

World Development Report 2006

Equity and Development

Chapter 10 Achieving greater global equity

Focus on drug access

Balancing access to medicines for the world's poor with incentives for pharmaceutical innovation

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Chapter 10: Achieving greater global equity

10.1 We read in chapter 2 that there are huge inequities in the world. Even better-off citizens in most of the developing world face worse opportunities than the poor in rich countries. The fact that country of birth is a key determinant of people's opportunities runs counter to our view of equity—that is, that people should face the same opportunities regardless of their background, including where they are born.

10.2 Greater global equity is desirable for itself to all those who find equity intrinsically valuable. The international human rights regime testifies to the shared belief that all should have equal rights and be spared extreme deprivation. Some even argue that there is a powerful moral case for rich countries to take action, because of the huge disparities and (arguably) because they partly created and perpetuate global inequities.¹ Greater equity is also desirable because it would likely be beneficial to global prosperity in the long run. Greater equity in access to health and health remedies, especially for transmittable diseases, would reduce global health inequalities and be beneficial to poor and rich countries alike. Greater equity in access to and control over natural resources and the global commons may lead to more sustainable use. Some argue that greater equity could also lead to greater international stability: fragile and failed states pose a threat to local and global stability.²

10.3 What can be done to reduce the huge inequities we experience today? The debate about what causes global inequities and how to address them is highly contentious. Some see globalization—greater global integration—as a source of equalization, others a source of widening inequalities, with richer countries and corporations making rules that benefit themselves at the cost of the weak, poor, and voiceless. There is some truth on all sides of the debate. In terms of trends, we saw in chapter 2 that the picture is mixed: convergence in health and (probably) education for many, convergence in incomes for some, but divergence in incomes and health for others. In terms of causes, just as some of the major sources of convergence have been associated with globalization of markets and knowledge—the East Asian tigers, China, India making use of global markets, the spread of green revolution and health-related technology—so unequal rules and unequal influence profoundly shape opportunity.

10.4 Domestic action is clearly central to reducing inequities. Developing countries hold the keys to their prosperity; global action cannot substitute for equitable and efficient domestic policies and institutions. But global conditions powerfully affect the scope for and impact of domestic policies. Global action—by governments, people, and organizations in developed countries and by international institutions—can determine whether the globalization process brings about greater equity, peace, and prosperity, or fuels tensions and conflicts that will lead to backlash and violence.

¹ Pogge (2004).

² Chauvet and Collier (2004) estimated that the cost, to a country and its neighbors, of a country descending into the status of low-income country under stress (LICUS), as defined by the World Bank, is in present value terms approximately \$80 billion, and that this cost was mostly borne by neighbors.

10.5 Current disparities are products of interactions between two factors: the endowments of different countries, and the rules shaping the options for deploying these endowments on domestic and global markets. Endowments are greatly unequal due to history and geography—although some of the history and aspects of geography are a product of unequal development patterns. Infrastructure underdevelopment in Africa, for example, is partly a legacy of colonial political and economic patterns. Institutional weaknesses of poorer societies—now part of their endowment—also reflect historical patterns, as discussed in chapter 6. Differences in endowments are often exacerbated by the inequitable functioning of markets. As in the domestic realm, market imperfections can be either a product of policy (as in barriers to labor mobility or agricultural protection) or of intrinsic market failures (as in weak protection of global commons and lack of incentives for knowledge creation).

10.6 Achieving greater global equity thus requires global policies that improve endowments and address market imperfections and more representative global institutions. We first discuss the global markets for labor, goods, ideas, and capital—all functioning within the context of international law (box 10.1). For each market, we highlight existing inequities and their impact, discuss the processes that lead to such inequities, and explore some options for change. We next turn to rectifying past and present inequities in the use of natural resources. Then we look at whether aid—the traditional response to global inequity—can be used effectively to accelerate domestic efforts to build endowments. The current state of international relations may cause some to wonder whether any change is possible. So we close the chapter by examining factors that have facilitated transitions to more equitable policies and institutions in the past. We conclude that change may be difficult but not impossible.³

Box 10.1 International law, globalization, and equity

Globalization takes place (mostly) in the context of international law, that governs relations among states and other international legal subjects, such as international organizations. More equitable development, application, monitoring, and enforcement of international law is essential to make globalization more equitable.

The meaning of equity in international law. Equity considerations inform the development of international law, confirming that greater global equity is a shared value. The principle of equity has accompanied the development of international law over the centuries (chapter 4). Equity in international law encompasses notions of corrective justice and distributive justice—that the strict application of the law should be tempered by considerations of equity or fairness to achieve a just result, and that international law should promote a more even distribution of resources among states. Equitable principles have been applied to many areas of international law, from the sharing of scientific benefits, technology, and natural resources to laws governing the sea, international waterways, outer space, and carbon emissions. As highlighted in chapter 4, the most pertinent example of the application of principles of equity in international law is the international human rights regime. In today's international law, equity has not only an interstate dimension; it also has an intergenerational dimension, in the preservation of the environment and other global commons, as we will see below.

³ These conclusions are consistent with the findings of the World Commission on the Social Dimensions of Globalization (2004).

Rule-setting processes. International laws are formed through complex negotiating processes. The degree to which these processes are perceived to be equitable affects their adoption and implementation—so processes matter greatly. Generally, a state remains free to decide whether to become a party to a convention or covenant. And a state's satisfaction with the process leading to the adoption of a convention may facilitate signing and subsequent adoption. For example, the Universal Declaration of Human Rights, seen by many as the basis of subsequent human rights instruments, was adopted by the UN General Assembly, where all countries are represented and have one vote. While only a declaration, and not intended to bind states at the time it was adopted, the process leading to its adoption was perceived to be equitable. The body of standards set by the ILO is another example of rules set through an international process that is broadly consultative, encompassing not just governments but unions and private sector representatives. On the other hand, the rule-setting processes of the World Trade Organization (and its predecessor, the General Agreement on Tariffs and Trade) are perceived by some as inequitable, and this is partly responsible for the current stalemate.

Application and enforcement mechanisms. The processes that interpret, apply, and enforce international laws are crucial to realizing greater equity. In general, the ability of states to pursue and enforce rights under international law depends on appropriate adjudication processes or complaint mechanisms and their effectiveness. A number of international courts and other adjudicative bodies often have voluntary jurisdiction, but there is a trend toward judicialization and compulsory jurisdiction. For example, dispute settlement arrangements established under the 1982 UN Convention on the Law of the Sea and the 1994 World Trade Organization Dispute Settlement Understanding mark a significant move toward compulsory jurisdiction and binding decision making.

The ability of citizens and other nonstate actors to pursue their rights and seek redress under international law depends on whether their state has become a party to the instruments that allow the use of compliance mechanism. For example, for citizens to make a complaint against their state under the International Covenant of Civil and Political Rights, the state must have signed and ratified the First Optional Protocol, which allows a complaint to be heard by the Human Rights Committee established by the covenant. As the discussion indicates and in parallel to what happens on the domestic arena, rules often block access, even before expenses, knowledge, and capacity limit effective recourse.

Source: Authors' creation.

Making global markets work more equitably

10.7 Global markets have many faces: Filipino nurses, Sri Lankan domestic workers, Polish care providers, Indian engineers, Ugandan coffee growers, Bangladeshi women working in garment factories, Moroccan craftsmen, employers of migrants, and the consumers of developing-country products in Australia, the European countries, Japan, the United States, and the richer middle-income countries. Global markets create valuable economic opportunities for millions of people, who develop ideas, raise capital, and sell their products and their labor.

10.8 But unequal endowments and unfair processes mean that opportunities and rules are not the same for all. Inequities exist in the functioning of these markets. Unskilled workers from poor countries, who could earn higher returns in rich countries, face great hurdles in migrating. Developing-country producers face obstacles in selling agricultural products, manufactured items, and services in developed countries. Foreign investors often get better deals in debt crises.

10.9 In most cases, more equitable rules would bring benefits to both developed and developing countries, but the extent of benefits varies by market. Barriers are massively

greater in the market for labor—the factor of production that the poor own in relative abundance—than in the markets for goods and capital, and factor price equalization clearly does not work through trade alone. So removing barriers to migration could have a significant impact on expanding people’s opportunities (of course, migration raises complex issues that are politically and socially difficult to tackle in sending and receiving countries).

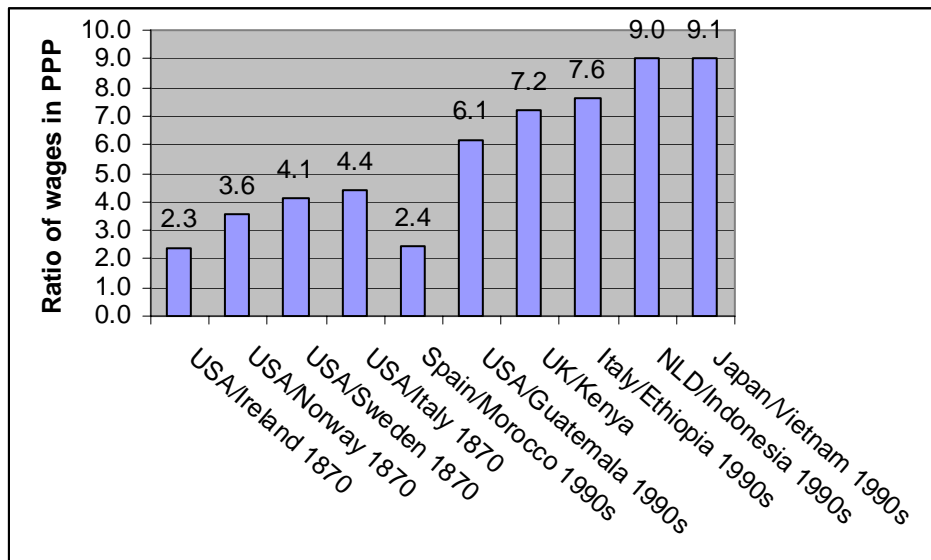
10.10 Benefits also vary greatly depending on country context. The fast-growing developing countries, including China and India that are home to half the world’s poorest people, stand to benefit significantly from more equitable global markets. Leveling the global playing field can help them sustain fast growth, while equitable domestic policies help ensure that this growth is shared. Countries with more limited endowments, such as many African countries, that are left behind in the global economy, stand to benefit less in the short to medium run from more equitable global markets.

Greater international labor mobility

10.11 Returns to capital, and to some extent skilled labor, tend to equalize across countries, but returns to unskilled labor, owned by poor people and in abundant supply in poor countries, generally do not converge. Wage differentials across countries for jobs requiring similar skills are large, and substantially larger than the wage gap between the United States and migrant-sending countries in the late nineteenth century (figure 10.1). Developed countries severely limit in-migration of unskilled and semi-skilled workers, which contributes to the lack of equalization in returns to unskilled labor.

Figure 10.1 Wage differentials are substantially larger today than at the end of the nineteenth century

Ratios of purchasing power parity adjusted wages of the United States and its migration partners in 1870 and pairs of countries in the 1990s



Source: Pritchett (2003).

10.12 Greater migration of unskilled labor would tend to equalize returns, with winners and losers, but with potentially beneficial effects on efficiency. History teaches us that migration has, at various times, alleviated human suffering and promoted cultural and technological exchanges. The mass migration from Europe to the Americas in the nineteenth and early twentieth centuries enabled 60 million people to escape poverty and persecution, creating some of today's wealthiest societies (although Native Americans faced enormous losses in the process).⁴

10.13 Economic analyses indicate that gains from expanding migration could be very significant. Hamilton and Whalley (1984) use a highly simplified economic model of the world to suggest that the benefits from reallocation of labor could be huge (on the order of doubling GDP). This, of course, depends on the specific assumptions used and ignores a host of adjustment issues, but it does serve to illustrate that the gains could be large and probably much larger than the gains from the, by comparison, already greatly liberalized trade in goods. Indeed, using an approach similar to that of analyses of trade impacts, Walmsley and Winters (2003) estimated that increasing temporary migration into industrial countries by 3 percent of host countries' current skilled and unskilled work force—equivalent to permitting an extra 8 million skilled and 8.4 million unskilled workers to be employed at any time, roughly a doubling of current net migration into high-income countries—would generate an estimated increase in world welfare of more than \$150 billion a year. This increase would be shared fairly equally between developing- and developed-country citizens. Much of the gain would come from the migration of unskilled workers. Country studies confirm that migration could have a significant impact. Annabi and others (forthcoming) found that a 50 percent increase in the flow of remittances to Bangladesh would reduce the incidence of \$1 per day income poverty by 0.8 percent in the short run and by 4 percent by 2020.⁵

10.14 Doesn't migration raise income inequality in sending countries? As a high-risk, high-return activity, migration is more likely to be undertaken first by members of wealthier, less credit-constrained, better-educated households. Successful migrants later provide information and assistance to potential migrants through social networks, thus lowering risks and costs and making it possible for members of households in lower parts of the income distribution to migrate.⁶ In the first stages of the migration process, remittances sent to wealthier households can increase inequality, if they are higher than forgone income.⁷ As migration expands, remittances begin to arrive to less well-off households and income distribution improves.⁸ Remittances also have indirect effects through greater spending, risk diversification, and easing of credit constraints, which are

⁴ Goldin and others (forthcoming).

⁵ That is, 4 percent not 4 percentage points.

⁶ Stark and Bloom (1985); Cox, Eser, and Jimenez (1998).

⁷ The assumption that income after migration is higher than income forgone does not always hold. Adams finds that income levels would have been higher without migration in three Egyptian villages and would have been the same in four rural districts in Pakistan (Adams (1989), Adams (1992)). Barham and Boucher (1998) find essentially similar results for three neighborhoods in Nicaragua. On the potential impact on income inequality, Mendola (2004) finds that remittances from members of households with large land holdings in rural Bangladesh are correlated with adoption of new agricultural technologies, thus leading to higher productivity for already better-off households and a possible increase in inequality.

⁸ McKenzie and Rapoport (2004).

generally inequality-reducing.⁹ On balance, the evidence does not support the view that migration leads unequivocally to higher inequality in sending countries.

10.15 In receiving countries, migration relieves labor shortages in labor-intensive sectors, such as health care, hotels and restaurants, and construction. As developed-country populations age and their levels of education and training rise, these shortages are likely to become more severe. Demographic trends are another powerful force behind migration. Current population projections imply that the labor forces of Europe and Japan will decline over the next century, and that the ratio of people of working age to people of retirement age (the support ratio) will grow to levels that would make current pension and social transfer schemes unviable. Meanwhile, the population of the North Africa countries south of Europe is growing rapidly.

10.16 Despite its large benefits, migration is fiercely opposed in receiving countries. Migration involves complex issues of national and individual identity exacerbated by concerns over security. Cultural and social integration appears more difficult in some countries than it was earlier thought. Moreover, unskilled workers experience wage erosion and unemployment. For industrial workers, however, this is no different than if goods produced in countries with lower labor costs displace domestic production.

10.17 In sending countries, there are concerns about the human and social costs of migration, for instance, on how migration of nurses and doctors hinders progress toward the Millennium Development Goals (MDGs) and migration of women creates major deficits in child rearing, family support, and care for the elderly.¹⁰ Licensing restrictions (as for doctors) often force skilled migrants to work in lower-skilled jobs in host countries—the “brain waste,” and higher returns to education, do not appear to spur human capital accumulation or “brain gain.”¹¹

10.18 Going against the political tide—with the partial exceptions of some currents in the United States, Canada and Spain—we argue that greater migration would be good for both equity and efficiency. But what are the prospects for greater migration in the current political climate? Multilateral negotiations in the World Trade Organization (WTO) offer a framework to address migration under Mode IV of the General Agreement in Trade and Services (GATS), part of the treaty establishing the WTO.¹² But progress toward greater liberalization of temporary migration under GATS Mode IV is unlikely in the near future, given that contentious issues on agricultural and merchandise trade are dominating negotiations on the Doha Round.

⁹ A number of studies by the World Bank Research Program on International Migration and by others document the positive impact of remittances. See Taylor (1992), Taylor and Wyatt (1996), and Yang (2004) for examples of easing of credit constraints. Adams Jr. (2005) finds that Guatemalan households receiving remittances spend significantly more on housing, which has positive indirect effects on wages, business, and employment opportunities. Yang (2004) finds that Filipino households receiving higher remittances, because of positive exchange rate shocks, had greater child schooling, reduced child labor, more hours worked in self-employment, and greater entry into relatively capital-intensive enterprises.

¹⁰ Ehrenreich and Hochschild (2003).

¹¹ On the phenomenon of brain waste, see Mattoo, Neagu, and Ozden (2005); on brain drain, see Faini (2003) and Schiff (2005).

¹² Mode IV is one of four interrelated modes of supply of services across borders considered in the GATS

10.19 In this context, progress is more likely to come from bilateral and regional negotiations. Receiving countries could bilaterally expand temporary migration (box 10.2 discusses some features of “development-friendly” temporary migration schemes). These countries could also extend greater protection to migrants. One way to do this could be to ratify the 1990 UN Convention on the Rights of All Migrant Workers and Their Families. If a significant number of host countries were to ratify the convention, none would risk being considered a haven for undocumented migrants, and fears about ratification leading to greater inflows might be allayed.¹³ Facilitating remittance flows is another action with potentially high payoffs, and governments should work together with the private sector and NGOs to achieve this.¹⁴

10.20 Sending countries should take action to reduce the likelihood that their migrants become victims of exploitation, with a focus on combating trafficking of girls and women.¹⁵ Two possible areas for action are to better regulate recruitment agencies to ensure greater respect for workers’ rights and to enter agreements that regulate migrant flows and conditions with key destination countries, as the Philippines has done. Sending countries should also help migrants use remittances properly, invest back home, and reintegrate upon return.

10.21 It is unclear whether an international organization in which poor countries have an equal seat at the table could help make progress toward freer migration. Bhagwati (2003), argued that a new World Migration Organization—or even a stronger International Organization for Migration in the UN system—might help increase the developmental impact of migration by protecting migrants’ rights, providing a forum to set rules on migration, and monitoring and enforcing compliance. But migrant-receiving developed countries resist proposals to give up even some control over immigration policies, which they view as part of the domestic policy agenda.

Box 10.2 Making migrant worker schemes more development friendly

Attention to the design of temporary migrant worker schemes and complementary policies could make them more development friendly. Temporary migration schemes usually allow workers into a country from several weeks to up to three to five years.

Recent research for the United Kingdom identified two main policy interventions: centralized recruitment with government screening in sending countries, and mandatory saving schemes, possibly coupled with credit schemes in home countries. Centralized recruitment and government screening could help reduce exploitation of potential migrants by local recruitment agencies and ensure that temporary migrants do not overstay their visas, reducing resistance in receiving countries. Saving schemes would encourage migrants to send remittances home, increase incentives to return, and facilitate the start of

¹³ As of May 2004, only 25 countries, mostly migrant-sending, had ratified the convention.

¹⁴ An interesting example of innovative partnerships to facilitate remittance flows is the New Alliance Task Force launched by the Federal Deposit Insurance Corporation (FDIC) and Mexican Consulate of Chicago, which aims to improve access to the U.S. banking system, provide financial education, and develop products with remittance features.

¹⁵ Smuggling and trafficking are a multibillion dollar industry increasingly run by criminal networks. The United Nations International Organization for Migration (2000) estimated that up to 2 million women and children are trafficked globally every year.

productive activities on return. Good examples are the Canada-Mexico program for agricultural workers and the agreement between France and Sri Lanka on sharing information about migrants.

Sources: Barber (2003); Schiff (2005).

Freer and fairer trade

10.22 Inequities in the trade arena are well known: rich countries protect their markets with tariff and nontariff barriers on the goods that poor countries produce more advantageously (such as agricultural produce and textiles). They provide handsome subsidies to their farmers, subsidize their exports, and discourage value-added processing in developing countries. Reducing such protection and subsidies would have a beneficial impact on world trade, growth, and poverty reduction.

10.23 *Potential benefits from liberalization.* Several recent studies have estimated the potential impact of various trade liberalization measures, including those being considered during the Doha Round of negotiations under the WTO. Estimates vary, depending on the reforms considered (various packages of partial reforms up to full liberalization) and on whether dynamic productivity gains are taken into account. At the lower end of the range, Hertel and Winters (2005)(forthcoming) estimated that the measures being discussed in the Doha Round would have a modest impact on world prices, welfare gains, and poverty, with the number of people living below \$2 a day declining by 9 million in 2015 over a baseline estimate of around 2 billion. According to this study, even full liberalization would not bring huge gains, as it would help lift 80 million people out of \$2 a day poverty. At the higher end of the range, Cline (2004) estimated that full trade liberalization would lift up to 440 million people out of \$2 a day poverty by 2015.

10.24 Whatever the size of the overall impact, researchers agree that it would be heterogeneous across countries and regions. In both partial and full reform scenarios, the gains would accrue mostly to large countries already significantly integrated in global markets, such as Brazil, China, India, and Indonesia. Parts of many Sub-Saharan countries and remote areas in Asia and elsewhere are simply not connected to global markets, and farmers eke out a living on subsistence agriculture, far from roads, markets, technology, and information. Many countries are unable to make full use of improved market access because of significant supply-side and institutional constraints. Detailed studies on Cambodia, Ethiopia, Madagascar, and Zambia showed that the potential impact of the trade reforms likely to be included in the Doha Round would be small for such countries. Some countries would even lose in the short run: Bangladesh and Mozambique, for instance, would experience a decline in incomes, as existing preferences are eroded and the prices of key food imports rise. Similarly, Bourguignon, Levin, and Rosenblatt (2004b) found that countries in the bottom two deciles of the international distribution of income would benefit more from a doubling of aid over current levels than from full trade reform. The estimated impact of trade liberalization varies greatly within countries as well (chapter 9).

10.25 Specific liberalization measures would also have differential impacts. Anderson and Martin (2004) found that the removal of OECD agricultural subsidies would hurt net food-importing least developed countries, such as those in the Middle East and North Africa, and countries that now enjoy special preferences, such as the Philippines, because of the consequent increase in prices.¹⁶ But net food-producing countries, and farmers within them, would benefit. There is, indeed, some evidence that rising agricultural world prices were partly responsible for the fact that rural incomes in China grew more rapidly than urban incomes in 2004.

10.26 The phasing out of the Multi-Fiber Agreement, which set quotas on exports of textiles from developing countries, also has heterogeneous effects. Chinese textile exports have made significant gains in markets not protected by tariffs—for instance, their share of Australian and Japanese markets, where there were no quota restrictions, is 70 percent. Their share of the U.S. baby clothes segment, where quotas were removed in 2002, jumped from 11 to 55 percent in two years. Exports from Cambodia and Nepal are reported to have declined significantly. The impact of these shifts on global income inequality is not clear and it depends on the relative position of garment workers and of those benefiting from indirect effects in the global distribution. Changes in the existing tariff structure, whereby producers from the poorest countries have duty-free access to markets in the United States and Europe while others face a 16 percent tariff on average, would also have an unclear impact on inequality.¹⁷ Conversely, renewed protectionism in developed countries is likely to have negative effects.

10.27 Currently, no global assistance program exists to compensate losers from trade liberalization. However, international assistance to help meet adjustment costs is an important focus, along with addressing supply-side constraints, of current efforts by a range of donors, recipients, and international organizations, including the World Bank, to increase aid for trade in the context of the WTO Doha round.

10.28 *Setting trade rules.* Where do the rules that govern trade come from, and what are the chances of changes? Trade rules, including the most egregiously inequitable, are part of complex multilateral, regional, and bilateral agreements. As mentioned in box 10.1, there are significant concerns about the fairness of WTO decision-making processes, and these processes are partly responsible for the current stalemate in negotiations.

10.29 But the reality of WTO negotiations is complex. In the WTO, each country has one vote, and the practice of decision making by consensus means that each country can veto decisions (although the practice of “single undertaking,” or voting on all matters together, in practice weakens veto power). Countries choose to sign on to the WTO following not only extensive external negotiations but also domestic decision-making processes. So this is not a *prima facie* example of unfair rule-setting. In practice,

¹⁶ One option to address these losses is to lock development assistance to poor countries hurt by specific measures into the WTO agreements on these measures; see Ricupero (2005).

¹⁷ The current tariff structure could change through both bilateral and multilateral negotiations. For instance, if the Central American Free Trade Agreement is approved by the U.S. Congress, most textiles from countries such as Honduras and El Salvador would benefit from tariff-free entry into the United States, now the case for some items under existing unilateral preferences.

however, poor countries find it difficult to follow negotiations, to understand the implications of proposals to them, and to develop alternative proposals—we saw in chapter 3 that even their capacity to be present in Geneva is limited.

10.30 So, in the end, the rules may at times be unfair not because the formal processes are unfair but because of the underlying power imbalance between rich countries with strong commercial interests and poor countries with weak capacity.¹⁸ The balance is even tilted against taxpayers and consumers in rich countries, who often stand to lose from the protection of vested commercial interests. Consider, for example, cotton subsidies (see box 10.3) and international cartels.¹⁹ Poor countries are in an even weaker position when negotiating bilaterally with stronger trading partners than they are when negotiating multilaterally. Paradoxically, in light of the intense antiglobalization protests, multilateral negotiations in the context of the WTO hold the greatest promise to reduce inequities that harm poor countries. Although even an ambitious Doha Round would bring limited benefits, it remains an important goal to pursue because failure would further undermine confidence in multilateral negotiations.

Box 10.3 Cotton subsidies are huge—and tenacious

The International Cotton Advisory Committee estimated that, in 2001/02, direct production assistance by the eight countries that provided subsidies (United States, China, the European Union, and to a much smaller extent Turkey, Egypt, Mexico, Brazil, Cote d'Ivoire, in that order) was around \$5.8 billion. Direct assistance to U.S. cotton producers reached \$3.3 billion, China's support totaled \$1.2 billion (although some question this estimate), and the European Union's support was \$979 million (for Greece and Spain) (International Cotton Advisory Committee (2003)). The main impact of U.S. and European subsidies is to make cotton produced in the United States and Europe competitive and depress world prices. It is estimated that in 2001/02 prices would have been 71 percent higher without subsidies.

Subsidies benefit large rich farmers in the United States and not-so-rich but relatively well-off farmers in Europe, and harm poor, small farmers in Africa. Cotton is a crucial commodity for a number of poor African and Central Asian countries, contributing up to 40 percent of merchandise exports and 5 to 10 percent of GDP. Most growers are smallholders, so the impact of cotton prices on poverty is significant. A study on Benin found that a 40 percent reduction in farmgate cotton prices—equivalent to the price decline from December 2000 to May 2002—implied an 8 percent reduction in rural per capita income in the short run and a 6 to 7 percent reduction in the long run, with the incidence of poverty among cotton growers rising in the short run from 37 percent to 59 percent (Minot and Daniels (2002)).

Estimates of the impact of subsidy removal on cotton prices are in the range of 8 to 12 percent. Increases of this magnitude would not hurt consumers—the price of raw cotton is a small component of the price of textiles and garments. Full subsidy removal and the consequent rise in prices would help African countries, although the distribution of in-country benefits would depend on domestic reforms. A recent study of the impact of subsidy removal on three cotton-producing provinces of Zambia, for instance, indicates that the direct impact of the subsequent cotton price increase would be small: about 1 percent of income on average. Greater gains would require farmers switching from subsistence crops to cotton, which

¹⁸ See for example Birdsall (2002).

¹⁹ Price-fixing by international cartels brings significant losses to developed- and developing-country consumers alike. Analysis of six high-profile cartels uncovered in the 1990s (vitamins, citric acid, bromine, seamless steel tubes, graphite electrodes, lysine) indicated that the estimated price increases ranged from 10 percent for stainless steel tubes to 45 percent for graphite electrodes, and that cumulative overcharges to developing countries over the life of the six cartels ranged from \$3 billion to \$7 billion, depending on the calculation method. See Connor (2001), OECD (2002), and World Bank (2003b).

in turn requires complementary domestic reforms in extension services and robust growth of demand for cotton exports (Balat and Porto (forthcoming)).

Benefits to African countries would increase if they were to expand their clothing production and exports. The U.S. African Growth and Opportunity Act provides an opening, but under rather restrictive conditions: apparel from 14 African countries gets duty-free and quota-free access to U.S. markets, but only if made from U.S. fabric, yarn, and thread. So to take advantage of this provision, countries need to establish an effective input visa system to ensure compliance with rules of origin (Baffes (2004)), which seems exceedingly complex.

Within the WTO, poor cotton-producing West African countries took the unusual step of issuing a joint statement calling for full subsidy removal and for cotton to be treated separately. But the July 2004 Framework Agreement of the Doha Development Agenda does not include separate treatment of cotton, stating only that cotton will receive “adequate priority” in agricultural negotiations. Subsidy removal is politically unlikely.

In the current climate, a second-best option would be to implement well-designed decoupled support, in which subsidies do not depend on production and thus do not encourage overproduction and consequent “dumping,” as is the case with the current schemes. Existing mechanisms would need to be reformed, because they still depend on acreage and thus create incentives for overproduction. Less overproduction may help lift prices a bit.

Source: Authors’ creation.

10.31 The WTO has another advantage: it provides for a mechanism to adjudicate disputes. This is important, as seen earlier, to ensure that international law is applied and enforced. The WTO dispute settlement mechanism provides a forum for poor countries to bring complaints and possibly win them. Unfortunately, winning a case does not automatically bring redress: the loser in the case may not necessarily change its action. The existing mechanisms to enforce decisions rely on voluntary compensation of the loser and, when this is not satisfactory, the possibility of retaliatory action (such as suspension of tariff and other concessions) on the part of the winner. Clearly, poor countries’ retaliation against powerful trading partners is unlikely to provide much of an incentive for rich countries to comply with unfavorable rulings, because of their typically smaller volume of trade with a developed-country defendant. Even so, developing countries have in recent years brought forward, and won, an increasing number of cases.

10.32 *The fair and ethical trade movements.* Interestingly, some NGOs and civil society organizations in both developed and developing countries have acted directly to establish more equitable trade relations. One such example is “fair trade.” Fair trade initiatives, led by consumer groups, NGOs, trade unions, and other civil society organizations, aim to control the supply chain from production to market to improve the well-being of developing-country producers by ensuring a stable price for their commodities, linking them more directly with markets in rich countries, and strengthening their organizations. The approach is working: sales of fair trade bananas, cocoa, coffee, brown sugar, tea, and a few other products have seen phenomenal growth in recent years and now represent a significant share of exports for some countries (for instance, 11 percent of Ecuadorian bananas and 20 percent of Ghanaian coffee are now sold through fair trade).

10.33 The few impact studies that exist show that fair trade initiatives have indeed made a difference to producers, not only through the premiums paid over world prices but also thanks to the services and assistance provided to farmers by producer cooperatives supported by fair trade organizations. When inequities arise from unequal access to markets and lack of information, credit, and risk-mitigation mechanisms, strengthening producer associations can lead to more equitable outcomes, even without paying a premium, in the context of existing trade rules.²⁰

10.34 The reach of fair trade initiatives, while growing, remains small. In Switzerland, where consumer support is strong, fair trade bananas still represented only 25 percent of overall banana purchases and consumer spending on all fair trade products was a mere \$10 per person in 2002 (Swiss agricultural subsidies amounted to roughly \$750 per person in the same year). Fair trade coffee accounts for, at most, 3 percent of world sales, and only about 20 percent of the capacity of certified fair trade producers is absorbed by the fair trade circuit.²¹

10.35 Another example of organizations acting directly to establish more equitable trade relations is the growing number of initiatives for corporate social responsibility and ethical trade. Companies that join an ethical trade organization, such as the Ethical Trading Initiative in the United Kingdom or the Fair Labor Association in the United States, pledge to respect a code of conduct in return for favorable consideration by consumers and investors who care about equitable development.²² Codes of conduct generally cover fair labor practices (usually those set out in ILO conventions), environmental standards, and monitoring mechanisms—and apply not just to a firm's direct production facilities but also to those of all its suppliers along the supply chain.

10.36 Are consumers in rich countries willing to pay a bit more to ensure that the goods they buy are produced in fair and safe conditions? Proponents of codes of conduct believe they are. Researchers found that almost 90 percent of Americans said they would pay at least an extra \$1 on a \$20 item if they could be sure it had not been produced by exploited workers.²³ Skeptics point to the fact that prices dominate the decisions of the major corporate buyers.

10.37 Codes of conduct inspired by ethical considerations might have a positive impact on equity, but are they applied? Impact studies conducted by the Ethical Trading Initiative found mixed evidence. Consumers may not be willing to pay higher prices in exchange for an uncertain (and often unmonitored) positive impact. Consumer pressure may thus not be enough (box 10.4). So, these initiatives, while important, are no substitute for more equitable trade rules under the WTO and other arrangements.

²⁰ Ronchi (2001) and Ronchi (2002).

²¹ Lewin, Giovannucci, and Varangis (2004).

²² For more information, see www.ethicaltrade.org and www.fairlabor.org.

²³ Fung, O'Rourke, and Sabel (2001).

Box 10.4 Will improved working conditions in Cambodia's textile industry survive the end of the quota system?

As mentioned in chapter 9, the 1999 bilateral trade agreement between Cambodia and the United States included a provision whereby Cambodia's clothing exports would increase each year if labor standards improved. The ILO was mandated to prepare a report twice a year based on factory visits and interviews with workers and unions and to make it widely available.

The provision helped bring about a gradual improvement in working conditions in clothing factories, but this progress is under threat with the end of the quota system. The government agreed to continue ILO inspections until 2008, but employers can no longer count on increases in exports to the United States if they uphold labor standards. Some are aware that labor standards compliance is their only real competitive advantage, but there are reports of union leaders being fired, lack of adherence to minimum and overtime pay rules, and repressed demonstrations. Employers are allegedly using the threat of tough competition from China to cut salaries and benefits. But the employers are being watched—an independent union movement has grown in the industry and ILO monitoring is increasingly sophisticated. Monitors are now using hand-held computers to transmit findings from their factory visits, allowing timely reporting. If working conditions deteriorate, activists, researchers, unions, and, most important of all, consumers will know. Whether their pressure will be enough to ensure adherence to labor standards is an open question.

Sources: International Confederation of Free Trade Unions (2005), Washington Post (2004).

Intellectual property rights and the global market for ideas

10.38 Protection of intellectual property rights (IPR) is another area in which market failure and power structures shape unequal processes and outcomes; the interests of a few powerful actors impose costs on the general public, particularly the poor. The requirement set forth in the Trade-Related Aspects of Intellectual Property Rights agreement (TRIPS)²⁴—that all member countries offer 20-year patent protection—is perceived by many to be grossly inequitable. Because patent protection was adopted in OECD countries before the 1990s, the main result of this requirement is to strengthen patent protection in poor countries that become WTO members. Countries adopting patent protection today are doing so at levels of GDP between \$500 and \$8,000 per capita, while OECD countries did so when their GDP per capita was around \$20,000 in 1995 prices.²⁵

10.39 Patents stem from a legitimate desire to provide incentives for the generation of knowledge and cover the cost of developing new knowledge. A drug or other patented innovation cannot be copied while a patent is in force, so developers enjoy a monopoly position and can charge higher prices. Extending patent protection to developing countries can thus increase total profits by allowing companies to earn them in poor countries—and changes the distribution of R&D financing, with a greater share borne by poorer countries. But protection of IPR must be balanced by the concern that it restricts access to new technologies. Patents restrict access to innovations by making them more expensive and more difficult to copy. There is great concern in developing countries on

²⁴ “Trade-Related Aspects of Intellectual Property Rights,” Annex 1C of the Agreement Establishing the World Trade Organization.

²⁵ Lanjouw and Jack (2004).

the availability of various innovations, including patented seeds and drugs. Antiretroviral drugs to fight AIDS are a case in point (box 10.5).

10.40 We look in more detail at pharmaceutical patents as an illustration of the broader issues. Chaudhuri, Goldberg, and Jia (2004) estimate that the gains to the Indian economy from not following international patent protection standards were around \$450 million, of which \$400 million were a gain to consumers and the rest profits of domestic producers. Profit losses to foreign producers were only around \$53 million a year. This study illustrates the important point that the profits pharmaceutical companies could gain in poor countries are not very large. Lanjouw and Jack (2004) estimate that extending patent protection to developing countries to 20 years would be equivalent, for firm profits, to extending patents in developed countries by two weeks.

10.41 A solution exists that would lead to more equitable provision without undermining efficiency: wherever rich country markets already support the cost of research, poor countries could be allowed to produce or import cheaper generic substitutes, at no significant cost to either rich countries or the firms that carry out research (see Focus on Drug Access at the end of this chapter).

Box 10.5 Expanding access to antiretroviral drugs in South Africa

In response to the rising AIDS crisis, the government of South Africa in 1997 amended the Medicines and Related Substances Control Act of 1965 in an attempt to ensure the supply of more affordable drugs to all South Africans. The amendment encouraged pharmacists to substitute costly patented drugs with cheaper generic equivalents, allowed for the importation of cheaper drugs available on the market elsewhere (parallel imports), and introduced a compulsory licensing system allowing competitors to produce patented drugs.

The Pharmaceutical Manufacturers Association and 39 drug companies challenged the government's legislation in the Pretoria High Court on several grounds, including that it violated South Africa's obligations under TRIPS. The Treatment Action Campaign (TAC) and a labor union, COSATU, supported the government defense in the case, asserting that the legislation was valid in that it constituted the government's positive duty to fulfill the right to health. Arguably as a result of public pressure and attention, the Pharmaceutical Manufacturers Association and the drug companies withdrew their case. An indirect result was to bring down the price of antiretroviral medicine from about 4,000 rand a month to 1,000 rand a month.

Other legal cases (not involving TRIPS) helped expand access to antiretroviral drugs. In 2002, a group of complainants, including TAC, brought a case against GlaxoSmithKline and Boehringer Ingelheim at the South African Competition Commission. In its October 2004 ruling, the commission found that the two firms had engaged in excessive pricing of patented antiretrovirals and refused to allow generic production of the drugs in return for royalty payments, actions that the commission ruled were in violation of the South Africa Competition Act. To keep the case from moving to a higher tribunal, the firms came to a settlement agreement that included licensing generic production.

TAC also attempted to compel the national and provincial governments to provide antiretroviral drugs to all pregnant women to prevent the transmission of HIV from mothers to their children; the impact of the existing government policy was to make the drug Nevirapine unavailable in public health facilities other than the 10 or so pilot sites. The government appealed to the Constitutional Court after TAC secured a successful decision.

The Constitutional Court declared that the South African Constitution required the South African government to devise and implement within its available resources a comprehensive and coordinated program to realize progressively the rights of pregnant women and their newborn children to have access to health services to combat mother-to-child transmission of HIV. The Court found the state policy of restricting the availability of antiretrovirals drugs and related services for preventing mother-to-child transmission of HIV to a few pilot test sites unreasonable, and ordered the government to rectify the situation by taking reasonable steps to facilitate the availability and use of antiretrovirals drugs in all public health facilities.

In 1999, TAC had also been part of a successful constitutional challenge relating to discrimination of South African Airways cabin attendants with HIV. The judgment reinforced the right to equality for people with HIV. These legal challenges had important indirect impacts, setting groundbreaking precedents, increasing judicial awareness of human rights obligations, and heightening public awareness of rights.

Sources: Decker and others (2005), South Africa Competition Commission (2003).

10.42 As with all international law, the existing IPR protection rules are the result of complex negotiations. TRIPS—which was basically written by industry lawyers²⁶—is part of the agreement establishing the WTO, a multifaceted deal that included the Multi-Fiber Agreement and other provisions that developing countries deemed beneficial to them. Many bilateral free trade agreements (such as recent agreements between the United States and Chile, Jordan, Morocco, Singapore, Vietnam, and others) include even stronger IPR protection rules than TRIPS, such as granting patent extensions on pharmaceuticals and specific types of protection on clinical trial data submitted to obtain marketing approval. Signatories to these agreements agreed on these rules generally in exchange for preferential access to U.S. markets for their products.

10.43 But it is hard to argue that the parties to these various bilateral and multilateral agreements were on a level playing field. Poor countries are in a weaker bargaining position overall. For example, the preferential access they gain through bilateral trade agreements is eroded whenever the United States reduces remaining tariffs and quotas in bilateral or multilateral negotiations, while IPR protection does not weaken over time.²⁷ Moreover, the issues involved in IPR protection are complex and require skills and capacity that rich countries can better afford—often with input from pharmaceutical firms. Some capacity-building efforts for developing countries are under way, but at least some of the agencies responsible (such as WIPO and developed-country patent offices) are perceived as biased. Inequitable as TRIPS may be, it still provides an internationally agreed standard subject to intense scrutiny and study, which does make it harder for rich countries to get more favorable deals in bilateral agreements.

10.44 An additional advantage of negotiating sessions under the WTO is that they provide focal events for mobilizing public opinion. An example of how positive results can be achieved within the WTO process is the Declaration on the TRIPS Agreement and Public Health adopted at Doha in 2001, which affirms the primacy of public health concerns over IPR protection. Three subsequent U.S. bilateral agreements include side

²⁶ Sell (2003).

²⁷ Fink and Reichenmuller (2005).

letters on public health that affirm the signatories' understanding that IPR protection does not affect their ability to "protect public health by promoting medicines for all."²⁸ When negotiations are shifted away from the spotlight, as drug companies managed to do with drug licensing under the July 2004 Doha Development Agenda Framework Agreement, monitoring progress and campaigning become more difficult. So multilateral negotiations within the WTO, which are held under the spotlight, probably hold the most promise in terms of adopting more equitable rules.

Financial market liberalization

10.45 Capital flows to developing countries have grown tremendously in the 1990s, bringing both advantages and challenges. Short-term capital flows are at times accused of contributing to financial instability while not enhancing growth in countries with immature financial systems. Most countries that received high volumes of short-term capital inflows in the 1990s—Argentina, Brazil, Indonesia, Korea, Mexico, Russia, Thailand, and Turkey—have been hit by financial crises, triggered or deepened by the flight of foreign short-term capital.

10.46 Domestic factors play a key role in financial instability, but global rules also play a role. For instance, debt workout mechanisms follow informal processes; the IMF's proposal for a Sovereign Debt Workout Mechanism was not adopted. The result is that deals tend to benefit international lenders at the expense of domestic investors and taxpayers.²⁹

10.47 In contrast to short-term capital flows, foreign direct investment (FDI) is generally regarded as having a positive impact on receiving countries, but it goes to only a few countries. In 2002, 84 percent of FDI to developing countries went to 12 mostly middle-income countries (including China and India), with the other 150-odd developing countries receiving almost nothing. Only 5.3 percent of FDI went to Sub-Saharan Africa.³⁰ Domestic factors play a key role also in determining the location of FDI, but again global rules contribute to inequitable outcomes. The Basel II Capital Accord, that sets capital adequacy standards for banks, may overestimate the risk of bank lending to developing countries (in part because it ignores the benefits of diversifying portfolios across countries), thus raising the cost and reducing access to external capital, in addition to increasing the procyclicality of loans and possibly contributing to increased volatility.³¹ Emerging global standards—including those assessed under the Reports on the Observance of Standards and Codes (ROSC), international accounting standards, and the Core 25 Principles for Banking Supervision—are also costly for developing countries and may not be appropriate to their level of development.

10.48 *Rules-setting in global financial markets.* Some of the key rules governing global financial markets are developed by institutions to which developing countries do not

²⁸ These are the agreements between the United States and Morocco (2004), Bahrain (2004), and the Dominican Republic-CAFTA (signed but not yet approved by the U.S. Congress).

²⁹ Claessens and Underhill (2004).

³⁰ World Bank (2005f) and UNCTAD (2004).

³¹ See Claessens, Underhill, and Zhang (2003) and Bhattacharya and Griffith-Jones (2004).

belong. The Financial Stability Forum, established in 1999 to promote global financial stability, brings together senior representatives of central banks, supervisory authorities and treasury departments of nine OECD countries, international financial institutions, international regulatory and supervisory groupings, committees of central bank experts, and the European Central Bank. The only emerging market economies that are members are Hong Kong (China) and Singapore.

10.49 The Basel Committee on Banking Supervision, which developed the Basel II Capital Accord, comprises representatives of the central banks and banking supervision authorities of Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom, and the United States. Its main interlocutor in the development of the Accord was the Institute for International Finance, a Washington-based consultative group of major international banks. Neither the Financial Stability Forum nor the Basel Committee can legitimately represent the interests of developing countries.³² Various other standards, often developed by semiprivate agencies (such as the International Accounting Standards Board), are based on practices in the United States and European Union. Greater participation and voice in rule-setting bodies would help ensure that outcomes are more favorable to developing countries.

Rectifying past and present inequities in the use of natural resources

10.50 The use of natural resources is another major arena in which market failures and unequal power conjure to create major inequities. This is greatly skewed in favor of developed countries and impacts are grossly inequitable. Without major technological innovations several key resources, such as oil, could be exhausted before the world's poor get a chance to attain standards of living comparable to those of today's developed-country citizens. Moreover, global warming threatens to destroy the livelihoods of people living in low-lying coastal areas, small islands, and semiarid regions. Yet the people potentially affected by these changes (tomorrow's citizens and many of today's poor) have virtually no voice in setting rules.

10.51 The international community has taken some steps to manage natural resources in a more equitable way. Some international legal instruments, such as the Convention on the Law of the Sea of 1982, reflect the concept of distributive justice discussed earlier by taking an approach whereby the seabed and ocean floor, beyond national jurisdiction, are classified as global commons and subject to a system of equitable sharing of the economic benefits derived from activities in these areas.

10.52 Key steps toward redressing inequities in the use of global resources are the 1992 UN Framework Convention on Climate Change and the 1997 Kyoto Protocol. The protocol is structured to reflect the principle of "common but differentiated responsibilities" between developed and developing countries. It recognizes that industrial nations have emitted the majority of greenhouse gases in the atmosphere, causing the majority of the harm, and places greater demands on them. It sets binding

³² We discuss representation on the World Bank and IMF Boards below.

quantified commitments for industrial countries to reduce their greenhouse gas emissions by 2008–12, with the understanding that the agreement would include emission reduction efforts by developing nations some time after 2012.

10.53 One important aspect of the Kyoto Protocol is the unique set of provisions that allow industrial nations to meet their commitments through actions not only within their borders but also outside. One of these provisions, the Clean Development Mechanism, helps address the perceived inequality of obligations and the costs of compliance. It allows industrial countries to purchase emission reduction “credits” generated from activities that reduce greenhouse gas emissions in developing countries and to apply these credits against their obligations under the Protocol. It thus assists industrial countries in meeting their commitments under the Kyoto Protocol more cost effectively and promotes sustainable development in developing countries, through supporting greater investments in cleaner, more efficient technologies as well as forestry projects.

10.54 Fairness in processes is also an issue. In negotiating the Kyoto Protocol, as in most global treaty negotiations, industrial nations had greater power at the negotiating table. An imbalance of technical expertise, a lack of adequate public support for the issues, and problems forming coalitions because of diverse interests have attenuated the bargaining power for many developing countries.

10.55 The United States, the single largest emitter of greenhouse gases, has announced that it is not becoming a party to the Kyoto Protocol, significantly reducing the protocol’s efficacy. With the protocol having come into effect in February 2005, the United States will be a mere observer at the Meetings of the Parties to the Kyoto Protocol, but because of the size of its emissions, the other parties will not want to ignore U.S. concerns.³³

10.56 Equitable access to information is an important ingredient for more equitable use of global resources. The UN/ECE Convention on Access to Information, Public Participation in Decision-making and Access to Justice in Environmental Matters (Aarhus Convention) deals with public participation in environmental management and access to information on environmental issues. The Convention, adopted in 1998 and in force among 35 parties since 2001, grants citizens the right to impose obligations on public authorities and parties to international environmental conventions, including information disclosure, access to information, public participation in environmental decision making, and access to justice. A Convention Compliance Committee has been established, to which citizens and NGOs can bring allegations of noncompliance.

Providing development assistance to help build endowments

10.57 In shaping global inequities, rules and processes interact with unequal endowments. Even if all the reforms suggested in the previous sections were implemented, many poor countries would still not be able to participate in global markets because of their limited endowments of skills, capital, infrastructure, knowledge, and

³³ O’Sullivan and Christensen (2005).

ideas. Action to build endowments is primarily domestic, through private and public investments in infrastructure and other areas. Can domestic action be supported by aid?

Better development assistance

10.58 From an equity perspective, the main roles of aid are to help countries build the endowments of those who are resource-poor, generally through no fault of their own, and avoid extreme deprivation (which justifies to some extent the use of aid to support current consumption). The focus on building endowments implies that both the level of aid and its effectiveness matter.

10.59 *Enhancing aid effectiveness.* If the goal is to equalize opportunities for the poor, aid effectiveness is crucial. Aid that sustains corruption or marginal projects, or is used to increase the resources at the disposal of the rich, does not help. Aid effectiveness hinges crucially on aid delivery modalities and on the fairness and transparency of domestic political processes. Birdsall (2004) cites seven “deadly sins”: impatience with institution building, failure to exit, failure to evaluate, pretending that participation equals ownership, failure to collaborate, stingy and unreliable financing, and underfunding of regional and global programs—in addition to tying aid to the use of consultants and firms from the donor country and allocating it according to political priorities. Existing aid planning and delivery practices are rooted in political and incentive constraints that the donors face, so change is difficult and slow. But some current directions are promising: emphasizing results (including through tracking indicators of intermediate actions and final outcomes related to the MDGs), moving away from ex ante conditionality, and progressively shifting design and management from donors to countries. The United Kingdom's Commission for Africa (2005) recommended a major shift away from ex ante conditionality toward a new partnership in which African countries continue to work to improve governance and accountability, and donors deliver more, cheaper, more predictable aid. High levels of aid reduce the need for domestic tax efforts, which have historically helped strengthen overall accountability of governments and citizen demand for quality services, so particular attention should be paid to revenue collection.³⁴ The preparation of poverty reduction strategies is a key, if imperfect, instrument to shift to country-led processes with greater participation and monitoring of how public resources are spent.

10.60 Fragile states pose a special challenge. Stabilization and peacekeeping need to be complemented with efforts to build state institutions and legitimacy. The sequencing of interventions matters—there is some evidence that ring-fenced, long-term investment in human capital development and working with NGOs and the private sector can be useful first steps. Technical assistance appears more effective after reforms take off and can help lay the basis for capital investment and service delivery interventions.³⁵

10.61 When domestic political processes are manifestly inequitable and corrupt, donors can try to support moves toward a more equitable revenue collection and allocation;

³⁴ Moore (2004).

³⁵ McGillivray (2005).

decentralization to lower levels of government, which can challenge central control; and the strengthening of community-based organizations, the media, and domestic entrepreneurship, which can help create a middle class with a voice and a stake in better governance.

10.62 *Improving the allocation of aid.* The distribution of aid matters as well. A lively debate has taken place in recent years on aid allocation criteria. Burnside and Dollar (2000) and Collier and Dollar (2002) found that aid was more effective in reducing poverty if it was allocated to countries that followed good policies and had good institutions. They calculated that reallocating actual aid provided in 1996 across countries to maximize poverty reduction according to their formula would have led to directing aid to roughly 20 instead of the 60 countries considered, and lifted twice as many people out of poverty.³⁶

10.63 Their findings have been questioned by Hansen and Tarp (2001) and others, who argued that their analysis does not take country conditions into account and is not robust to different specifications. If aid effectiveness varies across countries not because of policies but as the result of different country circumstances, such as climate, a different aid allocation rule would maximize the poverty impact of foreign aid.³⁷ Cogneau and Naudet (2004) suggested an alternative rule for aid allocation and showed that gains in poverty reduction similar to those found by Collier and Dollar could be obtained if aid was directed to countries that have greater structural disadvantages (geographic, historical, or economic, as discussed in chapter 3). The resulting allocation would spread the risk of poverty more evenly across the world's population, while reducing global poverty almost as much as the allocation proposed by Collier and Dollar.

10.64 In sum, an equity perspective suggests that an approach that does not take a country's circumstances into account is likely to ignore important information about need. But an approach that ignores aid effectiveness does not lead to expanded opportunities. To contribute toward an equalization of opportunities across the world's individuals, aid should be targeted where the probability is greatest that it effectively reaches those with the most limited opportunities—the poorest of the poor, in opportunity terms. That clearly depends on the poverty and deprivation levels in each country and on its government's ability and political commitment to deliver the aid where and how it is intended. But more research is needed to fully understand the causal mechanisms.

10.65 In practice, recent research showed that many donors indeed seem to rely on both good policies and poor initial conditions. A study of 40 donor agencies by Dollar and Levin (2004) found that aid was positively correlated with a measure of good policies and with per capita GDP, and the agencies that focused the most on good policies also directed their aid to poor countries. However, some fragile states ("aid orphans") receive less aid than predicted by their policy and institutional strength, mostly because of

³⁶ Updating the results for 2001 led to similar results (Levin (2005)).

³⁷ The findings of Burnside and Dollar (2000) and Collier and Dollar (2001), Collier and Dollar (2002) are not robust to changes in functional form, the specification of the interaction terms, and sample selection; see Hansen and Tarp (2001), Easterly, Levine, and Roodman (2004), and Dalgaard, Hansen, and Tarp (2004). These studies also point to the importance of climate, among other factors.

disproportionately low flows from bilateral donors, while others ("aid darlings") received more.³⁸

10.66 *Increasing aid levels.* Conditional on effectiveness and distribution, levels of aid do matter. Aid levels fell between 1990 and 2001 both as a share of rich countries' gross national income (GNI) and in nominal terms. Calls for more aid to help countries achieve the MDGs have resonated loudly in recent international gatherings. At the 2002 International Conference on Financing for Development in Monterrey, rich countries committed to increasing their aid flows significantly. Net aid flows indeed increased significantly in 2002–04 in nominal and real terms, reaching \$78 billion.³⁹ Three major factors were behind these increases: continuing growth in bilateral grants (but with a large share going to technical cooperation, debt forgiveness, emergency and disaster relief, and administrative costs); the provision of reconstruction aid to Afghanistan and Iraq by the United States (in 2004, \$0.9 billion to Afghanistan and \$2.9 billion to Iraq); and the depreciation of the U.S. dollar. While there was a small increase in new development assistance to Sub-Saharan Africa in 2003, even after accounting for debt relief and emergency assistance, Highly Indebted Poor Countries (HIPC) received less in real terms in 2004 than the year before. On the positive side, the International Development Association, the soft-lending arm of the World Bank, recently received a replenishment for 2006/08 that is at least 25 percent higher than the previous one and represents the largest funding increase in two decades.

10.67 These recent increases notwithstanding, aid flows remain small not just in relation to need but also in comparison to domestic human development and safety net programs that aim to equalize opportunities and ensure against deprivation. Such programs generally account for more than 10 percent of GDP in donor countries. Official development assistance (ODA), by contrast, was only 0.25 percent of donor countries' GNI in 2003. Only Denmark, Luxembourg, the Netherlands, Norway, and Sweden meet the UN target of providing ODA equal to or greater than 0.7 percent of GNI. Many countries are not on track to meet their Monterrey commitments (table 10.1).

³⁸ Levin and Dollar (2005).

³⁹ These figures include official development assistance (ODA) provided by countries that are members of the Development Assistance Committee (DAC) of the Organisation for Economic Co-operation and Development (OECD). Non-DAC countries also provide ODA; the largest non-DAC donors are Saudi Arabia (providing \$2.4 billion in 2003 out of a total of \$3.4 billion), the Republic of Korea (\$366 million), the United Arab Emirates (\$188 million), and Kuwait (\$133 million).

Table 10.1 ODA as a share of GNI, 2002, 2003, and simulation for 2006

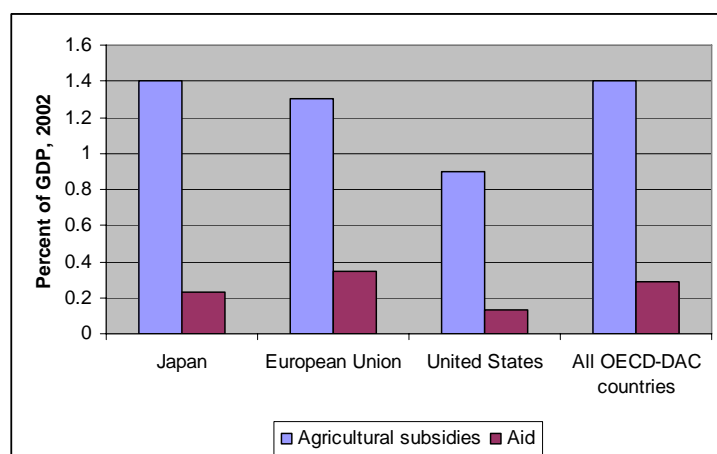
Country	Net ODA 2003 (\$ millions)	Net ODA 2004 (\$ millions)	ODA as % of GNI 2003	ODA as % of GNI 2004	ODA as % of GNI Simulation 2006
Austria	505	691	0.20	0.24	0.33
Belgium	1,853	1,452	0.60	0.41	0.64
Denmark	1,748	2,025	0.84	0.84	0.83
Finland	558	655	0.35	0.35	0.41
France	7,253	8,475	0.41	0.42	0.47
Germany	6,784	7,497	0.28	0.28	0.33
Greece	362	464	0.21	0.23	0.33
Ireland	504	586	0.39	0.39	0.61
Italy	2,433	2,484	0.17	0.15	0.33
Luxembourg	194	241	0.81	0.85	0.87
Netherlands	3,981	4,235	0.80	0.74	0.80
Portugal	320	1,028	0.22	0.63	0.33
Spain	1,961	2,547	0.23	0.26	0.33
Sweden	2,400	2,704	0.79	0.77	1.00
United Kingdom	6,282	7,836	0.34	0.36	0.42
EU members, total	37,139	42,920	0.35	0.36	0.44
Australia	1,219	1,465	0.25	0.25	0.26
Canada	2,031	2,537	0.24	0.26	0.27
Japan	8,880	8,859	0.20	0.19	0.22
New Zealand	165	210	0.23	0.23	0.26
Norway	2,042	2,200	0.92	0.87	1.00
Switzerland	1,299	1,379	0.39	0.37	0.38
United States	16,254	18,999	0.15	0.16	0.19
DAC members, total	69,029	78,569	0.25	0.25	0.30

Source: OECD-DAC (2004).

Note: DAC = Development Assistance Committee; EU = European Union; GNI = gross national income; ODA = official development assistance.

10.68 Aid also is low in comparison with other uses of public resources. Agricultural subsidies, for instance, were almost five times larger than aid in 2002. Japan, the European Union, and the United States had subsidies equal to 1.4, 1.3, and 0.9 percent of GDP and aid of 0.23, 0.35, and 0.13 percent respectively (figure 10.2). Rich countries should deliver on their Monterrey commitments; this alone would add around \$18 billion to development assistance by 2006. To make further progress toward the 0.7 percent goal, countries could establish intermediate targets for 2010. But again, higher aid that is poorly spent, supports corrupt regimes, or undermines domestic accountability can hinder, rather than support, greater equity.

Figure 10.2 More subsidies than aid (aid and support for agriculture as a share of GDP, 2002)



Sources: OECD-DAC (2004) and OECD (2003).

Additional debt relief

10.69 Aid should not be undermined by debt payments. Multilateral debt, the largest share of debt for the HIPC, is the result of loans received in the 1980s, and new loans, while generally on more concessional terms, continue to add to the debt burden. Supporters of debt relief argue that debt payments divert scarce resources from health and education and other pro-poor spending.

10.70 There has been progress in the last decade. In 1995, debt relief was not on the agenda of international organizations, partly because of financing issues and partly because of concerns about creating a moral hazard (if debts are forgiven, governments of borrowing countries may think they are really not expected to repay). Over the following five years, thanks to a strong grassroots mobilization in rich countries, effective research on the impact of debt and committed leadership in some rich countries and the World Bank, the HIPC Initiative was launched and then expanded. As of February 2005, 27 countries had received debt relief expected to amount about \$54 billion over time, up from \$34.5 billion at the end of 2000. The ratio of debt service to exports for HIPC has declined roughly by half, to 15 percent. Poverty-reducing expenditures in the 27 countries that receive HIPC assistance are estimated to have increased from 6.4 percent of GDP in 1999 to 7.9 percent of GDP in 2003.

10.71 Even so, many countries continue to bear an unsustainable debt burden, and more needs to be done. The agreements reached in October 2004 to extend the HIPC Initiative and in June 2005 to grant 100 percent debt cancellation of the debt owed to the African Development Bank, IMF, and World Bank to 18 countries are important steps.⁴⁰ This and any further debt relief should truly be additional rather than substitute fresh aid.

⁴⁰ Eighteen countries qualify immediately, and as many as another 20 could qualify over time. See the G-8 Finance Ministers' Conclusions on Development, London, June 10–11, 2005 (G-8 Finance Ministers, 2005) at http://www.hm-treasury.gov.uk/otherhmtsites/g7/news/conclusions_on_development_110605.cfm. The G8 Finance Ministers' agreement was confirmed at the July 2005 G8 Gleneagles Summit.

Further debt relief should also be accompanied by careful consideration of debt sustainability issues, including increasing grants for very low-income countries, to avoid the buildup of unsustainable debt in the future.

Innovative mechanisms to fund development assistance

10.72 Several innovative mechanisms to expand development assistance are under discussion, including the International Financing Facility (IFF), global taxes, and voluntary contributions. The IFF would make future aid available for immediate use (frontload aid) and possibly reduce volatility. It is an option for some donors, such as France and the United Kingdom, given their accounting and legislative frameworks, but not for others, who would not be able to make long-term commitments or consider them off-budget. Even when feasible, the IFF would move aid off-budget in the short term, but it would expand financing for development only if it increased overall aid levels rather than simply shift future aid forward.

10.73 Proposals involving global tax instruments have also been advanced, including a “Tobin” tax on short-term capital movements; taxes related to pollution, such as a global carbon tax, an international aviation fuel tax, and a maritime pollution tax; taxes on arms sales; and surcharges on multinational profits and on value-added or income taxes. These proposals would need to be assessed on the basis of the revenues they could generate, their efficiency, collectability, feasibility, and not least their impact on equity.

10.74 Voluntary contributions from individuals, corporations, private foundations, and NGOs—another source of development assistance alongside public aid—are increasing. But effectiveness is an issue for private assistance too. As seen for the December 2004 Asian tsunami, private charity can be mobilized faster than public resources. But private contributions are influenced by press coverage more than actual need; contributors were much less generous for the Iranian earthquake that hit in February 2005, which was virtually ignored in the news. Moreover, lack of coordination, fragmentation, and infrastructure bottlenecks—such as bad roads and a lack of electricity and telecommunications, which cannot generally be alleviated through private charity—can hinder its effectiveness. Moreover, alignment with recipient country strategies needs to be ensured.

Transitions to greater equity

10.75 Equity-enhancing changes in global policies and institutions come about through action by governments and coalitions of governments—often within international fora, informed leadership and grassroots mobilization, analysis and policy research to inform alternatives, and networks that disseminate those alternatives. This section looks at some examples illustrating the change processes; it does not attempt to be comprehensive or to assess the weight of individual factors.

10.76 *Governments.* Examples include developed-country governments that take initiative unilaterally—such as the countries that have already reached the target of 0.7 percent of GNI for developing assistance or that cancelled a large portion of the debts

owed to them by the poorest countries—as well as governments acting jointly to form coalitions for change. The latter are becoming more frequent in trade negotiations, in which a group of large developing countries (including Brazil, China, and India) is spearheading proposals for greater trade liberalization.

10.77 A way to spur equity-enhancing policy changes by developed countries is to accompany calls for change with tracking mechanisms. The eighth MDG relates to greater provision of aid and debt relief and more equitable trade policies. Progress toward this goal has been reviewed in September 2005 as part of the Millennium Summit+5.

10.78 Another exercise to monitor rich country policies, conducted by the Center for Global Development and *Foreign Policy* magazine, is the Commitment to Development Index. The index examines more indicators than the eighth MDG, including environment, security, investment, and technology (Center for Global Development (2004)). While there are questions about the methodology, particularly on aggregating scores in various areas, the index exposes how some countries do better in some areas than in others—Norway, for instance, does well on aid but poorly on trade; Switzerland scores poorly on trade but does better on environment; the United States scores poorly on environment but has, with Canada, the most favorable migration policies—and how all countries have considerable opportunities to improve their policies.

10.79 *Citizen mobilization.* Citizen mobilization, combining both grassroots and middle-class interest groups across countries, has grown in recent years. In some cases, an international social movement, network, or alliance has emerged to try to influence the global agenda. An example is the launching of the Enhanced HIPC Initiative in 2000. The original HIPC Initiative benefited some countries, but progress was slow and there were several problems. By 1999 these were largely recognized, but an expanded initiative needed to garner support in creditor countries and in the World Bank and IMF governing committees, because it required additional funding. The Jubilee 2000 campaign, which combined awareness of the pernicious effects of excessive debt with a call to debt forgiveness inspired by the Christian Jubilee idea, mobilized hundreds of thousands of people in countries such as Germany, Italy, the United States, and United Kingdom. The governments of these countries took notice and finally agreed to various actions, expanding the HIPC Initiative and canceling bilateral debt. Other examples of pressure by civil society organizations leading to changes in rules are the campaigns to reform World Bank policies on indigenous peoples, resettlement, and other safeguards.

10.80 In a second set of cases, international rules already exist on paper, and social movements bring them into effect by making them visible and insisting that they be implemented. In many cases, this process happens at the country level, but it involves an interaction with global rule and policy changes. The ethical trade initiatives discussed earlier are citizen mobilizations to enforce global and local laws. Similarly, efforts by indigenous movements, NGOs, and other activists ensured that ILO Covenant 169 on indigenous peoples was recognized as having legal weight (in practice) in various countries. Experience shows that citizen mobilization is most effective when it builds broad-based coalitions for change across countries and groups.

10.81 But citizen mobilization also poses risks. Civil society movements may partly counter unequal formal channels, but they are highly imperfect mechanisms of aggregating voice, and their accountability is often unclear. In recent years, there have been instances of NGO campaigns that have led to perverse outcomes, such as donors withdrawing from infrastructure and resettlement projects only to see governments move ahead anyway without international monitoring of social and environmental consequences.

10.82 *Analysis and research.* Socioeconomic analysis and policy research also contribute to making particular domains of inequity objects of public debate and action. Global analysis of gender discrimination and missing girls and women (box 2.9) has fostered public action to redress gender inequities. Ex ante analysis and policy research are also vital ingredients for informing the design of policy proposals. A vast body of recent research, including serious impact evaluations, has focused on efficient and effective ways to achieve the MDGs. The more research is conducted by and with developing-country researchers, the more likely it is that its results will inform policymaking.

10.83 Some of these key elements have been missing in failed attempts at change. Analysis and policy research is carried out and technical solutions are proposed; the political will to implement them is missing, however, because political leaders do not think the issue is important or coalitions are not formed that ensure sufficient support. In other cases, grassroots mobilization is strong, but it lacks well-developed, implementable proposals for reform. Indeed, some NGO campaigns have led to perverse outcomes, as when international organizations have withdrawn support for projects under international criticism only to see governments proceed without international monitoring of social and environmental safeguards.

10.84 *International organizations.* International financial institutions can help bring about global equity-enhancing action through setting agendas and providing a focal point for international negotiations. Their dispute settlement and enforcement mechanisms help ensure that their policies are implemented. But the governance structures of the World Bank and IMF have not evolved in line with the increased size and role of emerging market, developing, and transition countries in the world economy. Moreover, small and low-income countries have a limited role in their decision-making processes. Developed-country governments have a majority of the votes on the boards of the IMF and World Bank, and two executive directors represent more than 40 African countries.

10.85 Several options to enhance voice in the IMF and World Bank have been explored, but limited progress has been made. In April 2005, the ministers of the intergovernmental Group of Twenty-Four urged that a new quota formula be developed (voting rights depend on quotas), which would give greater weight to measures of gross domestic product measured in purchasing power parity terms. They also suggested that, in order to strengthen the voice of small and low-income countries, basic votes should be

increased to restore their original share of total voting power.⁴¹ Making progress on enhancing the voice and participation of developing countries in the decision-making processes of the World Bank and IMF is of fundamental importance to increase the legitimacy of international financial institutions and enhance their effectiveness in fostering greater global equity. The 13th General Review of IMF Quotas provides an important opportunity to make progress on issues of quotas, voice, and participation.

Summary

10.86 In sum, global actions can play a key role in redressing inequitable rules and helping equalize endowments. The rules that govern markets for labor, goods, ideas, capital, and the use of natural resources need to become more equitable. Domestic action to build the endowments of the poor can be supported through aid, but not if aid is poorly spent, supports corrupt regimes, or undermines domestic accountability. Changes will require, above all, greater accountability at the global level, with greater representation of poor people's interests in rule-setting bodies.

⁴¹ See the G-24 Communique, available at <http://web.worldbank.org/WBSITE/EXTERNAL/DEVCOMMEXT/0,,menuPK:60001663~pagePK:64001141~piPK:64034162~theSitePK:277473,00.html>.

Focus on drug access

Balancing access to medicines for the world's poor with incentives for pharmaceutical innovation

What's the best way to expand access to drugs in developing countries, while preserving incentives for pharmaceutical research? A possible solution entails recognizing that medicine markets are far from uniform and that both the nature of diseases and the income of countries matter for access and incentives.

S7.1 Some diseases, such as malaria, mainly affect poor countries, but they have received little R&D investment, and few treatments are available. Much attention has been devoted in recent years to creating the right incentives and structuring financing to increase R&D investment in drugs for diseases that affect poor countries, for which commercial potential does not provide enough stimulus.¹ Policy initiatives include the following:

- Increasing research through public sector institutions—for example, programs coordinated by the U.S. National Institute of Allergy and Infectious Diseases, the World Health Organization's Special Programme for Research and Training in Tropical Diseases, and the nonprofit Drugs for Neglected Diseases Initiative founded by Médecins Sans Frontières.
- Establishing public-private partnerships, such as the Medicines for Malaria Venture and the Malaria Vaccine Initiative, the International AIDS Vaccine Initiative, and the Global Alliance for Tuberculosis Drug Development.
- Designing a purchase commitment for new vaccines ("AdvancedMarkets"). Sponsored by the Bill and Melinda Gates Foundation, the groundwork has been laid to create markets by having donors commit, in advance, to paying part of the cost at a guaranteed price for a new, as yet undiscovered, vaccine. This would give firms an incentive to invest in this area.² (A similar initiative has been proposed for agricultural research relevant to developing countries.³)
- Developing an open-source approach to early-stage tropical diseases research. The idea is to harness the expertise and resources of academic scientists, students, public sector researchers, and others who may be happy to spend some of their time doing research on tropical diseases either for altruism or scientific curiosity (similar to what happens with open-source software). Leads that emerge could then feed into any of the other schemes for the next stages of development and clinical testing.⁴

¹ See Lanjouw and MacLeod (2005) and World Health Organization (2004).

² See Glennester and Kremer (2004) and Barder (2004).

³ See Masters (2005).

⁴ See an interesting article by Maurer, Sali, and Rai (2004) on how an open-source approach could work.

S7.2 Providing patent protection in poor countries for drugs primarily for their markets would not by itself provide sufficient incentives, because their purchasing power is very low. But, even a small increase in market-based research incentives could be a useful part of a larger strategy to address the treatment of diseases specific to the developing world.

S7.3 Other diseases have global incidence and worldwide markets, and they are an important cause of death and disability among the poor. In the high-mortality regions of the world, cardiovascular disease is estimated to cause a greater share of the total disease burden than malaria and other tropical diseases combined.⁵

S7.4 Although many people in poor countries suffer from global diseases, they are an insignificant part of the commercial market. Estimates suggest that currently almost half of the world's people live in countries that together represent less than 2 percent of global spending on drugs for cardiovascular disease.⁶ Because of the great asymmetries in markets, many of the poor could be allowed generic access to important classes of drugs without damaging research incentives. The foreign filing license approach described below is a feasible way to attain this outcome.

Legally binding commitments not to enforce patent rights

S7.5 The proposal considered here⁷ would have inventors in developed countries make legally binding commitments to their own governments not to enforce patent rights in certain pharmaceutical markets. These markets would be defined as those together representing the bottom, say, 2 percent of global drug sales in each disease class (figure S7.1).

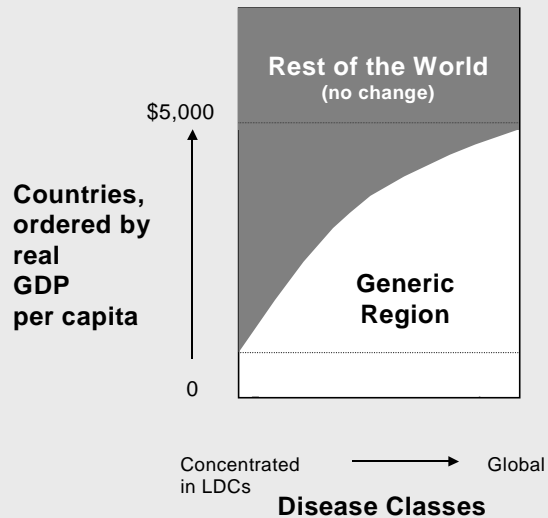
S7.6 Along the horizontal axis of the figure are disease classes, listed with those concentrated in poor countries toward the left, and those with worldwide incidence toward the right. Along the vertical axis are countries ordered by per capita income. The white area shows the "generic region" that would be created by the policy. Within the generic region, firms would be able to manufacture and trade in generic products without any political or procedural complexity arising from the patent system. The generic region would be recalculated each year to accommodate changes in income and the evolution of markets.

⁵ World Health Organization (2004).

⁶ Based on data from IMS HEALTH Global Services at <http://www.ims-global.com>.

⁷ This proposal is detailed in Lanjouw (2002).

Figure S7.1 The proposed generic region



Source: Lanjouw (2004).

S7.7 Because diseases to the left are more concentrated in developing countries, the 2 percent of global markets cutoff is reached at lower levels of real GDP per capita. It may seem counterintuitive to propose differentiating in this way, but it is precisely for diseases that are concentrated in developing countries that some incentive for product development may need to come from sales in the developing world.

S7.8 The poorest countries falling below the dashed line would be allowed generics on all pharmaceuticals. Countries higher up, such as India, would have a mixed situation. They would be in the TRIPS environment for diseases concentrated in the developing world, while in the generic region for more global diseases. For markets in the gray area above the curved line, the policy as no effect. Both the responsibilities and the flexibilities of TRIPS remain unchanged.

S7.9 The size of the generic region depends on two parameters: the ceiling income level (here \$5,000) and, more important, the global sales cutoff (here 2 percent).

S7.10 The proposal would be implemented by having inventors in developed countries make a legally binding commitment to their own governments not to enforce patent rights in the generic region, as part of obtaining a license to make foreign patent filings (the foreign filing license). Firms would continue to obtain patents wherever they like, and no decisions related to the policy would be needed at the time of applying for a patent. Instead, decisions that relate to the policy—about where to enforce patent rights—would arise only after products have reached the market. To ensure compliance, the patent holder would lose the right to enforce the domestic patent on the same product if the holder were to break the commitment and begin an enforcement action in one of the proscribed markets.

S7.11 Implementation would need to be coordinated across the developed countries that have pharmaceutical research activity, including, at least, Canada, Europe, Japan, and the

United States. The policy would require legislation to amend the patent code in each country. In the United States and the United Kingdom this would include adding an inventor declaration to an existing foreign filing license process; other countries would need to put a foreign filing license provision into their codes.⁸ The classification of countries and disease classes could be carried out by an international organization and reviewed annually.

S7.12 Developing countries would not be required to take any action to implement this policy. They would continue to take steps to comply with TRIPS and any bilateral treaty obligations in accord with their current plans. The countries in the generic region could be treated as one country from the viewpoint of patents. Production could be based in any one country and drugs could be exported to all other countries in that group, without any costs associated with patents and compulsory licensing.

S7.13 So, if any country in the generic region had the ability to produce a given drug, then all other countries in the region could take advantage of its production capacity. This would help get around the problem that most small countries do not have the capacity or market size to make domestic production of generic drugs a viable activity.

S7.14 Firms have been willing to make a voluntarily commitment not to exercise patent rights in the poorest countries. The foreign filing license proposal discussed here would take that commitment and convert it into a reliable part of the global rules-based system.

⁸ For legal details see Lanjouw (2002).