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Evolution of the international trading system and of international trade from a development perspective: Impact of the crisis

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Note by the UNCTAD secretariat

Executive summary

An economic and financial crisis of a scale and magnitude unprecedented in the post-war period has transformed the global economic landscape, disproportionately damaging developing countries. Global economic downturn and recession has undermined opportunities in many countries for jobs, growth, and economic and social well-being, seriously jeopardizing the achievement of the Millennium Development Goal (MDG) targets set for 2015. Countries now seek to make their economies and participation in international trade more resilient to external shocks by diversifying their economies and strengthening domestic demand, regulations and institutions, government's role as an enabling state and global cooperative actions. Balanced, more sustainable growth strategies making better use of national policy space, including through unorthodox approaches, can be an important recipe for recovery. The international trading system needs to be rethought to deliver greater inclusiveness and equity on trade and development challenges affecting the real economy and human needs.

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I. Introduction

1. The financial and economic crisis, which originated in developed countries, has affected all countries, with a severity that differs within and across countries. Developing countries have been particularly hard hit by declining commodity prices, exports, credit and trade finance, remittances, investments and capital outflows. The crisis emerges after two decades of globalization creating economic interdependence among nations. As barriers to flows of capital, goods and services have been dismantled, institutional and regulatory systems weakened and government's role reduced, countries have increasingly exposed their economies to free market forces. The current crisis – coming on the heels of a series of recent development crises affecting financial systems, food, energy, commodities, health and climate change – has lowered confidence in global governance and threatens to reverse progress made in the fulfilment of MDGs, with dire consequences for many developing countries and the poor. Despite emerging signs of recovery, it is unclear how long the crisis will endure and when the real economy, employment and trade will recover. The United Nations has a key role to play in catalyzing a prompt global recovery built on a coherent global response involving all countries and supporting development. UNCTAD can contribute to this process.

II. Economic trends

2. The global financial crisis emerged as the United States mortgage market collapsed in 2007 with associated losses widely transmitted, through mortgage-backed securities and derivatives, to financial institutions in developed countries. Failures and rescue attempts of major financial institutions in the United States and Europe led to a loss of confidence in markets and increased recognition that governments urgently need to improve their regulatory and institutional frameworks for financial services. Capital flew from higher risk assets and markets as market participants reduced their exposure to risk and deleveraged their portfolios, including cross-border positions in emerging markets. Many countries relying heavily on external finance suffered from capital outflows, sometimes requiring recapitalization through balance-of-payments support from the International Monetary Fund (IMF).

3. Global macroeconomic imbalances accumulating over years of strong consumer demand in developed countries running large current account deficits, financed mainly by surpluses in East Asian and oil exporting countries, played a significant role in precipitating the crisis. Coupled with extensive deregulation of financial markets and excess liquidity, these imbalances encouraged investors to engage in leveraged risk-taking in search of profits.

4. The real economy became affected as credit and liquidity dried up and global consumption, production and investment plummeted. The resulting trade slump was deep, sudden and synchronized across countries. The global gross domestic product (GDP) is projected to decline by 2.6 per cent in 2009 from positive growth of 2.1 per cent in 2008, heralding the first contraction of the global economy in over 60 years.[1]

5. Developing countries will see their GDP growth decline significantly from 5.4 per cent in 2008 to only 1.4 per cent in 2009. At the regional level, in 2009, Africa's GDP growth is projected to fall from 5.4 to 1.4 per cent, sub-Saharan Africa from 4.7 to -0.1 per

[1] United Nations (2009). *World Economic Situation and Prospects 2009.* (Update as of mid-2009.)

cent, Latin America and the Caribbean from 4.0 to -1.9 per cent, East and South Asia from 6.2 to 3.2 per cent, Western Asia from 4.5 to -0.7 per cent, and economies in transition from 5.3 to -5.1 per cent. Least developed countries (LDCs) could see their GDP fall from 6.1 to 2.7 per cent. Rapidly developing economies in Asia reliant on export-led growth have been impacted by falling exports. Impacts on larger Asian countries are less pronounced, owing partly to their diversified and large domestic markets, showing a measure of “de-coupling”. Commodity exporters, particularly LDCs, have been adversely impacted by declining demand and falling commodity prices. The latter have provided some relief from inflationary pressures for net food- and fuel-importing countries. Sub-Saharan Africa has been hard hit owing to reduced demand and commodity prices, and falling remittances, tourism revenues and foreign direct investment (FDI) inflows. Countries with transition economies have been affected by capital outflows and falling energy and mineral prices.

6. The International Labour Organization (ILO) projects global unemployment will rise from 5.9 per cent in 2008 to 6.5–7.4 per cent in 2009. The number of unemployed is expected to increase by up to 59 million, from 180 million to between 210–239 million,[2] with a 19–42 million increase in developing countries. There, job cutbacks have been greatest in export-oriented activities, particularly manufacturing, commodities, tourism and construction. The time lag between output reductions and labour market adjustments implies that the full social impact of the crisis remains to be felt and that job recovery will be slow.

7. The developmental impact of the crisis has been deep and comprehensive. Weak growth prospects are expected to reverse hard-won progress towards fulfilment of the MDGs and poverty reduction. Over 40 per cent of developing countries are estimated to be exposed to poverty effects and in 2009, 55 million more people will live below the poverty line than expected before the crisis. Deteriorating economic conditions will have broad repercussions for MDGs, with up to 400,000 more infant deaths per year; a major increase of people living with chronic hunger to 1 billion; reduced prospects to empower women; serious impacts on health and education; and increased financial constraints in building the infrastructure needed to meet environmental objectives.

8. Various national measures have been taken to restore confidence in financial markets and provide economic stimuli, including expansionary counter-cyclical fiscal and monetary policies. The estimated value of fiscal stimulus pledged amounted to $1.6 trillion: $1.3 trillion by developed countries and $360 billion by developing countries. Such market interventions marked a sharp contrast with less interventionist deflationary policies imposed by the international financial institutions’ (IFIs) lending conditions during financial crises affecting developing countries in the past. Developing countries tend to be disadvantaged in implementing counter-cyclical policies due to financial constraints and will require international assistance to avoid employment contractions and provide social safety nets. Investment in infrastructure and productive capacities will also require attention.

9. At the international level, the April 2009 Group of Twenty (G-20) Summit agreed on a series of measures to restore confidence to boost global demand, including increasing support to trade finance by $250 billion over two years, refraining from protectionism and supporting the conclusion of the Doha Round. The need remains for a more inclusive global response with the participation of all countries. The United Nations Conference on the World Financial and Economic Crisis and its Impact on Development of 24–26 June deliberated on various measures to address the current crisis and prevent similar future crises.

[2] ILO (2009). *Global Employment Trends*. May 2009 update.

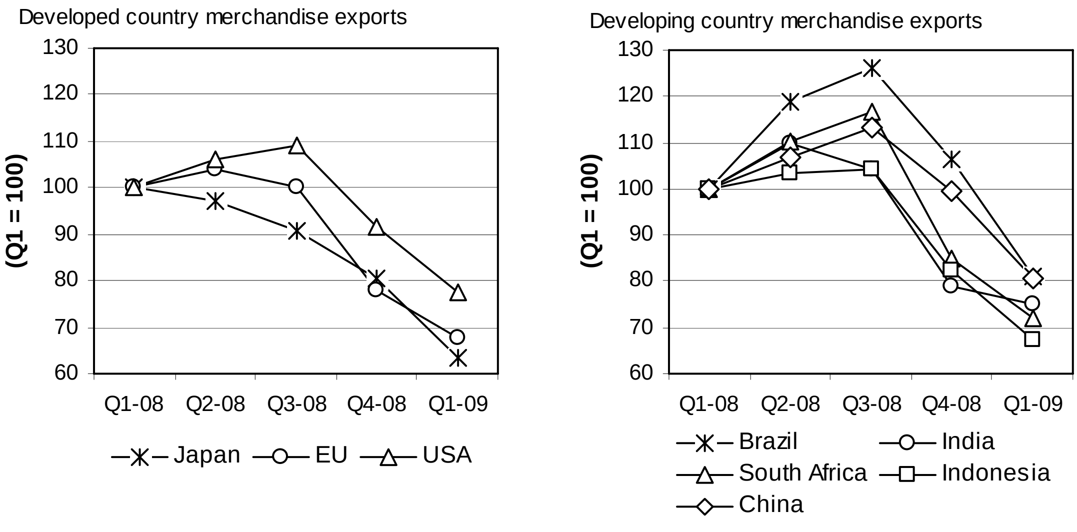
III. The effects of the crisis on international trade

10. For the year 2009, the IMF estimates goods and services exports will fall by 13.5 per cent for developed countries and 6.5 per cent for developing countries. At the regional level, with its trade projected to decline by 9.1 per cent, developing Asia will be most severely affected, followed by Latin America and the Caribbean (down 3.5 per cent) and Africa (down 2.2 per cent). UNCTAD estimates that world merchandise trade will fall by 6–8 per cent with developing country exports projected to decline by 7–9 per cent and LDCs' by 9–16 per cent.

A. Merchandise trade

11. With falling global import demand, merchandise exports witnessed a sharp drop since the fourth quarter of 2008 (figure 1). After falling by 17 per cent in the fourth quarter of 2008, developed country exports sank an additional 13 per cent in the first quarter of 2009, resulting in year-on-year declines of 36 per cent for Japan, 33 per cent for the European Union (EU) and 22 per cent for the United States. For selected developing countries, merchandise exports fell between 14 and 32 per cent in the fourth quarter of 2008 and further deteriorated during the first quarter of 2009 resulting in year-on-year declines of 32 per cent for Indonesia, 28 per cent for South Africa, 25 per cent for India and 19 per cent for the Brazil and China. Declining import demand in major developing countries, including a 30 per cent fall in China, demonstrated that growing South–South trade – representing 46 per cent of developing countries' merchandise exports – was affected by the crisis.

Figure 1
Merchandise export performance in 2008–2009



Source: Seasonally adjusted data from OECD Stat.

12. The magnitude and pervasiveness of the contraction of developing country merchandise exports and countries with transition economies became clear in 2009. For a representative sample of 39 countries, UNCTAD estimates indicate year-on-year merchandise exports fell by over 10 per cent in the fourth quarter of 2008 and by nearly 30 per cent in the first quarter of 2009.

13. Disaggregated import data in the United States, a market representing 21 per cent of developing country merchandise exports, reveals that the effect of the crisis initially fell intensely on developed countries and manufacturing exporters, becoming generalized and deeper in 2009 to affect virtually all products and regions. American imports from Africa declined by 53 per cent in the first quarter of 2009, largely due to a decline in fuel imports, while imports from Asia and Latin America decreased by 16 and 29 per cent respectively, and imports from LDCs, concentrated in fuel and miscellaneous manufactures, experienced a 28 per cent fall. The EU reduced its total merchandise imports from developing countries in early 2009.

14. Prominent in the initial phase of the crisis was a sharp drop in import demand for transport equipment, capital equipment and other durable manufactures as firms and households deferred purchases. American durable goods imports fell sharply in the fourth quarter of 2008, accounting for three fourths of the decrease in its merchandise imports. Fragmentation of production and global production chains contributed to a rapid contagion of export contraction across countries. A main mechanism behind global production chains is intra-firm trade, estimated to account for one third of world trade. As demand for final products drops, this shock is rapidly transmitted throughout a product's supply chain, reducing trade in product components in production and assembly worldwide.

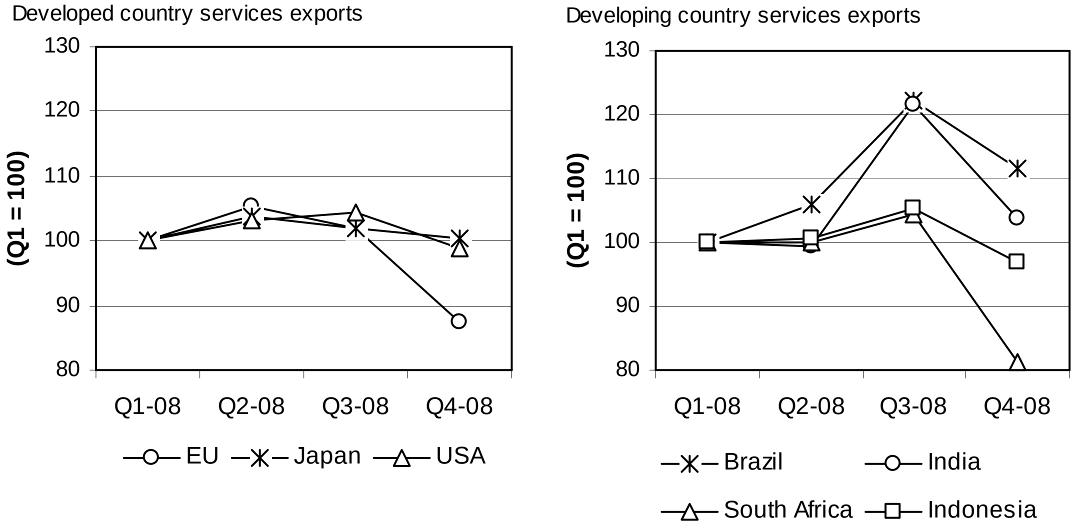
15. Shortages in trade finance – used to transact two thirds of developing countries' goods exports – have negatively affected trade. Credit has become scarcer as banks experience liquidity constraints and seek to limit risks due to commodity price volatility and client solvability. The limited availability and higher cost of trade finance continues to negatively impact developing country export prospects, particularly for small and medium-sized enterprises (SMEs) reliant on trade credit. A $100–$300 billion shortfall is expected in the $10 trillion trade finance market in 2009.

16. The sharp drop in value of developing country exports is attributable partly to falling commodity prices. The spectacular fall of commodity prices reversed an upward trend until mid-2008. By early 2009, commodity prices had fallen by over 36 per cent on average from their peak, with the sharpest decline recorded for crude petroleum (67 per cent), vegetable oilseeds and oils (62 per cent), minerals, ores and metals (52 per cent) and agricultural raw materials (16 per cent).

B. Trade in services

17. The crisis has affected the services sector with serious implications for countries dependent on services exports. Services import demand decelerated significantly in the fourth quarter of 2008 causing developed country services exports to drop 12 per cent (figure 2). The EU marked deepest decline (14 per cent) while export declines for Japan and the United States were less marked. For selected developing countries, services exports fell in the fourth quarter of 2008 between 8 and 22 per cent. The decline was particularly pronounced for South Africa (over 20 per cent), while declines for Brazil, India and Indonesia ranged between 9 and 15 per cent.

Figure 2
Services export performance in 2008



Source: Seasonally adjusted data from OECD Stat.

18. On aggregate, services exports contracted less severely than merchandise exports possibly because, unlike goods, services are not affected by inventory effect and reductions in services demand occur less abruptly since contracts end gradually. Certain services (energy, water, health, education, telecommunications and business and professional services) are regarded as necessities so declines in demand are expected to be limited. Demand has contracted for other more income-sensitive services including tourism and travel, financial services, construction, retail and services related to merchandise trade including transport. Some of these services account for sizeable share of developing country exports – travel and transport respectively account for 30 and 27 per cent of developing country services exports.

Box 1. Effects in selected services sectors

Financial services: United States imports declined by 13 per cent in the fourth quarter of 2008 and exports by 17 per cent. In Ireland, year-on-year exports were down by 50 per cent in the first quarter of 2009. Significant declines in exports in the fourth quarter of 2008 were reported in Argentina (34 per cent), Chile (31 per cent), the Republic of Korea (24 per cent) and South Africa (18 per cent).

Transport services: between mid-2008 and February 2009, container carrying capacity fell in Barbados (33 per cent), Chile (22 per cent), Angola (13 per cent), the United Republic of Tanzania (8 per cent), China (5 per cent) and India (2 per cent). In January 2009, port traffic decreased in Singapore by 19 per cent; Hong Kong, China (23 per cent); Long Beach, United States (14 per cent); and Le Havre, France (25 per cent). The Baltic Dry Index – a measure of the cost of shipping bulk cargo by sea – fell by 94 per cent between May and December 2008. By June 2009, the index recovered to only 63 per cent of its May 2008 high. The International Air Transport Association (IATA) indicates that air cargo traffic was down 20 per cent in December 2008 on a year-on-year basis, a trend confirmed for the first quarter of 2009; air freight volumes fell 20 per cent while passenger numbers decreased by 8 per cent.

Tourism: international tourist arrivals recorded a 1 per cent decline in the second half of 2008 and further declined by 8 per cent between January and February 2009. The marked slowdown in developed countries is spreading to developing countries. World tourism is projected to decline by up to 3 per cent and employment by 5 million jobs in 2009. Many LDCs and small and vulnerable economies (SVEs) are susceptible to falling tourist arrivals. In Antigua and Barbuda, first quarter 2009 tourism arrivals fell by 14 per cent, in Maldives by 11 per cent and in Seychelles by 14 per cent.

Construction: in the United States and the United Kingdom, new home construction starts fell respectively by 33 and 37 per cent in 2008. European construction output is expected to fall by 5 per cent in 2009, following a 3 per cent drop in 2008. The global construction market is projected to shrink to $5.6 trillion in 2009. Every region except Asia will see declines in construction spending. Gulf Cooperation Council (GCC) countries experienced a decline of 60 per cent in 2008 in the value of new construction contracts.

C. Impacts on FDI and remittances

19. Lower exports, capital outflows and higher loan premiums will exacerbate the already tight balance-of-payments positions of many developing countries. An overall financing gap of $350–$650 billion is estimated for developing countries in 2009. The situation will likely worsen with the expected decline of financial inflows through FDI, remittances and official aid. Preliminary UNCTAD estimates indicate that FDI inflows to developing countries are expected to fall in 2009 after having increased to $518 billion in 2008. The magnitude of the fall in 2009 is estimated to be $180 billion.

20. Negative effects of the crisis will be exacerbated for countries dependent on remittances as a source of foreign currency earnings. The World Bank estimates total remittance flows to developing countries in 2008 at $305 billion, only 7 per cent higher than in 2007, with a marked decline in growth from the double digit rate achieved in every other year since 2001. Remittances could fall by 10 per cent in 2009 to levels of $280–$290 billion.

Box 2. Remittances

Remittance flows are seen as relatively resilient to an economic downturn. The crisis could impact migrant movement and reduce remittance flows. With the crisis, many sectors (e.g. tourism in Ireland, financial services in the United Kingdom and construction in Spain and the United States) have shed jobs. With about 80 per cent of its remittances originating in advanced countries, sub-Saharan Africa would be vulnerable to an economic slowdown in those markets. The IMF finds that a 1 percentage point decline in host country growth leads to a 4 per cent decline in remittances. Due to their remittance dependence, sub-Saharan African countries remain vulnerable to remittance declines. Remittances account for over 20 per cent of GDP in Comoros and Lesotho, and over 5 per cent in ten other sub-Saharan African countries. Remittance inflows to Mexico from the United States decreased by 3.6 per cent in 2008 to $25 billion.

D. Implications for trade and development

21. Export sectors have played important role in the development process through productivity growth, income and employment creation and technology diffusion. The increasing contribution of exports to GDP in developing countries – from 26 per cent in 1990 to over 44 per cent in 2008 – reveals their economies' increased openness. Although in global economic upturns trade openness allows countries to secure gains from trade, in global economic downturns negative external shocks are readily transmitted to their economies. Falling global import demand has severely affected those countries most successful in export-led growth, calling for a reassessment of export-led growth strategy.

22. Unlike previous crises largely confined to particular countries/regions wherein countries recovered relying on external demand, global demand contraction in the current crisis has limited countries' ability to use trade to boost recovery. In the absence of improved global demand, domestic demand-creating and demand-driven strategies can complement outward-oriented strategies. Bolstering domestic demand, including by diversifying economic output and increasing private consumption, can help sustain national output and employment. Small developing countries would need special measures, including creating larger regional markets. In the long term, economies would need to adjust to slower growth and sustainable production and consumption.

23. It should be emphasized that global demand remains indispensable for sustaining growth. The challenge is to make developing countries' economies and participation in trade more resilient to external shocks. Improving productivity and competitiveness and diversifying trade and production bases into new dynamic products and services, by exploring new areas of comparative advantage and modern tradable activities, including through proactive industrial and other policy interventions, can generate greater retention of value added, forward and backward linkages, technology diffusion and capital formation.[3] While the Northern market remains important, export markets need to be diversified

[3] Dani Rodrik (2009). "Growth after the crisis". 12 May.

towards non-traditional and regional markets through a greater emphasis on regional and interregional South–South integration and cooperation.

24. Countries could place greater emphasis on the role of government as an “enabling state” in sustainable and inclusive development strategies aimed at improving regulation and incentives to encourage economic diversification. Stronger and more effective regulations, better market supervision, industry support mechanisms and social safety nets are important. Effective and adequately paced and sequenced macroeconomic and flanking policies, regulations and institutions, must be in place to benefit from trade liberalization.

IV. Evolution of the international trading system

A. Global governance reform and rethinking of the international trading system

25. The crisis has rendered coherent and effective global economic governance an urgent agenda for the international community. An open, equitable, rule-based, predictable and non-discriminatory multilateral trading system would provide a unique public good. However, concern emerged that the costs associated with liberalization and constraints (“lock-in”) over national policy space may increasingly be seen as outpacing the benefits of openness. Tensions have grown between trade and development policies, and uncoordinated trade, financial and monetary policies and systems are increasing countries’ vulnerability. Rectifying such a “development deficit” in the trading system and restoring beneficial policy coordination, coherence and solidarity is fundamental so that the benefits of liberalization are distributed in a balanced and equitable manner and that a sense of ownership and integration are shared by all.

26. The need to reconcile the tension between trade and development in a coherent framework has marked the history of the multilateral trading system. The WTO expanded its reach to “behind the border” measures – e.g. services, subsidies, trade-related investment measures (TRIMs) and trade-related aspects of intellectual property rights (TRIPS) – and enhanced its dispute settlement mechanism. The principle of “single undertaking” required all members to accept an entire package. This has significantly constrained developing countries’ policy autonomy and was not matched by an effective safety net and adjustment mechanism to support their development, financial and trade needs. Newly introduced special and differential treatment (SDT) provisions were largely best endeavour, relatively ineffective or artificially designed, as was the case with implementation time frames. Such a configuration of norms has resulted in observed imbalances in various substantive issues.

27. Meanwhile, flexibilities and legitimate policy space under the WTO have been bypassed by parallel processes. The WTO accession process, essential for the universality of the system, has led to commitments, including WTO-plus, in acceding countries that are not fully commensurate with their level of development. Conditionalities under the IFI-induced Structural Adjustment Programme have induced deep policy reform on a wide range of policies. Flourishing regional trade agreements (RTAs) have resulted in a deeper liberalization and upward harmonization of regulatory norms.

28. The Doha Round was expected to redress such imbalances and asymmetries by placing development at its heart and vigorously tackling agriculture and the core development agenda. The protracted negotiations have left such expectations largely unmet. The round appears to suffer from a lack of strong leadership and enabling structure and complex modalities not conducive to results. The overall balance has increasingly shifted away from a development agenda. Priority in the Doha road map needs to be restored to the

core development agenda, in particular strengthened and operational SDT and resolution of implementation issues and the built-in agenda of agriculture and services.

29. The participation of developing countries in the negotiations has increased significantly. They were successful in introducing the development agenda in the round. Concomitantly, diverse interests among developing countries became salient and some were successful in innovative agenda setting, such as duty-free quota-free (DFQF) market access for LDCs, special treatment of SVEs and recently acceded members and cotton. New approaches to SDT are being tested in substantive negotiations, including on trade facilitation, where it is proposed that substantive commitments be linked with implementation capacity. The diverse capacities, needs and interests of developing countries are addressed through de facto differentiation, departing from the traditional notion of SDT based on non-discrimination among developing countries.

30. The modus operandi of the multilateral trading system needs careful reassessment bearing in mind the imperatives of the MDGs**.** Stabilizing the system after negotiating rounds with sufficient time allocated for implementation, reviews and build-up of capacities, particularly in developing countries, could help avoid build-up of non-implementation risks and disputes that could affect its credibility. With regard to future negotiations, methods of managing a complex, broad-based agenda could be carefully examined. While a broader agenda under a single undertaking was expected to facilitate intersectoral trade-offs, it diverted attention from a core development agenda and was unmanageable. Such trade-offs did not materialize on issues of vital interest to countries, especially when they were not mature for harvesting. Recurrent setbacks have underscored the importance of getting substance right before moving to the final stage. A bold course correction may be needed to go beyond the logic of mercantilist self-interest towards collective interest, public goods and development, reflecting recognition of economies' interdependence. Redirecting the system from sanction-based to a more cooperative approach based on interdependence needs to be considered.

31. Defining the boundaries of the trading system is a salient systemic challenge. The series of recent development crises affecting food, energy, commodity prices, health and climate challenged the relevance and compatibility of the multilateral trading system in coping with such deep-rooted development challenges affecting basic human needs. Issues increasingly addressed in RTAs – investment, competition, labour and environment – might be proposed for introduction in the multilateral trading system. Their development implications warrant careful assessment as they could be far-reaching.

B. Regional trade agreements

32. RTAs have proliferated rapidly and now number over 220. While allowing for a faster, deeper and broader liberalization and regulatory reform, RTAs have altered incentives to negotiate multilaterally. Developing countries are actively engaged in South–South regional integration as they seek to use RTAs as an essential instrument of development. The rise of dynamic developing countries has created opportunities for South–South and South–South–North cooperation, as exemplified by the Chiang Mai Initiative and the Bank of the South in Latin America. South–South trade cooperation, including the Global System of Trade Preferences (GSTP), is instrumental for the diversification of economies.

33. North–South RTAs have grown as they transform unilateral preferences into reciprocal ones. A key concern has been designing reciprocal yet asymmetric and flexible market openings for developing countries.

Box 3. African, Caribbean and Pacific Group of States (ACP)–EU Economic Partnership Agreements (EPAs)

ACP–EU EPAs are a prominent example of North–South agreements involving low-income and vulnerable countries. CARIFORUM–EU EPA is the only concluded full EPA covering services, investment and intellectual property rights while negotiations continue for other regions. Some substantive issues stand out, including the definition of “substantially all the trade”, the most favoured nation (MFN) clause and the scope of the agreements. Making EPAs real instruments of sustainable development, poverty reduction and regional integration is the key challenge. Greater flexibilities are needed to ensure that all are better off at the end of the EPA process. Deeper cooperation matched with substantial funding remains key to their development dimension.

34. Development cooperation has been key to ensuring fairer distribution of benefits. Coordinating North–South RTAs with the ongoing subregional integration process to avoid a “chilling effect” on the latter became a prominent concern across regions. The crisis has highlighted that RTAs might have accentuated countries’ vulnerability by encouraging capital account liberalization, liberalization and deregulation in financial services. Multilateralism needs to be strengthened, including by ensuring coherence of RTAs with the multilateral trading system.

C. Protectionism and economic nationalism

35. With the crisis, signs of economic nationalism became widespread as pressure mounted to protect crisis-hit domestic industries. Various national crisis mitigation actions have had negative spillover effects on third countries that could change competition conditions and production location. Possible spirals of protectionism and retaliation could further contract trade, investment and finance flows. Domestic preference – “buy/lend/invest/hire local” conditions[4] – arose from governments’ desire to limit the leakage of stimulus measures to increased imports. Pressures for such preferences have been exacerbated because stimulus measures were not coordinated globally. Exceptional temporary measures should not become permanent. Some countries, mostly developing, have taken measures to facilitate trade.

36. While keeping markets open has been of primary importance, the rise of economic nationalism and protectionist sentiments has highlighted the limitation of the trading system to preempt such policies, as they were either not regulated by international trade rules or were regulated by rules that are ambiguous or whose effective application was difficult because many were taking similar actions such as subsidies. The adoption of a voluntary G-20 “standstill pact” was partly an attempt to fill such a gap. The protracted Doha Round has tested its ability to contribute to immediate crisis mitigation.

37. Governments’ support to banking and financial services has been a major part of the immediate crisis response to prevent systemic insolvency, implemented through purchase

[4] WT/TPR/OV/W/1, 20 April 2009.

of impaired assets, nationalization, promoting private takeovers, recapitalization and expanded government guarantees for banks' liabilities. Such measures are seen as generally covered by prudential carve-outs under the General Agreement on Trade in Services (GATS) Annex on Financial Services, which provides for "the protection of investors, depositors, policy holders …, or to ensure the integrity and stability of the financial system", subject to the condition that measures not conforming to the GATS "shall not be used as a means of avoiding … commitments or obligations under the Agreement". While no disciplines exist on subsidies in GATS, the manner in which subsidies are granted – i.e. whether access to subsidies could be limited to domestic, as against foreign-owned, financial services suppliers – is relevant to national treatment commitments under GATS. Lending by publicly supported banks at a preferential rate could constitute an indirect subsidy under the Subsidies and Countervailing Measures (SCM) Agreement if lending is made to industrial sectors.

38. The automotive industry was hard hit by the crisis. State aid to the industry included provision of credit, tax cuts and direct loans, including short-term loans to cover working capital. Reported conditions attached to the aid to maintain factories and employment at home were considered especially problematic. Under the SCM Agreement, state aid could give rise to actionable, if not prohibited, subsidies, if they cause "adverse effects" to the interests of other countries. Subsidies covering "operating losses" and "direct forgiveness of debt" may more likely be found actionable, judging from the now-expired related provisions of the SCM Agreement. The risk of insolvency crisis that could have caused acute social problems appears to give certain justifiable grounds for these measures.

Box 4. Buy American

Section 1605 of the United States stimulus bill, the American Recovery and Reinvestment Act of 2009, requires the use of American-made iron, steel, and manufactured goods in a project "for the construction, alteration, maintenance, or repair of a public building or public work". The Act provided that the provisions should "be applied in a manner consistent with the United States obligations under international agreements".

The act contains the Employ American Workers Act (EAWA) that limits the ability of companies that receive Troubled Assets Relief Programme to hire new H-1B workers. Normally businesses can employ for six years or more H-1B workers in various professional categories including engineers, computer programmers and accountants, free of the local labour market test, while limited to a national quota of 65,000 H-1B employees per year. The recipients of the funds are required to advertise positions before petitioning to employ H-1B workers and, inter alia, to show affirmative steps toward the recruitment of United States workers.

39. "Buy American" provisions in the United States stimulus bill raised concerns as they may involve discriminatory procurement practices**.** Government procurement was historically excluded from non-discrimination obligations, reflecting the fact that governments traditionally implement various "buy national" laws to promote local industries. The plurilateral WTO Agreement on Government Procurement (GPA) has

extended non-discrimination amongst its 13 parties but not to non-GPA parties. Government procurement has come to the forefront as a result of the crisis.

40. Concern over high unemployment has pressured governments to retain employment opportunities domestically. Such measures could adversely affect certain services activities, including outsourcing. For instance, fiscal incentives for companies not to outsource abroad have adversely affected IT-outsourcing services exports in developing countries. Labour mobility and migration has equally come under scrutiny as various services industries (tourism, financial or construction) have reduced jobs, particularly for foreign migrants and contractors. This may affect commitments on mode 4 under GATS.

41. The significance of increased border measures appears less pronounced. The relatively insignificant instances of tariff increases by developed countries points to the merit of the multilateral trading system as guarantor of open trade. Tariff increase was used by developing countries, including for balance-of-payments reasons, because their applied rates are lower than bound rates owing to unilateral liberalization, giving them a legitimate scope for tariff increase. Such flexibilities are considered important by developing countries in cushioning shocks particularly given that tariffs are often the only available instrument.

42. Increased recourse has been made to non-tariff measures, including standards, technical regulations and trade remedy measures. The number of new anti-dumping investigations increased during July–December 2008, with 120 new investigations conducted by 15 countries. Most frequently affected is China and the products targeted include base metals, chemicals, textiles and plastics. The number of new investigations further increased in the first quarter of 2009 by 19 per cent from a year earlier.

V. Developments in the Doha Round

43. A significant challenge of effectively managing the Doha Round in a global crisis confronts WTO members. Various estimates on the welfare effects of the round have used different assumptions and scenarios. The round's conclusion is reported to inject $150 billion as stimulus.[5] A global welfare gain of $100 billion from a "realistic" scenario is estimated using general equilibrium analysis.[6] Although such gains are small compared to global aggregate stimulus of $1.6 trillion, the round's conclusion could preempt the downside risk of potential welfare losses of $130–$350 billion that could arise from spiralling tariffs in all countries.[7] Benefits of the round will only accrue if the right macroeconomic and enabling conditions and flanking policies are in place.

44. The last major attempt to reenergize the round was an informal ministerial meeting held from 21–30 July 2008 to establish modalities for reduction commitments in agriculture and NAMA and advance services offers. The attempt failed on account of various issues including the Special Safeguard Mechanism (SSM). National developments had a bearing on the negotiations, including the expiration of the United States Trade Promotion Authority (TPA), national agricultural policies and proliferating RTAs. The revised draft modalities on agriculture and NAMA issued on 6 December largely incorporated progress since July 2008.

45. Prospects for completing the modalities in 2009 are uncertain. The changing economic context could further prolong the round as political capital is spent on the crisis. Possible target dates for conclusion are now proposed for end 2010. A key question remains

[5] DG-WTO (2009). Statement of the to the Trade Policy Review Body. 14 April.

[6] Kym Anderson et al. (2005). Market and welfare implications of Doha reform scenarios.

[7] IFPRI (2008). Potential cost of a failed Doha Round.

when conditions would become ripe for political engagement for a balanced and fair deal. This would require strong leadership by major countries. Recent changes in the leadership of some countries could lead to a redefinition of national trade policy agenda. The renewal of the United States TPA would facilitate credible engagement.

46. A possible two-track approach to the negotiations was recently suggested whereby modalities negotiations would continue in parallel with a scheduling exercise for "outcome testing" for greater clarity on the use of flexibilities. Many developing countries were wary of its possible adverse implication for the Doha mandate and multilateral modalities negotiations. Modalities negotiations could be conditioned upon a scheduling exercise to secure key market access interest. They have reached a high level of sophistication and complexity, making assessment of the overall value of the package difficult. Return to more facilitated and simple approaches in future rounds merits consideration.

47. The seventh WTO Ministerial Conference, to be held once every two years and overdue since 2007, is scheduled from 30 November–2 December 2009 in Geneva. It will take stock of implementation of WTO agreements and review issues facing the WTO under the current global economic environment.

48. The crisis has underscored the paramount importance of strengthening countries' resilience to exogenous shocks through proactive policies, targeted interventions and sound regulatory and institutional frameworks. Delivering on solid and meaningful development content, including through early harvest, would be key to maximizing the round's contribution to crisis mitigation. Specifically, development deliverables to be implemented on a fast track basis to help with the crisis could include:

(a) Improved market access in agriculture and industrial products of interest to developing countries;

(b) Accelerated implementation of DFQF market access for LDCs with simpler, more transparent rules of origin;

(c) Disciplining trade distortive non-tariff barriers;

(d) Accelerated elimination of export subsidies;

(e) Ambitious cut in cotton domestic support;

(f) Commercially meaningful market access in services modes 4 and 1, and implementation of LDC special modalities;

(g) Balanced disciplines on emergency safeguard measures (ESM) in services;

(h) Accelerated support to trade facilitation capacity-building;

(i) Scaled up and binding support through Aid for Trade.

A. Agriculture

49. While falling prices since mid-2008 have diminished commodity exporters' earnings by a simple price effect, the economic downturn has started to reduce import demand in volume terms too. Increased commodity price volatility and speculation has worsened economic prospects and access of the poor to food. Countries' capacity to absorb such shocks differs significantly and the potential contribution of agricultural policy reform through the round has concerned many. While the round could reduce distortion, liberalization could lead to greater vulnerability, particularly for net food-importing developing countries, which require specific support measures to encourage supply response.

50. The December 2008 draft modalities recorded progress since July 2008. On domestic support, the level of overall trade-distorting support (OTDS) cuts was determined, including a proposed 70 per cent reduction for the United States. The cut would set a new United States ceiling at $14.5 billion, compared to its actual spending level of $6.5 billion in 2007.

51. On market access, progress was recorded regarding tariff cuts of 70 per cent in the highest tariff band for developed countries, allowance of sensitive products for 4 per cent of tariff lines and a tariff ceiling at 100 per cent for all tariff lines except sensitive products. These parameters have largely determined the extent of market opening in developed countries. Developing countries are allowed to designate as special products up to 12 per cent of tariff lines to protect food and livelihood security. SVEs have the option of applying a tiered formula or an average reduction of 24 per cent.

Table 1
Agricultural tariff cuts

		With 4% sensitive products and 12% special products	
	Initial bound	**New bound**	**Average cut**
EU	21.6	11.4	54.0
Japan	31.3	17.1	54.0
United States	6.2	3.7	54.0
Brazil	35.4	23.2	36.0
China	15.7	12.9	14.4
India	113.1	74.8	36.0
Indonesia	47.1	31.7	36.0
South Africa	40.6	25.2	29.1
Jamaica	96.6	68.2 (73.3*)	31.6 (24*)
Kenya	100	70.2 (76.0*)	32.4 (24*)
Panama	27.7	21.6 (21.3*)	23.3 (24*)

Source: UNCTAD.

[a] Option of average cut of 24 per cent for SVEs.

52. The SSM remains outstanding. It is designed to allow developing countries to increase tariffs in response to an import surge or a price fall. Recent commodity price volatility has increased the SSM's significance. A key aspect has been how far developing countries can raise tariffs above the pre-Doha bound rates and under which conditions. The proponents are concerned that overly strict conditions would render the SSM difficult to use. Agricultural exporters consider that too lax a mechanism would foreclose their export opportunities, including South–South trade. The "price trigger" has received less attention although experience with the existing special safeguard suggests that the price trigger might be used more frequently.

53. The crisis and commodity price reversal have hit the cotton sector while persistently low cotton prices, partly caused by subsidies, have exacerbated income opportunities for cotton producers in Central and West Africa. The cotton price index has fallen by 40 per cent since its peak in 2008. World cotton trade is expected to shrink by 7 per cent in 2009 and the share of Cotton-4 countries decreased to 5.8 per cent in 2008–09 from their 10-year average of 8.3 per cent. Cotton-4 exports are forecasted to fall in volume terms too by 38 per cent in 2008–09. These combined effects could be particularly severe since cotton accounts for 30–60 per cent of exports and 6 per cent of GDP. Worldwide subsidies for cotton producers amounted to $4.5 billion and the removal of distortions could raise prices by 5–25 per cent. Cotton-4 seeks to ensure deeper and faster cuts of cotton support. In view of the crisis, cotton needs to be given fast track treatment.

54. Competing interests render the solution of preference erosion highly complex, exacerbated by a long-standing dispute on EU banana tariffs. Preference-dependent ACP and LDC countries have called for mitigating preference erosion through slower liberalization on selected products including sugar, beef, banana or tobacco. Agricultural exporters trading a few products under MFN conditions have argued for fuller liberalization of "tropical products". With 36 products falling in both categories, finding a compromise has been an issue.

B. NAMA

55. The crisis has severely hit manufactured products. With manufactures accounting for two thirds of developing country imports, and as developing countries seek to diversify their economy into higher value added activities, they are concerned that abrupt market opening could cause deindustrialization. The crisis has brought to the forefront the need for industrial policies. Translating the concept of "less than full reciprocity" into operational parameters has been central for many developing countries. Developed countries have sought to achieve "real market access" in dynamic developing country markets. Issues arose as developing countries would make higher average cuts in bound tariffs than developed countries, although they would maintain bound tariffs higher than developed countries, and applied rates are reduced less after the formula cut.

Table 2
NAMA tariff cuts

	Initial bound	**New bound**	**Average cuts**
		Coefficient 22	
Argentina	31.9	13.8	55.5
Brazil	30.8	13.5	54.5
China	9.1	6.5	25.4
India	38.6	15.0	58.6
South Africa	16.7	10.6	34.8
		Coefficient 8	
Canada	5.4	2.6	32.0
EU	4.0	2.2	27.4
Japan	2.9	1.3	16.6
United States	3.3	1.7	21.7

Source: UNCTAD. Flexibility is based on paragraph 7(b)(i).

56. The December 2008 draft modalities were the first to include specific parameters for the Swiss formula coefficients determining the depth of tariff cuts – coefficient 8 for developed, and 20, 22 or 25 for developing countries. For developing countries, the level of flexibilities allowing selected products to be excluded from formula application is dependent on the level of the coefficient, so that the lower the coefficient, the greater the flexibility. Concern over "real market access" and perceived uncertainty associated with the use of flexibilities has led to the introduction of an "anti-concentration" clause to prevent concentration of excluded tariff lines in a certain sector.

57. Sectoral initiatives have become a major bone of contention as developing countries were requested to participate in key sectorals, including chemicals, industrial machinery and electronics, while in Hong Kong (China) it was decided that their participation would be on a voluntary basis. An UNCTAD general equilibrium analysis shows that sectoral liberalization in the three sectors would cause Brazil, China and India welfare losses or lower welfare gains in output and employment.

58. Preference erosion in NAMA is significant in textile and clothing, fish, leather, electrical machinery and wood products. In one scenario, NAMA tariff cuts could reduce the value of preference for Bangladesh, Honduras and Mauritius by $335 million, $303 million and $82 million, respectively. As in agriculture, a longer liberalization time frame is suggested to mitigate preference erosion, while such an approach has concerned some LDCs not benefiting from preferential market access for their export products. The effects of preference erosion would be greater if the products are covered by sectorals that would eliminate preference margins. Rules of origin could be made more user-friendly to facilitate trade.

C. DFQF market access for LDCs

59. Achieving 97 per cent product coverage as early as possible by all developed countries and progressing towards 100 per cent coverage remain key issues in DFQF market access. Most developed countries have met this target and some developing countries (China and India) have taken significant steps in this direction. It is positive that the extension of WTO waivers for the United States preferential schemes, including AGOA, and South–South LDC preference, has been approved. On rules of origin, LDCs have called for harmonization of rules to make them simpler and more transparent. The ongoing reform of rules of origin in the EU is expected to address some LDC concerns. Easing their use remains key including by improving administrative aspects.

Box 5. DFQF market access in Quad

In 2007, DFQF tariff line coverage for LDCs was 99.0 per cent in Canada, 99.4 percent in the EU, 98.0 per cent in Japan and 84.1 per cent in the United States. The United States coverage is low because its Generalized System of Preference (GSP) excludes apparels, intensively exported by Asian LDCs. Consequently, Asian LDCs face high average tariffs in the American market – 10.4 per cent for Bangladesh and 12.5 per cent for Cambodia. When measured in import value terms, the coverage is 96.0 per cent in Canada, 99.0 per cent in the EU, 99.0 per cent in Japan and 71.8 per cent in the United States. The proportion of imports actually receiving DFQF treatment could be lower if preference utilization is taken into account. The utilization rate in the EU, for instance, is estimated at 70–80 per cent.

D. Services

60. The crisis poses major challenges to GATS negotiations, especially in key sectors such as financial services and other essential and infrastructural services. Deregulation and inadequate regulations in financial services, precipitated liberalization and capital account opening have exacerbated the effects of the crisis on developing countries. Developed and some developing countries have undertaken deeper commitments in financial services under the Understanding on Financial Services, including permitting financial service suppliers from other countries established in a country to offer any new financial service and a standstill provision proscribing new barriers for financial services covered under the understanding. The crisis has underscored the need for careful approach to liberalization as the sector is sensitive, affecting all segments of the economy. Given the continuing

weakness of developing countries' services sectors, there is a need for the extent of their commitments to be flexible according to the maturity of specific sectors' policy, regulatory and institutional frameworks. Phasing in commitments or a possibility to roll back commitments could facilitate developing country participation.

61. Services negotiations have been affected by the lack of progress in agriculture and NAMA and various attempts to modify the approach to negotiations as provided for in GATS and guidelines, e.g. benchmarking – committing "substantially current levels of market access and national treatment" and providing "new market access and national treatment, in areas where significant impediments exist". The Signaling Conference in July 2008 was an attempt to reenergize the request and offer process. Seventy-one initial and 31 revised offers have been submitted. Market access negotiations since Hong Kong (China) have been conducted in a plurilateral process where 21 requests have been made. The signals exchanged covered most major sectors and the four modes of supply. Developing countries were concerned over the lack of value added in areas of interest to them, particularly modes 4 and 1. Despite some improvements – including expanded EU mode 4 commitments on intra-corporate transferees and independent professionals – offers could be more commercially meaningful, consistent with development objectives of GATS Article IV.

62. The modalities on the special treatment of LDCs remain to be implemented, especially regarding the proposed mechanism for granting preferential access for LDCs, including through a waiver of MFN obligations.

63. Negotiations on domestic regulation aim to ensure that qualification requirements, technical standards and licensing requirements do not constitute unnecessary barriers to trade. A key objective is to strike a balance between the need for national regulatory autonomy including right to regulate, and disciplines to eliminate unjustifiable market access barriers, including for mode 4. Many consider the proposed "necessity test" to be a constraint on regulatory autonomy for pursuing public policy and development objectives. The proposed regulatory reform agenda for the financial sectors – which may lead to requirements to be applied to banks or credit rating agencies after these have already been licensed – highlights the importance of adequate regulatory space to effectively respond to evolving economic and social needs.

Box 6. The regulatory and institutional dimension of financial services[8]

The crisis exemplifies the importance of regulatory and institutional frameworks in infrastructure services, where the cost of regulatory failure is extremely high. The financial market boom preceding the crisis was not matched by parallel improvements in regulation and market oversight, leaving markets with insufficient controls on high risk financial products, risks and leverage of non-traditional financial institutions, capital adequacy regulation and incentive structures for compensation schemes. Governments and regulators and international regulatory systems and cooperative frameworks can help ensure sound regulatory and institutional frameworks to prevent future failures. Such frameworks need to be adapted to national economic and social specificities.

[8] Report of the Multi-year Expert Meeting on Services, Development and Trade: the Regulatory and Institutional Dimension on its first session (TD/B/C.I/MEM.3/3). Also see TD/B/C.I/MEM.3/2.

64. The crisis has re-emphasized the significance of GATS rules. Negotiations on ESM have evolved around proposals by eight South-East Asian countries. The proposals envisage that ESM would be applicable if domestic services suppliers incur serious injury or serious threat to the viability of domestic industry consequent to commitments. This would take the form of positive measures including grants or differential tax regimes with the possibility of suspending the commitments only as a last resort. On subsidies, GATS recognizes their role in relation to the development programmes of developing countries and takes into account their particular need for flexibility**.** Negotiations have centred around defining trade distortive and "non-actionable" subsidies, and a balance between developing countries' development objectives.

VI. Conclusion

65. International trade remains an engine of growth. The crisis has been transformational and challenged the development paradigm anchored on export-led growth strategy sustained by global macroeconomic imbalances leading to overproduction and consumption. This pattern is no longer sustainable. The task facing governments is to make their economies and trade more robust to shocks, by bolstering domestic demand and diversifying their economy into new products, services, and markets, including South–South trade. This could be underpinned by strengthened productive capacity and greater value added and retention and the facilitated movement of people and remittances, supported by proactive policies, financial sector reform, sound regulatory and institutional frameworks and substantial support for developing countries including through increased official development assistance. The global economic governance system needs to support such efforts through expanded policy space for developing countries. Coherence in trade, development, financial and monetary policies is essential. This would require an international trading system geared towards a more equitable and fairer trading system for the fulfilment of MDG8. Such a system could play a key role in bridging the credibility gap, assuring space for national policies, delivering fully the Doha Development Agenda and mobilizing trade finance and Aid for Trade.