

Chapter II

Trade

Since the early 1990s, growth of exports of developing countries as a whole has been robust. In both the first and second halves of the last decade, the average annual growth of developing-country exports surpassed the growth rate of world exports (12.2 versus 8.7 per cent for 1991-1995 and 7.7 versus 4.8 per cent for 1996-2000). Moreover, this trend continues—with global exports having expanded at an annual rate of 5.8 per cent per year in 2001-2003, compared with a comparable rate of 7.4 per cent for developing countries. A number of developing countries have focused explicitly on encouraging exports and have been remarkably successful with their strategies. In some instances, this vigorous trade growth has led to what has been termed a “new geography” of trade, with developing countries finding new markets for their commodities in other developing countries.

Progressive multilateral trade liberalization has supported this robust trade performance. Further multilateral trade liberalization, with a view to generating an equitable outcome to all participants, can contribute to growth and development in developing countries. In fact, the Monterrey Consensus of the International Conference on Financing for Development (United Nations, 2002, annex) acknowledged that “(a) universal, rule-based, open, non-discriminatory and equitable multilateral trading system, as well as meaningful trade liberalization, can substantially stimulate development worldwide, benefiting countries at all stages of development” (para. 26).

The present chapter begins by examining the relationship between trade and growth. It shows that the composition of its trade may affect a country’s ability to reap trade gains. In particular, dependence on primary commodity exports adversely influences a country’s capacity to benefit from trade and globalization. The second section of the chapter turns to the discussion of trade “vulnerabilities”. Dependence on primary commodity exports constitutes one such vulnerability. However, there are also geographical vulnerabilities, particularly those that affect small island developing States and landlocked developing countries.

The Doha Development Round of the World Trade Organization, discussed in the third part of this chapter, is taking place at a unique juncture. It has the opportunity to increase market access for products and services of interest to developing countries in agriculture and highly protected manufactures and to foster the increased provision of services through cross-border supply and the temporary movement of people for work-related purposes. The Round thus has the potential to be a major contributor to making the multilateral trading system more responsive to the needs of developing countries. Many developing countries, in an attempt to boost exports, are participating in the formation of preferential trading agreements. There are currently 230 such agreements (including bilateral ones), with about 60 more in formation. An important question raised in the last section of the chapter is whether such arrangements are consistent with the multilateral trading system.

Since the early 1990s, developing-country exports have expanded at a robust pace, supported by multilateral trade liberalization

Export composition may affect the potential gains from trade

The Doha Development Round has a role to play in making the multilateral trading system more responsive to the needs of developing countries

Trade, growth and specialization

Over the past two decades, developing countries have increased their share of world exports and diversified their exports

Between 1981 and 2003, developing countries increased their share of world exports from 27 to 33 per cent. A concomitant of this expansion was increasing diversification. The export concentration index for developing countries as a whole declined strongly between 1980 and 2003—from nearly 0.6 to about 0.2 (United Nations Conference on Trade and Development, 2004g). Hence, over the past two decades, developing countries have not only increased their share of global trade but, as a group, managed to move beyond their traditional specialization in agricultural and resource-based exports into manufactures.

The overall share of manufactures in developing-country exports, which had stood at 20 per cent in 1980, reached 65 per cent in 2001 and 75 per cent in 2003. Further, the share of high-value-added exports, which consist of manufactures with medium- to high-level skill and technology inputs, increased from 20 to nearly 50 per cent in the period from 1980 to 2003. Both low- and middle-income countries shared in this trend. Moreover, China and India were not the only countries driving these increases. When these two countries are excluded, the share of manufactures increased from 10 to more than 60 per cent of total exports of low-income developing countries in the period from 1980 to 2003.

While the share of manufactures rose in most geographical regions, there have been significant regional differences (see figure II.1). In the East Asian economies, almost 70 per cent of goods exports were manufactures in 2001 and over 80 per cent in 2003. Moreover, the relevant exports were often at the higher end of the value-added chain and many were also globally dynamic goods and services. At the other extreme, the share of manufactures in the exports of goods was only 47 per cent in Africa in 2003, still up from 31 per cent in 2001, and mostly in the area of processed primary commodities—which included exports of food products and preparations, as well as processed chemicals and materials. Latin America and the Caribbean was in an intermediate position, with manufactures accounting for 57 per cent of goods exports in 2001.

This shift away from commodities was important to counterbalance the long-term decline in commodity prices that was experienced during this period. In 2002, the price index of agricultural commodities deflated by the price index of manufactured exports of industrialized economies in United States dollars was half its 1980 value (74 as against 145). Still, half of all developing countries—mostly least developed countries and small island developing States—continued to be dependent on primary non-fuel commodities for over half their export earnings (United Nations Conference on Trade and Development, 2004h).

Not all developing countries participated in this “trade boom”. Forty-nine countries experienced negative real growth rates of their merchandise exports over the period in question. Poor performance was attributable to combinations of excessive dependence on one or two primary products (Cameroon on oil, Nauru on phosphates and Zambia on copper), civil conflict (including the Comoros, Rwanda and Timor-Leste) and politically motivated trade embargoes (including the Libyan Arab Jamahiriya and the Sudan).

A closer look at the dynamics of manufactures in world trade, classified according to their skill contents, reveals also the variable capacity of different developing countries to benefit from them. Whereas export growth of raw primary products has been relatively low—about 2 per cent per year since 1981—export growth rates for processed agricultural products (such as meats, processed foods, alcoholic beverages, tobacco products

The shift away from commodities since 1980 has counterbalanced the long-term decline in commodity prices

However, not all developing countries shared in this “trade boom”

Figure II.1.
Distribution of exports by commodity groups, 1960-2001
 (Billions of dollars)

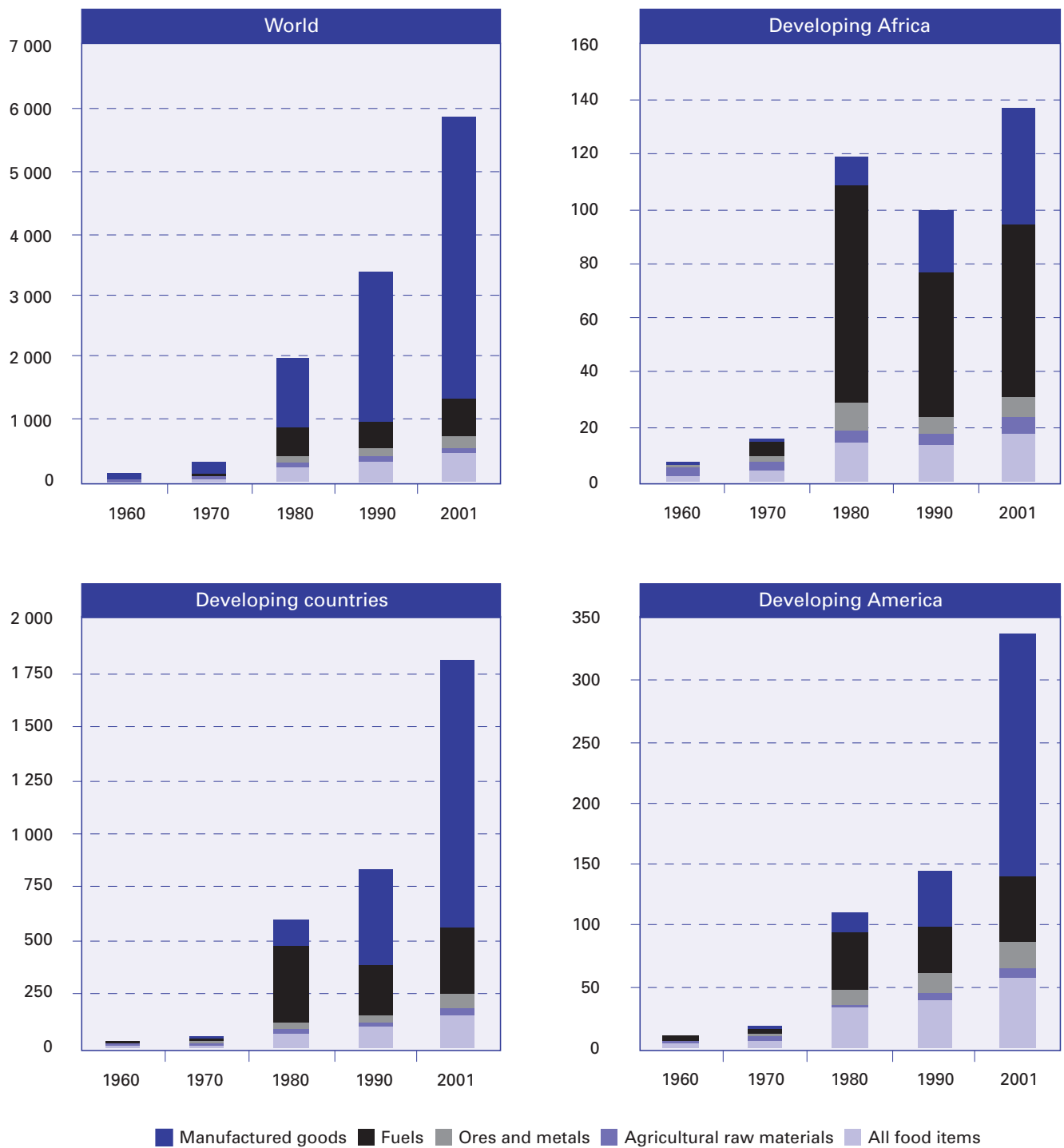
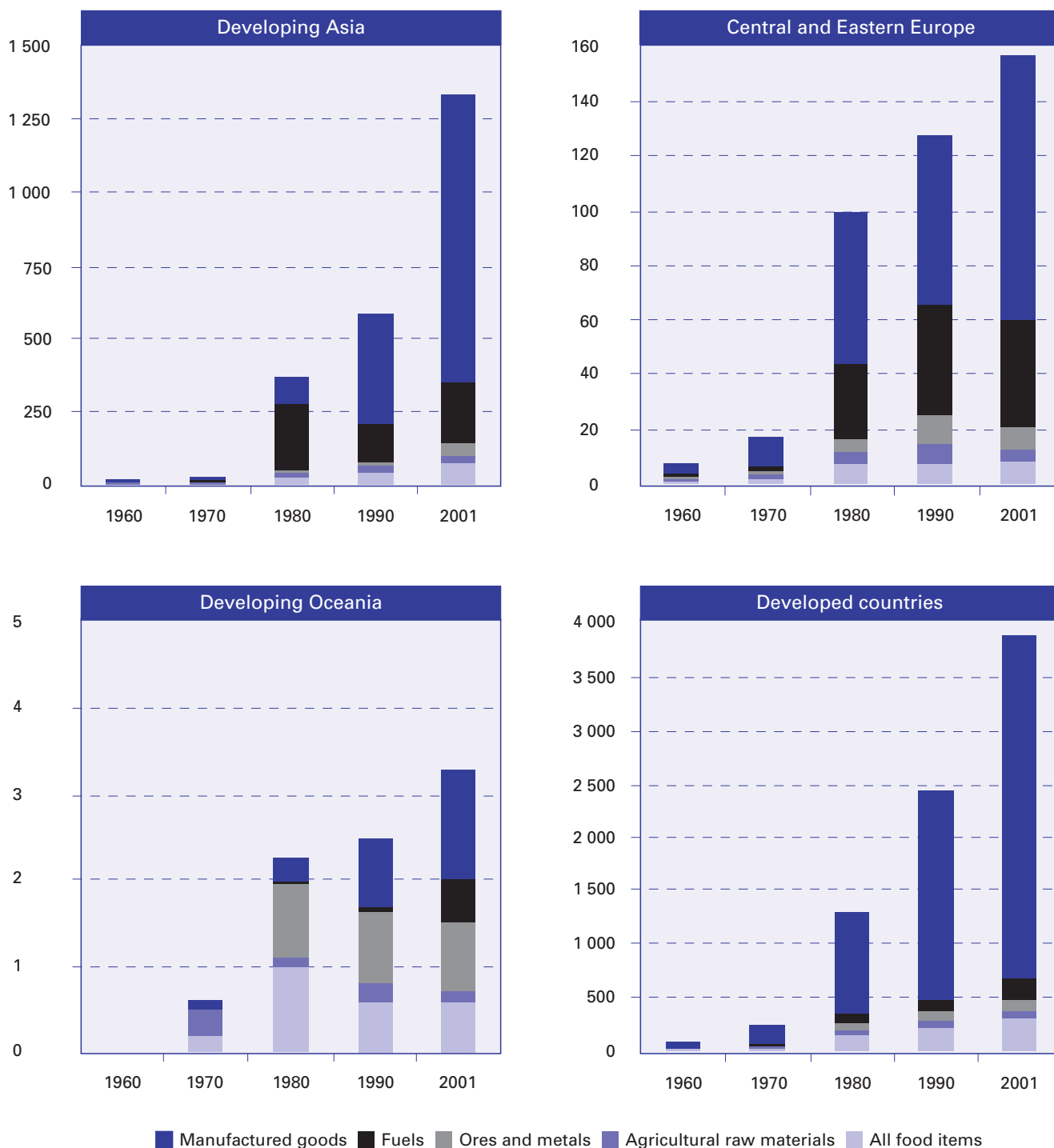


Figure II.1 (cont'd)
Distribution of exports by commodity groups, 1960-2001
 (Billions of dollars)



Source: DESA, based on UNCTAD GLOBSTAT website and UNCTAD, Handbook of Statistics, online.

and processed woods) have been significantly higher, 6 per cent globally. Meanwhile, trade in low-technology manufactures (such as textiles and clothing), simple manufactures (such as toys and sporting goods) and iron and steel products grew at rates that were well above the world average and highest of all for low-income developing countries. Similarly, in medium-technology manufactures (such as automobiles and components), growth rates of exports from low- and middle-income developing countries far outstripped comparable growth rates of exports from high-income countries. Meanwhile, exports of high-technology goods (for example, electronic goods, such as computers, televisions and components) grew more than twice as fast as overall world trade; and exports of these products from low- and middle-income countries grew more rapidly still.¹

Over the period 1985-2002, the most “dynamic” exports in world trade fell into three groups: electronic and electrical goods (Standard International Trade Classification (SITC) divisions 75-77); chemicals (SITC section 5) and miscellaneous manufactures (SITC section 8). “Dynamism” can be described in two ways—in terms of either the absolute increase in market share or average annual export value growth. Following the first criterion, four product categories stood out between 1985 and 2002 as belonging to the 40 most dynamic product groups: electronic and electrical goods; chemicals; engines and parts; and textiles and clothing. Following the second benchmark, a number of agricultural and processed foods and beverage items cropped up in the “top 40” (United Nations Conference on Trade and Development, 2004g).

Despite the dynamic growth of manufacturing exports from developing countries, developed countries generally accounted for the lion’s share of the total export value of products requiring high research and development (R&D) expenditures and characterized by high technological complexity (SITC section 5 and division 87), the exception being optical instruments. It was only a limited number of East Asian economies—for example, Malaysia, the Republic of Korea, Singapore and Taiwan Province of China—that made significant inroads as suppliers of higher-skill, higher-tech products to world markets.

Most developing countries are thus involved in the low-skill assembly phases of production. Because they have often increased their participation in the labour-intensive segments of production of high-tech goods, the question which arises is whether being engaged in the low-skill assembly stages of the production chain carries the same benefits as the export of more high-skill, high-tech products or whether, to the contrary, a form of “commoditization” is occurring. As an increasing number of developing countries export standardized, labour-intensive commodities, prices are likely to decline, necessitating ever-increasing export volumes.

The importance of these questions lies in the possible ramifications of trade and export expansion for growth. Orthodox economic analysis has argued that trade liberalization has a positive effect on resource allocation and economic growth.² The assumptions underlying orthodox theories are perfect competition, full employment of resources, and constant returns to scale in production. However, the real world is more complex—with market imperfections, high levels of unemployment and underemployment and economies of scale in many branches of industrial production worldwide. As notable an economist as Paul Samuelson has questioned the assumption that liberalization always has a benign outcome. As he pointed out recently (Samuelson, 2004), “it is dead wrong about the *necessary* surplus of winnings over losings”. In reality, unfettered trade liberalization has, at times, imposed heavy adjustment costs including output contraction, higher unem-

Some developing countries have benefited by being the source of dynamic exports

However, developed countries generally accounted for the bulk of the total export value of products with high R&D content, while most developing countries were involved in the low-skill assembly phases of production

Short-run costs of liberalization may infringe on expected long-term gains

Table II.1.

The 40 most dynamic products in world non-fuel exports ranked by annual average exports value growth, 1985-2002, and share of developing countries, 2002

Percentage			
SITC 2 code	Product	Average annual growth rate of world exports (1985-2002)	Share of developing countries (2002)
7524	Computer storage units	39	22
7643	Radiotelegraphic and radiotelephonic transmitters	23	22
7528	Off-line computers	22	28
2239	Flours or meals/oil seeds	20	25
2634	Cotton, carded or combed	18	53
6552	Knitted/crocheted fabrics	18	22
7764	Electronic microcircuits	18	15
6416	Building board	17	21
6880	Depleted uranium	17	1
5416	Glycosides; glands or other organs and their extracts	17	4
8462	Cotton undergarments	17	57
5417	Medicaments	17	4
7439	Parts of pumps, compressors, fans and centrifuges	17	9
8743	Non-electrical instruments for measuring, checking flow	16	17
8996	Orthopaedic appliances	16	3
6352	Casks, barrels, vats, tubs and buckets	16	7
6642	Optical glass and elements of optical glass	16	15
2223	Cotton seeds	15	12
5148	Nitrogen-function compounds	15	6
8710	Optical instruments and apparatus	15	12
8741	Surveying and hydrographic equipment	15	10
0488	Malt extract	15	9
5332	Printing ink	15	8
7923	Aircraft	15	23
2225	Sesame seeds	14	91
8732	Revolution counters, taximeters	14	11
5839	Polymerization and copolymerization products	14	7
5155	Organo-inorganic compounds	14	8
8742	Drawing, marking-out, disc calculators	14	7
7924	Aircraft	14	2
7832	Road tractors and semi-trailers	14	10
0546	Vegetables, frozen or in temporary preservative	14	24
5530	Perfumery, cosmetics and toiletries	14	11
8931	Packing materials	14	24
7712	Electric power machinery	14	32
8211	Chairs and other seats and parts	14	39
6589	Other articles of textile materials	14	60
1110	Non-alcoholic beverages	14	20
7144	Reaction engines	13	5
1122	Fermented beverages	13	17
	All 40 products	19	15

Source: United Nations Commodity Trade Statistics Database (COMTRADE).

Note: Average annual growth rates are computed using current values of exports. Lower average annual growth rates would be obtained if constant values were used, although the ranking would remain unchanged.

ployment and deeper trade deficits (Ocampo and Taylor, 1998). These short-term costs may reverberate and impair the realization of promised long-term gains.

From the viewpoint of growth and development, what is important is the ultimate impact of trade liberalization on domestic variables, such as output, employment, wages and investment; but evidence of the influence of trade on the domestic economy is hard to come by. Empirical studies are marred by data problems, by issues of causality and by the difficulties inherent in attempting to quantify social variables. Therefore, there is an ongoing debate as to the nature of the correlation between openness and growth.

Since the 1970s, several investigations have found evidence that outward-oriented economies grow faster (among the earlier studies, see Michaely, 1977). The widely known study by Sachs and Warner (1995), which examined the experience of over 100 developed and developing economies from the post-Second World War period to the mid-1990s, found a strong association between openness and growth. Within the group of developing countries, per capita GDP in the open economies grew at 4.49 per cent per annum, whereas in the closed economies, it grew at 0.69 per cent per annum.³ Using comparative data for 93 advanced and developing countries over the period 1980-1990, and nine different estimates of “openness”, Edwards (1997) also concluded that, regardless of how openness was defined, “more open countries have indeed experienced faster ... growth. More recently, an analysis of 73 developing countries indicated that “per capita growth rates have increased among the globalizing economies in the 1990s relative to the 1980s” (Dollar and Kraay, 2001). Recognizing that most of these countries had been engaged in wide-ranging economic reforms, the authors did not attribute all of the improvement in growth to greater openness. They nevertheless give a pivotal role to the fact that the faster growers were “globalizing” that is to say, they maintained that changes in trade volumes had had a strong positive relationship with changes in growth rates.

However, a growing number of studies have critiqued these conclusions from a variety of perspectives. In an extensive review of several of the aforementioned studies, Rodriguez and Rodrik (1999) argued that the indicators of openness used by researchers were generally measures of trade performance rather than of trade barriers (and thus of the extent of trade liberalization) or, alternatively, in effect measured other sources of bad economic performance (such as macroeconomic instability) rather than, again, trade liberalization. Indeed, an equally copious literature has shown that there is no association between growth and direct measures of protection (tariffs and non-tariff barriers) and thus that dynamic export performance has taken place under different trade regimes (United Nations Conference on Trade and Development, 1992, part two, chap. I; Rodriguez and Rodrik, 1999; Rodrik, 2001; Ocampo and Martin, 2003). Furthermore, the industrial upgrading necessary to spur the export of higher-value-added manufacturing exports does not occur automatically. Rather, it requires other policies, such as the development strategies undertaken in several East Asian economies “to incubate high-tech firms, and to attract high-tech investments by multinational corporations” (Woo, 2004). Another examination of these associations noted that trade liberalization often occurred at the same time as many other reforms, so that identification problems plagued the inference that differences in growth rates were due to differences in trade policy (Nye, Reddy and Watkins, 2002).

Thus, while there is growing acceptance of the positive association between export performance and GDP growth, the more specific association between trade *liberalization* and growth remains largely unproved. In several instances, export success has been associated with industrial and other supply-side policies, and even with the coexistence of protectionist and export promotion policies. Indeed, as Chenery, Robinson and Syrquin

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(1986) pointed out some time ago, the import substitution policies pursued by several countries in the past—even if less relevant today as a strategy—might have been essential in building the supply capacities that were reflected in their later export success. Equally, there appears to be no definitive evidence as to the effects of trade liberalization on employment and wages (Hoekman and Winters, 2005; Lee, 2005). The consensus at this point seems to be that trade liberalization “will create some losers (some even in the long run)” (Winters, 2000). Hence, government intervention may be warranted (Baldwin, 2003).

As some of the data cited earlier implies, the actual strength of the relationship between trade and growth also depends on the pattern of trade specialization of a country. Lowering trade barriers and increasing trade may be the consequence of the pattern of specialization, rather than the cause. According to Birdsall and Hamoudi (2002): “Countries with high natural resources and primary commodities in their exports are not necessarily ‘closed’ nor have they necessarily chosen to ‘participate’ more in the global trading system. For them, reducing tariffs and eliminating non-tariff barriers to trade may not lead to growth. In this context, terms like openness, liberalization and globalization are red herrings”. In other words, most commodity-dependent countries were not able to raise their trade-to-GDP ratio, whether they cut tariffs steeply or not. Similarly, the majority of the least commodity-dependent countries saw increases in their trade-to-GDP ratio irrespective of any tariff cuts.

Trade vulnerabilities

Commodities

There has been a long-run trend decline in the terms of trade of most non-oil commodity prices when measured against the prices of manufactured goods since the 1950s, coupled with volatile swings around the long-term trend

A variety of domestic interventions and international agreements have been developed since the early twentieth century

International commodity policy focuses on the impact on developing countries of heavy dependence on exports of one or a few commodities for the bulk of their foreign-exchange earnings. Two features of commodity price trends are important in this regard. The first is the long-run trend decline in the terms of trade of most non-oil commodity prices when measured against the prices of manufactured goods. This long-term trend had raised the alarm in the 1950s and was the basis of what came to be known as the Prebisch-Singer thesis. Numerous empirical studies have confirmed this thesis in recent decades and analysed the consequences for developing countries that specialize in commodity exports.⁴ The second feature of commodity price trends is reflected in the observation over the years that these price changes can be subject to volatile swings around the long-term trend for a variety of reasons related to unpredictable supply shocks and other market disturbances.

These concerns have led to the development of different domestic interventions and international agreements since the early years of the twentieth century. Since the 1950s, under the new umbrella of development cooperation, they gave rise to international commodity agreements (ICAs) and compensatory financing schemes. International commodity agreements were legally binding intergovernmental agreements between major commodity producers and consumers. Several of them were negotiated and implemented within the framework of the United Nations Conference on Trade and Development (UNCTAD) Integrated Programme for Commodities. These agreements contained economic clauses and specific instruments aimed at balancing supply and demand, and at reducing price volatility in international markets for the benefit of both producers and consumers. International commodity agreements for sugar, tin, coffee, cocoa and natural rubber operated with stabilization mechanisms at one time or another from the 1970s to the late 1990s. Agreements without economic clauses, which were often established after

attempts at price stabilization schemes had failed, served as trade associations aimed at protecting the interests of producing and consuming countries.

Price stabilization instruments were either buffer stocks or export quotas. A buffer stock scheme removed excess supply from the market during periods of low prices—where low prices were understood to be prices falling below some notional assessment of a long-run equilibrium price—by buying and warehousing the commodity until prices increased. An international commodity agreement based on exports quotas controlled the supply-demand balance in global markets much in the same way—though the responsibility for withdrawing the excess supplies to keep within their quota lay with individual surplus countries—and tried to limit price fluctuations to specific price bands within which the commodity was bought and sold.

Most international commodity agreements gradually ceased to function as price stabilization mechanisms during the 1980s and early 1990s.⁵ All were assessed as having achieved only limited success in securing stable, remunerative prices in international markets (Gilbert, 1987; International Task Force on Commodity Risk Management in Developing Countries (ITF), 1999). International commodity agreements with economic clauses came under additional and persistent criticism by major consuming countries to the effect that such stabilization schemes were “non-market” mechanisms that artificially manipulated prices and interfered with efficient allocation of global commodity resources (Maizels, 1994, p. 57).

Compensating financing schemes are financial mechanisms that have been and can be used to provide counter-cyclical financing to compensate developing countries for temporary shortfalls in earnings from commodity exports. The financing mechanisms were designed to provide loans and grants to qualified recipients so as to partially offset the collapse in export earnings. The most well-known compensatory financing schemes are the Compensatory Financing Facility (CFF) of the International Monetary Fund (IMF)—which was also known as the Compensatory and Contingency Financing Facility (CCFF) for a brief period until the contingency financing element was dropped—and the STABEX, SYSMIN and FLEX facilities of the European Union (EU).⁶

The STABEX and SYSMIN facilities provided compensatory financing to beneficiary African, Caribbean and Pacific (ACP) countries in order to offset losses in earnings from commodity exports to EU. Both facilities were judged as having achieved only limited success in their original objectives by the time they were abandoned at the conclusion of the Lomé IV Convention in 2000. The FLEX facility in the Cotonou Partnership Agreement (the successor agreement to the Lomé Convention) provides support to beneficiary ACP countries to compensate Governments for the impact on their budgets of export earnings instability from exports of agricultural and mineral commodities. The facility also provides financial support under conditions that extend beyond previous facilities—and is linked less to earnings shortfalls from commodity exports—in cases where losses in export revenues have caused increased public deficits that threatened social and economic reform programmes that were being implemented at the same time. The FLEX scheme is expected to put more emphasis on rewarding commitments to economic reforms and sound economic management and possibly provide financing for price risk-management arrangements (Page and Hewitt, 2001).

Even before the collapse of the major price stabilization and compensatory schemes, developing countries had been encouraged to use market-based financial instruments and techniques to manage commodity price risk. This strategy involved the use of basic forwards, futures and options contracts and a wide range of commodity-backed deriv-

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ative financial instruments. These tools were either tailor-made for specific transactions or traded publicly on international commodity exchanges.

Forward contracts, which are used extensively by commodity producers in developing countries (usually through brokers and other intermediaries), provide some (usually short-term) hedge against price risk. However, because of these risks of default, and several other reasons discussed in more detail in the specialized literature, forward contracts and similar instruments are generally not considered ideal hedging instruments through which to offset commodity price risk (United Nations Conference on Trade and Development, 1994).

Futures and options contracts, on the other hand, are considered better hedging instruments mainly because they are traded on organized international commodity exchanges such as the Chicago Board of Trade, the London Metals Exchange, the New York Mercantile Exchange, the Tokyo Commodity Exchange and commodity exchanges based in developing countries such as Argentina, Brazil, China, India, Malaysia, Singapore, South Africa and Thailand (in contract volume, the world's largest commodity exchange is now in the city of Dalian, China). Commodity exchanges operate with strict rules governing the financial solvency of traders, trading practices, contract settlement terms and other terms and conditions designed to guarantee and preserve the integrity of market operations. Commodity futures also offer institutional investors and hedge funds additional opportunities for portfolio diversification and hedges against inflation and interest rate changes.⁷

Commodity exporters in developing countries were encouraged to use relatively standard non-speculative risk management techniques such as options and swaps (financial contracts that resemble futures, but are easier to handle in terms of cash flow requirements) to trade away price risk and hedge future export earnings from volatile and unexpected price changes. Non-speculative hedging techniques offset losses from sales of the physical commodity with corresponding gains in futures, options and swap market transactions, and vice versa. In this way, the exporter would be guaranteed a known and predictable return from future sale of the commodity.

Several developing countries have independently used commodity derivatives over the years with some degree of success. The majority of commodity exporters, however, especially poor least developed countries in Africa, lack the institutional capacity or face considerable obstacles with respect to trading in commodity derivatives. UNCTAD studies have reported on successful and extensive use of futures markets and other commodity derivatives by countries such as Brazil, Chile, Colombia, Costa Rica, Indonesia, Malaysia, Mexico, Papua New Guinea and Venezuela (Bolivarian Republic of) to manage commodity price risk and hedge export revenues, import costs and government budget revenues.⁸

In Africa, the use of commodity derivatives is less widespread. Côte d'Ivoire and Ghana have in the past used forward contracts extensively in their cocoa export trade, and other West African countries for cotton exports (Commission for Africa, 2005, p. 266). Maize is traded in regional markets through the Johannesburg Stock Exchange (which has absorbed the South African Futures Exchange) but Africa so far lacks a major international commodity exchange that caters to regional or global commodity trade.⁹

Commodity risk management techniques started receiving much greater attention in international development assistance policies after the release of a report in 1999 by the International Task Force on Commodity Risk Management in Developing Countries that had been convened by the World Bank.¹⁰ The Task Force, which comprised representatives and experts in commodity markets and financial institutions drawn from a wide cross-section of international organizations, the private sector, the academic community and

Following a 1999 report, commodity risk management techniques began to garner much greater attention in international development assistance policies

independent experts, recommended the adoption of specially designed risk management instruments and trading techniques, which were cautiously presented as user-friendly financial instruments that would provide insurance cover for commodity exporters.¹¹

The Task Force compiled a large list of bottlenecks, obstacles and unanticipated difficulties of implementing its 1999 proposals after a series of pilot projects in several developing countries.¹² Severe limiting factors on both the demand and supply sides pointed to the weak financial institutional structures in most countries, and lack of knowledge and skills in trading sophisticated financial instruments. Moreover, despite the known benefits of transactional hedging techniques, many countries viewed trade in commodity derivatives as risky and speculative because of highly publicized accounts of massive fraud and mismanagement of derivatives trade on commodity exchanges in the 1980s and 1990s (United Nations Conference on Trade and Development, 2003d).

There was also a strong need for simple derivative instruments that would be easily understood by both buyers and sellers, which was a requirement that proved difficult to implement because simpler instruments could not provide the required protection from all price risk. A “simple” forward or futures contract, for example, might have to be hedged further with offsetting options contracts that could significantly increase the complexity of the entire transaction. From the point of view of the large international commodity risk management intermediaries, the regulatory framework and reporting requirements would make it costly and cumbersome to work with large numbers of developing countries.

Some commodity producers/exporters were more concerned about volume and revenue risk than price risk. Output volumes could fluctuate widely depending on vagaries of the weather, civil and political strife, armed conflict and a wide range of other unanticipated events in the domestic and global economies that could severely affect agricultural and mining output and sales. The concept of commodity risk, along with the development of appropriate market-based instruments to cope with such risks, has been broadened correspondingly to include weather-related risks as well as risks of volatile price swings in import prices for food and crude oil.

While acknowledging the usefulness of market-based risk management strategies in setting price floors for commodity producers, a group of eminent persons on commodity issues meeting under UNCTAD auspices in 2003 outlined a broader and more comprehensive agenda to address the problems and vulnerabilities of commodity-dependent exporters stemming from severe price erosion and adverse terms-of-trade developments (United Nations Conference on Trade and Development, 2003f). The recommendations of the group contained specific proposals for short- and medium-term actions in the international community that would improve the development prospects of commodity-dependent countries.

The highest priority among the group’s recommendations was given to measures to improve market access of primary commodity exports in developed-country markets, including through the elimination of market-distorting subsidies for cotton and other commodities; reduction of excess supply in some commodity markets and increased use of more flexible compensatory financing schemes to mitigate the adverse impact of export earnings shortfalls owing to the erosion of commodity prices. The recommendations called for closer considerations of export earnings potential in debt sustainability analyses and debt relief and longer-term measures to promote economic diversification in commodity-dependent countries. Further elaboration of current international commodity policy was contained in the São Paulo Consensus, adopted by UNCTAD at its eleventh session on 18 June 2004, which resolved to establish the International Task Force on Commodities

While the usefulness of market-based risk management strategies in setting price floors is acknowledged, a broader and more comprehensive agenda to deal with the problems and vulnerabilities of commodity-dependent exporters has been proposed

The highest priority has been given to measures to improve market access of primary commodity exports in developed-country markets

involving all stakeholders dealing in the production and trade of commodities to conduct a comprehensive review of commodity issues and solutions to existing problems (United Nations Conference on Trade and Development, 2004f, annex, sect. B).

For countries that will continue to derive a large proportion of export earnings from extractive industries in the hydrocarbons and mining sectors, an important element of international commodity policy will be the adoption of appropriate policies to promote effective and transparent management of fiscal revenues. IMF publishes fiscal transparency reports containing assessments of country practices for nearly 70 countries which were drawn up according to a Code of Good Practices on Fiscal Transparency that was first adopted in April 1998.¹³ The need for fiscal transparency was further underscored following the introduction of the Extractive Industries Transparency Initiative (EITI) which had been launched at the World Summit on Sustainable Development held in Johannesburg, South Africa, from 26 August to 4 September 2002.¹⁴

Geographically disadvantaged countries

Landlocked developing countries and small island developing States face exceptional difficulties in their trade relations—in the case of landlocked developing countries, owing to their lack of direct access to sea transport and their isolation and remoteness from major world markets and in the case of small island developing States, owing to the difficulties associated with both transportation and the disadvantages of “smallness”

Two sets of developing economies have been internationally identified as being “geographically disadvantaged”—the landlocked developing countries; and small island developing States, which were termed island developing countries before 1994. Sixteen of the 30 designated landlocked developing countries are least developed countries as well. While the “small island developing States” categorization is more loosely defined, a number of the economies that fall under this designation are also members of the least developed country category.

This overlap is not a coincidence. Both landlocked countries and small island developing States face exceptional difficulties in their trade relations, difficulties that undoubtedly impact their growth and development prospects. In the case of the former, the problems emanate from their lack of direct access to sea transport and their isolation and remoteness from major world markets. This may make their ability to respond quickly to export-demand shocks problematic and they may face obstacles when it comes to delivering goods on time, thus undermining their competitiveness. In the case of small island developing States, difficulties are associated not only with transportation but also with the disadvantages of “smallness”.

The majority of landlocked countries specialize in agriculture and mineral products for export. Only a small number, namely, the Lao People’s Democratic Republic, Lesotho, Nepal, the former Yugoslav Republic of Macedonia and Zimbabwe, specialize in manufactures. Commodities are of great importance to many of these economies for external revenue, income and employment. Moreover, this dependence on commodities is exacerbated by the extreme concentration of their exports on fewer than five of them. For example, in Africa, 7 of 11 landlocked developing countries depend on only two or so commodities for more than half of their export revenue. Landlocked developing countries also have a lower level of trade openness (export-to-GDP ratio) compared with non-landlocked economies. Additionally, regional trade is often important for these countries, given that a large proportion of such trade incurs lower average transport cost in light of the shorter distances involved.

Landlocked developing countries face high transport and transit costs

The most specific disadvantage experienced by landlocked developing countries are high transport and transit costs. Indeed, ad valorem transport costs, which include freight and insurance, are higher for landlocked countries than for either developed or developing countries (see table II.2), though such costs vary considerably from under 5 per

Table II.2.
Transport costs, including freight and insurance costs of various groups, 1995

Percentage	
Country group	Total export value
Landlocked countries	14.1
Least developed countries	17.2
Developing countries	8.6
Developed market economies	4.5

Source:
UNCTAD (2003e).

cent for Nepal and Swaziland to over 50 per cent for Chad and Mali. The significance of this lies in the fact that there is evidence of a negative correlation between transport costs and exports, as high transport costs may significantly reduce the potential for export-led economic growth (United Nations Conference on Trade and Development, 2003e).

High transport and transit costs also imply that the costs of importing are higher for landlocked developing countries. In 1995, freight costs as a share of the landed cost of imports were roughly 3.5 per cent of cost, insurance and freight (c.i.f.) import values for developed economies, about 7.4 per cent for developing countries as a whole and about 10.7 for landlocked developing countries (United Nations Conference on Trade and Development, 2003e). Such high transport costs inflate import costs of consumer goods, as well as of capital goods and intermediate inputs, thus increasing the cost of any domestic production that relies on imports.

Given these statistics, it is not surprising that one analysis comparing transport costs in landlocked developing countries with those in coastal countries found that the median landlocked country faces transport costs that are some 50 per cent higher than those of a median coastal country and that the former have trade volumes that are 60 per cent lower (Limão and Venables, 1999).

Landlocked developing countries generally border other developing countries. Thus, their transit neighbours are typically in no position to offer a transport system of high technical and administrative standards. Landlocked countries may often therefore find themselves competing with their transit neighbours for scarce, and not exceptionally efficient, transport facilities. This is probably less of a problem, however, for the landlocked countries of Latin America—Bolivia and Paraguay (which, in any case, relies a great deal on river transport)—and of Southern Africa—Botswana, Lesotho and Swaziland—whose immediate neighbours have relatively developed transport infrastructures.

Second, insofar as frontiers and the need to transfer from one national transport system to another constitute institutional impediments to the flow of goods and persons, landlocked countries face greater impediments to trade than do their coastal neighbours. This added burden may be termed the “frontier transiting cost” and may be reckoned in terms of both expenditures incurred and time lost. Furthermore, dependence on transit through another country gives rise to foreign-exchange outlays that would not arise if the country had access to the sea. Fourth, and most important, is the fact that a landlocked country finds itself dependent on another country’s transport policy, transport enterprises and transport facilities. This can be a special problem since, in many instances, landlocked countries are in potentially competitive situations vis-à-vis their transit neighbours, which makes compatible harmonization of transit facilities a more elusive and hence difficult undertaking.¹⁵

Landlocked countries may find themselves competing with their transit neighbours for scarce, and not exceptionally efficient, transport facilities

While the recent attention in relation to both landlocked developing countries and small island developing States has been on geographical disadvantages, the focus on “smallness” actually goes back to 1957, at which time the implications of small size were discussed at a meeting of the International Economics Association.¹⁶ Since that time, the Commonwealth Secretariat has been among the main bodies that have taken up the concerns of this category of economies in recent decades. In 1997, the problems of small States were discussed at a meeting of the Commonwealth Heads of State and Government and thereafter the Commonwealth Secretariat together with the World Bank established a Joint Task Force on Small States. Consideration of small economies has been undertaken in the World Trade Organization as well, including in the 2001 Doha Ministerial Declaration (see document A/C.2/56/7, annex; of 26 November 2001).

In turn, since 1992, the United Nations has phased out its designation of “island developing countries” in favour of the more focused small island developing States category. The 1992 United Nations Conference on Environment and Development adopted Agenda 21 (United Nations, 1992, resolution 1, annex II), which contained a special section devoted to the sustainable development of small island developing States. The United Nations Conference on Environment and Development was followed by two major global conferences dedicated to this group of countries (one held in Barbados in 1994 and the other in Mauritius in 2005). Through this process, there has been an increasing emphasis on the vulnerabilities of small island developing States—not only to climate change and potential natural disasters, such as hurricanes, but also to exogenous shocks, such as commodity price and other trade shocks, as well as the loss of trade preferences.

While some small island developing States have seen increased private financial flows since the 1990s, particularly foreign direct investment (FDI) (for example, the Bahamas, Jamaica, Saint Kitts and Nevis and Trinidad and Tobago), others have experienced declines as FDI was attracted to larger markets (for instance, Bahrain, Guyana, Papua New Guinea and Vanuatu) (United Nations, 2002, chap. I, resolution 1, annex). Much of FDI was attracted to the tourism industry. Growth in tourism and in other service sectors has fared well in several small island developing States over recent decades. Similarly, growth in the financial services sector and other business sectors, including insurance, has advanced in some small island developing States. In Mauritius, for example, the contribution of this sector to GDP increased from about 10 per cent in 1992 to almost 17 per cent in 2001. However, those States still heavily dependent on non-oil commodity exports have not done as well, because of both declines in commodity process and the loss of preferential market arrangements.

Because exports of small economies are sometimes highly concentrated in a few sectors, such States are characterized by higher income volatility than their larger counterparts. Whether this is due to export concentration or openness is a subject of debate (Jansen, 2004). However, while some small island States are characterized by commodity export concentration (including Cape Verde with its dependency on mining and Jamaica and Trinidad and Tobago with their dependency on bauxite and petrochemicals, respec-

There has been an increasing emphasis on the vulnerabilities of small island developing States—not only to climate change and potential natural disasters, such as hurricanes, but also to exogenous shocks, such as commodity price and other trade shocks, as well as the loss of trade preferences

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tively), some small island States belong to an “export-diversified cluster”.¹⁷ Included therein are many Caribbean countries, as well as Cyprus (Liou and Ding, 2002). Indeed, the actual heterogeneity of small island developing States has led to a debate in the literature. The dominant assumption is that smallness creates diseconomies of scale. Conversely, some analysts have cited the benefits of smallness—such as the possibility of higher levels of social cohesion. Indeed, “a number of small island countries have somehow succeeded in achieving relatively high standards of living, as evidenced by relatively high average per capita incomes, sustained levels of economic growth and a high ranking on the human development index” (Prasad, 2003).

The fact remains, however, that smallness may exacerbate the effects of any global volatility. From this perspective, these States need support for their efforts to reduce their exposure to both external and internal shocks.

Multilateral trade liberalization

The signing of the General Agreement on Tariffs and Trade (GATT) in 1948 provided a clear set of rules governing international trade in a non-discriminatory and reciprocal fashion, thus reversing the break-up that the multilateral trade order had experienced during the interwar period. Subsequently, several rounds of trade liberalization took place, lowering industrial tariffs from an average of 40 per cent in 1947 to some 5-6 per cent in most developed countries in the early 1980s (World Bank, 1987). Admittedly, developing countries’ exports gained relatively less from tariff reductions, and a significant number of their export products remained outside GATT disciplines (for example, agriculture and textiles). Developing countries, however, were not asked to make major commitments on tariffs and were extended preferential market access. Moreover, they were allowed considerable latitude in the use of quantitative restrictions for balance-of-payments and infant industry purposes.

Fast economic growth during the “golden years” of the post-Second World War facilitated liberalization. With lower growth since the mid-1970s, protectionism intensified. Non-trade barriers were increasingly resorted to, including numerous anti-dumping measures and voluntary export restraints—which came to be called the “grey area” of international trade—thus reducing effective market access despite the relatively low tariff environment. Threats of unilateral action to promote national policy objectives further eroded the multilateral system.

The Uruguay Round of multilateral trade negotiations (1986-1993), which created the World Trade Organization, brought renewed discipline to the multilateral trading system. Among other provisions, agriculture and textiles were included in GATT rules, a flexible framework for the liberalization of services through “positive lists” was created (the General Agreement on Trade in Services (GATS)),¹⁸ and multiple forms of protectionism were prohibited. An effective dispute settlement mechanism was installed, thus reinforcing members’ rights and obligations. Developing countries were asked to accept greater commitments in all areas, though “special and differential treatment” was maintained, particularly for low-income countries. The Uruguay Round adopted a “single undertaking” approach, with transitional measures envisaged to bring developing countries to the same level of obligations as that of developed countries (United Nations Conference on Trade and Development, 2002). On the other hand, in view of their considerable technological capability differences, the upward harmonization of intellectual property standards of developing countries with those of industrialized countries entailed additional

Several rounds of trade liberalization had lowered industrial tariffs from an average of 40 per cent in 1947 to some 5-6 per cent in most developed countries in the early 1980s

costs and loss of policy space by the former. Developing countries also accepted multilateral discipline in relation to production and export subsidies, and the prohibition of measures that had been widely used to promote domestic content of assembly activities, through trade-related investment measures (Ocampo, 1992).

The Uruguay Round therefore brought benefits, but also challenges to developing countries. Further, it left considerable scope for further liberalization, particularly in the areas of export interest to developing countries: agriculture, labour-intensive manufactures and the supply of services through the temporary movement of natural persons. In the case of agriculture, for instance, the Uruguay Round brought limited liberalization to the sector as the levels of protection and export and domestic subsidies were kept relatively high (see box II.1 below).

After a failed attempt in Seattle, Washington, in 1999, a new round of trade negotiations was launched in Doha in November 2001. Ministers pledged to place developing countries' "needs and interests at the heart of the work programme adopted", thus taking into account the major concerns these countries had expressed at Seattle. Over three years later, limited progress has been made. Negotiations suffered a setback in Cancún, Mexico, in 2003, and the agreed date for the conclusion of the round (1 January 2005) was postponed. In July 2004, a framework for negotiations on modalities represented a first breakthrough. In all, developing countries have encountered resistance in steering negotiations to their benefit. Yet, they have been able to form successful coalitions that have succeeded in bringing into the negotiating agenda issues of interest to them, such as cotton and property rights of medicines, as well as forcing others to be dropped out of the agenda, such as government procurement, competition and investment rules. The sections below provide a brief summary of some of major issues at stake and the state of multilateral negotiations as of mid-2005.

The new round of trade negotiations launched in Doha in November 2001 pledged to place developing countries' "needs and interests at the heart of the work programme adopted". Over three years later, limited progress has been made

Assessing the potential benefits of multilateral trade liberalization

Extensive research is available quantifying the possible gains that the Doha Round could generate. Most of this research uses computable general equilibrium (CGE) models, which take into account interactions across different sectors of the economy and allow researchers to observe the effects of liberalization and other policy scenarios on volumes, prices and income. These models therefore estimate the impact of trade on national income through changes in allocative efficiency, as market distortions are removed and resources are reallocated to more productive uses, and through changes in a country's import and export prices. Besides the usual caveats related to data availability and quality, these models are often a simplified representation of the economy and rely on crude assumptions. Therefore, results produced are only a reference in respect of possible outcomes and not accurate assessments of costs and benefits (Stiglitz and Charlton, 2004).

The estimates of annual global welfare gains range widely, with several results within the range of \$250 billion-\$400 billion, depending on the type of gains assessed (static or dynamic), the modalities and depth of liberalization, the number of sectors and countries considered, whether existing preferences are incorporated into the models or not, and so on (see table II.3). Models often assume that the Uruguay Round was fully executed and that implementation of Doha commitments would start in 2005. The implementation schedule, however, varies across models. Results, therefore, are not comparable across mod-

Estimates of potential global welfare gains from the Doha Round vary widely, with several results within the range of \$250 billion-\$400 billion per year

Box II.1

A snapshot perspective on tariffs and domestic support

Despite progress brought about by the Uruguay Round of multilateral trade negotiations, agricultural markets remain highly distorted. Liberalization has been modest. In both developed and developing countries, average tariffs on agricultural products are two to four times higher than those on manufactures (see table 1). Tariff dispersion is marked, and tariff peaks are pronounced, indicating “sensitive” products.

Table 1.
Average tariffs applied to agriculture and manufactures by selected countries, 1999-2001

Country or country group	Percentage				
	Manufactures	Agriculture			
	Average tariff	Average tariff	Maximum tariff	Standard deviation	Binding proportion of lines covered
Quad	4.0	10.7	86.7
Canada	3.6	3.8	238.0	12.9	76.0
EU	4.2	19.0	506.3	27.3	85.9
Japan	3.7	10.3	50.0	10.0	85.5
United States	4.6	9.5	350.0	26.2	99.3
Middle-income countries	12.9	26.2	96.3

Source: World Bank (2004b). Tariff estimates comprise MFN, applied, ad valorem, out-of-quota duties.

Developed countries often impose lower tariffs than developing countries—not only on agricultural but also on industrial products—and tariffs applied on traditional agricultural exports by developing countries are either zero or minimal. However, the fact that tariffs usually increase with the level of processing helps to discourage higher-value-added activities in developing countries, or on those products (for example, fruits and cut flowers) that have faster growth potential.

Products sheltered by high tariffs often receive domestic support and require export subsidies to be placed in international markets (Laird, Cernat and Turrini, 2003). Producer support reached some \$257 billion on 32 per cent of total farm receipts in Organization for Economic Cooperation and Development (OECD) member countries in 2003, having declined from 38 per cent in 1986-1988. While distorting forms of support have decreased (market price support, output and input payments), they still constitute the most widely used form of support granted to farmers (about 75 per cent). Moreover, as indicated by the producer subsidies equivalent, the concept used prior to 1999 to measure producer support in OECD economies, support had increased between 1979-1981 (29.5 per cent) and 1986-1988 (47 per cent), which was used as the benchmark for the reduction in support (OECD, 1988 and 1992). The use of peak years as the benchmark for the reduction of agricultural support thus limited the extent of the commitments effectively made by developed countries during the Uruguay Round. Total support for agriculture (producer, consumer and general services support) was about \$350 billion in 2003 (Organization for Economic Cooperation and Development, 2004).

Producer support is a complex and controversial issue. It may contribute to improving a country's food security. Yet, producer support may contribute to widening income inequality in the subsidizing country, as a considerable share of these transfers goes to the larger farms. Furthermore, by maintaining

Box II.1 (cont'd)

domestic prices artificially high, domestic support can also be detrimental to consumers, particularly the poor. In the international sphere, domestic support, by encouraging additional production that would not have taken place in the absence of such subsidies, has contributed to lower international prices. The latter are beneficial for foreign consumers but hurt producers abroad, as they erode producers' competitiveness and discourage production in non-subsidizing countries.

The trade of least developed countries is particularly affected by OECD agricultural subsidies: over 18 per cent of their exports, on average, are products receiving domestic support by at least one of their World Trade Organization partners. The average for other developed countries, which have more diversified exports, is below 4 per cent. On the other hand, a larger share of least developed countries imports (9 per cent) involves subsidized products, most of it food, compared with the corresponding share of other developing countries (3-4 per cent) (Hoekman, Ng and Olarreaga, 2003).

Tariffs on industrial goods are on average low, but this hides the existence of tariff peaks, which are frequent both in developed and in developing countries. In developed countries, tariff peaks exist on low-skill, low-technology products, while products requiring high skills and sophisticated technology that are exported by the more advanced developing economies and by developed countries face considerably less protection (Bacchetta and Bora, 2004). Most protected sectors, therefore, are precisely those that are of interest for developing countries (textiles and clothing, leather and footwear, fish and fish products) (see table 2). Tariff escalation is also present in non-agricultural goods, as evidenced by the fact that tariffs on semi-processed and processed raw materials are relatively high, thus discouraging diversification by commodity exporters.

In turn, many developing countries have bound their industrial tariffs at a very high level (that is to say, they have committed not to increase tariffs beyond that level) but apply much lower tariffs (see table 3). The difference between bound and applied tariffs leaves these countries with some policy flexibility for meeting industrial development objectives or facing temporary difficulties (for example, a balance-of-payments crisis). Other developing countries, least developed countries in particular, have not yet bound a significant share of their tariff lines.

Table 2.
Tariff escalation in selected countries, 2001-2003

		Percentage							
	Process	United States 2002	EU-15 2002	Japan 2002-2003	Canada 2002	China 2002	India 2001-2002	Brazil 2003	South Africa 2002
Total	First stage of processing	4.4	8.1	14.5	5.0	11.3	28.6	7.9	5.5
	Semi-processed	4.8	4.9	4.9	3.9	9.7	32.3	9.6	12.9
	Fully processed	5.5	7.0	7.8	8.9	14.0	33.0	13.4	11.5
<i>of which</i> Food, beverages and tobacco	First stage of processing	3.6	13.2	23.6	10.2	15.3	36.3	9.4	10.7
	Semi-processed	8.8	19.1	20.3	6.8	28.1	36.6	12.6	10.3
	Fully processed	12.5	18.7	22.6	34.1	21.5	48.2	15.0	15.4
Textiles, clothing and leather	First stage of processing	3.8	1.0	10.2	1.1	13.0	25.9	9.1	5.0
	Semi-processed	9.3	6.7	6.8	6.9	15.1	28.4	15.8	22.1
	Fully processed	10.1	9.8	12.0	13.5	20.4	34.2	19.3	32.4

Source: Acharya and Daly (2004).

Box II.1 (cont'd)

Table 3.
Most Favoured Nation (MFN) tariff binding by developing countries

	All	Latin America and the Caribbean	Western Asia	East Asia	South Asia	Africa	Least developed countries
Average binding (percentage of total product lines)	66.9	93.2	85.4	75.5	34.5	47.4	43.4
	Number of countries						
Proportion of tariff lines bound (B) (percentage)							
B = 100	36	19	5	3	0	9	7
90 ≤ B < 100	14	4	0	3	0	7	2
50 ≤ B < 89.9	10	1	2	4	1	2	2
35 ≤ B < 49.9	3	0	1	1	1	0	0
10 ≤ B < 34.9	10	1	0	0	1	8	7
0 ≤ B < 10	17	0	0	1	1	15	11

Source: World Trade Organization (2004a).

els. Yet, they provide a general idea of who the major beneficiaries are and in which areas trade liberalization can bring the most benefits. Some assumptions are very optimistic, often above what can be realistically achieved. Additionally, models do not incorporate any policy measure that the simulated liberalization may trigger. For instance, not all sectors of a given economy may gain from liberalization. This may trigger protectionist measures, which can reduce benefits for countries that are expected to profit from liberalization. Additionally, CGE models do not address issues of adjustment costs. Thus, net gains may be less than those estimated here. On the other hand, the vast majority of models capture only static gains and do not take into account the long-term effects on the growth rate.

As a minimum, models assess gains from increased market access via tariff cuts, both in agriculture and in manufacturing, in view of the existing scope for continued liberalization in these areas (see box II.1). Other models also incorporate a reduction or elimination of agricultural export subsidies and domestic support, liberalization of services and trade facilitation. Research indicates that the gains are roughly equally shared between developed and developing countries, with some advantage to developed countries in certain models largely owing to agricultural liberalization. Among developing countries, Asian economies reap relatively bigger gains than Latin American and African countries owing to their competitive advantage in labour-intensive manufactures. Across regions and groups, however, a major source of gains is countries' unilateral liberalization. However, perhaps more important than assessing relative gains across countries is evaluating the potential gains that the liberalization of specific sectors can bring to developing countries in particular.

Table II.3.

Selected estimates of annual welfare effects from multilateral trade liberalization

Source	Region	Unit	Total annual welfare gains	Gains from developed countries' liberalization	Gains from developing countries' liberalization	Agriculture and food and other primary	Manufactures
Anderson and others (2001) Full merchandise trade liberalization	Global	\$ 1995 billion	254.3	139.6	114.7	167.5	86.8
	Developed		146.2	96.6	49.6	121.8	24.4
	Economies in transition		6.4	4.5	1.9	3.5	2.9
	Sub-Saharan Africa		4.6	2.6	2.0	4.0	0.6
	Northern Africa and Middle East		0.3	-1.0	1.2	-3.1	3.4
	Latin America		35.7	17.9	17.8	23.0	12.7
	Asian NIEs ^a and China		22.3	5.1	17.2	1.6	20.7
	South Asia		15.4	9.0	6.4	5.7	9.7
Rest of the world	23.4	4.9	18.5	11.0	12.4		
			Total annual welfare gains	Agriculture	Manufactures	Services	
Brown, Deardorff and Stern (2002) 33 per cent tariff reduction on goods; 33 per cent reduction on service barriers	Global	\$ 1995 billion	686.4	-8.1	267.3	427.2	
	Developed countries		544.4	-1.8	190.9	355.4	
	Asia		103.0	5.2	58.4	39.3	
	Latin America		24.9	-6.7	8.0	23.6	
	Northern Africa and Middle East		14.1	-4.8	10.1	8.9	
			Total annual welfare gains	Agriculture and food	Textile and clothing	All other sectors (goods only)	
World Bank (2002a) Elimination of all import tariffs, export and domestic production subsidies (goods only)	Static gains	\$ 1997 billion					
	Global		355.0	248.0	41.0	70.0	
	High-income		171.0	106.0	17.0	50.0	
	Low- and middle-income	184.0	142.0	24.0	20.0		
	Dynamic gains	\$ 1997 billion					
	Global		832.0	587.0	189.0	62.0	
High-income	539.0		196.0	66.0	35.0		
Low- and middle-income	293.0	390.0	123.0	27.0			
			Total annual welfare gains				
Laird, Cenart and Turrini (2003) Worldwide 50 per cent reduction of all merchandise tariffs	Global	\$ 1997 billion	39.6				
	Developed		20.1				
	Economies in transition		0.6				
	Sub-Saharan Africa		--				
	Northern Africa and Middle East		3.7				
	Latin America		1.4				
	Asian NIEs ^a and China		11.6				
	South Asia		1.4				
Rest of the world	0.8						

Table II.3 (cont'd)

Source	Region	Unit	Total annual welfare gains	Trade facilitation	Services	Manufactures	Agriculture
François, van Meigl and van Tongeren (2003) Full liberalization on border measures and subsidies and trade facilitation (3 per cent of value trade)	Global	\$ 1997 billion	367.3	150.9	53.1	54.2	109.1
	OECD countries		205.2	95.7	38.0	17.4	54.1
	Developing countries		162.1	55.2	15.0	36.9	55.0
							0.5

a Newly industrializing economies.

Most models indicate significant gains due to liberalization in agriculture, benefiting largely consumers in developed countries.¹⁹ A closer look at these estimates points to different outcomes depending on whether tariff reduction, or cuts in domestic support and/or export subsidies—the three pillars of agriculture negotiations under Doha—are pursued.

Net food importers would be negatively affected by the removal/reduction of (food) subsidies in Organization for Economic Cooperation and Development (OECD) countries as their food bill would increase, at least initially. In fact, research seems to indicate welfare losses for most developing regions when domestic support is cut in OECD economies, owing to deterioration in their terms of trade (see table II.4).²⁰ In some countries, these losses are manageable, but other countries may face sizeable difficulties. Of particular concern are the potential welfare losses incurred by sub-Saharan Africa, which is already facing severe constraints in dealing with existing challenges. Countries will require additional assistance in dealing with these costs.

Tariff cuts on agricultural products can generate relatively higher global benefits, including for the majority of developing countries. Additionally, they can mitigate most of the negative impact of a larger food bill. Net food importers will also benefit from increased market access for their exports, which may offset losses coming from higher food prices.

All regions will benefit from liberalization of manufactures trade, although some will gain more than others. Sub-Saharan Africa's gains (excluding South Africa), for instance, are negligible in most models owing to its reduced supply capacity, its limited competitiveness and surging imports from Asia (Laird, Cernat and Turrini, 2003).

Considerable potential gains could accrue from liberalization of trade in services, owing to the large share of services in the consumption of many countries and to the fact that services are also a major input to other productive activities. Yet, caution is called for, as there are severe data and modelling deficiencies related to trade in services, particularly in developing countries. Additionally, liberalization per se will not be sufficient to bring benefits for this group of countries. Developing countries have already identified several factors that need to be taken into account and acted upon for them to fully benefit from service liberalization. These include supply constraints; the existence of certain preconditions, policy measures and technical assistance to ensure capacity-building and competitiveness by

Significant gains from agricultural liberalization, largely benefiting consumers in developed countries, are projected

Net food importers are expected to be negatively affected by the removal/reduction of (food) subsidies in OECD countries

All regions will benefit from liberalization of trade in manufactures and estimates suggest that considerable potential gains might accrue from liberalization of trade in services as well

Table II.4.

Selected estimates of annual welfare effects from multilateral trade liberalization

Source	Unit	50 per cent tariff cut	50 per cent domestic support cut	Elimination of export subsidies
Hoekman, Ng and Olarreaga (2003)	\$ 1995 billion			
World		16.8	0.2	..
Industrialized countries		14.5	0.5	..
Developing countries		2.3	-0.3	..
Least developed countries		0.0	0.0	..
François, van Meigl and van Tongeren (2003)	\$ 1997 billion			
World		57.0	8.7	..
EU-15		9.8	8.4	..
Northern America		2.7	2.2	..
High-income Asia		16.1	-0.5	..
Middle- and low-income Asia		7.5	-0.3	..
Central and Eastern Europe		1.7	0.0	..
Mediterranean		15.0	-0.6	..
South America		2.0	-0.2	..
Sub-Saharan Africa		2.7	-0.1	..
Others		-0.5	-0.2	..
Laird, Cenart and Turrini (2003)	\$ 1995 billion			
World		30.3	..	-4.7
Developed countries		11.1	..	1.9
Transition economies		0.2	..	-0.9
Developing countries		9.5	..	-2.9
NIEs ^a and China		4.4	..	-0.2
South Asia		0.3	..	0.0
Sub-Saharan Africa		0.2	..	-0.4
Northern Africa and Middle East		3	..	-2.2
Latin America		1.3	..	0.1
Others		0.3	..	-0.2
Dimaranan, Hertel and Keeney (2004)	\$ 1997 billion			
Developing countries		..	-0.4	..
Asia		..	-0.1	..
Latin America		..	0.1	..
Northern Africa and Middle East		..	-0.3	..
Sub Saharan Africa		..	-0.1	..
Others		..	0.0	..

^a Newly industrializing economies.

their domestic sector; the need for proper sequencing of liberalization and policy flexibility; and ensuring universal access to certain essential services (Manduna, 2004). On the other hand, further liberalization of Mode 4 of service provision—liberalization of temporary movement of workers—could bring more immediate benefits.²¹ According to Winters (2002), a 3 per cent increase in industrialized countries' quota of temporary workers (both skilled and unskilled) would increase global welfare by \$156 billion per year, with \$70 billion accruing to developing countries. Potential benefits would also accrue from a more liberal Mode 1 provision (cross-border supply (outsourcing)).

Notwithstanding the above, the benefits of multilateral liberalization are often of a long-term nature, while implementation costs frequently occur in the short term. The latter include tariff revenue losses, lower output and employment losses in import competing sectors, implementation costs of agreed commitments and reduced policy flexibility (Laird, Fernandez de Cordoba and Vanzetti, 2003). Additionally, the Round will also imply some long-term adjustment costs. For instance, some developing countries have been concerned with the erosion of preferences that further most favoured nation (MFN) tariff reduction may entail for these countries' competitiveness in preferential markets (see box II.2).

Built-in flexibilities and a sufficiently long implementation period may help developing countries to deal with the challenges mentioned above and should be provided for in the negotiations. Policy interventions may mitigate some of these negative effects. Yet, developing countries, already resource-constrained, may not afford these measures and thus have fewer policy instruments available to them. In this regard, the IMF proposal of a Trade Integration Mechanism (TIM) is a welcome development. TIM, however, addresses only one aspect of the adjustment costs—those leading to balance-of-payments difficulties, which are often of a temporary nature. The fiscal implications of World Trade Organization induced reforms, besides lower tariff revenue, need to be tackled as well.

More importantly, some countries—particularly preferences-dependent economies—will require support beyond assistance with short-term adjustment costs. They will need to build production and technological capacities aimed at diversifying their economies and allowing them to fully benefit from their integration into the world economy on a sustainable basis. In fact, the inadequacy of existing support mechanisms has been recognized and several proposals have been put forward. Among others, Mr. Peter Mandelson (2004), the European Commissioner for Trade, has recently called for the establishment of a special trade adjustment fund for investment in trade capacities in poor countries and assistance with mitigating the costs of liberalization. Similarly, the United Nations Millennium Project Task Force on Trade urged the creation of a temporary “aid for trade fund”, in addition to current aid flows, to support countries in dealing with costs resulting from the implementation of Doha (UN Millennium Project, Task Force on Trade, 2005).

The Doha Round: where does it stand?

After the setback in Cancún, negotiations drifted for a while. The adoption of the framework agreement of 1 August 2004, the “July package”, provided the Round with a renewed momentum, particularly in view of the need to produce tangible results for consideration by the Sixth Ministerial Conference of the World Trade Organization in Hong Kong, Special Administrative Region (SAR) of China in December 2005 and the evolving consensus among World Trade Organization members to conclude the negotiations no later than the end of 2006. Additional political momentum has been provided through a series

The benefits of multilateral liberalization are often of a long-term nature while implementation costs tend to occur in the short run

Built-in flexibilities and a sufficiently long implementation period may help developing countries to deal with such challenges and should be provided for

Preference-dependent economies will require support beyond assistance with short-term adjustment costs

The adoption of the framework agreement of 1 August 2004, the “July package”, provided the Round with a renewed momentum

Box II.2

Multilateralism or preferential access?

Developed countries extend non-reciprocal preferential market access treatment to developing countries under the Generalized System of Preferences (GSP) and through special schemes such as those available to least developed countries. While the former often excludes products of export interest to developing countries, but are applied to a large number of qualifying developing countries, the latter is more restrictive in terms of beneficiaries but, in many instances, provides virtually quota- and duty-free treatment, thus giving beneficiaries significant preference margins in relation to tariff peak products. Differences between MFN and GSP treatments, however, can be small (see table below).

Most Favoured Nation and Generalized System of Preferences tariffs and least developed country preferential treatment in Canada, European Union, Japan and the United States, 2002-2003

Percentage			
	MFN	GSP	Least developed countries
United States (2002)	5.2	4.2	2.8
World Trade Organization agricultural products	10.4	9.3	6.5
Textiles and clothing	9.7	9.4	9.4
EU (2002)	6.4	4.5	1.7
World Trade Organization agricultural products	16.1	14.5	9.0
Textiles and clothing	8.4	7.2	0.0
Japan (2002-2003)	6.9	5.7	3.6
World Trade Organization agricultural products	20.0	19.3	18.3
Textiles and clothing	7.0	5.4	0.1
Canada (2002)	6.8	5.4	4.1
World Trade Organization agricultural products	21.7	20.8	18.2
Textiles and clothing	9.9	8.9	7.1

Source: Acharya and Daly (2004).

Despite advantages, the utilization rates (defined as the ratio of imports actually receiving preference to covered imports) of such programmes are not as high as expected and are often concentrated in a few countries and few products. For instance, UNCTAD (2003a) found that, on average, the least developed countries utilization rate had been about 67 per cent in 2001.

Low utilization rates are in part due to supply constraints in most beneficiary countries. This indicates, as recognized by the Monterrey Consensus of the International Conference on Financing for Development, that increased trade opportunities are not enough to put a country on a faster growth path and that necessary conditions need to be created and implemented in order for countries to benefit from increased liberalization. Low utilization rates are also due to stringent rules of origin, complex standards and other requirements (United Nations Conference on Trade and Development, 2003g). Moreover, most preference schemes carry some degree of uncertainty, as the benefits either are timed and renewed at the judgement of the offering country or can be withdrawn if performance requirements (often policy-related) are not fulfilled by the beneficiary. There is therefore a great deal of discretion that beneficiaries are not able to influence.

The impact of preference erosion on beneficiaries may be on average less than feared. Assuming a 40 per cent reduction in each beneficiary's aggregate preference margin, full utilization of pref-

Box II.2 (cont'd)

erences and no gains from lower MFN tariffs in third markets, export revenue losses for the group of middle-income countries have been estimated to be small, ranging from 0.5 to 1.2 per cent of total exports. Vulnerability, however, is much higher in those countries whose exports are concentrated in preferential markets or dependent on sugar and bananas (in particular a large number of small island economies) and to a lesser extent, on textiles (Alexandraki and Lankes, 2004).

In the case of least developed countries, Subramanian (2003) estimates losses from preference erosion at 1.7 per cent of the group's total exports, reflecting the fact that only a few least developed countries actually enjoy relatively large preference margins. Only five countries (Cape Verde, Haiti, Malawi, Mauritania and Sao Tome and Principe) are to suffer losses above 5 per cent of their export revenue. In value terms, the group as a whole is estimated to lose \$530 million in export revenue, 75 per cent of which is concentrated in five countries (Bangladesh, Cambodia, Malawi, Mauritania and the United Republic of Tanzania).

It has been argued that these losses would be gradual as liberalization occurred over a number of years and that because the losses were anticipated, it could be easier for countries to adjust (Subramanian, 2003). This, however, does not imply that preference-dependent economies may not need financial and technical assistance to facilitate their adjustment, particularly taking into account their limited resources and the multiple handicaps they confront.

It thus seems more advantageous for developing countries, on average, to obtain more secure MFN reductions, particularly on export products of interest to them, as mandated by the Doha Declaration, rather than for existing preferences to be maintained. Multilateralism offers a more predictable and stable trading environment. There is also some evidence that the granting of preferences (non-reciprocal and otherwise) has implied higher MFN tariffs for non-beneficiaries than would otherwise have been the case (Limão, 2003).

This is not to say that preferences do not have a role to play. Preferences offer developing countries an opportunity to develop new sectors or to overcome certain disadvantages in promoting existing sectors. The challenge for beneficiaries is thus the transformation of an enhanced competitiveness brought about by preferential treatment into one based on increased productivity and product upgrading, which can create lasting benefits for the economy once preferences are removed. Independently of the final outcome of the Doha Round, some preferences are bound to be reduced anyway owing to reforms in preferential markets or past agreements at the multilateral level. The reforms in the EU sugar regime—including those triggered by the recent World Trade Organization ruling on export subsidies—and its banana regime are cases in point. The recent expiration of the Agreement on Textiles and Clothing is another.

of mini-Ministerial meetings (Davos, Kenya and Paris). The road to Hong Kong SAR, however, has proved to be as difficult as the road to Cancún. Negotiations have not advanced and there is urgent need to expedite the process in time for Doha to contribute to the achievement of the Millennium Development Goals.

The July framework envisages, in the case of **agriculture**, the complete elimination of export subsidies, and substantial reductions in trade-distorting measures and in overall tariffs according to a tiered formula, which imply that members with higher levels of trade-distorting measures and/or tariffs will make deeper cuts.

The World Trade Organization Agreement on Agriculture²² classifies domestic support policies according to their level of trade distortion (amber, blue and green boxes).²³ The July framework maintains this distinction, placing a cap on blue box support while criteria for green box inclusion will be reviewed and clarified. Developed countries, however, can maintain high tariff protection on “sensitive products” provided that other products receive deeper cuts. Developing countries can designate “special products” that would be eligible for a “special safeguard mechanism”. Special and differential treatment (SDT) is accorded to developing countries in terms of reduced commitments (or no commitments by least developed countries) and longer implementation periods (World Trade

The July framework envisages the complete elimination of agricultural export subsidies

Organization, 2004b). A subcommittee was created to look at cotton as a “special issue” within the agriculture negotiations.²⁴ The framework, however, only pointed to the general direction of negotiations (United Nations Conference on Trade and Development, 2004e). The amount and schedule of liberalization as well as base periods, modalities and other relevant details have remained open, subject to further negotiations.

The major issues in non-agricultural market access are tariff reduction and tariff binding

The major issues in **non-agricultural market access** are tariff reduction and tariff binding. A non-linear formula approach will be applied on a line-by-line basis and on the bound rates. For unbound tariff lines, twice the level of the MFN applied tariff was suggested. This implies that higher tariffs would receive relatively deeper cuts. All proposals submitted up to early May 2005 were based on a “Swiss” harmonizing formula, which narrows the gap between high and low tariffs and produces a maximum final rate. Developing countries, therefore, would undergo relatively larger liberalization owing to the relatively higher tariffs. Besides developing countries’ concerns over deindustrialization and reduced policy instruments for industrial development, this could bring negative implications for countries dependent on tariffs for government revenue. Technical discussions have been difficult regarding how to convert specific tariffs into ad valorem tariffs or how to deal with unbound tariffs.

The framework also has provisions on autonomous liberalization provided that these resulted in tariffs lines being bound on an MFN basis at the World Trade Organization. Countries having binding coverage of less than a given percentage (35 per cent was suggested) are not required to participate in the formula approach but are expected to bind their tariffs. This, however, may leave these countries with relatively higher levels of obligation in future rounds. Developing countries will also have longer implementation periods (not specified) for tariff reduction. They may also apply less than formula cuts (within some specified parameters) to some tariff lines or may keep tariff lines unbound.

The framework also envisages a sectoral tariff component aiming at the harmonization or elimination of tariffs on products of export interest of developing countries. Product coverage is still to be identified.

The General Agreement on Trade in Services contains a built-in agenda, committing members to “progressive and higher levels of liberalization”

Like agriculture, **services** were incorporated into the multilateral trading rules with the Uruguay Round. The General Agreement on Trade in Services contains a built-in agenda as members committed to “progressive and higher levels of liberalization”. Negotiations had been to start in 2000 on the basis of national policy objectives and the level of development of individual members (both overall and in individual sectors), with flexibilities for developing countries to liberalize fewer sectors and types of transaction. Negotiating guidelines were adopted in March 2001 and established a “request-offer” approach as the modality of negotiations (World Trade Organization, 2001b).

The Doha Declaration reaffirms the 2001 guidelines “as the basis for continuing the negotiations” and sets deadlines for the submission of request and offers, which were subsequently extended by the July package to May 2005. By early 2005, some 90 initial requests and 50 offers had been received, the latter mostly from developed countries. The offers often bypass sensitive sectors such as health, audiovisual and labour-intensive lower-skill services, particularly those rendered through Mode 4, that is to say, areas and modes where developing countries have most competitive advantage and interest. Recently, some developing countries have also increased participation of Mode 1 of services supply—India is the most prominent example of such trend—although from a small base.

Currently, General Agreement on Trade in Services commitments in Mode 4 are more restrictive than in the other modes of delivery. Yet, limited liberalization has been offered in this area so far, and most Mode 4 offers often refer to highly skilled labour and

require commercial presence in the country (Mode 3). Additionally, offers seem not to advance previous commitments made and, in some cases, imply reciprocity (United Nations Conference on Trade and Development, 2005b). In all, the process is proceeding behind schedule and the extent of liberalization offered has been limited.

The Agreement on Trade-related Aspects of **Intellectual Property Rights**²⁵ (TRIPS) establishes minimum levels of protection that World Trade Organization members have to extend to one another. Compliance with TRIPS, however, has proved costly and difficult to implement for developing countries. Moreover, the Agreement does not necessarily pay due attention to these countries' needs.²⁶ For instance, it places restrictions on practices to promote industrial development, and does not provide enough protection to traditional knowledge and folklore. It also implies potentially higher prices and reduced access to some goods. A particularly important issue in this regard has been that of medicines, where the Agreement can be a source of significant difficulties if countries confront acute health crises.

At Doha, Ministers addressed some of these concerns as well as implementation and built-in issues of the Agreement. The following issues were to be tackled: (a) public health; (b) geographical indications; (c) biodiversity issues, including the relationship between TRIPS and the Convention on Biological Diversity²⁷, and the protection of traditional knowledge and folklore; (d) non-violation disputes; and (e) technology transfer to least developed countries.

As in other areas, negotiations have been contentious. On the eve of the Cancún meeting, the General Council adopted a decision that allowed countries to export pharmaceuticals produced under compulsory licensing to countries lacking such manufacturing capacity, provided that both importing and exporting countries met specific conditions (World Trade Organization, 2003). The Decision is a temporary waiver to particular TRIPS obligations, which are to be permanently amended. As of early May 2005, however, no importing or exporting country had notified the World Trade Organization about its intention to make use of the decision. This is due in part to the difficulties faced in fulfilling the stringent requirements specified in the decision and in part to the fact that large pharmaceutical companies have been providing the required medicines at reduced cost. More worryingly, no agreement on how to modify the Trade-related Aspects of Intellectual Property Rights was reached by the established deadline of end of March 2005. While the decision remains binding until the Agreement is amended, the system has not been tested and its usefulness cannot be properly assessed (Page and Conway, 2004).

Turning to the other TRIPS-related issues, a decision has been adopted on the establishment of a mechanism to ensure monitoring and implementation of commitments that developed countries made to provide incentives to the private sector and institutions for the transfer of technology to least developed countries. Nonetheless, no agreement has yet been reached on the other mandated areas of negotiation mentioned above.

The July framework also includes modalities on negotiations on **trade facilitation**. They represent a new approach in respect of special and differential treatment, as both the extent and timing of commitments are to be related to developing countries' implementation capacity. There is concern, however, over implementation costs despite the potential benefits of trade facilitation measures.

At Doha, Ministers agreed that "all **special and differential treatment** provisions shall be reviewed with a view to strengthening them and making them more precise, effective and operational" (para. 44). They also instructed the Committee on Trade and Development to identify which of those special and differential treatment provisions were

While the Agreement on Trade-related Aspects of Intellectual Property Rights establishes minimum levels of protection, compliance with the Agreement has proved costly and difficult to implement for developing countries

mandatory, and to consider the implications of making mandatory those that were currently non-binding (World Trade Organization, 2001c). The July framework reiterates that the needs of developing countries and least developed countries are at the centre of the Doha round and that SDT is an integral part of the World Trade Organization agreements, but it does not advance additional guidelines for negotiations.

The revision of special and differential treatment provisions has not advanced smoothly

The revision of SDT provisions has not advanced smoothly. Deadlines were postponed. One of the difficulties is related to different interpretations of the Doha mandate. Developing countries argue that strengthening existing SDT provisions requires making past negotiations effective. They thus call for changes in the language of World Trade Organization agreements. However, some analysts caution about the legal difficulties in making some of the “best endeavour” into mandatory provisions (Keck and Low, 2004). Developed countries, on the other hand, argue that changes in existing agreements are subject to new negotiations and are unwilling to adopt changes that would alter the “balance of Member’s rights and obligations”. Moreover, they maintain that proposals should be assessed in relation to the objectives SDT aims to achieve (International Centre for Trade and Sustainable Development (ICTSD), 2003). The latter position opens up an entire range of questions. In the developing countries’ perception, these issues extend beyond the Doha mandate, which is agreement specific.

Another contentious issue—and one that is perhaps more difficult to deal with—is that of the segmentation and/or graduation of developing countries. Developed countries argue that the different levels of development across the developing world call for different types of treatment across countries. Moreover, they claim that they would be able to offer deeper preferences if these applied to a more restricted number of poorer countries.

Differences between developed and developing countries remain significant, however, even when those considered to be “more advanced” are taken into account. Additionally, there is overall concern that several World Trade Organization obligations were drafted on the basis of policy practices in developed countries, which may not be compatible with the reality and the developmental path of developing countries, thus justifying the need for increased flexibility in the implementation of agreed commitments. Moreover, it is not obvious why measures to facilitate development should discriminate among countries, nor whether preferential treatment extended to developing countries would imply significant additional costs for developed countries.

Regional trade arrangements

The number of regional trade arrangements has increased sixfold in the past two decades and fourfold since 1990, and totalled roughly 230 as of early 2005

When a World Trade Organization member enters into a regional integration agreement²⁸, it grants more favourable terms to its trade with other parties to that arrangement than to its trade with other World Trade Organization members. It is thus departing from the guiding principle of non-discrimination as defined, for example, in article I of the General Agreement on Tariffs and Trade (GATT) and article II of the General Agreement on Trade in Services. Nevertheless, World Trade Organization members are permitted to enter into such arrangements under specific conditions.²⁹ Meanwhile, other preferential schemes—such as non-reciprocal preferential agreements involving developing and developed countries—require World Trade Organization members to seek a waiver from its rules.

Despite the need for waivers and exemptions, a variety of arrangements, encompassing various forms of preferential agreements including bilateral, regional and multilateral accords, have proliferated. The number of such agreements has increased sixfold in the past two decades and fourfold since 1990, and totalled roughly 230 as of early 2005 (Crawford and Fiorentino, 2005).

These types of accords, allowing members to grant preferences to other members that are denied to outsiders, have the potential to reconfigure trade flows as well as the workings of the global trading system. This raises two concerns. The first is whether the trade that an agreement generates is welfare-enhancing, both for members and for the global system. This is the traditional “trade-creation” versus “trade diversion” concern first analysed by Jacob Viner (1950) more than half a century ago.³⁰ The second concern is whether the creation of such preferential agreements distracts from the workings of the multilateral trading system or, conversely, aids in the process of global trade liberalization. The present section looks at the validity of these concerns. It argues that, while multilateralism is the best means to achieve a better integration of developing countries into the global economy, preferential agreements may aid in this process.

Such accords, allowing members to grant preferences to other members that are denied to outsiders, have the potential to reconfigure trade flows as well as the workings of the global trading system

The proliferation of trading blocs and free trade agreements

While the formation of preferential trading agreements has flourished in recent years, the movement towards such trade agreements goes back to the 1950s and 1960s. Both the European Economic Community (established by the 1957 Treaty of Rome) and the European Free Trade Association (established 1960), had their origins in that period, as did the Central American Common Market (established 1960), the Andean Pact (established 1969), now the Andean Community, the Latin American Integration Association (LAIA) (formed in 1960) and the Southern African Customs Union (established 1969).

The trend towards such trade agreements goes back to the 1950s and 1960s

By the time the European Community (EC) had segued into EC-92 in July 1987—envisaging further enlargement, as well as the free movement of goods, services and factors by 1992—similar efforts were under way elsewhere, resulting for example, in the United States of America-Canada Free Trade Agreement of 1988. In turn, many developing countries initiated their own schemes, for example, the Southern Common Market (MERCOSUR), which was formed in 1991. In Asia, the Association of Southeast Asian Nations (ASEAN), whose orientation had been a relatively political one when it was founded in 1967, established the ASEAN Free Trade Area in 1992.

The new integration agreements differed from the older ones both qualitatively and quantitatively. To begin with, the focus is now far broader and extends beyond trade in goods to encompass trade in services as well as investment protection, intellectual property rights and, in some cases, labour standards, environmental issues and some domestic regulations that may affect international trade. Further, trade facilitation measures are often an important element in these schemes. In addition, the newer schemes tend to be more outward-looking, thus following a policy of “open regionalism” (Economic Commission for Latin America and the Caribbean, 1994). Finally, schemes are emerging that link developed and developing countries, such as the North American Free Trade Agreement (NAFTA), the EU-Turkey Customs Union (1 January 1996) and the proposed Euro-Mediterranean economic area, to be formed by 2010.

Newer integration agreements differ from the older ones qualitatively as well as quantitatively

This process has been interwoven with the proliferation of free trade agreements. Since 1990, the number of free trade agreements has risen from 50 to almost 230 as of 2004. According to the World Trade Organization, another 60 are in various stages of formation. Only 12 countries or territories are currently not a party to at least one such agreement.³¹ Moreover, many countries belong to several such schemes. On average, a country belongs to six arrangements, though there is a great deal of variation depending on

the region and the level of development. For example, for the 25 countries constituting OECD, plus Lichtenstein, there are, on average, 11 arrangement per country and as many as 29, in some instances. In Latin America and the Caribbean, there are 8 schemes, on average, per country, and as many as 19 in some cases; for East Asia and the Pacific, the comparable numbers are 2 and 7.

The result, as a single country becomes a member of several schemes, is what has been termed a “spaghetti bowl” of overlapping arrangements. Such arrangements generally have different provisions—different tariff schedules, different rules of origin and different periods for implementation—all of which strain trade policy and trade administration and complicate customs procedures.

As a single country becomes a member of several schemes, a “spaghetti bowl” of overlapping arrangements evolves

Impact of preferential agreements and policy implications

Trade agreements, which have the potential to deviate trade flows, have not necessarily done so

Trade agreements have the potential to deviate trade flows. Nonetheless, it is not valid to generalize that they have necessarily done so (see table II.5). Rather, looking back as far as 1970, three patterns appear to predominate. First, there are schemes where intra-trade clearly increased. Asia-Pacific Economic Cooperation (APEC)³² (though it actually did not

Table II.5.

Trade within selected regional trade blocs, 1970-2002

	Percentage of total bloc exports					Percentage of world exports	
	1970	1980	1990	1998	2002	1970	2002
High-income and low- and middle-income economies							
APEC ^a	57.8	57.9	68.3	69.7	73.3	36.0	46.0
EU	59.5	60.8	65.9	56.8	60.6	45.6	37.9
NAFTA	36.0	33.6	41.4	51.7	56.7	21.7	17.2
Latin America and the Caribbean							
Andean Group	1.8	3.8	4.1	12.8	9.5	1.9	0.8
CACM	26.1	24.4	15.3	15.8	11.1	0.4	0.4
CARICOM	4.2	5.3	8.1	17.3	12.5	0.4	0.2
LAIA	9.9	13.7	10.8	16.7	11.1	4.5	5.0
MERCOSUR	9.4	11.6	8.9	25.0	11.6	1.7	1.4
Africa							
COMESA	8.7	6.0	6.3	7.7	6.4	1.6	0.4
ECOWAS	2.9	10.1	7.9	10.7	10.6	1.1	0.4
UDEAC	4.9	1.6	2.3	2.3	1.5	0.2	0.1
Asia							
Arab Common Market	2.2	2.4	2.7	4.8	4.8	1.6	0.6
ASEAN	22.9	18.7	19.8	21.9	23.7	2.0	6.3
Bangkok Agreement	2.7	3.7	3.7	5.0	5.6	1.6	5.1
EAEC	28.9	35.6	39.7	42.0	48.2	11.3	25.2

Source: DESA, based on World Bank, *World Development Indicators*, 2004.

^a No preferential trade agreement.

have an operational preferential trade agreement over the period 1970-2002), NAFTA, the Bangkok Agreement³³ and the East Asian Economic Caucus (EAEC)³⁴ are included in this set. A second group of arrangements experienced an increase in intra-bloc exports as a share of total bloc exports, but the “peak” had been in fact achieved in the second half of the 1990s and declined thereafter. This has been the case for the Andean Community,³⁵ the Caribbean Community and Common Market (CARICOM),³⁶ LAIA, formerly the Latin American Free Trade Area,³⁷ MERCOSUR, the Economic Community of West African States (ECOWAS)³⁸ and the Arab Common Market.³⁹ A final observed trend was for intra-bloc trade as a share of total exports to either not increase, or actually decline, over the period in question. In the case of EU, for example, intra-trade had been already substantial and therefore did not grow significantly over the period. However, intra-trade declined within the Central American Common Market (CACM),⁴⁰ the Common Market for Eastern and Southern Africa (COMESA)⁴¹ and the Central African Customs and Economic Union (UDEAC).⁴²

These trends indicate, in short, that it cannot simply be presumed that, following the formation of a trading bloc, trade flows will deviate from outside to inside the bloc. In part, this may be due to the fact that many recent schemes overlap with already existing agreements, so that possible further shifts in the direction of trade are likely to be marginal. Moreover, especially in OECD countries, the importance of such preferences is less than it might be because of already reduced tariff barriers among members.

The situation for many developing countries is different, however, because the number of low-duty tariff lines is small. South-South blocs are, therefore, potentially far more important as regards the preferences gained. Nevertheless, many developing countries have endeavoured to reduce tariff levels over the past two decades—though most of these reductions can be attributed to autonomous liberalization and not to trade agreements. According to an estimate by Martin and Ng (2005), only 10 per cent of total tariff reductions between 1983 and 2003 could be attributed to regional agreements, compared with 25 per cent to multilateral agreements and 66 per cent to autonomous liberalization. A recent analysis of the South Asian Preferential Trading Agreement—initiated in 1995 and comprising Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka—makes precisely this point, maintaining that it was not regionalization but “previous unilateral liberalization efforts” that “had a positive impact in boosting both intra- and extraregional trade” in the South Asia region (Pitigala, 2005).

For trade agreements to have a positive impact on their member economies in terms of integration into the global economy, it is necessary for such schemes to stimulate overall trade flows, not just intra-trade. The evidence in this regard is difficult to measure and appraise. Part of the difficulty emanates from the fact that such agreements generally encompass far more than trade and even far more than economic objectives, thus including broader socio-political and regional concerns. Then, too, global developments may swamp regional trends, making it difficult to disentangle the two. Moreover, trade between countries and regions may grow spontaneously, without preferential schemes, as box II.3 suggests in relation to the growing trade of China with Latin America and Africa. Figures in table II.5 do make clear, however, that it was only in the Asian region that bloc exports as a share of world exports expanded dramatically between 1970 and 2002. In Africa, the opposite was the case.

Two basic methods that are used to examine the effects of trade agreements are *ex ante* general equilibrium simulation studies, which look forward to potential gains, and *ex post* econometric analyses via a gravity model, which look back at actual performance.⁴³

South-South blocs are potentially very important as regards the preferences gained by members

Analyses examining the effects of trade agreements produce widely disparate results

Box II.3

Current trends in trade relations between China and Latin America and China and Africa: potential and challenges

With real GDP growth of 9.5 per cent and an increase in its trade volume by approximately 30 per cent in 2004, the continued strong performance of the Chinese economy is often seen as a major determinant of recent developments in international trade conditions and, in particular, the rise of global commodity prices. However, in addition to this price effect, China's economic growth also appears to be accelerating the emergence of a "new geography" of trade, describing the dynamic rise of new South-South trade flows.

In this context, besides the increasing role of intraregional trade in Asia, the rising importance of trade relations between China and Latin America and between China and Africa appears particularly noticeable. Combined with a potentially positive effect on FDI inflows, the improvements in trade conditions create an opportunity to achieve significant progress in economic and social development in the exporting countries concerned.

Data show that there has been a uniform increase in the relative importance of trade relations between China and Latin America as well as between China and Africa. China's exports to Latin America as a share of its total exports increased from 1.9 per cent in 1993 to 2.6 per cent in 2003, while the share of exports to China in total exports of Latin American economies more than tripled in the same period, from 1.2 per cent to 3.8 per cent (see table). Similarly, the share of China's exports to Africa in total exports increased from 1.6 to 2.3 per cent whereas the share of Africa's exports to China in its total exports increased from 1.0 to 4.8 per cent over the same period.

With respect to the composition of trade, evidence suggests that trade flows from Latin America to China consisted mainly of raw materials, while in the case of Africa, fuel products played a dominant role (see figure). In the reverse direction, Chinese exports to both Latin America and Africa consisted especially of manufactured goods as well as machines and transportation equipment.

An interesting implication of these developments is the significant benefit that China is generating for other developing countries with respect to their increasing their earnings from commodity exports, a major change with respect to patterns observed in previous decades. Furthermore, the benefits may be extended to other areas, particularly with respect to FDI. Indeed, the increasingly significant trade relations

Significance of China's trade with Latin America and Africa: percentage share of imports from/exports to partner region in total imports/exports of reference region, 1993-2003

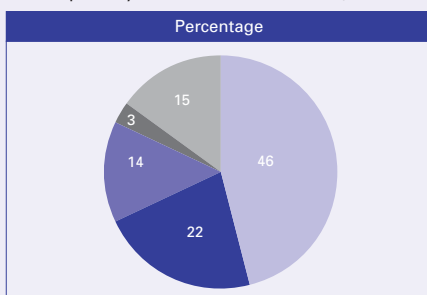
Reference region:	China		China		Latin America		Africa	
Partner (from/to):	Latin America		Africa		China		China	
Year	Imports	Exports	Imports	Exports	Imports	Exports	Imports	Exports
1993	1.9	1.9	0.8	1.6	0.9	1.2	1.4	1.0
1994	1.9	2.0	0.7	1.4	1.1	1.2	1.6	0.9
1995	2.2	2.1	1.1	1.7	1.3	1.3	2.0	1.4
1996	2.6	2.0	1.1	1.7	1.1	1.4	2.0	1.3
1997	2.6	2.4	1.7	1.7	1.4	1.3	2.5	2.1
1998	2.1	2.8	1.1	2.2	1.5	1.1	3.1	1.5
1999	1.8	2.6	1.4	2.1	1.5	1.0	3.2	2.2
2000	2.1	2.8	2.1	2.0	1.8	1.3	3.8	3.3
2001	2.7	3.0	1.9	2.2	2.1	1.9	4.6	3.6
2002	2.8	2.8	1.8	2.1	2.5	2.4	4.8	3.8
2003	3.6	2.6	2.0	2.3	2.9	3.8	5.6	4.8

Sources: IMF/DOT database; and United Nations calculations.

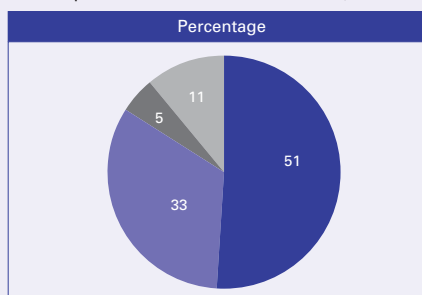
Box II.3 (cont'd)

Composition of trade between China and Latin America, and China and Africa, 2003

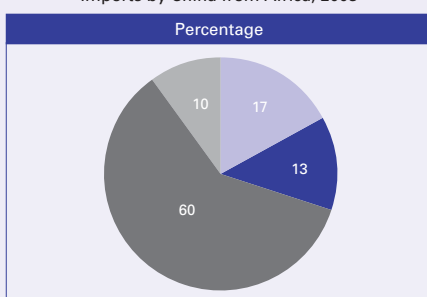
Imports by China from Latin America, 2003



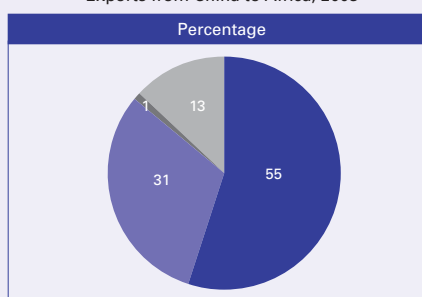
Exports from China to Latin America, 2003



Imports by China from Africa, 2003



Exports from China to Africa, 2003



Legend: Raw materials (light blue), Manufactured goods (dark blue), Machines, transport equipment (medium blue), Fuels (grey), Others (white).

Sources: COMTRADE database; and United Nations calculations.

of China with Latin America and with Africa are likely to be accompanied by increasing flows of FDI from China to those two regions. Thus, according to some forecasts, China's investments in Latin America will amount to US\$ 100 billion over the next decade.^a In parallel to this, China's investment in Africa is also expected to rise, particularly in the oil sector. This is likely to at least partially offset the effects of China's role as a competitor for FDI, which is often seen as one of the difficulties that other developing countries face in attracting international investment funds.

Such FDI flows are likely to be channelled particularly into the primary sector of the recipient countries, given the prominent role of primary goods and commodities in Latin American and African exports to China. One reason for this is that Latin America and Africa are rich in natural resource endowments. A further reason lies in China's demand for raw materials, which is based on its need to sustain an economic growth that is driven especially by the raw material-intensive and energy-dependent industry sector as well as construction. In addition, rising per capita incomes and urbanization in China have given rise to lifestyle changes as well as a change in the composition of the demand for food products, including an increase in imports by China of non-traditional products such as coffee and cocoa. The latter effect can help to not only increase the magnitude of the benefits of China's economic expansion for Latin American and African economies, but also spread these positive effects over a larger number of developing countries.

Especially in the area of agricultural products, an important international determinant of the extent to which Latin American and African economies will be able to reap the benefits of increasing demand from China is the design of the world trade system and, in particular, the support from developed countries for the further liberalization of international trade. Only a further reduction in subsidies and the phasing out of measures that support domestic producers in the developed economies will help to avert a situation where a disproportionate share of the benefits of the improved conditions in the world market for agricultural products accrues to firms and producers in the developed world.

The challenge for policy makers in countries in Latin America and Africa will be to maximize the actual social welfare effects of both higher export revenues and an increase in investment flows into their primary sectors stemming from the positive developments in trade relations with China.

^a BBC News, 17 November 2004, available from <http://news.bbc.co.uk/1/hi/world/americas/4018219.stm> (accessed 13 June 2005).

Such analyses can produce widely disparate results. For example, one assessment of the recent spate of preferential trade agreements that emerged in the 1990s, “found no indication that the ‘new wave’ of regionalism boosted intra-bloc trade significantly” (Soloaga and Winters, 1999). However, an investigation of the effects of NAFTA—10 years after its inception—found that it played an important role in boosting trade and financial flows in the region (Kose, Meredith and Towe, 2004). Likewise, estimates of the potential effects of the Free Trade Agreement of the Americas and of a trade agreement between MERCOSUR and EU suggests that these schemes will be net trade-creating ((Harrison, Rutherford and Tarr, 2001; Harrison and others, 2003). Finally, an investigation that distinguished between various degrees of integration and implementation of trading schemes found that “more integrated arrangements”⁴⁴ generated greater total trade-creation (Ghosh and Yamarik, 2004).

While concern with the welfare effects of trade-creation and trade diversion has been associated with static analyses, in recent years, dynamic considerations have become progressively more important

Concern with the welfare effects of trade creation and trade diversion has been associated with static analyses. However, in recent years, because of vastly increased flows of capital, people and technology, dynamic considerations have become progressively more important. One of the benefits of a preferential agreement, for example, may be its impact on technology diffusion, which will be greater from partner than from non-partner countries. Thus, one examination of Mexico in the context of NAFTA found that Mexico had benefited from the R&D content of its trade with its Northern neighbours, as well as from direct contact and close exchanges of information, especially in the case of subcontracting firms that were more closely integrated with the United States and Canada than with the more distant countries of the rest of OECD (Schiff and Wang, 2003).

While the evidence is generally favourable as regards the benefits to member countries of participation in a preferential scheme, according to several empirical analyses, the ramifications for non-member countries are negative

If the evidence is generally favourable as regards the benefits to member countries of participation in a preferential scheme, several empirical analyses indicate that the ramifications for non-member countries are negative. For instance, an assessment of the welfare gains associated with nine of the new proposals for regional trade arrangements in the Asia-Pacific region—using both the gravity model and CGE approaches—suggests that there may be significant welfare gains associated with some of these proposals. The gains appear largest when the group considered is large and diverse. However, it also appears that these schemes “often impose substantial costs on non-members” (Gilbert, Scollay and Bora, 2001). Similarly, the examination of the Free Trade Area of the Americas (FTAA) found that excluded countries lose, in the case not only of that scheme, but of other regional agreements as well (Harrison, Rutherford and Tarr, 2001).

There is a concern as to the impact of the current wave of regionalism on the multilateral trading system

The fact that membership in multiple agreements creates a so-called spaghetti bowl of overlapping arrangements has already been noted. However, the most important aspect of this is its impact on the multilateral trading system. One analysis (Andriamananjara, 1999) has argued that “there is a real possibility that, left on its own, the current wave of regionalism will not lead to global free trade”. Another study (Karacaovali and Limão, 2005) was equally sceptical. Preferential trade agreements, it is maintained, slowed down multilateral trade liberalization. It has further been pointed out that the effects of preferential agreements may be detrimental for multilateral bargaining. The reason is that countries in such an arrangement may want less broad-based liberalization through World Trade Organization channels because their preferential access to each other’s main export markets would thereby be eroded (Mattoo and Subramanian, 2005).

In summary, the current spate of preferential trade agreements is seen as a novel phenomenon by some, who regard them as reflecting what they term “open regionalism”, and who differentiate such schemes from those of the 1960s and 1970s. The older schemes

generally involved countries at more or less similar levels of development, usually in close geographical proximity and focused on the liberalization of trade in goods, primarily as a means of overcoming small market size-related limitations faced by import-substituting industries (Majluf, 2004). Today, in contrast, integration agreements and free trade agreements have a broader perspective, intended to promote competitiveness and aid in integrating members into the world economy. From this standpoint, current schemes may be more trade-creating and more consistent with multilateralism than were some of the more inward-looking arrangements of the past. Moreover, they involve reciprocity among members. Furthermore, such schemes allow countries to maintain some level of trade protection—an important consideration since total elimination of protection is not always optimal for a country. Thus, these arrangements may have a beneficial role to play. However, their compatibility with multilateralism cannot be presumed and policy vigilance is needed to ensure their consistency with the goals, objectives and tenets of the global trading system. Preferential agreements may be a useful addition to multilateralism, but they are not a substitute for it.

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Notes

- 1 Data from World Bank (2004b), table 2.1.
- 2 According to these analyses, estimates of the efficiency gains from trade reform associated with a reallocation of resources to more productive uses range from 1-2 per cent of gross domestic product (GDP) per annum up to 10 per cent of GDP per annum if production is characterized by increasing returns to scale. Moreover, elimination of incentives to smuggle, lobby or evade tariffs (all termed “directly unproductive profit-seeking activities”) can add additional indirect benefits that have been estimated to be as high as 6 per cent of GDP in countries such as India and Turkey. See Thomas and others (1991).
- 3 The authors classified the developing economies into one of three sets: those that had always been open; those that had opened by 1994 after initial closure; and those that had been closed as of the end of 1994.
- 4 See a summary of alternative explanations in United Kingdom Department for International Development (DFID) (2004). While the view that there is persistent long-term decline has been subject to a heated debate, the recent literature has shown that there are recurrent adverse shocks that become permanent, giving rise to such long-term decline. See, for example, Ocampo and Parra (2003). UNCTAD (2003b) describes the situation in Africa where most commodity-dependent countries are located.
- 5 Price stabilization schemes on tin ended in 1985, on cocoa in 1988 and on coffee in 1989. Buffer stock activities of the International Sugar Agreement were suspended in 1985 and abandoned in 1992. The most durable and last surviving price stabilization scheme, the International Natural Rubber Agreement, collapsed in 1999 under the weight of the Asian financial crisis after Malaysia and Thailand, two of the world’s largest suppliers, had withdrawn from the Agreement.
- 6 United Nations Conference on Trade and Development (1992), pp. 267-268, contains an account of the shortcomings of the IMF Compensatory Financing Facility and the STABEX facilities. On the CFF, see also chap. VI.
- 7 A considerable literature has been devoted to explaining the investment properties of commodity-linked derivatives. For example, Gorton and Rouwenhorst (2005, p. 28) found that commodity futures were an “attractive asset class to diversify traditional portfolios of stocks and bonds”.
- 8 See United Nations Conference on Trade and Development (1998). One of the most comprehensive and successful risk management schemes is Mexico’s Agricultural Products Options Programme established by the Support Services for Agricultural Marketing Agency (ASERCA) in 1994. The programme successfully uses futures and options contracts on the Chicago, Kansas City and New York Boards of Trade and the Chicago Mercantile Exchange to guarantee price floors for cotton, corn, wheat, sorghum, soybeans and other agricultural commodities; see International Task Force (ITF) (1999), pp. 46-48; and <http://www.infoaserca.gob.mx/coberturas/sublistacoberturas.html>.
- 9 It may be interesting to note that in the agreement establishing the African Economic Community (the predecessor of the African Union), such a regional exchange is mentioned as one of the key “instruments of integration” for Africa. See chap. VIII, article 46 (1) (d), of the Treaty establishing the African Economic Community (AEC) (Abuja Treaty), which was signed by the African Heads of State and Government of member States of the Organization of African Union at Abuja, Nigeria, on 3 June 1991. The text of the Treaty is contained in the annex to document A/46/651 of 15 November 1991 and is also available from the African Union website at: http://www.au2002.gov.za/docs/key_oau/aectreat1.htm (accessed 10 June 2005).
- 10 International Task Force (ITF) (1999). It should be noted, however, that UNCTAD had started receiving donor support for training activities in this area 10 years earlier, in 1989, and that the World Bank had a series of country projects in risk management in the first half of the 1990s.
- 11 The 1999 recommendations of the Task Force contained much more comprehensive operational and institutional details pertaining to the functions of an intermediary institution that would assist developing countries in managing their price risks. See International Task Force (ITF) (1999) for a detailed account of the 1999 proposals.
- 12 Descriptions of results of the pilot projects can be found in several documents and annual reports of the International Task Force at the World Bank’s Commodity Risk Management Group website, <http://www.itf-commrisk.org> (accessed 10 June 2005).

- 13 The IMF Revised Code of Good Practices on Fiscal Transparency is available from <http://www.imf.org/external/np/fad/trans/code.htm> (accessed 10 June 2005).
- 14 The Statement of Principles and Agreed Actions of the Extractive Industries Transparency Initiative (EITI) can be found at <http://www2.dfid.gov.uk/pubs/files/eitidraftreportstatement.pdf> (accessed 10 June 2005) and the EITI official website at www.eitransparency.org (accessed 10 June 2005).
- 15 The 2003 Almaty Programme of Action: Addressing the Special Needs of Landlocked Developing Countries within a New Global Framework for Transit Transport Cooperation for Landlocked and Transit Developing Countries (United Nations, 2003), which covers the core areas necessary for the progressive integration of landlocked developing countries into the international trading system through the establishment of efficient transit transport systems, constitutes one attempt to overcome the inherent problems of landlocked developing countries.
- 16 For a more detailed exposition of the history and problems of small island developing States, see UNCTAD (2004a).
- 17 Cluster analysis, a statistical method, was used by Liou and Ding (2002) to subgroup small States based on their socio-economic characteristics. One such characteristic, or factor, is the degree of export diversification. The designation "export-diversified" reflects a situation of having "moderately diversified commodity exports" (*ibid.*, p. 1295).
- 18 The full text of the Agreement is available from http://www.wto.org/english/docs_e/legal_e/26-gats.pdf (accessed 9 June 2005).
- 19 In the model of Anderson and others (2001), developed countries' welfare is increased by \$110 billion owing to their own liberalization in agriculture, while the World Bank (2002a) put that estimate at about \$73 billion. Most of these gains will go to consumers who have access to cheaper products. Producers would lose unless lower domestic protection was replaced by some other type of income support. In any case, as mentioned in note 20 below, domestic support in OECD countries is expected to decline owing to fiscal considerations.
- 20 Budgetary constraints in developed economies will build up pressures for lower support for agriculture in these countries—despite resistance from farmers—and developing countries need to prepare themselves for these changes. In the case of EU, for instance, the recent enlargement contributed to the revision of the Common Agricultural Policy. Similarly, in its budget proposal for fiscal 2006, the United States Government lowered the support that is to be extended to farmers.
- 21 The General Agreement on Trade in Services recognizes four modes of supply: cross border supply (Mode 1), consumption abroad (Mode 2), commercial presence (Mode 3) and temporary movement of natural persons (Mode 4).
- 22 The full text of the Agreement is available from http://www.wto.org/english/docs_e/legal_e/14-ag.pdf (accessed 13 June 2005).
- 23 Measures that are considered to distort production and trade (with some exceptions) belong to the amber box. These include support price measures and subsidies directly linked to production quantities. Amber box support is currently subject to certain limits. Support measures that require some kind of reduction of production (acreage, number of animals, etc.) fall into the blue box. There are currently no established limits to blue box subsidies. The green box support consists of no trade distorting measures or at least minimally trade distorting measures, often not targeted at a particular product and not linked to price support or production. These subsidies do not face any limit either.
- 24 Benin, Burkina Faso, Chad and Mali had called for a speedy elimination of cotton subsidies as well as compensation to cover for economic losses caused by these subsidies.
- 25 The full text of the Agreement is available from http://www.wto.org/english/docs_e/legal_e/27-trips.pdf (accessed 13 June 2005).
- 26 A group of developing countries is proposing changes to the mandate and functioning of the World Intellectual Property Organization (WIPO) in order to incorporate a development dimension in the activities of the Organization. See proposal by Argentina and Brazil for the establishment of a development agenda for WIPO: document prepared by the WIPO secretariat (WO/GA/31/12, 24 September 2004). Another 12 developing countries co-sponsored the proposal. WIPO was to organize a series of meeting on intellectual property and development to consider this proposal and additional ones submitted by other members.
- 27 United Nations, Treaty Series, vol. 1760, No. 30619.

- 28** Following the World Trade Organization convention, the term “regional trade agreement” will be taken as synonymous with “preferential trade agreement”. It includes reciprocal free trade or customs areas, as well as bilateral and multicountry agreements. These are all to be distinguished, however, from non-reciprocal voluntary arrangements, such as the Generalized System of Preferences.
- 29** These are spelled out in three sets of rules: first, paras. 4-10 of article XXIV of GATT, which provide for the formation and operation of customs unions and free trade areas covering trade in goods; second, the so-called Enabling Clause (decision of 28 November 1979 on differential and more favourable treatment, reciprocity and fuller participation of developing countries), which deals with preferential trade arrangements in trade in goods between developing-country members; and third, article V of the General Agreement on Trade in Services, which governs preferential arrangements in the area of trade in services, for both developed and developing countries.
- 30** Trade-creation involves substituting for domestic production imports from a lower-cost and more efficient producer and is therefore welfare-enhancing. Trade diversion, meanwhile, suggests that imports from a lower-cost supplier from outside the arrangement are replaced by imports from a higher-cost supplier from within, and is welfare-reducing.
- 31** American Samoa, Bermuda, Channel Islands, Guam, Isle of Man, Monaco, Mongolia, Northern Mariana Islands, Palau, Puerto Rico, Timor-Leste and the Virgin Islands.
- 32** Australia, Brunei Darussalam, Canada, Chile, China, Hong Kong Special Administrative Region of China, Indonesia, Japan, the Republic of Korea, Malaysia, Mexico, New Zealand, Papua New Guinea, Peru, the Philippines, the Russian Federation, Singapore, Taiwan Province of China, Thailand, the United States and Viet Nam.
- 33** Bangladesh, India, the Lao People’s Democratic Republic, the Philippines, the Republic of Korea, Sri Lanka and Thailand.
- 34** Brunei Darussalam, China, Hong Kong Special Administrative Region of China, Indonesia, Japan, the Republic of Korea, Malaysia, the Philippines, Singapore, Taiwan Province of China and Thailand.
- 35** Bolivia, Colombia, Ecuador, Peru and Venezuela (Bolivarian Republic of).
- 36** Antigua and Barbuda, the Bahamas (member of the Caribbean Community but not of the Common Market), Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, Montserrat, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Suriname and Trinidad and Tobago.
- 37** Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Mexico, Paraguay, Peru, Uruguay and Venezuela (Bolivarian Republic of).
- 38** Benin, Burkina Faso, Cape Verde, Côte d’Ivoire, the Gambia, Ghana, Guinea, Guinea-Bissau, Liberia, Mali, Mauritania, the Niger, Nigeria, Senegal, Sierra Leone and Togo.
- 39** Egypt, Iraq, Jordan, the Libyan Arab Jamahiriya, Mauritania, the Syrian Arab Republic and Yemen.
- 40** Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua.
- 41** Angola, Burundi, the Comoros, the Congo, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Madagascar, Malawi, Mauritius, Namibia, Rwanda, Seychelles, the Sudan, Swaziland, Uganda, the United Republic of Tanzania, Zambia and Zimbabwe.
- 42** Cameroon, the Central African Republic, Chad, the Congo, Equatorial Guinea and Gabon.
- 43** For more on these assessment methods, see World Bank (2004).
- 44** “Degrees of integration” in that investigation followed the conventional definitions of “preferential tariff agreement”, “free trade area”, “customs union”, “common market” and “monetary union”, with the level of integration increasing with each type (see Ghosh and Yamarik, 2004, p. 3).