Lacourt-Parra, Mariangela, Manuel F. Montes, and Rob Vos. "Retooling Global Trade." *Retooling Global Development and Governance*. Ed. Rob Vos and Manuel F. Montes. London: Bloomsbury Academic, 2013. 73–112. The United Nations Series on Development. *Bloomsbury Collections*. Web. 26 Apr. 2023. <<http://dx.doi.org/10.5040/9781472544933.ch-004>>.

Downloaded from Bloomsbury Collections, www.bloomsburycollections.com, 26 April 2023, 12:09 UTC.

Copyright © United Nations 2013. You may share this work for non-commercial purposes only, provided you give attribution to the copyright holder and the publisher, and provide a link to the Creative Commons licence.

Chapter IV

Retooling global trade

MARIANGELA LACOURT-PARRA, MANUEL F. MONTES AND ROB VOS

Export-led growth emerged as a pillar of development strategies in the last three decades. The progressive reduction of tariff and non-tariff barriers to trade between countries has been instrumental in generating a five-fold expansion of the volume of world exports since 1980. Paradoxically, economic growth in most developing countries has not matched the rates of economic progress achieved in the decades following the Second World War when many followed import-substitution strategies. Notably, exceptions to this pattern—China and the newly industrializing countries in East Asia—have systematically followed a pragmatic approach that combines gradual exposure to external markets with effective collaboration between the private and the public sector in order to build dynamic long-term competitiveness. Their experiences suggest that neither protectionism nor abrupt liberalization is the best strategy to achieve high and sustained rates of economic growth.

A significant portion of the measured rise in trade volumes is accounted for by increasing trade in intermediate goods (World Trade Organization, 2009a), in line with the worldwide trend towards delivering goods and services through global value chains (GVCs). Inside global chains, however, unfinished goods cross borders several times during the assembly process. Since each border crossing of a product (intermediate or final) is recorded as an international transaction, the same product gets counted more than once in international trade statistics, thereby inflating the recorded volume.

Capital account and trade liberalization were promoted as part of market-oriented reforms in developing countries in the 1980s and 1990s. Capital account opening constrained countries' use of exchange rates to promote trade competitiveness as exchange rates became increasingly determined by volatile capital flows and inflation-related considerations. Trade liberalization,

in turn, limited the scope of trade protection and incentives, such as tariffs and subsidies, for promoting economic diversification as well as supporting domestic activities through business cycles. The proliferation of international agreements on subsidies, intellectual property rights, trade-related investment measures and services has set further limits to national policy space.

Traditional instruments of trade policy are also losing relevance in a world where trade is increasingly taking place through global value chains and transnational corporations engaged in international production. New policy approaches will be needed to provide incentives to foreign investors if countries are to “buy into” these chains.

This chapter aims to identify how interactions between the current multilateral trade rules and national development policy space can be reconfigured to promote a fairer trading system, one more congruent with development objectives.

THE RECENT CRISIS AND TRADE

The global recession of 2008-2009 has been the deepest and most disruptive in the last quarter-century. What started as a crisis in financial markets in major economies quickly spread to the rest of the world, through the international financial system to other developed economies and mainly through trade channels to developing countries. World trade entered into a free fall in the last quarter of 2008, lasting until the second quarter of 2009.

Exporters from Asia were among those most affected by the drop in global aggregate demand, associated mainly with the decline in imports from developed countries (United Nations, 2010). The sharp decline and recovery of Asian exports reflect the impact of the value chain-dominated production structure, where changes in orders and inventories are transmitted rapidly from one market to another (Escaith, 2009). As much of export production depends on suppliers of intermediate inputs, many of which are also located in Asia, the demand shock triggered in developed economies spread out quickly, but with a strong regional concentration, through abrupt declines in orders inside the global value chains.

The seizing up of world financial markets has also negatively affected trade volumes through higher spreads on developing-country debt and reduced availability of trade credits. Commodity prices collapsed. Oil and metal prices were the most affected, dropping by about 70-80 per cent from their peak levels reached in 2008. Although a recovery from these trends began in the first quarter of 2009, the close link between commodity prices

and financial markets, including through the United States dollar exchange rate, suggests the presence of highly volatile prices in the near future (United Nations, 2010b).

The magnitude of the crisis, and the fact that it originated in and first affected the advanced industrialized economies, led to policy responses—including financial sector bail-outs, wage subsidies, cheap credits and direct interventions to rescue industries—that have affected trade competitiveness. Notably, the responses in rich countries relied more on subsidies, while poor countries used mainly duties to restrict imports (Gamberoni and Newfarmer, 2009). Besides other traditional trade policies (such as anti-dumping measures), many fiscal and financial packages have included elements—like direct support from the government to industries, bail-outs, subsidies and actions associated to “buy/lend/invest/hire” locally—that favour the consumption of domestic goods and services.

These measures have broken the pattern imposed by the market discipline and laissez-faire hegemony that dominated the economic thinking in the last quarter-century. As discussed below, these crisis responses have brought back to the centre of the debate the role of policy space in mitigating the effects of economic downturns.

Data for 2008 show that the use of trade remedies increased significantly. The World Trade Organization Secretariat reported a 28 per cent increase in anti-dumping investigations in 2008 compared with 2007. The measures taken can be characterized as exemplifying “low-intensity” trade protectionism in contrast with the “beggar thy neighbour” measures of the 1930s (Drache, 2010). During the interwar years, governments had responded to the recession by introducing high and escalating tariffs on imports, competitive currency devaluations and discriminatory trading blocs which paralysed international trade flows almost entirely. This prolonged the global recession and fed into trade conflicts among countries, adding to the factors that built up to the Second World War. This experience led international leaders to conclude that economic cooperation was the only way to achieve peace and prosperity, at home and abroad. This awareness led in 1947 to the signing of the General Agreement on Tariffs and Trade (GATT) which was succeeded by the World Trade Organization in 1994.

Changing global production and trade

Current account liberalization triggered an important expansion in global trade flows. Global exports of goods and services grew at a real average rate

of 6.3 per cent from 1980 to 2008, while gross domestic product (GDP) growth averaged 2.9 per cent during the same period (see figure IV.1).

Developing countries played an important role in the expansion of trade. As shown in figure IV.2, although developed economies continue to dominate world markets, developing countries expanded their market shares, especially in low- and high-technology manufactures, which both reached about 40 per cent of global exports by 2005-2008. The developing-country share in global exports of primary commodities had decreased from an average of 50 per cent during the period 1976-1979 to 40 per cent during the period 1985-1999. During the 2000s, however, this share increased again to about 45 per cent. Trends in terms of trade that had showed declining prices for primary commodities relative to those for manufactures in the 1980s and 1990s were reversed in the 2000s and this influenced trade shares (Ocampo and Parra-Lancourt, 2010).

The share of primary commodities in total non-fuel exports from developing countries also declined from more than 50 per cent around 1980 to less than 30 per cent in the 2000s. Developing countries as a group also managed to substantially increase their share of exports of high-tech manufactures, which reached 25 per cent of their total exports during the 2000s (figure IV.3).

Figure IV.1
GDP/breakdown at constant 2005 prices in US Dollars (all regions)

Source: UN/DESA estimates, based on United Nations National Accounts Main Aggregates Database.

Figure IV.2

Share of exports of developing countries, by technology content, in world trade, 1976-2008

Source: UN/DESA calculations, based on UN Comtrade.

Note: For methodology, see United Nations (2006b, chap. III, appendix).

However, traditional export patterns continue to prevail in regions where export growth was not rooted in dynamic structural transformation. In South America, for example, the share of primary commodities and natural resource-based manufactures in total non-fuel exports even increased slightly in the period from the 1990s to the 2000s, reflecting the incentives that the *laissez-faire* trading system provides towards maintaining static comparative advantages (see figure IV.4A). A similar, although more dramatic pattern can be observed in sub-Saharan Africa (see figure IV.4B).

As illustrated in Ocampo and Vos (2008), the increase in exports of high-tech manufactures has been highly concentrated, partly as result of the so-called flying-geese pattern in East Asia, which had entailed the diffusion to other Asian countries of the more labour-intensive components of production from Japan that were destined for other industrialized countries (Memis and Montes, 2006). The opening of China to the world economy was the next manifestation of this pattern in which production is transferred to neighbouring countries with lower real wages (Memis, 2009). Other emerging economies, like Mexico and small countries in Central America and the Caribbean, came to play a role in assembly (*maquila*) industries and

Figure IV.3
Exports of developing countries, by technological intensity,
as a share of their total non-fuel exports, 1976-2008

Source: UN/DESA calculations, based on UN Comtrade.

Note: For methodology, see United Nations (2006b, chap. III, appendix).

other mostly low- and medium-tech industries, following duty-free market access granted by the United States of America (see figure IV.5).

This increase in developing countries' participation in exports of manufactures can be explained to a large extent by the increased dominance of transnational corporations and global value or supply chains. Today, there are some 82,000 transnational corporations worldwide, with 810,000 foreign affiliates. These companies play a major and growing role in the world economy. For example, exports by foreign affiliates of transnational corporations are estimated to account for about one third of total world exports of goods and services, and the number of people employed by transnational corporations worldwide totalled about 77 million in 2008 (United Nations Conference on Trade and Development, 2009a).

However, the internationalization of production goes beyond the expansion of transnational corporations. In effect, over the past 40 years, the world has seen an accelerated geographical fragmentation of components production processes within networks of firms connected through contractual

Figure IV.4

Share of exports, by technology content of commodities, in total non-fuel exports, South America and sub-Saharan Africa, excluding Nigeria and South Africa, 1980-2008

Source: UN/DESA calculations, based on UN Comtrade.

Note: For methodology, see United Nations (2006b, chap. III, appendix).

a This figure excludes Nigeria and South Africa because of their size and distinct productive structure, as compared to the rest of the region.

or informal arrangements forming global value or supply chains (GVCs). This shift coincided with the increasing importance of branding in the markets of industrialized economies and with the pursuit of low-cost labour by private companies seeking to maximize the value of their shares in highly speculative financial markets. Nowadays, specific industrial operations, from the conception stage to the assembly of final products, are no longer undertaken by a single establishment but are increasingly outsourced within these global value chains, which has resulted in what is known as “trade in tasks”.

Two main types of value chain systems have emerged: one demand-driven and the other supply-driven. In the first type, retailers in advanced countries in sectors like textiles and other consumption goods focus only

Figure IV.5

Selected regional patterns of exports, by technological intensity, 1980-2008

Source: UN/DESA calculations, based on UN Comtrade.**Note:** For methodology, see United Nations (2006b, chap. III, appendix).

on coordination and distribution. They delegate production to outside firms, exploiting the opportunity to maximize their profits by fostering competition among external suppliers. In the second system, companies distribute their production processes, optimizing costs by producing and assembling different parts of a product in different countries. Both systems profit from the advances in information and communications technology and from the simultaneous formation of productive clusters, initially in East Asian countries and, more recently, in other developing-country regions.

Evaluating the share of intermediate goods and services in total exports is not an easy task. The most recent estimates of the World Trade Organization (2009a) suggest a share of intermediate manufactured products in non-fuel world trade of about 40 per cent in 2008. A study combining trade statistics and input-output tables produced estimates of the shares of trade in intermediates in trade in goods of about 56.2 per cent and in trade in services of about 73.2 per cent for Organization for Economic Cooperation and Development (OECD) countries in 2006 (Miroudot, Lanz and Ragoussis, 2009). According to the study, trade in intermediates represented more than half of total trade in every region in 2006.

Another factor behind the observed expansion of world trade (ninefold in nominal terms) has been the increase in international outsourcing and offshoring of services. As in the case of trade in goods mentioned above, this was facilitated by radical innovations in communications technology. These innovations have allowed companies to transfer their customer services to other locations where technicians speak English and other relevant international languages but where salaries are lower. As observed in figure IV.6, trade in services rose from \$500 million in the 1980s to an average of \$2.5 billion in the 2000s. The participation of developing countries in global services trade rose from 19 to 24 per cent during the same period.

As table IV.1 shows, financial services, services that entail the receipt of royalties and licence fees, communications, and computer and information services, collectively comprised almost 20 per cent of total services exported in the period 2005-2007, with countries like India profiting from this new development.

In summary, trade patterns have moved from country specialization in terms of goods (manufactures for the North; primary commodities for the South) to intra-firm/network specialization in terms of tasks, with the South gaining considerable advantage in the production of manufactures.

Despite these important changes in trade specialization patterns and production processes, however, much of the attention, when developing-

Table IV.1: Global services exports by sector, as a percentage of total, 1980-2007

	1980-85	1985-90	1990-95	1995-2000	2000-05	2005-07
Transport	34.9	30.2	26.5	24.1	22.5	23.0
Travel	28.5	33.1	33.6	32.8	29.9	26.9
Other services	36.6	36.6	39.9	43.2	47.5	50.1
Other business services	27.7	23.4	24.3	23.6	24.2	24.8
Financial services	1.1	3.1	3.9	5.0	6.3	7.7
Royalties, license fees	2.9	3.1	4.1	4.8	5.3	5.3
Computer and information	0.0	0.3	0.6	1.6	3.8	4.4
Communications	0.7	1.4	1.5	2.1	2.3	2.4
Construction	2.2	2.0	2.4	2.9	2.0	2.2
Insurance	1.9	2.8	2.5	2.0	2.4	2.2
Personal, cultural, recreat	0.1	0.5	0.7	1.1	1.4	1.2

Source: UNCTAD Handbook of Statistics 2009, online access, March 15, 2010.

country interests are addressed in trade negotiations, remains focused on gaining market access for agricultural products, as discussed further below.

Although many developing countries, especially the poorest among them, still depend on exporting primary commodities (see figure IV.7), a narrow focus in trade negotiations on market access for primary products might be costly for long-term development. In the present context of the negotiations, it would imply giving up substantial policy space for promoting industrial diversification, needed to generate dynamic gains from trade, in exchange for greater market access based on existing static comparative advantages. For many of the low-income countries, the latter would reinforce reliance on traditional exports and a weaker impetus towards effecting the structural change needed for dynamic productivity growth.

THE MULTILATERAL TRADING SYSTEM AND ECONOMIC DEVELOPMENT

Reconciling national development strategies with multilateral trade rules

When a government joins with other governments in complying with certain rules, it has the objective of securing benefits (often referred to as international public goods) that are not to be had when market forces

Figure IV.6

Total exports of services, developed and developing economies, 1980-2008

Source: UN/DESA calculations, based on *UNCTAD Handbook of Trade Statistics* online.

operate unimpeded (Toye, 2010). Multilateral trade rules help to limit the discriminatory or exploitative trade behaviour of economically powerful nations. Ex ante, the expectation is that limiting national sovereignty by accepting some self-imposed constraints on and limits to policy space will increase total national welfare.

Given the differences in the level of national development among members of the GATT, there has been an ongoing internal conflict regarding how to deal with developing countries' aspirations of secure development policy space within a multilateral trading system that upholds non-discrimination as a core principle. This has been evidenced by the fact that the rules had to be modified several times over the years to handle development issues (Laird, 2007). The original GATT was conceived not as a development institution, but as part of the International Trade Organization (ITO) to be established under the Havana Charter for an International Trade Organization, signed on 24 March 1948. After the effort to bring about the ratification of the International Trade Organization Charter failed, it became necessary to amend the GATT

Figure IV.7

Continued reliance of least developed countries on exports of primary products, 1980-2008 **Source:** UN/DESA calculations, based on UN Comtrade.**Note:** For methodology, see United Nations (2006b, chap. III, appendix).

by introducing special provisions for dealing with development issues. In 1955, for example, developing countries were granted special treatment in the GATT, which allowed them, contrary to normal GATT rules, to protect particular industries and to plead balance-of-payments-related justification for adding to quantitative restrictions on trade.

Part IV of the GATT, introduced in 1964, did recognize the special needs of developing countries within the trading system, but much of the language was couched in terms of “best endeavours”. The Enabling Clause of 1979, officially called the Decision on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries (decision of 28 November 1979 (L/4903)), provided legal cover for the Generalized System of Preferences (GSP), for regional arrangements among developing countries, and for special treatment in favour of the least developed countries. As a result of these modifications to the GATT rules, there was little pressure put on the developing countries to make burdensome commitments, but this changed with the Uruguay Round.

The Uruguay Round

Developing countries participated actively in the Uruguay Round, partly because of the pressure from developed countries, partly because of their own reforms, and partly because of some disillusionment regarding the value of special and differentiated treatment (S&D). The bargain behind the creation of the World Trade Organization was that developed countries would allow agriculture to be subject to trade disciplines and would dismantle the quota system on textiles and clothing (two areas in which developing countries are thought to enjoy a comparative advantage) in exchange for some important concessions regarding opening of markets and the acceptance of a wide range of concrete obligations (Laird, 2007). The treatment of agriculture by developed countries continues to be the subject of negotiations, previous promises not having been followed by their concrete realization.

The first of these obligations was the severe curtailment of subsidies for local industries, under the World Trade Organization Agreement on Subsidies and Countervailing Measures (World Trade Organization, 1994). Article 8 of the Agreement defined certain specific subsidies as non-actionable (that is, non liable to a lawsuit) (United Nations Conference on Trade and Development, 2006). Subsidies extended to research fell in this category, as did subsidies provided in the pursuit of regional or environmental objectives. The subsidies permitted for research and development (R&D) included the financing of venture capital funds and the transfer to the private sector of technologies and innovations developed in government research laboratories. Also included in this category was public procurement policy in support of the proliferation of domestically defined standards for particular technologies. Moreover, activities in support of a shift in economic activity to new products or the use of new technologies could be subsidized as long as they were in the pre-competitive phase (that is, before they resulted in the production of goods that were exported or subject to significant import competition).

However, it is important to note that the provision that classified those subsidies as non-actionable had come up for review in 2000, when no agreement over its extension could be reached. Thus, the subsidies concerned became actionable. The Fourth Ministerial Conference of the World Trade Organization, held in Doha from 9 to 14 November 2001, revisited this issue along with the proposal of some countries to allow certain subsidies for development.¹ In practice, this has meant that these subsidies are tacitly allowed, with neither developed nor developing countries challenging them.

Probably the most serious drawback of the Agreement on Subsidies and Countervailing Measures for development is that it prohibits making subsidies conditional on export performance. In other words, the Agreement withdraws a major monitoring standard that outward-oriented sectoral strategies in East Asia utilized successfully to ensure that support was given only to those enterprises that were able to compete in international markets. It is still possible to establish other performance standards under a reciprocal control mechanism (such as the percentage of technology personnel employed, the percentage of sales contributed by new products and the allocation of retained earnings); but none of these alternatives enable a performance-based incentive policy that directly relates to international competitiveness and minimizes the risk of abuse and rent-seeking.

In any case, it is clear that fiscal cost is a major constraint on many developing countries' use of such subsidies. In addition, although a flexible tariff policy is still possible for many developing countries, this potential has remained largely unexploited. Further, additional constraints on flexible tariff policies potentially resulting from the Doha Round negotiations on agricultural and non-agricultural market access could reduce policy space in the future.

As the World Trade Organization system has the ability to restrict discriminatory policies of large market economies, non-members seek accession even under the costly conditions imposed by existing members. Additionally, the World Trade Organization has a dispute resolution process which constitutes the only effective international economic enforcement mechanism. This has stimulated the expansion of the World Trade Organization's purview to include the so-called trade-related areas, namely, investment, property rights and services.

The second obligation developing countries accepted came into effect through the Agreement on Trade-Related Investment Measures (TRIMS), (World Trade Organization, 1994). This Agreement limits regulations on foreign investment, such as local-content requirements, technology transfer and local employment requirements (critical in efforts to improve linkages to the local economy), and makes it difficult to link investment support to export-related disciplines aimed at withdrawing support from producers that do not achieve international competitiveness within a predefined period of time. Nonetheless, foreign direct investment (FDI) regulating measures that do not violate national treatment² or impose quantitative restrictions continue to be consistent with World Trade Organization rules.

The third concession was reflected in the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) (World Trade Organization, 1994), which established restrictions on the use of intellectual property. The Agreement reduced developing countries' ability to develop domestic technological capabilities, as they can no longer profit from freely copying and replicating technologies from abroad, a privilege (reverse engineering) that all developed countries and others had profited from successfully in earlier periods. In practice, the Agreement poses serious challenges in the areas of public health (Dommen and Kamoltrakul, 2004 and Ford and others, 2004)) and climate change policies. Yet, the TRIPS Agreement does allow some flexibility through the mechanisms of compulsory licensing and parallel imports.

Last, but not least, there is the General Agreement on Trade in Services (World Trade Organization, 1994), through which World Trade Organization rules (the most-favoured-nation and national treatment principles), applicable only to trade in products, were extended to trade in services—encompassing a variety of areas ranging from banking, education and rubbish collection, to tourism, health delivery, water supply and sanitation. Inasmuch as the General Agreement on Trade in Services covers the case of companies that establish themselves in a foreign country to provide services there, it is also an investment agreement (Wade, 2005). In that sense, it restricts the scope for competition policies for FDI coming under Mode 3 (so-called commercial presence) in each subsector listed by a nation in its commitments under the General Agreement on Trade in Services.

Although the General Agreement on Trade in Services permits a considerable range of exemptions, since governments can specify limitations on some of the commitments in particular sectors, such reservations must be signalled at the beginning, because it is difficult from a legal point of view for governments to introduce them later. Because of the complexity of regulatory needs in many services, developing countries are at a disadvantage in identifying what limitations should be included in advance.³

As a result of the introduction of this substantial new agenda, the multilateral trading system has become more restrictive at the same time that its influence over national policies has expanded. The World Trade Organization requires countries to change existing domestic laws that conflict with their membership obligations,⁴ while the Trade Policy Review Mechanism requires members to give regular public accounts of the state of their compliance with those obligations; the World Trade Organization has also strengthened its dispute settlement mechanism. These institutional

innovations, taken together, have had two general effects. They have made considerable inroads on what, before the coming into force of the Uruguay Round agreements, were traditionally matters of domestic governance; and they have further “judicialized” the process of trade cooperation. This has given rise to the temptation to use the World Trade Organization as a forum for consideration of other global issues, like climate change, that could be used to justify protectionism, as explored below.

In various instances, provisions were added to particular World Trade Organization agreements that meant that developed countries, in their application of the terms of those agreements, would have to take special account of the needs of developing countries. Nevertheless, the cost and administrative difficulties faced by the latter in implementing their commitments were greater than anticipated, while many of the gains promised by the developed countries did not materialize.

The Doha Round

The Doha Round was launched in 2001 with the express intention of establishing more development-oriented multilateral trading rules. In the Doha Ministerial Declaration of the Fourth Ministerial Conference of the World Trade Organization, the determination was expressed to place the needs and interests of developing countries at the heart of the Doha Work Programme.⁵ Positive efforts were to be made “to ensure that developing countries, and especially the least developed among them, secure a share in the growth of world trade commensurate with the needs of their economic development”.

The Hong Kong Ministerial Declaration, adopted on 18 December 2005 (World Trade Organization, 2005), included a limited package for the least developed countries, comprising five specific proposals (annex F). The Ministerial Declaration also expressed its support for developments regarding the TRIPS Agreement and public health, the extension of the TRIPS Agreement transition period for least developed countries, and an enhanced Integrated Framework (EIF).⁶ Regarding trade in services, it was decided (para. 26) that the least developed countries would not be expected to undertake new commitments (this paralleling the wording of the draft text on non-agricultural market access), while there was a “best endeavours” agreement to give priority to the sectors and modes of supply of export interest to least developed countries, particularly under Mode 4 (temporary movement of labour, para. 47).

To no effect, Leaders from the Group of Twenty (G-20) have repeatedly called for greater progress on the Doha Round. They see completion of the Round as an integral part of the concerted efforts towards benign rebalancing of the global economy. However, the additional progress urged has not materialized. There is still an important gap in terms of providing developing countries, especially the least developed among them, with duty-free and quota-free market access for their products. Most of the progress in this area has been due to the elimination of tariffs through most-favoured nation agreements (see United Nations, 2009c, pp. 27-28; and box IV.1). Agricultural subsidies in advanced countries remain high and continue to reduce income opportunities for farmers in developing countries.

Box IV.1: The least developed countries in WTO

There have been notable improvements in market access for least developed countries. Twenty-eight World Trade Organization (WTO) members have pledged expanded market access. Many of them have actually agreed to drop all barriers and provide “duty-free and quota-free” treatment to all least developed country exports. They thereby join a number of other countries that already provide open markets. The average non-weighted tariff applied by major trading partners to exports of least developed countries fell from 10.6 per cent in 1997 to 6 per cent in the first quarter of 2001.

Technical assistance to enable least developed countries to make the most of their rights and perform based on their obligations under World Trade Organization Agreements is also being provided. For instance, under the Joint Initiative on Technical Cooperation for Least Developed Countries, launched by the World Intellectual Property Organization (WIPO) and the WTO, assistance is being offered to enable these countries to bring their intellectual property system up to standard while fully utilizing WTO flexibilities. Members of the WTO are currently looking at means to assist least developed countries in the process of joining, since least developed countries acceding to the WTO have to learn how it works. They also need to draft domestic laws that comply with WTO rules, to establish mechanisms for enforcing those rules, and to negotiate with existing members suitable conditions for entry into the WTO.

Finally, the WTO provides a forum where least developed countries can and do raise particular issues relating to food safety and quality standards; indeed, least developed countries may find it difficult to ensure that their exports comply with developed countries’ sanitary standards. In this regard, World Trade Organization Agreements limit importing countries’ capacity to impose arbitrary requirements on exports of least developed countries, and encourage the use of internationally developed standards.

Source: World Trade Organization (2001b).

However, even if the limitations introduced by the multilateral framework and its application at the national level are overcome, this does not imply that developing countries will automatically be able to reap much higher gains from trade. Historical evidence indicates that for this to happen it is essential for countries to have built up adequate production and trading capacities so that trade can be an engine for growth. Aid for Trade, as well as space for implementation of industrial and productive policies, is key in this respect.

Aid for Trade

The Aid for Trade initiative (AfT) recognizes that the trading and production capacity of developing countries, especially the poorest ones, needs to be strengthened. The case made for Aid for Trade is based generally on the belief that while trade can be a tool for development, countries need infrastructure, institutions, technical capacity and investment in order to take advantage of the market access-related concessions that they have obtained under the World Trade Organization (Page, 2007). To some extent, the debate presents a challenge to the call for “Trade, not aid”, through recognition of the fact that there is a need for assistance to developing countries so as to enable them to expand and diversify their trade in a manner that deepens the development impact. Put another way: aid can help develop trade, to the point where trade eventually replaces aid.

As table IV.2 shows, lower middle-income countries and low-income countries that are not least developed countries have together received the highest share of Aid for Trade-related funds over the period 2002-2010. Least developed countries have received the lowest level of trade-related assistance spending relative to total aid among the large aid recipients. These figures are a cause for concern as least developed countries and African countries are among the most likely to need support for strengthening of their trading and productive capacities.

The benefits of an Aid for Trade programme can be categorized first in terms of assistance to help developing countries generate supply-side responses, as removal of tariffs on agricultural products in the developed world, for example, might not trigger a strong export response given the large shares of small-scale farming and a general lack of infrastructure (Laird, 2007). Furthermore, developed countries are increasingly tightening import restrictions through the application of (sanitary and phyto-sanitary) standards, with which poor countries are often unable to comply. Second,

Table IV.2:
Destination of Aid for Trade commitments to countries, by income group, 2002-2010

	<i>Least developed</i>	<i>Other low-income</i>	<i>Lower middle income</i>	<i>Upper middle income</i>	<i>MADCT</i>	<i>Unallocated by income</i>	<i>Total Aid for Trade</i>
	<i>Percentage</i>						<i>US\$ million</i>
2002	22.23	18.42	45.96	8.73	0.09	4.56	15,971
2003	30.11	13.40	43.68	7.19	0.01	5.62	17,497
2004	25.00	14.53	52.91	3.68	0.01	3.88	23,785
2005	30.90	14.26	40.79	10.11	0.01	3.92	23,131
2006	27.72	12.56	44.79	5.07	0.01	9.85	23,903
2007	33.75	18.57	34.30	6.25	0.01	7.13	28,119
2008	29.08	14.01	43.52	6.64	0.00	6.74	39,565
2009	32.50	18.73	33.93	5.23	0.00	9.61	39,538
2010	33.21	16.91	35.79	7.33	0.00	6.76	44,770

Source: OECD/DAC CRS Database.

assistance may be provided for microtrade adjustment, designed to help developing countries cope with undesirable outcomes in particular industries due to the factor redeployment effects of trade liberalization. Macro adjustment assistance could include compensation for preference erosion and lost tariff revenue; compensation for the latter could play a substantial role in repairing the loss of fiscal space of small developing countries.

Despite general agreement that these are important issues for all developing countries, there is no consensus on the relative importance of what is essentially infrastructure development assistance—both hard and soft—and support for responding to adverse external shocks. Equally important, there is no defined mechanism for the collection, allocation and disbursement of Aid for Trade funds. When this was a subject of negotiations, there was pressure to define a new structure for trade aid, one that was outside normal aid mechanisms and parallel to the structures created to deal with other international concerns such as health and the environment. For the purpose of sidestepping the necessity of securing developing countries' support within the framework of the trade agreement being negotiated, Aid for Trade has been absorbed into normal country aid programmes.

Although there may be increased funding for trade-related purposes, it will be difficult to ensure that the actual use of funds is in accord with the objective of expanding global trade or is aligned with national trade and development priorities. This can be explained, first, by the fact that, given its

distinct area of influence, the World Trade Organization as an organization is not inclined to challenge traditional aid agencies. Second, aid agencies are generally reluctant to subject their allocation or mechanisms to external criteria. Finally, Aid for Trade had been carved out of the trade negotiations with the effect that developing countries lost the ability to have a direct influence on deciding modalities. Inevitably, the question also arises to what extent Aid for Trade would be additional to existing aid commitments or merely a re-categorization⁷ of existing funding directed towards trade and related activities, which, in some countries, could well be of lower priority in terms of development.

Policy space and regional trade agreements

Under the World Trade Organization's multilateral framework, countries can still use certain types of subsidies and flexible tariffs policies, particularly FDI regulating measures and flexible compulsory licensing. However, the rise of bilateral and regional trade agreements has the effect of restricting some of these flexibilities and, in fact, eroding the policy space available to developing countries (Haque, 2007).

Slow progress in the Doha negotiations combined with their bilateral negotiating advantage has spurred developed countries, in particular, to aggressively pursue bilateral and regional trade agreements. Indeed, the surge in regional trade agreements (RTAs), bilateral free trade agreements (FTAs) and, more recently, economic partnership agreements (EPAs), has continued unabated since the early 1990s, with 271 regional trade agreements in force in March 2010.⁸

Economic partnership agreements, regional trade agreements and free trade agreements are drawn up overwhelmingly by parties of vastly different trade capacities.⁹ What motivates the establishment of those agreements is the promise of preferential treatment. They seem, in fact, to generate a domino effect: non-members are tempted to join existing North-South preferential agreements so as not to lose out on access to sizeable export markets and sources of FDI (Baldwin, 1997). Hence, while to engage in international commitments may be a "sovereign" decision, there is often little alternative.

The issue is whether there is a net benefit accruing to developing countries from bilateral or regional North-South agreements. In many cases, industrialized countries have succeeded through these agreements in extracting the compliance of developing countries in areas where they

failed to secure consent in the World Trade Organization. In effect, many regional trade agreements impose binding obligations on the contracting parties with regard to investment liberalization and protection, as well as competition policy and government procurement (the so-called Singapore issues or “WTO plus”), thus expanding the rights and access of foreign firms and their products in developing-country markets, and further curbing or prohibiting government policies that encourage or favour local firms and the domestic economy (Shadlen, 2005).¹⁰

Additionally, many North-South bilateral free trade agreements and bilateral investment treaties (BITs) have provisions requiring all transfers relating to investment from the other party (including contributions to capital, profits, dividends, capital gains, interest and loan repayment) to be allowed without delay into and out of a country’s territory, which severely limits the capacity to regulate capital flows and impose capital controls.

In summary, resolving the conflict between economic development and the principle of non-discrimination in the trading system has been difficult. However, some progress has been made in terms of more policy space given to the least developed countries, specifically in terms of longer adjustment periods (see also box IV.1). On the other hand, low-income countries that are not least developed countries, as well as many middle-income countries, have seen their options constrained by their acceptance of World Trade Organization terms and limitations emerging from other policy areas, such as those encompassing bilateral trade agreements and other measures discussed below.

In practice, the international system has placed great value on the rapid convergence of developing countries’ trade policies with those of developed countries. In fact, through regional and bilateral agreements, many developing countries have even agreed to assume obligations that extend beyond those imposed by membership in the World Trade Organization, through bilateral commitments on tariff levels, for example. This is explained by the fact that poorer countries typically have limited fiscal resources, which constrains their capacity to support large-scale enterprise and sectoral economic development programmes. Moreover, the volatility of private capital flows has made exchange-rate management in support of international competitiveness difficult.

These limitations to national policy space have been compounded by changing global trade patterns. Together with the revolutions in information and communications technology, trade liberalization has further stimulated the expansion of trade, which is being driven by the

fragmentation of production and the unprecedented growth of global value chains. In general, countries that had managed early on to jump on the global value chains bandwagon, while at the same time strengthening linkages with their domestic economies, had better growth performance. However, successive iterations in trade negotiations have led to constraints on the space available for conducting the policies that create such linkages.

THE WAY FORWARD

Although it was evident early on that GATT mechanisms fell short in regard to development orientation, and despite several attempts to provide a special and differentiated space to developing countries in the World Trade Organization, effective implementation of this promise has yet to occur. Although the Doha Round has been labelled a “development round”, its limitations with respect to providing enough policy space for development have been evident, which helps to explain its stalled status. The World Trade Organization’s single-undertaking approach compounds the difficulties of achieving agreement. Special treatment now applies mainly to least developed countries even as their market access remains limited.

Behind these limitations lies policy incoherence in a number of areas which are explained below, with a view to suggesting how to retool national development efforts.

Retooling counter-cyclical policies

Because downturns have proved more costly in terms of unemployment and lost opportunities, there is a strong economic case to be made for managing aggregate demand and reducing the impact of business cycles on investment, employment and incomes. Trade policies, as an important complement to monetary, exchange-rate and fiscal policies, were formerly used for this purpose. Members of the World Trade Organization have an unchallenged right to use contingency measures that are consistent with its rules. In fact, protectionism has always been a structural element of the free trade system—an institutional safety net in the liberal trading order. In effect, trade agreements foresee a range of measures, commonly referred to as contingency measures, or safety valves, that countries may use to manage adverse circumstances. These rules must strike a balance between commitments and flexibility. Too much flexibility may undermine the value of commitments, but too little flexibility may render the rules

politically unsustainable (World Trade Organization, 2009b). The design of contingency measures is frequently a central element of negotiations.¹¹ Such measures include safeguards, dumping and anti-dumping measures, subsidies and countervailing duties, as well as others like renegotiation of provisions. Developed economies have the advantage of possessing the greater fiscal resources needed to offer the kind of business subsidies that are still allowed under the World Trade Organization rules to handle economic downturns. For developing countries, trade liberalization has restricted the range over which tariffs can be applied for counter-cyclical policy.

In response to the current global crisis, countries all over the world are using a variety of available means to protect their industries from the devastating consequences of a contracting world economy and rising mass unemployment (Drache, 2010). As mentioned above, the multilateral framework has been instrumental in preventing an escalation of beggar-thy-neighbour measures. While it is a comparatively straightforward matter to detect the use of contingency measures, it is more difficult to identify trade-restrictive measures and subsidies embedded in financial rescue and fiscal stimulus packages that might have adverse trade effects (see table IV.3).

Table IV.3:
A selected list of modern protection(ist) practices

<i>Difficult but acceptable</i>	<i>Legal but contentious</i>	<i>Distorting and controversial</i>
Stimulus packages	Anti-dumping duties	Import quotas
Wage subsidies	Countervail duties	Customs and barriers
Packaging/labelling	Industrial policy	Beggar-thy-neighbour tariff walls
Technology licensing restrictions	Currency devaluation	Voluntary export restraints
Industry rescue packages	State aids/subsidies	Export bans
Food/health standards	Unilateral Safeguard action	
Bail-outs	"Buy local"	

Source: Drache (2010).

The global recession has uncovered what could be considered a coordination problem. A single country's use of a contingency measure within a trade agreement, triggered by unexpected import competition or a downturn in its domestic industry, gives the industry the opportunity and time to recover. However, such a reprieve will be difficult to procure in the

midst of a generalized recession, particularly when all other countries are imposing trade contingency measures. The Great Depression of the 1930s demonstrated that protectionism in the face of a global crisis can deepen and lengthen a crisis. At the same time, the “Great Recession” has shown that recourse to the other extreme—free markets and market discipline—is not enough to maintain sustainable and stable rates of growth. In this regard, these counter-cyclical efforts can be seen as reflecting the search for a new and necessary balance between state interventions and market efficiency in a demand-constrained world.

Restoring coherence between trade and development policies

At a time when developing countries must industrialize to meet their development goals even as they strive to achieve climate change-related goals, it is difficult to imagine an integrated approach that does not take industrial policy seriously. Stronger intellectual property rights and efforts to attract FDI are no substitute for sound industrial policies in developing countries (United Nations, 2009a).

As has been documented in the literature¹² and discussed in chapter II, accelerated rates of growth have generally been accompanied by strategic interventions and collaboration between a developmentally oriented state and the private sector. The capability-building requirements are both direct—to put infant-industry enterprises on a learning curve for mastering new technologies without incurring enormous and unpredictable losses; and indirect—to ensure that skill, capital, technology and infrastructure markets support these efforts. There is also a need to coordinate learning across enterprises and activities (Lall, 2005).

Because what a country produces and exports does indeed matter (Rodrik, 2004; Hausmann and Klinger, 2006; United Nations, 2006b) industrial policies involving infant-industry protection, export subsidies, directed credit schemes and local content rules have proved to be a key ingredient of successful development, particularly in East Asia (Memis and Montes, 2008). The record of East Asia confirms that the most effective subsidies for infant industries have been selective (not across the board), temporary (not open-ended) and performance-related (not unconditional). One key instrument will be recalibration of the use of subsidies and other mechanisms in support of export industries in developing countries, so as to ensure that they feature: (a) targeted incentives; (b) regulation; (c) coordination of investment decisions; (d) control mechanisms; and

(e) environment-friendly characteristics. These elements can be implemented through diverse instruments, according to the particular characteristics of the sector and country (United Nations, 2009a).

As discussed in chapter II, economic diversification and structural change are critical to self-sustaining poverty reduction; and integrating social, labour-market and industrial policies can be an effective approach to achieving these goals. How to reorder priorities in industrial policy so as to promote social objectives will depend on the country context. In many countries, this will require a return to public investment in rural areas and agriculture in order to develop the livelihoods of the poor. It will also entail supporting the expansion of the domestic production of the goods required in the education and health sectors, possibly by taking advantage of government procurement policies. Also important will be reviving domestic support for export industries offering the best opportunities for backward integration instead of promoting industrial policy focused implicitly on *maquila*-type production (Memis and Montes, 2008). For example, in Viet Nam, state support in expanding rice and (in the nation's hinterland) coffee production improved household incomes and created new export capabilities.

In the context of implementing a national strategy, the state should play the role of facilitator by helping the business sector choose a path that achieves an optimal balance between the economy's deviation from comparative advantage and its growth rate (Chang, 2009). If it deviates too little, it may be efficient in the short run, but its long-term growth may be slowed down, inasmuch as it is not upgrading. On the other hand, too much deviation may accelerate industrialization in the short run, but after a point, the negative effects of protection (for example, excessive learning costs and rent-seeking) may overwhelm the acceleration in productivity growth generated by the infant industries, resulting in negative growth overall.

The changing patterns of trade and production described above have important implications for the formulation of trade and industrial policies in the context of broader development strategies. The rapid spread of information technology, the shrinking of economic distance and the skill requirements and institutional needs of new technologies have made the competitive environment more demanding (Lall, 2005). The fact that minimum entry levels in terms of skill, competence, infrastructure and connectivity are higher, creates the need for the provision of support to local enterprises for learning. This is even more important in the context of global value chains, as discussed below.

For a developing country that wishes to export, it is no longer sufficient to produce goods efficiently and competitively. In order to actually export, developing-country suppliers of labour-intensive products now must not only overcome the traditional trade barriers—which remain high for certain developing-country exports—but also become part of some trade network. Managing to get “picked up on this dance floor” covered by the many competitors worldwide is due as much to luck as to productive efficiency (Mayer, 2008).

Based as they were on the low labour cost advantage, the kind of “outward-oriented” strategies pursued, for example, by the Republic of Korea and Taiwan Province of China at the stage of their early industrialization, would not be as feasible or effective or as easy to implement in today’s environment. This points to a catch-22-type situation: a developing-country producer needs to secure a major sales order to get started in business, at the same time that corporate buyers in industrialized countries look for firms with a proved track record.

The relationship between the large international firms and small producers in developing countries is fundamentally unequal. The rise of supply chains, as drivers of international trade, has resulted in what are basically monopsony situations, where foreign buyers more or less dictate the prices that they pay to developing-country producers. It is the former that decide where to buy, invest and situate industrial activity and that by and large determine the return received by a developing-country producer. This is because in industries with high sales costs, advertisement expenditures or R&D expenses, large firms enjoy a distinct competitive advantage over small producers.

In such trading networks, there is little commitment on the part of buyers to their suppliers, which can be easily replaced by others (Mayer, 2008). If a developing-country producer succeeds in joining a trade network, there is no assurance that such an arrangement will be durable, as new and more attractive sources of supplies are constantly emerging. Thanks to the universal appeal of the mantra of export-led growth, simple labour-intensive manufacturing has become fiercely competitive, with suppliers struggling to contain costs and remain attractive to foreign buyers. Activist policies in support of domestic firms in one country are either promptly challenged in the World Trade Organization or quickly matched by similar actions in other countries. Passive responses to these constraints by countries can compel them to join in a race to the bottom, a condition characterized by compressed wages, stagnant or falling living standards, and the neglect of environmental consequences.

Successful cases like Costa Rica, which attracted Intel to its export processing zone (EPZ) as a major investor and which helped crowd in foreign investments in other sectors, show that prior domestic investments in infrastructure and human capital and export subsidy schemes were key to dynamizing and diversifying export sectors with strong linkages to the domestic economy. In the case of East Asian newly industrializing economies, although some level of labour repression was present (and often justified for national security reasons), this did not reflect a deliberate policy action designed to attract foreign investment (Chowdhury and Islam, 1993).

The inability of individual countries to avoid being swept up into self-defeating competition with others points to a global governance gap in the area of oversight mechanisms covering the operations of global value chains and transnational corporations. In domestic contexts, by contrast, private companies are subject to national laws. There is no legal framework specific to intra-GVC relations, including contractual obligations applicable to GVC operations. Similarly, there is no international dispute settlement mechanism applicable to relations between small and medium-sized enterprises (SMEs) and transnational corporations.¹³

Developing countries need to cooperate and adopt a collective approach on this issue. Interesting proposals which merit consideration have been put forward. Singh (2002) proposes the establishment of an international competition authority, which would aim “to control the anti-competitive conduct of the world’s large multinational corporations ... as well as to control their propensity to grow by takeovers and mergers”. Absent an international competition mechanism, it would be advisable for individual countries to design their own domestic competition policies which would permit the emergence of larger domestic companies able to compete internationally.¹⁴ This could require abrogation of some World Trade Organization commitments regarding national treatment of foreign firms, as discussed above.

Pack and Saggi (2001) propose the establishment of national trading companies like those set up by some East Asian countries. They note: “Governments could attempt to encourage the development of trading companies as there may be a market failure given the characteristic that setup costs for such companies may be significant but marginal costs of adding firms to the network may be small. Such trading firms could operate across clusters of manufacturing firms.”

From the point of view of countries hosting transnational corporations or participating in global value chains, tax coordination is another key issue. By the end of 2008, the total number of double taxation treaties had

reached 2,827 and the network of international investment agreements (IIAs) continues to expand: there were a total of 2,278 bilateral investment treaties by the end of 2007 (see table IV.4).

Table IV.4:

Number of bilateral investment treaties (BITs) and double transaction treaties (DTTs), by country groups involved, 1959-2007 and 1928-2008

<i>Country groups concerned</i>	<i>Number of bilateral investment treaties, 1959-2007</i>	<i>Number of double taxation treaties, 1928-2008</i>
Developed-developed	233	708
Developed-developing	900	1 053
Developed-least developed	172	86
Developed-transition economies	259	285
Developing-developing	371	390
Developing-least developed	107	89
Developing-transition economies	181	167
Least developed-least developed	1	3
Least developed-transition economies	5	1
Transition-transition economies	49	45
Total	2 278	2 827

Sources: International Centre for Settlement of Investment Disputes Database of Bilateral Investment Treaties (<http://icsid.worldbank.org/ICSID>); and United Nations Conference on Trade and Development data on double taxation treaties (<http://www.unctad.org>).

It has become increasingly evident that it is better cooperation—not unbridled competition among countries through tax incentives and decreases in regulatory requirements—that is in the interest of all countries. For one thing, transnational corporations or value chains typically do not decide to move to one country rather than another mainly on the basis of tax incentives. Progress in establishing mechanisms of coordination, cooperation and exchange of information is necessary to fill yet another gap in international governance.

The number of other international agreements with investment provisions had reached 273 by the end of 2008. These agreements established rules, standards and mechanisms for managing tax and investment-related treatment of cross-country business activities. As regards these agreements, developing countries, as in the World Trade Organization, suffer a disadvantage in

terms of negotiating and enforcement capacity. Bilateral investment treaties, which have been proliferating since the early 1990s (see figure IV.8), take the obligations of host governments under the TRIPS Agreement, the Agreement on Trade-Related Investment Measures (World Trade Organization, 1994) and the General Agreement on Trade in Services as a mere starting point (Wade, 2005). They require the host government to lift even more restrictions on the foreign firms hoping to operate in their territory, and to make even more concessions, in return for better market access.

To deal with disagreements between foreign investors and host country governments, firm-state arbitration boards are established as components of bilateral investment treaties. These boards allow a private firm to take a government to arbitration that is conducted by a body dominated by private sector adjudicators who are, more often than not, sympathetic to the needs of the firm. The boards operate using private contract law rather than public

Figure IV.8
Number of bilateral investment treaties (BITs) and double
taxation treaties (DTTs) signed per decade, 1960-2008

Source: International Centre for Settlement of Investment Disputes Database of Bilateral Investment Treaties (<http://icsid.worldbank.org/ICSID>); and United Nations Conference on Trade and Development data on double taxation treaties (<http://www.unctad.org>).

law and allow damages against the government to be levied retroactively. The fact that the World Trade Organization dispute settlement mechanism, where states deal with states under public law, looks evenly balanced by comparison should be a cause for concern.

Obtaining the proper level of tax revenues from resident foreign companies is often constrained by the ability of multinationals to set transfer prices on within-firm cross-border transactions so as to minimize domestic tax liabilities. Although there are discrepancies in the specifics of each country's laws concerning the application of the "arm's-length principle", many countries have based their transfer pricing laws and regulations on the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (Organization for Economic Cooperation and Development, 2009), which are quite difficult to enforce in actuality.

Most of the double-taxation treaties contain provisions that force both taxing authorities to resolve transfer-pricing disputes on the basis of the arm's-length principle. Developing-country authorities tend to be at more of a disadvantage because of the high informational requirements needed to control transfer pricing.¹⁵ Progress is needed on achieving improved, automatic exchanges of information among countries. Such improvements would be in the interest of advanced countries as well by helping them bridge information gaps when enforcing financial regulations. The international community should also consider mandatory country-by-country reporting by transnational corporations as a means of filling this international governance gap.

Coherence with the climate agenda

The Director-General of the World Trade Organization (Lamy, 2009) has suggested that climate policy must take priority, since trade is not an end in itself but is supposed to enhance human welfare, which in turn is heavily dependent on climatic conditions. Consistency between trade and climate policies must entail the internalization of environmental costs, including of greenhouse gas emissions. Trade is important because environmental technologies and know-how are generated primarily in developed countries and transferred to developing countries mainly through embodied technologies in imported goods and services, FDI or licensing.

Given the lack of detail in, and the status of, the Copenhagen Accord,¹⁶ some countries that are prime movers in the field of greenhouse gas mitigation may try to neutralize the competitive disadvantage that their

industries would face at home if they applied unilateral climate policies, for instance, through border adjustment measures (BAMs) such as duties on imports from countries not undertaking comparable mitigation efforts based on carbon-content of products or production methods, or through climate-related standards (Opschoor, 2010). It has been shown (Pew Center on Global Climate Change, 2009) that unilateral border adjustment measures might be relatively ineffective (in terms of their emission reduction effects) and, in fact, counterproductive in terms of achieving climate objectives (owing, for example, to their impacts on the negotiation environment).

Additionally, border adjustment measures could put developing countries at a disadvantage, as those countries do not have the technologies required to engage in production with higher carbon efficiency. As with other issues, there is a risk that climate objectives would be translated into, or used as the basis for, protectionism. Generally, process and production methods (PPMs) should not be used as grounds for the application of trade-related environmental measures. If they were so used, it would become necessary to address more generally the unresolved issue of how to treat them (United Nations, 2009a).

Because subsidies are and will continue to be used to support the development of alternative energies, the issue of determining how to handle those subsidies under the rules of the World Trade Organization will also have to be dealt with. The issue would be addressed at least in part by having schemes in place for compensating incremental costs of any cleaner or leaner technology in developing countries.

Multilateral trading rules are also posing hurdles to transfers of technologies to developing countries, thereby making the TRIPS Agreement an area of continued controversy (United Nations, 2009a). It has been argued that “commodified knowledge, protected by private property rights” reduces economies’ dynamic efficiency, as this leads to underutilization of knowledge and a slowdown of innovation (Stiglitz, 2006). Resolution of this issue is particularly crucial if those technologies are to be effective against the danger of climate change. In the World Trade Organization system, there are several flexibilities available within the framework of the TRIPS Agreement such as compulsory licences, exceptions to patent rights, regulation of voluntary licences, and strict application of patentability criteria. However, although these measures may enable access to technologies to a certain extent, they are usually more difficult to operationalize in developing countries and their use would be limited to specific (mostly emergency and humanitarian) circumstances.

Options such as allowing developing countries to exclude critical sectors from patenting, and establishing a global technology pool for climate change, merit serious consideration, as these options would provide certainty and predictability in accessing technologies and further enable much-needed research and development for local adaptation and diffusion, which would further reduce the cost of the technologies. In addition, modalities for access to publicly funded technologies by developing-country firms need to be explored.

Coherence with the financial architecture

Maintaining a competitive exchange rate has been a common strategy in most developing countries that successfully diversified exports and moved onto a path of sustained economic growth. However, this policy target may be in jeopardy within a context of capital flow volatility. Private international asset flows are by now the most decisive determinants of foreign-exchange rates for most economies. Successful exporters also tend to attract higher private capital inflows since these tend to move in pro-cyclical fashion.¹⁷ This puts upward pressure on real exchange rates which in turn would lead to conflict with trade promotion objectives. Countries also facing domestic inflationary pressures often have opted to allow the exchange rate to appreciate under such circumstances. Such inflation targeting often undermines export competitiveness. During downward cycles in international capital flows, pressures towards currency depreciation would emerge. Governments often try to limit the degree of exchange-rate devaluation by letting macroeconomic stability targets prevail, which then may jeopardize trade policy objectives.¹⁸

Restructuring the international financial system so that it sustains exchange-rate values consistent with real sector growth is imperative. To restore coherence between the trade and financial policy arenas, increased capability in managing the capital account, particularly the capacity to control the volume, maturity and currencies of inflows, is critical. Promoting strengthened regional cooperation in monetary and financial matters, particularly to the extent of enhancing intraregional trade, may also be a feasible alternative and could facilitate global cooperation. Both these solutions would bring about greater coherence between the international trading and financial systems to the point where they reinforced, rather than undermined and destabilized, each other.

The Bretton Woods institutions have been active in both trade and financial liberalization. The cornerstone of the policy coherence behind

these efforts had been the proposition that international private financial markets are the best judge of national economic policies. The integrity of this proposition was shattered with the outbreak of the global crisis in the developed-country financial markets, which has led to many suggestions that the focus of the operations of these institutions should be sharpened and concentrated more on their areas of competence—effective global payments and reserve mechanisms in the case of the International Monetary Fund (IMF) and development project finance in the case of the World Bank—and that they should leave to national policymakers and the outcomes of international negotiations the determination of the overall structure of developing-country trade regimes.

The current Doha Round involves plurilateral-type negotiations on specific services sectors, including financial services. In the financial services group, developed countries and their financial institutions are pressing a group of developing countries to open up their financial services markets by allowing the establishment of foreign financial institutions (under Mode 3) and by allowing freedom of cross-border financial flows, instruments and services (under Modes 1 and 2). If negotiations conclude along the proposed lines, the developing countries could be subject to the type of financial liberalization that would reduce the regulatory capacity they need to minimize financial vulnerability.

Policy coherence in matters of international labour mobility

The trend among World Trade Organization disciplines towards encompassing services has led to the creation of areas such as “consumption abroad” (tourism, for example, comprises services consumed abroad) and “movement of natural persons” (referring to the migration of people for the purpose of working abroad temporarily). As noted in chapter II, population ageing trends raise the possibility that increasing the flow of the younger workers to rich countries could help reduce poverty in developing countries. The potential of labour migration to enhance global growth and welfare is associated, by some, with the fact that wage differentials across countries of the world remain very high.

As Rodrik (2002) observes, after several decades of liberalization, price differentials of goods, services and capital across countries of the world have narrowed significantly. As a result, the welfare effects of the liberalization of labour flows currently have the potential to be 25 times greater than the further liberalization of flows of goods, services and capital. However, as

Rodrik's finding is based on a back-of-the-envelope calculation, studies of greater rigour are necessary to determine more satisfactorily the relative benefits to be derived from further liberalization along different dimensions.

It is unlikely, however, that much progress will be made in liberalizing labour movements within the context of the multilateral trade regime. Given the complexity of the matter, the issue of the movements of workers, and people in general, might be better addressed in a global forum capable of dealing more broadly with issues of migration and development.

As pointed out in chapter II, labour migration involves not just the question of filling vacant jobs in developed countries but also the matter of the difficult social adjustments required in receiving and sending countries. In the case of the receiving countries, it must be recognized that temporary labour migration involves the movement of (natural) persons, which often requires addressing issues of family and other social support structures. Moreover, the setting of labour migration policies will require difficult political decisions regarding migrants' access to social services, including health, education, pensions and unemployment benefits. Finally, receiving societies must often wrestle with and manage the social and cultural dissimilarities between labour migrants and the long-term resident population.

Unless the global community is content to retain the present untidy and often inhumane migration modalities, these difficult issues should be addressed, most preferably under a specialized international migration regime equipped to deal with the complex contractual, coordination and social mechanisms involved.

Coherence between the multilateral and regional trading systems

Bilateral agreements are intrinsically more difficult to evaluate than either multilateral or unilateral liberalizations because of their second-best nature, that is, the net benefits tend to be uncertain and difficult to assess (Rollo, 2007). Economic analysis deals with this difficulty by utilizing concepts of trade creation and trade diversion; but measurement of these effects, even for relatively simple trade barriers such as tariffs, is not always straightforward and requires a relatively specialized set of economic analytical skills. This problem of measurement is further complicated by the fact that, increasingly, regional trade agreements extend their compass beyond the simple dismantling of border barriers to trade in goods. As mentioned before, such agreements now include within their purview

services and other elements of deep integration for which data are poorer, analytical tools are less developed and the domestic legal implications of any consensus are complex and potentially substantial.

Given that, historically, preferential integration has been a major policy instrument of the World Trade Organization membership—most notably of the members of EU and the parties to the North American Free Trade Agreement (NAFTA)—and that the notifications of preferential agreements have increased since the formation of the World Trade Organization¹⁹—it is not surprising that negotiations on procedures and disciplines for regional trade agreements were included in the Doha mandate. The new transparency mechanism agreed (albeit provisionally) in December 2006 is the first product of those negotiations. The difficulty with World Trade Organization rules on regional trade agreements is, however, that they apply *ex post*, after countries have already ratified their commitments, at which point little can be done to establish more development-oriented agreements. Even the transparency mechanism asks only that countries engaged in new negotiations on regional trade agreements endeavour to notify the WTO thereof and of the provisions of any signed agreement when they are made public.

As the number of these agreements is likely to keep increasing, especially while the Doha negotiations remain stalled, fostering developing countries' awareness of exactly what they are signing and the consequences thereof is of fundamental importance. Negotiators of regional trade agreements face important challenges, because of the second-best nature of these arrangements. The bureaucratic stresses for developed countries with relatively well-resourced administrations can be substantial. For administrations in developing countries, where human capital is often the binding constraint, the resource demands of negotiating one or more regional trade agreements alongside multilateral and unilateral trade-related policymaking are potentially much greater. This could lead to serious misunderstandings about the implications, in particular for economic and social development, of specific policy changes demanded by an agreement. The situation is further complicated by the possibility that a regional trade agreement negotiated by a given country could differ markedly from other regional trade agreements under negotiation or in operation by or in that country. Such interactions could mask possibly serious economic and developmental costs.

Given the factors of international negative spillovers from regional trade agreements and asymmetric information, there is a case to be made for public provision of the needed analytical frameworks free or at low cost to

developing countries. An interesting proposal that could be considered is that for the creation of a new international organization, an advisory centre on RTAs (ACORTA), closely modelled on the Advisory Centre on WTO Law (ACWL) set up to help developing countries involved in trade disputes (Rollo, 2007).

Rebalancing World Trade Organization processes

Expanding developing-country participation in trade rule-making, even in the World Trade Organization where countries are formally equal, is a necessary step in reforming the trade system so as to enable it to support development. There are two main sources of inequality: (a) differential access to information regarding which features of an agreement will benefit one's country; and (b) differential power to influence the outcome of negotiations (Toye, 2010). Countries whose resources are inadequate need assistance; but trade-related technical assistance continues to be inadequate and needs further expansion.

Enforcement mechanisms for trade commitments have to be made more equitable. Unfortunately, it is still true that, in this regard, serious deficiencies remain at every stage of the World Trade Organization dispute settlement process, from inception through judgement and granting remedy to enforcement (Toye, 2010). These deficiencies arise from the interaction of the standard features of a legal process—its cost, absorption of time and uncertainty of outcome—with the inadequacies of the international legal machinery and the huge inequalities of wealth and power that currently exist between nations. Given the substantial cost of bringing a case before the World Trade Organization, in terms of legal and diplomatic person time, poor countries are deterred disproportionately from engaging in a dispute. Poor Governments will also be disproportionately deterred from bringing a case to the dispute settlement mechanism by the prospect of antagonizing more powerful countries, on which they depend in many areas not connected with trade, such as foreign assistance.

The fact that by convention, the loser pays no compensation for a violation (after a process that can still take over two years to complete) bears more heavily on poor states than on rich ones. There is no centralized sanction for a country that does not take measures to comply with its World Trade Organization obligations. The only sanction is retaliation. Since all economic sanctions are costly to the initiator, a poor country has a much more limited ability than a rich one to impose a sanction. Thus, even if

developed and developing countries violate World Trade Organization rules to the same extent, and dispute panels render perfect formal justice, developing countries will win fewer cases than they lose, and will be less sure of a remedy in the cases that they do win.

Toye (2010) argues that it should be possible to tilt the system in ways that counteract its existing biases. In domestic litigation, legal aid is used to give the poor better access to costly justice; the injured party is awarded its costs by the court; and centrally organized sanctions prevent it from having to bear all the costs of punishing the violator. Progress along these lines could be made in the international sphere as well, given sufficient imagination and willingness to cooperate. An interesting example is the ILEAP initiative (International Lawyers and Economists against Poverty), a not-for-profit non-governmental initiative to provide timely, responsive and practical legal and economic expertise to developing countries so as to assist them in achieving trade-related development and poverty reduction.

The key problem is the non-existence in the international sphere of a central sanctioning mechanism. Although there is a mechanism in place through which countries band together in pursuing a dispute, this still imposes heavy costs of coordination on poor countries and does not guarantee attention to the kind of disputes that are particular to very small economies. Still, an improved dispute settlement mechanism in the World Trade Organization would be capable of furthering the interests of the developing countries.

CONCLUSIONS

Rebalancing the trade system by strengthening the pillar that supports “differentiated” responsibilities, after decades of emphasizing the pillar that supports the “common” ones, is critical to ensuring that trade can play a positive developmental role. Greater coherence between trade policies and the international trade regime, on the one hand, and sustainable development, on the other, requires new flexibilities in the multilateral regime to enable the marking out of a domestic policy space for:

- Counter-cyclical policies designed to stabilize growth and diversify exports.
- The development of economic sectors through interventions that are truly selective (not across the board), temporary (not open-ended) and performance-related (not unconditional) and consonant with the decent work and environmental objectives.

Creating these capabilities will entail reducing the inconsistencies among the areas of trade, finance and macroeconomic policy coordination at the international level. Overcoming such inconsistencies will require strengthening domestic capacity in managing capital inflows; reforms of the international financial architecture that will reduce capital flow and exchange-rate volatility; and an alignment of implicit financial rule-setting through the General Agreement on Trade in Services with a new framework for international financial regulation. These issues are taken up in chapter V.

Greater policy coherence can be further achieved by rationalizing the international trade agenda which has expanded its scope to include other areas such as intellectual property, international finance and labour services. Inasmuch as the World Trade Organization appears at present to be overseeing issues in areas for which there are missing global regimes, its agenda is overloaded. It might therefore be more effective to address such issues through more specialized agencies. There are missing or weak regimes of global governance not only for financial services, migration, and intellectual property but also for:

- International competition policy and oversight over the operations and impact of global value chains and transnational corporations.
- Tax coordination, exchange of information and cooperation in the collection of tax debt.
- Climate change, where a regime is needed that directs and expands cooperation in aid, trade, investment and technology.

Greater coherence in the global trading regime will also require strengthening multilateral disciplines over regional trade agreements, bilateral trade agreements and investment agreements. Such coherence can be achieved fairly only if, at the same time, equity in the negotiation processes and enforcement of World Trade Organization rules are improved, particularly through providing developing countries with the necessary resources to participate more actively and more fully in international trade rule-making.

NOTES

- 1 More specifically, the Fourth Ministerial Conference took note of the proposal to treat measures implemented by developing countries with a view to achieving legitimate development goals, such as regional growth, technology research and development funding, production diversification and development and implementation of environmentally sound methods of production, as non-actionable subsidies, and agreed that that issue should be addressed as an outstanding implementation issue. During the course of the negotiations, members were urged to exercise due restraint with respect to challenging such measures (World Trade Organization, 2001a, para.10.2). According to Aguayo Ayala and Gallagher (2005), this call for restraint has been respected, and developed and developing countries alike continue to utilize such subsidies under a tacit agreement not to challenge them under the dispute settlement mechanism.
- 2 Foreign investors must be treated as well as domestic investors. Treating foreign investors better than domestic investors does not violate this principle.
- 3 United States action could find itself subject to dispute should current proposals to re-regulate the financial sector become law. In the additional protocol under the General Agreement on Trade in Services entitled “Understanding on Commitments in Financial Services”, which the United States signed with other countries, the United States carved out only trading in onion derivatives under the World Trade Organization category “Trading of securities and derivative products and services related thereto”. It is thus subject to complaint on additional regulation on all derivatives except those related to onion futures. (The Onion Futures Act is a 1958 United States law banning the trading of futures contracts on onions and constitutes the first and only ban in United States history on the trading of futures contracts of a specific commodity). Moreover, the United States signed on to a standstill provision on regulatory changes applicable to the World Trade Organization financial services list which is still in effect (Public Citizen, 2009).
- 4 The TRIPS Agreement, for example, requires the introduction of minimum standards, border controls and domestic enforcement procedures along with the setting up of the respective authorities. Although it came into force on 1 January 1995, together with the other World Trade Organization Agreements, it gave all members a transition period within which to effect the necessary changes in legislation and practice.
- 5 See document A/C.2/56/7, annex, para. 2.
- 6 The Integrated Framework For Trade-related Technical Assistance to Least Developed Countries, also known as the Integrated Framework (IF), was established at the High-level Meeting on Least Developed Countries’ Trade Development, held at the World Trade Organization in October 1997, to support least developed countries in trade capacity-building and integrating trade issues into overall national development strategies. The IF has been redesigned and is in operation on a pilot basis in Cambodia, Madagascar and Mauritania. It will help least developed countries mainstream trade into their national development plans and strategies for poverty reduction.
- 7 Most of the reporting on Aid for Trade concerns commitments. However, in the case of least developed countries, there have been some attempts within the enhanced Integrated Framework to match the supply (offers of assistance) to the demand (recipient country requirements).

- 8 Some 462 RTAs had been notified to the GATT/World Trade Organization as of February 2010. Of these, 345 RTAs were notified under article XXIV of GATT 1947 or GATT 1994; 31 under the Enabling Clause; and 86 under article V of the General Agreement on Trade in Services. World Trade Organization statistics on RTAs are based on notification requirements rather than on physical numbers of RTAs. Thus, for an RTA that includes both goods and services, two notifications are counted.
- 9 The ongoing economic partnership agreement negotiations between European countries and the 79 countries members of the African, Caribbean and Pacific (ACP) Group of States (mostly former colonies) are necessitated by the fact that existing preferential arrangements are in violation of World Trade Organization rules. The trend in these negotiations, in respect of responsibilities, has been towards the “common” as opposed to the “differentiated” side of the balance.
- 10 See Gallagher (2005) for a description of the main contentious issues associated with several regional agreements.
- 11 A categorization of the circumstances warranting, and the arguments for, a temporary increase in protection is presented in World Trade Organization, 2009b, chap II.B, table 1.
- 12 See Gallagher, ed., 2005.
- 13 In current GVC practice, legal contract enforcement is seldom an option for small and medium-sized enterprises because a dispute usually signals the end of a contractual relationship (Dembinski, 2007).
- 14 The emergence of the “too big to fail” problem is a recent example of the exercise of competitive forbearance by developed countries in respect of the establishment of large companies in the financial sector at the same time that these countries were pushing World Trade Organization disciplines directed at forcing increased competition in domestic sectors in developing countries.
- 15 The informational requirements are high because the standard for establishing the existence of transfer pricing is the OECD “arm’s-length principle”, which treats the subsidiaries engaged in trade in goods and services as if they were separate companies. Disentangling the complications associated with the issue of price among subsidiaries requires both information about transactions among hypothetically independent companies and the kind of highly specialized international tax expertise that is practically absent in developing countries. Developing countries could, instead, consider using the simpler approach of setting reasonably wide price range benchmarks (say, within the 80th percentile range of historically observed prices) beyond which the price of an international transaction would be considered a transfer price.
- 16 See document FCCC/CP/2009/11/Add.1, decision 2/CP.15.
- 17 This dynamic was particularly applicable to South-East Asia before the 1997 financial crisis (Montes, 1998) but it also applies to other countries that were seen as having “sound” macroeconomic policies, such as Mexico before its 1994 crisis and Argentina before its 1999 crisis. Recently, the International Monetary Fund (see Ostry and others, 2010) brought attention to this seeming paradox.
- 18 Currency devaluation tends to increase domestic inflationary pressures and may lead to a widening of budget deficits, especially in a context where Governments have large outstanding external debts.
- 19 The database on World Trade Organization notifications is available from http://www.wto.org/english/tratop_e/region_e/region_e.htm.