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Evolution of the international trading system and of international trade from a development perspective: The impact of the crisis-mitigation measures and prospects for recovery

Note by the UNCTAD secretariat

Executive summary

The world economy is recovering from the global economic crisis, although on a fragile basis. Countries seek to accelerate growth along new paths to generate jobs, induce structural transformation and sustainable development, and make their economies more resilient to external shocks. International trade remains indispensable for growth, and the quality of integration matters more. Export-led and demand-led growth strategies need to be combined with deliberate policies for building competitive and diversified productive capabilities. The international trading system (ITS) – in a multi-polar environment with multilateral, regional, subregional and bilateral initiatives – needs to better support countries' efforts to tackle post-crisis recovery, growth and pressing development challenges by providing greater policy space and reflecting rapidly evolving economic realities. Greater inclusiveness, equity and fairness needs to be mainstreamed into the ITS for achieving the Millennium Development Goals (MDGs).

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Introduction

1. The current recovery remains fragile with persisting high levels of unemployment and rising national debt. Waning effects of public stimulus measures, fiscal consolidation and continued global imbalances compromise the recovery's sustainability. The recovery remains to be transformed into a "human recovery" wherein lost jobs and income opportunities are restored and social well-being improved. There is increasing poverty and inequality within and between countries. The crisis has long-lasting effects on the achievement of the MDGs by 2015. International cooperation has intensified in the United Nations, G-20 and other forums to address the crisis and support the recovery.

I. Recent trends and policy issues

A. The economic recovery

2. The global economy is recovering from the deep downturn. After contracting by 2.1 per cent in 2009, world gross domestic product (GDP) is projected to increase by 3.3 per cent in 2010 and by 3.3 per cent in 2011.[1] The return to growth is driven by developing countries (DCs), particularly emerging economies with strong demand (e.g. 9.5 per cent in China and 8.2 per cent in India, approaching or outpacing the pre-crisis levels), and resurgence of world trade. Their import demand is rising twice as fast as in developed countries. Commodities prices recovered from the lows registered in 2009. Expansionary counter-cyclical policies were important in fostering recovery. The pace of growth is increasingly dependent on private demand, private sector activities and structural factors. The public debt poses a major challenge, as manifested in the recent euro zone debt crisis.

3. The recovery has been uneven, with 6.2 per cent expected for DCs in 2010 and 2.3 per cent for developed countries. East Asia is leading the recovery, with the growth rate expected to climb from 7.1 per cent in 2009 to 8.7 per cent in 2010. Economic growth is less pronounced in other regions. It is projected to climb from 1.6 per cent in 2009 to 4.5 per cent in 2010 in sub-Saharan Africa (SSA), from -2.3 to 4.5 per cent in Latin America and the Caribbean, and from -5.3 to 4.1 per cent in transition economies in Europe and Central Asia. Least developed countries (LDCs), some middle-income countries, and smaller and more vulnerable economies also face slower growth.

4. Foreign direct investment (FDI) inflows to DCs remain weak.[2] These fell 40 per cent in 2009, to $358 billion from $598 billion in 2008. Significant growth to higher levels is not expected until the output and trade recovery gains further momentum.

5. Remittance flows to DCs are projected to increase by 6.2 per cent in 2010 and 7.1 per cent in 2011. Remittances to DCs reached $316 billion in 2009, down 6 per cent from $336 billion in 2008. In 2009, remittances to Europe and Central Asia, Latin America and the Caribbean and the Middle East and North Africa fell deeply, while flows to South Asia continued to grow, reflecting a varying degree of exposure to the job loss in host countries. Remittances remained resilient compared to aid and other private capital inflows, becoming an even more important source of external financing for development. For many LDCs and

[1] World Bank (2010). Global Economic Prospects.
[2] UNCTAD and the Organization for Economic Cooperation and Development (OECD) (2010). Third Report on G-20 Investment Measures, 14 June.

SSA countries, remittances form 10 to 20 per cent of their GDP. Strategies to maximize the remittances' contribution to development and productive capacities, including by strengthening the financial sector, is a key feature of growth strategies for DCs.

Box 1. Remittances, poverty and development

Recent UNCTAD research indicates that remittances significantly reduce poverty in recipient countries, especially where remittances constitute 5 per cent or more of GDP. For the given level of GDP, a 10 per cent average increase in remittances reduces the poverty headcount ratio by 3.1 per cent and poverty gap by 3-5 per cent. To enhance these gains, sustained policy intervention at each stage is important to induce productive use of remittances. Managing migration for poverty reduction requires strong cooperation at both the bilateral and multilateral levels. Effective partnerships are needed between sending, receiving and transit countries.

B. Recovery in international trade

6. After falling by an unprecedented 12.2 per cent in volume terms in 2009, world trade would expand by 9.5 per cent in 2010 with 7.5 per cent expansion expected from developed countries and 11 per cent by the rest of the world.[3] The pace of trade recovery is weak as the value of world trade in the first quarter of 2010 was 20 per cent lower than its pre-crisis level. The resurgence in world trade supported the economic recovery, particularly in economies relying on external demand for growth.

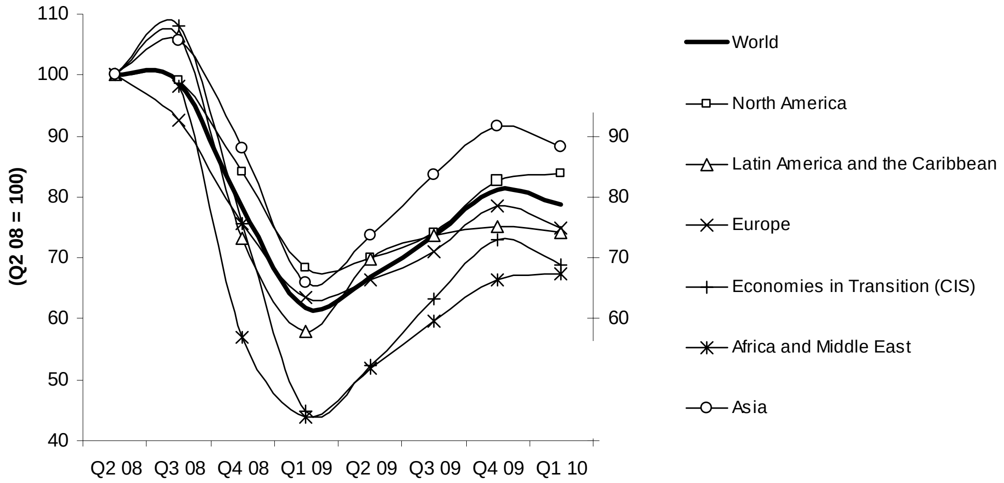
7. The contraction of world merchandise trade in 2008–2009 was sudden, deep, generalized and synchronous. The magnitude of trade contraction far exceeded that in output, and was the largest in the post-war period. The major explanatory factors include an abrupt and sharp demand reduction, particularly for “postponable” durable consumer and capital goods, the purchases of which often depends on finance and consumer credit. The effect was magnified and transmitted rapidly through global supply chains (GSC), radical price reversals of raw materials – such as fuels and metals – and food commodities, and shortages in trade financing.

8. Figure 1 shows that the fall and recovery of exports were synchronous across all regions. The pace of recovery is slower than the contraction with a slippage in export levels for all regions during the first quarter of 2010. This may be because trade recovery depended on temporary bounce-back effects such as public stimulus and inventory rebuilding with waning effects.

9. The recovery was most pronounced in Asia. The upturn of global demand, including dynamic growth in China, supported export growth. This corroborates the expected faster and broad-based recovery implied by integrated GSC production. For Africa and the Middle East, and transition economies, where oil and mineral exports were predominant, exports contracted severely with slower recovery due largely to commodity prices fluctuations. The trade impact of the crisis on LDCs was exacerbated by export concentration in commodities, and stronger competition in market of labour-intensive, low value added manufactures.

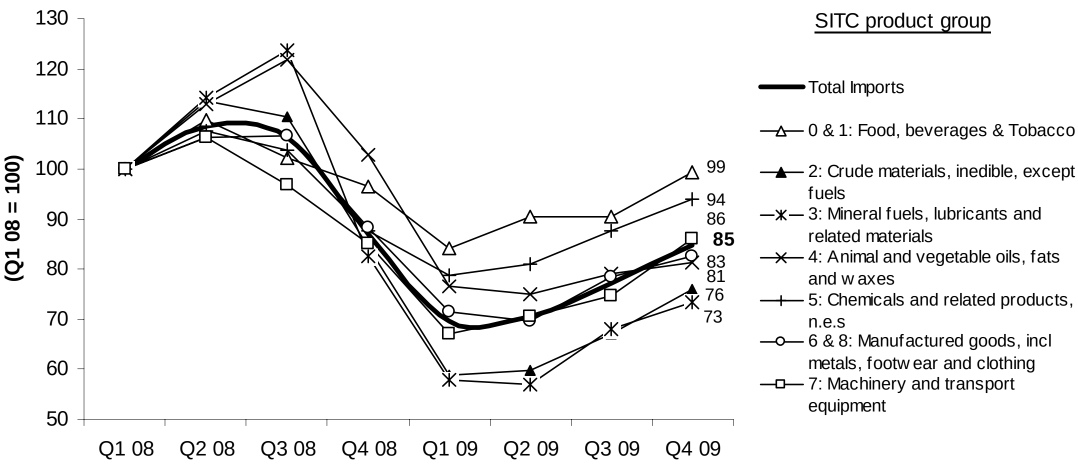
[3] World Trade Organization (WTO) estimates.

Figure 1
Evolution of merchandise exports by region 2008–2009.



Source: UNCTAD based on WTO Quarterly Trade Report, 2010.

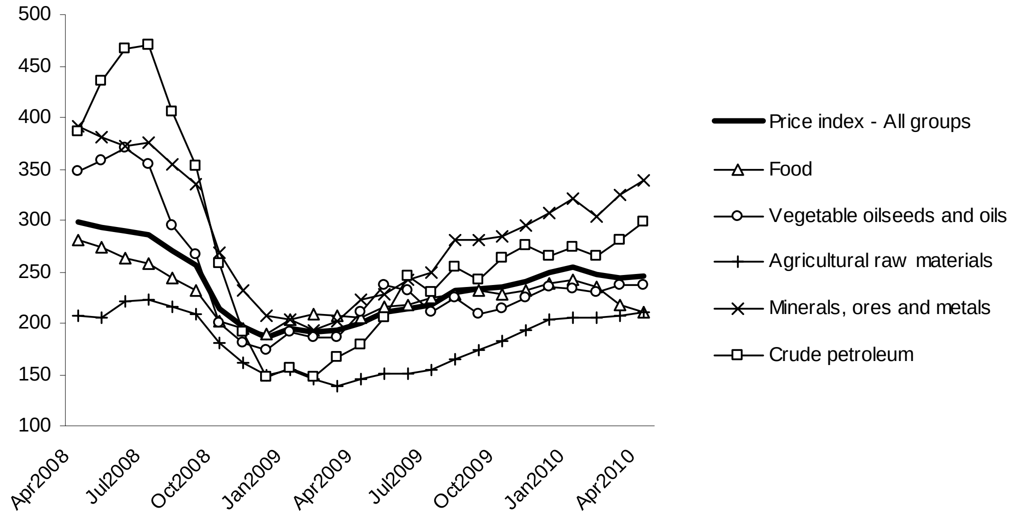
Figure 2
Indexed value of OECD country imports by SITC product group



Source: UNCTAD based on OECD Stat.

10. The cyclical downturn and upturn of merchandise trade occurred across all product groups. Figure 2 reveals that, apart from mineral fuels and crude materials, imports of machinery and transport equipment decreased most in the first quarter of 2009 and recovered steadily. The value of imports of crude materials and fuels experienced the deepest contraction and recovered the least.

Figure 3
UNCTAD commodities price indices



Source: UNCTAD Commodities Database.

11. The trade performance of DCs is closely associated with commodity price movements, which witnessed large volatility since 2008. The sharp decrease in the value of commodity exports owes much to a precipitous fall in commodities prices in the first quarter of 2009. Energy prices lost their value by two thirds, metals by 50 per cent, and agricultural commodities by 30 per cent (fig. 3). The lower commodities prices are responsible for below-average trade recovery of commodity-dependent regions, while they eased access to basic commodities by commodity-importing countries by lowering import bills. Bringing greater stability in commodities prices, including through revitalization of international commodity agreements and dealing with commodity price speculation, is important.

12. Integration into GSC enables countries to benefit from specialization but enhances vulnerability to external shocks. GSC intensified vertical specialization and increased trade, particularly in intermediate goods. By increasing cross-border trade at various production stages, the expansion of global value chains contributed to trade growing consistently faster than GDP, and to the resulting higher trade-to-GDP ratio. A decline of the demand for industrial goods equivalent to a -1 per cent demand shock in the United States is estimated to cause a reduction of exports from South America by 0.9 per cent or from China by 0.95 per cent, demonstrating the high degree of vertical integration of these economies.[4]

[4] Bems, Johnson and Yi (2009). "The collapse of global trade: Update on the role of vertical linkages."

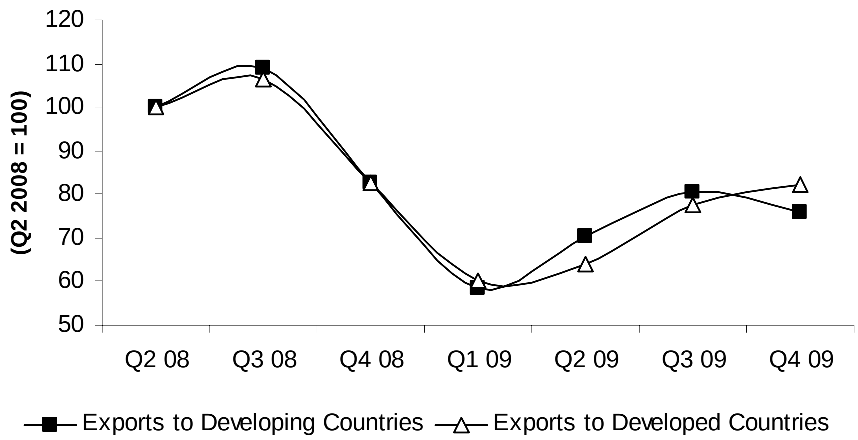
Table 1
Shares of intermediate and consumption goods exports in exporter's bilateral non-fuel merchandise exports (2008)

Importer	*EU*		*United States*		*Asia*	
Exporter	Intermediates	Consumption	Intermediates	Consumption	Intermediates	Consumption
EU	47.9	25.4	47.0	22.0	49.6	12.4
United States	49.8	16.3	-	-	48.5	10.0
Asia	40.0	26.9	34.1	29.7	57.2	15.3

Source: UNCTAD based on United Nations Comtrade.

13. Trade in intermediate goods is a proxy of trade conducted in the GSC. UNCTAD estimates that the share of intermediate products in non-fuel merchandise trade was about 48 per cent in 2008. This is attributable largely to the integration of East and South-east Asia in GSC since 1990, where the total import share of intermediate goods exceeds 55 per cent. This is equally pronounced in intra-Asian trade where intermediate goods account for 57 per cent of regional total exports (table 1). The region's high import content, particularly China, implies that their higher growth contributes positively to growth in other countries. This provides an important lesson to elaborate strategies to strengthen participation in GSC, in diversified set of goods and services, including regional value chains to build resilience and benefit from trade.

Figure 4
Developing country merchandise exports



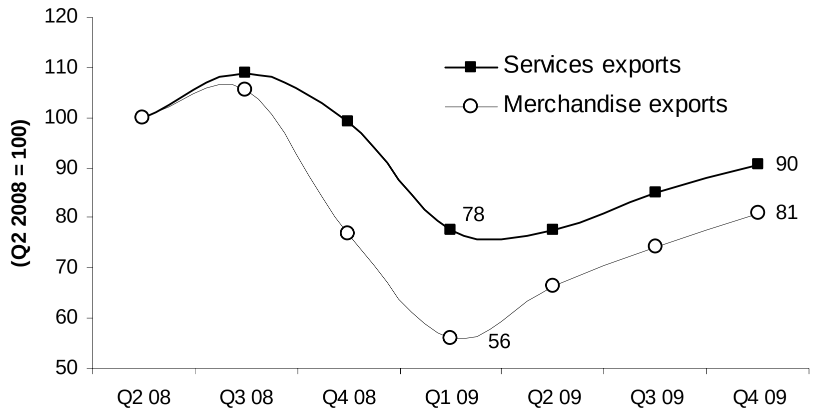
Source: UNCTAD based on IMF DOTS Database.

14. South–South trade is a major driver of increased participation of DCs in trade. It has grown faster than world total exports, accounting for about 50 per cent of DCs' total merchandise exports. The bulk of South–South trade – 63 per cent – is concentrated in Asia. There is potential to expand South–South trade. Figure 4 shows that both South–North and South-South exports experienced synchronous movement due, inter alia, to greater integration in GSC as a decrease in Northern import demand reduced import demand for intermediate goods from the South.

15. On the supply side, 10–15 per cent of the reduction in trade is attributable to the shortage in trade finance. While trade finance markets have improved since 2009, significant variation persists across countries and types of banks and firms as banks are more stringent in their assessment of counterparty risk. The difficulty in access to trade finance is most important for small countries, small counterparty banks and small and medium-sized enterprises (SMEs), particularly in Africa and LDCs, and in the financing of manufacturing imports and inputs.[5] An International Chamber of Commerce survey found that 40 per cent of respondent banks reported cuts in their trade credit lines in 2009.[6] Accessing trade financing remains a major issue for DCs in attaining sustained recovery.

16. The crisis affected the services trade differently from merchandise trade. Fluctuations in services exports exhibited less synchronicity across countries, experienced lower magnitudes of decline, and recovered more completely. The lower volatility of total services exports highlighted the relative "resilience" of services trade to the crisis.

Figure 5
Aggregate services and merchandise exports for a sample of 10 developing countries and transition economies

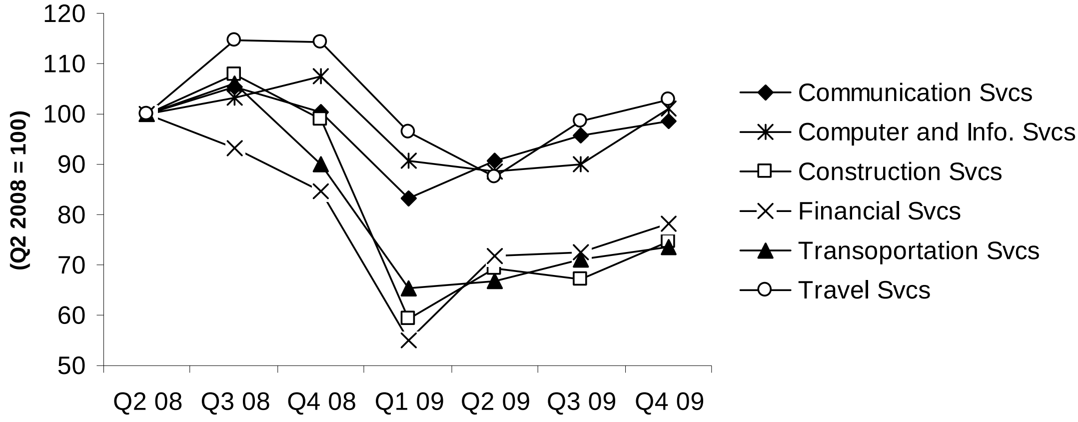


Source: UNCTAD based on IMF BOP Database.

17. There is greater inter-country variation in services exports fluctuation. Exports from the Russian Federation and Ukraine declined much more sharply than those from Brazil, Panama and South Africa. The degree to which exports recovered also varies; while exports of most countries had fully recovered to their pre-crisis levels by end 2009, exports of the Republic of Korea, the Russian Federation, Ukraine and the Bolivarian Republic of Venezuela only partially recovered.

5 WT/TPR/OV/W/3.
6 ICC (2010). *Global survey: Rethinking Trade Finance 2010.*

Figure 6
Aggregate services exports by services category for a sample of 10 developing countries and transition economies



Source: UNCTAD based on IMF BOP Database.

18. The intersectoral variation of services exports fluctuations is significant (fig. 6). The variation in communication, computer and information and travel services exports are relatively limited while the decline in construction, financial and transportation services exports is much deeper and recovered less. Since those sectors relatively strongly affected by the crisis represent sizable proportion of exports, their impact is important. Consistent with world trade, the Baltic Dry Index began a recovery in the second quarter of 2009 and stabilized to between 3,000 and 4,000 points, well below its record high of 2008. Transport represents 27 per cent of DCs' services exports. Sectoral variation is attributable to varying responsiveness of sectoral demand to income shocks. Given its relative resilience, and economic importance, the development of the services sector, particularly infrastructural services, is indispensable for realizing robust economies, higher economic growth and welfare improvement.

19. Services play an important facilitation role, as producer/intermediate services enhance productivity and competitiveness of an entire economy.[7] A large part of productivity growth in the United States since 1995 is attributed to growth in distribution and financial services. Technology advances in information and communications technology (ICT) and disintegration of production processes led to a rapid growth of intermediate/producer services. Trade in such services, including outsourcing and off-shoring, represents 73 per cent of OECD countries' total services trade. Intraregional trade is important owing to growing regional production networks. Emerging countries such as India are increasing their share in some intermediate services exports such as business services. Growth in India's services sector (9.3 per cent) owes to growth in domestic demand and exports, helping in withstanding the crisis. UNCTAD supports DCs to strengthen policy, regulatory and institutional dimensions of services and conducting national services policy reviews to foster competitive sectoral services capabilities.[8]

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[7] TD/B/C.I/8
[8] National services policy reviews of Uganda, the Kyrgyz Republic and Nepal. (UNCTAD/DITC/TNCD/2010/1-3).

II. Post-crisis challenges and opportunities

A. MDGs challenges

20. Falling growth and trade levels, and weaker provision of essential services, inhibited poverty reduction and progress towards the MDGs, including Goal 8. Fifty-three million more people will remain in extreme poverty by 2015 than otherwise would have had the crisis not occurred.[9] Strong and sustained recovery is fundamental to alleviating poverty. Hunger has been exacerbated, with a billion hungry people. Redirecting resources to agriculture , prioritizing food security and livelihood for vulnerable farmers and enhancing access to essential services in national and international economic policy making, including the Doha Round of trade negotiations, is imperative. Full implementation of the $20 billion G-8 pledge for agricultural development is urgent.

B. Persistent unemployment

21. The unemployment rate has been exceptionally high in this crisis and would persist in the recovery phase. The International Labour Organization (ILO) estimates the global unemployment rate for 2009 climbed to 6.6 per cent, or 212 million. In 2008–2009, the largest jumps in unemployment rates occurred in developed countries, with an increase of 2.3 percentage points. Due to excess capacity created by the crisis and uncertainty over the sustainability of recovery, firms will delay recruiting new workers until growth in their output rises substantially. Unemployment in 2010 is projected to decline marginally, towards 6.5 per cent.

22. The deep reduction in exports had disproportionate effects on sectors and countries most exposed to international trade - manufacturing sector (e.g., iron, steel, automotive) - with redundancy affecting particularly low-skilled labour, including women and youth. Such employment effects affected the entire economy as exporters reduced their demand for supplies and other expenditure. This reduced income in the exporting sectors is estimated to have been responsible for half of the employment effects triggered by the trade shocks. Labour adjustment occurred through layoffs, lowered wages and informalization of workers. Concern exists that improved productivity during the recovery could result in higher unemployment as companies re-organize their production to save costs. This underlines the need for policy responses to reflect trade-employment linkages.

[9] IMF/World Bank (2010). The MDGs after the Crisis.

Box 2. Trade, productivity and employment

Trade policy has an impact on the productivity of companies. The recent developments in trade theory onfirm-level heterogeneity within an industry[10] holds that the average productivity of a country increases after trade liberalization due to a selection process, i.e. by facilitating the growth of highly productive enterprises rather than by increasing the productivity of these enterprises. The impact on the labour market is less clear. Increasing productivity could mean increased competitiveness on world markets but could mean less demand for the factor labour. Owing to the United States–Canada free trade agreement (FTA) – productivity in both countries rose by 15 per cent, while employment decreased by 12 per cent.[11] The impact on employment depends on the complementarity and learning spillover from foreign goods. Adjustment costs after liberalization – temporarily higher unemployment – and rising inequality due to higher demand for skilled labour need to be addressed. Globally, trade has likely contributed to a lower income share of workers vis-à-vis capital owners due to increased mobility of production and increasing competition. Further research and an integrated trade, FDI, industrial, employment and social policies are needed.

C. Rebalancing and exit strategy

23. The euro zone crisis accentuated the urgency for fiscal consolidation, which could slow growth. In developed countries, average debt is expected to reach 110 per cent of GDP by 2015. While countries still facing weak domestic demand continue to apply fiscal stimulus in 2010, some are engaged in exit strategies towards fiscal consolidation. The sustainability of recovery hinges on, inter alia, global macroeconomic rebalancing while the net effect of rebalancing could be deflationary. The reduced United States private consumption (16 per cent of world output) is unlikely to be fully offset by an increase in Chinese consumption, and other surplus countries and those with increasing per capita income would need to increase consumption. Structural macroeconomic adjustments are urgently needed in countries running imbalances. For example, orderly exchange rate adjustment plays a key role. The valuation of currencies, especially the Chinese yuan renminbi, has attracted increased attention. Recently, China resumed its managed floating exchange system.

24. Strengthened and globally coordinated financial market regulations will be important in addressing structural flaws in financial regulatory systems that precipitated the crisis. The Basel III higher banking capital requirement will be implemented by end 2012. Tighter financial sector regulations and increased high-income sovereign borrowing are estimated to reduce DCs’ growth rates by 0.2–0.7 per cent for a five-to-seven-year period.

10 Helpman E *et al*. (2003). *American Economic Review*. 94(1).
11 Trefler D (2004). *American Economic Review.*

Box 3. Impact of changing financial regulatory landscape[12]

An UNCTAD expert meeting expressed that corrective actions required in the post-crisis regulatory regime varied among countries. There could be a case for separate standards of bank regulation, applicable to the needs of DCs. Should DCs be required to maintain the same macro prudential framework, the cost of capital could increase, especially in under-banked economies, and adopting some of the Basel requirements might cripple future growth. The financial sector should be regulated towards contributing to economic and social development, including financial access. A key lesson is that there should be synchronization between the strength of regulators' skills and regulatory institutions, the sophistication of the products and the extent of liberalization of financial markets.

D. Growth strategies

25. Designing integrated, comprehensive and sustainable growth strategies has become a central issue in the post-crisis period. Many countries are forging new more powerful "industrial policies" to strengthen and diversify their competitive productive capabilities in agriculture, manufacturing and services sectors, and promote greener production and exports.[13]

26. Since specialization in some products brings higher growth than in others, governments can play a central role in shaping a nation's specialization patterns, production structure and development.[14] Countries producing more "sophisticated" products, requiring a relatively large number of capabilities, therefore, would have economies more adaptable than others to producing less complex products. Development requires a host of polices, including (a) promoting capabilities to produce a range of products; (b) complementary economic activities; (c) learning and sharing of experiences about producing and trading in different products; (d) economizing coordination, and developing public/private partnerships; and (e) learning from others in regional framework to produce similar products. Policies to facilitate coordination efforts and networks among governmental, economic and other stakeholders to strengthen productive capabilities at the national, regional and international levels would enhance growth prospects.

27. Industrial policy and proactive trade policy have been used successfully in the past by most countries that experienced high growth rates (developed countries and Asian Tigers). Furthermore, countries following the Washington Consensus have not witnessed higher growth rates than during periods with proactive industrial policies (Latin America during the 1990s compared to previous decades).[15]

28. Recent research[16] suggests that successful industrial policies comprise (a) building efficient institutions, incentives and subsidies; (b) selective government interventions; (c) appropriate protection of domestic industries; (c) use of public enterprises to enter risky sectors; (d) investments in skill creation, innovation, and technological and physical infrastructure; and (e) selective use of FDI. The policies need to be adapted to country-

[12] TD/B/C.I/MEM.3/6.
[13] TD/B/C.I/7.
[14] Hidalgo C (2009). The Dynamics of Economic Complexity and the Product Space over a 42 year period, Harvard University.
[15] Hausmann R and Rodrik D (2003). *Journal of Development Economics.* December.
[16] Cimoli, Dosi and Stiglitz (2009). *Industrial Policy and Development: The Political Economy of Capabilities Accumulation.*

specific situations. Governments, as developmental State, play a formative role in this growth model. Trade, industrial, investment, technology and social policies, including employment creation, are intertwined.

29. Governments, within their stimulus measures, supported productive capacities and diversifying export baskets and markets. For instance, the United States National Export Initiative (NEI) seeks to double its exports in five years to support 2 million jobs domestically and secure new markets through strengthening enforcement of trade agreements, concluding the Doha Round and completing outstanding FTAs. This will affect the direction of trade flows including by increasing competition for market access in export markets.

Box 4. The NEI

Exports constitutes 11 per cent of United States GDP and support 10 million jobs while currently less than 1 per cent of United States companies export. The NEI will enhance export funding, mobilize Government services to engage in export advocacy, launch export tools for SMEs, reduce barriers to trade, including United States export control for high-tech products, and open new foreign markets. SMEs are considered the largest source of untapped export potential and job creation – 120 million non-farm private sector workers are estimated to be with SMEs. NEI requires exports to expand at 15 per cent annually, against its average export growth rates of 13.6 per cent over 2000–2008. From 1995, the United States took 13 years to double its merchandise exports.

30. Some DCs embarked on proactive structural growth strategies, supported by sound macroeconomic fundamentals. South Africa, under its National Industrial Policy Framework, is promoting growth, industrial upgrading, export diversification and employment creation. Brazil embarked on growth strategies combining targeted tax cuts, financial incentives and expanded credit lines for business intermediated by public development banks and State enterprises targeting infrastructure, research and development (R&D) and entrepreneurship. Bangladesh expanded financial support to key sectors such as agricultural development, credit line for SMEs, skill development, fiscal incentive for garment sector and social safety nets.

Box 5. South Africa’s Industrial Policy Action Plan for 2010–2013

To boost the country’s growth, industrial upgrading, export diversification and employment, South Africa’s action plan seeks to scale up industrial transformation including into labour-intensive sectors through (a) stronger coherence between macro and micro economic policies (e.g. exchange rate); (b) facilitated and cheaper industrial financing through the recapitalized Industrial Development Corporation; (c) leveraging public and private procurement to raise domestic production and employment; (d) developmental trade policies deploying trade measures in a selected and strategic manner, including tariffs, and standards; (e) strategic global and African integration, including cross-border infrastructure development; (f) competition and regulation policies, particularly those affecting intermediate inputs to labour-absorbing downstream sectors, and consumer goods to low-income households; (g) skills and innovation policies aligned to sectoral priorities.

31. LDCs and other vulnerable economies suffered from reduced trade, FDI and remittance inflows, and commodity price reversals. Decelerated growth and modest recovery, together with limited financial and institutional capabilities, had long-lasting impact on poverty and worsened deep rooted structural deficiencies. For example, Haiti

suffers from a combination of inappropriate policy prescriptions and deep liberalization, which weakened its productive capabilities, including in agriculture. Tariffs on rice were reduced from 35 to 3 per cent under an IMF-led structural adjustment programme in 1995. Today, 70 per cent of Haiti's rice is imported subsidized rice from the United States. Haiti and other vulnerable economies need policy space to build robust economies and support for diversification and integration in GSC. International support, including Aid for Trade (AfT), can be usefully deployed to buttress these development efforts.

32. Growth strategies would need to strike a balance between the role of the market and the role of the States to enhance development impact. A strategic industrial policy is important within the required policy space.

III. Post-crisis ITS

33. ITS has become multi-layered in a multi-polar world, with significant differences in development conditions among countries. It is evolving at multilateral, regional, subregional and bilateral levels with sub-global arrangements taking increased prominence. Economic power and opportunities are shifting to emerging countries, where half of global economic growth will originate, thereby increasing their influence in shaping globalization. This requires the ITS to better adapt itself to the evolving economic landscape and relations, and drastically different development needs, by providing policy space for structural transformation, diversification, job creation and sustainable development. The multi-layered trading system is significant, as countries' international commitments are framed not only multilaterally under WTO and WTO accession, but also, increasingly, regionally or bilaterally under regional trade agreements (RTAs) and international finance institution (IFI) advice and lending policies, and in other forums. The cumulative effects of the multi-layered economic governance system warrant greater attention to ensure coherence across different layers while prioritizing development.

34. The powerful mercantilist motivations, which supported the previous success of General Agreement on Tariffs and Trade (GATT)/WTO, require rethinking. By exclusively relying on exporters' interests in advancing liberalization, it has not reflected concerns of import-competing industries, farmers and workers, and development. Liberalization processes flounder when a critical mass of exporters' support is lacking, which seems to be the case in major net-importing developed countries. Shifting towards an alternative developmental, cooperative and solidarity-based logic of mutually beneficial market opening, paying due regard to collective interests, exporters and importers alike, and economic, societal and sustainability concerns, including poverty, adjustment and unemployment, reflecting the interdependent nature of global economy, are needed.

A. Developments in the MTS

35. Much-feared protectionism following the crisis has not materialized, due essentially to WTO disciplines, international cooperative measures as under G-20 and enhanced international surveillance. Crisis mitigation measures included trade remedies, SPS/TBT, industrial producer subsidies, "buy/invest/hire/lend" local provisions associated with State aid, public works, government procurement (GP) and outsourcing. Intermediate trade resulting from the increased vertical integration of international production also reduced incentive for tariff protection on input materials, as even low tariff barriers increase overall production costs. This explains why many jurisdictions did not resort to tariff protection but rather non-tariff measures (NTMs). DCs generally showed restraints in making use of border measures. The prospects for weak recovery, persistent unemployment and rising imports may lead to possible policy reversals and increased NTMs. Closer monitoring,

surveillance and analysis of national policies remain important. Protectionist tendencies must continue to be resisted.

36. New import restricting measures introduced since October 2008 until May 2010 cover around 1.4 per cent of total world merchandise imports.[17] These are concentrated in chemicals, iron and steel, machinery, textiles and apparels that are already intensively protected. China is the single most affected country. Trade-restrictive measures are estimated to have reduced global exports only by 0.25 per cent.[18] Where measures were implemented, an import-restricting measure reduced trade on average by about 2.5 per cent. Economic effects of trade-restrictive measure on exporters depend on the importance of the products concerned in the total export basket of exporters. For instance, base metal, which attracted the highest number of measures, represents about 18 per cent of total merchandise exports of LDCs. The effects of large-scale financial and fiscal support, State aid and subsidies continue to be a matter of concern. Their effects on trade can be significant in particular sectors concerned, while their measurement has been difficult.[19]

37. Governments actively intervened in the financial services sector to prevent systemic insolvency. Such public support and subsidies are generally covered under General Agreement on Trade and Services (GATS) prudential carve-outs while some have questioned its exact scope and conditions. Concerns exist regarding WTO consistency of some of the rescue measures such as nationalization of financial institutions and funding programmes with a subsidy component provided to certain domestic banks. The resulting large financial conglomerates could distort competition negatively impacting DCs.

38. The Doha Round is in its ninth year. Since the Seventh session of the WTO Ministerial Conference in 2009, no significant progress has been recorded. The tenor of current talks is on whether or not to proceed on the basis of modalities for agriculture and non-agricultural market access. There are concerns about an erosion of the mandate to redress asymmetries and imbalances in the existing agreements, and balance market access commitments and strengthened rule-making with developmental concerns towards a singular focus on market access. DCs have high expectations from the Doha development agenda and continue to have development concerns regarding de-industrialization, food security, revenue loss and essential services. Re-interpretation of the Doha mandate further heightens uncertainty over the prospects of concluding the Round in 2010. There is need for full transparency and inclusiveness in the negotiations as the use of small groupings is not representative of the interest of all members, and has not facilitated outcomes.

39. There is debate on possible options for a Doha Round outcome including early harvest for LDCs, “Doha-light” and using “variable geometry”. Further prolongation risks loss of interest in the Round, leaving a greater role in global economic governance for other forums as the G-20 and RTAs. Dispute settlement maybe increasingly used to settle trade concerns. The development agenda requires as a minimum meaningful solution to agricultural market access, domestic support, the special safeguard mechanism, cotton, NAMA flexibilities, preference erosion, commercially meaningful market access in services sectors of export interest to DCs and Modes 4 and 1 and, reprioritization of implementation issues and special and differential treatment (SDT)(such as subsidies, trade-related investment measures (TRIMs), and Trade-Related Aspects of Intellectual Property Rights (TRIPS)), an LDCs package, scaled-up capacity-building support in trade facilitation, and effective AfT with sectoral focus. AfT links with poverty reduction objectives should be strengthened. A development audit of AfT would be useful.

[17] WT/TPR/OV/W/3.
[18] IMF (SPN/10/07), 2010.
[19] OECD. Trade and economic effects of responses to the economic crisis.

40. On duty-free, quota-free (DFQF) market access for LDCs, the Hong Kong (China) Ministerial Decision's target for covering at least 97 per cent of tariff lines has been achieved in all but one developed country. There is need to achieve at an early date the target and move towards 100 per cent coverage. This could bring an additional export gain of about $2 billion. The gains would be greater – about $5 billion – if major DCs also extended DFQF access.[20] China, India and Brazil have taken initiatives. For example, Brazil announced in 2009 DFQF access for 80 per cent of tariff lines by mid-2010, and full coverage by 2014.

Box 6. DFQF for LDCs

Product coverage and simplified rules of origin are two major issues regarding DFQF. In United States, AGOA benefits for SSA are significant for those receiving apparel benefits because preferential margin is large and are fully used by eligible exporters. In contrast, non-African LDCs trading under the normal GSP scheme do not enjoy similar preferences. This implies scope for improvement by extending product coverage for Asian LDCs. UNCTAD estimates that full coverage (assuming full utilization) would increase the value of preferences (rent) from $1.4 million to $555 million for Bangladesh. Extending DFQF to 100 per cent of products would induce preference erosion for SSA. While it will increase Bangladesh's exports by $847 million and Cambodia's by $555 million, or 23 per cent and 28 per cent of their pre-shock export levels respectively, Lesotho, Madagascar, Kenya, Mauritius and Swaziland will see a decrease in exports in the range of $3 million–6 million or 1.6 per cent–1.9 per cent of their pre-shock export value.

41. Twenty-five countries have acceded to WTO and 30 are in accession. The process is complex, and often leads to deeper and more stringent commitments than for existing WTO members, reducing acceding countries' policy flexibilities. This has led to a multi-tiered system of membership facing different levels of obligations. Such commitments often have significant implications for long-term developmental objectives. Proposals have been made to make the accession process fairer and more balanced, particularly by fully implementing LDC guidelines, setting up institutional mechanism, limiting terms of accession to WTO-covered measures and ensuring that they are commensurate with countries' level of development.

B. Regional developments

42. RTAs proliferated in all regions, eroding the most favoured nation (MFN) principle – 462 RTAs were notified to WTO and 270 are operational. Despite an improved transparency mechanism, lack of clear understanding on key parameters of WTO rules on RTAs such as GATT Article XXIV, and enforcement thereof, limit the ability of WTO to discipline RTAs. New North–South RTAs are increasingly targeting commercial interest in dynamically growing developing markets or suppliers of key raw materials. The trend of RTAs encompassing deeper and broader liberalization commitments ("WTO-plus") continues. Thus, countries' international commitments are increasingly defined by RTAs, often limiting policy flexibilities and increasing implementation costs. Attention needs to be given to the development impact of RTAs, including improving WTO rules on RTAs to ensure coherence between RTAs and MTS.

[20] Bouët A *et al* (2010). "The Costs and benefits of Duty-Free, Quota-Free Market Access for Poor Countries: Who and What Matters".

43. The Asia–Pacific region witnessed an acceleration of RTAs, with the Association of South-East Asian Nations (ASEAN) increasingly becoming a hub. Several Asia–Pacific Economic Cooperation (APEC) members formed the Trans-Pacific Partnership Agreement with the potential to catalyse a larger Free Trade Area of Asia and the Pacific. Africa embarked on a continent-wide common market by 2023 built on regional economic communities. The multiplicity of regional initiatives has hampered effective integration, so harmonization and rationalization of existing arrangements has started. The tripartite FTA initiative between the Southern African Development Community (SADC), the Common Market for Eastern and Southern Africa (COMESA) and the East African Community (EAC) engaged in harmonization of integration programmes, while the East African Common Market was launched. Increasing the depth of integration and full implementation of existing RTAs would expand intraregional trade. Latin America and Caribbean countries intensified negotiations with developed countries (e.g. EU–Colombia, Peru, Central America and the Southern Common Market (MERCOSUR)). In 2008, the intra-RTA trade was the highest in ASEAN (25 per cent), followed by the Central American Common Market (CACM) (18 per cent), EAC (18 per cent), MERCOSUR (15 per cent) and the Caribbean Community (CARICOM) (15 per cent). African groupings have a generally lower level of intra-grouping trade.

44. ACP-EU negotiations for economic partnership agreements (EPAs) continued in 2010. Following conclusion of one full comprehensive EPA (Cariforum) and seven goods-only "interim" EPAs, negotiations continued towards comprehensive EPAs. This has proved challenging, as African, Caribbean and Pacific Group of States (ACP) need to harmonize commitments regionally while national liberalization commitments differed significantly in scope and timing across different interim agreements. Some issues remain to be addressed, including clauses regarding infant industry protection, third-party MFN clause, export duties and taxes, free circulation of goods, rules of origin, Singapore issues and intellectual property rights (IPRs). Some of these measures have served as developmental policy tools and the third-party MFN clause could impact South–South agreements with larger DCs. Conclusion of agreements by a subset of members of customs unions in Africa has made customs union's operation difficult (e.g. Southern Africa Customs Union).

45. The dynamic import demand of emerging economies offers real opportunities for South–South integration and cooperation in productive capacities, agriculture, technology transfer, human capacities, regulations, standards and institutions, building infrastructure including transport – such as North–South Corridor programme of COMESA, EAC and SADC – to reducing costs of cross-border trade and transport in Africa, and COMESA's initiative on Regional Multi-disciplinary Centre of Excellence for training.

46. Interregionally, the 22 Global System of Trade Preferences (GSTP) Participants conducting the Third Round of GSTP negotiations reached an agreement in December 2009 on the modalities for market access negotiations. These consist of an across-the-board line-by-line linear cut of 20 per cent on applied duties for at least 70 per cent of dutiable tariff lines. Market access negotiations and technical discussion including on rules of origin are underway aiming at concluding in September 2010.

Box 7. Potential trade effects of the GSTP negotiations

GSTP participants collectively represent significant markets – 43 GSTP participants represent some 20 per cent of world imports. Intra-GSTP trade among 22 participants represents about 16 per cent of their total exports. GSTP negotiations could bring about significant commercial gains. Preliminary UNCTAD estimates indicate that this would lead to a total trade creation effect of $5.6 billion, representing 4.3 per cent of intra-GSTP total exports. If the same tariff cut approach is extended to all 43 GSTP participants, trade creation effect would amount to almost $7 billion. Potential dynamic gains will be much larger.

C. Implications of the post-crisis growth strategies for the ITS

47. As countries pursue growth strategies, some policy instruments are recognized as key such as subsidies, investment measures, GP and intellectual property, technology transfer, innovation and R&D. While countries seek to deploy these measures, international disciplines may restrain their use. Many development policies disciplined by existing rules are the very policies that were essential to industrial development in industrialized countries. Where WTO rules allow for certain flexibilities, trade disciplines are increasingly framed in RTAs, WTO accession and elsewhere tend to limit such flexibilities. There is need for policy space for building productive capacities, creating employment and promoting sustainable development.

1. Financial services

48. Robust financial services sector linked to the real economy and supporting productive sectors is conducive for economic development. Some trade-related rules and liberalization commitments can increase the vulnerability of economies to financial shocks. This has led to reappraisal of liberalization approaches taken so far and adoption of more caution.

49. The financial crisis raised the question of the extent to which liberalization commitments in cross-border supply of financial services enabled the transmission of financial shocks to DCs. The crisis has highlighted the need for careful management of capital account. Certain GATS cross-border commitments have presumed open capital account. GATS commitments require opening of the capital account for Members that have undertaken commitments under modes 1 (cross border) and 3 (commercial presence) for financial services. They are required under Footnote 8 to GATS Article XVI to permit capital to flow freely to the extent that such capital is an integral part of the services provided. Article XI (2) also requires that a WTO Member “shall not impose restrictions on any capital transactions inconsistently with its specific commitments regarding such transactions”, except for the Balance of Payments reasons. Experience proves that capital account management is important for DCs to ensure that short-term capital flows do not affect currency stability and the real economy.

50. Countries have stressed the need for local incorporation of foreign commercial presence (as subsidiaries rather than branches) as a condition for the admission of foreign financial institutions, clearer distribution of costs between home and host countries in the event of cross-border insolvencies and being cautious in allowing foreign financial firms to offer new financial products.

2. Industrial subsidies

51. Subsidies played key role historically in industrialization and services sector development. Examples included textiles, aircraft, transport, energy and automobile industry. Recognizing some industries stimulate industrialization and create forward and backward linkages more than others, governments have sought to subsidize them. Subsidies have also been used to address positive externalities to maximize social returns. Certain subsidies are allowed under WTO and support promoting human capital development, SME development, technology development and transfer, R&D, and environmental technology upgrading. The crisis underscored the role of industrial subsidies in rescuing affected industries like automotives, stimulating recovery and building greener economies. Some subsidies were conditioned on maintaining production and employment at home.

52. Local content requirements were successfully used by countries in fostering the growth of domestic industry. Subsidies provided to users of local content may offset market power of investors, including transnational corporations (TNCs). Such subsidies are currently prohibited under the SCM agreement. Not all DCs are allowed to use export subsidies. Developed countries can avail of certain flexibilities relating to export credit. Export credit granted according to OECD arrangements is not prohibited export subsidies. Under implementation issues in the Doha Round, DCs have sought to reinstate and expand non-actionable subsidies that promote regional growth, technology research and development funding, production diversification and development and implementation of environmentally sound methods of production.

53. While traditionally, State aid and subsidies have not been dealt with substantially in RTAs, some recent initiatives such as the Republic of Korea–EC FTA contain WTO-plus rules on subsidies.

3. Government procurement

54. Governments traditionally implemented various "buy national" laws, domestic preferences and set-asides in GP to promote local industries and SMEs, create employment, help disadvantaged communities and ethnic groups, as well as environmental and social protection. GP market accounts for about 15–20 per cent of GDP in developed, and 40–50 per cent in DCs. GP played an important role, for instance, in the development of aircraft industry Boeing, Airbus and Embraer. This shows how preferences in government contracts allowed industrial development and economies of scale, incorporation of local content, and development of new technologies. GP is a strategic development tool for DCs.

55. GP became salient in the crisis as governments expanded public expenditures and local preference conditions were attached to preempt the leakage of stimulus to imports. Since GP is regulated under the plurilateral Government Procurement Agreement (GPA) (to which most DCs are not party), non-party, DCs and transition economies risk discriminatory treatment in export markets. Non-GPA parties are free to design procurement polices supporting their growth strategies. WTO accession has led to commitments for acceding countries to negotiate accession to GPA. There are about 14 advanced or pending accessions to the GPA with virtually all of them being recently acceded WTO members. Recent North-South RTAs including those under negotiations have included market access commitments on GP. CARIFORUM countries have undertaken commitments to provide national treatment, with the decision on its coverage to be made by the Joint CARIFORUM–EC Council.

4. TRIMs

56. The need to diversify productive capacities to build economic resilience underlines the importance of some TRIMs. TRIMs were traditionally used to extract greater benefits from FDI in strategic sectors including machinery, electronics and automotives for building domestic production capacity and enlarging technology bases through spillover effects. Performance requirements on FDI can help to maximize welfare benefits. Local content requirements have been used by developed countries, particularly in the auto industry to promote localization of value-added production. The TRIMs agreement prohibits local content and other trade-related requirements. In the context of review of TRIMs, attention could be given to the importance of these instruments for development. At Hong Kong (China), LDCs were provided with SDT to use existing and new TRIMs for a limited period of time which can be extended. This is recognition of the role of TRIMs.

57. While certain types of TRIMs such as export performance requirement and technology transfer requirement are not prohibited under the TRIMs Agreement, WTO accession commitments and North–South RTAs increasingly led to the prohibition of these requirements. This weakened host country efforts to promote exports by using foreign investors’ network in their home or third markets and in acquiring modern and advanced technology.

5. Technology, innovation and development

58. Technology and innovation are key ingredients for value addition and diversification. The crucial issue regarding IPRs is how they help or hinder DCs gaining access to technologies that are required for their development. Weak IPRs have been used as a means of gaining access to foreign technologies and developing them using reverse engineering, thereby enhancing indigenous technological capacity. Countries protected IPRs once they reached a certain level of technological development. Granting patents for production process, and not for the resulting product, was used for strategic industries such as food and pharmaceuticals. This enabled the Swiss pharmaceutical industry to reengineer alternative processes for producing the same product by importing know-how and exploring new ways for the production process already protected in an existing patent. Concerns have been expressed that the ability of DCs to follow this path is restricted by TRIPS and other agreements

59. It is important that in accordance with Article 7 of the TRIPS Agreement, the protection and enforcement of IPRs should contribute to the promotion of technological innovation and to the transfer and dissemination of technology, to the mutual advantage of producers and users of technological knowledge and in a manner conducive to social and economic welfare, and to a balance of rights and obligations. TRIPS has been amended for public health reasons and flexibilities have been provided to LDCs. The relationship between IP and development is being reinforced in the World Intellectual Property Organization (WIPO) Development Agenda through implementing 45 recommendations, including that the cost of IPRs does not outweigh the benefits for DCs.

60. North–South RTAs have incorporated new forms of IPRs protection levels. These obligations are applied on an MFN basis as TRIPS does not allow for preferential treatment. WTO-plus IPRs have included: (a) patent terms extension; (b) minimum five years of test data exclusivity; (c) extension of copyright protection from 50 years to 70 years; (d) stronger protection for copyright digital environment; (e) obligations to apply the 1991 International Convention for the Protection of New Varieties of Plants ; and (f) stringent enforcement. Such commitments can impact on public health and access to medicines. There is concern that FTAs reverse an important balance between innovation and access by elevating IPRs at the expense of public health considerations.

6. Climate change

61. Industrial policy to promote environmentally friendly products can help sustainable development and diversification . Such policies include: public sector engagement in R&D, simplifying access to patents, fiscal and financial support for new production activities and integration into GSC, GP and temporary protection of specific subsectors. Facilitating such transformation requires exploiting new opportunities for investment and trade, arising from natural comparative advantages as in renewable energy. Trade negotiations can contribute to climate change objectives through the liberalization of environmental goods and services (EGS), particularly those of interest to DCs, and facilitating access to technologies that reduce greenhouse gas emissions. Proposals were made to include in the definition of EGS those needed to implement projects under the clean development mechanism.[21] To promote technology transfer to achieve clean development, TRIPS flexibilities on compulsory licenses could prove useful.

62. Green protectionism should be avoided. Initiatives such as border tax adjustment proposed to offset competitiveness differentials by restricting imports from DCs whose governments are less aggressively taxing carbon use can constitute green protectionism. There is need to safeguard interests of DCs to continue their growth to meet development and poverty reduction needs. There is debate over whether such measures would pass a WTO test of non-discrimination as justified on environmental ground under GATT Article XX. TBT/SPS related to environmental requirements may be used for protectionist purposes. There emerged concern over burdensome technical standards linked to production of climate friendly goods and services. Higher inclusiveness and avoidance of abuses in standard setting process could generate higher levels of buy-in from DCs. Reconciling potential conflict of norms under international environmental and trade regimes will require attention.

7. Raw materials and export taxes

63. While the overall welfare effects of export taxes depend on various factors, some commodity-exporting countries have identified export taxes on raw materials, including energy, as a policy tool to promote economic diversification, value addition and downstream processing. Revenues generated from export taxation have been used to support domestic industries. Since export taxation, inter alia, causes welfare shift from importers/producers that are mostly based in resource-scarce countries to producers in resource-abundant exporting countries, it causes concern on the part of former. For example the recent dispute regarding China’s export restrictions on certain raw materials was challenged by the United States, EU and Mexico.

64. Existing WTO rules do not prohibit the use of export taxes. WTO accession has sometimes led to commitments by acceding countries to reduce the scope of export taxation or put a ceiling on export tax. In RTAs, , export tax has been reduced or prohibited, as in the Chile–United States FTA, DR-CAFTA and CARIFORUM EPA. These have further reduced policy flexibilities for development. The development and trade impact of export taxes on exporters, importers, producers of raw materials and downstream industries are different and require analysis.

[21] *Trade and Development Report, 2009*.

IV. Conclusion

65. The crisis has challenged prevailing economic orthodoxies and policy prescriptions, and shifted policy focus from a narrow perspective of external balances and price stability to accelerated growth and structural rebalancing, as well as addressing persistent unemployment and growing poverty. This calls for a redefinition of growth strategies for all countries. Emerging economies are becoming locomotives of global growth and provide opportunities for new trade patterns and equitable economic relations. South–South trade and economic cooperation has become a prominent feature of this new landscape. Greater integration of DCs into GSC contributes to further growth and value addition. GSC needs further research. Active polices – including trade, industrial, technological and related policies – play an important role in building productive capacities, including services and environmentally sustainable products, and creating employment. Trade policy and the ITS should directly contribute to broader development goals and strategies. A combination of export-led and demand-led growth strategies, depending on the country situations concerned, is needed to build competitive and diversified productive capacities and enhanced resilience of economies to future shocks. Active policies requires greater role of the State and policy space providing for multiplicity of approaches to development.

66. The MTS remains a central public good and pillar of the ITS. It needs to be adapted to reflect development imperatives. The mercantilist logic underpinning the MTS needs to be overhauled with development logic. The Doha Round should be completed with concrete development deliverables that will bring substantial gains for DCs and the system. The rapidly increasing role of developing economies in production, trade and investment needs to be fully harnessed. Given the multiplication of preferential trade initiatives, greater coherence across different layers of the trading system, and with the financial and monetary system, is essential to ensuring that the ITS is genuinely universal, rule-based, open, non-discriminatory and equitable for all. The United Nations and G-192 have an important role in strengthening global cooperation and building coherence for development in a post-crisis environment.