.3

Guatemala—the limits to export-led success

Increased agricultural exports are widely seen as a route to higher rural incomes and reduced poverty. In some cases they are. But the pattern of growth and distribution also matters.

Over the past decade Guatemala has sustained export growth rates of more than 8%, with minimal progress in human development. The country's HDI ranking is 11 places below its economic wealth ranking. While income poverty fell during the 1990s from 62% to 56%, it fell far less than would be predicted on the basis of growth levels. Since 2000 extreme poverty levels have risen. Already extreme income disparities are also rising: from 1989 to 2002 the income share of the poorest 20% of the population fell from 2.7% to 1.7%.

Why the weak link between export growth and human development? One reason is that high initial inequalities exclude poor people from market opportunities and limit human development. Despite being a middle-income country, Guatemala has malnutrition rates that are among the highest in the world, and one-third of its population is illiterate. Extreme inequality extends to land ownership. An estimated 2% of the population owns 72% of agricultural land, including the most fertile land.

Traditional exports—such as sugar, beef and rubber—are dominated by some 20–50 families. At the other extreme, smallholders constitute 87% of farmers, but hold just 15% of land and have limited access to credit and marketing infrastructure. Over half of rural households are landless or own less than 1 hectare. Poverty rates in this group are over 80%.

Source: Krznaric 2005.

Smallholders have effectively been excluded from export growth in traditional sectors such as sugar. While jobs have been created, employment conditions are poor. Three-quarters of agricultural labourers receive less than the minimum wage—a share that rises to 82% for indigenous people.

Developments in the non-traditional sector have been more encouraging. Exports of vegetables such as snow peas have increased rapidly over the past decade. Production is dominated by 18,000–20,000 Mayan farmers in highland areas, most of them working on plots of less than 2 hectares.

Non-traditional exports have generated high economic returns, created employment and provided opportunities for diversifying away from coffee. However, only 3% of farmers are involved in the sector. Moreover, there is evidence that small farmers are being pushed out by large exporters linked to the US market. The failure of successive Guatemalan governments to extend credit provision, insurance coverage and marketing support has limited the potential for non-traditional exports to act as a force for poverty reduction.

No export growth strategy in Guatemala is likely to produce substantive benefits for human development without deep structural reforms to reduce inequalities and extend opportunity through the redistribution of land and other productive assets, increased public spending for the poor and targeted programmes aimed at breaking down the barriers facing indigenous people. Such measures will ultimately require a change in the distribution of political power in Guatemala.

Participation in trade creates losers as well as winners, and it brings with it adjustment costs

Greater openness to trade can exacerbate inequalities linked to education. In Latin America deep inequalities in primary and secondary school completion rates and the resulting shortage of skilled workers have increased the premium on higher education. Wage differentials between people with a college education and people with lower levels of schooling increased during the 1990s: on average a college education in Latin America now generates higher economic returns than in the United States, pointing to an extraordinarily high level of inequality. While trade can play a positive role, policies to overcome structural inequalities are of pivotal importance for converting export success into human development.²⁵

Reducing vulnerability

Integration into world markets creates opportunities, but it also creates risk. Participation in trade creates losers as well as winners, and it brings with it adjustment costs. Poorly managed adjustment can inflict high human development costs.

Many poor countries and small island states that depend heavily on trade—especially commodity trade—face high market risks. These risks are linked to price vulnerability and the potential for policy change in importing countries to create external economic shocks—a problem suffered in recent years by exporters of bananas and sugar to the European Union. Exporters of some manufactured goods also face acute vulnerability. Garment exports have created millions of jobs in Bangladesh and Nepal. Today, competition from China threatens to destroy many of these jobs (box 4.4). Vulnerability is not limited to poor countries. The effects of imports from developing countries on wages and employment in rich countries are often exaggerated. Even so, evidence from the United States shows that 75% of people re-entering the labour market following a trade-related job loss received lower wages than before. Unlike poor countries, rich countries have a capacity to reduce adjustment costs for workers, but most fail to do so. The US Trade Adjustment Act, one of the few pieces of legislation designed explicitly to address this task, covers barely 10% of affected workers.²⁶

Weak labour rights, allied to the absence of support for labour market adjustments, exacerbate problems of vulnerability. In Latin America only 40% of employed workers are protected by labour laws and have access to social security benefits.²⁷ Women suffer disproportionately from weak labour rights. Less than one-quarter of women in Chile's fruit industry have a contract, exposing them to excessive levels of risk and insecurity. Workers in export processing zones often have weaker rights than those outside: in 2003 at least 16 countries—including Bangladesh and Malaysia—fell into this category.²⁸ Weak labour rights and discrimination against female workers, especially in core areas such as freedom of association and collective bargaining, limit the capacity of workers to negotiate reasonable wages and conditions. What is needed is a combination of strengthened labour rights with institutions and policies that can facilitate adjustment and adaptation to change. Basic economics teaches that trade can raise aggregate income, even though part of the population may lose as a result of adjustments. In order to maximize the welfare gains from trade, and to strengthen the political case for participation in trade, it is important that the winners compensate the losers. That compensation can take various forms, including transfers between countries and public policies within countries to create the conditions under which losers are protected and provided with opportunities.

Confronting the “resource curse”

When it comes to human development, some export activities have a better record than others. Oil and mineral wealth generated through exports can be bad for growth, bad for democracy and bad for development.

In the 34 developing countries with oil and gas resources that make up at least 30% of their export earnings, half of their combined populations live on less than \$1 a day. Two-thirds of these countries are not democratic.²⁹ Oil exports have made Equatorial Guinea one of the world's fastest growing economies, but it also holds the record for the largest gap between its national wealth and its human development

The elimination of textile and garment quotas maintained under the Multifibre Arrangement (MFA) starkly illustrates the human development threats posed by the loss of preferences. Handled badly, as it has been so far, the transition to a more liberalized market could jeopardize the welfare of millions of people.

Under the WTO Agreement on Textiles and Clothing, drawn up in 1994, all textile and clothing quotas maintained by industrial countries under the MFA have been phased out. As the last quotas are withdrawn, the shake-up in the \$350 billion textile and clothing market will produce winners and losers. Impoverished female workers, who make up two-thirds of the global labour force in this sector, are likely to be the biggest losers.

The MFA provided a powerful stimulus to the development of industries across a large group of countries. In Bangladesh, Cambodia, Nepal and Sri Lanka textile and clothing sectors grew as a result of quota constraints on lower cost producers, such as China and India. Foreign investors from China, the Republic of Korea, Taiwan Province of China and elsewhere arrived to take advantage of the protected market.

Today, the ready-made garment sector in Bangladesh accounts for more than three-quarters of the country's exports and about 40% of manufacturing employment. Apart from the 1.8 million mainly female workers directly employed by the industry, another 10–15 million people are indirectly supported through workers' remittances to the countryside and employment generated in other sectors. Wages earned in producing garment exports help keep children in school and help relatives in the countryside meet health costs and maintain nutrition. In Nepal the industry employs 100,000 people and accounts for 40% of export earnings; in Cambodia 250,000 jobs are directly at stake.

Abolition of the preferences under the Agreement on Textiles and Clothing in 2005 heralds the onset of what could be a brutal process of restructuring. WTO projections show that the share of China and India in the US market could rise to more than 60% in the medium term, or three times current levels. Prospects for Bangladesh are less encouraging. IMF forecasts point to a 25% reduction in exports, with losses of \$750 million. Countries such as Lao PDR, the Maldives and Nepal are considerably less competitive than Bangladesh.

Adjustment will inevitably be transmitted from global markets to enterprises as price pressures, affecting wages and employment.

In Bangladesh the scale of the adjustments could roll back some of the human development gains documented in chapter 1, with lower wages translating into reduced income for education and health as well as increased pressure on women to work longer hours.

Industrial countries have directly contributed to the scale of the adjustment costs. For example, instead of removing quotas in a balanced manner over the 10-year phase-out period, the European Union and the United States backloaded quota removal, magnifying the impending 2005 shock.

Strategies that could have been put in place to reduce adjustment costs were ignored. Take the case of Bangladesh. Almost the entire output of its textile and garment sector is exported to protected EU and US markets. Bangladesh continues to face high tariffs for its other exports in the US market, reaching 30% for some products. These tariffs could have been progressively lowered as part of the phase-out to provide a protected breathing space.

The European Union has been equally remiss. Nominally, Bangladesh enjoys duty-free access to the EU market under the Everything but Arms initiative, but the rules of origin present a barrier. Bangladesh's knit garments can generally meet the eligibility requirements because they have a high domestic value-added content. However, woven garments, which rely heavily on imported inputs, face problems in meeting domestic value-added requirements. Well over half of Bangladesh's exports to the European Union are in this category, so less than half of Bangladesh's exports actually receive duty-free treatment.

Having created industries through MFA protectionism, the European Union and the United States are jeopardizing these same industries through the rapid phase-out of quotas. Ironically, the policy response has been to authorize a new wave of antidumping protection against China at the behest of the garment industries of Europe and the United States. Faced with the prospect of further sanctions, the Chinese government has also introduced export taxes. In practice, the protectionist measures directed at China can be traced to vested interests and political pressures. In stark contrast to the sensitivity shown towards protectionist lobbies at home, developed countries have failed to put in place even the most rudimentary forms of protection and adjustment assistance for the losers from the MFA phase-out.

Source: Page 2005; UN Millennium Project 2005g; Alexandraki and Lankes 2004; Mlachila and Yang 2004.

index (HDI), at 93 places. By some estimates less than 10% of Equatorial Guinea's \$700 million in oil revenue finds its way into government accounts. And despite Angola's wealth of natural resources it ranks 160 out of 177 countries on the HDI. The rush to exploit oil

reserves in the Caspian Sea has led to a surge of foreign investment in Azerbaijan, Kazakhstan and Turkmenistan. Meanwhile, human development indicators have been worsening, and institutions for public accountability suffer from systemic corruption.

For a group of self-declared free traders, rich country governments have found it difficult to turn words into action

The “resource curse” operates by weakening institutions, creating perverse economic incentives and creating conditions for conflict—but it can be broken by sensible policies and democratic governance (see chapter 5).

Counting social and environmental costs

Inappropriately regulated export growth can undermine human development through its impact on the environment. In the 1990s Bangladesh strongly promoted export-led growth in shrimp aquaculture. Today, shrimp exports amount to 1.1% of GDP. Research by the United Nations Environment Programme estimates that water salinization, loss of grazing land and wider environmental impacts have cost 20%–30% of

the value of exports. Poor farmers have lost grazing land and suffered lower yields.³⁰ In Tajikistan the government has promoted intensive cotton production through state companies. Cotton is now the country’s third largest export. However, the incidence of water-borne illness is three to nine times higher in cotton growing areas. The reason: weakly regulated use of toxic chemicals that filter into irrigation ditches used for water supply.³¹ As these cases demonstrate, export growth figures do not take into account human costs and environmental externalities that weaken the links between trade and human development. Factoring in these costs and externalities is one of the primary conditions for making trade work for human development.

Unfair rules: how the trading system favours developed countries

The Doha Round of multilateral trade negotiations provides developed countries with an opportunity to bring international trade rules and domestic policies in line with their development pledges. It would be unrealistic to expect the Doha Round to fully resolve this long-standing mismatch—but it would be disastrous for the multilateral trading system if it failed to deliver tangible progress.

There are three benchmarks for assessing the outcome of the Doha Round. First, it needs to produce rules that tackle long-standing unfair and unbalanced trade practices by improving market access for poor countries. Second, it needs to focus in particular on agricultural trade and a reduction in agricultural subsidies. Third, it needs to revisit agreements and negotiations that limit the policy space available to developing countries, directly threaten human development or skew the benefits of integration towards rich countries. The issues raised by WTO rules on investment and intellectual property and by current negotiations on services demonstrate the problem in different ways.

Access to markets

To benefit from trade and achieve human development gains developing countries and poor people need access to rich country markets. This was recognized in the declaration that launched the Doha Round, which included a promise by rich countries “to reduce or as appropriate eliminate tariffs as well as non-tariff barriers on products of export interest to developing countries”. For a group of self-declared free traders, rich country governments have found it difficult to turn words into action.

System of perverse graduation

Most systems of taxation start from a simple principle: the more you earn, the more you pay. The international trading system flips this principle on its head: when it comes to access to industrial markets, the lower a country’s average income, the higher the tax. Although industrial countries apply very low average tariffs in their trade with each other, they reserve some of their highest import barriers for the world’s poorest countries.

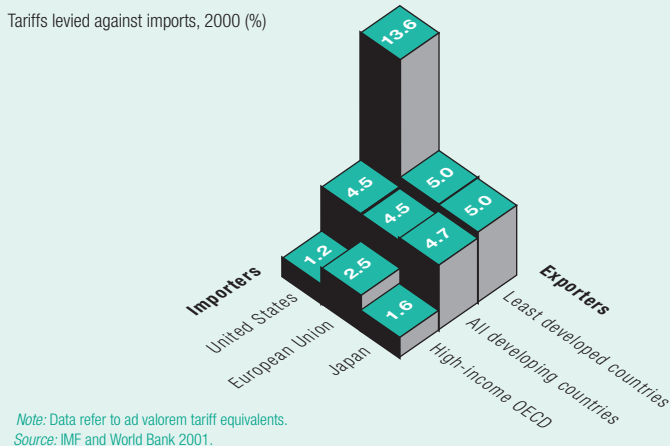
On average, low-income developing countries exporting to high-income countries face tariffs three to four times higher than the barriers applied in trade between high-income countries (figure 4.9).³² The average conceals very large differences between countries and the very high tariffs on labour-intensive products of great importance for employment in developing countries. For example, while the average tariff on imports from developing countries to high-income countries is 3.4%, Japan imposes a tariff of 26% on Kenyan footwear. The European Union taxes Indian garment imports at 10%. Canada levies a 17% tariff on garments from Malaysia.³³

Trading partners' ability to pay has little bearing on developed country tariffs. Developing countries account for less than one-third of developed country imports but for two-thirds of tariff revenues collected. They also account for two-thirds of developed country imports subjected to tariffs higher than 15%.³⁴ In concrete terms this means that Viet Nam pays \$470 million in taxes on exports to the United States worth \$4.7 billion, while the United Kingdom pays roughly the same amount on exports worth \$50 billion.³⁵ Customs revenue collection as a share of imports graphically illustrates perverse taxation in operation (figure 4.10). The effective US import duty for countries like Viet Nam and Bangladesh is some 10 times higher than for most countries in the European Union.

Tariff escalation is one of the more pernicious forms of perverse graduation. Developed countries typically apply low tariffs to raw commodities but rapidly rising rates to intermediate or final products.³⁶ In Japan tariffs on processed food products are 7 times higher than on first-stage products; in Canada they are 12 times higher. In the European Union tariffs rise from 0 to 9% on cocoa paste and to 30% on the final product.

This tariff structure prevents developing countries from adding value to their exports. Tariff escalation is designed to transfer value from producers in poor countries to agricultural processors and retailers in rich ones—and it works. It helps explain why 90% of the world's cocoa beans are grown in developing countries,

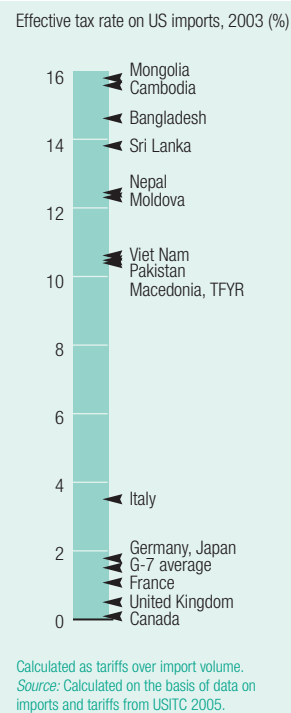
Figure 4.9 Perverse graduation in trade taxes



while only 44% of cocoa liquor and 29% of cocoa powder exports originate in those countries. Escalating tariffs help to confine countries like Côte d'Ivoire and Ghana to the export of unprocessed cocoa beans, locking them into a volatile, low value-added raw cocoa market. Meanwhile, Germany is the world's largest exporter of processed cocoa, and European companies capture the bulk of the final value of Africa's cocoa production.

In addition to facing high barriers in developed countries, developing countries impose high trade barriers on trade with each other. Indeed, they impose even higher tariffs on each other's imports than those imposed by industrial countries. Average tariffs on low- and middle-income countries exporting to South Asia are more than 20%, for example. Tariff peaks (import duties higher than 15%) are also common in developing countries, rising to more than 100% in Bangladesh and India, for example. Exports from least developed countries to other developing countries face among the highest average tariff barriers in world trade. On a regional basis the highest average tariffs are Sub-Saharan Africa's 18% import duties and South Asia's 15% tariff. High tariffs help explain why intraregional trade accounts for less than 1% of GDP in South Asia and 5% in Sub-Saharan Africa, compared with more than 25% in East Asia. Liberalization of regional trade under the Common Market for Eastern and Southern Africa since 2000 has led to a marked increase in trade value, with imports

Figure 4.10 Perverse taxation in operation



In practice, the European Union's rules of origin have protectionist consequences

and exports rising from \$4.5 billion in 2002 to \$5.3 billion in 2003 alone.

Preferential trade schemes and preference erosion

Preferential trade schemes provide some countries with protection from some discriminatory import duties. The European Union grants preferences for least developed countries through its Everything but Arms initiative—a duty-free and quota-free market access provision introduced in 2001. The US African Growth and Opportunity Act, which gives preferential access to US markets for several products, including textiles and clothing, has spurred garment exports from some countries in Africa. More broadly, however, preference schemes often suffer from limited product coverage, uncertain duration and complex eligibility requirements.

Among the most onerous requirements are rules of origin, which specify how much value must be added to any inputs used to produce exports that are entitled to preferences. Rules of origin are often deployed as protectionist trade barriers. For entry to the European Union, exporting countries must add “the majority” of the value to export products. Canada has set the bar at the lowest level: exporting countries have to add just 25% to the value of imported inputs.

Why do these apparently arcane differences matter? Consider the position of a vegetable exporter in Uganda who uses imported packaging from Kenya. The exporter would not be eligible for duty-free access under the EU Everything but Arms scheme because of the value of the imported items. Similarly, an African garment exporter wanting to import fabric from India to stitch into garments would fall foul of the European Union's rules of origin.³⁷ The sheer complexity of the rules, allied to unrealistic value-added requirements, undermines the capacity of poor countries to make use of preferences.

In practice, the European Union's rules of origin have protectionist consequences. Only a small proportion of eligible goods are imported to the European Union on a duty-free basis. As a least developed country, Bangladesh is eligible for duty-free status, but less than half of its

exports enter duty free.³⁸ Similarly, only about one-third of eligible exports from Cambodia enter the European Union duty free.³⁹ Senegal is nominally eligible for duty-free access, but it pays an effective tariff of about 10%.⁴⁰

Changing Europe's rules of origin could open up new opportunities for some of the world's poorest countries. When Canada lowered its eligibility requirements for local value added in 2003, imports from Bangladesh doubled within a year. Similarly, when the United States waived its rules of origin under the African Growth and Opportunity Act in 2001, eligible imports from Sub-Saharan Africa rose sharply. By 2003 imports had increased in value from \$54 million to \$668 million. More than 10,000 jobs were created in Lesotho alone.⁴¹ European imports from Sub-Saharan Africa fell over the same period.

Whatever the benefits and limitations of existing trade preferences, developing countries that use them stand to suffer from their erosion. When trade is liberalized, preference margins fall or disappear altogether. Under the Multifibre Arrangement (MFA), some developing countries—such as Bangladesh, Nepal and Sri Lanka—enjoyed protected access to industrial country markets under a quota system. The removal of the quotas through a WTO trade liberalization agreement exposes these countries to competition from more competitive suppliers, such as China and India. China has already been expanding market share, prompting a surge of appeals for protection from the EU and US textile and garment industries, ostensibly on grounds of unfair competition. The appeals are misplaced. There is no substantiated evidence of unfair competition. Moreover, while Chinese imports have surged since the ending of MFA quotas, it is developing country exporters, not industrial country producers, that have borne the adjustment costs (see box 4.4).

Some of the biggest losses from liberalization could happen in agriculture. For example, EU trade preferences mean that countries such as Fiji and Mauritius have quotas for sugar exports for which they receive three times the current world market price. The International Monetary Fund (IMF) estimates the potential

losses at 2% of GDP for Fiji and 4% for Mauritius.⁴² For Mauritius this translates into a one-quarter reduction in government revenue, threatening vital social sector budgets.

What these cases underline is that trade liberalization creates winners and losers within the developing world. Developed countries are belatedly responding to the challenges posed by preference erosion, but had human development been front and centre in trade policies, assistance schemes would already be in place. Financial support and other measures urgently need to be implemented to protect vulnerable countries and people. More broadly, the failure of developed countries to align their import policies with a commitment to the MDGs has limited the capacity of poor countries to benefit from trade.

Agricultural trade

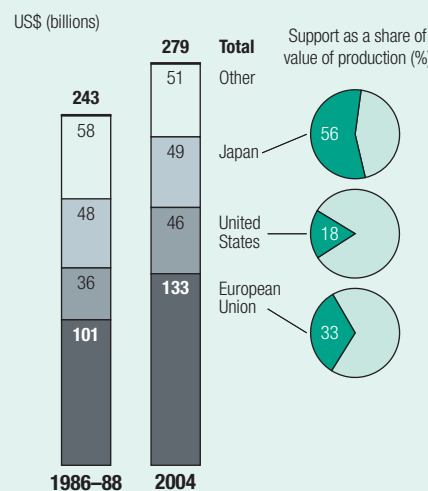
Agriculture has become the flashpoint for tensions in the Doha Round. At stake is an issue that is central to human development and the MDGs—the rules governing world agricultural trade. More than two-thirds of all people surviving on less than \$1 a day live and work in rural areas either as smallholder farmers or as agricultural labourers. Unfair trade practices systematically undermine the livelihoods of these people, hampering progress towards the MDGs in the process.

The problem at the heart of the Doha Round negotiations can be summarized in three words: rich country subsidies. Having promised to cut agricultural support in the last round of world trade negotiations—the Uruguay Round—the world’s richest countries have increased the overall level of producer subsidies. Led by the world’s farm subsidy superpowers, the European Union and the United States, developed country support to agricultural production amounts to \$350 billion a year. Direct support to producers can be calculated on different measures. The Organisation for Economic Co-operation and Development’s (OECD) producer support estimate measures the cost of all policies and transfers that maintain domestic prices above world levels at about \$279 billion, or one-third of the

value of production—and rising to more than one-half for Japan (figure 4.11).⁴³ This support comes in different forms, most of which have the effect of raising prices, increasing output and boosting exports. Import tariffs, rising to more than 100% for several products—including rice, sugar, and fruit and nuts⁴⁴—keep domestic prices above world market levels, while budget transfers inflate incomes. Most developed country governments would take a dim view of any developing country contemplating tariffs and subsidies on this scale, but when it comes to agriculture, developed countries are able to set their own standards.

Some political leaders in developed countries seek to justify agricultural support by reference to rural development objectives and the interests of vulnerable communities. There is little evidence to support this justification. In the real world the winners in the annual cycle of multi-billion dollar subsidies are large-scale farmers, corporate agribusiness interests and landowners. Research carried out for this Report estimates that subsidy distribution in rich countries is more unequal than income distribution in Brazil (box 4.5). It would be hard to design a more regressive—or less efficient—system of financial transfer than currently provided through agricultural subsidies.

Figure 4.11 Big and getting bigger: rich country support to agriculture



Source: OECD 2005.

One former European agriculture minister has described the EU Common Agriculture Policy (CAP) as an integral part of the EU “social model”. In the United States the controversial 2002 Farm Act was presented as an investment in family farming. The facts tell a different story.

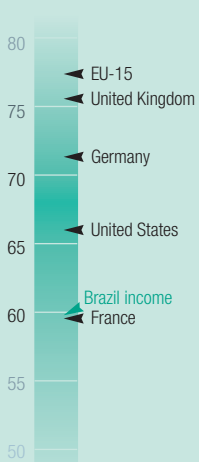
Subsidies in Europe and the United States are directly linked to output and the size of land holding, with one overwhelming consequence: the bigger you are, the more you get. In the European Union more than three-quarters of CAP support goes to the biggest 10% of subsidy recipients. In 2003 six sugar processors shared a payment of €831 million. The United States has an even more skewed pattern of distribution. Only 40% of farmers receive any subsidy. Within this group, the richest 5% get over half, or about \$470,000 each.

One way of assessing distributional equity for agricultural subsidies is to construct a Gini coefficient for government support. Measured in this way, EU and US subsidy distribution is more unequal than income distribution in the world’s most unequal countries, calling into question the idea that subsidies play an important social welfare role (see figure). The subsidy Gini coefficient for the European Union is 77; the income Gini coefficient for Brazil, one of the world’s most unequal countries, is 60. These figures understate how regressive agricultural subsidies are. Much of the final value of subsidies is capitalized into rising land values and rents or converted into profits for input suppliers. US farmers retain only about 40% of the value of government payments.

Source: Burfisher and Hopkins 2003; Oxfam International 2004a; Environmental Working Group 2005.

Subsidies are heavily skewed towards the biggest farms

Gini coefficient of farm subsidies, 2001



Source: Samman 2005b; data on Brazil from indicator table 15.

wastes money at home and destroys livelihoods abroad. When it comes to world agricultural trade, market success is determined not by comparative advantage, but by comparative access to subsidies—an area in which producers in poor countries are unable to compete.

High levels of agricultural support translate into higher output, fewer imports and more exports than would otherwise be the case. That support helps to explain why industrial countries continue to dominate world agricultural trade. At the end of the 1990s developed countries accounted for two-thirds of world agricultural exports—the same share as in 1980.⁴⁵ Rural communities in developing countries are hurt through several channels. Subsidized exports undercut them in global and local markets, driving down the proceeds received by farmers and the wages received by agricultural labourers. Meanwhile, producers seeking access to industrial country markets have to scale some of the highest tariff peaks in world trade.

Recent estimates suggest that developing countries lose about \$24 billion a year in agricultural income from protectionism and subsidies in developed countries, not counting the dynamic and spillover effects.⁴⁶ Every \$1 lost through unfair agricultural trade policies costs more than \$1 in rural communities because lost purchasing power means less income for investment and employment. The spillover effects are very large: research in Africa suggests that for every \$1 increase in income the rural economy generates another \$3 through local markets. This would suggest that the real costs for developing countries of rich country agricultural support may be as high as \$72 billion a year—an amount equivalent to all official aid flows in 2003.

The EU Common Agricultural Policy

Nothing better demonstrates the perverse logic of agricultural subsidies than the European Union’s Common Agricultural Policy (CAP)—an arrangement that lavishes \$51 billion (€43 billion) in support on producers. The CAP supports a sector that accounts for less than 2% of employment but absorbs more than 40% of the total EU budget. Sugar is first

The financial commitment to a small group of largely high-income beneficiaries in developed countries puts the financing requirements for the MDGs in perspective. Rich countries spend just over \$1 billion a year on aid to developing country agriculture and just under \$1 billion a day supporting their own agricultural systems. For a fraction of what rich countries spend subsidizing the overproduction of crops like rice and sugar, it would be possible to meet the financing requirements for achieving the MDGs in areas such as education, health and water. Adding insult to injury, the subsidies in rich countries not only divert resources but also reinforce rural poverty in poor countries. Industrial countries are locked into a system that

among equals as a case study in irrational public policy behaviour (figure 4.12). Farmers and processors are paid four times the world market price for sugar, generating a 4 million tonne surplus. That surplus is then dumped on world markets with the help of more than \$1 billion in export subsidies paid to a small group of sugar processors. The result: Europe is the world's second largest exporter of a product in which it has no comparative advantage.

Developing country producers foot the bill. Subsidized EU sugar exports lower world prices by about one-third. As a result, far more efficient sugar exporters in developing countries suffer foreign exchange losses estimated at \$494 million for Brazil, \$151 million for South Africa and \$60 million for Thailand—countries with more than 60 million people living on less than \$2 a day.⁴⁷ Meanwhile, Mozambique, a country that is building a competitive sugar industry that employs a large number of agricultural labourers, is kept out of EU markets by an import quota allowing it to supply an amount equivalent to less than four hours' worth of EU consumption. When it comes to agriculture, there are distinct limits to EU openness.

US cotton and rice policies

Cotton policy in the United States provides another example of subsidized market distortions that harm human development. As with EU sugar policies, the scale of the subsidies stretches credulity. The US Department of Agriculture estimates that the country's 20,000 cotton farmers will receive government payments of \$4.7 billion in 2005—an amount equivalent to the market value of the crop and more than US aid to Sub-Saharan Africa.⁴⁸ Subsidies of this order are reminiscent of the state planning systems that characterized the former Soviet Union. Of more direct relevance is the effect of the subsidies on cotton producers in poor countries.

Price distortions caused by US subsidies have a direct impact on these smallholder producers. These subsidies lower world prices by 9%–13% and enable US producers to dominate world markets, accounting for about one-third of total world exports. These exports would

not be possible without subsidies. High levels of government support effectively insulate US producers from world price signals, enabling them to expand production regardless of market conditions. Perversely, the increased subsidy payments triggered when world prices fall create incentives to expand production during periods of low prices, while other countries bear the adjustment costs (figure 4.13). These adjustment costs are very high. When world cotton prices fell to a 50-year low in 2001, losses attributable to US subsidies were estimated at 1%–3% of GDP for countries such as Burkina Faso and Mali in West Africa—a region in which some 2 million smallholders depend on cotton as their main, and in some cases only, source of income. These losses hurt poor households, with lower incomes compromising nutritional status and resources available for health, education and investment in agriculture. In Benin alone the fall in cotton prices in 2001–02 was linked to an increase in poverty from 37% to 59%.⁴⁹

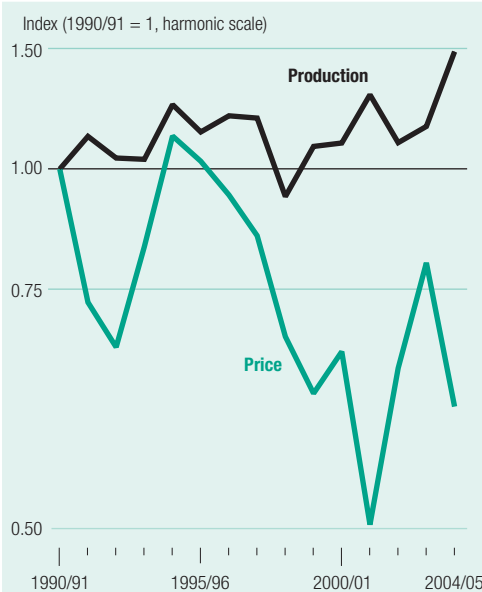
Whole economies are being destabilized by world cotton market distortions, with poor countries bearing the brunt. Cotton exports are of marginal relevance for the United States. For Burkina Faso, by contrast, cotton represents

Figure 4.12 EU sugar—how to overproduce and dump on world markets



Source: Oxfam International 2004a.

Figure 4.13 US cotton production—immune to world price changes



Source: International Cotton Advisory Committee 2005.

The 20,000 cotton farmers in the United States will receive government payments in 2005 equivalent to the market value of the crop and more than US aid to Sub-Saharan Africa

50% of the value of exports and is a mainstay of the national economy. With the world cotton market heading for another deep price slump in 2005, the IMF estimates that worsening terms of trade will reduce economic growth in Burkina Faso by 2.5% of GDP, halving the projected growth rate.⁵⁰ This outcome has grave implications for efforts to achieve the MDG target of halving income poverty. It also threatens to destabilize the balance of payments, with aid inflows insufficient to cover a widening deficit. Human development will suffer as a result of both the impact on rural poverty and the diminished capacity to import.

Not all of the problems in international cotton markets can be traced to US agricultural policy. Rising production elsewhere, especially in China, and heavy subsidies in the European Union, also contribute.⁵¹ However, because the United States is the world's largest exporter, its policies have particularly strong global market effects.

It is not only smallholders involved in export crop production that suffer income losses. US rice policies harm domestic producers in many countries. Between 2002 and 2003 rice grown in the United States at a cost of \$415 a tonne was exported at \$274 a tonne.⁵² Rival rice exporters such as Thailand and Viet Nam have to adjust to this unfair competition. So do millions of rice farmers growing for their domestic markets. In countries such as Ghana and Haiti rice farmers have been pushed out of national markets by US imports, undermining prospects for the development of a dynamic rural economy. In Ghana rice farmers in the poorest northern part of the country have seen markets squeezed by cheap US imports. The IMF has opposed the use of tariffs to restrict these imports on the grounds that there is no evidence of unfair competition. That judgement is hard to square with the fact that US budget payments for rice in 2003 amounted to \$1.3 billion, or almost three-quarters of the value of output.

Rewriting the rules for agriculture

The Doha Round provides an opportunity to remove one of the most egregious examples of

unfair trade. Developed country agricultural subsidies may have a long and ignoble history. But reducing them is now more urgent than ever because doing so would remove a barrier to the realization of the MDGs. Unfortunately, there has been little progress in this direction. Since the Doha Round started, the United States has passed legislation that increases agricultural support by about \$7 billion a year.⁵³ The new legislation also strengthens the links between subsidies and production that had been weakened in previous legislation.

The latest twist in the long-running saga of CAP reform similarly gives little cause for optimism. Under measures agreed in 2003 the European Union has created a framework that will restructure, but not reduce, overall support: the CAP budget is set to increase over the next decade. The European Union argues that the reformed CAP payments will be "WTO-friendly" and therefore exempt from any cuts agreed as a result of the Doha Round. However, national provisions also allow governments the scope to maintain a link between subsidies and output. How will CAP reform affect the overall level of support under the policy? An OECD evaluation based on projections that capture the effect of the new payments structure concludes that producer support will still amount to more than one-third of the value of production (with the producer support estimate falling by just over 1%) as a result of the reform.⁵⁴ Because payments are still linked to past production and size of land holding, support will continue to benefit larger and richer farmers. And while the structure of payments will change, market price support will continue to account for 52% of the total under the reformed CAP.

At the WTO itself new threats are emerging. Instead of addressing head on the fundamental challenge of removing market distortions, developed countries have embarked on an elaborate subsidy repackaging exercise (box 4.6). The danger now is that an agreement at the WTO will leave intact the very distortions that the Doha Round was intended to remove, in the process undermining prospects for achieving the MDGs.

The answer to the question posed in the title is simple: when developed countries say so. One problem now facing developing countries is that industrial countries have transferred support into subsidy areas that are weakly covered by WTO rules—rules crafted under heavy EU and US influence.

The Uruguay Round Agreement on Agriculture, negotiated largely between the European Union and the United States, introduced three categories of subsidy. Amber Box subsidies are subject to any cut in support agreed at the WTO. Green Box subsidies, deemed to be “non-distorting”, are permitted. In between are Blue Box subsidies, which are exempt from cuts if the subsidies are linked to taking some land out of cultivation. These were introduced at EU insistence to accommodate CAP reforms, under which eligibility for direct payments was made conditional on producers removing a certain proportion of their holdings from cultivation.

Why do these distinctions matter? Because the WTO framework exercises weak or non-existent disciplines over precisely the forms of support into which developed country governments are now directing agricultural subsidies. In 2001 (the last year for which notifications to the WTO are available) the United States spent \$50 billion on Green Box payments—three times what it spent on Amber Box payments (see table). Not to be outdone the European Union spent \$50 billion on Green Box and Blue Box payments—more than it spent on Amber Box payments. In both cases the subsidy superpowers have been able to remain below the WTO subsidy

ceiling by restructuring, rather than cutting, overall support. The upshot is that for WTO purposes many of the subsidies that allow Europe to export cereals and the United States to sell rice, cotton, maize and other crops at below cost on world markets are not currently categorized either as export subsidies or trade distorting and are therefore potentially exempt from any agreement to cut such subsidies.

Some developing countries have already used WTO dispute panels to challenge specific subsidies. Brazil successfully challenged the US Green Box categorization of direct payments to cotton. Brazil, India and Thailand have successfully challenged the legality of EU sugar subsidies, with a WTO panel ruling that these subsidies are not in compliance with WTO rules. However, there is a growing danger that a WTO agreement could provide sufficient space to enable overall agricultural support, as defined by the OECD’s producer support estimate, to remain around current levels, albeit in repackaged form.

Such an outcome would severely diminish the credibility of any Doha Round agreement on agriculture. Not all subsidies are equally distorting in their effects. However, the annual transfer of billions of dollars to large agricultural producers clearly has market-distorting effects, even if the payments are nominally categorized as non-distorting. This is especially the case in sectors where large surpluses are produced for world markets. At the very least these payments provide a guarantee against risk, capital resources for investment and a source of collateral for loans.

From the perspective of cotton farmers in Burkina Faso or rice farmers in Ghana, the precise legal categorization of subsidies in the WTO is of less immediate relevance than whether subsidies in rich countries undermine their livelihoods. The problem with the current framework of rules in agriculture is that it institutionalizes unfair trade practices behind a veneer of WTO legality, weakening the legitimacy of the rules-based multilateral system in the process. The development of WTO rules that prohibit unfair competition between developed and developing countries should be one of the benchmarks for judging the outcome of the entire Doha Round.

Large subsidies escape World Trade Organization regulation

US\$, 2001/02 (billions)

	European Union	United States
Amber Box	44.3	14.4
Maximum Amber Box allowed under WTO rules	75.7	19.1
Blue Box	26.7	0.0
Green Box	23.3	50.7

Source: WTO 2005.

Source: US Department of Agriculture, Economic Research Service 2005b; Watkins 2003b.

Closing down the space for development policies

The last round of world trade negotiations extended the remit of WTO rules into new areas. It also strengthened enforcement mechanisms. Under the new regime WTO members now have to comply with all agreements taken as a package—an arrangement known as the Single Undertaking. Compliance is enforced through a

dispute resolution procedure. In parallel to the strengthening of multilateral rules, there has been a proliferation of regional agreements. There are now some 230 regional trade agreements covering about 40% of world trade. In four areas in particular stronger multilateral rules or regional agreements will have a major bearing on human development and the future distribution of benefits from world trade: industrial policy, intellectual property, services, and tariffs and revenue.

Industrial policy

One of the most pressing challenges for developing countries is to develop the capacity to enter higher value-added areas of world trade. For reasons explained earlier, an active industrial and technology policy is a critical requirement. Current rules severely restrict the scope for government action in this area.

Several WTO agreements expressly limit the policy space available to governments. The Agreement on Subsidies makes a wide range of

fiscal and credit incentives for export illegal. Similarly, the Trade-Related Investment Measures (TRIMs) agreement prohibits tools that successful economies in East Asia and elsewhere once used to maximize the benefit of foreign investment, including local content requirements, technology transfer, local employment, and research and development provisions.

This is unjustified. Not all industrial policy has worked. There is no shortage of examples of such policies being captured by special interest groups or of leading to industrial white elephants. At the same time, it is difficult to find examples of sectors competing successfully in world markets without active state involvement. Many of the policy measures that underpinned East Asian industrial development are now prohibited by WTO rules.⁵⁵ China made extensive use of local content and technology transfer provisions, leading to the emergence of globally competitive firms that rapidly climbed into higher value-added areas of world trade. Brazil's aircraft industry, the country's third largest source of export earnings, was supported through subsidized credit. India's fast-growing automobile components sector has been supported through regulation of foreign investors, including local content rules (box 4.7). In Latin America, where the automobile components industry conforms closely to the proposed WTO rules, domestic firms have been almost entirely displaced by foreign transnational companies.⁵⁶

The aim of industrial policy should be to create the conditions under which countries can acquire the technological capabilities needed to raise productivity, maximize the advantages of trade and develop a dynamic comparative advantage.⁵⁷ Blanket protection and disincentives for foreign investment are not helpful. To be successful, industrial policy needs to focus on dynamic new sectors, offer time-bound import protection and promote activities that generate investments and technological dispersion. Transparent interaction between public and private sector bodies is vital.

Broad WTO rules could foster the transparency and predictability needed to ensure that industrial policies do not spark trade disputes,

Box 4.7

The Indian automobile components sector

A key driver of industrial development is the integration of local firms into global supply chains. Success depends critically on industrial policy.

The most highly developed supply chain is that of the automobile industry. Over the past decade companies in India have emerged as a powerful force, especially in the components sector. Indian firms—such as Bharat Forge, Brakes India and Sundaram—have moved into high value-added areas of production, often in partnership with multinational companies. The contrast with Latin America is striking. There, a fairly well developed industry has been pushed out of domestic and regional markets by foreign car companies using their own suppliers.

From the early 1990s a wave of multinational investors entered the Indian market. These entrants were required to achieve a high level of domestic content within a specified period (typically 70% within three years). To do that, multinational companies had to switch from importing components to sourcing from local companies. That created incentives for automobile makers to work closely with suppliers to raise quality standards. In addition, the Indian government imposed training requirements on multinational investors.

Export success followed a lengthy period of market protection. High import barriers created an incentive for foreign investors to locate in India and build alliances with local firms. These barriers were reduced slowly, in stark contrast to Latin America. Tariffs on imported automobiles and parts averaged more than 30% in India in the mid-1990s, whereas they were less than 3% in Latin America.

The component supply chain has developed rapidly. The value of output increased from \$2.4 billion in 1997 to \$4.2 billion in 2001. India has also emerged as a significant exporter. Exports now account for about 15% of the sector's output, reaching \$800 million in value terms in 2002–03. International comparisons show that the top Indian companies are globally competitive across a wide range of automobile component products. Local firms have dramatically reduced defect rates and are using skilled labour to master new technologies.

Evidence from firm-level research in India suggests that changes in WTO rules are unlikely to erode the position of local firms. Most foreign investors report that Indian suppliers are as efficient as imported alternatives.

Domestic content restrictions were used to stimulate development of the components industry. Policies of this kind are not always appropriate or successful. But in this case the infant industry was successfully nurtured, with the participation of international automobile companies. The key question in other cases is whether multinational firms will source locally since WTO rules preclude local content rules.

Source: Sutton 2004; Tewari 2003.

as is increasingly the case between the European Union and the United States. But the current regime is entirely out of step with what is required to strengthen the links between trade and human development. The starting point for reform should be a recognition that the purpose of multilateralism is not to impose common rules or a free market blueprint on countries with different approaches and different levels of development, but to accept the case for diverse public policies. The rules-based system could then focus on the key challenge of strengthening predictability and avoiding conflict.

Intellectual property

Intellectual property rules have an important bearing on human development. They influence the terms on which poor countries can acquire and adapt the new technologies needed to raise living standards and succeed in world trade. They also influence access to medicines. Any intellectual property rules have to strike a balance between two objectives: creating incentives for innovation through patents and other measures and spreading the benefits of innovation as widely as possible. The WTO's Trade-Related Intellectual Property Rights (TRIPS) agreement, along with "TRIPS plus" variants in regional and bilateral agreements, strikes the wrong balance between the interests of technology holders and the wider public interest.

The TRIPS agreement establishes a global regime for intellectual property rights based on the level of protection provided in the world's most developed countries, including a 20-year patent protection period. Reduced to its essentials, the new regime will increase the price of patented technologies, creating gains for patent holders and raising the cost of technology transfer. Firms in developed countries currently account for 96% of royalties from patents, or \$71 billion a year.⁵⁸

The TRIPS agreement threatens to widen the technological divide between technology-rich and technology-poor countries. The ability to copy technologies developed in economically advanced countries has historically been an important element enabling other countries to catch up. In the nineteenth century the United

States copied British patents. In East Asia, Japan, the Republic of Korea, Taiwan Province of China and China have all upgraded technologies through reverse engineering and copying. The space for such strategies has now been closed by the countries at the top of the technology ladder. With technology increasingly important to international trade competitiveness, the rising cost of technology imports could further marginalize many developing countries.

The human development threats posed by the TRIPS agreement are especially pronounced in public health.⁵⁹ Prices for medicines are heavily influenced by the terms on which generic products, produced through reverse engineering, can enter markets and compete with brand name, or patented, products. For example, when the generic version of fluconazole, a medicine used in the treatment of HIV/AIDS, entered the market in Thailand, prices fell to 3% of the original level. Strengthened intellectual property rules will delay the entry of generic drugs, driving up prices. Demand for medicines is highly sensitive to price in poor countries, where households pay three-quarters of the costs of medicines. One estimate for India suggests that costs to households associated with higher prices for medicine will increase by some \$670 million, almost double current spending on all antibacterial medicines.⁶⁰ Public health providers will also have to adjust to higher costs. Estimates by the government of Costa Rica suggest that its pharmaceutical budget would have to rise fivefold to maintain universal coverage without access to generic drugs.

Concerns that stronger patent protection would lead to higher drug prices motivated governments in 2003 to adopt the Doha Declaration on Public Health. In principle, the declaration strengthens the right of countries with insufficient manufacturing capacity to use compulsory licensing to import low-cost copies of patented medicines—to promote public health. It stipulates that the TRIPS agreement "should not prevent members from taking measures to protect public health".⁶¹

It remains to be seen whether the declaration is interpreted in a spirit that reflects this commitment. Following international pressure,

The TRIPS agreement threatens to widen the technological divide between technology-rich and technology-poor countries

Easing restrictions on temporary movements of labour would offer developing countries huge gains

pharmaceutical companies have lowered prices towards cost level for drugs used in treating HIV/AIDS. This is an encouraging development. What is unclear is whether this action will weaken intellectual property protection on patented products for treating less high-profile health problems, such as diabetes (which affects 115 million people in developing countries) and cervical cancer (which affects 400,000 women in developing countries), or for preventing such illnesses as pneumonia (which causes one-quarter of child deaths worldwide).⁶²

Even if the declaration is interpreted as intended, developed countries are demanding “TRIPS plus” provisions in many regional trade agreements. These provisions explicitly strengthen the protection afforded to pharmaceutical companies beyond WTO provisions and circumscribe the policy space for governments. Indeed, some developing countries appear to have adopted trade negotiating strategies that accept more stringent patent protection in return for improved market access.⁶³ The bargains struck have been unequal, reflecting inequalities in negotiating power (box 4.8).

Trade in services

Liberalization of trade in services offers potential benefits to developing countries. The problem is that industrial countries have focussed on areas that threaten to undermine human development prospects, while failing to liberalize areas that could generate gains for poor countries.

The General Agreement on Trade in Services (GATS) sets the framework for legally binding rules in the WTO. It covers four “modes of supply”: cross-border (e-commerce and telecommunications are examples); consumption overseas (tourism or health provision, for instance); commercial presence (for example, through the establishment of banks, insurance companies or financial institutions); and temporary movements of people.

Developed countries have concentrated their efforts almost exclusively on commercial presence. Their priority has been to establish WTO rules that enforce the right of multinational banks, insurance companies and other

service providers to operate in developing countries on terms equivalent to those applied to domestic providers. This negotiating strategy reflects a sustained lobbying campaign by bodies representing corporate financial service providers, for which such rules would offer expanded global markets. Developing countries have prioritized other areas, notably reducing barriers to the temporary movement of labour.

Efforts to promote across-the-board liberalization of services in developing countries through the WTO are entirely misplaced. In some cases services liberalization does offer benefits. Poor quality services are a major constraint on human development, growth and trade in developing countries. The presence of foreign companies providing services can improve transport infrastructure, reduce the costs of telecommunications and improve access to credit. However, liberalization is best managed through national strategies rooted in planning for the MDGs and wider human development goals, not through multilateral trade rules. This is especially the case in areas such as water, health and education. The starting point for any WTO regime should be a full assessment of the human development implications of the rules on a sector by sector basis—a provision that was included in the GATS but has so far been a dead letter.

Developed countries have been unwilling to enter substantive negotiations on the temporary movement of labour even though this is where developing countries stand to make the greatest gains. Easing restrictions on temporary movements of labour would offer developing countries the opportunity to exploit one of their areas of strongest comparative advantage: low wages linked, in many cases, to high skills. Consider the software sector in India, which accounts for 16% of exports and provides jobs to half a million people. Two-thirds of exports go to the United States and another quarter to Europe. Almost half of these exports—valued at more than \$3 billion in 2002—are delivered on site by professional staff.⁶⁴ Delivery depends on market access.

Access barriers include some immigration-related issues, along with onerous visa eligibility

Recent years have seen a marked shift in US trade policy. While the WTO remains an important focus, regional and bilateral free trade agreements are being used to strengthen and extend multilateral provisions. Intellectual property rules figure prominently. Many of the bargains being struck raise concerns for human development.

Bilateral agreements with Jordan (2000), Viet Nam (2001), Chile (2003), Morocco (2004) and Australia (2004) and the regional agreement with six countries in the Central America Free Trade Agreement (CAFTA, 2004) have all resulted in “TRIPS-plus” provisions. Although the detailed provisions vary, three themes recur:

- *Extension and expansion of patent protection.* All free trade agreements provide patent protection for 20 years, as in the WTO. Under certain conditions, they require an extension of the period of patent protection. Under CAFTA, for example, patent holders can demand extensions to compensate for any delay by national regulatory bodies in granting the patent. All free trade agreements go beyond TRIPS in strengthening patent protection for plants and animals.
- *Restrictions on use of clinical data.* Before drug patents are granted, pharmaceutical companies have to register clinical trial data with national drug registration bodies. Access to that data is important for generics-producing companies, to enable them to produce copies of patented medicines without having to repeat costly trials. The TRIPS agreement states only that governments must prevent “unfair commercial use” of data. By contrast, most free trade agreements establish a five-year “market exclusivity” period in line with US law. During this period access to trial data is prohibited, potentially delaying the market entry of generic drugs and limiting the scope for compulsory licences. In addition, exclusivity applies across borders. The restrictions applied in one country (say, the United States) must be enforced in another (say, Nicaragua) and across all free trade agreement jurisdictions.
- *Restrictions on compulsory licensing and parallel importing.* Under TRIPS governments can authorize compulsory licences to allow generics companies to produce low-cost copies of patented medicines to promote public health. They can also

import patented products being sold more cheaply overseas than in domestic markets, an arrangement known as parallel importing. The free trade agreements weaken both provisions. For example, some agreements restrict the use of compulsory licensing to emergencies and cases of proven anti-competitive behaviour. The onus on poor developing countries to “prove” an emergency or anti-competitive behaviour is likely to limit recourse to compulsory licences. Similarly, while TRIPS allows WTO members flexibility in deciding whether to authorize parallel imports, most free trade agreements allow patent holders to prevent this.

The overall effect of these provisions will be to limit the capacity of governments to put downward pressure on pharmaceutical prices. The danger is that enhanced profit margins for the pharmaceutical industry will compromise the capacity of governments to address public health concerns.

Some developing countries have been willing to commit to stronger intellectual property rules while seeking concessions in other areas. Preferential access to the US market is the main negotiating carrot, especially for agricultural goods. However, the negotiating process has produced some unbalanced outcomes.

CAFTA grants limited market openings for the six developing countries involved (Costa Rica, the Dominican Republic, El Salvador, Guatemala, Honduras and Nicaragua). For sugar, a crop in which these countries have a considerable advantage, tariffs will remain at more than 100% and imports will be restricted to a 1.7% market share. Meanwhile, the United States has secured extensive market openings for rice, gaining immediate duty-free quotas for rice that rise 5% annually. More than one-third of US rice exports will now enter duty free, having previously been subjected to tariffs of 15%–60%.

So in return for, at best, limited market advantages for export crops grown mainly by large commercial farmers, CAFTA developing countries have agreed to accept intellectual property rules that could compromise public health and technological innovation and to expose domestic rice producers to heavily subsidized competition from the US rice sector.

Source: Tussie 2005; Mayne 2005; US Department of Agriculture, Foreign Agricultural Service 2005.

requirements.⁶⁵ Would-be importers of Indian professional services are required to conduct prior searches in domestic labour markets to prove that no alternative labour supply is available. They also have to meet wage parity requirements. This means that employers have to pay the wage prevailing in the host country (negating cost advantages), while foreign workers have to contribute to social security schemes (to whose benefits they are not entitled). Software

engineers are also required to meet minimum experience requirements (five years in the United Kingdom and three years in the United States) and to pass through cumbersome procedures for work permits. In addition, there are quota restrictions on how many workers can enter, and complex “economic needs” tests to be passed.

Immigration controls constitute an even more formidable entry barrier for unskilled

It would be wrong to use regional trade negotiations to pressure governments into rapid liberalization

labour. The wage differentials between, say, a Zambian mechanic or a Honduran agricultural labourer and their counterparts in Europe or North America are huge. The average wage differential between developed and developing countries is 10:1—five times the differential for the price of goods. It follows that temporary access to the higher wage labour market offers big advantages. Those advantages are closed down by migration policies.

The temporary movement of labour could generate very large welfare gains. One exercise has estimated the potential impact of a transfer of skilled and unskilled workers from the developing world at \$157 billion, equivalent to 3% of the work force in industrial countries. While developing countries would be the main beneficiaries, industrial countries would also gain through higher growth and increased revenue collection. Just as in trade in goods, however, there would also be losers in developed countries: unskilled workers competing in the same sector of the labour market as the new entrants could see wages capped or even cut. These estimates should not be taken as indicative of precise outcomes: they merely point to orders of magnitude. But to put the estimated welfare gain in context, a Doha Round agreement that liberalized trade in agriculture and manufacturing by 40% would generate a welfare gain estimated at only \$70 billion.⁶⁶

Tariffs and revenue—Economic Partnership Agreements

Multilateral and regional trade rules have a direct bearing on tariffs and other import policies—and on the revenues associated with them. While regional agreements involving the United States have been a focus in international debates, EU policies are also important.

In 2000 the European Union agreed to revise its system of trade preferences with the countries in the African, Caribbean and Pacific (ACP) group by replacing the Cotonou Agreement with a new set of Economic Partnership Agreements with six ACP regions covering 76 countries. The agreement, to be in place by 2008, will define the terms of Europe's trading relationship with some of the world's poorest

countries. It remains to be seen whether these terms will be consistent with a commitment to human development and the MDGs.

Under WTO rules regional trade agreements are required to extend liberalization to “substantially all trade”. The European Union has put this commitment at the centre of its negotiating mandate. In addition to tariff reductions the European Union also plans to cover in the negotiations a range of non-tariff charges on imports, trade in services and the so-called Singapore issues of competition policy, investment trade facilitation and government procurement. There are no plans for any special provisions for ACP countries to limit surges of imports. Taken as a package, the negotiations mandate has the potential to produce an unbalanced outcome that is bad for human development.

Consider first the implications of liberalizing “substantially all trade”. For rich countries this has limited relevance for government revenue. In Sub-Saharan Africa, by contrast, tariffs account for about one-third of government revenue, rising to about one-half for Lesotho and Uganda. Lower tariffs do not automatically lead to lower revenue—if imports rise enough they can outweigh the effects of lower import tax rates—but the potential for a sharp decline in revenue is marked. One detailed study concludes that three-quarters of the ACP countries could lose 40% or more of tax revenue, with more than one-third of them losing 60%.⁶⁷ Such an outcome would have profound implications for government financing of basic services and economic infrastructure.

Other aspects of the mandate are also problematic. During the Doha Round the European Union's attempt to secure a WTO agreement on the Singapore issues contributed to the breakdown of negotiations, with many developing countries—especially in Sub-Saharan Africa—opposing the strengthening of WTO rules in these areas. For practical purposes multilateral negotiations on the Singapore issues have been suspended. Critics now argue that the European Union is using its negotiating leverage over the ACP countries to bypass opposition at the WTO and develop stronger rules through the back door of regional trade negotiations.

Similarly, the European Union's failure to allow for rules that enhance the ability of ACP countries to protect their economies against import surges is problematic—not least in the case of products subsidized under the CAP.

The terms on which the European Union will apply its negotiating mandate remain uncertain. In practice, it has choices. While some EU countries have emphasized the binding nature of the WTO requirement to substantially liberalize all trade, that rule is open to

interpretation, and a challenge at the WTO is unlikely. While many countries in Sub-Saharan Africa could benefit from lower tariffs, especially to promote intraregional trade, it would be wrong to use regional trade negotiations to pressure governments into rapid liberalization. Given the potentially damaging impact on ACP countries of opening up to subsidized agricultural trade, the European Union could also allow far more flexibility to provide protection on imports linked to CAP subsidies.

Millions of primary commodity producers face a depression more severe than that of the 1930s

Beyond the rules: commodities, the new gatekeepers and capacity building

It is not just the rigged rules of the world trading system that tilt the balance of power against developing countries. Deep structural changes in the world economy are narrowing the opportunities for vulnerable economies to secure the benefits from trade that they need to help kick-start human development. Two trends, one longstanding and one more recent, are proving particularly challenging. The first is the long-run decline in commodity prices. The second is the increasing power of such market gatekeepers as supermarkets. And in addition to these secular changes in the structure of world trade, poor countries, as always, are challenged by capacity constraints in their own economies. What currently passes for capacity building falls far short of what is needed.

The commodity crisis

“Proper economic prices should be fixed not at the lowest possible level, but at a level sufficient to provide producers with proper nutritional and other standards in the conditions in which they live...and it is in the interest of all producers that the price of a commodity should not be depressed below this level, and consumers are not entitled to expect that it should.”⁶⁸ Half a century has passed since British economist John

Maynard Keynes made these comments. His view was moulded by the memory of the Great Depression, when the collapse of commodity prices contributed to the breakdown of the world trading system, caused mass social dislocation and exacerbated international tensions.

Fifty years later millions of primary commodity producers are locked in a depression more severe than that of the 1930s. While surging growth in China has underpinned a recovery in the prices of some commodities, low and unstable prices are undermining progress towards the MDGs across a large group of countries. Yet the crisis in commodity markets is conspicuously absent from the international trade agenda. If the international community is serious about halving extreme poverty and meeting the other MDGs, this picture will need to change.

The protracted crisis in coffee markets demonstrates the devastating consequences of the wider crisis in commodity markets. From the designer coffee bars in high-income countries, where the price of coffee and the profits of retail outlets are soaring, the crisis in coffee is scarcely visible. Yet it is destroying the livelihoods of more than 20 million households in which smallholder production of coffee provides a critical source of income.

For more than a decade coffee producers have been trapped on a downward price escalator, growing more and more coffee in a desperate—and counterproductive—bid to protect their incomes. At the end of the 1980s coffee exporters received about \$12 billion for their exports. In 2003 they exported more coffee, but received less than half as much income—\$5.5 billion. Meanwhile, the coffee economy in high-income countries has been moving in the opposite direction. Since 1990 retail sales have increased from about \$30 billion to \$80 billion.⁶⁹ Low world prices have reduced costs and boosted profit margins for the six coffee roasters that account for 50% of world trade—and for retailers. Exporting countries, meanwhile, have seen their share of final consumer expenditure fall from one-third to one-thirteenth.⁷⁰ Viewed from the farms of coffee smallholders, the change has been even more dramatic. For every \$1 worth of high quality Arabica coffee from Tanzania sold in a coffeehouse in the

United States, a farmer now receives less than 1 cent (box 4.9).

Developing country exporters have absorbed huge economic shocks as a result of falling prices. Nine countries in Sub-Saharan Africa and Central America depend on coffee for one-quarter or more of export earnings. For each of them the price slump has undermined the growth and revenue generation vital to accelerated progress towards the MDGs. Because most producers are smallholders, falling prices directly affect household income and access to basic services such as health and education.⁷¹

Ethiopia is one of the most affected countries.⁷² Coffee is its single largest cash crop, providing more than 60% of foreign exchange earnings and 10% of government revenue. About one-quarter of the population is involved directly or indirectly in producing and marketing coffee. What happens in international coffee markets has a profound bearing on Ethiopia's prospects for achieving the MDGs. In contrast to agricultural producers in the European Union and the United States, farmers in Ethiopia have no protection from falling prices.

The price shocks absorbed by coffee producers in Ethiopia have been enormous. Exports have increased by two-thirds since the mid-1990s, but export earnings have fallen dramatically (figure 4.14). Beyond the adverse implications for the balance of payments and economic growth, lower export earnings translate into diminished opportunities for human development. Coffee, grown alongside food staples, is the primary source of cash for vulnerable households. Sales of coffee finance spending on education, health and other vital household needs.

Estimating the financial losses suffered by households is difficult. Information about production at the household level is incomplete. Moreover, in a market with wildly fluctuating prices the choice of reference years will have a major bearing on estimated losses. Taking as a reference point the 1998 price of \$1 per kilo (a level that approximates the average for the past 15 years), we used household-level data to estimate how much the lower price of \$0.30 per kilo in 2003 reduced incomes in coffee-producing households. Household-level data indicate that

Box 4.9 The crisis in coffee

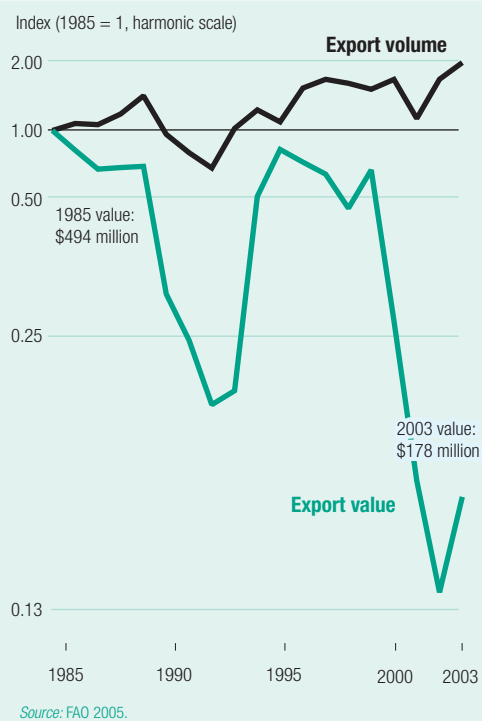
“Coffee income is very important to this household. I use it for paying school fees, meeting medical bills and running family affairs. But now I am losing hope in coffee. It has disappointed me so much.” These are the words of one coffee farmer in the Masaka District near Lake Victoria in Central Uganda. They capture the desperation felt by millions of producers.

As in other countries, coffee in Uganda is predominantly a smallholder crop. It is grown alongside food crops—such as potato, maize and bananas—to provide a source of household income. Surveys of coffee farmers in 1999 and 2002 covering four regions that account for half the country's production capture the impact of falling prices. During the first half of the 1990s rising household incomes among coffee farmers—a result of currency devaluation, reduced taxation on producers and stable world prices—were one of the main forces driving poverty reduction in Uganda. Since 1997, as world prices plummeted, forced adjustments by farmers have begun to reverse this progress:

- *Increased debt.* More than one-third of coffee farmers reported being unable to pay back a loan because of falling prices.
- *Reduced consumption.* Families reported having to cut meat and fish from their diets and to reduce the number of meals eaten. On the day the farmer quoted at the top of this box was interviewed, his 10- and 12-year-old sons had not eaten breakfast.
- *Reduced investment.* Families reported cutting spending on home maintenance and the purchase of goats, an important source of protein.
- *Sale of food crops.* Families reported having to sell food staples to pay for health costs and school fees.

Source: Vargas Hill 2005.

Figure 4.14 Coffee prices and production in Ethiopia



the median coffee-producing household sold about 300 kilos of coffee in 2003. The loss in income as a result of the price decline amounts to about \$200 per household—a huge loss in a country where more than one-third of the rural population survive on less than \$1 a day. At a national level the loss translates into \$400 million.⁷³ This means that for every \$2 in aid received by Ethiopia in 2003, \$1 was lost through lower coffee prices—a loss that widens the financing gap for achieving the MDGs.

Ethiopia is but one example of a far wider problem. In Central America falling prices produced economic effects amounting to a drop of 1.2% of GDP, without taking into account multiplier effects. The impact on poverty can be

traced through household expenditure data. In Nicaragua the incidence of extreme poverty rose by 5% among coffee farmers while declining by 16% for households not growing coffee (table 4.1). Falling household income has affected other areas of human development, including education, illustrating again how problems in commodity markets can undermine progress towards the MDGs across a broad front.

As in other commodity sectors the problems facing coffee producers are easier to describe than to resolve. Oversupply has been driven by intense competition for market share, rising production and a widening gap between output and demand, reflected in rising stocks. Commercial practices have also contributed. For example, coffee roasters have developed clean-steaming techniques that enable them to substitute low-value, low-price coffee for higher value coffees, adding to a global price depression that has inflated their profit margins while consigning millions of producers to poverty.⁷⁴

In the rush to liberalize agricultural marketing systems, donors and governments have sometimes compounded the problems of commodity producers. While state agencies were inefficient and sometimes corrupt, they also provided producers with inputs such as credit. Loss of these services has often made it more difficult for smallholders to enter global markets, especially for higher value-added products. In Tanzania rapid liberalization of coffee marketing led to the collapse of cooperatives that had maintained quality through price differentiation. The coffee price premium subsequently fell much more sharply for Tanzania than for Kenya, where the domestic market was only marginally liberalized.⁷⁵ The same process was repeated in cotton. Rapid liberalization of marketing in Tanzania led to the collapse of input,

Table 4.1 Welfare changes in Nicaragua—the cost of falling coffee prices 1998–2001

Percentage change

Household	Poverty rate	Extreme poverty rate	School enrolment	Per capita consumption
Non-coffee producing	-15.0	-16.0	9.0	9.6
Coffee producing	2.4	5.0	-7.0	-7.0

Source: Based on Vakis, Kruger and Mason 2004.

Supermarkets are now the main gatekeepers of the fastest growing market in agricultural trade

credit and market information functions previously performed by state agencies, with adverse consequences for production and producer prices. In West Africa, by contrast, more active state involvement has facilitated increased productivity and maintained a high price premium for quality.⁷⁶

There are no simple or universal solutions to the rolling crisis in global commodity markets. In some cases supply management is needed to restore market balance, though the problems with old-style commodity agreements have been well rehearsed. Market-based risk management tools could provide some protection against price volatility, but not price decline—and extending such tools to the poorest producers is difficult, though not impossible. Compensation is another option, using aid and debt relief to cushion balance of payments shocks. The IMF has a Compensatory Finance Facility, but it provides finance on terms that are unaffordable to most low-income countries in Africa. The EU Flex facility, launched in 2000, is more promising. It provides budget support in the form of grants, but eligibility requirements are so restrictive that few countries qualify: countries have to suffer a 10% loss in overall export earnings and a comparable worsening of the budget deficit. As a result, only \$12 million a year on average was disbursed in 2000–03 and to just 6 of the 51 countries that applied.⁷⁷

The role of market gatekeepers

International trade debates tend to focus on governments. Far less attention has been paid to distortions associated with the concentration of economic power in the hands of gatekeepers to developed country markets. Global retail and trading companies are increasingly important in the international trading system, linking millions of producers to consumers worldwide. These companies contribute to the wealth generated through international trade. But their increasing market power poses a threat to efforts aimed at strengthening the links between trade and human development.

Supermarkets are now the main gatekeeper to developed country markets for agricultural

produce. Their growth is transforming markets. To sell in world markets, especially markets for higher value-added crops, is increasingly to sell to a handful of large supermarket chains. This has important implications for the distribution of benefits from trade.⁷⁸

The top 30 supermarket chains and food companies account for about one-third of global grocery sales.⁷⁹ Within developed countries the market share of the largest operators is increasing rapidly. Wal-Mart, now the world's largest company, accounts for more than one-third of US food industry sales. In the United Kingdom the top five supermarkets account for 70% or more of grocery sales—double the share at the end of the 1980s. Parallel developments are under way in developing countries. In the late 1980s supermarkets accounted for less than 20% of food sales in Latin America. That share has now climbed to 60%. The pace of change has been astonishing: in one decade Latin America experienced a scale of supermarket expansion that took five decades in Europe.⁸⁰

Concentration of power has gone together with the development of global sourcing and supply systems. Wal-Mart buys its supplies from more than 65,000 sources. Carrefour sources its melons in northeast Brazil to supply its retail outlets in that country and its distribution centres in another 21 countries. Royal Ahold sources apples in Chile for distribution through a centre in Peru. Companies such as Tesco in the United Kingdom source fruit and vegetables from more than 200 suppliers, many of them in developing countries.⁸¹

These trends matter for the distribution of benefits from international trade for three related reasons. First, supermarkets are the gatekeepers to the fastest growing markets in world agricultural trade and to markets with higher levels of value added. Successful participation in these markets has the potential to generate large income gains for small farmers, especially for those able to diversify out of primary commodity markets. Second, the concentration of buying power information gives supermarkets an enormous capacity to influence prices and the wider terms and conditions under which small farmers in developing countries trade with rich

countries. Third, the emergence of global supply networks spanning large numbers of countries gives supermarkets the capacity to shift their demand across large numbers of suppliers, further strengthening their power in the market.

The dominant business model in the supermarket sector places a premium on rapid delivery, high quality and—above all—intense price pressure. As an Oxfam report puts it: “Buyers work in a business culture of performance targets and incentives which encourages them to squeeze suppliers on prices and delivery times, with scant attention to the ethical repercussions down the supply chain.”⁸² Supermarket purchasing power ensures that adjustments to lower prices are passed back to producers. For example, in 2002 UK supermarket chains engaged in a price war in bananas, the country’s most popular fruit. Between 2001 and 2003 prices to producers were cut by one-third, with devastating impacts on smallholder farmers in the Caribbean and plantation workers.⁸³

Such trends point to a danger that exporters of higher value-added products in developing countries will be locked into the type of adverse terms of trade trends faced by primary commodity exporters. Supermarkets are also creating barriers to market entry that are far more formidable than tariffs for small producers. While prices are being squeezed, suppliers are required to meet improved product standards, along with stringent criteria for just-in-time delivery. Compliance requires a financial and institutional capacity beyond the means of many smallholders. This is especially the case when supermarkets delay payments; the standard commercial practice is to pay 45–60 days after delivery.⁸⁴

With western consumers increasingly worried about food safety, supermarkets are under pressure to guarantee the standards and provenance of the goods they sell. But the cost of monitoring compliance with standards rises with the number and geographical dispersion of producers. This creates an incentive to contract with large production and distribution centres. The upshot is that the obstacles to market entry are highest in precisely the areas in which trade has the greatest potential to reduce poverty.

The experience of Kenya highlights the problem. Over the past 15 years Kenya has emerged as a dynamic exporter of fresh vegetables to the European Union, a rare example of successful entry by an African country into higher value-added markets. However, smallholders are being left behind. In 1997 almost three-quarters of Kenya’s high value-added horticulture exports were supplied by small farmers. By 2000 this share had fallen to 18%.⁸⁵ The biggest change to the industry has been the increased importance of farms owned or leased by major export companies. One of the motivating factors behind this change has been the need to comply with UK supermarket standards, especially on traceability. Another has been the requirement to provide guaranteed quantities, which supermarkets can change at short notice. Looking to the future, demands imposed by supermarkets could further marginalize smallholders unable to afford the electricity, greenhouses and artificial lighting needed to provide uniform produce.

Kenya is not an isolated example. Worldwide, there is growing evidence of smallholder exclusion. In Brazil the inability to meet rising technical standards required by supermarkets resulted in 60,000 small-scale dairy farmers being pushed out of the local market in the second half of the 1990s.⁸⁶ As supermarkets extend their reach, the danger is that price pressures will intensify and market barriers through product-standard requirements will increase.

Lack of capacity

Export markets can offer huge opportunities for human development. Exploiting those opportunities requires more than open markets. Above all, it requires a capacity to respond to market openings—and to deal with adjustments. Many poor countries and poor producers lack that capacity.

Access to markets is a necessary but not sufficient condition for successful integration into international trade, as Sub-Saharan Africa has found. The region faces the lowest tariff barriers in developed countries, but this has not halted its marginalization. One reason is high

Access to markets is a necessary but not sufficient condition for successful integration into international trade

Invariably,
poor producers
face the highest
marketing costs

marketing costs—a problem linked to weak institutions and lack of infrastructure capacity. Transport costs add 15%–20% to the price of Sub-Saharan Africa's exports. At more than three times the world average this is a barrier that dwarfs the tariffs faced by African exporters.⁸⁷ The report of the UK-sponsored Commission for Africa has proposed a \$10–\$15 billion fund to overcome Africa's infrastructure deficit, underlining both the scale of the problems and the critical role of aid in addressing trade concerns.

Invariably, poor producers face the highest marketing costs. Many do not have access to the roads, technologies, market information or productive assets—land, capital and water—required to succeed. In Lao PDR almost 40% of villages are more than 6 kilometres from a main road, and half the roads are inaccessible during the rainy season. This makes it difficult to get output to markets and raises the costs of inputs. In Sub-Saharan Africa the density of the rural road network is only 55 kilometres per square kilometre, compared with more than 800 in India.⁸⁸ The inadequacy of rural roads raises transaction costs, reduces farm-gate prices and returns to labour and weakens market incentives. It helps explain why it is not uncommon for small farmers in Sub-Saharan Africa to receive 10%–20% of the export price of their produce, with the remainder being lost to transport and market costs.⁸⁹

At one level the prerequisites for human development through trade are no different from those for human development more broadly. Without measures to overcome the deep deficits and inequalities in access to health, education and productive assets, integration into global markets will bring few gains. That is why trade policy needs to be developed as part of an integrated strategy for poverty reduction and human development. Leaving it to the market is not an adequate approach.

Some of the success stories in agricultural trade teach important lessons. In Senegal exports of fruit and nuts have grown by more than 40% since 1998, with smallholders the driving force. More than 10,000 rural jobs have been created. The key to success: a partnership of smallholders,

government and the autonomous Agricultural Export Promotion project.⁹⁰ The project is developing refrigeration centres, providing market information and rehabilitating freight facilities. In Ghana five smallholder cooperatives have created a company that has been at the forefront of an increase in pineapple exports to the European Union and regional markets. Initially supported by the World Bank, the company works with public bodies and private providers to contract for technical services that assist farmers in meeting product standards, procuring credit and exporting.⁹¹ In India the Spices Board provides a regulatory structure and marketing systems linking 2.5 million producers to world markets, providing support for marketing and pest management systems and maintaining quality standards. In each case, public-private partnerships have been critical to success.⁹²

Since the start of the Doha Round developed countries have committed to increased efforts in capacity building to overcome the capacity constraints hindering developing country exports.⁹³ An extensive set of aid measures has emerged under the banner of Trade-Related Technical Assistance and Capacity Building (TACB). On a conservative estimate, about \$2.1 billion is now directed towards TACB, 70% of it for relieving supply-side constraints and the remainder allocated for institutional capacity building in trade policy.

While some important benefits have been delivered, TACB suffers from the problems in aid outlined in chapter 3, writ large. There is a multiplicity of technical assistance initiatives, with weak coordination, limited funding and, in many cases, limited ownership on the part of recipient governments. Technical assistance is frequently delivered randomly, indiscriminately and on a stand-alone basis. Equally damaging has been a narrow focus on implementation of WTO agreements, many of dubious benefit to developing countries (box 4.10).

Coherence is important for capacity building. All too often, trade policies undermine the very objectives pursued under TACB programmes. While EU and US aid programmes invest in capacity development for smallholder farmers, their trade policies undermine the

Box 4.10 The limits to technical assistance for trade-related capacity building

Capacity building is critical to successfully integrating developing countries in world trade. Developed countries have made this a growing priority in their aid programmes. But technical assistance for capacity building suffers from shortcomings that undermine its effectiveness. This is particularly the case under the Trade-Related Technical Assistance for Capacity Building (TACB) measures.

Donor-driven priorities. All too often TACB is biased towards donor priorities. At the start of the Doha Round the EU negotiating agenda prioritized competition policy, trade facilitation and investment—the Singapore issues. The overwhelming majority of developing countries, especially in Africa and among the least developed countries, rejected this agenda. Even so, in 2001 the Singapore issues accounted for one-half of total technical assistance in trade policy recorded by the WTO. By contrast, 1% of policy support was directed towards negotiations on agriculture—an area of vital concern for developing countries. In bilateral programmes bias occurs through negative discrimination (donors refuse to fund activities inimical to their immediate interests) and positive discrimination (support is offered in areas prioritized by donors).

Biased and restricted advice. Too much TACB advice is about how to implement WTO agreements dictated by developed countries, including much of the WTO activity conducted under the Global Trust Fund established in 2001. Too little advice is about

areas that might redress power imbalances and enhance public policy objectives.

Underfunding. Some of the most effective TACB programmes are chronically underfunded. One example is the Joint Integrated Technical Assistance Programme of the WTO, the United Nations Conference on Trade and Development and the International Trade Centre. This programme is highly regarded by African governments in particular. However, the programme is currently financed through a Common Trust Fund amounting to \$10 million for 20 countries—hardly commensurate with the scale of disadvantage facing African governments at the WTO. Current funding for the Integrated Framework for Trade-Related Technical Assistance to least developed countries amounts to less than \$6 million.

Weak links to development strategies. Donor efforts to make TACB integral in development cooperation and national poverty reduction planning have fallen far short of expectations. The Integrated Framework, a case in point, has carried out several high-quality diagnostic assessments of supply-side constraints, especially as they relate to the poor. Yet there is no evidence that the recommendations have been integrated into Poverty Reduction Strategy Papers, most of which say little about trade policy. Weak coordination, conflicting and overlapping mandates of the agencies involved and bias towards technical assistance over financing for infrastructure have further weakened the Integrated Framework's effectiveness.

Source: Deere 2005.

Box 4.11 Fishing for coherence

Sometimes capacity building suffers from outright policy incoherence. A stark example is EU fisheries policy in Senegal. While one part of EU aid and trade policy aims to support sustainable resource management and to balance export growth with local market needs, another part is undermining these objectives.

The fisheries sector currently accounts for more than one-third of Senegal's export earnings, an estimated 75% of national protein consumption and direct and indirect employment of about 600,000 people, including a large number of small-scale fishers.

Development of a fisheries export industry has been supported by the French Development Agency, which has financed about one-third of the costs associated with meeting EU food safety standards. EU trade preferences have protected Senegal from low-cost competition from Thailand. Other EU donors, along with the World Bank, are supporting projects to improve Senegal's capacity to manage fish stocks on a sustainable basis. The European Union is spending \$12 million to support inspection and monitoring. Diagnostic work under the Integrated Framework for Trade-Related Technical Assistance has highlighted the critical importance of developing a national capacity to monitor stocks and control access.

While one part of EU aid and trade policy aims to support sustainable resource management and to balance export growth with

local market needs, another part is undermining these very objectives. Since 1979 the European Union has financed a series of agreements that give European vessels access to Senegal's fish stocks. The latest "cash for access" deal, a \$64 million transfer covering the period up to 2006, is part of a wider network of agreements through which the European Union has subsidized access to the fish stocks of other countries to compensate for overfishing in EU waters.

After 15 years of "cooperation" with the European Union, Senegal's fisheries sector is in deep crisis. Stocks have been severely depleted, disrupting the artisan sector, pushing up fish prices in local markets and jeopardizing supplies to canning factories producing for export. Like earlier agreements, the current arrangement puts no limit on harvesting. And since there are no tonnage records, Senegalese authorities are unable to monitor stocks. This is in stark contrast with the European Union's domestic fisheries management, where limits are set on total catches.

The upshot is that the European Union is systematically undermining the development of a fish resource management system. All of this rests uneasily with policy coherence objectives set out in the Treaty of Rome.

Source: Brown 2005b; Kaczynski and Fluharty 2002; UNEP 2002; Picciotto 2004; CTA 2004; Jensen 2005.

The WTO's one-country one-vote facade obscures the unequal power relationships between rich and poor countries

markets on which the livelihoods of rural producers depend. One particularly stark illustration of incoherence in operation is the EU's

fisheries policy, which actively undermines an industry in Senegal supported through the aid programmes of EU member states (box 4.11).

Turning Doha into a development round

As argued throughout this chapter, strengthening the links between trade and human development will require action across a broad front. The immediate priority is to consider trade policy as a central part of national planning for poverty reduction—and then to ensure that multilateral and regional trade rules support human development priorities.

The Doha Round—and the WTO itself—are an important part of this broader process. Good trade rules will not resolve many of the most pressing problems facing developing countries, but good rules can help. And bad rules can inflict serious damage. The next ministerial meeting of the WTO in December 2005 provides a critical opportunity to adopt a negotiating framework that delivers on the commitment to a development round. It can also set the scene for future negotiations that put human development—alongside progressive and balanced liberalization—at the centre of the WTO's remit. Failure to seize this opportunity will weaken—perhaps fatally—the already strained legitimacy and credibility of the WTO.

Rethinking WTO governance

Rule changes do not take place in a vacuum. They are shaped by institutions and, in the case of the WTO and world trade, by power relationships. The critical challenge for a multilateral system is to provide a framework in which the voices of weaker members carry weight.

In principle, the WTO is a supremely “democratic” body. Unlike the World Bank or the IMF, its decision-making structures do not reflect the financial power of members. The

prevailing rule is one country, one vote, with each member having the right to veto decisions taken on what purports to be a consensus basis. In a formal sense, Benin has the same vote as the United States, and Bangladesh as the EU.

In practice, the one-country one-vote facade obscures the unequal power relations that shape the outcome of WTO negotiations. Some countries are more able than others to influence the WTO agenda. In the Uruguay Round developing countries, despite being in the majority, were unsuccessful in opposing the extension of the WTO's rules into areas such as intellectual property, investment and services. The agreement on agriculture left most EU and US farm subsidy programmes intact for the simple reason that it was in all but name a bilateral agreement between the two parties that was forced onto the multilateral rules system. In effect, the world's economic superpowers were able to tailor the rules to suit their national policies.

Institutional factors exacerbate inequalities between countries. The ability to shape agreements depends on the capacity of countries to follow complex, wide-ranging negotiations, an area in which some countries are distinctly more equal than others. In 2004, 33 developing countries, 10 of them in Africa, that were WTO members or in the process of accession had no permanent representative. The average size of a least developed country WTO mission is two professional staff. At the other extreme the European Union has 140 staff to make its case in WTO negotiations. That is without taking into account trade officials in national capitals, which would multiply that number several times over.⁹⁴ While some developing countries—such as Brazil, China and

India—field large negotiating teams and are effective participants in negotiations, most developing countries are marginalized.

This deficit in representation matters. In day to day negotiations sheer weight of numbers and easy access to expertise count a great deal. Capacity to use the system is also reflected in the dispute procedure: not a single country in Africa has taken out a WTO case. Correcting these institutional imbalances is a requirement for creating a meaningful democracy at the WTO.

How trade could deliver for the MDGs

Fairer international trade rules could give a powerful impetus to the MDGs. Generating that impetus will require greater coherence between the trade policies of developed country governments and their development policies and commitments. Unfair and unbalanced trade rules are hampering international efforts to achieve the MDGs. The Doha Round provides an opportunity to address this problem, but there has been little progress so far. What is needed is a two-step approach to refocus the round on its development objectives and to set a development framework for future negotiations.

A down payment on the development round

The ministerial meeting in Hong Kong, China (SAR), in December 2005 provides a last chance to restore confidence in the Doha Round. That meeting needs to deliver tangible and practical results. These results should include a down payment on the development round in three specific areas: market access, agricultural support and special and differential treatment for developing countries.

The 2005 ministerial meeting provides an opportunity to remove some of the more egregious market access restrictions that limit the ability of poor countries to benefit from trade. Binding schedules should be agreed upon to:

- Eliminate tariff peaks and reduce tariff escalation by lowering maximum tariffs to no more than twice the average tariff by 2010.
- Implement the proposal of the UK-sponsored Commission for Africa to apply

duty-free and quota-free access to all exports from low-income Sub-Saharan Africa and to extend this access to all least developed countries in other regions.

- Relax rules of origin by adopting before 2007 legislation based on international best practice to reduce the value-added requirement for eligible products to 25% of export value and allow countries receiving preferences to source inputs from anywhere in the world.
- Establish in 2006 a trade adjustment compensation fund providing \$500 million a year for the next decade to compensate countries for preference erosion.

Progress in agriculture is critical. Developed country policies destabilize and depress world markets, undermine the position of competitive agricultural exporters and increase rural poverty by flooding food markets in poor countries with subsidized exports. After four years of negotiations, nothing has been achieved. No timetable has been set for eliminating export subsidies, and developed countries are restructuring subsidies to evade WTO disciplines. Immediate priorities for a schedule of commitments by developed countries should provide for the following:

- A binding prohibition on all direct export subsidies by 2007.
- A reduction in overall subsidies by 2010 to a level no higher than 10% of the value of production.
- Compensation for developing country producers most affected by developed country agricultural policies in key commodities such as sugar and cotton.
- Phased reduction in import tariffs through the so-called Swiss formula, which makes the deepest cuts on the highest tariffs, with a ceiling of 10% by 2010.
- An end to Blue Box provisions that allow countries to provide unlimited market-based support.

WTO rules recognize in principle that developing countries should not have to make commitments incompatible with their economic status and development needs. In practice, the special and differential treatment

Fairer international trade rules could give a powerful impetus to the MDGs

provision has failed to provide a framework for aligning WTO obligations with a commitment to human development. This was recognized in the Doha Declaration, which called for “more precise, effective and operational” rules. However, developing countries have come under pressure to liberalize imports at a rate inconsistent with their development needs. While import liberalization can offer advantages for human development, it should be applied in a sequenced fashion consistent with national poverty reduction strategies and the MDGs, with which WTO rules should be aligned. The 2005 ministerial meeting provides a chance to elaborate these rules for market access and agriculture. To this end, developed countries should agree to:

- Limit reciprocal demands for market access in non-agricultural goods, allowing developing countries to reduce average tariffs through a formula that allows a high degree of flexibility.
- Exempt “special products” in agriculture from any requirement to liberalize, and permit developing countries to apply safeguard mechanisms to restrict market access when import levels threaten food security. These products should include basic food staples as well as crops that are important for rural livelihoods and the income of poor households.
- Revise WTO accession rules to ensure that new developing country members do not have to comply with liberalization demands inconsistent with their development status.

Looking to the future

It would be unrealistic to expect the Doha Round, let alone the 2005 ministerial meeting, to resolve all of the tensions between WTO rules and developed country trade policies on the one side, and the MDGs and wider human

development goals on the other. However, ministerial meetings are important partly because they can signal intent. In the current context industrial countries need to signal their intent to revise agreements and rebalance negotiations in the following areas:

- *Industrial and technology policy.* There should be a commitment to relax the constraints imposed on the development of active industrial and technology policies through Trade-Related Investment Measures and other agreements.
- *Intellectual property.* The TRIPS agreement arguably should not have been brought on to the WTO agenda. While intellectual property protection is important, the current framework suffers from a one size fits all model that fails to take into account the needs and interests of developing countries. The challenge now is to strengthen the public health provisions in the agreement, increase the scope for technological innovation and, for developed countries, to act on the TRIPS commitment to help finance technology transfer.
- *Services.* Liberalization of rules on temporary movements of people under the General Agreement on Trade in Services would do a great deal to achieve a more equitable distribution of the benefits from trade. Developed countries should put the liberalization of service markets in developing countries on the WTO back-burner and prioritize instead a phased liberalization of their domestic labour markets.
- *Commodities.* The crisis facing commodity producers has to be placed squarely at the centre of the international trade agenda. An integrated approach that encompasses increased debt relief, compensation, risk insurance and, in some cases, supply management should be developed.