

Making Trade work for Development: Time for a Geneva Consensus

By Pascal Lamy (2006)

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I am very honoured to be invited to deliver the Emile Noel lecture today. No surprise, you're thinking, they all start by saying they are very honoured! But I have a very special reason to be honoured, or more precisely, to honour Emile Noël. I worked with him for more than 2 years. I liked him. I admired him and I am sure his family will be happy to know that we have remembered him together today.

With the inspiration from the exceptional man who was Emile Noël, I will not jump into details of the WTO negotiation — we will discuss this during our debate afterwards if you wish. **But I will try to address the question that is the basis of the present multilateral negotiation: how to make trade work better for development.** To this end I will develop **three points:**

- First, that **trade is beneficial to individuals' welfare but it is never sufficient:** other domestic policies are needed to ensure the effectiveness of market opening.
- Second, that the challenges of **market opening and globalization for developing countries** are so important that they call for international action.
- And, finally, I will discuss the **role of the WTO** in that regard.

Trade is beneficial and needed but not sufficient to ensure individuals' welfare

Trade has played an increasing role in the world economy over past decades as illustrated by the fact that the growth of real trade exceeded that of world output. The ratio of world exports of goods and services to GDP rose from 13.5% in 1970 to 32% in 2005 and all major geographic regions recorded an excess of trade over output growth.

Trade expands because individuals and companies around the globe increasingly resort to importing and exporting goods and services, presumably because they find it advantageous. Adam Smith made reference to the propensity in human nature to “truck, barter, and exchange one thing for another” that would lead to a division of labour advantageous to everyone involved. Indeed, by reshuffling resources in accordance with the principles of comparative advantage, they can be used more appropriately and effectively for production. The result is increased efficiency, reflected in lower prices of inputs and final goods. Besides, consumers and producers benefit from a larger product and quality choice. For all these reasons, market opening boosts national incomes and possibly economic growth.

Two developing countries with very large populations, India and China, have in recent years experienced impressive growth rates. In the same period both countries pursued policies that allowed their economies to become increasingly integrated in the global economy. China, in particular, acceded to the WTO in 2001, since when its GDP has nearly doubled. Such examples may explain why some have praised globalization as the “most powerful — and life-enhancing — force on earth.”

Such praise could give rise to the impression that the WTO is in the business of creating “magic potions” that, if taken, automatically stimulate growth and create jobs around the globe. But over fifty years of multilateral trade negotiations have taught us that our potions are not magic and have a number of flaws similar to those of ordinary medicine on offer in pharmacies:

First, the mix of potions matters, and mixes that have magic effects for some patients may have far more limited benefits for others. Along the same line, a given mix of trade policy rules is more beneficial to some countries than to others.

Second, medicines in pharmacies are of no use if they do not find their way to the patients, and market access commitments are of not much use if Members face capacity constraints that impede them from making commitments work to their own benefit.

Third, trade reforms like medicines have undesired side effects and neither are of much use if the negative side effects come close to wiping out the positive effects of the remedy.

The impression has also arisen that in the case of the multilateral trading system, all three flaws have tended to work to the disadvantage of a certain part of the WTO Membership, that comprising the developing countries. This bias will in the long run not be sustainable and it is therefore necessary to correct it if we want the multilateral trading system to thrive.

Economists have always known that the benefits of trade are not distributed evenly across nations nor within nations. History teaches us that trade reform meets social resistance if the distribution of gains from trade is too uneven. It is therefore important for policy makers to ensure that the benefits of trade expansion are spread widely enough to avoid social resistance leading to a backlash against trade liberalization. As the Director-General of the World Trade Organization, I can only encourage insistence and creativity in the search for answers to this challenge, and I do so by reminding policy makers of the important economic gains society as a whole can expect from further integration.

The challenge of market opening and globalisation for developing countries call for enhanced international action

For the WTO, this challenge comes down to guaranteeing that trade negotiation outcomes are balanced, that Members have the capacity to transform market access commitments into trade expansion and that Members can deal with the negative side effects of trade reform.

With respect to the first point, a number of the substantive rules of the WTO do perpetuate some bias against developing countries and some observers have argued that this bias is significant. To understand why, it is instructive to look at the evolution of market access in two sectors in which developing countries are commonly expected to have a comparative advantage: textiles and agricultural products. With respect to textiles, the outcome of the Uruguay Round allowed for another 10 years of textiles quotas ending in 2004, notwithstanding the GATT/WTO general prohibitions on quantitative restrictions. A similar picture arises when looking at the rules for subsidies in agriculture which, contrary to the general rules on subsidies, allow for various forms of farm support. Both exceptions tend to benefit producers in rich countries to the detriment of those in developing countries.

Existing trade rules also give the impression of bias when they are analysed from a more dynamic point of view. Along the development path, countries typically diversify and move from the production and export of raw material into those of processed and final goods. Existing tariff structures of developed countries render this process difficult, as tariff levels are lower for raw materials than for processed or final goods. Indeed, significant levels of tariff escalation can be observed in the textile and clothing sector and for leather and leather products. The same is true for agricultural products like cocoa, coffee, cotton or soybeans. For instance, in the United States, bound tariffs on raw materials for leather and leather products are zero, but tariffs amount to over ten per cent for finished products in the same sector. In the European Union, bound tariffs for textiles and clothing are below three per cent for raw materials but close to ten per cent for finished goods. Similar tariff patterns can be observed in other industrialized countries.

In sum, while the political decolonization took place more than 50 years ago, we have not yet completed the economic decolonization. It is therefore one of the purposes of the current multilateral negotiations to continue the rebalancing of our rules in favour of developing countries.

Balanced market access commitments open the doors for growth-enhancing trade, but do not necessarily trigger more of it. The reduction of tariffs and other trade barriers lowers transaction costs and therefore makes trade more beneficial. But if other transaction costs are very high, trade may still not be sufficiently beneficial. Trade-related transaction costs refer to a myriad of components, including: communication costs with clients, domestic transport costs to bring goods from the production site to the border, time and money spent in ports on border procedures or to make products ready for shipment, international transport costs and inspection and certification costs. Many of these costs are higher, often significantly higher, in developing countries than in industrialized countries.

In certain African countries, it takes small-scale farmers four days to transport their produce by road over a distance of 300 kilometres. In Switzerland, it would take less than three hours to travel the same distance. In Denmark, an exporter needs 3 documents and two signatures to complete all shipping formalities. The entire process takes 5 days from start to finish. In contrast, in Burundi, it takes 11 documents, 17 visits to various offices, 29 signatures and 67 days on average for an exporter to have his goods moved from factory to ship. These time delays limit countries' export potential and also have a limiting impact on the ability of developing countries to diversify into time-sensitive products such as cut flowers where competitiveness is dependent on a country's ability to get the flowers from the farm to retailers in Europe, Japan or the United States, in three days.

It has been estimated that each day goods are delayed in transit reduces trade by at least 1 per cent. Reducing the number of days goods spend in customs clearance could therefore have hugely beneficial trade effects. The same is true for increases in port efficiency. It has, for instance, been estimated that if a country like Peru were to improve sea port efficiency to a level similar to that of Iceland or Australia, it would be able to increase trade by roughly 25 per cent.

But high transaction costs are not the only constraint developing countries face. Export growth implies that production is expanded in existing activities or that entrepreneurs venture into entirely new activities with export potential. In order for this to happen, entrepreneurs need to have adequate and credible information about policy changes, adequate information about possible export markets, and they need to be able to make the investments necessary to expand or start exports. Often these conditions are not satisfied in developing countries. In Tanzania, for instance, less than 10 per cent of the population have access to the formal banking sector. This certainly represents a formidable difficulty in mobilizing the entrepreneurial potential that may be available in the population.

The third flaw that often turns the magic potion of trade reform in developing countries into a very bitter one are adjustment costs. Indeed, adjustment problems linked to trade opening tend to be exacerbated and more serious in developing countries. This is so, because they often hit larger parts of the population and because of the weak capacity of those countries to handle the much needed accompanying policies to assist the victims of globalization.

In many small and developing economies, production and exports are highly concentrated in a few sectors. If only one of them is hit negatively by trade reform, the country as a whole may find it very hard to recover. In Rwanda, the Seychelles and Sudan, for instance, the countries' three main export products represent 75 per cent or more of their total manufacturing exports. In Botswana and Comoros, this share is as high as 90 per cent. If one of those sectors is negatively hit by a trade policy change at home or abroad, large parts of the population will be affected.

Developing countries are typically characterized by inadequate or even *absent social safety nets*. For the poor in such countries, losing their job as a result of trade reform can cause severe hardship. It is one thing to lose your job when you are entitled to unemployment benefits or to trade adjustment assistance, but it is quite another thing to become unemployed when this reduces your income to zero.

Where the supply response to market opening is low on the export side, where a lot of the benefits of trade are lost in transaction costs and the social consequences of shrinking import competing sectors are harsh, the overall gains from trade may be disappointing. In the by now infamous “cashew case”, economists have estimated that a significant share of the gains to cashew nut farmers in Mozambique from the liberalization of the cashew sector were offset by the costs of increased unemployment in the cashew nut-processing industry. In the end the net gain to farmers amounted to around \$5 per year for the average cashew nut-growing household. This is not much, even for a poor country like Mozambique.

In order to avoid further disappointments, the international system decided to step in so as to ensure that market opening translated into tangible benefits for individuals in developing countries. In the WTO’s most vulnerable Member countries — particularly the least-developed countries — adjustment costs, along with capacity constraints related to supply responses to globalization, cannot be left to be taken care of through the national budget or by the private sector alone. We therefore have to build an effective international response to complement these countries’ efforts in opening trade. Managing public support for trade expansion in these countries means assisting people to benefit directly from it — training officials, strengthening institutions and building infrastructure that will help businesses grow, jobs to be created, and allow these countries to expand and diversify their trade.

The WTO’s contribution to making trade work for development

But what is the role of the WTO in this? How can it make trade work for development?

A fundamental aspect of the current Round of trade negotiations is to correct the remaining imbalances in trade rules in favour of developing countries and to improve rules that will provide developing countries with authentic market opportunities. This is one of the reasons why we call this round the Development Round. The development dimension is not a stand-alone pillar or silo of the negotiations, but is an element of the negotiations that permeates all negotiating areas. I’ll give a few examples of the direct benefits now on the table to developing countries.

In the **important area of agriculture**, the agreement to eliminate all forms of export

subsidies by 2013, with a substantial part to be reduced by 2010, is in line with key demands of developing countries since the launch of the Round. The removal of this artificial form of competition will enhance the ability of developing and least-developed countries to compete in a fair and market-oriented agricultural trading system. In addition, developing countries will stand to gain from important cuts in domestic subsidies as we have already agreed that developed countries will undertake deeper cuts than developing countries.

Another important area where gains will accrue to developing countries and particularly to least-developed countries, is in cotton. We have already agreed to provide duty-free quota-free access for LDC cotton exports by 2008 and it has also been agreed that export subsidies affecting cotton will be eliminated by the end of 2006. In Hong Kong, we also agreed that at least 97% of the rich countries' LDCs' import tariff lines products would be duty-free and quota-free — that is without any trade restrictions, with the aim of reaching a full coverage. In my view this is quite an achievement. This will benefit exports from the 32 least-developed countries and is a positive step towards addressing a long-standing demand from the development community.

In July 2004 WTO Members formally agreed to launch negotiations on trade facilitation, with a view to expediting the movement, release and clearance of goods. The negotiations also aim to enhance technical assistance and capacity building in this area and to improve the cooperation between customs and other domestic authorities on trade facilitation and customs compliance issues. The negotiations on trade facilitation are a complement to broader trade liberalization and are considered central to the ability of developing countries to secure tangible gains from the Round. A successful conclusion of the trade facilitation negotiations will make a significant contribution towards lowering transaction costs in developing countries and, as a result, will enhance their overall level of competitiveness.

But, as we have seen, administrative hurdles at the border are not the only transaction costs that limit trade expansion or its benefits to developing countries. Nor are transaction costs the only problems these countries face. As mentioned before, other capacity constraints exist and adjustment costs are often too high. With these additional problems in mind, I advocated including the debate on Aid For Trade in the WTO agenda as well as substantially increasing the funding of Aid for Trade. This has an important political role to play to complement the trade negotiations, as additional development assistance can help these countries unlock their full trade and growth potential. Increasing Aid for Trade is not contingent on the Round, but its value and importance will be greatly increased if it is

implemented in conjunction with substantial new market access opportunities and new rules that will facilitate their trade.

There is no hidden agenda here. The WTO's role is strictly one of advocacy on this issue, neither managing nor disbursing aid beyond our traditional activities in trade-related technical assistance. We are therefore working closely with the main donors and the existing experts in the field. Pursuant to the mandate given to me in Hong Kong, I have been actively consulting with various partners, including the World Bank, IMF, UNDP, bilateral donors and regional development banks. The Aid for Trade Initiative certainly requires funding but, most importantly, in order for it to be successful, Aid for Trade has to be delivered effectively. By building on past experience and on the significant expertise within the WTO and its partners involved in Aid for Trade, I am confident that creative and efficient ways can be found to make aid work for trade and, ultimately, for development.

The WTO is not a development agency, but it is the place where those encountering difficulties linked to market opening in their country regularly come together and is therefore an ideal place to refine our understanding of how to disburse Aid for Trade. For the same reason, the WTO can play an important role in facilitating the networking with relevant international actors that is much needed for effective assistance policies. It offers a forum where these interconnections can be discussed and be subject to surveillance. But all this will only be useful if new rules and liberalization promises ensuing from the current round of negotiations reflect the interests of developing countries, thus giving justice to its name, the “Doha Development Round”. And if we achieve that, everybody, including industrialized countries, must stick to the promises they make.

It is clear that I see an important role for national governments and for international institutions, like the WTO, in guaranteeing the stability of the global economy in general and of the multilateral trading system in particular. I know that some believe that governments can only do harm. I dare to disagree — markets do a better job, the better the institutional environment in which they act. The hand that determines the quality of institutions tends not to be invisible but, instead, often belongs to a policy maker. Markets do a good job in creating wealth, but they do not care about the distribution of this wealth. I therefore strongly believe in the positive role of governments and I agree with others that we have passed the time of the Washington Consensus. It is time for a new consensus. Call it “Geneva consensus”, if you like. This will make trade work for development!