World Vision

TRADE FOR DEVELOPMENT

MAKING THE WTO WORK FOR THE POOR

A World Vision Discussion Paper

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November 1999

Cover design: Damien Watson

First Published November, 1999
(Reprinted with corrections October 2000)

Published by World Vision

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Preface

Anyone who has dealt with trade policy knows that it is an immensely complex field, covering a bewildering variety of interrelated issues. My intention here is merely to provide a brief overview of some of the principal trade-related issues facing developing countries in general and their poorest citizens in particular.

I have tried to give a reasonably detailed bibliography so that readers may pursue further matters that are of interest to them. The literature on these subjects is immense, so naturally this bibliography is partial.

The footnote references are to the cited pages only - full references are to be found in the Bibliography. All references to dollars ($) are to US dollars unless otherwise stated and one billion means 1000 million.

I would like to thank the following people for their invaluable assistance at various times during the preparation of this paper:

Within the World Vision partnership: Lynn Arnold, Jane Backhurst, Theresa Banda, Ken Casey, Jayakumar Christian, Kelly Currah, Ian Curtis, João Helder Diniz, Heather Elliott, Kerrie Engel, Beth Fellows, Brenda Fitzpatrick, Eliana Franco, Jane Gomes, Melanie Gow, Kevin Gray, Rosemary Hermans, Joe Muwonge, Eduardo Nunes, Dean Owen, Eric Ram, Brian Sellers-Petersen, Jaisankar Sarma, Greg Thompson, Kathy Vandergrift, Bill Walker, Susan Warren, Damien Watson, David Westwood, Alan Whaites.

At the World Bank: Martin Ravallion, Kangbin Zheng, J. Michael Finger, Giovanna Prennushi, Stephen Commins.

At the IMF: Gita Bhatt

At Monash University: Dietrich Fausten, Robert Rice, Christis Tombazos

At the Victoria University of Technology: Graham Dunkley

At the Centre for International Environmental Law, Geneva: Matthew Stilwell

At Agriculture Victoria, Dept. of Natural Resources and Environment: Susannah Tymms

And of course my wife Julie for her constant support and friendship.

I am particularly grateful to Alan Whaites, Melanie Gow, Kelly Currah, Eliana Franco, Kevin Gray, Matthew Stilwell, Susannah Tymms, Brenda Fitzpatrick and Dietrich Fausten for their detailed and helpful comments on an early draft. None should be held responsible for the remaining errors and the instances when I failed to take their advice.

I would also like to thank Environment Australia for its financial support for part of the research and writing on the trade and environment section, and for permission to use the results of that work in this document.

Finally, I would be grateful to readers who are able take the time to point out some of this paper's shortcomings and ways it could be improved in any future editions. Feel free to write to me at: brett_parris@wvi.org

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November, 1999

Executive Summary

Summary

The time is not right for the launch of a new round of trade negotiations. There remain substantial problems with both the provisions and the implementation of some of the Uruguay Round Agreements and most developing countries do not have the resources to undertake a new round of negotiations. Before any future round is launched, there should be a thorough evaluation of the impacts of the Uruguay Round on the world's poorest citizens, and a serious and sustained effort to build the capacities of developing countries to engage in WTO processes.

Trade and the WTO

The World Trade Organization (WTO) is one of the more powerful international institutions and its influences on the poor are pervasive and profound. It is one of the few multilateral bodies with 'teeth' in that it can lay down binding rulings supported by the threat of trade sanctions. As a result, the WTO has attracted the attention of thousands of NGOs – particularly those who feel the decisions by the panels of WTO's Dispute Settlement Body (DSB) have failed workers and the environment, or who believe that the WTO is simply a tool in the hands of powerful, exploitative and unaccountable corporations.

These controversies take place against the backdrop of declining real wages for low-skilled workers and growing inequality in many industrialised countries. Trade is often blamed – perhaps because it is easier to blame foreigners than domestic government and corporate policies. But this blame is largely misplaced. For the most part, trade offers very significant *net* static and dynamic gains over the long term to all countries:

Specialisation in comparatively more efficient sectors can lead to a more efficient allocation of resources in the economy and less waste;

Greater competition from overseas can lead to greater technical efficiency in domestic industries;

Greater competition reduces the scope for the exercise of monopoly power by domestic industries, resulting in cheaper goods and services for citizens;

Trade provides citizens with a greater variety of more differentiated goods;

Trade introduces new ideas, technology and expertise;

Trade permits the realisation of economies of scale – goods can be produced more cheaply with larger production runs, which are only possible in a small domestic market if some can be exported;

Access to international markets can provide a vent for surplus domestic production of goods;

Trade can lead to greater employment – not only in export sectors, but also in the 'downstream' handling of imports (freighting, marketing, retailing, servicing etc) and throughout the economy since businesses have more resources to employ workers when other goods cost them less because of trade;

Trade facilitates Foreign Direct Investment (FDI) because of the ease of access to production inputs that need to be imported;

Trade permits imports of intermediate goods, which may prevent bottlenecks in domestic production;

Even if countries cannot produce some final products efficiently themselves, trade enables them to gain through the production of intermediate inputs which may be exported for use in the production of final goods elsewhere.

This is not to suggest that each individual, or even necessarily each local community, will benefit from greater openness to trade. When resources are redirected from less efficient to more efficient sectors, there will necessarily be winners and losers, but under most circumstances there should be a net gain for the community or nation as a whole. However, policies which bring about *net* efficiency gains and *net* welfare gains can produce great hardship and suffering for the communities, families and

individuals who may be forced to adjust to harsher international competition. This means that a comprehensive policy of trade reform *must* be accompanied by compensation, retraining and other safety nets for those who lose from the reforms, as well as equitable policies which help redistribute some of the gains from trade to the whole community.

Trade can bring enormous benefits to developing countries and a rules-based international trading system has much to commend it. A rules-based system can offer greater transparency and coordination, as well as some recourse for small countries in the face of protectionist abuse by more powerful trading partners.

The Uruguay Round

The current system under the WTO is far from perfect of course. There are a number of outstanding problems with the Uruguay Round Agreements and most developing countries face significant resource constraints which affect their capacities to represent adequately their interests at the WTO and to undertake further negotiations. Some 28 developing country members do not even have a mission in Geneva and the proliferation of complex rules and committees is itself a drain on the resources of poorer countries.

Developing countries face a range of significant challenges, including poverty, illiteracy, serious debt burdens, fluctuating or declining terms of trade, and export volatility. Because of their special circumstances, developing countries require special and differential treatment in the provisions of WTO rules and their implementation. While some WTO agreements do provide for this, they generally do not go far enough, and financial and technical assistance so far from developed countries has been inadequate.

Both economic theory and empirical studies acknowledge that under some circumstances, liberalisation and even export growth can harm developing countries. Even under normal circumstances, developing countries face a range of substantial barriers to their exports, such as tariff peaks (high tariffs on certain sensitive goods), tariff escalation (greater tariffs on more processed goods) and quotas.

The Uruguay Round was the most comprehensive trade round yet undertaken. It lasted eight years from its launch at Punta del Este, Uruguay in 1986 until the signing of the Final Act establishing the WTO and embodying the results of the round at Marrakesh, Morocco on 15 April 1994.

The implementation of Uruguay Round Agreements by developed countries has been disappointing in some areas of critical importance to developing countries such as agriculture, textiles and clothing. There have also been widespread abuses of the anti-dumping provisions and other non-tariff measures, in ways which discriminate against developing country exports. These issues, left over from the previous round, should be resolved before any new round is launched.

WTO Reforms

A range of reforms to WTO procedures should be implemented, including stronger disclosure rules on who is lobbying whom, a presumption that all WTO documents should be publicly available unless there are compelling grounds for confidentiality, and the opening of Dispute Settlement Procedures to submissions from NGOs.

Agriculture

The inclusion of agricultural trade under GATT/WTO disciplines is a positive development and greater liberalisation in agricultural trade should be encouraged – especially the elimination of export subsidies from developed countries. However, food security is also a legitimate policy goal for countries and net food importing developing countries should be assisted to develop their own agricultural capacities and, in the medium-term, should be compensated for any increases in their food bills as a result of price rises induced by the implementation of the Agreement on Agriculture.

The structure of the agricultural commodity market is of considerable concern, with some evidence that falls in commodity prices have been captured by major trading companies, rather than being passed onto consumers and fostering greater demand for developing country exports. There should be a formal inquiry into the activities and market power of the major agribusiness and life sciences corporations to clarify this issue.

Trade in Services

Services are a key area for developing countries, most of which have a natural comparative advantage in labour-intensive services. However, developing countries have encountered numerous significant barriers imposed by developed countries to the expansion of their services exports, including undue restrictions on the movement of natural persons and the concentration of market power in a small number of developed country firms in key sectors. These issues should be addressed in the upcoming GATS negotiations.

Subsidies and Countervailing Measures

Trade-distorting developed country subsidies should be phased out, especially in fisheries, energy, water and agriculture. Any phase out of subsidies though, must also take place with careful attention to the impact on those less well off and with appropriate safety nets and compensation payments to mitigate social dislocation and hardship.

Subsidies necessary for development in developing countries - such as, for example, cheaper finance, support for the adoption of advanced technology, or for market and product diversification - should be considered non-actionable.

Trade-Related Intellectual Property Rights

Aspects of the Agreement on Trade-Related Aspects of Intellectual Property Rights are of considerable concern – especially the provisions pertaining to the patenting of life forms. Some biotechnologies offer many benefits to developing country agriculture. However, such technologies should be subjected to rigorous independent field trials, impact assessments and safety studies before they are introduced. The TRIPS Agreement must be altered to be brought in line with the Convention on Biodiversity, and must give developing countries greater flexibility. The introduction of the combination of new patented seed varieties and the widespread application of western-style intellectual property rights regimes to poor farming communities in developing countries, could have adverse effects on food security and could result in widespread indebtedness, poverty and malnutrition.

Rigid intellectual property rights regimes which might be appropriate for developed countries, may be very unhelpful in a developing country context. Innovative solutions are required to ensure that developing countries are given access to safe, beneficial biotechnologies, without the crippling financial burden that Western-style patent protection can impose. The TRIPS agreement must also provide for the compulsory licensing and parallel importing of essential drugs.

The TRIPS Agreement explicitly obliges developed countries to provide technical and financial assistance and incentives for their own enterprises to promote technology transfer to developing countries. Little seems to have been done to meet these requirements, which should be made obligatory and subject to periodic notification.

Trade and the Environment

Trade can have significant impacts on the environment and it is generally the poorest people who are least able, either to escape the consequences of environmental degradation, or to avoid contributing to it. Environmental costs need to be incorporated into prices, otherwise unfettered trade based on false price signals and incentives will lead to greater environmental degradation. The WTO needs to recognise explicitly the 'precautionary principle' as a legitimate reason for trade restrictions on

potentially harmful goods, particularly live organisms that are self-replicating once introduced to the environment.

Trade and Labour

The interactions between trade and labour issues are complex. The empirical evidence does not lend strong support to the contention that increased trade is the primary cause of increased inequality, nor that trade with developing countries has been the primary cause of the growing wage gap between skilled and unskilled workers in developed countries.

Developed countries should move towards a regime of zero tariffs and non-tariff barriers to exports from developing countries – especially those from the least developed countries. Wealthy nations which can afford to provide good safety nets, compensation and retraining for displaced workers should not artificially and selfishly protect domestic jobs at the expense, not only of impoverished workers elsewhere in the world, but at the hidden expense of their own citizens who must unknowingly and unnecessarily pay more for their goods and services. Such protection is fundamentally unjust.

Equally unjust however are the current trends towards greater wage inequality in OECD countries, where the real wages of low-skilled workers are static or declining during a time of record profits, booming stock markets, and exorbitant executive salaries and CEO packages. Corporate and government leaders cannot expect broad public support and confidence in the face of such perverse policies. A form of globalisation that marginalises people is not only unjust, it is unsustainable.

The idea of a 'social clause' in the WTO permitting trade restrictions on goods produced under poor labour conditions is very controversial. Even if an appropriate social clause could be drafted in theory, developing countries' experiences in the GATT and WTO suggest that such a measure would be extremely likely to be abused by developed countries for protectionist purposes. This would harm both developing countries and the workers it was meant to help. Rights-based core labour standards are essential for a well-functioning trading system, but a social clause permitting trade sanctions is not the best way to help repressed or child workers. Instead, a combination of measures including direct anti-poverty and education programmes, appropriate product labelling schemes and stronger corporate codes of conduct, is more likely to achieve the same goals without introducing the distortions and opportunities for protectionist abuse which trade measures can produce.

Production and Processing Methods

Production and processing methods (PPMs) also need to be properly considered in WTO rules. Production processes which are environmentally destructive, which are dangerous to the health and safety of workers, or which use child labour, repressed labour, or labour subjected to regular human rights violations, are not examples of comparative advantage. They are more appropriately thought of as hidden subsidies, paid for by workers, their families and the environment, which distort trade. To permit a transition to more sustainable economic systems, ways must be found to take the PPM issue seriously – but not at the expense of developing countries. Developed countries have made many promisees in the past to help provide developing countries with the financial and technical expertise to make their economies more sustainable. Such funds should be provided to help developing countries upgrade their PPMs. Appropriate, internationally agreed and supervised consumer labelling schemes are a more appropriate means of dealing with PPMs than trade restrictions on goods – especially unilateral restrictions.

'New Issues' – Investment, Competition Policy and Government Procurement

A range of 'new issues' has been proposed for inclusion in a new round, including investment, competition policy and government procurement. For a range of reasons these issues should not be included in a new round. In particular, while there is growing recognition of the need for some form of multilateral antitrust arrangements to counter the monopolistic tendencies of the largest

corporations, investment and competition policy should probably be dealt with in time by a joint UNCTAD-WTO facility rather than just the WTO.

Key Recommendations

If there is to be a new round, then a comprehensive 'single undertaking', in which nothing is sealed until all is sealed would be preferable to one based on 'early harvests'. This would give developing countries more leverage.

However, the time is not right for a new comprehensive trade round. A number of initiatives and reforms should be implemented by the WTO and the international community before the next round, including:

A thorough, scientific, independent review to be conducted on the results and implementation of the Uruguay Round - with special attention to how developing countries and their poorest citizens have been impacted;

A sustained programme of capacity building and institution building for developing countries to enable them to take part properly in the next round;

The immediate introduction of duty-free, quota-free market access by developed countries for all exports of goods and services from Least Developed Countries (LDCs);

The phasing out of trade-distorting subsidies in developed countries, especially those which encourage wasteful overproduction and overconsumption in fisheries, energy, water and agriculture. Any phase out of subsidies though, must also take place with careful attention to the impact on those less well off and with appropriate safety nets and compensation payments to mitigate social dislocation and hardship;

A significant real increase in OECD countries' aid budgets for education, technical assistance and capacity building for developing countries - but in the context of an overall increase in the aid budget, not at the expense of other programmes;

The upgrading of the WTO Sub-Committee on LDCs to a full Committee, to enable more effective representation of LDC concerns in the WTO;

More effective resourcing and implementation of the Integrated Framework for Trade-Related Technical Assistance to LDCs;

Substantial debt relief for the most heavily indebted poor countries to enable them to use more resources for poverty eradication, capacity building and human resource development;

Reforms to the WTO institution and process, addressing areas such as:

- a legal assistance facility for developing countries
- transparency and compulsory disclosure of who is lobbying whom, with strict limits on gifts, meals, trips and so on which trade officials (both national representatives and WTO staff) can receive from those with an interest in WTO proceedings;
- opening GATT council meetings to NGOs
- mandatory release of all WTO documents unless just cause can be demonstrated for confidentiality in particular cases
- greater formal cooperation between the WTO and key multilateral agencies such as UNCTAD, UNEP and the ILO.

1. Introduction

World Vision is a Christian international relief, development and advocacy organisation that works in 87 countries and has offices in 81. Its extensive operational presence in so many countries over the last fifty years has brought it in touch with millions of poor children and their families. In that time international economic forces such as trade and investment flows have had an enormous impact on their lives.

The World Trade Organization (WTO) is one of the more powerful international institutions and its influences on the poor are pervasive and profound. It is one of the few multilateral bodies with 'teeth' in that it can lay down binding rulings supported by the threat of trade sanctions.

As a result, the WTO has attracted the attention of thousands of NGOs – particularly those who feel the decisions by the panels of WTO's Dispute Settlement Body have failed workers and the environment, or who believe the WTO is simply a tool in the hands of powerful, exploitative and unaccountable corporations.

These controversies take place against the backdrop of declining real wages for low-skilled workers and growing inequality in many industrialised countries. Trade is often blamed – perhaps because it is easier to blame foreigners than domestic government and corporate policies. But this blame is largely misplaced. For the most part, trade offers very significant *net* static and dynamic gains over the long term to all countries.

Trade can and does bring enormous benefits to many poor countries and their people. Isolationist policies which worked poorly in the past will be virtually impossible in a more integrated world next century. But trade policy is complex and policies which can bring about *net* efficiency gains and *net* welfare gains, can produce great hardship and suffering for the communities, families and individuals who may be forced to adjust to harsher international competition.

The Uruguay Round was the most comprehensive WTO round yet undertaken. It lasted eight years from its launch at Punta del Este, Uruguay in 1986 until the signing of the Final Act establishing the WTO and embodying the results of the round at Marrakesh, Morocco on 15 April 1994.

There are a number of concerning aspects to the Uruguay Round Agreements (URAs) and their implementation, the process of negotiations in the WTO and also the issues and timing that have been suggested for a new round.

This paper begins with a survey of the interactions between trade and development in poorer countries, and some of the ways in which those countries participate in international trade negotiations through the WTO.

Some of the results of the Uruguay Round are then discussed, focusing particularly on agriculture and food security, but also including the implementation of the agreements by developed countries, services, subsidies and the TRIPS Agreement.

The vexed issues of trade and environment and trade and labour are then examined, concluding with a brief discussion of new issues such as investment, competition policy and government procurement. Finally, the paper concludes with some recommendations on the ways in which the system could be reformed.

2. International Trade and the Developing Countries

2.1 Gains from Trade and the Special Features of Developing Economies

One surprising aspect of the debates over the role of the WTO and globalisation is that there seems to be considerable ideological opposition to trade itself. For the most part however, international trade potentially offers very significant net static and dynamic gains over the long term to all countries:

Specialisation in comparatively more efficient sectors can lead to a more efficient allocation of resources in the economy and less waste;

Greater competition from overseas can lead to greater technical efficiency in domestic industries;

Greater competition reduces the scope for the exercise of monopoly power by domestic industries, resulting in cheaper goods and services for citizens;

Trade provides citizens with a greater variety of more differentiated goods;

Trade introduces new ideas, technology and expertise;

Trade permits the realisation of economies of scale – goods can be produced more cheaply with larger production runs, which are only possible in a small domestic market if some can be exported;

Access to international markets can provide a vent for surplus domestic production of goods;

Trade can lead to greater employment – not only in export sectors, but also in the 'downstream' handling of imports (freighting, marketing, retailing, servicing etc) and throughout the economy since businesses have more resources to employ workers when other goods cost them less because of trade;

Trade facilitates Foreign Direct Investment (FDI) because of the ease of access to inputs that need to be imported;

Trade permits imports of intermediate goods, which may prevent bottlenecks in domestic production;

Even if countries cannot produce some final products efficiently themselves, trade enables them to gain through the production of intermediate inputs which may be exported for use in the production of final goods elsewhere.

This is not to suggest however that each individual or even necessarily each local community will benefit from greater openness to trade. When resources are redirected from less efficient to more efficient sectors, there will necessarily be winners and losers, but under most circumstances there should be a net gain for the community or nation as a whole. But this means that a comprehensive policy of trade reform *must* be accompanied by compensation, retraining and other safety nets for the poor who lose from the reforms, as well as equitable policies which help redistribute some the gains from trade to the whole community.

Having introduced the topic in broad-brush terms however, when developing countries are considered things become more complex.

2.2 Terms of Trade Effects – Does Trade Impoverish Developing Countries?

Developing countries tend to produce and export more primary commodities - food, raw materials, fuels and base metals - than manufactures and services. This is by no means as true as it once was, but as a first approximation it holds reasonably well. Most developing countries therefore tend to be highly dependent on commodity exports and vulnerable to commodity price fluctuations and downturns in international demand. The recent Asian financial crisis for example, led to a 40% decline of copper sales from Zambia in 1998. The Zambian Government claimed that because it is so highly dependent on copper exports, this massive drop in sales led to an increase in inflation in Zambia from 18.6% in 1997 to 30.6% in 1998.[1]

[1] Zambia, (1999) "Statement of the Zambian Delegation During the Opening Session of the Symposium on Trade and Development", Paper presented by the Government of Zambia to the WTO High Level Symposium on Trade and Development, 17-18 March, 1999, Geneva, p. 4.

Have Developing Countries' Terms of Trade Declined?

It has long been argued by some that developing countries have been becoming increasingly disadvantaged in international trade because their commodity terms of trade (or net barter terms of trade) have been steadily declining.[2] This contention, called the Prebisch-Singer hypothesis after the economists who first advanced it, has been highly controversial since it was first proposed in the 1950s.[3] On balance, the evidence does seem to indicate that the prices developing countries have been receiving for their primary commodity exports have been declining somewhat over the last century relative to manufactured goods, which are exported mainly from developed countries. This means that the manufactured goods which developing countries import have become relatively more expensive for them over time. They have had to export more just to make up for these relative falls in prices – and more again to make any real gains.

A major 1980 review of the evidence concluded that while there did seem to be some deterioration in the relative price of primary products in the 70 years prior to World War 11, there could be no finality about the conclusion. The author concluded that the series chosen originally by Prebisch exaggerated the rate of deterioration "at worst by a factor of more than three" and that the period 1900-1970 was essentially trendless.[4]

This was countered in 1985 by new research which argued that once allowance was made for a substantial once-off upward movement in the intercept of the terms of trade's growth path following World War II, a significant downward trend re-emerged which was not significantly different from that which existed from 1900 to the outbreak of the war.[5] In 1990, the same author again analysed a number of studies of commodity price trends and concluded that when the possibility of at least one structural break in the trend was considered, the data yielded "some quite strong support" for the hypothesis of a declining trend in terms of trade of developing countries from 1900 to the early 1980s.[6]

In 1988, a comprehensive World Bank study found that the relative prices of non-fuel commodities declined by about 0.6% annually from 1900-1986 compared with the prices of manufactured goods. The resulting net decline of about 40% since 1900 translated approximately (based on 1953 to 1983 data) to a cumulative decline in non-oil-exporting developing countries' terms of trade of at least 11%. Furthermore, non-food agricultural raw materials sustained the heaviest reduction in purchasing power over this period, relative to the prices of manufactures, falling 50%.[7]

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[2] The **Commodity, or net barter, terms of trade (N)** = the ratio of the price index of the nation's exports (P_X), to the price index of its imports (P_M) multiplied by 100 to express it in terms of a percentage:

i.e. $$\mathbf{N = (P_X / P_M) \times 100}$$

While the terms of trade for developing countries cannot be equated simplistically with the ratios of primary commodity prices to the prices of manufactures, (since developing countries also produce some manufactures), trade in primary commodities forms such a large proportion of the exports for developing countries that commodity prices have significant effects on the terms of trade of developing countries.

[3] Prebisch, R., (1950) "The Economic Development of Latin America and Its Principal Problems", *Economic Bulletin for Latin America,* Vol. 7, United Nations, New York; and Singer, H.W., (1950) "The Distribution of Gains between Investing and Borrowing Countries", *The American Economic Review,* Vol. 15, May, pp. 473-485.

[4] Sparos, J., (1980) "The Statistical Debate on the Net Barter Terms of Trade between Primary Commodities and Manufactures", *The Economic Journal,* Vol. 90, March, pp. 124,126.

[5] Sapsford, D., (1985) "The Statistical Debate on the Net Barter Terms of Trade between Primary Commodities and Manufactures: A Comment and Some Additional Evidence", *The Economic Journal,* Vol. 95, No. 379, September, pp. 781-788.

[6] Sapsford, D., (1990) "Primary Commodity Prices and the Terms of Trade", *The Economic Record,* Vol. 66, No. 195, December, pp. 342-356.

[7] Grilli, E. and Yang, M.C., (1988) "Primary Commodity Prices, Manufactured Goods Prices, and the Terms of Trade of Developing Countries: What the Long Run Shows", *World Bank Economic Review,* Vol. 2, No. 1, January, pp. 18, 34-35.

Another comprehensive analysis in 1991 confirmed the original hypothesis that the net barter terms of trade for primary commodities do have a tendency to deteriorate, but with three important qualifications: the effect was relatively small in size; it was statistically significant at only the lowest confidence level; and in most cases it reversed itself given a sufficiently long time horizon.[8] The authors further emphasised that:

> Care should also be given in drawing policy conclusions from terms of trade changes. Deterioration of a country's terms of trade does not have obvious welfare implications. Terms of trade trends provide information only about changes in prices and/or values of tradables and give no indication of either real value of exports or the intracountry distribution of export earnings.[9]

Sapsford & Balasubramanyam reached stronger conclusions, noting that by the early 1990s a large number of studies had demonstrated a decline in the ratio of primary commodity prices to the prices of manufactures over time, ranging from a minimum of around 0.7% *per annum* to over 1.3% *per annum*. They conclude that this evidence amply supports the declining terms of trade hypothesis, and argue:

> It cannot ... be denied that the phenomenon is real and even if the estimates at the lower end of the scale were to prevail it bodes ill for the growth and development prospects of countries which rely heavily on primary product exports for their foreign exchange earnings.[10]

Some do deny it though. Cuddington examined the price trends for 26 individual commodities, rather than aggregated price indices, and found that the prices of 16 commodities were approximately trendless, five were negative and five were positive. On this basis he argues that the Prebisch-Singer hypothesis is not supported and should certainly not be considered a 'stylised fact'. [11]

However, in making this conclusion, Cuddington seems to consider only the prices of the individual commodities, not their ratios to an index of manufactures. Since the Prebisch-Singer hypothesis concerns the decline in the terms of trade given by the *ratio* of commodity prices to manufacture prices, Cuddington's conclusions do not appear to be warranted by his analysis. The terms of trade for commodities can still decline, *even if* commodity prices are rising, if the prices of manufactures are rising faster than commodity prices. It is the ratio that counts, not the absolute price level.

Nevertheless, Cuddington makes an important point when he emphasises that overarching statements based on the analysis of aggregate indices can yield quite misleading results. A disaggregated approach is essential to be able to say much that is useful about the prospects for a particular commodity or particular commodity exporting country.[12]

What then should be concluded about this idea which has spawned so many econometric studies and controversies? It is probably right that whatever has been the overall trend in the commodity terms of trade, its has not been of a terribly large magnitude, and that more important than the *overall* secular movement in commodity terms of trade are the *types* of products that a nation exports and the changes in the prices of those products over time.[13] Moreover, most studies have concluded that despite any secular declines in the *commodity* terms of trade over time, the *income* terms of trade for most developed countries have improved due to a significant expansion of the *volume* of their

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[8] Diakosavvas, D. and Scandizzo, P.L., (1991) "Trends in the Terms of Trade of Primary Commodities,1900-1982: The Controversy and Its Origins", *Economic Development and Cultural Change,* Vol. 39, No. 2, January, p. 250.

[9] Diakosavvas, D. and Scandizzo, P.L., (1991) p. 251.

[10] Sapsford, D. and Balasubramanyam, V.N., (1994) "The Long-Run Behaviour of the Relative Price of Primary Commodities: Statistical Evidence and Policy Implications", *World Development,* Vol. 22, No. 11, November, p. 1741.

[11] Cuddington, J.T., (1992) "Long-run trends in 26 primary commodity prices: A disaggregated look at the Prebisch-Singer hypothesis", *Journal of Development Economics,* Vol. 39, October, p. 221.

[12] Cuddington, J.T., (1992), p. 221.

[13] Salvatore, D., (1998) *International Economics,* 6th Edition; Prentice Hall International Inc., Upper Saddle River, NJ, pp. 339-340.

exports.[14] The World Bank study mentioned previously for example, reported that from 1953-1983, while the net barter terms of trade of developing countries declined by about 0.6% per annum, overall export *quantities* were rising by about 6% per annum.[15]

What this all means for developing countries is that there *is* some evidence that the prices they have been receiving for their primary commodity exports have been declining over the last century relative to manufactured goods exported mainly from developed countries. They have had to export more just to make up for these relative falls in prices – and more again to make any real gains. However, the case cannot be sustained that the export of primary products by developing countries necessarily reduces their welfare.

Liberalisation Strategies and Terms of Trade Effects

It is also worth noting at this point the fact that export-oriented liberalisation strategies can in fact themselves lead to *falls* in commodity prices. Much trade policy advice to developing countries rests on the so-called *small country assumption* – the assumption that the country is too small for changes in the volume of its exports and imports to affect world prices. This of course is an empirical question with two potential problems.

First, even when the assumption is valid at an individual country level, it may be invalid at the aggregate level, when the combined actions of all the small countries are considered. This is an illustration of the *fallacy of composition* – the assumption that what applies to the constituent parts also applies to the whole. But when a large enough number of countries all try to produce the same goods, a global oversupply can lead to a fall in prices. Sapsford and Singer highlight the importance of this dynamic in their analysis of the ways in which views on commodity prices have shifted within the World Bank and the IMF:

> Policy recommendations which may be made on the basis of partial equilibrium analysis, may be completely inappropriate when the global general equilibrium effects are considered. In other words, advice which may be quite appropriate when given to one country in isolation, may, if given to many countries result in an overall detrimental effect when the systemic consequences are considered.[16]

The second problem occurs when the small country assumption is not even valid for the individual countries themselves. One recent study of the effects of trade liberalisation on countries' terms of trade, concluded that contrary to widespread belief, there is a sizable number of countries, both Least Developed Countries (LDCs) and non-LDCs, for whom the 'small country assumption' is invalid. The authors caution that their results are tentative, but strongly suggest that terms of trade considerations should be included in the assessment of trade-liberalisation policies.[17]

A final point on the terms of trade debate is that while the major factor is the long-term deterioration in the net barter terms of trade of primary products compared with manufactures, there is also some evidence of a decline in value of developing country *manufactured* exports *vis-à-vis* those from developed countries over the period 1970-87.[18] The authors stress that the real core of the Prebisch-Singer thesis which links these two declining trends, is the evidence for the loss of *productivity gains* for developing countries, which applies to *both* primary products-manufactures trade and manufactures-manufactures trade.

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[14] The **Income terms of trade (I)** = the commodity terms of trade multiplied by the volume of exports, Q_X. **I** measures the nation's export-based capacity to import. i.e. $\mathbf{I = (P_X/P_M)Q_X}$

[15] Grilli & Yang (1988) p. 26.

[16] Sapsford, D. and Singer, H., (1998) "The IMF, the World Bank and Commodity Prices: A Case of Shifting Sands?", *World Development,* Vol. 26, No. 9, September, pp. 1655.

[17] Lutz, M. and Singer, H.W., (1994) "The Link Between Increased Trade Openness and the Terms of Trade: An Empirical Investigation", *World Development,* Vol. 22, No. 11, November, pp. 1697-1709.

[18] Sarkar, P. and Singer, H.W., (1991) "Manufactured Exports of Developing Countries and their Terms of trade Since 1965", *World Development,* Vol. 19, No. 4, April, pp. 333-340.

Immiserising Growth

It is now also acknowledged, both in trade theory and from empirical studies, that adverse terms of trade effects due to strong growth in exports from a single country can, under some circumstances, further impoverish that country.[19] This is termed *immiserising growth*. It can occur when a country is a sufficiently large producer of a particular good or commodity to affect world prices, and faces inelastic demand for its exports of this product. If substantial growth in the production and export of this commodity leads to oversupply, a drop in world prices and deterioration in the country's terms of trade may result that is large enough to cause an overall deterioration in the country's welfare. An identical effect can be caused by a large number of small countries all over-producing the same commodity.

Such immiserising growth may be induced by technological change in the agricultural sector[20], or even, under certain circumstances, by foreign investment.[21]

Specialisation in the export of primary commodities therefore may not only be yielding less and less foreign exchange over time, relative to manufactures (let alone when compared with sophisticated services such as banking and insurance!), it can also potentially drive prices down even further.

This is not necessarily an argument for an import substitution strategy but it is certainly an argument for export diversification into, for example, greater processing of raw commodities and value-adding before export. Obviously any trend decline in their terms of trade presents particular challenges in terms of food security for Net Food-Importing Developing Countries (NFIDCs), which must export more and more to earn the foreign exchange to buy food on international markets.

But terms of trade problems are not the only trade challenge facing developing countries. Often the products they export have very volatile prices.

2.3 Export Volatility

Developing country exports are often highly concentrated in a small number of commodities. One study estimated that around half the developing countries earn over 50% of their export receipts from just one primary commodity and around three quarters of developing countries earn over 60% of their export receipts from three or fewer primary commodities.[22]

Demand for many primary products is inelastic (i.e. the quantity demanded is relatively unresponsive to price changes) because households in developed nations generally spend only a small percentage of their budgets on basic commodities such as tea, coffee, cocoa, sugar and so on. But there is also instability in the demand for these exports because of business cycle fluctuations in developed countries.

The supply of primary products from developing countries is also generally price inelastic because of rigidities and inflexibilities in resource use in many those countries. The supplies can also be unstable because of changeable weather patterns, pests, political upheavals and so on.[23]

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[19] See for example; Bhagwati (1958, 1968, 1969); Johnson (1967), Bhagwati *et al.* (1998), pp. 369-380; Bagi (1990), Salvatore (1998), pp. 199-201.

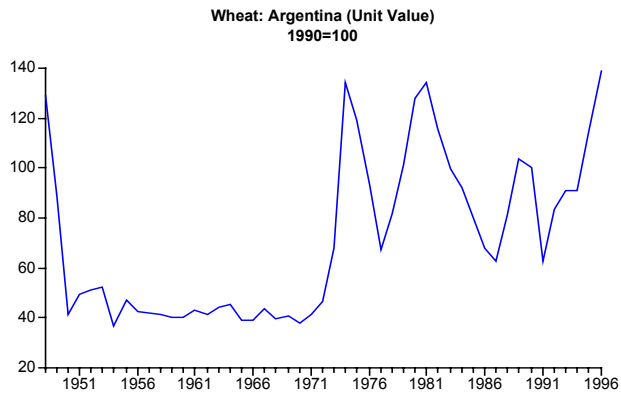
[20] Alston, J.M. and Nathan, W.J., (1995) "Reversal of Fortune: Immiserizing Technical Change in Agriculture", *American Journal of Agricultural Economics,* Vol. 77, No. 2, May, pp. 251-259.

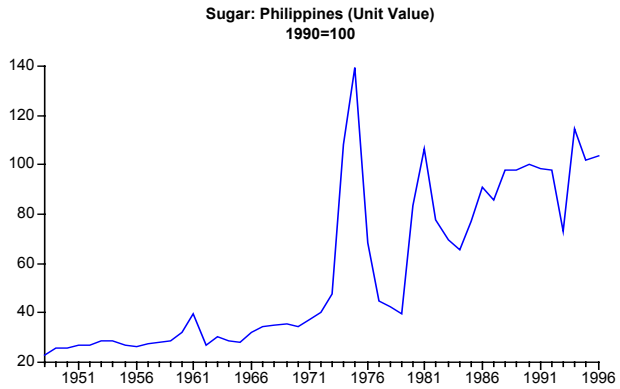
[21] Young, L. and Miyagiwa, K., (1986) "International Investment and Immiserizing Growth", *Journal of International Economics,* Vol. 20, February, pp. 171-178. Immiserisation can occur when the elasticity of supply of foreign capital, and the elasticity of substitution between labour and capital in the host country are both low.

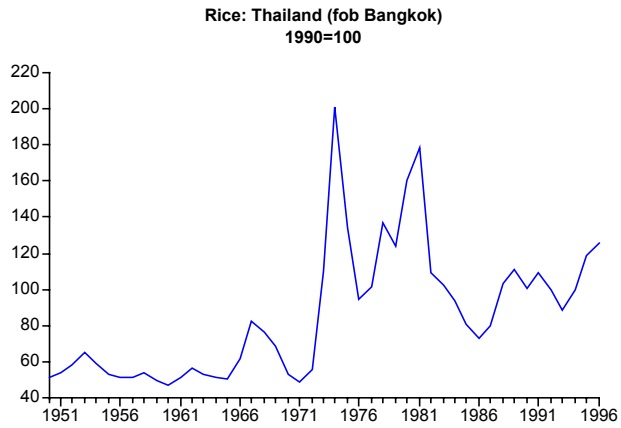
[22] Sapsford, D. (1990) p. 342.

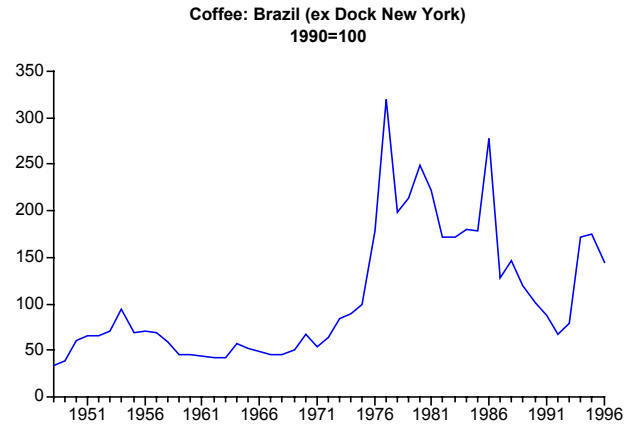
[23] Salvatore, (1998), p. 342.

The following figures illustrate the volatility in prices of some commodities which developing countries have had to contend with over the last 40 years, particularly since the early 1970s:[24]









This volatility of prices has ripple effects on the rest of the economy. When prices boom, export earnings are high, exporters invest in more production and increase demand for other goods and services in the local economy. When prices collapse, the reverse occurs and many producers and local businesses go bankrupt or find themselves in debt traps. This boom and bust cycle based on volatile commodity prices can be amplified by the normal business cycle and makes development planning difficult.[25]

Whether such export instability has significantly hampered the development process is still being debated. In 1991 Brock found that some pieces of the empirical evidence on export instability are more consistent with each other than had been previously realised, and that most of them support the conclusion that export instability lowers investment and the capital stock.[26]

In a 1992 study Basu and McLeod investigated the effects of export price fluctuations on output growth in 20 developing countries using an open economy growth model and some standard time series tests. They concluded that even transient terms of trade shocks can have permanent effects on

[24] Source: IMF International Financial Statistics, DX Database.
[25] Salvatore, (1998) p. 342.
[26] Brock, P.L., (1991) "Export instability and the economic performance of developing countries", *Journal of Economic Dynamics and Control*, Vol. 15, No. 1, January, p. 144.

output levels and growth rates, since output generally fails to return to its pre-shock trend path. They also note that unstable export prices generally reduce expected domestic investment.[27]

The same year, Fosu examined the evidence from 35 African LDCs and a sub-sample of 30 sub-Saharan African LDCs, comparing them with other LDCs for the period 1970-86 and concluded that while the export instability did appear to have a negative effect on the growth of the African LDCs, this effect was not statistically significant. For the other LDCs however, export instability *did* appear to have a significantly negative effect on growth.[28]

More recently, Ghirmay, Sharma and Groabowski reviewed the economic literature on export instability and used data over 30 years from 14 developing countries to analyse the relationships between export instability, income terms of trade instability, investment and economic growth.[29] They argue that export instability can influence the development process through two pathways. Firstly, it can directly affect output or capital formation. Secondly, it can indirectly affect capital formation and output via its influence on the income terms of trade. Their results indicate income terms of trade instability had a negative effect on output for most countries over the long run. The relationship between export instability and output however was mixed. They caution that these results are based on relatively limited data across different regions so no firm conclusions should be drawn to the effect that instability necessarily has negative effects throughout the developing world. Nevertheless, they emphasise that their results indicate that instability may well be more important in the development process than most economists currently believe.

Most studies over the last 30 years seem to have indicated that export instability has not been very large, and that it has not significantly hampered development.[30] Even if this is true however, these aggregate country-level results can disguise significant regional differences, as well as significant disruption and pain at the village level. In developing countries where many small producers are one planting season away from destitution and even starvation in some cases and where there is little in the way of social safety nets or insurance, such volatility in commodity prices can lead to severe hardship. In NFIDCs, large variations in world food prices can also create severe unexpected balance of payments difficulties, and potentially food import shortages, local price rises and hunger.

There have been substantial problems associated with trying to set up international commodity agreements to stabilise prices, such as the *International Tin Agreement*, the *International Cocoa Agreement*, and the *International Natural Rubber Agreement* - all of which collapsed. Problems include the potential for corruption, the possibility of encouraging substitution (eg. synthetic rubber, beet sugar), the high cost of storing buffer stocks which can grow larger and larger if the minimum price is set above the equilibrium world price, and incentives for members to cheat and undercut other members.[31]

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[27] Basu, P. and McLeod, D., (1992) "Terms of trade fluctuations and economic growth in developing economies", *Journal of Development Economics,* Vol. 37, pp. 89-110.

[28] Fosu, A.K., (1992) "Effect of Export Instability on Economic Growth in Africa", *The Journal of Developing Areas,* Vol. 26, No. 3, April, pp. 329.

[29] Ghirmay, T., Sharma, S.C. and Grabowski, R., (1999) "Export Instability, income terms of trade instability and growth: causal analyses", *The Journal of International Trade & Economic Development,* Vol. 8, No. 2, June, pp. 209-229. They emphasise that instability in the income terms of trade is actually a better measure of the effect of export instability on import instability and growth than simply export revenues, since income terms of trade takes into account import prices and measures the real purchasing power of exports.

[30] Salvatore (1998) p. 343.

[31] Thailand and Malaysia, the world's first and third largest producers of natural rubber respectively, recently agreed to a pact to try to keep rubber prices above $0.80 per kg. The two countries had earlier withdrawn from the International Rubber Organisation, frustrated by its inability to maintain prices after they hit a 30 year low early in 1999. Indonesia, the second largest producer, has yet to join the pact. Bardacke, T., (1999) "Thailand, Malaysia form rubber pact", *The Financial Times,* London, Tuesday 21 September, [http://www.ft.com/nbearchive/email-ftibcmq163142.htm, 21 September 1999].

Other suggestions for dealing with this problem have focussed on the use of financial instruments such as futures and derivatives. India, for example, has recently begun trading in soybean futures.[32]

However, there are a number of problems facing most developing countries wanting to follow this path:

these instruments do not cover the whole range of internationally traded commodities;

where futures markets do exist in developing countries, the transaction costs may be so high as to discourage their use;

poor communications facilities prevent producers being in constant touch with markets;

the move away from state trading firms has led to a proliferation of small firms with no experience in the use of financial markets;

developed country banks and trading houses may have limits on their exposure to perceived risk in some developing countries;

most financial market contracts have relatively short maturities which may not be suitable for products with long lags between investment and production.[33]

For these reasons the use of financial instruments to reduce market risks for developing country products is likely to grow fairly slowly and should not be used as a reason not to negotiate new international commodity stabilisation agreements, nor as a reason not to renegotiate old ones. In particular, there is still a place for a system of international buffer stocks covering all the main traded commodities to provide a substantial stabilising element.[34]

Far more could be also done by the international community in setting up compensatory financing schemes for developing countries to help stabilise their export earnings - such as that set up by the IMF in 1969 to compensate developing countries whose export earnings for a given year fell below the previous five-year moving average.[35] Such schemes, which have been very limited so far, could provide many benefits and avoid most of the problems associated with commodity agreements mentioned above.

The World Bank's recent initiative to try to introduce commodity insurance for small-scale farmers is an encouraging development. Working with an international task force, the Bank intends to create an international intermediary that would increase access to commodity price risk insurance in developing countries to offer price floor guarantees to producers and price ceiling guarantees to consumers. The task force estimates that a feasible subsidy for the insurance would cost between $80-350 million – a small fraction of what is currently spent on grants and concessional loans to help countries ride out price fluctuations.[36]

Another factor that makes planning difficult for developing countries is that, as will be discussed more fully in Section 5.3, under the WTO agreements developed countries may adjust significantly the levels of protection they assign to different commodities in different years under the overall ceiling on commodity protection. Producers in developing countries do not know in some cases, what levels of protection in key markets they will have to contend with from one year to the next.

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[32] Bose, K., (1999) "India to begin trading soybean futures", *The Financial Times,* London, Friday 24 September, [http://www.ft.com/nbearchive/email-ftibcmq16e7c2.htm, 24 September 1999].

[33] Maizels, A., (1994) "The Continuing Commodity Crisis of Developing Countries", *World Development,* Vol. 22, No. 11, November, p. 1693.

[34] Maizels, (1994), p. 1694.

[35] Salvatore, (1998) p. 344-345.

[36] Kangbin Zheng, World Bank, personal communication and Chote, R., (1999) "Commodity insurance 'could help the poor'", *The Financial Times,* London, Tuesday 14 September, [http://www.ft.com/hippocampus/q15905a.htm, 14 September 1999].

2.4 Trade liberalisation

While trade can be a problem for many developing countries, many others have undoubtedly benefited substantially – including from the export of primary products.

One recent study of the evidence for Ghana from 1960 to 1992, conducting a variety of different tests, concluded that primary export growth in Ghana helped cause the growth rate of GNP over the period. This evidence indicates that to some extent, Ghana was able to spread the dynamic gains from trade to other sectors of the economy and that Ghana gained from its comparative advantage in primary commodities.[37] In this respect, the positive role of primary commodity exports in Ghana is not unlike that in Indonesia and Thailand where positive causality between exports and growth has also been documented.[38]

In a recent World Bank study, Baysan concludes that Bangladesh has also benefited significantly from trade liberalisation reforms undertaken in the 1990s. One factor leading to the acceleration of food grain productivity, for example, was the decision in the late 1980s to liberalise trade in pumps and engines.[39]

Research on Brazil's moves towards more liberalised trade from 1989 to 1996, also seems to indicate that the impacts were generally positive for the country overall.[40] Brazil's reform was faster than that of Korea but not as fast as Chile's, and while it has had to cope with an appreciation of its currency the real, it has brought about some necessary changes in the structure of Brazil's manufacturing sector:

> Decades of a non-selective, inward-oriented incentive regime took industrial diversification in Brazil well beyond what would be economically sound. Too many sectors were promoted at the same time, despite the obvious constraints in terms of market size, technology and human and physical capital. Excessive and widespread protection has also produced in most sectors crowded and inefficient industrial structure, with most plants below the minimum efficient scale, not to mention the firms' lack of incentives to cut costs and improve quality, paving the way for X-inefficiency and monopolistic profits.[41]

Finally, of course, there is the evidence of the Asian Newly Industrialised Countries (NICs) – South Korea and Taiwan in particular. Sophisticated government intervention was employed in both cases, but export-oriented trade was an essential component of their development strategy.[42]

There is in fact some evidence that productivity tends to be higher in the export sector than the rest of a country's economy. One cross-country study of 31 semi-industrialised countries over the period 1964-1973 found strong evidence that productivity was higher in the export sector and that the success of countries like Korea, was due in part to the enormous shift of resources into this more productive sector, resulting in a more efficient overall allocation of resources.[43]

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[37] Boame, A.K., (1998) "Primary-Export-Led Growth: The Evidence of Ghana", *Journal of Economic Development,* Vol. 23, No. 1, June, pp. 175-194.
[38] Bahmani-Oskooee, M. and et al., (1991) "Exports, Growth and Causality in LDCs: A Re-examination", *Journal of Development Economics,* Vol. 36, pp. 405-415.
[39] Baysan, T., (1999) *Bangladesh - Trade Liberalization: Its Pace and Impacts*, The World Bank, Washington DC.
[40] Moreira, M.M. and Correa, P.G., (1998) "A First Look at the Impacts of Trade Liberalization on Brazilian Manufacturing Industry", *World Development,* Vol. 26, No. 10, October, pp. 1859-1874.
[41] Moreira and Correa (1998) p. 1871.
[42] Rodrik, D., (1995) "Getting interventions right: how South Korea and Taiwan grew rich", *Economic Policy,* Vol. 20, April, pp. 55-107. See also: Rodrik, D., (1995) "Trade Strategy, Investment and Exports: Another Look at East Asia", NBER Working Paper No. 5339, November, National Bureau of Economic Research, Inc., Cambridge, MA, 40 pp. and Rodrik (1996).
[43] Feder, G., (1982) "On Exports and Economic Growth", *Journal of Development Economics,* Vol. 12, pp. 59-73.

2.5 Does trade liberalisation *necessarily* lead to stronger growth?

To listen to many free trade advocates though, one would think that an ironclad case had been made for the virtues of the total deregulation of trade in any and all circumstances.

In one substantial 1997 study of trade liberalisation and growth in developing countries which have undertaken liberalisation programmes since 1985, the authors, came to the surprising conclusion that while trade liberalisation has led to better growth in some cases, it has led to stagnation in others and that the majority of liberalisers in fact experienced an investment *slump*.[44] Problems with the programmes could have included such things as the programme design being overly ambitious, problematic implementation, low export supply elasticities, or a lack of programme credibility with investors who feared policy retreats.[45] There may also not have been enough time since the liberalisation programmes were undertaken for growth to have recovered. However, even with all these qualifications, the authors conclude that:

> the fact is that liberalization does come through consistently with a negative sign and it is for the most part significant. ... Our results suggest that on average liberalization seems to have been associated with a deterioration in growth for this particular sample.[46]

These results suggest that liberalisation, even of trade (let alone the capital account as the IMF was pushing before the Asian crisis) may not always produce favourable results for developing countries – especially in the short to medium term. Any moves towards greater trade liberalisation should, therefore, be undertaken with great care and with adequate safety nets for those likely to be adversely affected.

Salvatore and Hatcher studied the effects of inward-oriented versus outward-oriented trade strategies using the World Bank's classifications of 'openness' introduced in its 1987 *World Development Report*. They concluded that the econometric results only *partially* supported the hypothesis that international trade benefits most developing countries and that an outward orientation leads to a more efficient use of resources. They are also critical of the methodology used in a number of previous cross-sectional studies. Their final conclusion is worth quoting since it serves as a warning against simplistic analysis of these issues:

> Finally, and perhaps most serious is the fact that all empirical studies to date have only succeeded in estimating the trade-development relationship within a static or at least a short-run framework, while it is widely acknowledged that the trade-development nexus is clearly dynamic and long-run in nature. But ... there is no model that captures such dynamic long-run aspects of development. Since most of the critics of development through trade base their argument on such long-run dynamic framework, their criticisms remain largely unanswered to date. As usual in economics, we tend to study those problems that readily lend themselves to analytical and empirical analysis and push the other more complex and important problems to the background. After paying lip service to these problems, we proceed to examine those relationships that are easier to analyze and practically forget the more difficult ones, almost as if they did not exist. And in this case, this can potentially provide a very distorted picture of the world in general and of trade and development in particular.[47]

More recently a landmark study by Rodríguez and Rodrik published by the National Bureau of Economic Research in April 1999, calls into question several previous cross-country studies which

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[44] Greenaway, D., Morgan, W. and Wright, P., (1997) "Trade Liberalization and Growth in Developing Countries: Some New Evidence", *World Development,* Vol. 25, No. 11, November, pp. 1887, 1891.

[45] When a product is said to have a low supply or demand *elasticity*, (i.e. it is *inelastic*), this means that the quantity supplied or demanded is relatively unresponsive to price changes. So an export product with a low supply elasticity indicates that exporters are unable to adjust the quantities they supply in response to fluctuating prices.

[46] Greenaway *et. al.*, (1997), p. 1891.

[47] Salvatore, D. and Hatcher, T., (1991) "Inward Oriented and Outward Oriented Trade Strategies", *Journal of Development Studies,* Vol. 27, No. 3, April, pp. 22-23.

purported to demonstrate a strong link between open trade regimes and economic growth.[48] They argue that while there may exist a large body of empirical literature purporting to demonstrate this link, in fact, methodological problems endemic in the economic literature leave the question wide open. Often, the indicators of openness used by the researchers are either poor measures of trade barriers, or they are themselves highly correlated with other sources of bad economic performance. In a number of other cases the methods used to try to establish a link between trade policy and growth are flawed. They conclude, after a detailed analysis of several key papers, that there remains little evidence that open trade policies - in the sense of lower tariff and non-tariff barriers to trade – are significantly associated with economic growth.[49] However, they also close with a warning:

> We do not want to leave the reader with the impression that we think trade protection is good for economic growth. We know of no credible evidence – at least for the post-1945 period – that suggests that trade restrictions are systematically associated with higher growth rates. On the other hand we believe there has been a tendency in academic and policy discussions to greatly overstate the systematic evidence in favor of openness. We view this paper as a corrective to this tendency. What we would like the reader to take away from this paper is some caution and humility in interpreting the existing cross-national evidence on the relationship between trade policy and economic growth.[50]

The Economist's response to this research was essentially that it illustrates the danger of relying unduly on cross-sectional studies and that the real evidence for the benefits of trade liberalisation can be amply demonstrated by individual country case studies.[51] There is certainly some truth to this, but the case for blanket trade liberalisation as some kind of sure path to strong growth should not be simply considered an established or 'stylised' fact.

Even growth itself, does not always reflect improving welfare. For example, in his study of poor farmers in Madagascar, Barrett argues that liberalisation reforms appear to have led to both real agricultural output growth *and* greater food security stress.[52] External price shocks led to reduced smallholder farmer welfare, which then stimulated agricultural output growth. It is usually thought that price rises are good for farmers. But Barrett shows that this analysis is too simplistic in many developing country situations where households are both producers and consumers. Thus an external shock which leads to a net rise in the mean and variance or variability of prices can end up leading to a net loss of welfare – especially for net buyers and those who are price risk averse. He concludes:

> The subpopulation of price risk-averse net buyer farmers thus stands to lose unambiguously from market-oriented reforms that increase both the mean and the variance of an agricultural price distribution. This is most likely to be true among small producers of staple foods.[53]

In some cases therefore, growth may be associated with a loss of welfare for poor farmers and reduced food security.

The Dominican Republic has also experienced immiserising employment growth by specialising in unskilled labour in its Export Processing Zones (EPZs).[54] The pursuit of static comparative advantage

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[48] Rodríguez, F. and Rodrik, D., (1999) "Trade Policy and Economic Growth: A Skeptics Guide to the Cross-National Evidence", NBER Working Paper No. 7081, April, National Bureau of Economic Research, Inc., Cambridge, MA, 79 pp. The key studies critiqued are those by Dollar (1992), Ben-David (1993), Sachs and Warner (1995) and Edwards (1998).

[49] Another recent study reaches the same conclusion after examining Sachs & Warner (1995): Harrison, A. and Hanson, G., (1999) "Who gains from trade reform? Some remaining puzzles", *Journal of Development Economics,* Vol. 59, No. 1, June, pp. 125-154.

[50] Rodríguez and Rodrik (1999), p. 39.

[51] The Economist, (1999) "The never-ending question", *The Economist,* Vol. 352, No. 8126, July 3, pp. 70.

[52] Barrett, C.B., (1998) "Immiserized Growth in Liberalized Agriculture", *World Development,* Vol. 26, No. 5, May, pp. 743-753.

[53] Barrett (1988), p. 744.

[54] Kaplinsky, R., (1993) "Export Processing Zones in the Dominican Republic: Transforming Manufactures into Commodities", *World Development,* Vol. 21, No. 11, November, pp. 1851-1865.

through the exploitation of unskilled labour was pursued simultaneously by a number of similar adjacent economies in Central America. This led to a process of competitive currency devaluations, which were induced in part by conditionalities on aid disbursements. So while employment in the EPZs grew by nearly 100,000 in the 1980s, real wages payed by the foreign investors more than halved. This is another example of the fallacy of composition mentioned previously: "the introduction of a particular policy instrument may be logical for a single implementing country, but it is eroded by simultaneous adoption in competitor countries".[55]

Results such as these mean that simplistic assumptions about the benefits of trade liberalisation and growth for the poor in particular developing countries at particular times should be treated with caution.

2.6 Comparative Advantage, New Trade Theory and Trade Policy

The bedrock of modern trade theory is David Ricardo's powerful insight into the nature of comparative advantage - the idea that even if one country has an absolute advantage over another country in the production of all goods (i.e. it can produce them more efficiently), both countries can still gain through trade if each country specialises in what it produces *most* efficiently, and trades these products for that which the other country can produce most efficiently.

The problem when the idea of comparative advantage is used in the trade policy arena, is that it is so often implicitly assumed to be a static concept – either a county has a comparative advantage in something or it does not. But comparative advantage can also be acquired – it is dynamic.

This is well known to international economists. Redding for example, recently explored this notion with respect to developing countries.[56] He highlighted again importance of the fact that comparative advantage should not be thought of as a static, given state (exogenously determined), but as a dynamic, changing (endogenously determined) process, determined by past technological change which also shapes current rates of innovation.

Forty years ago for example, no one would have said South Korea had a comparative advantage in steel production – it did not have the raw materials and had only a small domestic market. In fact, the World Bank turned down a request for a loan from South Korea in the early 1970s to set up a steel industry on the grounds that it did not have a comparative advantage in steel making.[57] Nevertheless, the government decided to found the Pohang Iron and Steel Company Ltd (POSCO) in 1973 with an initial investment of $3.6 billion and continued to assist the company by subsidising the cost of capital and providing infrastructure. By 1988 POSCO was the 11th largest steel company in the world with 80 plants.[58] By 1999, it was the world's largest and most efficient steel producer, and was being targeted by US anti-dumping measures because of the US industry's inability to compete.[59]

Developing countries may actually face something of a trade-off between specialising according to their existing comparative advantage, which will most often be in low-technology goods such as primary commodities, and entering sectors in which they could acquire a comparative advantage over time because of the potential for significant productivity growth.[60] Free trade may not be the

[55] Kaplinsky, R., (1993), p. 1860, 1852.
[56] Redding, S., (1999) "Dynamic comparative advantage and the welfare effects of trade", *Oxford Economic Papers,* Vol. 51, No. 1, January, pp. 15-39. See also: Wong and Yip (1999) and Long and Wong (1997).
[57] Rodrik, D., (1995) "Getting interventions right: how South Korea and Taiwan grew rich", *Economic Policy,* Vol. 20, April, p. 91.
[58] Redding (1999) p. 15.
[59] Marsh, P., (1999) "Steel Imports: US restrictions under attack", *The Financial Times,* London, Thursday 7 October, [http://www.ft.com/hippocampus/q1daa6e.htm, 9 October 1999].
[60] Redding (1999) p. 15.

developmentally best policy for developing countries if it retards their accumulation of skills by causing them to specialise in goods of low skill intensity.[61]

Specialisation according to *current* comparative advantage under free trade may, in fact, be welfare *reducing* over the long term, whereas selective intervention may be welfare improving, not only for the country following this strategy, but also for its trade partner, who is ultimately able to buy goods and services more cheaply.[62]

An important consideration here is the fact that the private sector often tends to underinvest in projects in which the payoff is a long way into the future. When the private discount rate is greater than the social discount rate, private investors may be discouraged from investing in a project which will not reap any benefits for them for a number of years, even though such investments would be of considerable benefit to society. In such cases the government can help by providing appropriate incentives.

What does this mean in practice? Much has been written against the pursuit of infant-industry protection strategies by developing countries.[63] Often inappropriate protection has fostered wasteful and inefficient industries that show no signs of ever wanting to leave their comfortable 'infancy'. In many cases, they have become a drain on the national economy leading to overvalued exchange rates, slower growth and skewed income distribution in favour of industrialists who often favour imported goods, leading to further balance of payments problems.

Ng and Yeats for example, conclude that it was mainly inappropriate domestic policies that led to Africa's marginalisation in world trade, rather than OECD protection against African exports.[64] Such policies in particular included high import barriers designed to foster infant industries, an inability to diversify its export base, political and policy uncertainty and a lack of serious governmental commitment to needed reform. Africa was not helped during this time however by declining world demand for its major exports relative to other goods.

Some have argued that the 'new' trade theories which incorporate imperfect competition such as oligopolistic markets, economies of scale in production, and 'learning by doing' effects, provide new justification for import-substitution strategies and the protection of developing country industries. It has long been acknowledged that a large country can favourably improve its terms of trade by means of an 'optimal' scientifically-determined tariff – assuming other countries do not retaliate to this beggar-thy-neighbour stance. The new trade theory also revealed that even a small country could gain from a foreign monopolist operating in its territory by applying a 'rent extracting' tariff.[65]

As the MIT economist Paul Krugman has argued repeatedly however, the information requirements for these kinds of sophisticated interventions are very substantial and policy recommendations are highly sensitive to the analysis. There is therefore the need for an extremely highly skilled and inscrutably honest bureaucracy.[66] Devising an optimal policy for a country facing oligopolistic foreign firms for example, depends on how the firms are interacting and the parameters of the system – the optimal policy may be either an export tax or an export subsidy. Working out the details of the system could be exceedingly difficult and it would be very easy for policy makers to get it wrong and introduce a policy that made things worse.[67]

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[61] Wood, A. and Ridao-Cano, C., (1999) "Skill, trade, and international inequality", *Oxford Economic Papers,* Vol. 51, No. 1, January, p. 116.
[62] Redding (1999) p. 15.
[63] See for example, useful discussions by Baldwin, (1969), Krueger, (1974), Krueger & Tuncer, (1982), Grossman & Horn (1988), Mayer (1984) and Waterbury (1999).
[64] Ng, F. and Yeats, A., (1997) "Open Economies Work Better! Did Africa's Protectionist Policies Cause its Marginalization in World Trade?", *World Development,* Vol. 25, No. 6, June, p 901.
[65] See for example: Katrak (1977), Vousden (1990), pp. 122-125.
[66] See for example, Krugman (1987), (1989), (1993). See also: Srinivasan, (1989).
[67] Vousden, (1990), pp. 136-139; Eaton and Grossman (1986), Benchekroun, Long and Tian (1999).

On balance, most international economists argue that while the new trade theory no longer permits the claim that free trade is always the absolutely optimal path available, for most countries, given the real world and the political economy dimensions of policy making it remains the best rule of thumb available to policy makers.

However, it is not always appropriate for particular developing countries at particular times in their histories. Developing countries should liberalise trade only if detailed studies and rigorous impact assessments suggest it is a good idea – and such studies may well indicate that it is. But 'free trade' should certainly not be pushed on developing countries as some kind of panacea by donors and multilateral agencies.

Where there does exist the potential for significant productivity growth and the potential to acquire a comparative advantage in a certain sector, there remains a strong argument for governments to assist certain local industries in the least trade-distorting ways possible. This does not necessarily have to be through tariffs or other trade barriers, which also harm consumers through higher prices, but could be through tax breaks and/or subsidies on capital, equipment, research and development, the provision of essential infrastructure such as roads, ports, electricity and so on.[68]

There is also considerable evidence that improvements in South-South trade could be of great benefit to developing countries. Stewart cites the example of the car industry and how few developing countries have a large enough market to support one world-class efficient producer, let alone several.[69] In Mexico in 1977 for example, 37 different automobile models were being produced, with costs over 50% higher than country-of origin costs. In Brazil conversely, fewer varieties had been permitted and Volkswagen had captured almost 90% of the domestic market, producing on a scale that made costs competitive and fostered exports.

Do developing countries then face a trade off between efficiency and variety? Stewart argues that opening up to free trade in the initial stages would normally lead to the elimination of local production. However, if developing countries were able to specialise in different models, produce them on a large scale, and then preferentially trade between themselves, this could effectively combine infant industry protection against powerful developed country competitors, exploitation of economies of scale and economies of specialization and variety.

[68] For further useful discussion see: Porter, M.E., (1990) *The Competitive Advantage of Nations,* Macmillan, London, 855 pp; Porter, M.E., (1990) "The Competitive Advantage of Nations", *Harvard Business Review,* Vol. 68, No. 2, March-April, pp. 73-93.

[69] Stewart, F., (1984) "Recent Theories of International Trade: Some Implications for the South", In *Monopolistic Competition and International Trade,* Ed. Kierzkowski, H.; Oxford University Press, Oxford, pp. 95.

3. The Developing Countries and the WTO

The extent of poverty and deprivation in the developing and LDCs is quite well known so there is no need to go into detail here. This section will concentrate on just a few of the challenges developing countries face: their capacities to negotiate the trade agreements, their need for special and differential treatment under the agreements, and ways in which WTO procedures should be reformed.

3.1 Capacity to undertake trade negotiations

A rules-based multilateral trading system has much to commend it. A rules-based system can offer greater transparency, coordination and some recourse for small countries in the face of protectionist abuse by more powerful trading partners. The current system is by no means perfect of course - the very proliferation of complex rules and committees is itself a drain on the resources of poorer countries.

The capacities of various governments to engage in WTO negotiations vary enormously - ranging from the vast numbers and resources of the US and EU delegations to small African and island states with no representation in Geneva.

Many developing countries were not able to take part effectively in the Uruguay Round negotiations and, as a result, the agreements largely reflect the key concerns of the wealthier OECD countries. Many developing countries are still struggling to implement the URAs and even, in some cases, to understand their implications.

The Government of Egypt has pointed out that in 1997 a total of 2849 formal and informal WTO meetings took place - an average of approximately *ten* per working day.[70] Even with a delegation of five members, each delegate would have to attend an average of two meetings every working day of the year. The proliferation of meetings is contributing to the further marginalisation of many developing countries, especially those of Africa.

Constantine Michalopoulos, Special Economic Advisor at the WTO, studied of the participation of developing countries in the WTO. He reported on the range of capacities of developing countries – from those with substantial missions in Geneva (15 staff or more) such as Thailand and the Republic of Korea, to countries with no representatives at all for WTO matters, or who list their national capital as the location of their representative.

At present, developing countries account for some 74% of the WTO's membership.[71] He noted that 65 developing countries maintain WTO missions in Geneva, but 26 others are represented by missions or embassies elsewhere in Europe and seven others list their representatives as being located in ministries in their national capital. Of the 29 LDCs which are members of the WTO, only 12 had representation in Geneva and virtually *all* the small island economies were represented from missions in Europe or their national capitals.[72] Some 30 developing countries were also barred from chairmanships on WTO committees because they were in arrears to the organisation.[73]

Michalopoulos estimated that just to follow the topics of the various WTO bodies and to attend their meetings requires a staff of 4-5 people and that, as of mid-1997, the overwhelming majority of developing countries did not meet this minimum. In fact, 56 developing countries (60% of the total developing country members) were in some way handicapped from being properly represented,

[70] Egypt, (1999) "The High Level Symposium on Trade & Development: Communication from Egypt", Paper presented by the Government of Egypt to the WTO High Level Symposium on Trade and Development, 17-18 March, Geneva, p. 11.
[71] Michalopoulos, C., (1999) "The Developing Countries in the WTO", *The World Economy,* Vol. 22, No. 1, January, p. 121.
[72] Michalopoulos, (1999) p. 125.
[73] Michalopoulos, (1999) p. 121.

either by having no mission in Geneva (33 countries), a mission with a less than three staff available to deal with WTO matters (the barest minimum!) (17 countries), or by having arrears problems with the WTO Secretariat which made them formally 'inactive' members (6 countries). A further 15-20 developing countries had nominally adequate missions, but the staff also had to deal with non-WTO matters. That left just 20-25 developing countries able to participate fully in WTO proceedings![74]

By November 1999, some 28 developing countries and 9 observers negotiating accession to the WTO had no permanent presence in Geneva. The WTO, together with twelve other international organisations, decided to hold a 'Geneva Week' from 1-5 November for these non-resident delegations. The week was funded by the governments of the UK, Norway and Switzerland and was intended "to help non-resident WTO Members and Observers inform themselves about the work going on in the WTO in the count-down to Seattle, and also to expose them to the work of other relevant agencies in Geneva."[75]

Due to the growing range and complexity of issues that the WTO is taking on, the capacity of developing countries to participate effectively in the work of the WTO depends very substantially on the analytical capacity and strength of the governmental and other institutions which are handling WTO issues in the capital.[76]

Even implementing the URAs, (let alone undertaking any new negotiations as part of a comprehensive round), is placing heavy burdens on many developing countries – especially for those 50 or so developing countries with weak representation at the WTO. Of the more than 30 needs assessments that were completed by LDCs in 1997-98, virtually all requested assistance in strengthening national trade-related institutions. The greatest area of weakness however is probably in relation to the Dispute Settlement Body (DSB). As Michalopoulos comments:

> The legal issues underlying the WTO agreements are very complex requiring specialist legal expertise in international law which in most developing countries is absent in either the private sector or the government. ... Hiring international law firms that do possess the necessary expertise is an extremely expensive proposition with costs ranging from $250-$1,000 an hour, raising the total costs of prosecuting a case to levels that cannot be supported by developing country government budgets. [77]

Furthermore, while the Secretariat at the time of his study provided two legal experts as consultants, their services were available for only four person days per month – or 400 hours per year – not usually enough time to prosecute *one* case. But even enhancing this capacity would present the problem of supposedly impartial secretariat staff taking sides in legal disputes.[78]

Two of Michalopoulos' most important proposals should be implemented immediately[79]:

1. Considerably increased funds for capacity building and technical assistance to developing countries.
2. The establishment of an independent 'Advisory Centre on WTO Law', legally separate from the WTO, which would provide case-level assistance to developing countries and which would be funded partly by donors and partly by developing country users.

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[74] Michalopoulos, (1999) p. 126-127.

[75] WTO, (1999) "WTO organizes "Geneva Week" for non-resident delegations", Press Release 141, 26 October, Geneva, 4 pp. The 37 countries invited were: Andorra*, Antigua & Barbuda, Armenia*, Belize, Benin, Botswana, Burkina Faso, Cambodia*, Central African Republic, Chad, Dominica, Republic of the Fiji Islands, Gambia, Grenada, Guinea Bissau, Guyana, Laos* P.D.R. of, Macau, Malawi, Maldives, Mali, Namibia, Niger, Papua New Guinea, St. Kitts & Nevis, St. Lucia, St. Vincent & The Grenadines, Samoa*, Seychelles*, Sierra Leone, Solomon Islands, Suriname, Swaziland, Togo, Tonga*, Uzbekistan*, Vanuatu*. [* indicates WTO Observers negotiating WTO membership].

[76] Michalopoulos, (1999) p. 135.

[77] Michalopoulos, (1999) p. 136.

[78] Michalopoulos, (1999) p. 138.

[79] Michalopoulos, (1999) p. 140-142.

The recent formal proposal for such a centre by a group of countries is an encouraging development and it is to be hoped that enough funds will be found for it to be implemented.[80] But in addition to the Advisory Centre, which will focus mainly on disputes, a facility is required to help developing countries to plan for future negotiations, and to link them with other international organisations such as UNCTAD, UNDP and others who can undertake the necessary empirical and theoretical research. Currently there are many *ad hoc* efforts, which could be usefully coordinated by a more central body. The South Centre, based in Geneva, is performing this function admirably, but is understaffed and underfunded, and thus unable to do the full range of work required.[81]

The launch of the "Integrated Framework for Trade-Related Technical Assistance to Least Developed Countries" by the IMF, ITC (International Trade Centre), UNCTAD, UNDP, World Bank and WTO is a positive development, but it should be more effectively resourced and implemented.

The capacity constraints facing developing countries for implementing the URAs and for negotiating a new round are one of the main reasons World Vision is opposed to the rush into a new comprehensive round.

Against this background, the continuous decline in aid from most OECD countries is thrown into stark relief. When the OECD's Development Assistance Committee (DAC) adopted its development targets at its 34th High Level Meeting in May 1996, the average level of aid given by OECD countries was 0.3% of their combined GNP.[82]

In 1998, when the DAC's targets already seem unreachable, the level of aid was a paltry 0.23%. This figure is actually slightly higher than that for 1997, when it reached an all-time low of 0.22%. In fact from 1992 to 1997 total DAC members' aid fell by 21% in real terms. Only *four* OECD countries consistently give above the UN target of 0.7% of GNP: Denmark, Norway, the Netherlands and Sweden.[83]

The decline in aid giving by OECD governments is nothing less than a tragedy at such a critical time. It is not as if a decisive case has been made against the effectiveness of aid – quite the contrary in fact. The World Bank, in its landmark 1998 study, *Assessing Aid?,* demonstrated that well-targeted aid can significantly reduce poverty.[84]

Any further demands on developing countries to participate in a new trade round should be accompanied by significant real increases in aid flows, capacity building programmes and technical assistance from OECD countries as well as deep cuts to the debt of the most heavily indebted poor countries. It is hypocritical for developed country governments to call continuously for developing country participation in new comprehensive trade negotiations while emasculating their ability to do so by endless aid cuts and crushing debt repayment regimes.

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[80] Bangladesh *et. al.,* (1999) "An Advisory Centre on WTO Law", Proposal developed by a working group consisting of Bangladesh, Columbia, Hong-Kong China, the Netherlands, Norway, the Philippines, South Africa, Tanzania, Tunisia, the United Kingdom and Venezuela, 7 June, WTO, Geneva, 47 pp. [http://www.itd.org/links/acwlintro.htm, 23 June 1999].

[81] Matthew Stilwell (1999), Centre for International Environmental Law, Geneva, personal communication.

[82] DAC, (1996) "Shaping the 21st Century: the Contribution of Development Co-operation", May, Development Assistance Committee of the OECD, Paris, 20 pp.

[83] OECD, (1999) "Financial Flows to Developing Countries in 1998: Rise in Aid; Sharp Fall in Private Flows", Press Release, 10 June, OECD, Paris, 6 pp. [http://www.oecd.org/news_and_events/release/nw99-60a.htm, 29 September 1999].

[84] World Bank, (1998) *Assessing Aid: What Works, What Doesn't and Why - A World Bank Policy Research Report*, Oxford University Press, Oxford & New York, 148 pp. See also: Burnside, C. and Dollar, D., (1997) "Aid Spurs Growth - in a Sound Policy Environment", *Finance & Development,* Vol. 34, No. 4, December, pp. 4-7.

Box 1: The OECD's Development Assistance Committee Targets[85]

Goals to Help Define the Vision

We believe that a few specific goals will help to clarify the vision of a higher quality of life for all people, and will provide guideposts against which progress toward that vision can be measured. Many goals have been formulated through the series of recent United Nations conferences addressing subjects important to development - education (Jomtien, 1990), children (New York, 1990), the environment (Rio de Janeiro, 1992), human rights (Vienna, 1993), population (Cairo, 1994), social development (Copenhagen, 1995), and women (Beijing, 1995).[86] These conferences have identified a number of targets to measure the progress of development in particular fields. They reflect broad agreement in the international community, arrived at with the active participation of the developing countries.

The selection of an integrated set of goals, based on these agreed targets, could provide valuable indicators of progress. We are suggesting several such indicators in the fields of economic well-being, social development and environmental sustainability.

1. Economic well-being: The proportion of people living in extreme poverty in developing countries should be reduced by at least one-half by 2015. The 1995 Copenhagen Declaration and Programme of Action set forth the goal of eradicating poverty in the world, through decisive national actions and international co-operation "as an ethical, social, political and economic imperative of humankind". The World Bank has used the standard of $370 per capita in annual income, or about $1 per day, as the threshold of extreme poverty. Based on that standard, it has estimated that 30 per cent of the population in developing countries - or some 1.3 billion people - live in extreme poverty, and that their numbers are increasing.

2. Social development: There should be substantial progress in primary education, gender equality, basic health care and family planning, as follows:

a) There should be universal primary education in all countries by 2015. This goal, building on the ground laid at the Jomtien Conference on Education for All in 1990, was endorsed by the 1995 Copenhagen Summit on Social Development and also by the 1995 Beijing Conference on Women as a goal for 2015. The attainment of basic literacy and numeracy skills has been identified repeatedly as the most significant factor in reducing poverty and increasing participation by individuals in the economic, political and cultural life of their societies.

b) Progress toward gender equality and the empowerment of women should be demonstrated by eliminating gender disparity in primary and secondary education by 2005. The Cairo and Beijing Conferences, as well as the Copenhagen Summit, recommended that the gender gap in primary and secondary education be closed by 2005. Investment in education for girls has been shown repeatedly to be one of the most important determinants of development, with positive implications for all other measures of progress. Achieving gender equality in education will be a measure of both fairness and efficiency.

c) The death rate for infants and children under the age of five years should be reduced in each developing country by two-thirds the 1990 level by 2015. The rate of maternal mortality should be reduced by three-fourths during this same period. The 1994 Cairo Conference on Population and Development established the goals of reducing the infant mortality rate to below 35 per thousand live births, and reducing under-five mortality to below 45 per thousand, by 2015. This target endorses those goals. Child mortality, as a measure of the availability of health and nutrition for the most vulnerable members of society, is a key indicator of the overall state of health in a society.

d) Access should be available through the primary health-care system to reproductive health services for all individuals of appropriate ages, including safe and reliable family planning methods, as soon as possible and no later than the year 2015. This objective, agreed to at the 1994

[85] These edited excerpts are taken from: DAC, (1996) "Shaping the 21st Century: the Contribution of Development Co-operation", May, Development Assistance Committee of the OECD, Paris, 20 pp, especially pp. 8-11 and 15-16.

[86] Additional major conferences on the important issues of human settlements and food security took place in 1996.

Cairo Conference on Population and Development, is key to enabling people to make active choices on their reproductive behaviour and thus to contribute to stabilising the world population and assuring the sustainability of development.

3. Environmental sustainability and regeneration: There should be a current national strategy for sustainable development, in the process of implementation, in every country by 2005, so as to ensure that current trends in the loss of environmental resources - forests, fisheries, fresh water, climate, soils, biodiversity, stratospheric ozone, the accumulation of hazardous substances and other major indicators - are effectively reversed at both global and national levels by 2015. This objective is derived from the 1992 Rio Conference on the Environment and Development. It is intended to supplement the global targets established under international environmental conventions. Sustainable development needs to integrate a number of additional key elements, not all of which lend themselves to indicators along the lines suggested here. The Copenhagen Declaration, for example, included a commitment to promote social integration by fostering societies that are stable, safe and just and based on the promotion and protection of all human rights. In the same vein, the 1995 DAC *Development Partnerships* policy statement identified democratic accountability, the protection of human rights and the rule of law as among the key elements of integrated development strategies. Investment of development resources in democratic governance will contribute to more accountable, transparent and participatory societies conducive to development progress.

Making Aid Work Better - *Commitment of adequate resources*

Our vision of development is one that fosters self-reliance in which countries and people are less in need of aid. However, many poorer countries simply do not yet have access to other resources sufficient to achieve the outcomes that serve everyone's interests. … Development will depend upon the continued availability of concessional resources, while countries build the capacity to create and mobilise domestic resources and attract private capital flows. For a number of highly indebted poor countries, development will also depend upon concerted international action to alleviate an unsustainable burden of debt.

In our 1995 Development Partnerships policy statement we reaffirmed our commitment to generating substantial resources for development co-operation to back the efforts of countries and people to help themselves. … Only four of the DAC's 21 Member countries consistently meet the widely accepted volume target of 0.7 per cent of GNP established by the United Nations in 1970 as an appropriate level for official development assistance.[87] For the DAC as a whole, ODA disbursements are now only 0.3 per cent of GNP. Moreover, a growing portion of available ODA resources has been devoted to humanitarian needs and debt relief in recent years, placing an even greater strain on aid budgets. Among other things, these strains have created unprecedented shortfalls in financing of the United Nations system and the multilateral development banks. These multilateral institutions remain a cornerstone in global efforts to foster development. Their difficult financial situation is a cause for concern.

As recently as 1992, in the programme of action agreed at the United Nations Conference on the Environment and Development in Rio, developed countries reaffirmed their commitments "to reach the accepted United Nations target of 0.7 per cent of GNP for ODA, and to the extent that they have not yet achieved that target, agree to augment their aid programmes in order to reach that target as soon as possible...". Other developed countries agreed at Rio "to make their best efforts to increase their level of ODA".

In this report we have focused on indicators of development progress - on outcomes rather than the volume of inputs. Nevertheless, as we have pointed out, ODA is an essential investment to complement other development resources. Clearly, we need to sustain and increase official development assistance if we expect to see a reversal of the growing marginalisation of the poor and achieve progress toward realistic goals of human development.

It is equally clear than an effort to build stronger compacts with developing countries on a foundation of shrinking resources and declining commitment will lack credibility. Therefore, it is necessary to express, once again, our deep concern that domestic preoccupations and budgetary pressures in some Member countries seriously jeopardise the international co-operation effort at a critical juncture.

[87] The four are Norway, Denmark, Sweden and the Netherlands.

3.2 The Need for Special and Differential Treatment for Developing Countries

Given the immense challenges facing developing countries, it is essential that they be given Special and Differential (S&D) treatment under WTO rules. While some S&D provisions are in place, they are generally inadequate and do not go far enough.

As the Government of Zambia has pointed out, while S&D provisions exist on the books in WTO agreements, many developing countries have entered into structural adjustment programmes with the IMF which prevent them taking advantage of some of the flexibilities built into the WTO agreements.[88] There have also been reports of developing countries being pressured not to take advantage of the S&D provisions that do exist in the WTO agreements.

For the most part, the S&D treatment meted out to developing countries is inadequate and hardly makes up for 100-200 years of colonialism and the protection of industries and companies in industrialised countries. As the governments of Cuba, the Dominican Republic, Honduras, Indonesia and Pakistan emphasised:

> trade rules do not adequately take into account the unequal size of competitors in the global market. Slightly longer phase in periods for developing countries to meet their obligations and modest 'technical assistance' do not 'level the playing field'.[89]

The WTO rules need to include positive discrimination in their obligations in favour of developing countries, not merely longer time periods for implementation of the same obligations. Zero tariffs for LDCs is one such measure, but more is required.

The SPS, TRIPS and Customs Valuation agreements are unsuitable for many developing countries and skew their development priorities. J. Michael Finger from the World Bank and Philip Schuler from the University of Maryland have characterised their approach as the advanced countries saying to the others: "Do it my way!"[90] More research and consultation needs to be conducted on what really *is* required by developing countries, and then the substantive rules need to be renegotiated accordingly.[91]

T.N. Srinivasan from Yale has argued that the provisions for S&D treatment for developing countries in WTO agreements have contributed to the marginalisation of developing countries in the multilateral trading system. Had developing countries *not* demanded and received the "permanent status of inferiority under the 'special and differential' treatment clause", and had they instead participated "fully, vigorously, and on equal terms with the developed countries in the GATT" and adopted outward-oriented development strategies, they could have achieved far faster and better growth.[92]

But, as was noted earlier, it is the very capacity of developing countries to participate fully in the WTO which is one of their biggest problems. Hence, until such time as developing countries have the technical capacity, resources and political clout to engage fully in the WTO negotiating process, there remains a strong need for S&D treatment.

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[88] Zambia, (1999) p. 4.

[89] Cuba *et al.,* (1999) "High Level Symposium on Trade and Development", Joint paper presented by the Republic of Cuba, the Dominican Republic, the Republic of Honduras, the Republic of Indonesia and Pakistan at the WTO High Level Symposium on Trade and Development, 17-18 March, 1999, Geneva, p. 2.

[90] Finger, J.M. and Schuler, P., (1999) "Implementation of Uruguay Round Commitments: The Development Challenge", The WTO/World Bank Conference on Developing Countries' Interests in a Millennium Round, 20-21 September 1999, WTO Headquarters, Centre William Rappard, Geneva, p. 23.

[91] Matthew Stilwell (1999), Centre for International Environmental Law, Geneva, personal communication.

[92] Srinivasan, T.N., (1999) "International Trade and Economic Development: Developing Countries and the World Trading System", Paper presented to the WTO High Level Symposium on Trade and Development, 17-18 March, 1999, Geneva, pp. 8-9.

3.3. WTO Procedures

There have been encouraging signs that the WTO is beginning to open up to dialogue with NGOs and other members of 'civil society', but much more remains to be done.[93] With regard to further reforms of WTO procedures, the following proposals of Dan Esty from Yale merit serious consideration[94]:

strengthening the disclosure rules in WTO procedures on who is lobbying whom, with strict limits on gifts, meals, trips and so on which trade officials (both national representatives and WTO staff) can receive from those with an interest in WTO proceedings;

presuming that all WTO documents should be released into the public domain unless a substantial and compelling reason can be advanced for keeping them confidential;

opening the Dispute Settlement Procedures to submissions from NGOs;

the introduction of consultative status with the WTO for NGOs; and

opening GATT Council meetings to NGOs as observers.

There are also other concerns which require serious attention such as the overly-complex accession process for LDCs. In particular, LDCs recognised by the UN should be given automatic LDC status under the WTO and should not have to meet any higher standards than is required of current LDC members. The Sub-Committee on LDCs should also be upgraded to a full Committee, to give greater attention and a higher profile to the challenges facing LDCs.

Finally, many developing countries have complained that they have been required by World Bank and IMF structural adjustment programmes to liberalise trade beyond what is required of them under the WTO.[95] These instances of the misalignment of the policies of the multilateral institutions need to be rectified.

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[93] For a useful discussion, written by WTO Secretariat staff, see: Marceau, G. and Pedersen, P.N., (1999) "Is the WTO Open and Transparent? A Discussion of the Relationship of the WTO with Non-governmental Organisations and Civil Society's Claims for more Transparency and Public Participation", *Journal of World Trade,* Vol. 33, No. 1, February, pp. 5-49.

[94] Esty, D.C., (1999) "Economic Integration and Environmental Protection: Synergies, Opportunities, and Challenges", Paper presented to the WTO High Level Symposium on Trade and Environment, 15-16 March, 1999, Geneva, pp 9-10.

[95] Bangladesh, (1999) "The Challenge of Integrating LDCs into the Multilateral Trading System: Coordinating Workshop for Senior Advisers to Ministers of Trade in LDCs in Preparation for the Third WTO Ministerial Conference, Sun City, South Africa, 21-25 June 1999 - Communication from Bangladesh", WTO Document: WT/GC/W/251, 13 July 1999, World Trade Organization, Geneva, p. 5, para 14; and
OAU/AEC, (1999) "Statement of the OAU/African Economic Community Conference of Ministers of trade on the Third World Trade Organisation (WTO) Ministerial Meting, Seattle, USA, November 30 - December 3, 1999", OAU/AEC/TD/MIN/ST.1 (II), OAU/African Economic Community Second Ordinary Session of OAU/AEC Ministers of Trade Committee on Trade, Customs and Immigration, Algiers, Algeria, 20-24 September 1999, p. 4.

4. Results of the Uruguay Round

The final act of the Uruguay Round of GATT was signed at Marrakesh in April 1994, and brought into being the updated and amended text GATT94, a number of key Uruguay Round Agreements (URAs), and the World Trade Organization (WTO) as the successor to GATT.

There have been a number of significant problems with the implementation of the Uruguay Round, as well as some major imbalances in the URAs which need to be addressed.

4.1 Implementation of the Uruguay Round Agreements

There has been a disturbing lack of progress from a number of developed countries on the implementation of the URAs which are of key concern to developing countries – particularly the Agreement on Agriculture (AoA) and Agreement on Textiles and Clothing (ATC).

One Ministerial decision adopted by the Trade Negotiations Committee on 15 December 1993 which was critical for many developing countries was the *Decision on Measures Concerning Possible Negative Effects of the Reform Program on Least-Developed Countries and Net Food-Importing Developing Countries.*[96] This Decision is cited explicitly in Article 16 of the AoA.

The terms of this decision committed developed countries to provide various forms of compensation to LDCs and NFIDCs if they were adversely affected as a result of the URAs. Progress on the implementation of this Decision since 1994 has been very limited and the reluctance of developed countries to offer any compensation gives little cause for confidence in any such commitments in the future.

The Government of Pakistan concluded that the Ministerial Decision "has been completely ignored".[97] This is particularly galling, the Government of Egypt noted, since this Decision "was a major reason for an important number of developing countries to agree to conclude the Uruguay Round Negotiations".[98] The Government of Zimbabwe tried to be diplomatic when it outlined the extent to which developed countries were compounding the problems of their poorer trading partners:

> We are however concerned that developed countries who do not have the same capacity constraints have not been implementing fully and faithfully the Uruguay Round Agreements – especially in those areas of critical developmental interest to developing countries. These areas include, among others, the question of special and differential treatment; textiles and clothing; agriculture; and the plight of net food importing countries. There has also been unjustified resort to the application of Anti-dumping provisions as well as tariff peaks and tariff escalation against products of export interest to developing countries – especially on manufactured products.[99]

While the phase out of the Multi-Fibre Arrangement (MFA) was a major achievement of the Uruguay Round, the ATC was written in such as way that the developed countries were still able to legally delay the elimination of MFA restrictions until 2005. The provision of four 'stages' in the ATC

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[96] WTO, (1994) *The Results of the Uruguay Round of Multilateral Trade Negotiations: The Legal Texts*, World Trade Organization, Geneva, 558 pp. The countries which officially have this status under the WTO for the purposes of the Decision are: (a) least-developed countries as recognised by the Economic and Social Council of the United Nations; plus (b) Barbados, Botswana, Côte d'Ivoire, Cuba, Dominican Republic, Egypt, Honduras, Jamaica, Kenya, Mauritius, Morocco, Pakistan, Peru, Saint Lucia, Senegal, Sri Lanka, Trinidad and Tobago, Tunisia and Venezuela. See in Bibliography: WTO Committee on Agriculture (1999).

[97] Pakistan, (1999) "Preparations for the 1999 Ministerial Conference - Agreement on Agriculture: Communication from Pakistan, 26 March 1999", WTO Document WT/GC/W/161, 1 April 1999, World Trade Organization, Geneva, p. 2.

[98] Egypt, (1999), p. 8.

[99] Zimbabwe, (1999) "Statement by the Delegation of Zimbabwe at WTO High Level Symposium on Trade and Development", Paper presented by the Government of Zimbabwe to the WTO High Level Symposium on Trade and Development, 17-18 March, 1999, Geneva, 3 pp.

suggested that 33% of the agreed liberalisation should have been in place by the end of 1997, in fact the US had by September 1999, eliminated only 1% of its MFA quotas, and the EU just 7%. Overall, developed countries' tariffs on textiles and clothing remain two to three times greater than their tariffs on other industrial goods.[100]

The actual implementation thus far of the ATC has been therefore been poor. The Government of Pakistan noted that those products in the US and EU which have been freed from quotas so far under the ATC in fact represent a "miniscule" percentage of the total restrained imports in those two major markets. In addition, Pakistan points out, these countries have resorted to very frequent use of transitional safeguard measures, which were supposed to be used "as sparingly as possible" (ATC Article 6.1).[101] However, Pakistan notes, one country in the four years up to 1998, had resorted to 28 transitional safeguard actions, affecting $1 billion worth of trade - a number of which were directed against small countries.[102]

In 1999, Pakistan was in dispute with the US over its exports of combed cotton yarn to the US. The US had restricted imports with a transitional safeguard measure on March 17 citing damage to the domestic industry. An investigation by the WTO's Textiles Monitoring Body resulted in a recommendation to the US to rescind the measure.[103] On 22 September, the US negotiator wrote to the Chairman refusing to implement the recommendation.[104] The purpose of this illustration is not to single out the United States, but to illustrate the way developed countries are using provisions in the agreements for protectionist purposes. In their joint paper, the governments of Cuba, the Dominican Republic, Honduras, Indonesia and Pakistan note that:

> In the case of the implementation of the ATC, the integration programmes for the first two stages have not lead to any meaningful liberalisation of the sector. Additionally, the textiles exporting countries continue to face export barriers due to frequent use of the exceptional transitional safeguard mechanism, anti-dumping measures, as well as other unilateral measures. This has lead to the rather ironic situation where growth in the textile exports of the developing countries have been less than the growth rates registered previously under the MFA restraints.[105]

Substantial tariff peaks, tariff escalation and quotas on exports from developed countries, such as textiles, agricultural goods and forest products remain a very real problem for developing countries – even after the Uruguay Round. [106] The penalisation of value-added developing country exports hinders developing country growth and the elimination of poverty. Such measures can trap countries at low levels of industrialisation.

The recent example of protectionist attempts in the United States to limit imports of Brazilian steel is a clear example of the flaws of current trading arrangements. Brazil is facing severe economic

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[100] Finger, J.M. and Schukecht, L., (1999) "Market Access Advances and Retreats: The Uruguay Round and Beyond", The WTO/World Bank Conference on Developing Countries' Interests in a Millennium Round, 20-21 September 1999, WTO Headquarters, Centre William Rappard, Geneva, p. 62.

[101] WTO, (1994), p. 94.

[102] Pakistan, (1999) "Preparations for the 1999 Ministerial Conference - Textiles - Some Elements of Implementation of the ATC: Communication from Pakistan, 24 March 1999", WTO Document WT/GC/W/159, 1 April 1999, World Trade Organization, Geneva, p. 2.

[103] WTO Textiles Monitoring Body, (1999) "Fifty-Sixth Meeting of the TMB - Note by the Chairman", WTO Document: G/TMB/19, 29 June, World Trade Organization, Geneva, 11 pp.

[104] United States, (1999) "Agreement on Textiles and Clothing: Communication from the United States", WTO Document: G/TMB/N/346, 24 September, World Trade Organization, Geneva, 2 pp.

[105] Cuba *et al.* (1999), p. 3.

[106] A useful summary of OECD trade barriers and trends in market openness is: Coppel, J. and Durand, M., (1999) "Trends in Market Openness", OECD Economics Department Working Papers No. 221, August, OECD, Paris, 25 pp. [http://www.oecd.org/eco/eco]. See also: Michalopoulos, C., (1999) "Trade Policy and Market Access Issues for Developing Countries", Working Paper 2214, October, World Bank, Washington DC, 80 pp, and Finger and Schukecht (1999).

challenges in both the short and long term. They are told to boost their exports, yet market access may be further restricted by the most economically powerful nation on earth.[107]

Developed countries should stand firm against local rent-seeking protectionist interests and move towards a regime of duty-free, quota-free, full market access for all exports from developing countries – especially the LDCs.

The slow pace of implementation of the URAs by developed countries is fuelling anger and frustration in many developing countries and creating growing suspicion and cynicism towards proposals for a new round – as well as deep resentment at any suggestions that entering a new round will increase the likelihood of actually securing the benefits that were meant to flow to them from the Uruguay Round.

A number of developing countries are also finding that resource and skill constraints are severely hampering their attempts to implement the obligations they undertook in the Uruguay Round. Finger and Schuler point out for example, that the costs involved in purchasing equipment, training people, establishing systems of checks and balances, strengthening institutions, administrative and monitoring capacities are very substantial. Based on World Bank project experience in the areas covered by the agreements, they note that an entire year's development budget is at stake in many of the LDCs. For example:

> To gain acceptance for its meat, vegetables and fruits in industrial country markets, Argentina spent over $80 million to achieve higher levels of plant and animal sanitation. Hungary spent over $40 million to upgrade the level of sanitation of its slaughterhouses alone. Mexico spent over $30 million to upgrade intellectual property laws and enforcement that began at a higher level than are in place in most least developed countries; customs reform projects can easily cost $20 million. Those figures, for just three of the six Uruguay Round Agreements that involve restructuring of domestic regulations, come to $130 million … more than the annual development budget for seven of the twelve least developed countries for which we could find a figure for that part of the budget.[108]

One consequence of these impossible demands, and the lack of involvement in the actual negotiations which produced them, is an almost complete lack of 'ownership' of the agreements in many LDCs.[109]

4.2 Abuses of Anti-Dumping Provisions and other Non-Tariff Measures (NTMs) by Developed Countries

The benefits of trade liberalisation for many developing countries have been compromised by the widespread abuse of anti-dumping measures against competitive imports from developing countries.[110] Moreover, this abuse is compounded by the lack of resources available to small and medium enterprises in developing countries and indeed, their governments, to defend themselves against such legal action. These kinds of resource constraints also hinder the abilities of the governments of many developing countries to effectively protect the legitimate concerns of their own industries by means of anti-dumping duties and countervailing measures.[111]

Pakistan cites significant developed country abuse of anti-dumping measures during the transition phase of the ATC, and notes that the mere initiation of anti-dumping proceedings by the EC resulted in a yearly *decline* of 7% in exports of textiles and clothing from the target countries![112]

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[107] Marsh (1999), p. 1.
[108] Finger and Schuler (1999) p. 25.
[109] Finger and Schuler (1999) pp. 3-5.
[110] For an examination of the extent to which the developing countries had any part in framing the anti-dumping regulations, see Kufuor (1998).
[111] Useful discussions on this issue and the relationship between anti-dumping and competition policy can be found in: Hoekman and Mavroidis (1996), Morgan (1996), Niels and ten Kate (1997) and Tharakan (1999).
[112] Pakistan, (1999a), p. 2.

Clark carried out a statistical analysis of NTMs employed by the US and found that it systematically discriminated against the exports of countries with a per capita GDP below $2,600 – the poorest 60% of developing countries.[113]

Australia is also a disproportionate user of anti-dumping measures against its trading partners. In its *Trade & Assistance Review 1997-98*, the Productivity Commission noted that Australia accounted for 18 (8%) of the 224 anti-dumping and countervailing cases launched internationally in 1996. Moreover, despite accounting for only about a third of Australia's merchandise imports in 1997-98, countries in the Asian region, excluding Japan, have been subjected to 46% of the 203 initiations since 1992-93. Poor countries such as China, India, Indonesia, Thailand and Malaysia, together accounted for 23% of actions, and South Africa alone was subjected to 16 actions, or 8% of the total.[114]

The Commission concluded that: "Relative to its share of world trade (less than one per cent), Australia continues to be one of the most frequent users of anti-dumping and countervailing measures".[115]

4.3 Trade-Distorting Price Supports and Export Subsidies in Developed Countries

The continuing high levels of price support and the ongoing use of export subsidies in many OECD countries are also of great concern - especially support in the form of production-linked assistance, which encourages wasteful and often environmentally-destructive overproduction of commodities which are often then dumped on world markets and which squeeze out non-subsidised developing country producers and exporters.

The deciduous fruit canning industry in South Africa, for example faces a variety of problems and market distortions introduced by developed countries. These include high levels of protection in US and EU markets, the capturing of most of the value-added by developed country retailers, and the ability of EU producers to cross-subsidise in third country markets on the back of high levels of protection and subsidies to their growers.[116]

The OECD recently estimated that total support to agriculture in OECD countries reached $362 billion in 1998, and that support to producers *increased* from 32% of total gross farm receipts in 1997 to 37% in 1998. Market price supports accounted for 65% of these payments. Furthermore, average OECD total farm receipts were 59% higher than at world prices, with support in individual countries ranging from 1% to over 80% in some instances.[117]

Trade-distorting agricultural export subsidies in developed countries should be eliminated as these introduce substantial distortions into world markets and cost governments, tax payers and consumers billions of dollars annually.

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[113] Clark, D.P., (1998) "Are Poorer Developing Countries the Targets of U.S. Protectionist Actions?", *Economic Development and Cultural Change,* Vol. 47, No. 1, October, pp. 193-207.
[114] Productivity Commission, (1998), *Trade & Assistance Review 1997-98,*Annual Report Series 1997-98; AusInfo, Canberra, 110 pp 67 & 69.
[115] Productivity Commission, (1998), p. 68.
[116] Kaplan, D. and Kaplinsky, R., (1999) "Trade and Industrial Policy on an Uneven Playing Field: The Case of the Deciduous Fruit Canning Industry in South Africa", *World Development,* Vol. 27, No. 10, October, pp. 1787-1801.
[117] OECD, (1999) *Agricultural Policies in OECD Countries 1999 - Monitoring and Evaluation*, OECD, Paris.

5. Agriculture & Commodity Trade

5.1 Agricultural Liberalisation and Food Security

Agricultural trade has been highly contentious for many years and it was only in the last round of GATT negotiations that agriculture was finally brought under the disciplines of GATT rules, albeit in a limited way.

Developing countries are divided over the benefits of agricultural trade liberalisation. Twelve out of the fifteen members of the Cairns Group are developing countries, and distortions in agricultural trade, caused by price supports, export subsidies and other market-distorting forms of protectionism in many developed countries, cause great harm to countries which are net food exporters. However, a number of NFIDCs benefit from cheap subsidised exports from the EU and US and many developing country governments must subsidise food prices for the poor.

Agricultural trade liberalisation has been pushed very strongly by agricultural exporters, such as the Cairns Group and more recently by the US, now that it has reduced its production-linked farm support programmes.[118] The EU has strenuously resisted any changes to its Common Agricultural Policy (CAP) which provides massive price supports and export subsidies to its farmers, and accounts for around half the EU budget.

Much of the lack of efficiency and even the lack of any comparative advantage in food production in many developing countries can be attributed to the neglect of agriculture in favour of misguided, capital-intensive, import-substitution development strategies. In many cases, the protection given to the manufacturing sector resulted in *negative* effective rates of protection for agriculture.

The issues involved in agricultural trade are extremely complex. Food is not just like other commodities. If there is a shortage of commodities such as coffee, or goods like radios, prices go up a bit but consumers manage. If there are food shortages however, people and livestock can starve to death.

In a revealing interview, the director of the French Federation of Oilseed Producers, once explained why European farmers were so opposed to relying on imports. After World War II, demand for meat and animal feed skyrocketed. At first, Europeans were content to import cheap soybean from the US, but this complacency was shattered in 1973 when President Nixon embargoed oilseed exports during a drought. "Our livestock starved. … We realised that oilseeds were a strategic commodity and we needed to be more self-sufficient."[119]

It is commonly argued that countries do not need to be relatively self-sufficient in food because food can be produced more efficiently elsewhere – in countries with a comparative advantage in food production – and then imported into the food-deficient country more cheaply than the country could produce the food itself. NFIDCs should specialise in the production and export of other goods and services in which they have a comparative advantage, so that they can earn foreign exchange to buy food from the rest of the world. In this way they will achieve food security.

Therefore, it is claimed, developing country governments (and NGOs who claim to serve the poor) should support further liberalisation in the next trade round and abandon agricultural policies which restrict imports for the sake of promoting food security.[120]

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[118] The Cairns Group consists today of Argentina, Australia, Brazil, Canada, Chile, Colombia, Fiji, Indonesia, Malaysia, New Zealand, Paraguay, Thailand, Uruguay and South Africa. Hungary was a member but dropped out and was replaced by South Africa.

[119] Hornblower, M., (1992) "Bitter in the Fields", *Time,* 23 November, p. 37.

[120] This argument is used in various forms by the Cairns Group, and it underlies its recent statements at the WTO. See Cairns Group (1999).

This argument is valid - as long as certain assumptions are fulfilled, including:

1. That there will always be an exportable net surplus in food exporting countries and that food prices will be reasonably stable;
2. That the channels of international trade will flow freely with minimal risk of disruption by war or other strife;
3. That there will be adequate safety nets for those food producers who would be displaced by the cheaper food imports;
4. That the recipient countries will have sufficient access to foreign exchange to pay for the food imports;
5. That the market for agricultural goods and primary commodities will be efficient, with vigorous, even if not perfect, competition.

Since these essential conditions are often not fulfilled, the simplistic argument against countries pursuing policies of greater food security fails for all practical purposes.

The unique importance of food led the World Food Summit in 1996 in Rome to recognise explicitly food security as a right and a legitimate policy goal for countries to pursue:

> Food security exists when all people, at all times, have physical and economic access to sufficient, safe and nutritious food to meet their dietary needs and food preferences for an active and healthy life.[121]

A study of 49 food deficit countries over the period 1966-1976, found that while external factors, such as values of food imports and real merchandise exports, were important in food security, the most important single factor bearing on food consumption instability was *domestic* food production. Moreover, the single most important factor constraining the use of food imports to stabilise food consumption was the availability of foreign exchange – affecting 31 out of the 47 countries and that the higher the degree of a county's dependence on imports, the higher food consumption instability was likely to be.[122] The cross-sectoral pressures on available foreign exchange funds can be very substantial: in 1996 at least 14 developing and transition countries were paying out over 30% of their annual export earnings in debt servicing, and the *average* for Latin America and the Caribbean was 32.3%.[123]

5.2 Net Food Importing Developing Countries

While some developing countries are clearly in favour of greater agricultural trade liberalisation – notably the 12 developing countries of the 15 member Cairns group – the situation of developing countries which are net food importers needs to be given special consideration.

Liberalisation of agricultural trade and the elimination of massive EU and US subsidies would lead to higher prices for agricultural commodities - good news for producers able to gain higher returns for their exports, but bad news for food importers.

The 1996 study of the effects of the URAs on the food import bills of developing countries by the FAO concluded that for the developing countries as a whole, their food import bill was likely to be nearly $25 billion (62%) higher in 2000 than in 1988, of which $3.6 billion (15%) would be due to the URAs. The effects on Africa are particularly concerning since the region is projected to widen its trade deficit in agricultural products, and the URAs did not change this outcome. Both its volume of imports and the prices it pays for them were expected to increase substantially – mainly reflecting population-induced growth in demand. The net effect was expected to be an increase in the total food bill from $6 billion in 1988 to $10.5 billion in 2000 – of which $500 million would be due to the

[121] World Food Summit, 1996 Plan of Action, Paragraph 1.
[122] Diakosavvas, D., (1989) "On the Causes of Food Insecurity in Less Developed Countries: An Empirical Evaluation", *World Development,* Vol. 17, No. 2, pp. 227 & 230.
[123] World Bank, (1998), pp. 242-244.

URAs. Overall, the food import bill of the NFIDCs was expected to increase by nearly $10 billion, of which around 14%, or $1.4 billion would be due to the effects of the URAs.[124]

NFIDCs should be allowed greater latitude in developing their own agricultural productivity and capacity by, for example, allowing them to use domestic support measures which developed countries have to phase out under the AoA.

NFIDCs should also be compensated for any increases in world food prices that arise from the implementation of the AoA and this compensation should not be deducted from normal development assistance.

Box 2: Trade Liberalisation and Household Food Security in Malawi

Theresa Banda[125]

Trade liberalisation helps people to buy and sell commodities including food that they need from within the country or outside. This policy has facilitated the emergence of middlemen in Malawi who buy food commodities from farmers soon after harvest at very low prices and who then sell these commodities to cities or even outside the country. Sometimes some traders sell within the communities but at very high prices which households are unable to afford. The buying and selling is based on market forces of supply and demand but many farmers do not understand these forces. They get excited to see people buying the maize within the vicinity at any time. Very few smallholder farmers keep their produce to sell when supply is low in order to fetch high prices, which would bring them reasonable cash for fertilisers and other necessities.

This policy has weakened ADMARC's (Agricultural Development Marketing Corporation) role in these activities for smallholder farmers in Malawi. ADMARC was buying from farmers and selling back to them in the communities at a higher price than the buying price, but which was still reasonable. This was like a buffer for smallholder farmers that they could lean on during lean period. These smallholder farmers constitute over 80% of the total Malawian population.

The current system is good for people who can keep enough food for themselves throughout the year and just sell the surplus. Most people do not sell to ADMARC because of low prices and fixed times for buying, which leads to low stocks at ADMARC hence problems during lean periods. ADMARC has to compete at the community level to buy these food commodities where prices respond to supply. For example this year, prices started with MK2-3 per kg of maize in April-May and by September it was around MK5-8 per kg. By December, the price for selling back to farmers and everybody else will be over MK10 per kg, which most people cannot afford. This competition means that ADMARC has to become commercialised to survive, which entails very high selling prices to the farmers. This policy will perpetuate household food insecurity for the poor.

Currency instability can also make life extremely difficult for poor farmers. In Malawi last year, farmers sold their tobacco (the main cash crop) at MK26.00 to US$1.00. As soon as they finished selling, the Kwacha was devalued to MK45.00 to US$1.00. This devaluation made the prices of all the commodities increase, including fertilisers and seed. Most farmers could no longer afford to buy these inputs, leading to low food and cash crop production. Far better would have been to devalue before farmers sold their produce so that the cash they were going to receive would be the same value in dollar terms.

High demand for certain commodities in neighbouring countries can also affect local supply. For example, in Malawi certain foods such as poultry from Zimbabwe and tomatoes Tanzania are cheaper than those produced locally. This is good for the consumers because it even makes the local producers reduce prices sometimes. However, it discourages local production, which means that when imports are scarce due to currency fluctuations, locally produced poultry is even more expensive and scarce than it would otherwise have been.

[124] Greenfield, J., de Nigris, M. and Konandreas, P., (1996) "The Uruguay Round Agreement on Agriculture: food security implications for developing countries", *Food Policy,* Vol. 21, No. 4/5, pp. 372 & 374.

[125] Theresa Banda has taken leave of absence from her position as National Micronutrient Coordinator for the Ministry of Health in Malawi to coordinate the national Micronutrient and Health (MICAH) programme. MICAH is funded by the Canadian International Development Agency in five African countries. World Vision Malawi manages the programme in Malawi with about 12 implementing partners drawn from the local NGO community.

5.3 The Agreement on Agriculture

While the Agreement on Agriculture is an encouraging start to agricultural trade reform, its provisions largely reflect the concerns of developed countries – particularly the US and EU and much remains to be done.[126]

Market Access

The key components of the Agreement with regard to market access are a 'tariffs-only' regime. The tariffs are unable to be increased (i.e. they are 'bound') and are subject to progressive reduction. All Non-Tariff Barriers (NTBs) such as quantitative restrictions, variable levies, import bans and so on, had to be converted to bound tariffs (the process is called 'tariffication') and members were to refrain from introducing new NTBs (Article 4).[127] Some of these new 1995 tariffs reached prohibitive levels, higher in some cases than the previous levels of protection strictly warranted (so-called 'dirty tariffication'), particularly in sensitive areas for developed countries such as sugar (197% - US; 126% - Japan; 297% - EU), wheat (240% - Japan; 167.7% EU), and dairy products (144% - US; 489% - Japan; 289% - EU).[128]

Only 40 countries in fact did convert their NTBs to tariffs. Many developing countries, especially in Africa and South Asia, took advantage of provisions to set new base and bound tariffs at often quite high levels which were apparently unrelated to previous levels of protection. [129] These were termed 'ceiling bindings'.[130]

Under the Agreement, developed countries had to reduce the new tariffs resulting from the tariffication process by 36% over an implementation period of six years, from 1995 to 2000, on a simple unweighted annual basis, with a minimum reduction of 15% for each product line. Developing countries were required to reduce levels of support by only 24% and, over a period of ten years, with a minimum reduction of 10%.[131] LDCs were exempted from all of these reduction requirements under Article 15 on Special and Differential Treatment.

One requirement of the process was that market access levels for trading partners had to remain the same after the process. Minimum access levels were also introduced if the level of 'current access' was less than 5% of the domestic consumption of the product concerned during the base period. Countries were then required to open tariff rate quotas (TRQs) at a low enough rate of duty to provide 'minimum access opportunities.' The current and minimum access requirements were together to provide access opportunities equivalent to 3% of the domestic market in the base period, rising to 5% by 2000 for developed countries and by 2004 for developing countries.[132]

Countries that converted their NTBs to tariffs were also given the right to *special safeguard actions*, to protect themselves against import surges of those goods which had their NTBs converted to

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[126] See Tanner (1996) and Josling (1998) for good accounts of the history of agricultural reform in the GATT and the development of the AoA.

[127] Agreement on Agriculture, in WTO (1994) *The Results of the Uruguay Round of Multilateral Trade Negotiations: The Legal Texts*, World Trade Organization, Geneva, pp. 39-68. See also: Goldin and van der Mensbrugghe (1996).

[128] Hathaway, D.E. and Ingco, M.D., (1996) "Agricultural liberalization and the Uruguay Round", In *The Uruguay Round and the Developing Countries,* Ed. Martin, W. and Winters, L.A.; Cambridge University Press, Cambridge, p. 45.

[129] Hathaway and Ingco (1996) p. 46.

[130] WTO, (1999) *Guide to the Uruguay Round Agreements,* World Trade Organization & Kluwer Law International, Geneva & the Hague, p. 54.

[131] The percentages and provisions regarding the base period tariff equivalents and the initial tariffs are not part of the Agreement itself, but are found in a document referred to as the *Modalities* paper. This was a key document during the negotiations and contains the legally binding commitment schedules for each country: WTO, (1993) "Modalities for the establishment of specific binding commitments under the reform programme", WTO Document MTN.GNG/MA/W/24, 20 December, World Trade Organization, Geneva.

[132] WTO (1999), pp. 53-54 and WTO (1993), para 5, and Annex 3, Sections A, B and C.

tariffs (not those which already were subject to tariffs) (Article 5). These safeguard actions would be triggered if the price of imports were to fall below a reference price based on average import prices in 1986-88.[133]

Domestic Support

The Agreement's provisions relating to domestic support are based on Aggregate Measures of Support (AMS) or Equivalent Measures of Support (EMS) where calculation of AMS was not practical, using the base years 1986-1988 (Annex 3). Total AMS levels covering all domestic agricultural support that did not qualify for exemption had to be reduced, starting in 1995, by 20% for developed countries within six years, and 13.3% for developing countries within ten years. LDCs were again not required to make any reductions.[134]

Annex 2 of the Agreement sets out a number of categories of support that are exempted from reduction requirements – the so-called *Green Box*. These include measures such as support for:

General services, such as services for research, pest control, training, extension, advice, inspection, marketing and infrastructure services (other than subsidies to inputs and operating costs);
Public stockholding for food security purposes;
Domestic food aid;
Direct payments to producers (which may not be linked to production);
Decoupled income support;
Income insurance and income safety-net programmes;
Payments for relief from natural disasters;
Structural adjustment assistance provided through producer retirement programmes;
Structural adjustment assistance provided through resource retirement programmes;
Structural adjustment assistance provided through investment aids;
Payments under environmental programmes;
Payments under regional assistance programmes.

All measures of support not covered by Annex 2 were considered to fall in the *Amber Box* of measures which were automatically subject to the reduction commitments outlined above. There were only three exceptions to the *Amber Box* which were not *Green Box* measures[135]:

Developed countries could maintain *de minimus* levels of support below 5% of the value of production of any given commodity and developing countries, 10% (Article 6.4).

Certain measures designed to encourage rural development in developing countries such as generally available investment subsidies, input subsidies to low-income producers, and support for diversification away from growing illegal narcotics (Article 6.2).

Certain direct payments under production limiting schemes – the so-called *Blue Box*. Such *Blue Box* payments had to be made on the basis of fixed areas and yields (or number of head for livestock) or on a maximum of 85% of base levels of production (Article 6.5).

The *Blue Box* exception was added to the Agreement under the Blair House Accord of November 1992 to break the deadlock between the EU and US to enable the Uruguay Round to be completed. It accommodated US and EU agriculture support programmes such as the US's deficiency payments under the 1990 Farm Bill and the EU's compensation payments under the reformed Common Agricultural Policy (CAP).[136]

[133] WTO (1999), p. 55.
[134] WTO (1999), p. 58.
[135] WTO (1999), p. 58.
[136] Josling (1998), pp. 32.

Export Subsidies

Export subsidies which are subject to reduction commitments under Article 9.1, include such measures as:

subsidies contingent on export performance;

government export sales or stock disposals at prices below domestic market prices;

payments on the export of an agricultural product that are financed by virtue of government action;

subsidies on transport and marketing costs;

subsidies of agricultural products contingent on their incorporation into exported products.

Developed countries had to reduce the value of export subsidies to a level 36% below the 1986-90 base level over the six-year implementation period, and to reduce the volume of subsidised export by 21% over the period. Developing countries had to reduce their subsidy levels by only 24% in value and 14% in quantity over ten years (Article 9.b.iv).[137] Developing countries were also exempted from reductions during the implementation period of subsidies on marketing and transport, as long as these measures did not circumvent their overall reduction requirements (Article 9.4). LDCs were again not required to make any reductions.

Importantly, export subsidies were not to be extended to commodities that were not subsidised in the base period (Article 3.3, *Modalities*). This means that developing countries that had not been subsidising the exports of their commodities in the past, were forbidden to do so in the future.

Article 10 of the Agreement outlines rules on the prevention of circumvention of the export subsidy regulations, including the requirement that the burden of proof falls on the exporter to prove that exports are not subsidised if that country exports more than its reduction commitment permits (Article 10.1). The Article goes on to say that Members will "undertake to work toward the development of internationally agreed disciplines to govern the provision of export credits, export credit guarantees or insurance programs" (Article 10.2). These disciplines should be drafted and enacted swiftly to prevent the circumvention of the rules on export subsidies by developed countries with a penchant for subsidising exports.

Article 10 also contains crucial rules on the provision of food aid which, when used carelessly, has had devastating effects on developing country agricultural markets. Donors of food aid must ensure:

> (a) that the provision of international food aid is not tied directly or indirectly to commercial exports of agricultural products to recipient countries;
> (b) that international food aid transactions, including bilateral food aid which is monetised, shall be carried out in accordance with the FAO "Principles of Surplus Disposal and Consultative Obligations", including, where appropriate, the system of Usual Marketing Requirements (URMs); and
> (c) that such aid shall be provided to the extent possible in fully grant form or on terms no less concessional than those provided for in Article IV of the Food Aid Convention 1986.[138]

This is a welcome provision.

Implementation of the Agreement, such as it is, has been somewhat problematic. In a joint paper, the governments of Cuba, the Dominican Republic, Honduras, Indonesia and Pakistan note that:

> In the area of agriculture, major developed countries have been able to transform their restrictive agricultural regimes into extremely high levels of tariff protection, much higher than those which the developing countries can maintain under the Agreement. The aggregate measure of support has also

[137] In some circumstances where subsidised exports had increased since the 1986-90 base period, 1991-92 was used as the beginning point of reductions, but the end-point remained that based on the 1986-90 base period level. WTO, (1999), pp. 137, 60.

[138] Article 10.4, WTO (1994), p. 50.

been used to apply much lower reductions of production subsidies in sensitive sectors. The cumulative effect of such measures has been the erosion of market access benefits.[139]

Necessary Changes

A number of amendments are required to make the Agreement on Agriculture more appropriate for developing countries' needs:

1. Developing countries should be exempted from minimum access obligations – especially for basic food items.

2. Export subsidies by developed countries should be eliminated entirely, as these profoundly distort agricultural markets and harm developing country producers. Disciplines on the provision of export credits, export credit guarantees and insurance programs should also be drafted and enacted swiftly to prevent the circumvention of the rules on export subsidies.

3. Under articles 3, 6 and 7 of the Agreement, while developed countries are able to retain significant levels of agricultural support and export subsidies, albeit at a reduced level, those countries which have not had agricultural support in the past are forbidden from introducing it in the future beyond the *de minimis* level. This is unfair and penalises those developing countries which had not substantially supported their agricultural sector in the past. NFIDCs should be allowed greater latitude in developing their own agricultural productivity and capacity by, for example, allowing them to use domestic support measures which developed countries have to phase out under the AoA.

4. Under the Agreement, food-importing countries face uncertainty on food prices and availability due to the ability of exporters to adjust their levels of protection from year to year. Each country may choose the products and rates of subsidy within the overall limit for the total amount of subsidy permitted for that year.[140]

5. The 1996 US Farm Bill, called the FAIR Act, removed the acreage-set-aside conditions for receiving direct payments for cereals – essentially decoupling payments from output levels and thereby placing such payments firmly in the *Green Box*.[141] This major change of policy leaves only the EU sheltering its direct payments from challenge in the *Blue Box*. The *Blue Box* should be eliminated in the coming negotiations.

6. The Special Safeguard action provisions to block imports into developed countries should be eliminated for exports from developing countries, particularly LDCs.

7. There should be some kind of multilateral compensatory food import facility to enable NFIDCs to cope with foreign exchange shortages.[142] It is possible, however, that a food commodity price rise following the elimination of developed country price supports and export subsidies could be fairly temporary if more efficient producers, including some developed countries, step into the breach and boost production.

It is to be hoped that the new discussions on the Agreement, which are mandated to begin later this year, will address some of these concerns.

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[139] Cuba *et al.* (1999) p. 3.
[140] Das, B.L., (1998) *The WTO Agreements: Deficiencies, Imbalances and Required Changes*, Third World Network, Penang, Malaysia, p. 60.
[141] Josling (1998) p. 39.
[142] Raffer, K., (1997) "Helping Southern Net Food Importers after the Uruguay Round: A Proposal", *World Development,* Vol. 25, No. 11, November, pp. 1901-1907.

5.4 Market Structure and the Role of Agribusiness TNCs

The concentration of market power in the agricultural sector is particularly controversial. Some, such as Lauck argue that recent scholarship and theoretical breakthroughs on the theory of what constitutes a monopoly are not supportive of the traditional view that US agriculture suffers from a chronic monopoly problem.[143]

Others, such Heffernan and his co-workers at the University of Missouri take a much less sanguine view.[144] In their February 1999 report to the US National Farmers Union, the authors describe how a small number of dominant vertically-integrated 'clusters' of firms control the decision-making throughout all levels of the food chain in the US and are threatening America's system of independent family farms. The three major clusters are Cargill/Monsanto, ConAgra, and Novartis/ADM. The economic strength of these firms is extraordinary:

> Reports suggest that Cargill paid about one billion dollars for Continental (*Wall Street Journal,* 11/11/98, p. A10). … That is economic power. There is freedom of entry into the global food system for those firms that can match that level of purchasing power.[145]

Cargill is already the world's largest trading company of cereals but the report further notes that Cargill's corporate goal is to double in size every five to seven years – something they have achieved for the past 40 years.[146]

Cargill are not alone in their expansionary plans. In the first six months of 1998, Monsanto spent £3.7 billion (around $6.1 billion!) buying Cargill's international seed business, Dekalb Genetics, Delta & Pine Land and Unilever's Plant Breeding International Cambridge.[147]

One recent analysis of allocative efficiency losses in the US food and tobacco manufacturing industries due to oligopolies, found that losses amounted to around $15.2 billion, or over 5% of sales in 1987. These results were consistent with previous studies, as well as "with the fact that most industries with the highest estimated welfare losses relative to sales had been the focus of public scrutiny for their alleged anticompetitive behaviour in the United States."[148]

Jacques Morisset of the World Bank recently researched the growing gap between world prices and domestic prices in commodity markets over the last 25 years. He found that the price of coffee, for example, *declined* on world markets by 18% between 1975 and 1993, while coffee prices for consumers in the US *increased* by 240% over the same period![149] In fact, for the seven commodities Morisset examined, the spread between world prices and consumer prices between 1975 and 1994

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[143] Lauck, J., (1996) "American Agriculture and the Problem of Monopoly", *Agricultural History,* Vol. 20, No. 2, Spring, pp. 196-215.

[144] Heffernan, W., Hendrickson, M. and Gronski, R., (1999) "Consolidation in the Food and Agriculture System: Report to the National Farmers Union", February, 19 pp. [http://www.nfu.org, 26 April 1999]. See also: Chalmin (1980), Clunies-Ross and Hildyard (1990), Heffernan (1998), McMichael, (1998) and Nye (1993).
Cargill's reported sales were $45 billion and its net earnings $597 million in 1999, down from nearly $56 billion and $902 million respectively in 1996. Source: Cargill (1999), *Financial Information*, 1 pp. [http://www.cargill.com/finance/highlights.htm, 22 October 1999].

[145] Heffernan *et al.* (1999), p. 6.

[146] Heffernan *et al.* (1999), p. 6; See also: Kneen (1995) and Sexton (1996).

[147] Mortished, C., (1998) "Monsanto acquires seed business from Unilever for £320m", *The Times,* London, Thursday 16 July, p. 27.

[148] Bhuyan, S. and Lopez, R.A., (1998) "Oligopoly Power and Allocative Inefficiency in US Food and Tobacco Industries", *Journal of Agricultural Economics,* Vol. 49, No. 3, September, p. 441.

[149] Morisset, J., (1998) "Unfair Trade? The Increasing Gap between World and Domestic Prices in Commodity Markets during the Past 25 Years", *The World Bank Economic Review,* Vol. 12, No. 3, pp. 503. Morisset investigated prices for Canada, France, Germany, Italy, Japan and the US for seven commodities: beef, coffee, fuel-oil, gasoline, rice, sugar and wheat.

increased on average by around 100%.[150] He argues that the likely cause is that world price *increases* are well transmitted to domestic prices, but world price *falls* are not. This asymmetry of price transmissions is an area relatively unexplored in the economic literature.

Morisset considered a range of possible explanations for the emergence of these spreads but found them unsatisfactory. He concluded that among a few possible alternatives, the role and influence of large international trading companies had to be considered. Their size, strategic positions and market power enable them to affect the spreads in most commodity markets. The concentration of ownership is also significant – approximately 70% of the total international trade in the seven commodities covered by the article is controlled by six or fewer companies. Furthermore, the vertically-integrated nature of these companies enables them to affect both wholesale and retail prices. Cargill for example owns plantations, storage facilities and vessels around the world. [151]

Significantly, Morisset notes a high degree of correlation between the profits of the major US oil companies and the spread between domestic and world prices between 1979 to 1994. Perhaps even more important though is his aside that similar calculations could *not* be performed for the other major commodities because of the absence of basic publicly available data – since, as most of the major international trading companies are not publicly traded, they do not publish their results.[152]

What this suggests is that while citizens in developed countries have been paying steeper prices for the last 25 years, the extra money has not been going to developing country producers, but instead into the coffers of large multinational trading companies. This has meant that any increases in demand for developing country commodity exports which might have been expected to have resulted from price falls, have not occurred because these price falls have not been passed on to consumers.

Poor peasant farmers have been adversely affected in some cases by the encroachment of agribusiness firms into areas of traditional farming. Feder, writing on the effects of this mechanisation of agriculture in Latin America in the late 1970s, noted that since mechanisation demanded heavy investments and large operating capital needs, it became a major factor in bringing about concentration of land ownership and production. This led to the swift displacement of small 'inefficient' producers.[153] He concluded that:

> the progress of capitalist expansion by transnational agribusiness firms and their take-over of Latin American agriculture is conducive to the rapid displacement of peasants from the land, without their having the slightest possibility of finding employment elsewhere ...[154]

The role of these major trading companies needs to be properly researched and taken more seriously by institutions such as the WTO and the World Bank in any further work done on competition policy and trade liberalisation.

It is clear that not only is agricultural trade distorted by developed country protectionism, but the market itself is dominated by a small number of oligopolistic firms which are virtual monopolies in some sectors. This introduces further distortions and significantly reduces market efficiency.[155]

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[150] Morisset, (1998), p. 520. Even if, as was discussed above, demand for commodities is relatively price inelastic, drops in prices would still have stimulated *some* increase in demand.
[151] Morisset, (1998), p. 519. Just five companies control cereal exports for example: Cargill, Continental, André, Dreyfuss and Bunge-Born. This was written before Cargill bought Continental's global grain division last year.
[152] Morisset, (1998), p. 519-520.
[153] Feder, E., (1977) "Agribusiness and the Elimination of Latin America's Rural Proletariat", *World Development,* Vol. 5, No. 5-7, pp. 559.
[154] Feder (1977) p. 567. See also: Clunies-Ross & Hildyard, (1992).
[155] Other useful discussions of Agribusiness corporations, export trading companies, and imperfect competition in commodity markets can be found in: UK Food Group (1999), RAFI (1999), Nye (1993), Lord (1991), Chalmin (1980) and Jones (1988).

5.5 Agriculture - Conclusions

It is a significant and positive development that agriculture is finally being brought under the WTO's rules, but far more extensive reforms are needed.

The adverse terms of trade movements for primary commodities and the volatility of export prices for these commodities make foreign exchange earnings for many of the poorer developing countries unreliable. Moreover, despite the Uruguay Round, major distortions still exist in the international agricultural markets, in terms of ongoing developed country protectionism, faults with the Agreement on Agriculture itself, the inadequate implementation of that Agreement as well as other key URAs, and also the dominance of agricultural trade by a small number of powerful firms.

When there is also the potential for global food shortages in a given year, for disruption of international markets by war, and for inadequate safety nets for displaced poor farmers, then the case against developing countries relying too strongly on trade for food security and neglecting domestic agricultural development becomes even more compelling.

A review of strategies to improve food security is beyond the scope of this paper, but on the basis of the foregoing discussion, developing countries should be very wary of arguments that their food security strategies should be abandoned in favour of trade. Developing countries should pursue appropriate agricultural development and food security strategies which account explicitly for the needs of their poorest and most vulnerable people, while at the same time pushing for the reform of distorted world agricultural and primary commodity markets.

Finally, there should be significantly increased scrutiny of the major agribusiness corporations and trading companies, and their role in international agricultural production and trade by multilateral institutions such as the World Bank, UNCTAD and the WTO. A formal inquiry into their role and conduct in the world's food markets should also be conducted. If TNCs control the food chain, this could have significantly negative impacts on developing countries, with serious implications for governance and food security.

6. Trade in Services

The completion of the General Agreement on Trade in Services (GATS) was one of the most important developments of the Uruguay Round. It laid out a framework of multilateral rules to govern trade in such important areas as air transport services, financial services, telecommunications, maritime transport services, tourism and so on. A full examination of GATS is beyond the scope of this paper, but a few points are in order.

Services are clearly a key sector for developing countries, which have an obvious comparative advantage in labour-intensive service industries. Some have also invested considerable in more high-tech sectors, but these can be more problematic if not linked effectively into the rest of the economy. In one recent study of the Indian software industry for example, the authors found that while the industry has a valuable role in earning foreign exchange, it functions much like an export enclave with few forward or backward linkages into the rest of the economy and may misallocate valuable human capital.[156]

Nevertheless, expansion of trade in services offers clear opportunities for developing countries. Aaditya Mattoo from the World Bank, in a recent paper argues strongly that developing countries should abandon their reluctance with regards to the negotiations on services, which are also mandated to begin again by the end of this year.[157] Instead, he says, they should push aggressively for reforms such as the liberalisation of domestic services markets, the development of improved rules for domestic regulations that encourage economic efficiency and the effective liberalisation of foreign service markets by the elimination of both explicit restrictions and implicit regulatory barriers.

Bipul Chatterjee, of CUTS, an Indian NGO also contends that the negotiations on services offer significant opportunities for developing countries, which should pursue vigorously the reforms of their own domestic services sectors.[158]

However, a stark contrast should be noted on the issue of trade in services: on the one hand, the developed countries' enthusiasm to liberalise the flows of investment and capital-intensive services and, on the other, their almost complete reluctance to liberalise flows of that factor of production in which developing countries have a comparative advantage – labour, and labour-intensive services.

This has manifested itself particularly in the problems developing countries have faced with the fourth mode of service delivery (under Article 1 of GATS), the so-called 'movement of natural persons'. This is when a service is supplied by the physical movement of a country's service provider to a foreign country. Developing countries have complained that the implementation of this aspect of GATS has been particularly problematic, with little in the way of commercially meaningful commitments from developed countries.

Access has been frustrated by developed countries' abuse of measures such as strict and discretionary visa and licensing requirements, lack of recognition of qualifications and economic needs tests which are themselves often quite discretionary and opaque in their criteria. This lack of access for developing country service providers creates major imbalances in trade, by preventing developing countries' technicians and business people from participating in a wide variety of activities which are essential for the penetration of world service markets.[159]

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[156] Balasubramanyan, A. and Balasubramanyan, V.N., (1997) "Singer, Services and Software", *World Development,* Vol. 25, No. 11, November, pp. 1857-1861.

[157] Mattoo, A., (1999) "Developing Countries in the New Round of GATS Negotiations: From a Defensive to a Pro-Active Role", The WTO/World Bank Conference on Developing Countries' Interests in a Millennium Round, 20-21 September 1999, WTO Headquarters, Centre William Rappard, Geneva, 56 pp.

[158] Chatterjee, B., (1997) "Trade in Services - Cul de Sac or the Road Ahead!", CUTS Briefing Paper No. 7 / July 1997, CUTS Centre for International Trade, Economics & Environment, Jaipur, India, 10 pp.

[159] UNCTAD, (1999) "Assessment of Trade in Services of Developing Countries: Summary of Findings", UNCTAD/ITCD/TSB/7, August 16, UNCTAD Trade and Development Board, Geneva, p. 10;

However, the benefits of services liberalisation should be separated from the push to negotiate a multilateral framework to promote it. In services, like in agriculture, there are serious concerns about the monopolization of domestic service industries by powerful, established OECD firms and the possibility of a loss of control by developed country governments of large sections of their economies. To the extent that services liberalisation is beneficial, developing countries should liberalise. However, they should not be forced to agree to multilateral, binding rules on market access to their service sectors.[160]

UNCTAD has noted for example that many markets for services are dominated by relatively few large firms from developed countries. In tourism for example, around 80% of the tour market belongs to just four 'mega companies' – Thomas Cook, Thomson, Airtours and First Choice. They face little effective competition because the next tier of competitors is so small. Service providers from developing countries, mainly small and medium enterprises "face competition from large service multinationals with massive financial strength, access to the latest technology, worldwide networks, and sophisticated information technology infrastructure."[161]

The fact that services trade frequently involves foreign corporations means that it has substantial overlaps with issues of investment. Developing countries have repeatedly blocked moves towards any OECD-style Multilateral Agreement on Investment in the WTO and investment-style rules should not be negotiated at the WTO under the cover of the GATS negotiations.

Services, along with agriculture, is one of the sectors mandated for further negotiations to begin by the end of 1999. It is to be hoped that the renewed negotiations will redress the imbalances against developing countries – particularly in relation to the movement of natural persons and other market access barriers to developing country service exports.

[160] Matthew Stilwell (1999), Centre for International Environmental Law, Geneva, personal communication.

[161] UNCTAD, (1999) "Assessment of Trade in Services of Developing Countries: Summary of Findings", UNCTAD/ITCD/TSB/7, August 16, UNCTAD Trade and Development Board, Geneva, p. 13; See also: UNCTAD, (1999) "Analysis of Experiences in Selected Services Sectors", TD/B/COM.1/28, August 17, UNCTAD Trade and Development Board, Geneva, 19 pp.

7. The Agreement on Subsidies and Countervailing Measures

This agreement is of great interest to developing countries due to the fact that certain types of subsidies are vital for effective development. It is widely acknowledged that direct producer subsidies are a less trade-distorting means of protection for local industries than are tariffs and quotas. Tariffs increase local prices and harm both local consumers as well as foreign producers.

However, subsidies can be used inappropriately, resulting in distorted markets and environmental destruction. The continuing high levels of support in many OECD countries is of great concern - especially support which takes the form of production-linked assistance, which encourages wasteful and often environmentally-destructive overproduction.

The extremely high levels of support given to agriculture in many OECD countries has already been noted. But the problem of over-subsidisation of the world's fishing fleets is also critical. Safina, for example, observes that government subsidies attempting to preserve employment have for years enticed investors to buy more fishing boats than the sea could possibly support:

> Between 1970 and 1990, the world's industrial fishing fleet grew at twice the rate of the global catch, fully doubling in the total tonnage of vessels and in number. This armada finally achieved twice the capacity needed to extract what the oceans could sustainably produce.[162]

In general, trade-distorting subsidies should be phased out, especially in fisheries, energy, water and agriculture – *except* when such measures would adversely affect the poor who rely on them for their survival.

Any phase out of subsidies though, must also take place with careful attention to the impact on those less well off and with appropriate safety nets and compensation payments to mitigate social dislocation and hardship.

Subsidies necessary for development - such as, for example, cheaper finance, support for the adoption of advanced technology, or for market and product diversification - should be considered non-actionable under the terms of Article 8 of this agreement.

[162] Safina, (1995) p. 34.

8. Trade-Related Intellectual Property Rights

A number of developing countries, particularly India, have expressed the view that the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) gives higher priorities to private profits than to the public good and that, because of the TRIPS agreement, technology transfer to developing countries is becoming more difficult and more expensive.[163]

The TRIPS agreement's articles pertaining to biological patenting, and the food security implications of poor farmers being forbidden to save patented seeds for replanting are particularly concerning.

In one recent example, which would be amusing if it were not so tragic, Prince Hans Adams II of Liechtenstein was involved in a dispute with India and Pakistan over a patent he holds on a variety of basmati rice. India and Pakistan argue, among other things, this it is absurd for the rice to be patentable because the vast bulk of the 'intellectual property' for the variety was developed over hundreds of years by traditional farmers' selective breeding. Compared with that, the adjustments made by the seed technology company involved, Texas based RiceTec, are miniscule, yet the company and the Prince who owns it will reap *all* of the economic benefits. The Indian government is quoted as describing the granting of the patent to RiceTec as "a classic case of economic hijack."[164]

Under the provisions of TRIPS Article 27.2, members may exclude inventions from patentability "to protect the *ordre public* or morality, including to protect human, animal or plant life or health or to avoid serious prejudice to the environment…"[165]

TRIPS article 27.3(b) states that Members may exclude from patentability, "plants and animals other than micro-organisms, and essentially biological processes for the production of plants or animals other than non-biological and microbiological processes." Yet then immediately goes on to say: "Members shall provide for the protection of plant varieties either by patents or by an effective *sui generis* system or by any combination thereof."[166]

There seem to be two clear contradictions here: First, allowing Members to exclude plants from patentability and then requiring them to patent plant varieties. Second, an artificial distinction between biological and micro-biological processes.

The development of such *sui generis* (indigenous) systems should be encouraged to protect traditional medicine and biodiversity. Calls to harmonise such *sui generis* systems under UPOV 1991[167] should be resisted.[168]

The TRIPS Agreement should be brought in line with the Convention on Biodiversity (CBD), and the International Undertaking on Plant Genetic Resources, so that the rights of communities are recognised and that patents which may not be granted under the CBD, may also not be granted under TRIPS. In this regard, Monsanto's recent decision to abandon its pursuit of 'terminator' technology to produce sterile seeds is a welcome development.

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[163] India, (1999) "Intervention by Ambassador Narayanan of India in the Opening Session on 17 March 1999", Paper presented by the Government of India to the WTO High Level Symposium on Trade and Development, 17-18 March, 1999, Geneva, p.3.

[164] Hall, W., (1999) "Prince firm on rice patent dispute", *The Financial Times,* London, Monday 27 September, [http://www.ft.com/nbearchive/email-ftibcmq18196e.htm, 27 September 1999].

[165] WTO, (1994), p. 379.

[166] WTO, (1994), pp. 379-380.

[167] UPOV 1991 is the 1991 Convention administered by the International Union for the Protection of New Varieties of Plants.

[168] For an excellent discussion of options for reviewing this article, see: Tansey, G., (1999) "Trade, Intellectual Property, Food and Biodiversity: Key issues and options for the 1999 review of Article 27.3(b) of the TRIPS Agreement", February, Quaker Peace & Service, London, 26 pp. [http://www.quaker.org/quno].

The introduction of new seed varieties such as drought-resistant, salt-resistant, pest-resistant, vitamin A-enriched, or iron-enriched rice, has a potentially enormously positive impact on food security and health in developing countries. What matters is the framework under which such technology is introduced. Beneficial technologies should be made readily available for use in local communities by local plant breeders and farmers.[169] However, the widespread application of western-style intellectual property rights regimes to poor farming communities in developing countries could have adverse effects on food security and could result in widespread indebtedness, poverty and malnutrition.

As Harvard economist Jeffrey Sachs has emphasised recently, the research and development of new technologies are overwhelmingly directed at rich-country problems.[170] But the poor live in different ecological zones, face different health conditions and must overcome agronomic challenges that are very different from those of most wealthy countries.

Major public health problems facing poorer countries such as malaria and tuberculosis attract little interest from the big vaccine producers such as Merck, Rhône-Poulenc's Pasteur-Mérieux-Connaught and SmithKline Beecham. The companies know that they would not be able to recoup the hundreds of millions of dollars in research and development it would cost them to develop effective vaccines. Likewise, there is little incentive for the big life-sciences companies such as Monsanto to invest in R&D in tropical agriculture problems if they cannot be confident that there will be a reasonable return on their investment.

So far, companies have tried to secure their investments by patents. But another way may be more effective. Sach's approach is for governments and the UN to *guarantee* a market to the companies, to give them the incentive to direct their considerable resources and expertise towards the problems facing the poorest countries. A Welcome Trust study a few years ago found that only about $80 million was spent each year on malaria research, and only a small fraction of that was spent on vaccines. Under Sach's proposal:

> Rich countries would make a firm pledge to purchase an effective malaria vaccine for Africa's 25m newborn children each year if such a vaccine were developed. They would even state, based on appropriate and clear scientific standards, that they would guarantee a minimum purchase price – say $10 per dose – for a vaccine that meets minimum conditions of efficacy, and perhaps raise the price for a better one. The recipient countries might also pledge a part of the cost, depending on their incomes. But nothing need be spent by any government until the vaccine actually exists.
>
> Even without a vast public sector effort, such a pledge could galvanise the world of private-sector pharmaceutical and biotechnology firms. Malaria vaccine research would suddenly become hot. Within a few years, a breakthrough of profound benefit to poor countries would be likely. The costs in foreign aid would be small: a few hundred million dollars a year to tame a killer of millions of children. Such a vaccine would rank among the most effective public health interventions conceivable. And, if science did not deliver, rich countries would end up paying nothing at all.[171]

Rigid intellectual property rights regimes which might be appropriate for developed countries, may be very unhelpful in a developing country context. Innovative solutions are required to ensure that developing countries are given access to safe, beneficial biotechnologies, without the crippling financial burden that Western-style patent protection can impose.

There should also be flexibility in the TRIPS agreement to facilitate access to drugs recognised as essential by the World Health Organisation in developing countries, particularly for AIDS which is

[169] Susannah Tymms, (1999), Agriculture Victoria, Department of Natural Resources and Environment, personal communication.
[170] Sachs, J., (1999) "Helping the World's Poorest", *The Economist,* Vol. 352, No. 8132, August 14th, pp. 17-20.
[171] Sachs (1999) p. 19.

devastating many societies in poor countries. Parallel importing and compulsory licensing for such drugs should be recognised and upheld.[172]

The TRIPS Agreement explicitly obliges developed countries to provide technical and financial assistance (Article 67) and incentives for their own enterprises to promote technology transfer to developing countries (Article 66.2). Little seems to have been done to meet these requirements, which should be made obligatory and subject to periodic notification.

Kenya recently submitted an important document on the TRIPS Agreement to the WTO on behalf of the African Group.[173] The document makes a number of important points and recommendations, some of which are reproduced in Box 3.

Box 3: Excerpts from the African Group's Proposals on the TRIPS Agreement:
29 July 1999

IV. Article 66.2 - Incentives for Transfer of Technology to LDCs:

9. The provisions of this Article are couched in "best endeavour" terms. Best endeavour provisions are fundamentally flawed in that they are neither enforceable nor do they constitute a real benefit for developing and least-developed countries. Consequently many developed countries have as yet not demonstrated how they are fulfilling the provisions of this Article."

Proposal

10. Need for a regular full review of the implementation of the provisions of Article 66.2 by developed countries.

Nature and scope of review

12. The question of interpretation of the nature and scope of the review of Article 27.3(b) still remains to be resolved. The debate is about whether Article 27.3(b) provides for the review of the implementation of the provisions therein, or for the review of the substantive provisions of the Article itself. It is our view that the review mandated and meant is a review of the substance of the subparagraph itself, and is not meant to be confined to the implementation of the subparagraph. This is clear from the wording of the last sentence of Article 27.3(b): "The provisions of this subparagraph shall be reviewed four years after the date of entry into force of the WTO Agreement."

Artificial distinctions between biological and microbiological organisms and processes

19. There is lack of clarity on the criteria/rationale used to decide what can and cannot be excluded from patentability in Article 27.3(b). This relates to the artificial distinction made between plants and animals (which may be excluded) and micro-organisms (which may not be excluded); and also between "essentially biological" processes for making plants and animals (which may be excluded) and microbiological processes.

20. By stipulating compulsory patenting of micro-organisms (which are natural living things) and microbiological processes (which are natural processes), the provisions of Article 27.3 contravene the basic tenets on which patent laws are based: that substances and processes that exist in nature are a discovery and not an invention and thus are not patentable. Moreover, by giving Members the option whether or not to exclude the patentability of plants and animals, Article 27.3(b) allows for life forms to be patented.

[172] Consumers International, (1999) "Consumer Rights and the Multilateral Trading System: What needs to be done before a Millennium Round", August, Consumers International, London, p. 10. [http://www.consumersinternational.org/trade]. See also: Chaudhuri, R., Chatterjee, B. and Mehta, P., (1997) "TRIPs and Pharmaceuticals: Implications for India", CUTS Briefing Paper No. 8 / August 1997, CUTS Centre for International Trade, Economics & Environment, Jaipur, India, 8 pp.

[173] Kenya, (1999) "Preparations for the 1999 Ministerial Conference: The TRIPS Agreement - Communication from Kenya on behalf of the African Group", WTO Document: WT/GC/W/302, 6 August 1999, World Trade Organization, Geneva, 5 pp.

Proposals

21. (a) The review of the substantive provisions of Article 27.3(b) should clarify the following:

- Why the option of exclusion of patentability of plants and animals does not extend to micro-organisms as there is no scientific basis for the distinction.

- Why the option of exclusion of patentability of "essentially biological processes" does not extend to "microbiological processes" as the latter are also biological processes.

(b) The review process should clarify that plants and animals as well as microorganisms and all other living organisms and their parts cannot be patented, and that natural processes that produce plants, animals and other living organisms should also not be patentable.

Clarifying the option of a *sui generis* system for plant varieties

23. After the sentence on plant variety protection in Article 27.3(b), a footnote should be inserted stating that any *sui generis* law for plant variety protection can provide for:

(i) the protection of the innovations of indigenous and local farming communities in developing countries, consistent with the Convention on Biological Diversity and the International Undertaking on Plant Genetic Resources;

(ii) the continuation of the traditional farming practices including the right to save, exchange and save seeds, and sell their harvest;

(iii) preventing anti-competitive rights or practices which will threaten food sovereignty of people in developing countries, as is permitted by Article 31 of the TRIPS Agreement.

9. Trade and the Environment

The issue of trade and environment is multifaceted, involving three main areas of concern.[174] First, there is the physical linkage between trade liberalization and environmental degradation, which occurs both at the macro-level (eg. the physical scale of economies) and the micro level (eg. the impacts on specific resources in particular locations).

Second are the linkages between international environmental and trade law and institutions, manifesting themselves particularly in the tensions between the WTO rules and those of the Multilateral Environmental Agreements (MEAs). Here, greater coherence between international rules, institutions, and dispute settlement procedures is required. It is necessary to clearly delineate the WTO's mandate and those of other international organizations and to find rules and principles to mediate between them where their mandates clearly intersect.[175]

Third are the linkages between WTO rules and national and sub-national laws and policies, and the ability of governments to *regulate* to protect health and the environment, whilst subject to the WTO's generally *deregulatory* rules.

This discussion will concentrate primarily on the first area, but will also touch on the other two, which are just as vital to a proper appreciation of trade and environmental linkages.

The poor tend to suffer most from environmental degradation. They usually do not have much choice where or how they live. Unlike most of the citizens of the developed world and the wealthy educated elites of their own countries, they are usually unable to escape the consequences of environmental degradation. They farm marginal, degraded land, if they have any land to farm. They drink polluted water or walk for hours each day to fetch clean water. They scrounge scarce fuelwood and get respiratory illnesses from burning animal dung in smoky cooking fires.

One of the greatest contributors to environmental degradation is undoubtedly poverty. To meet the global environmental challenges facing us, poverty must be eradicated.[176] However, the very process of eliminating poverty is itself likely to lead to a certain amount of environmental degradation, simply because it will require the consumption of physical resources. So this presents a dilemma – how can the international economic system be reformed so that it promotes the elimination of poverty *and* halts global environmental degradation?

International trade and the rules that govern it under the WTO play a crucial role here and will either help or hinder the process. The WTO's Third Ministerial Meeting in Seattle takes place at a critical juncture not just for the multilateral trading system, but for the vision of 'sustainable development' itself.

Many ecologists raise serious questions about whether there can be such a thing as development that is ecologically sustainable. The debate on trade and the environment therefore, needs to be set in the context of the vision of sustainable development and the underlying question of whether growth itself can be ecologically sustainable.

9.1 Growth and Sustainable Development

Questions of sustainability must relate both to 'sources', from which raw materials are derived and 'sinks', where the waste is deposited. Much of the early work on sustainability focussed on 'sources' and the danger of running out of key resources such as minerals and fossil fuels. Some of this work

[174] I am grateful to Matthew Stilwell, Centre for International Environmental Law, Geneva, for this useful categorisation.

[175] For a major recent study on Trade and the Environment by the WTO see: Nordström, H. and Vaughan, S., (1999) *Trade and Environment,* Special Studies 4; World Trade Organization, Geneva, 108 pp.

[176] For a detailed account of these challenges see: UNEP, (1999) *Global Environment Outlook 2000,*(Ed. Robin Clarke); UNEP, Nairobi.

was legitimately criticised for not taking into account sufficiently the opportunities provided by substitution and technical innovation. At the end of the century, we find that we have not run out of key resources and prices for many have even declined. This has led to an unfortunate degree of complacency in some circles - unfortunate because the world does face serious challenges in a number of other 'source' areas, including: inadequate fresh water supplies, biodiversity losses and species extinctions, deforestation, exhausted fisheries, ongoing land degradation and plateauing food production.

We also face real problems on the 'sink' side. Even if growth is sustainable on the basis of resource availability and more and more matter and energy can be used in the international economic system - there is still the problem of the disposal of the waste. The world has already witnessed the effects of this waste on the ozone layer. Other major challenges include climate change and the continuing problems of the permanent disposal of nuclear and toxic wastes.

Economic growth can be thought of as being composed of the growth of three components: first, growth of the *physical* characteristics of products and services - the growth of the physical *scale* of the economy, the matter and energy employed in the economic system; second, growth in the *efficiency* of the use of matter and energy; and third, the growth in the *value* of those products and services. Together these lead to a growing economy and rising GDP.[177]

So is growth sustainable? Few people seriously believe that on a finite planet the exponential growth of matter and energy being churned through the economic system can be sustained indefinitely – no matter how efficiently it is used. Goods and services always have an irreducible physical component – even if that is just electricity. At a 3% growth rate, the world economy doubles in size roughly every 24 years. If the physical scale of the world's economy were to double at this rate, it would be 16 times as large by 2100 – i.e. the global economy would be consuming 16 times as much matter and energy as it does now. This has very serious environmental implications.

So if development is to be truly sustainable in the developed countries, there certainly need to be efficiency improvements, but the bulk of *sustainable* growth must come from the greater *value* of the products and services that are produced, per unit of matter and energy. Given the environmental challenges the world faces, and the constraints on the biosphere to both provide resources and absorb wastes, the continued growth in the net physical *scale* of developed country economies seems difficult to justify.

However, developing countries, where absolute poverty is still widespread, need to considerably *increase* their use of resources to help lift their people out of poverty and build the physical and social infrastructures needed to sustain a decent standard of living. They need growth in the volume of resources they are using. Some of that growth is going to be environmentally destructive, simply because it requires physical resources such as mines, power stations, water and timber – and it will produce waste.

The crisis of the vision of sustainable development then is not simply one of tweaking the edges of the current economic systems while helping developing countries develop with the latest environmentally-friendly technologies. Many ecological economists argue that we have reached the point where the physical scale of the global economy is now pushing up against the limits of the biosphere's capacity.[178] This means that while it is right and appropriate that we talk about *synergies* between trade and environmental concerns that can produce 'win-win' outcomes, the challenges we face are wider than this. The liberalisation of trade in environmentally-friendly goods and services should certainly be encouraged, but such 'win-win' outcomes will *not,* in themselves, make up for the

[177] Whether these components are independent or interdependent is an important question, but the primary issue to be addressed here is whether there exists limits to the growth of any one of the components, regardless of its relationship to the others.

[178] Goodland, R. and Daly, H., (1993) "Why Northern Income Growth is Not the Solution to Southern Poverty", *Ecological Economics,* Vol. 8, No. 2, October, pp. 85-101.

environmental damage inflicted by the uncontrolled growth of the physical scale of the world's economies.

In a very real sense the developed countries must move towards economic systems which are truly sustainable - not in an isolationist autarkic sense, but economies in which environmental and social costs are fully incorporated into prices and economic decision making. The growth of the physical *scale* of the industrialised economies must at some point be curtailed to create the ecological biophysical space needed for developing countries to grow and develop. This crowding of the ecological space is seen most acutely with climate change – a problem caused by developed countries which are now saying to poor developing countries after two or three centuries of growth that they need to bear the burden too, while most of their people still live in poverty.

In short, the rules of international trade must provide opportunities for developing countries to grow and develop and, at the same time, they must not create disincentives for industries and economic systems in developed countries (or indeed anywhere) to move to a more sustainable basis.

9.2 Can Trade and the Environment be Separated?

One of the most disturbing features of some of the discourse on trade and environment is an argument that runs something like this:

The WTO was set up purely to govern international trade arrangements.
Trade is essentially an economic matter that can and should be separated from environmental considerations.
Therefore, the environment is an issue outside the scope of the WTO.

This is a flawed argument. Firstly, trade and trade-induced production of goods and services have environmental implications and consequences. Trade can affect the environment for good or ill, so the rules that govern trade must take this into account. Trade rules cannot simply ignore the environmental dimensions of trade and growth. It is not good enough to pretend that trade and environment can be neatly separated. If the WTO is not competent to deal with environmental issues then it should refrain from ruling on disputes that impinge on the environment until such time as it has the relevant expertise, or until some new institutional arrangement is put in place - such as a joint WTO-UN body to rule on environmentally-related trade disputes and to oversee the trade-environment nexus. In any case, there should be stronger formal links between the WTO and UNEP.

Secondly, trade theory says that free trade will generally produce optimally efficient outcomes, but it makes a number of important assumptions, particularly that the prices of goods and services accurately reflect their true costs of production. However when significant social and environmental costs are unaccounted for – when they are simply ignored or 'externalised', then a free-market solution will be based on false price signals and will produce sub-optimal outcomes – a polite way of describing ruined lives and devastated environments.

9.3 The Need for Full Cost Accounting

Environmental costs, such as the pollution of the atmosphere, groundwater and waterways, the depletion of soils and the disposal of wastes are generally ignored or externalised and treated as 'free'. Yet when measured in dollars, the impact of this neglect on national economies is astounding.

The deterioration of Europe's forests due to air pollution for example, causes economic losses of around $35 billion every year; the estimated annual losses in agricultural production due to air pollution are $1.5 billion in Sweden, $1.8 billion in Italy, $2.7 billion in Poland and a massive $4.7 billion in Germany.[179]

[179] UNDP, (1996) *Human Development Report 1996,*Oxford University Press for the United Nations Development Programme, Oxford and New York, p. 26.

The UNDP argued that simply using GNP growth as the primary economic barometer was like navigating with a faulty compass. It meant that the earth ended up being treated 'like a business in liquidation'.[180] Or, as Robert Repetto from the World Resources Institute in Washington, DC, wrote:

> A country can cut down its forests, erode its soils, pollute its aquifers and hunt its wildlife and fisheries to extinction, but its measured income is not affected as these assets disappear. Impoverishment is taken for progress.[181]

The growth of this sort of distorted economic activity can only lead inexorably to greater environmental destruction. It is not trade as such, but trade in goods and services that ignore environmental and social costs which is the root of the problem.

The notion that strong domestic social and environmental regulations can distort trade needs to be examined. What are the criteria used to define 'distortion'? The underlying assumption is that by definition *de*regulated trade is *non*-distorted trade. But this simply ignores the well-established fact that left to itself, an unregulated market fails to incorporate environmental and social 'externalities' into the pricing structure. Strong and well-designed regulations are essential for social and environmental costs to be incorporated into prices. Without these, the market, and therefore trade in the market, is *profoundly* distorted. To talk of 'free', 'undistorted' trade, when these costs are ignored is simply misleading. Shrybman is right to argue that:

> as long as the environment remains an externality that is ignored during the trade negotiation process, trade agreements will often institutionalize principles that are at odds with, and at times antithetical to, the objectives that are being pursued through international environmental agreements.[182]

Externalising environmental costs forces others to pay for the damage, either directly with money or indirectly through loss of amenity. It is both unjust and extremely inefficient because the costs of repairing environmental damage are usually far greater than the costs of preventing it in the first place. The logic that says, "we need to get wealthy before we can afford to worry about the environmental consequences of rapid growth", is deeply flawed for three reasons:

First, it is a direct contravention of the economic argument for efficiency and precise, well-targeted policies for dealing with distortions and externalities. It is usually much less costly and more efficient to prevent environmental degradation than to try to clean up and repair the damage later.

Second, much environmental degradation is irreversible, such as species extinctions, habitat and rainforest destruction, loss of topsoil due to erosion, and climate change. Those who believe that technology will come to our rescue on most of these issues should bear this irreversibility in mind.

Third, those who make such arguments seldom have to actually live with the consequences of their advice. The argument is often made that people in developing countries demand different levels of environmental quality. The problem with this contention is that 'consumer demand' as used appropriately by economists is a very misleading term when simplistically applied in the public policy arena because the concept is inherently biased towards the wealthy. It only actually measures the willingness to pay of those who are *able* to pay – it does not reflect the desires of those who simply cannot pay no matter how much they may 'demand' or desire something. The unemployed landless peasant living in a slum does not want to drink polluted water or breath toxic fumes any more than you or I do. The difference is that those with money can express that desire with their wallets. She can not.

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[180] UNDP, (1996), p. 57.
[181] Repetto, R., (1992) "Accounting for Environmental Assets", *Scientific American,* Vol. 266, No. 6, June, p. 64.
[182] Shrybman, S., (1990) "International Trade and the Environment: An Environmental Assessment of the General Agreement on Tariffs and Trade", *The Ecologist,* Vol. 20, No. 1, January - February, p. 31.

The task of incorporating the environmental and social costs of goods and services into their prices is not an easy one. There is of course a great deal of controversy among economists over the actual method of accounting for environmental costs because of a basic philosophical difference: some argue that social and environmental costs should be internalised *within* the economy - that *everything* be given a price and then markets be left to work out the optimally efficient allocations. Conversely, others argue that the level of analysis should be the community and the biosphere as a whole, with the economy located within it and that the economy should be given very definite boundaries.[183]

Amir, for example, claims that internalisation of environmental externalities by pricing everything is not the panacea it is thought to be and can be no more than a temporary solution because it is impossible to internalise all costs. Partial internalisation is also inadequate because it saves harmed resources by abusing other environmental resources whose costs remain externalised.[184]

Daly and Cobb reach a similar conclusion on the horrendous complexities involved in trying to guesstimate the costs of global warming and how these could be incorporated into prices:

> Instead of beginning with the impossible task of calculating full-cost prices and then letting the market determine the right quantities on the basis of these prices, we could begin with the 'right' quantities and let the market calculate the corresponding prices. But what do we mean by the 'right' quantities? Only that the economy is constrained to operate with volumes of resource flows that are within the renewable biospheric capacities of regeneration and waste absorption. Environmental carrying capacity and sustainable exploitation rates of natural sources and sinks are roughly definable in physical terms. We say 'roughly' because we recognise that the concept of carrying capacity has its ambiguities. But these are small compared to the truly impossible calculations used to internalize a pervasive externality by the same method used to deal with localized externalities. Imposing sustainable biophysical limits as a boundary on the market economy will lead to changes in market prices that reflect these newly imposed limits. These new prices would have 'internalized' the value of sustainability, the sacrifice of which had previously been an external cost.[185]

Whatever method is used to account for environmental and social costs, we need to avoid what forecaster Daniel Yankelovich calls 'the McNamara fallacy' (after Robert McNamara, former US Defence Secretary and former World Bank president):

> The first step is to measure whatever can be easily measured. This is okay as far as it goes. The second step is to disregard that which cannot be measured or give it an arbitrary quantitative value. This is artificial and misleading. The third step is to presume that which cannot be measured easily is not really very important. The fourth step is to say what cannot be measured really does not exist. This is suicide.[186]

As long as prices do not somehow reflect reality, they will continue to give misleading signals resulting in market failures, inefficiencies in the allocation of resources, distortions in trade and ruined environments.

A crucial question then arises: should not the WTO agreements permit, or indeed encourage, the differential treatment of products which endeavour to incorporate environmental and social costs of production, compared with those which do not? This question leads to the complex and controversial issue of Production and Processing Methods, which will be addressed in Section 11.

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[183] Daly, H.E. and Cobb, J.B., Jr., (1994) *For the Common Good: Redirecting the Economy Toward Community, the Environment and a Sustainable Future*, Second Edition; Beacon Press, Boston, p. 142.
[184] Amir, S., (1994) "The Role of Thermodynamics in the Study of Economic and Ecological Systems", *Ecological Economics,* Vol. 10, No. 2, July, p 139.
[185] Daly and Cobb (1994), pp. 142-143.
[186] Quoted in Daly, H.E., (1992) *Steady–State Economics: Second Edition With New Essays,* Earthscan Publications Ltd., London, p. 145.

9.4 The Precautionary Principle

Another environmentally-related concept which should be explicitly recognised in WTO rules is the precautionary principle – the principle that where there exists the possibility of serious or irreversible harm, the absence of full scientific certainty should not be used as a reason to postpone measures to prevent environmental damage (Rio Declaration, Principle 15, 1992).

Some argue that the Agreement on the Application of Sanitary and Phytosanitary Measures adequately incorporates the precautionary principle. Key articles emphasise that any measures must be "necessary to protect human, animal or plant life or health" (Article 2.1) or that standards than international standards may be introduced, "if there is a scientific justification" (Article 3.3), and most critically Article 5.7:

> In cases where relevant scientific evidence is insufficient, a Member may provisionally adopt sanitary or phytosanitary measures on the basis of available pertinent information, including that from the relevant international organizations as well as from sanitary or phytosanitary measures applied by other Members. In such circumstances, Members shall seek to obtain the additional information necessary for more objective assessment of risk and review the sanitary or phytosanitary measure accordingly within a reasonable period of time.[187]

One of the keys here of course, is the definition of 'a reasonable period of time'. By its very nature, scientific analysis can require five, ten and even fifty years of monitoring and experimentation to yield data series which will give the kinds of statistically significant results that would constitute adequate scientific evidence. Public debates are distorted when appropriate scientific caution is seized upon by those with vested interests and is exploited in public relations campaigns to give the impression that there is no reason for concern. To release potentially dangerous products prematurely can be disastrous for the environment and for human health.

A distinction should also be made between products that are relatively inert, such as chemicals, and those that can grow, reproduce and disperse – such biological organisms.[188] There are no shortages of examples of ecological devastation wrought by the inappropriate introduction of an animal or plant into a foreign ecosystem. Once organisms are introduced to an ecosystem they can be virtually impossible to eradicate if they turn out to be harmful.

There must be flexibility in WTO rules for appropriate precautions when there is reasonable doubt about a product's safety or reasonable cause for concern about an environmental problem.

[187] WTO (1994), p. 73.

[188] For one example of unexpected consequences of genetic modification, see: Bergelson, J., Purrington, C.B. and Wichmann, G., (1998) "Promiscuity in transgenic plants", *Nature,* Vol. 395, 3 September, p. 25.

10. Trade, Equity, Labour, and Human Rights

10.1 The Concept of Inequality

The issues of trade, equity, labour and human rights are intertwined and extremely controversial. Developing countries quite rightly feel that often, beneath the supposed concerns of developed countries regarding exploited labour, lie thinly veiled protectionist interests – interests which wish to remove one of the only sources of comparative advantage which many developing countries feel they have – their relatively low wages and abundant labour. Workers in many developed countries conversely, wonder why they must be forced to compete with workers who not only work for less money, but often do so under appalling conditions. They fear a 'race to the bottom' where workers are pitted against each other and the only winners are the rich capitalists. Meanwhile, many believe that the process of growth itself inevitably leads to growing inequality.

Inequality however, is a slippery concept. Inequality can obviously result when the 'winner' is gaining and the 'loser' is going backwards. However, inequality can also result when the 'winner' is gaining more rapidly than the 'loser' – even though *both* are gaining. Is the second scenario as bad as the first? Of course not – but the growth of the gap can look the same in both circumstances. Care should therefore be taken with the interpretations of claims that 'inequality' has increased (or decreased). Have the poor simply become *absolutely* worse off, or have they become absolutely better off, but *relatively* worse off compared to the rich who may have become absolutely better off by a greater margin?

A uniform percentage *increase* in income will automatically *increase* absolute inequality by increasing the incomes of the rich by more in absolute terms than those of the poor, simply because the rich start from a higher base. Similarly, a uniform percentage *reduction* in income will reduce absolute inequality, but will also make the poor worse off in absolute terms. The different effects involved here can be easily illustrated: If a rich family earns $50,000 each year, and a poor family earns $5000, the absolute inequality gap is $45,000. With a uniform *increase* in income of 10%, the rich family now earns $55,000, the poor family earns $5,500, and the absolute inequality gap has *increased* by $4,500 to $49,500. Conversely, if there is a uniform *reduction* in income for both families of 10%, the rich family would then earn $45,000, the poor family would earn $4,500 and the absolute inequality gap would have *reduced* by $4,500 to $40,500. Few would suggest that the poor family is better off in the second scenario than the first, yet inequality improved in the second case and worsened in the first.

Beyer, Rojas, and Vergara's analysis of trends in inequality in Chile over the last 30 years indicated that trade liberalisation contributed in some measure to inequality in Chile by widening the wage gap between skilled and unskilled workers. They attribute this to two main factors: First, technological change may have been biased against unskilled labour in the 1980s and 1990s. Second, the structure of the economy changed considerably as a result of trade liberalisation, substantially *increasing* the demand for and thus the wages of skilled workers. It is important to note that over the period they studied, poverty *declined* significantly. In 1987, 45% of the population lived under the poverty line, whereas in 1996 the figure was around 23%. In other words, the growth in *relative* inequality has been in the context of most people becoming *absolutely* better off. They conclude that the link between inequality and trade liberalisation "in no way implies that opening up to trade should be avoided. On the contrary, much of the success of the Chilean economy in the last decade is linked to trade liberalisation."[189]

This use of this illustration should not, in any way, be interpreted as sanctioning inequality – far from it! It merely serves to emphasise that care should be taken in dealing with the concept of 'inequality', since movements in inequality in one direction can mask changes in absolute living standards for the poor that trend in precisely the opposite direction.

[189] Beyer, H., Rojas, P. and Vergara, R., (1999) "Trade liberalization and wage inequality", *Journal of Development Economics,* Vol. 59, No. 1, June, pp. 103-123.

10.2 Growth and Inequality

Some have argued that economic growth *causes* inequality to increase, but there is little empirical evidence for this. It used to be assumed that inequality must necessarily get worse with economic growth before it could get better – the so-called Kuznets hypothesis, but recent World Bank research shows that growth does not consistently affect inequality either way and that changes in inequality due to economic growth generally tend to be small. The authors argue that consequently, growth almost always improves the incomes of the poor and there is no *necessary* trade-off between long-run efficiency and equity.[190]

In another recent study, Galbraith, Jiaqing and Darity conclude that in most countries, growth has been good for equality, and that in fact, strong growth appears to be an indispensable prerequisite for equity. In sharp contrast, the weak growth in most developing countries in the 1980s "was an inequality disaster."[191] Research on economic growth and inequality in India between 1970 and 1989, led Tendulkar and Jain to conclude that:

> contrary to the earlier widely held perceptions, compared with the 1970s which was characterised by slow economic growth, the faster rate of growth in India in the 1980s was associated with more frequent equitable distributional outcomes.[192]

There is however, a growing body of evidence to suggest that *inequality* is bad for growth. Persson and Tabellini's 1994 study, for example, concluded that both historical panel data and postwar cross-sections indicated a significant and large negative relation between inequality and growth.[193] Deininger and Squire emphasise that inequality *does* affect growth – and inequality in land distribution does so in particular.[194] Bruno and his co-authors concluded that policies aimed at facilitating the accumulation of productive assets by the poor and helping to reduce inequality through securing access to basic education and health provide not only direct immediate benefits to the poor, but provide long term benefits to the society through fostering higher growth rates.[195]

Even the IMF have recently said that economic policy makers need to pay greater attention to equity issues, in part because equity-enhancing policies such as investment in human capital can boost economic growth in the long run and reduce poverty. It also now advocates: "Well targeted social safety nets to mitigate the adverse short-term effects of, and ensure political support for, reforms designed to achieve macroeconomic stability and remove impediments to long-term sustainable growth."[196]

The World Bank has also produced some excellent work recently on safety nets and the need to protect the poor from macroeconomic shocks.[197]

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[190] See: Bruno, M., Ravallion, M. and Squire, L., (1995) "Equity and Growth in Developing Countries: Old and New Perspectives on the Policy Issues", Working Paper 1563, January, World Bank, Washington DC, 30 pp.; and Deininger, K. and Squire, L., (1998) "New Ways of Looking at Old Issues: Inequality and Growth", *Journal of Development Economics,* Vol. 57, No. 2, pp. 259-287. See also: Deininger and Squire (1996) and (1997).

[191] Galbraith, J.K., Jiaqing, L. and Darity, W.A., Jr., (1999) "Measuring the Evolution of Inequality in the Global Economy", UTIP Working Paper No. 7, January 30, University of Texas Inequality Project, Austin, Texas, p. 9.

[192] Tendulkar, S.D. and Jain, L.R., (1995) "Economic Growth, Relative Inequality, and Equity: The Case of India", *Asian Development Review,* Vol. 13, No. 2, p. 138.

[193] Persson, T. and Tabellini, G., (1994) "Is Inequality Harmful for Growth?", *The American Economic Review,* Vol. 84, No. 3, June, pp. 600-621.

[194] Deininger & Squire, (1998).

[195] Bruno, Ravallion & Squire (1995) pp. 1 & 21.

[196] IMF Staff, (1998) "Should Equity Be a Goal of Economic Policy?", *Finance & Development,* Vol. 35, No. 3, September, pp. 2-5. See also: IMF, (1998) *Should Equity Be a Goal of Economic Policy?,* Economic Issues 16; IMF, Washington DC, 12 pp.

[197] See for example: Ferreira, F., Prennushi, G. and Ravallion, M., (1999) "Protecting the Poor from Macroeconomic Shocks: An Agenda for Action in a Crisis and Beyond", World Bank Working Paper No. 2160, August, World Bank, Washington DC, 23 pp.

10.3 Trade, Jobs and Inequality – The 'Sweatshop Labour' Argument

What about the effects of trade? It is a very widely held belief, particularly in the OECD countries, that trade with poorer 'low-wage' countries has led to growing inequality in OECD societies – and particularly that such trade harms low-skilled workers in OECD countries. Workers in developing countries are believed to be exploited, working for a mere fraction of developed country wages and providing an incentive for developed country firms to relocate there. The claim that firms are likely to relocate production from high wage to low wage countries is often called the "sweatshop labour argument".

That inequality has grown in most OECD countries over the last few decades is well recognised. But is trade the main culprit? A couple of points should be made here to begin with:

First, labour costs relate primarily to the value-added per worker, not simply their wages. Hence, workers who are more productive, due to the availability of superior capital equipment and processes, can 'cost' less in real terms than workers on substantially lower wages. Just because the wages in one country may be lower does not *necessarily* mean that the unit labour costs for the producers there are lower. This is a simple point but it is often forgotten in the debates over 'cheap labour'.

Second, while wages in many developing countries may seem very low to workers in developed countries, they are often substantially better than what the same workers had been able to earn previously. Many came from situations of widespread unemployment in impoverished rural communities.[198] One of the reasons millions of hopeful workers are flocking to burgeoning developing country cities is precisely because wages in booming manufacturing industries are often far better than what they were able to make back home. Just because wages are low does not *necessarily* mean the workers are being exploited. They might be, but it depends on the social context, the local prices of essential goods and, as will be discussed in Section 10.4, on precisely *why* wages are relatively low.

Nevertheless, a substantial number of economists believe trade with poor countries harms developed country workers, and, as Golub observes, the legitimacy of the international trading system is damaged by this perception of unfair labour practices in developing countries.[199] Wood for example argues that the *main* cause of the deteriorating situation of unskilled workers in developed countries has been the expansion of trade with developing countries.[200]

Larudee and Koelchin contended recently that the idea that wages tend to align themselves with productivity levels assumes simplistically that all firms in a country have access to the same technology.[201] Instead, both the theory and empirical evidence of Multinational Enterprises (MNEs) shows that MNE affiliates derive their labour productivity to a significant extent from the firm-specific advantages the firm brings with it. Therefore, wage differences between countries *should* have some influence on FDI flows. Moreover, the value-added per worker will probably be substantially underreported by many export-oriented MNEs in developing countries through transfer pricing, with the result that the productivity gap is smaller and the unit labour cost (ULC) gap larger than what is reported.

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[198] Krugman's chapter "In Praise of Cheap Labor: Bad Jobs at Bad Wages Are Better Than No Jobs at All", in Krugman (1998) pp. 80-86 is a useful and succinct (if provocatively titled) discussion of this point.

[199] Golub, S.S., (1997) "International Labor Standards and International Trade", IMF Working Paper WP/97/37, April, International Monetary Fund, Washington DC, p. 32. A useful general introduction to this debate can be found in: Diwan, I. and Revenga, A., (1995) "Wages, Inequality, and International Integration", *Finance and Development,* Vol. 32, No. 3, September, pp. 7-9.

[200] Wood, A., (1995) "How Trade Hurt Unskilled Workers", *Journal of Economic Perspectives,* Vol. 9, No. 3, Summer, pp. 57-80. See also: Revenga (1992) and Sachs and Shatz (1994).

[201] Larudee, M. and Koechlin, T., (1999) "Wages, Productivity, and Foreign Direct Investment Flows", *Journal of Economic Issues,* Vol. 33, No. 2, June, pp. 419-426.

They conclude:

> For these reasons even where a low-wage country's reported ULC is approximately equal to that of a high wage country, we would expect significant FDI flows from the high-wage into the low-wage country. Removing any existing barriers to such flows would then increase these flows and typically result in some job loss in the source country. Thus, the 'sweatshop labour' argument is better grounded in theory and evidence than its critics would have us believe.[202]

Richardson's substantial 1995 survey however, leads him to conclude that trade is a moderate, but by no means the primary cause, of income inequality trends.[203] But he does not go on from there and suggest that restricting trade is the solution. One reason is that such restrictions would sacrifice potential growth gains from trade that would allow the poor to be better off than they used to be, even if the non-poor have gained more. Freeman comes to similar conclusions – trade matters but it is not all that matters, and is *not* the primary cause of the observed changes in wage levels.[204]

Edwards' 1997 cross-country survey finds no evidence linking openness or trade liberalisation to increases in inequality. But he cautions that the results are still subject to some measurement problems and the well known shortcomings of cross-country surveys and that they should not be considered substitutes for detailed historical studies of specific countries' experiences with trade reform.[205]

Krugman strongly rejects the suggestion that trade has been a primary cause for any growth in inequality and deindustrialisation in the US economy over the last three decades, attributing these phenomena instead primarily to domestic causes such technological change - particularly the use of computers and the widespread replacement of workers by machines.[206] Consumers spend less on manufactured goods now than they did 30 years ago because productivity gains in the manufacturing sector have led to a fall in the prices of manufactured goods relative to services such as health care, travel, entertainment and so on. In fact between 1970 and 1990, the price of goods relative to services in the US fell by 22.9%. As a result, consumers spend proportionately more on services than previously and the manufacturing sector has become comparatively less important. A high technology economy, moreover, has less and less demand for the skills of less skilled workers.[207] Elsewhere he notes that 45 million jobs were created in the U.S. over the last 25 years – far more were added in the service sector than were lost in the manufacturing sector.[208]

In a major study of the effects of trade on the US job market, Lawrence and Slaughter found that while trade can reduce the relative demand for unskilled labour by shifting the production mix towards more skill-intensive sectors, in reality much of the shift towards higher demand of skilled workers has taken place *within* sectors, with relatively little of the shift of the industry mix of employment toward skill-intensive products.[209] In other words, it is not competition from imports reducing the size of particular sectors that has been the primary cause of job losses in those sectors, but rather skill-based technological change occurring simultaneously within many sectors.

More recently Krugman, responding to his own and others' unease that there may well be more to it than just 'trade or technology', has postulated another very interesting model relating to the *function*

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[202] Larudee and Koechlin (1999) p. 425.

[203] Richardson, J.D., (1995) "Income Inequality and Trade: How to Think, What to Conclude", *Journal of Economic Perspectives,* Vol. 9, No. 3, Summer, pp. 33-55.

[204] Freeman, R.B., (1995) "Are Your Wages Set in Beijing?", *Journal of Economic Perspectives,* Vol. 9, No. 3, Summer, pp. 15-32.

[205] Edwards, S., (1997) "Trade Policy, Growth, and Income Distribution", *The American Economic Review - AEA Papers and Proceedings,* Vol. 87, No. 2, May, pp. 205-210.

[206] Krugman, P.R., (1996) *Pop Internationalism,* The MIT Press, Cambridge MA & London, pp. 35-48.

[207] Krugman, P.R., (1996) pp. 40 & 48.

[208] Krugman, P.R., (1998) *The Accidental Theorist - And Other Dispatches from the Dismal Science,* W W Norton & Company, New York & London, p. 22.

[209] Lawrence, R.Z. and Slaughter, M.J., (1993) "International Trade and American Wages in the 1980s: Giant Sucking Sound or Small Hiccup?", *Brookings Papers on Economic Activity, Microeconomics,* Vol. 2, pp. 161-226.

of skills and education in the labour market. In this model the labour market is characterised by multiple locally stable equilibria, some of which are more equal than others. External shocks to these equilibria, originating in *either* changing trade patterns or changing technology, or both, could then push the economy out of an equitable equilibrium and into a process of growing, cumulative inequality.[210]

In his model, the relationship between the number of good workers who acquire a college education and the payoff for such an education depends on the 'regime' of the labour market. This regime can take two forms: the *human capital regime* – where college-educated workers are employed only in jobs for which such skills are actually necessary; and the *quality screening regime*, where increasing numbers of college-educated workers are employed in jobs where the particular skills they gained in college are not really needed, but their education serves as a signal to their employer that they are 'good' as opposed to 'bad' workers.

Hirsch noticed this effect over 20 years ago.[211] Educational standards have increased enormously in the Western democracies in the last few decades. Jobs that required only a basic high school education a generation ago, now require university degrees, and this is not only due to the increased complexity of jobs. In addition to providing skills, educational attainment is being used by employers as a way of trying to select the most capable job applicants even if their skills are not strictly required for the job. Goodstein calls this process 'credentials inflation'.[212]

It may be then, as Krugman has suggested, that one of the major underlying dynamics in the problem of rising inequality relates not simply to trade and technology, but to the labour market 'regime' operating in a particular sector in a particular country at a particular time, and whether it is operating primarily under a 'human capital' regime or a 'quality screening' regime. In other words, inequality can be significantly affected by whether skill-level and education remain productive investments in themselves, or whether they have come to function merely a way of supposedly signalling the suitability of an applicant for a limited number of desirable jobs.

In Krugman's model, in the event of the pure transition of a given labour market from a human capital regime to a quality screening regime, neither the average wage rate, nor the wage rate of skilled workers changes, but the wage rate of workers without a college education falls. As a growing fraction of 'good' workers become educated, the expected productivity and thus the wages of non-college workers will fall, which creates a further incentive to become better educated in order to get a job, even if the skills gained through the education are not strictly required for the job. This makes jobs harder to get for those with little education, even if they could do the job, and so exacerbates the trend towards greater inequality.[213] A further corollary would be that in a transition from human capital to quality screening, nothing real would actually change, but firms across the board would begin to employ college-educated workers for previously unskilled jobs, raising the observed skill-intensity in all sectors.[214]

This process could be entirely unrelated either to trade or to technology. But even if trade pressures *did* originally drive the move from a human capital regime to a quality screening regime in a particular instance, it by no means follows that imposing trade restrictions would return the labour market to where it had been previously.

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[210] Krugman, P., (1998) "And Now for Something Completely Different: An Alternative Model of Trade, Education, and Inequality", Paper presented to "a conference on trade and inequality", MIT, 26 pp. [http://web.mit.edu/krugman/www/EXOTIC.pdf, 20 September 1999].
[211] Hirsch, F., (1976) *Social Limits to Growth,*1977 British Edition; Routledge, London, p. 5.
[212] Goodstein, E.S., (1995) *Economics and the Environment,* Prentice Hall, Englewood Cliffs, NJ, p. 160.
[213] Krugman (1998) p. 16.
[214] Krugman (1998) p. 15. This phenomenon is captured perfectly in a common but rather unfair joke: What did the Humanities graduate say to the Engineering graduate? 'Would you like fries with that?'

Tombazos' recent research attempts to correct two endemic methodological shortcomings of a number of previous studies:[215] First, their disregard for the role of non-manufactured imports, including imports of services, in domestic production; and second, their inability to capture, in addition to the conventional domestic output-substitution effects, the impact of imports on demand for domestic factors which are employed in the downstream processing of the imports – eg. the freighting, marketing, retailing and servicing of imports. A significant proportion of the final 'shelf price' of imports in fact reflects value added domestically.

Tombazos' model, which considers all imports, not just manufactures, fits the US data extremely well. His results confirm that imports *do* tend to cause a net displacement of unskilled workers, but in addition, they reveal a previously ignored factor – the fact that the downstream processing of imports *stimulates* employment of skilled workers.[216] In another recent study he found that imports from East Asia and the Pacific actually stimulated labour demand in Australia.[217]

In conclusion, the evidence seems to indicate that trade *does* have some negative effects on the demand for unskilled workers in developed countries. However, there seems little basis for the contention that trade has been *primarily* responsible for the growth of inequality between low-skilled and high-skilled workers.

If low-skilled workers in developed countries suffer some harm from trade, the important question is, how much? If trade and international competition have not been the major cause of the decline of the US manufacturing sector, many would still argue that it has been a *significant* factor. Krugman again contends that the evidence simply does not support this argument – however intuitively appealing it might be. In fact it can only be blamed for a tiny proportion of the stagnation in the wages of US workers:

> In 1990, for example, the trade deficit in manufacturing was $73 billion. This deficit reduced manufacturing value added by approximately $42 billion (the other $31 billion represents leakage – goods and services that manufacturers would have purchased from other sectors). Given an average of about $60,000 value added per manufacturing employee, this figure corresponded to approximately 700,000 jobs that would have been held by U.S. workers. In that year, the average manufacturing worker earned about $5,000 more than the average nonmanufacturing worker.
>
> Assuming that any loss of manufacturing jobs was made up by a gain of nonmanufacturing jobs – an assumption borne out by the absence of any long-term trend in the U.S. unemployment rate – the loss of "good jobs" in manufacturing as a result of international competition corresponded to a loss of $3.5 billion in wages. U.S. national income in 1990 was $5.5 trillion; consequently, the wage loss from deindustrialization in the face of foreign competition was less than 0.07 percent of national income.[218]

A 1997 IMF study noted that the consensus of empirical research suggests that increased trade accounts for only about 10-20% of the changes in wages and income distribution on labour markets in developed countries in the 1980s and 1990s – with most of the rest due to the technology-driven shift in demand away from less-skilled toward more-skilled workers.[219] Another IMF study a year later found that deindustrialisation in developed countries was overwhelmingly due to trends internal

[215] Tombazos, C.G., (1999) "The role of imports in expanding the demand gap between skilled and unskilled labour in the US", *Applied Economics,* Vol. 31, pp. 509-516.
[216] Tombazos (1999) p. 515.
[217] Tombazos, C.G., (1999) "The impact of imports on the demand for labour in Australia", *Economic Letters,* Vol. 62, No. 3, March, pp. 351-356.
[218] Krugman, P.R. and Lawrence, R.Z., (1994) "Trade, Jobs and Wages", *Scientific American,* Vol. 270, No. 4, April, p. 25.
[219] Slaughter, M.J. and Swagel, P., (1997) "The Effect of Globalization on Wages in Advanced Economies", Staff Working Paper WP/97/43, April, International Monetary Fund, Washington DC, 33 pp. See also Slaughter, M.J., (1999) "Globalisation and Wages: A Tale of Two Perspectives", *The World Economy,* Vol. 22, No. 5, July, pp. 609-629.

to those countries, and that North-South trade explains less than one fifth of the deindustrialisation of the advanced economies.[220]

A recent analysis of the antidumping cases pursued by the United States from 1980-1988 found that even 'unfairly' traded imports, those that are subsidised or 'dumped', in fact cause only minor injury to most industries, despite widespread perceptions to the contrary.[221]

Does this order of magnitude of harm to low-skilled developed country workers justify trade restrictions against goods from developing countries? There are two issues here – a justice issue and a self-interest issue.

On the justice side, it is a question of weighing the benefits of providing trading opportunities for poor countries trying to lift their people out of poverty, as well as cheaper goods and services for domestic citizens, against the real costs of some domestic job losses, involving real pain and suffering for many families.

Wealthy nations who can afford to provide good safety nets, compensation and retraining for displaced workers should not artificially and selfishly protect domestic jobs at the expense, not only of impoverished workers elsewhere in the world, but at the hidden expense of their own citizens who must unknowingly and unnecessarily pay more for their goods and services. Such protection is fundamentally unjust.

Equally unjust however, are the current trends towards greater wage inequality in OECD countries, where the real wages of low-skilled workers are static or declining during a time of record profits, booming stock markets, and exorbitant executive salaries and CEO packages. An October 1999 report by Incomes Data Services in the UK for example, found that chief executive pay in the UK's largest FTSE 100 companies rose by an average of 17.6% over the past financial year, with deals often bearing little relation to company performance. These pay surges are more than four times the average rate of increase in national earnings, and continue despite government calls for boardroom restraint.[222]

In the US, the difference between the highest and lowest paid workers in an average company has widened from 44:1 in the mid-1960s to around 209:1 today.[223] If average production worker wages in the US had risen at the same rate as CEO pay between 1990 and 1998, they would now be $110,399 rather than the current $29,267 and the minimum wage would be $22.08 per hour instead of $5.15.[224] Corporate and government leaders cannot expect broad public support and confidence in the face of such perverse policies. A globalisation which induces these kinds of inequitable wealth disparities and which marginalises people is not only unjust, it is unsustainable.

On the self-interest side, developed countries have a great deal to gain over the long term in new jobs and new export markets for their own goods by engaging in trade with developing countries. As such countries gradually grow and reduce levels of poverty, if the gains from growth are reasonably evenly spread through the population, the rising per capita GDP levels create new generations of wealthier citizens who will want to buy goods and services from the developed countries. Restricting

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[220] Rowthorn, R. and Ramaswamy, R., (1998) "Growth, Trade and Deindustrialisation", IMF Working Paper WP/98/60, April, International Monetary Fund, Washington DC, 28 pp.

[221] Kelly, K.H. and Morkre, M.E., (1998) "Do Unfairly Traded Imports Injure Domestic Industries?", *Review of International Economics,* Vol. 6, No. 2, May, pp. 321-332.

[222] Taylor, R., (1999) "Boardroom pay surging ahead", *Financial Times,* London, 27 October, [http://www.ft.com/hippocampus/q2c0336.htm, 27 October].

[223] Collins, C., (1999) "The Growing Income Inequality Problem", United for a Fair Economy, Boston, 3 pp. [http://www.stw.org/html/growing_inequality.html, 28 October].

[224] Anderson, S., Cavanagh, J., Estes, R., Collins, C. and Hartman, C., (1999) "A Decade of Executive Excess: The 1990s - Sixth Annual Executive Compensation Survey", September 1, United for a Fair Economy, Boston, p. 2, [http://www.stw.org/html/decade_of_executive_excess.html, 29 October].

exports from such countries now only hinders this process and is self-defeating for developed countries.

10.4 Repressed Labour & Child Labour

Things become more clouded when the question is asked *how* wages are kept low. Wages may be low in the context of just laws and respect for workers' rights, simply due to well functioning labour markets responding to the supply of workers and the demands of local employers. In this case, the lower wages of the society are a legitimate source of comparative advantage.

However, wages may also be kept low artificially, by repression, bonded and slave labour, child labour, draconian labour laws and the persecution of labour leaders. This is an entirely different scenario.[225]

Most governments are desperate for foreign investment and can unwittingly feed a self-defeating 'race to the bottom' as they compete for corporate investment - perhaps waiving local labour or environmental laws or health and safety standards. Workers are frequently forbidden to strike or form unions. Sometimes this is quite blatantly advertised.

For example a four page 'promotional feature' from the Government of Nigeria advertising the Calabar Export Processing Zone appeared in *The Economist* on 15 February 1997. Aside from the provision of infrastructure such as fully-serviced plots, pre-built factories, a well laid out road network and back up water and power supplies, the advertisement boasts:

> Under the laws of the export processing zones in Nigeria, investors are exempted from all forms of taxes and levies. They have unrestricted exportation and repatriation of capital and profits rights, duty free importation of goods, exemption of such goods from pre-shipment inspection and 100 percent business ownership, foreign or local. Services offered in the zone can be paid for in foreign currency and unrestricted employment of managerial staff. Apart from the tax holiday, there is a *10-year ban on labour strikes and lockouts* in the zone. Protection of investments is also guaranteed. Getting business done at the Calabar Export Processing Zone is very easy. It is a 'one stop' approval system.[226]

It is possible to recast the debate in a human rights framework – in particular, through the lenses of the Universal Declaration of Human Rights (1948), the two Covenants emanating from it: the International Covenant on Civil and Political Rights (1966) and the International Covenant on Economic, Social and Cultural Rights (1966); and for child workers, the Convention on the Rights of the Child (1989). These treaties have received very widespread support.

Seven International Labour Organization (ILO) Conventions have been identified by the ILO's Governing Body as being fundamental to the rights of human beings at work, irrespective of levels of development of individual member States. Some countries have refused to ratify these conventions for various reasons.[227] However, these rights are a precondition for all the others in that they provide for the necessary implements to strive freely for the improvement of individual and collective conditions of work.[228]

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[225] A useful discussion of ways of approaching these issues can be found in: Langille, B.A., (1997) "Eight Ways to think about International Labour Standards", *Journal of World Trade,* Vol. 31, No. 4, August, pp. 27-53.

[226] Nigeria (1997) 'Calabar Export Processing Zone', *The Economist*, Vol. 342, No. 8004, February 15, pp. 79-82 (emphasis added).

[227] See Maskus, K.E., (1999) "Should Core Labor Standards Be Imposed Through International Trade Policy", Working Paper No. 1817, August, The World Bank, Washington DC, 83 pp particularly pp. 49-53 for a good discussion of some of these problems which have prevented countries ratifying the conventions.

[228] ILO, (1999) "Fundamental ILO Conventions", ILO Web Page, International Labor Organization, Geneva, 2 pp. [http://www.ilo.org/public/english/50normes/whatare/fundam/index.htm, 13 September 1999].

They may be conveniently grouped under four headings:

Freedom of association
Freedom of Association and Protection of the Right to Organise Convention, 1948 (No. 87)
Right to Organise and Collective Bargaining Convention, 1949 (No. 98)

The abolition of forced labour
Forced Labour Convention, 1930 (No. 29)
Abolition of Forced Labour Convention, 1957 (No. 105)

Equality
Discrimination (Employment and Occupation) Convention, 1958 (No. 111)
Equal Remuneration Convention, 1951 (No. 100)

The elimination of child labour
Minimum Age Convention, 1973 (No. 138)

More recently, in June 1999 the Worst Forms of Child Labour Convention (No. 182) was passed at the 87th session of the ILO's international conference.[229] (See Box 4).

These rights may be summarised as:

The rights of workers to associate freely
The rights of workers to collectively bargain with their employers
The right to freedom from forced, bonded and slave labour
The right to non-discrimination in employment based on gender or ethnic origin
The rights of children to be free from exploitative forms of child labour

World Vision strongly affirms these rights and particularly their emphasis on the fundamental human rights of workers. The question remains, however, whether trade restrictions are necessarily the best policy instrument to deal with products believed to have been produced under conditions of repressed labour.

Interestingly, one of Maskus' main conclusions from his substantial study of this issue is that rather than improving countries' competitiveness, the repression of labour and the lack of provision of core labour standards generally diminishes it because of the distortionary effects such repression induces. As a result, developed country concerns about losses of competitiveness *vis-à-vis* states employing repressed labour is largely misplaced.[230]

This result was also noted in a major 1996 OECD report.[231] The OECD concluded that "core labour standards do not play a significant role in shaping trade performance", and that:

> The view which argues that low-standards countries will enjoy gains in export market shares to the detriment of high-standard countries appears to lack solid empirical support.
>
> These findings also imply that any fear on the part of developing countries that better core standards would negatively affect either their economic performance or their competitive position in world markets has no economic rationale. On the contrary, it is conceivable that the observance of core standards would strengthen the long-term economic performance of all countries.[232]

[229] Its full title is: Convention Concerning the Prohibition and Immediate Action for the Elimination of the Worst Forms of Child Labour, adopted 17 June 1999.
[230] Maskus (1999) pp. 43-45, 66-67.
[231] OECD, (1996) *Trade, Employment and Labour Standards: A Study of Core Workers' Rights and International Trade*, OECD, Paris.
[232] OECD (1996) p. 105 (as cited by Langille (1997), p. 40.)

Moreover, regarding the issue of freedom of association, the OECD concluded:

> The results reveal a relatively clear pattern. The more successful the trade reform in terms of the degree of trade liberalization achieved, the greater is the respect of association rights in the country.
>
> … the clearest and most reliable finding is in favour of a mutually supportive relationship between successfully sustained trade reforms and improvements in association and bargaining rights. This positive two-way relationship appears to be strongest after trade reforms have been in place several years … There is similarly no case where promoting freedom of association and bargaining rights impeded trade liberalization. This means, at least for these countries, that fears the freer trade could lead to an erosion of these standards or that improved compliance with them could jeopardize trade reforms, are unfounded.[233]

These conclusions are extremely important. What they imply is that, while it is true that some in developed countries may be mistakenly pursuing a protectionist agenda under the guise of pursuing international labour standards, it is also true that some developing country governments may be denying core labour rights to workers in the mistaken belief that this will aid their pursuit of economic development.[234]

The WTO already has a rule permitting countries to refuse to import products produced with prison labour. Article XX on *General Exceptions* of the GATT94 states[235]:

> [N]othing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures:
> (e) relating to the products of prison labour;

Should similar trade restrictions be permitted against products produced with repressed labour, by means of a so-called 'social clause' in the WTO agreements? This is a difficult and complex question.

The case of child labour is a good example.[236] Some attempts at simply banning products produced with child labour have utterly failed to take into account the consequences of such bans on the child workers, given their socio-economic situation and lack of other opportunities. The Child Labour Deterrence Act, otherwise known as the Harkin Bill, for example, was introduced to the US Congress to advocate trade restrictions on goods made with child labour. World Vision predicted that the adoption and implementation this Act could lead to around 70,000 children employed in the garment industry in Bangladesh being forced into more exploitative occupations such as brick carriers, chippers, rickshaw-pullers, rag-pickers and prostitutes.[237] Earlier, an Oxfam study reported that 30,000 child garment workers in Bangladesh were forced into the more hazardous welding and sex industries, simply due to the threat of trade restrictions on the goods they had formerly produced.[238]

Far better than trade bans are precise policy initiatives aimed at tackling the problem directly, such as the provision of health care, education and training for the child workers, and their families. Technical assistance programs such as the ILO's International Programme for the Elimination of Child Labour can be far more effective than simply banning the goods.[239]

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[233] OECD (1996) p. 111-112 (as cited by Langille (1997), p. 40.)
[234] Lagille (1997), p. 40.
[235] WTO (1994), p. 519.
[236] A useful discussion can be found in: Muntarbhorn, V., (1998) "Child rights and social clauses: Child labour elimination as a social clause?", *The International Journal of Children's Rights,* Vol. 6, No. 3, pp. 255-311.
[237] World Vision Staff, (1998) "Eradicating child labour without putting children on the streets", *Together - A Journal of the World Vision Partnership,* No. 58, April - June, pp. 9-10.
[238] *The Economist* (1995), June 3.
[239] Cullen, H., (1999) "The limits of international trade mechanisms in enforcing human rights: The case of child labour", *The International Journal of Children's Rights,* Vol. 7, No. 1, pp. 1-29.

Box 4: Exploitative Child Labour

Melanie Gow[240]

The ILO estimates that some 120 million children (aged between 5-14) world wide work everyday, full time, often at the expense of their education, health and natural development. Another 130 million children are said to work part-time, attempting to combine education and other commitments. That's 250 million children working on a regular basis. Many millions of these children are working under exploitative and hazardous conditions as child prostitutes, bonded labourers (some 100 million), welders or rubbish pickers. Around 61% of all child labourers are found in Asia, but there are also large numbers in Africa and Latin America. In Africa about 40% of all children are said to work in some capacity.

The ILO defines exploitative child labour as work which: "*deprives children of their childhood and their dignity, which hampers their access to education and the acquisition of skills and which is performed under conditions harmful to their health and their development.*" Opinions on when work becomes exploitative are divided, but the debate focuses on questions such as what is the physical nature of the work? How does the work impact the child's current activities (i.e. education) and future choices? What impact is the work having on the child's access to their most fundamental human rights?

World Vision's experience in working with the most marginalised people informs us that children will continue to work until there are viable and sustainable alternatives, which reach the entire family and community. If we ignore this we do so at the peril of the children. In a world increasingly characterised by entrenched poverty and disparities between rich and poor, work is a reality for many children. In line with this, World Vision, along with many other children's rights activists and NGOs, has been working to abolish the most extreme and hazardous forms of child labour such as child prostitution, bonded labour, any work which involves very young children and any work which is hazardous to the children's physical, emotional or spiritual health.

The underlying causes of child labour are basically structural - widespread poverty, gross inequality, income distribution, poor or inadequate education, malnutrition, unjust land distribution, the status of women, structures of countries' economies, consumer patterns, as well as macro-economic policy frameworks. It would be wrong to suggest however that poverty automatically leads to child labour. Although it is true that the large majority of child labourers are from poor families, not all poor children are working. Indeed the reasons children are preferred to adult workers can be of a non-economic nature. Children are less aware of their rights; they accept repetitive and dangerous work more readily and are more obedient. Children are easier to exploit.

In June this year at the 87th session of the ILO's international conference, a new Convention was passed to protect children from the worst forms of child labour. Known as the Convention on the Worst Forms of Child Labour, the new international law instrument will now become one of the fundamental human rights treaties. The Convention was adopted without dissent amongst the ILO's member governments, worker and employer groups. The Convention applies to all those under the age of 18 and is part of a multi-pronged approach to prohibit and immediately take action to eliminate the worst forms of child labour around the world. The definition for such exploitative labour includes slavery, sale and trafficking of children, offering a child for illicit activity, offering a child for prostitution or forcefully or compulsorily recruiting a child for use in armed conflict.

Under the Convention, governments are expected to take action to assist exploited child labourers and their families, through prevention, rehabilitation and social reintegration. In addition, governments are also expected to promote international assistance and co-operation to assist those countries where exploitative forms of child labour are known to be most prevalent. Once governments ratify this international Convention they will be under a legally binding obligation to assist such countries. In addition, governments will have to give regular reports to the ILO on how they are meeting their obligations under the Convention.

It is possible to eradicate child labour. In the short term we should aim at eradicating the most extreme forms of exploitative labour. Over the longer term, governments, consumers, child rights groups and child labourers, should work together to ensure that all children have the opportunity to have their full development potential realised and their fundamental human rights met.

[240] Melanie Gow from World Vision Australia is the World Vision partnership's lead policy officer on the issues of child labour and child soldiers. She also sits on the NGO Advisory Panel to the World Bank's Child Labour Programme.

One of the major causes of child labour is a level of poverty that prevents poor households being able to forego children's earnings in order to send them to school. In the presence of relatively high economic returns to education however, the provision of adequate credit markets could significantly reduce the incidence of child labour by enabling households to borrow against future earnings.[241] Care would have to be taken with this approach of course to ensure that the poorest households did not become trapped by these debts, perhaps through a comprehensive approach that included insurance against unforeseen contingencies.

Trade restrictions are not the best way of dealing with products produced with repressed labour. Tariffs are a blunt and ineffective instrument because it would be extremely difficult to use product-based trade sanctions to penalise some offending firms without harming others with a better record. But not only are they blunt instruments, they can also harm the very people they are meant to help by pushing them into the informal sector where conditions may be worse. It would also be virtually impossible to calculate accurate or meaningful 'social dumping tariffs' and these would be extremely vulnerable to manipulation and abuse by those with purely protectionist motives. More fundamentally though, the use of trade measures is misguided because they would be aimed at policies that generally *reduce* countries' competitiveness rather than help their exports.[242]

In addition, one of the main problems with using trade measures to deal with the repressed labour issue is that even if they were a theoretically effective instrument to deal with the problem, they would be very vulnerable to protectionist abuse. The sad history of the abuse of safeguard and anti-dumping provisions by developed countries against developing countries provides ample evidence of this. Perhaps just as importantly however, they would be vulnerable to the *perception* of abuse in the eyes of developing countries and so they are unlikely even to get on the table in the negotiations. Attempts to introduce them would place severe strains on the multilateral trading system.

For these reasons the adoption of a 'social clause' in the WTO's trade rules is not be the best policy to deal with labour issues.[243] Instead, measures such as the following would be more appropriate:

the strengthening of the ILO – particularly its monitoring and reporting of violations of core labour standards;

a renewed push to boost the number of countries ratifying the core ILO conventions, and the Convention on the Worst Forms of Child Labour;

the establishment of a more formal arrangement between the ILO and the WTO such as a joint committee on international trade and labour rights and child rights (potentially also with UNICEF involvement);

substantially increased international resources devoted to providing primary and secondary education to children in developing countries;

appropriate product labelling schemes (See Section 11);

strong corporate codes of conduct with provisions for independent monitoring and evaluation, which encourage companies to apply the same labour standards abroad as they do at home;

substantial increases in aid to reduce poverty – the major cause of child labour.

Like the environmental issue, the problem of products produced with repressed labour relates to the question of *how* products are produced. Under current WTO rules, this is a virtually unaskable question: no discrimination of any kind is permitted between 'like products' – with the apparent sole exception of products produced with prison labour. In other words, if two products look the same, then they are the same – which brings us to the vexed issue of Production and Processing Methods.

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[241] Ranjan, P., (1999) "An economic analysis of child labour", *Economic Letters,* Vol. 64, No. 1, July, pp. 99-105.

[242] Maskus (1997) p. 66.

[243] For useful and succinct discussions from developing country perspectives coming to similar conclusions see: Raghavan, C., (1996) "Barking Up the Wrong Tree: Trade and Social Clause Links", *Third World Economics,* No. 129, 16-31 January, pp. 11-15; and Evans, P., (1998) "Trade, Labour, Global Competition and the Social Clause", CUTS Briefing Paper No. 5 / June 1998, CUTS Centre for International Trade, Economics & Environment, Jaipur, India, 6 pp.

11. Production and Processing Methods and Product Labelling

The consideration of Production and Processing Methods (PPMs) is a difficult and complex area because of the danger that appropriate provisions will be abused by protectionist interests. Nevertheless, the time has come for the WTO to take this issue seriously. PPMs matter – they have significant environmental and social implications.

Production processes which are environmentally destructive, which are dangerous to the health and safety of workers, or which use child labour, repressed labour, or labour subjected to regular human rights violations, are not examples of comparative advantage. They are more appropriately thought of as hidden subsidies, paid for by workers, their families and the environment, which distort trade. The failure to internalise environmental and social costs in products exported from developing countries effectively means that developing countries are subsidising consumers in developed countries. To permit a transition to more sustainable economic systems, ways must be found to take the PPM issue seriously – but not at the expense of developing countries.

The crux of the matter with PPMs is the question of who will pay for the necessary upgrades. Most countries have acknowledged this as a goal and developed countries at the Rio Earth Summit in 1992 and elsewhere, have pledged significant additional financial and technological resources to help developing countries. These promises have largely been ignored since then and the resources have never been forthcoming to any significant extent. To ensure efficient and environmentally sound PPMs, trade liberalisation must be paralleled by "flanking measures" - measures that are imposed by the *exporting* country to ensure that the production of its exported products is environmentally responsible, efficient and best promotes that country's development. This would be a far more effective and fair approach than the imposition of trade restrictions by the importing country. To the extent that these flanking measures impose costs on developing countries, or limit their export markets, developing countries should be compensated with the technical and financial assistance that developed countries have already promised, but not delivered.[244]

It is true that different regions have different 'assimilative capacities'. This is a legitimate reason to reject the absolute quantitative harmonisation of environmental standards. One country's domestic environmental standards should certainly not be unilaterally applied to another country. However, domestic industries that are attempting to internalise their environmental costs should be treated differently in some way from 'subsidised' competitors making no such attempt. Domestic firms trying to internalise environmental and social costs will be at a competitive disadvantage compared with other domestic and foreign firms that are not.[245] Firms trying to achieve the highest environmental and social standards and internalise these costs should not have to compete on a so-called 'level playing field' with firms which continue to externalise these costs.

As long as PPMs are ignored and social and environmental costs of production continue to be externalised, then prices will continue to give false, inefficient and sub-optimal signals and a global shift to sustainable development will be impossible.

But differential treatment based on PPMs does not have to mean old-style tariff or quota protection. It could include a variety of mechanisms such as subsidies (particularly for adapting to new environmental laws and R&D[246]), tax breaks (such as a progressive drop in company tax for companies meeting higher social and environmental standards) and relatively costless mechanisms such as free advertising, promotion and awards by government, which would help improve the company's business. Tariffs and quotas should be avoided because of the market distortions they introduce, the burdens they add to domestic consumers in the form of higher prices, and the way they penalise overseas producers.

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[244] Matthew Stilwell (1999), Centre for International Environmental Law, Geneva, personal communication.

[245] Foy, G., (1992) "Toward Extension of the GATT Standards Code to Production Processes", *Journal of World Trade,* Vol. 26, No. 6, December, pp.128-129.

[246] These would appear to be permitted under the WTO's Agreement on Subsidies and Countervailing Measures, Article 8.2 (WTO, 1994, pp. 273-276).

Some 'dirty' industries and plants would not be viable once social and environmental costs were incorporated – but this would simply demonstrate that they were uneconomic once properly costed. Their closure would be a correction of an existing market distortion. However, other more socially and environmentally appropriate industries would flourish once the appropriate price incentives were in place.

Strong environmental regulations can cost jobs in some industries which are environmentally destructive and wasteful. Conversely, they can contribute to job creation and indeed *not* protecting the environment can *also* cost jobs. Safina reports a study in the US which found that annual profits of the yellowtail flounder fishery could increase from *zero* to $6 million by *removing* more than 100 boats.[247]

Related to PPMs is the issue of labelling. While it may be legitimate at the nation state level for countries to be forbidden to unilaterally block imports based on their domestic environmental preferences, the same lack of choice should not be forced on individual citizens. Consumers should be given adequate information to make product choices which accord with their own tastes, values and preferences. If consumers do not want their food irradiated or genetically modified or their tuna caught in ways harmful to dolphins, then appropriate labels should be provided to enable them to make that choice.[248]

A number of researchers suggest that product-labelling schemes may be an effective measure to deal with labour issues, despite some conceptual and practical difficulties.[249] The 'Rugmark' label, for example, is used to certify rugs made without the use of child labour.[250]

Of course, such labelling schemes could be open to protectionist abuse. If exporting countries are not to be faced with a bewildering variety of product labelling requirements, which could easily become non-tariff barriers to trade, then some internationally-agreed standardisation of labels needs to be developed.[251] These would not be barriers to trade since they would simply be a way of giving more information to consumers who themselves would decide whether or not to buy the products.

The resource constraints of developing countries have already been mentioned. If such a multilateral arrangement were to be developed, developing countries would require substantial technical and financial aid to implement it.

Another way in which the PPM issue could be abused is through the inappropriate use of anti-dumping and countervailing duty provisions. It has been argued that the externalising of environmental costs is really just 'ecological dumping' and, therefore, under Article VI of GATT 1994, such cases should be subject to anti-dumping levies or countervailing duties. Under Paragraph 3 of GATT Article VI it is legitimate to levy a countervailing duty against an *estimated* subsidy determined to have been granted *indirectly* on the *production* of a product. [252] However this interpretation would

[247] Safina, C., (1995) "The World's Imperiled Fish", *Scientific American,* Vol. 273, No. 5, November, pp. 34.

[248] Useful discussions of this issue can be found in: OECD, (1997) "Eco-Labelling: Actual Effects of Selected Programmes", OCDE/GD(97)105, OECD, Paris, 82 pp; and Chang, S.W., (1997) "GATTing a Green Trade Barrier: Eco-Labelling and the WTO Agreement on Technical Barriers to Trade", *Journal of World Trade,* Vol. 31, No. 1, February, pp. 137-159.

[249] See for example, Maskus, (1997) p. 21; Golub (1997) p. 29-30; Blowfield (1999) also gives a very helpful overview of ethical trading initiatives,

[250] See for example: Kruijtbosch, M., (1995) *A Brief Resume of Concept to Reality for Visual Guarantee of Carpets Made Without Child Labour,* South Asian Coalition on Child Servitude, New Delhi, 14 pp.

[251] See for example: ISO, (1999) "Internationally Agreed Definitions of Environmental Labeling Within the International Organization for Standardization (ISO) and Related Work - Communication from the ISO", WTO Document: WT/CTE/W/114, 31 May, World Trade Organization - Committee on Trade and Environment, Geneva, 6 pp.

[252] "A special duty levied for the purpose of offsetting any bounty or subsidy bestowed directly or indirectly, upon the manufacture, production or exportation of any merchandise" GATT Article VI.3, WTO, (1994), p. 494.

almost certainly run foul of the new Agreement on Subsidies and Countervailing Duties, which has a much tighter definition of subsidies.[253]

In any case, developed countries have already demonstrated their willingness to abuse antidumping and other Non-Tariff Measures (NTMs) in a way that discriminates against competitive exports from developing countries.

Box 5: World Vision Brazil Helps Small Farmers to Export Melons

João Helder Diniz[254]

Since September 1999, World Vision Brazil has been helping 20 small farmers of the Baraúnas area, in the State of Rio Grande do Norte to export their melons. So far, five shipments have been sent to Rotterdam, totaling 6,077 boxes of melons. The quality and packing of the melons has been widely praised by the buyers in Europe.

It is anticipated that by the end of March 2000, some 50,000 boxes of melons will have been exported. All the production is being sold to buyers in Denmark, who have been advertising the melons as "FAIR TRADE", emphasizing that they were produced by small farmers and exported through an international NGO. Several buyers are quite interested in this operation, as they notice an excellent business opportunity.

In the Baraúnas area, the two main companies that buy melons for export, used to pay just US$1 per box to the small producers. After World Vision started to help the small farmers export their produce, they had to increase the price to US$1.74 per box. That price increase represents real gains in the incomes of those approximately 1,000 farmers who sell their produce to these companies.

This initiative is part of World Vision Brazil's Economic Development Program that is helping to export the organic products of small farmers from the semi-arid region, which is one of the poorest areas in Brazil. As part of this project, 20 small farmers from the Alagoas State are producing bell pepper without the use of chemicals, seeking to export to produce to Europe in February and March 2000.

[253] See Article I of the Agreement on Subsidies and Countervailing Measures (WTO, 1994, p. 264).
[254] João Helder Diniz is the Economic Development Coordinator for World Vision Brazil.

12. Other 'New Issues'

12.1 Investment and Competition Policy

Foreign investment and competition policy are critical areas for developing countries. Last year a number of World Vision offices, along with thousands of other NGOs around the world, opposed the Multilateral Agreement on Investment that was being developed by the OECD. World Vision did not oppose it because it was opposed in principle to a framework of international rules to govern investment, but because the negotiations had completely excluded developing countries and because some of the MAI's specific provisions were felt to be detrimental to the interests of the poor.

Foreign Direct Investment (FDI) can bring significant benefits to developing countries, including greater technology transfers, employment and training of local staff, the introduction of 'world's best practice' production and management techniques, the production of goods or services for export, and so on.[255] However, foreign investment can lead balance of payments problems through channels such as the repatriation of profits to the firm's home country, the importing of intermediate inputs for production processes, or if the money has gone into relatively unproductive, speculative sectors such as real estate, rather than production of exportable goods which would earn foreign exchange.

At present, there is no regime of international competition rules that is able to address issues of international market structure and the domination of markets by a few large multinational firms. UNCTAD noted for example that in 1997 total cross-border mergers and acquisitions (M&As) amounted to around $342 billion, eclipsing 1996's record, and that in fact cross-border M&As accounted for the bulk of the increase in FDI flows: their value rose from 49% of FDI in 1996 to 58% of all FDI in 1997.[256] This trend continued in 1998 with deals such as the takeover of Amoco by BP for $55 billion and the acquisition of Chrysler by Daimler-Benz for $44.5 billion. By the year's end, the publicly announced value of all cross-border M&As in 1998 was $655 billion. This year has seen an even greater acceleration in M&As, with the value of cross-border M&As in the first half of 1999 reaching $574 billion.[257] By October, the consulting group KPMG reported that cross-border M&As reached $608 billion in the first nine months of 1999, a jump of 58% over the same period in 1998.[258]

UNCTAD estimates that cross-border M&A activity has accounted for between one half and two thirds of world FDI flows in the 1990s. The fact that the figure is higher for developed rather than developing countries is mainly due to the small role of M&As in China. When China is excluded, the share of M&As in FDI from 1992-1997, is 72%, a massive increase from 1988-1991 when M&As accounted for just 22% of FDI. Treating the 'greenfield' investments as the difference between total FDI and M&As, UNCTAD found that such greenfield investments were consistently below their 1991 levels since that year, while M&As have skyrocketed.[259] Thus UNCTAD concludes:

> the recent boom in FDI flows to developing economies has, with the exception of China, consisted predominantly of M&A, largely in the services sector. The surge in M&A, especially in the services sector, is closely linked to privatisation programmes adopted during the 1990s in which TNCs have often played a prominent role.[260]

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[255] See further: UNCTAD, (1999) "Foreign Direct Investment by Transnational Corporations Can Produce Major Benefits, if the Right Government Policies are in Place", Press ReleaseTAD/INF/2819, 23 September, UNCTAD, Geneva, 5 pp. [http://www.unctad.org/en/press/pr2819en.htm]; and more fully: UNCTAD, (1999) *World Investment Report 1999 - Foreign Direct Investment and the Challenge of Development,* UNCTAD, Geneva, 540 pp; UNCTAD, (1999) *Foreign Direct Investment in Africa: Performance and Potential,* United Nations, New York and Geneva, 77 pp; See also Helleiner (1989).

[256] UNCTAD, (1998) *World Investment Report 1998 - Trends and Determinants*, UNCTAD, Geneva, p. 19.

[257] UNCTAD, (1999) *World Investment Report 1999 - Foreign Direct Investment and the Challenge of Development*, UNCTAD, Geneva, pp. 11, 30.

[258] Michaels, A., (1999) "Mergers: Cross-border activity soaring", *Financial Times,* London, 26 October, [http://www.ft.com/hippocampus/q2b439a.htm, 26 October].

[259] UNCTAD, (1999) *Trade and Development Report,* UNCTAD, Geneva, pp. 117-118.

[260] UNCTAD, (1999) *Trade and Development Report,* UNCTAD, Geneva, p. 118.

These trends are concerning because they mean that "foreign direct investment" among OECD countries now more often means buying out a competitor than it means building new plants.

Some have argued that investment and competition policy could not be dealt with effectively under the auspices of the WTO – in part because of the fear that the negotiations could be non-transparent and could be compromised by the substantial behind-the-scenes political influence of major TNCs.[261] Any international competition rules must be able to address issues of international market structure and the dominance of markets and employment of restrictive business practices by a few large multinational firms.[262] As has already been mentioned, the concentration of market power in the agricultural sector is particularly worrying.

The extension of provisions such as 'Most Favoured Nation' (MFN) and 'National Treatment' (NT) into the field of investment, could confer a *de facto* 'right of entry' for foreign multinational firms into domestic developing country markets. This would have adverse implications for developing countries and their domestic industries and corporations.

Investment was introduced tentatively in the Uruguay Round with the Agreement on Trade Related Investment Measures (TRIMs). However, full negotiations on investment should not be included in the next trade round. This area is too critical to developing country interests. If it does make it onto the agenda however, UNCTAD should be formally involved. With UNCTAD's active involvement, there could be a reasonable chance that investors and corporations might be given binding *obligations* as well as rights and that international anti-trust laws would have a hope of a hearing.

Regardless of whether investment is included in any new round, developing countries should work towards strengthening their own competition rules to ensure they are not prey to large foreign TNCs. This may be best done outside the WTO in a forum such as the G77, with the help of UNCTAD - so as to ensure the rules are not skewed in favour of developed countries. In addition, competition considerations could be added to specific sectoral negotiations such as agriculture. Much has been made by some of the problems that State Trading Enterprises supposedly cause in this sector, but the distortions caused by the largest agribusiness and 'life science' firms warrant at least as much attention.[263]

12.2 Government Procurement

Government contracts represent a far larger source of business for local firms in many developing countries than they do in developed countries. Governments should have the option of opening tenders to foreign firms, but to make such tendering compulsory would lead to the extinction of thousands of small local firms in developing countries which are not able to compete against more powerful and efficient OECD firms.

While there might be short-term gains in efficiency for the government from the opening up of such contracts, in the long term, developing countries can find that entire sectors of their economy are dominated by foreign firms, leading to the balance of payments problems and vulnerability mentioned above. So while government procurement may sound like a relatively unimportant sector, in fact it is critical, due to its disproportionate size in many developing country economies.

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[261] For some disturbing evidence of the power of corporate lobbying and manipulation of public opinion, see: Stauber, J. and Rampton, S., (1995) *Toxic Sludge is Good for You: Lies, Damn Lies and the Public Relations Industry,* Common Courage Press for the Center for Media and Democracy, Monroe, Maine, 236 pp; and Beder, S., (1997) *Global Spin: The Corporate Assault on Environmentalism,* Scribe Publications, Melbourne, 288 pp.

[262] A useful discussion of ways of dealing with restrictive business practices in the WTO can be found in: Malaguti, M.-C., (1998) "Restrictive Business Practices in International Trade and the Role of the World Trade Organization", *Journal of World Trade,* Vol. 32, No. 3, June, pp. 117-151. Other discussions of competition policy can be found in: Helleiner (1989), Hoekman and Mavroidis (1994), Hoekman and Holmes (1999), Lloyd and Sampson (1995), and Martin, (1999).

[263] Matthew Stilwell (1999), Centre for International Environmental Law, Geneva, personal communication.

13. Conclusions and Recommendations

World Vision is not opposed in principle to further rounds of trade negotiations at some point in the next few years. However, launching a new round at Seattle would be rushing the process, especially for developing countries, and this could jeopardise broad-based support for the multilateral trading system. A number of important matters remaining from the URAs and their implementation need to be addressed first and there also should be a comprehensive assessment of the effects of the Uruguay Round on developing countries and the poor – both men and women.

Therefore, instead of a new comprehensive round, World Vision recommends:

A thorough, scientific, independent review to be conducted on the results and implementation of the Uruguay Round - with special attention to how developing countries and their poorest citizens have been impacted;

A sustained programme of capacity building and institution building for developing countries to enable them to take part properly in the next round;

The immediate introduction of duty-free, quota-free market access by developed countries for all exports of goods and services from LDCs;

The phasing out of trade-distorting subsidies in developed countries, especially those which encourage wasteful overproduction and overconsumption in fisheries, energy, water and agriculture. Any phase out of subsidies though, must also take place with careful attention to the impact on those less well off and with appropriate safety nets and compensation payments to mitigate social dislocation and hardship;

A significant real increase in OECD countries' aid budgets for education, technical assistance and capacity building for developing countries - but in the context of overall increases in the aid budgets, not at the expense of other programmes;

More effective resourcing and implementation of the Integrated Framework for Trade-Related Technical Assistance to LDCs;

The upgrading of the WTO Sub-Committee on LDCs to a full Committee, to enable more effective representation of LDC concerns in the WTO;

Substantial debt relief for the most heavily indebted poor countries to enable them to use more resources for poverty eradication, capacity building and human resource development;

Reforms to the WTO institution and process, addressing areas such as:

- a legal assistance facility for developing countries
- transparency and compulsory disclosure of who is lobbying whom, with strict limits on gifts, meals, trips and so on which trade officials (both national representatives and WTO staff) can receive from those with an interest in WTO proceedings;
- opening GATT council meetings to NGOs
- mandatory release of all WTO documents unless just cause can be demonstrated for confidentiality in particular cases
- greater formal cooperation between the WTO and key multilateral agencies such as UNCTAD, UNEP and the ILO.

There have been suggestions from some major trading countries for a round based on 'early harvests'. If there is to be a new round, a comprehensive new round in which nothing is sealed until it is all sealed is preferable to one based on early harvests.

A round based on early harvests would allow powerful members to push though some of their favoured agendas in the early stages and then stall on sensitive areas later on. Developing countries could maximise their leverage in the context of a comprehensive round.

In conclusion we would ask those governments pushing hard for a new round to consider the plea of the representative of Sri Lanka on the first day of the High Level Symposium on Trade and Development in Geneva on March 17 this year:

> [W]e hope that we could prevail upon those countries not to drag the developing countries into further abyss with their call for a comprehensive new round of negotiations that would incorporate additional commitments and obligations in new areas, when most of us are struggling to digest what we have already swallowed under the Uruguay Round.[264]

[264] Sri Lanka, (1999) "Statement by Sri Lanka", Paper presented by the Government of Sri Lanka to the WTO High Level Symposium on Trade and Development, 17-18 March, 1999, Geneva, p. 2.

Glossary and Acronyms

Commodity, or net barter, terms of trade (N) = the ratio of the price index of the nation's exports (P_X), to the price index of its imports (P_M) multiplied by 100 to express it in terms of a percentage:

i.e. $$N = (P_X / P_M) \times 100$$

Elasticity When a product is said to have a low supply or demand *elasticity*, (i.e. it is *inelastic*), this means that the quantity supplied or demanded is relatively unresponsive to price changes. So an export product with a low supply elasticity indicates that exporters are unable to adjust the quantities they supply in response to fluctuating prices.

Where **Qx** = Quantity of good X demanded (or supplied)
Px = Price of good X
= 'change in'

The price elasticity of demand (or supply), $$= \frac{\%\ Qx}{\%\ Px} = \frac{Qx/Qx}{Px/Px} = \frac{Px}{Qx} \cdot \frac{Qx}{Px}$$

Income terms of trade (I) = the commodity terms of trade multiplied by the volume of exports, Q_X. **I** measures the nation's export-based capacity to import.

i.e. $$I = (P_X/P_M)Q_X$$

Acronyms

AoA	Agreement on Agriculture
AMS	Aggregate Measure of Support
ATC	Agreement on Textiles and Clothing
CAP	Common Agricultural Policy (EU)
DAC	Development Assistance Committee (OECD)
DSB	Dispute Settlement Body (WTO)
FAO	Food and Agriculture Organization (UN)
FDI	Foreign Direct Investment
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
LDC	Least Developed Country
M&A	Mergers and Acquisitions
MNE	Multinational Enterprise
MEA	Multilateral Environmental Agreement
MFN	Most-Favoured Nation (GATT Article I)
NFIDC	Net Food Importing Developing Country
NTB	Non-Tariff Barrier
NTM	Non-tariff Measure
OECD	Organisation for Economic Cooperation and Development
PPM	Production and Process Method
SAP	Structural Adjustment Programme
S&D	Special and Differential (treatment)
SPS	Sanitary and Phytosanitary Measures (GATT Standards Code)
TNC	Transnational Corporation
TRIMs	Agreement on Trade-Related Investment Measures
TRIPS	Agreement on Trade-Related Aspects of Intellectual Property Rights
UNCTAD	UN Conference on Trade and Development
URAs	Uruguay Round Agreements

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