
Through the Window: Beacons for a Pro-Poor World Trading System

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While enormously beneficial for most people in developing countries, globalization has bypassed many of the poorest countries and poorest people.¹ Domestic policies and obstacles matter, but inequities in the world trading system also put developing countries at a disadvantage. Three forces have the potential to open global markets to more people: the current round of multilateral trade negotiations, regional trade negotiations, and the prospect of new “aid for trade” to help the poorest countries invest in infrastructure and institutions necessary to participate more effectively in the global marketplace.

The Doha Round hangs precariously in the balance. Even if there is an agreement in Hong Kong (China), a pro-poor outcome is not automatic. Results depend critically on the details of any trade agreement. This book peers through the mass of complexity—in agriculture, nonagricultural market access, services, and trade facilitation—to see what really matters for poor people.

Even as multilateral negotiations continue, many developing countries are engaged on a second front of negotiations, regional trade agreements. Some 75 countries are negotiating so-called Economic Partnership Agreements (plurilateral free trade agreements) with the European Union. The United States, having just completed a free trade agreement with Central America and the Dominican Republic as its seventh FTA, has a half-dozen new agreements in train. Many developing countries are following a similar path; consider Chile’s recent free trade agreement with China.

Regional trade agreements can widen markets, deepen integration, and promote economies of scale in regulation and investment. However, they also are inherently discriminatory. Often the weakest countries are excluded; in effect, they pay for the preferences received by others. So how can these new arrangements minimize the disadvantages of preferential agreements and maximize advantages? A section of this book sets out guideposts for evaluating the development effects of upcoming regional negotiations.

Even with greater access to markets, many of the poorest countries may be unable to seize the opportunities that come with more open markets, either because of inadequate infrastructure, poorly performing trade-related institutions (such as customs), or domestic policies that create disincentives or impediments to trade. Still other developing countries may need additional help in adjusting domestic, regional, or global policy reforms to take advantage of new trade opportunities. For these reasons, the G-8 summit in Gleneagles in July 2005 supported calls for

additional “aid for trade.” A final section of this book discusses aid for trade related to standards, trade facilitation, and managing any adjustment costs from the erosion of preferences or from higher food prices that developing countries may experience as a consequence of a trade deal.

This introduction, drawing on the chapters of this volume, highlights the key decisions that will mean the difference between the success and failure of current efforts to open markets for products of the poor. In that sense, it provides “policy beacons” to assess outcomes in the three broad areas: multilateral negotiations, regional negotiations, and aid for trade.

Realizing the development promise of the Doha Agenda

A Doha Round agreement that slashed trade barriers would stimulate trade and raise incomes around the world, leading to a substantial reduction in global poverty. Although any agreement is not likely to be ambitious enough to generate the \$290–460 billion in annual income that full liberalization might bring to the global economy, it could realize part of this potential and lift incomes of poor countries—and poor people—over the long term. The opening chapters by Anderson, Martin, and van der Mensbrugge use quantitative methods² to assess where the main pay-offs are to be found in merchandise trade liberalization, with the conclusion that agriculture is the key to the Doha Round.

Agriculture is the locomotive of the development round

Agriculture is central to the development promise of this trade round. First, some 70 percent of the world’s poor live in rural areas. Second, most of the world’s trade protection is applied to agricultural products. Agriculture alone would produce roughly two-thirds of the gains that could be anticipated from full liberalization of merchandise trade. Progress can be made in increasing access to markets, reducing trade-distorting domestic support, and export subsidies.

Market access

Protection facing developing-country exporters in agriculture is four to seven times higher than in manufactures in the Organisation for Economic Co-operation (OECD) countries, and two to three times higher in developing countries. *Tariff peaks* against products from poor countries are particularly high in rich countries. *Tariff escalation* that discourages development of further processing is more pronounced in agriculture than in manufactures in both rich and poor countries. And hefty *specific duties* are common in rich countries. Because they automatically increase protection when commodity prices fall, specific duties throw the burden of adjustment onto global prices and poor countries. Forty-six percent of agricultural tariff lines in Europe contain such duties.

Tariff- and budget-based support to agriculture in OECD countries amounted to \$350 billion in 2004—of which some \$280 billion went directly to producers (roughly one-third from the budget and two-thirds from border measures).³ Nontariff measures—including antidumping and other forms of contingent protection, sanitary standards, and technical barriers to trade—augment formal barriers. In fact, such measures may restrict trade more than border barriers (World Bank 2005). The combined effect of all of these forms of support is to stimulate overproduction in high-cost rich countries and shut out potentially more competitive products from poor countries. As Mitchell’s chapter shows, the European Union went from being a net importer of sugar in the early 1980s to being a net exporter today.

The chapters by Anderson, Martin, and van der Mensbrugge and by de Gorter set out important benchmarks of success in overcoming the problems posed by restrictive trade policies in agriculture. Increasing market access is by far the most important element of success. Their chief findings are as follows:

- *Tariff cuts must be deep to have effect.* This is true because WTO-agreed ceilings (bound tariffs) are well above today’s applied rates, so negotiators will have to agree on cuts of 70 percent or more to ensure that applied rates decline (or at least do not rise).
- *Exclusions for sensitive products have to be extremely limited.* Exempting even 2 percent of tariff lines is enough to render virtually meaningless any deal that is likely to emerge from Doha. Why? Because most countries rely on tariff peaks in just a few product lines, but those lines account for a significant share of trade.
- *Capping all tariffs at 100 percent would help.* In many countries, very high tariffs, often in combination with tariff rate quotas, keep out products. Establishing binding caps can prevent or limit this effect. Steps should be taken to limit the application of specific duties, reduce tariff escalation, and curb nontariff barriers.
- *All countries have to contribute.* While agricultural protection is highest in rich countries, many developing countries also have high protection.⁴ It is in the interest of all countries—and of great interest to the world’s poor—to reduce protection everywhere.

Domestic support

Domestic support, while less damaging to developing countries than border barriers, greatly distorts trade in particular commodities and for particular countries.

Sugar is illustrative. In the European Union, Japan, and the United States a combination of quotas, tariffs, and subsidies allows domestic sugar producers to receive more than double the world market price. OECD governments support sugar producers at the rate of \$6.4 billion annually—an amount nearly equal to all developing-country exports of sugar.⁵ Prices are so high that it has become economic to grow sugar beets in cold climates and to convert corn to high-fructose corn syrup. Sugar imports in the OECD have shrunk to next to nothing.

Similarly, U.S. subsidies to cotton growers totaled \$3.1 billion in 2003, about 1.5 times higher than U.S. foreign aid to Africa (see chapter by Baffes). These subsidies depress world cotton prices by 10–20 percent, reducing the income of thousands of poor farmers in West Africa, Central and South Asia, and other poor countries. In West Africa alone, where cotton is a critical cash crop for many small-scale and near-subsistence farmers, annual income losses for cotton growers surpass \$150 million annually.

More than 70 percent of subsidies in rich countries are directed to large (often corporate) farmers. These farmers have incomes that are higher—often substantially so—than average incomes in Europe, Japan, and, to a lesser extent, the United States. Subsidies make the rich richer and the poor poorer. What should be done about domestic support in agriculture?

- *Deep cuts in bound levels of support are required to discipline actual levels.* As with tariffs, the bindings in the Uruguay Round were exceedingly generous, and applied levels of support have usually fluctuated well below the ceilings. Therefore, cuts in excess of 70 percent are required to have positive effects—and to protect against the temptation to raise applied levels of support. At the same time, loopholes that allow relaxation of disciplines on trade-distorting subsidies have to be closed.

Export subsidies

Although export subsidies distort world trade less than border barriers and domestic support, they are not trivial. Of the \$280 billion in support to farmers, some \$10–12 billion takes the form of export subsidies. The WTO's July 2004 Framework on agriculture contained a commitment to phase them out upon successful conclusion of the round. At issue is the timetable.

- *Phasing out of export subsidies by 2010, mentioned by some G-8 leaders at the Gleneagles summit in July 2005, would promote development.*

Nonfarm trade is important to growth in poor countries

Having grown at nearly twice the rate of agricultural exports, exports of manufactures now constitute nearly 80 percent of all developing-country exports. Tariffs on manufacturing in high-income countries are on average lower than in developing countries. But the tariffs that rich countries charge developing countries are about twice those they charge other industrial countries, in the aggregate. Exporters of manufactures from industrial countries face, on average, a tariff of 1 percent on their sales to other industrial countries; exporters in developing countries, by contrast, pay anywhere from 1.2 percent (if they are from Latin America, where NAFTA weighs heavily) to 5.4 percent (if they are from South Asia). However, the problem is not solely a North–South issue. Latin American exporters of manufactures, for

example, face tariffs in South Asia that are thirteen times higher than in industrial countries. Similarly, Sub-Saharan African exporters face tariffs in South Asia that are nearly six times higher than the tariffs they face when exporting to industrial countries. Tariffs that East Asian exporters pay to Latin America are three times higher than those they face in high income countries.

Protection takes forms other than tariffs—among them quotas, specific duties, and contingent protection measures such as antidumping duties. As with tariffs, both rich and poor countries tend to use these measures more frequently against labor-intensive products from developing countries, particularly textiles and clothing. Average antidumping duties are seven to ten times higher than tariffs in industrial countries, and around five times higher in developing countries (World Bank 2005).

Textiles and clothing are particularly important for developing countries. The good news is that the quotas under the Agreement on Textiles and Clothing (ATC) ended on January 1, 2005; the bad news is that behind those quotas remains a wall of high tariffs. As Brenton and Hoppe point out in their chapter, the feared takeover by China of textile and clothing exports with expiration of the ATC quotas has been overblown. With increasing trade volumes in general, many developing countries, including least developed countries (LDCs) such as Bangladesh, have expanded their market share in the European Union and United States in the half-year since the end of quotas. At the same time, exports especially of some relatively high-wage exporting regions, such as Hong Kong (China), Taiwan (China), and Republic of Korea have declined. Some adjustment is sure to be required, and the international community should be ready to help those countries that experience difficulties—a challenge taken up in the aid-for-trade discussions.

Martin and Ivanic point to guideposts for reform of nonfarm trade:

- *The tariff ceilings chosen and the formula for cutting the highest tariffs will determine how much new access to markets Doha will provide. As with agriculture, exempting a large number of tariff lines from cuts could easily eviscerate the gains from any cutting formula adopted.*

Services liberalization could raise productivity

Services are the fastest-growing component of the global economy. Even in developing countries, services exports grew more rapidly than manufactures in the 1990s (World Bank 2001: chapter 3). More efficient backbone services—in finance, telecommunication, domestic transportation, retail and wholesale distribution, and professional and business services—improve the performance of the whole economy through broad linkage effects. Estimates suggest that, after controlling for other determinants of growth, countries that fully liberalized trade and investment in finance and telecommunications grew on average 1.5 percentage points faster than other countries over the past decade (Mattoo and others 2001).

So far, however, the Doha Round has fallen far short of its potential to unlock access to foreign markets for services exports. While many countries have made ambitious requests, the responding offers are said to be disappointing. This is despite the fact that many developing and industrial countries have an interest both in liberalizing their own services markets and obtaining improved access to the markets of their trading partners.

Mattoo, in reviewing the lack of progress to date, suggests a set of negotiating goals with which both the business and the development community could identify: locking in the current openness of cross-border trade for a wide range of services; eliminating barriers to foreign investment, either immediately or in a phased manner if regulatory inadequacies need to be remedied; and allowing greater freedom of international movement at least for intra-corporate transferees and for service providers engaged to fulfill specific services contracts.

Three types of actions might pave the way to these goals.

- *First, self-selected groups of WTO members could articulate their broad liberalization goals in model commitments and regulatory principles for specific modes or sectors—along the lines of the Understanding on Financial Services and the Telecommunications Reference Paper. Once a critical mass of members sign up, they could extend the benefits to all WTO members on a most-favored-nation (MFN) basis; others could join later when they felt it in their interest to do so. An individual member's incentive to participate in a particular sector or mode would, of course, depend on the willingness of its trading partners to make commitments in modes and sectors (within and outside services) in which the member had an export interest.*
- *Second, the international community should establish a mechanism to provide policy advice and regulatory assistance for developing countries at their request, helping them to identify services that they can comfortably liberalize without fear of dislocation or macroeconomic turbulence and others that may require improvements in regulation and supervision prior to liberalization.*
- *Third, to spur progress on labor mobility, governments in countries that supply labor could assume responsibility for screening and selecting workers, facilitating and verifying their return, and for combating illegal migration. Immigration authorities in member countries would be requested to define a set of obligations that source countries would have to fulfill to be eligible for an allocation of temporary-presence visas; these could be limited, at least at the outset of the program, to just a few categories of individuals, such as intra-corporate transferees and service providers engaged to fulfill specific services contracts.*

The larger services framework advanced by Mattoo would allow members, on the basis of greater confidence in their regulatory frameworks and the scope for

regulatory cooperation, to respond more meaningfully to the requests for liberalization made by their fellow WTO members.

Regional trade agreements and unilateral preferential regimes

Regional trading agreements constitute a second front of trade negotiations for many developing countries. With the expiration of the European Union's Cotonou Agreement with the African, Caribbean, and Pacific countries (ACP), some 75 developing countries are undertaking complex negotiations with the European Union to establish new Economic Partnership Agreements. The United States, meanwhile has opened discussions of free trade with the Andean countries, the Southern African Customs Union, and others. Developing countries, too, are engaged in a quickening pace of negotiations: China with the ASEAN countries, India, and Brazil; and Chile with Republic of Korea, to name a few examples. All in all, regional trade agreements (RTAs) are proliferating rapidly, now covering more than 40 percent of world trade.

As many as half of all RTAs are counterproductive: they divert trade and end up depriving countries of income. RTAs are most likely to increase national incomes over time if they pursue a strategy of "open regionalism" (World Bank 2004). For that reason, regional negotiators should follow a few basic rules.

- *Negotiators in North–South plurilateral arrangements should work with partners to ensure that intraregional obstacles to trade are phased out and that a competitive external MFN regime is in place before trade preferences for the northern trade partners are introduced*, a suggestion elaborated in the chapter by Hinkle, Hoppe, and Newfarmer.
- *Liberal rules of origin can make the difference between genuine market openings and illusory ones*. The Blair Commission recommended a 10 percent value-added rule or a change in tariff heading for transformed goods. Rules would be less burdensome if they were uniform across agreements (see Brenton's chapter).
- *Rules and regulations governing investment and intellectual property rights must be appropriate to the development context in which they are promulgated*, as Fink and Hoekman argue in their respective chapters.
- *Openings in services should be introduced with adequate regulation, permit entry on an MFN basis and, where possible, encourage competition*.

Even RTAs based on open regionalism grant preferences to some while discriminating against others. The best way to minimize those effects is to bring down the high tariffs that create the discriminatory benefits offered to preferred countries. That can be done only through multilateral agreement.

Unilateral and voluntary preferential regimes—such as the U.S. African Growth and Opportunity Act and the European Union's Everything But Arms program—are a prominent feature of some countries' trade regimes. Each has

different rules and exemptions that have the effect of limiting market access. As Brenton shows in his chapter, the actual value of trade preferences is remarkably low for all but a few developing countries. One reason is that rich countries grant preferences voluntarily rather than as part of a binding multilateral negotiation; those preferences often come laden with restrictions, product exclusions, and administrative rules that prevent beneficiaries from taking full advantage of them. For example, only 39 percent of potentially preferred imports into the Quad countries—Canada, the European Union, Japan, and the United States—under the Generalized System of Preferences (GSP) actually took advantage of preferential access, and usage rates are declining.

To make preferences more effective, especially for LDCs:

- *Programs in the Quad countries should be expanded to cover all exports of LDCs, with an indefinite time period.*
- *Restrictive rules of origin that raise the cost of taking advantage of preferences should be replaced with a simple rule that facilitates access and use of globally sourced competitive inputs.* A nonrestrictive rule of origin, as with RTAs generally, would require no more than 10 percent value added or a change of tariff heading (see Brenton's chapter).

Aid for trade

Market access is not the whole development story. Even if developing countries succeed in obtaining access to new markets, they will have to adopt complementary policies—removing obstacles to private investment, improving public investment in infrastructure, and providing education—to ensure that domestic firms respond to the new opportunities and that benefits are transmitted to the poor. Said differently, liberal trade policies must be embedded in a coherent development strategy—they are not a substitute for it. Aid for trade, as Nielson shows in her chapter, can play an important role in helping countries design complementary trade policies.

The cost of moving goods across international borders is often as important as formal trade barriers in determining the landed cost of goods—and ultimately market share. Every day spent in transit because of poor roads or delays in customs adds nearly one percent to the cost of goods on average (Hummels 2001). In developing countries, moreover, transit costs are routinely two to four times higher than in rich countries.

Additional aid for trade through investments in roads, ports, logistics, and through policy advice on reforms of trade-related institutions such as customs can play an important role. Eliminating delays in developing countries would lower trading costs very significantly, particularly if accompanied by liberalization of transport and telecommunications and streamlined regulations to promote domestic competition. As Jaffee's chapter makes clear, adapting to standards set in the high-income countries can be costly and prevent access to markets, although the effort

to adapt usually brings rewards. Multilateral efforts are under way outside the WTO to promote—and in some cases finance—institutional changes to facilitate trade and meet rising food-safety standards. Key players include the bilateral donors, the World Customs Organization, the regional development banks, and the World Bank. Newfarmer and Nowak in their chapter describe how the World Bank is increasing its aid-for-trade efforts and how those efforts have moved away from the policy conditionality of the 1980s. Even with these increased efforts, however, resources are likely to fall short of demand.

- *Greater development assistance for much-needed trade infrastructure, help with standards and compliance, and support for policy reforms could help overcome impediments to exports.* Abundant examples come from the 20 or so trade diagnostic studies undertaken as part of the Integrated Framework, as described in the chapter by Newfarmer and Nowak.

The inclusion of trade facilitation in the WTO General Council's decisions of July 2004 is appearing increasingly felicitous. Many countries now share the view that reforms to lower the costs of trading make good development sense. McLinden's chapter reviews progress to date in negotiations on trade facilitation, noting that discussions on binding disciplines have taken a back seat to the dissemination of best practice in institutional reforms. McLinden offers recommendations on how to make the most of the opportunity presented by the launch of negotiations:

- *High-income countries should make disciplines flexible enough to accommodate countries that have low capacity to implement accords, and developing countries should view the WTO negotiations as an opportunity to advance their domestic reform agenda* and accelerate the implementation of best practices. On the basis of close consultations between negotiators in Geneva and specialists at home, governments should secure agreement on practical measures that will enable their traders to compete better in regional and international markets.

Aid for trade can also help in managing adjustment to a new world of incentives. A Doha Round agreement may precipitate a terms-of-trade loss for *a few* developing countries, as Hoekman, Martin, and A. Primo Braga show in their chapter. Likewise, Mitchell and Hoppe show that if Doha succeeds in reducing rich-country subsidies to food production, *a few* countries may experience terms-of-trade losses. Such losses are likely to be limited for several reasons. The value of preferences for most countries is actually quite small (see Brenton), and these are eroding under pressure from regional trade agreements and domestic adjustment in the US and EU. Similarly, only a few food importers are likely to suffer income losses from terms of trade. First, any upward price movement is estimated to be less than half the average adjustments these economies experience *annually* as a result of normal cyclical fluctuations in prices (see the Mitchell and Hoppe chapter). Second, many food importers also export other agricultural products that will benefit from liberalization;

moreover, some food importers will gain access to new markets in nonagricultural products and be able to export. Third, countries that now impose tariffs on food imports can lower those tariffs to offset any increase in global prices on poor domestic consumers. Fourth, since prices will change relatively slowly, some food importers will increase domestic production in response to higher prices and become self-sufficient or even net exporters. All these caveats notwithstanding, some countries nonetheless may require help and need additional resources, and that should be forthcoming.

- *Donor countries and development institutions should make additional resources available to support internal and external adjustment in countries that clearly stand to suffer from a Doha agreement.* To be effective, these have to be supportive of a coherent program of domestic reform to promote growth rather simply dedicated to maintaining unsustainable consumption without resource reallocation.

The world's trading system at the crossroads?

A. Primo Braga and Grainger-Jones in their chapter consider differing views on the evolution of the WTO negotiations, including the possibility that the world trading system is entering a systemic crisis. Ultimately they discount that notion, in part because all countries have an interest in maintaining and strengthening the system. The expansion of global trade at nearly twice the rate of world GDP growth has fueled an unprecedented prosperity, for which the multilateral system, by lowering trade barriers and preventing endemic trade wars, can claim much of the credit. At the same time, Primo Braga and Grainger-Jones also caution against complacency.

Complacency and unwillingness to tackle domestic forces of protection could well spell the demise of the Doha Round. However, positive action is the antidote, and now would be a good time to act in all three of the policy arenas discussed here: doing a pro-poor Doha deal, designing trade-creating regional agreements, and augmenting aid for trade. High-income countries could take the lead by, among other things, moving forward with assertive new steps to open agricultural markets, offering less restrictive rules of origin in regional accords, and providing additional aid for trade. Middle-income countries, with their now established interest in the global system, could contribute through assertive new proposals in manufactures and services. Low-income countries, which have a new interest in and responsibility for the emerging global system, could contribute by accepting core disciplines consistent with their development interests, crafting proposals in regional negotiations that link domestic reforms to trade reforms, and working with donors to use aid for trade effectively. In the event the Doha agenda were to founder, the regional trade agenda and aid for trade effort will assume an ever greater importance for developing countries. Here too both rich and poor countries have a responsibility

to design these agreements so they create trade and reinforce domestic reforms rather than preempt them. The challenges are daunting. But the rewards are substantial.

Notes

1. The author is Economic Adviser, International Trade Department, World Bank. He gratefully acknowledges comments from Carlos A. Primo Braga, Bernard Hoekman, Aaditya Mattoo, and Julia Nielson.

2. These models are necessarily limited because, as described in the chapter, they do not take into account services liberalization; they assume all preferences are utilized; they do not account for increasing returns to scale, and they cannot account for the effect that new market opportunities have in spurring new products and diversification; all of these tend to underestimate the effect of trade liberalization on income. On other hand, it is assumed that all countries will be able to respond to shifts in relative prices and demand, an assumption that will not hold in some countries because of inadequate infrastructure and/or other supply side constraints.

3. The difference goes to spending on research and development, food programs for low-income consumers, and other programs that indirectly benefit agriculture.

4. The WTO has a wide definition of “developing countries” that includes some members of the OECD, such as Republic of Korea.

5. This figure includes transfers from consumers associated with border barriers.

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Further reading

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