

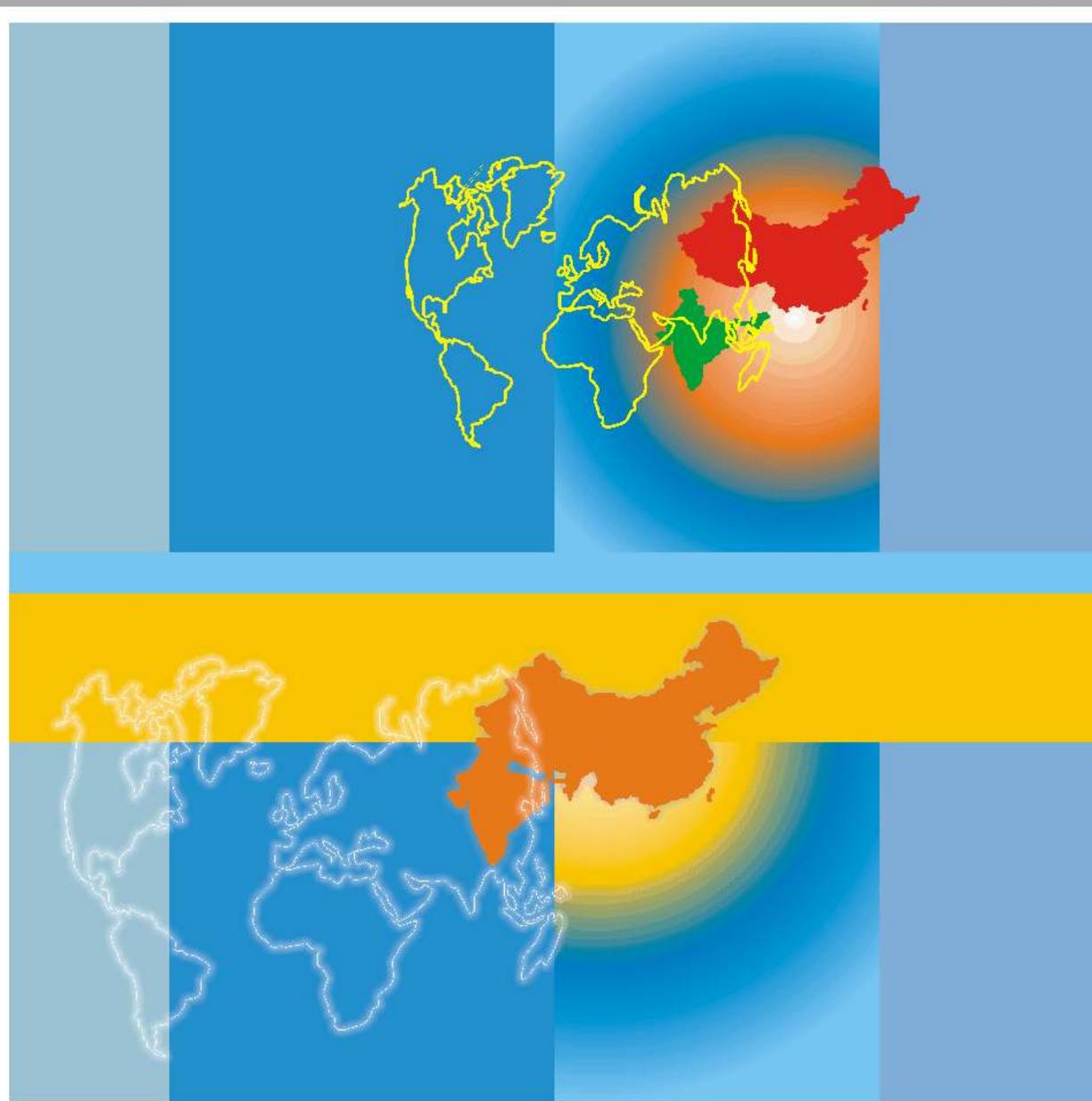
# TRADE AND DEVELOPMENT REPORT, 2005

New features of  
global interdependence



UNITED NATIONS

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UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT  
GENEVA

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# TRADE AND DEVELOPMENT REPORT, 2005

Report by the secretariat of the  
United Nations Conference on Trade and Development



**UNITED NATIONS**  
New York and Geneva, 2005

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## FOREWORD

This year's *Trade and Development Report* demonstrates that the conditions for achieving the Millennium Development Goal of halving extreme poverty by 2015 have improved considerably over the past three years, as economic growth in the developing world has become more broad-based and embraced many of the poorest countries.

At a time when the forces of economic expansion in some major developed countries have been slackening, China and India have become major engines of growth for the world economy as a whole. Rapid economic development in both countries has helped reduce levels of extreme poverty at home, by generating employment and boosting incomes. It has also had positive effects beyond the two countries' borders, in particular in many other developing countries.

However, the *Report* stresses that progress remains far too slow in certain regions. In sub-Saharan Africa, which has the highest proportion of people living in extreme poverty, per capita income growth is still too low to make decisive progress. This only underscores the need for further action by the international community to achieve and maintain strong global growth dynamics with broad-based participation.

The recent rise in the prices of many primary commodities has provided some economic breathing space in commodity-dependent economies, but this must not lead to complacency. On the contrary, this breathing space should be viewed as an opportunity for many developing countries to accelerate the process of structural change and capital accumulation, and indeed to reduce their dependence on exports of such commodities. This would boost progress towards all development goals, and have positive effects in countries with more advanced manufacturing sectors that provide the machinery and equipment needed for such change.

Our challenge is to sustain the recent positive developments. The *Report* argues that it is important not only that the fast-growing Asian countries make the right policy choices, but also that developed countries take appropriate policy measures to overcome the persistent imbalances and inequities in the international trading system. A global approach, based on international action with the effective participation of developing countries in global policy coordination, is in the interest of all, developed and developing countries alike.

The Goals can still be reached – worldwide and in most, or even all, individual countries – but only if we break with business as usual. The information and analysis contained in this *Report* should contribute to the debate about how best to make the global partnership for development a reality – and how to help many millions of people realize their long-standing hopes to live in dignity and peace. In that hopeful spirit, I recommend this volume to a wide global audience.



Kofi A. Annan  
Secretary-General of the United Nations



## Contents

	<i>Page</i>
<i>FOREWORD</i> .....	<i>iii</i>
<i>Explanatory notes</i> .....	<i>xiii</i>
<i>Abbreviations</i> .....	<i>xiv</i>
<i>OVERVIEW</i> .....	<i>I-X</i>

### Chapter I

<b>CURRENT ISSUES IN THE WORLD ECONOMY</b> .....	<b><i>1</i></b>
<hr/>	
<b>A. Introduction</b> .....	<b><i>1</i></b>
<b>B. The world economy: growth performance and prospects</b> .....	<b><i>2</i></b>
1. Economic activity in developed countries .....	<i>2</i>
2. Economic activity in developing countries .....	<i>4</i>
3. Recent developments in world trade and finance .....	<i>10</i>
<b>C. The global imbalances and the United States current-account deficit</b> .....	<b><i>12</i></b>
1. Twenty-five years of deficits in the United States .....	<i>14</i>
2. The surplus regions .....	<i>18</i>
3. Tailoring policy measures .....	<i>19</i>
<b>D. Oil price hikes in perspective</b> .....	<b><i>20</i></b>
1. The impact of an oil price shock on prices and economic activity .....	<i>20</i>
2. The 1973–1974 and 1979–1980 oil price shocks: putting current events in perspective .....	<i>22</i>
3. The impact on oil-importing developing economies .....	<i>25</i>
<b>E. Rapid growth in China and India and the profit-investment nexus</b> .....	<b><i>28</i></b>
1. The sectors driving economic growth .....	<i>30</i>
2. Stable and balanced demand growth as a condition for sustained rapid growth .....	<i>33</i>
3. Policy conditions underlying the Asian catching up processes .....	<i>35</i>
4. Challenges for sustained growth in China and India .....	<i>38</i>
<b>Notes</b> .....	<b><i>39</i></b>

Chapter II

<b>INCOME GROWTH AND SHIFTING TRADE PATTERNS IN ASIA</b> .....	41
<b>A. Introduction</b> .....	41
<b>B. Evolving demand and trade patterns in Asia: a comparative perspective</b> .....	44
1. Changing patterns of food consumption .....	44
2. Intensity of metal and energy use .....	46
<b>C. Domestic resource constraints and the balance-of-payments constraint</b> .....	51
1. Relative resource constraints and country size .....	52
2. Shifts in trade composition: experiences of Asian industrialization .....	54
<b>D. World market shares and prices</b> .....	70
1. The growing impact of China and India on global primary commodity markets .....	70
2. The role of textile and clothing exports .....	77
<b>Notes</b> .....	82

Chapter III

<b>EVOLUTION IN THE TERMS OF TRADE AND ITS IMPACT ON DEVELOPING COUNTRIES</b> .....	85
<b>A. Introduction</b> .....	85
<b>B. The terms-of-trade problem revisited</b> .....	87
<b>C. Recent trends in the terms of trade</b> .....	92
<b>D. Effects of terms-of-trade changes on domestic income</b> .....	101
<b>E. The distribution of gains or losses from terms of trade</b> .....	103
<b>F. The distribution of export income and rent from extractive industries</b> .....	108
<b>Notes</b> .....	114

Annex to chapter III

<b>Distribution of Oil and Mining Rent: Some Evidence from Latin America, 1999–2004</b> .....	117
---	-----

*Chapter IV*

---

**TOWARDS A NEW FORM OF GLOBAL INTERDEPENDENCE** ..... 129

---

**A. Introduction** ..... 129

**B. The growing importance of developing countries in global markets** ..... 132

**C. Shifts in the composition of developing-country exports** ..... 146

**D. What has changed? An assessment** ..... 153

**E. Policies for managing the new forms of global interdependence** ..... 155

**Notes** ..... 160

---

**REFERENCES** ..... 163

---

---

## List of tables

---

<i>Table</i>	<i>Page</i>
1.1	World output growth, 1990–2005 ..... 3
1.2	GDP growth in selected developing economies, South-East Europe and CIS, 1990–2005 ..... 6
1.3	Export and import volumes of goods, by region and economic grouping, 1996–2004 ..... 8
1.4	Current-account balance, selected economies, 2000–2004 ..... 13
1.5	Real GDP per capita and GDP growth in China, India, Japan and the Republic of Korea during their rapid growth periods ..... 29
1.6	Contribution of consumption, investment and trade to GDP growth in China, India, Japan and the Republic of Korea ..... 34
2.1	Dietary composition in China and India, 1994 and 2002 ..... 46
2.2	Per capita metal consumption, selected countries, 2003 ..... 47
2.3	Food self-sufficiency ratios in China and India, selected products, 1994–2002 ..... 57
2.4	China's agricultural trade by major product category, 1980–2003 ..... 58
2.5	Product structure of imports of selected Asian countries, 1965–2003 ..... 61
2.6	Magnitude of change in selected raw material imports by Japan, the Republic of Korea, China and India, selected periods ..... 64
2.7	Product structure of exports from selected Asian countries, 1965–2003 ..... 66
2.8	World primary commodity prices, 1999–2004 ..... 72
2.9	Shares in world exports of manufactures of selected Asian developing economies and major developed countries, 1962–2003 ..... 78
2.10	United States apparel imports from selected sources, market shares and unit values, 1995–2005 ..... 80
3.1	Export structure of developing countries, by region and by broad product category, 1980–2003 ..... 91
3.2	Distribution of developing countries by their dominant export category, 2003 ..... 91
3.3	Sensitivity of developing countries to terms-of-trade changes, by broad product category and by region, 1996–2004 ..... 102
3.4	Impact of changes in terms of trade and net income payments on national income, selected economies, 2002–2004 ..... 106
3.5	Government revenue from international trade and extractive industries, selected developing countries ..... 112
3.6	Government revenue from fuel industry in selected developing countries ..... 113
3.A1	Argentina: estimate of oil rent, 1999–2004 ..... 118
3.A2	Argentina: estimate of government revenue from oil rent, 1999–2004 ..... 118
3.A3	Ecuador: estimate of oil rent, 1999–2004 ..... 119
3.A4	Ecuador: estimate of the distribution of oil rent, 1999–2003 ..... 120
3.A5	Mexico: estimate of oil rent, 1999–2004 ..... 120
3.A6	Venezuela: estimate of oil rent, 1999–2004 ..... 121
3.A7	Venezuela: estimate of the distribution of oil rent, 1999–2004 ..... 122
3.A8	Venezuela: composition of government revenues from oil, 1999–2004 ..... 122
3.A9	Chile: estimate of copper rent, 1999–2004 ..... 124

---

## *List of tables (concluded)*

---

<i>Table</i>	<i>Page</i>
3.A10 Chile: estimate of government revenue from copper rent, 1999–2004.....	124
3.A11 Peru: estimate of gold rent, 1999–2004.....	125
3.A12 Peru: estimate of copper rent, 1999–2004.....	126
3.A13 Peru: estimate of government revenue from gold rent, 1999–2004.....	126
3.A14 Peru: estimate of government revenue from copper rent, 1999–2004.....	127
4.1 Matrix of world merchandise trade by major product category, 1965, 1985 and 2003.....	131
4.2 The origin and destination of merchandise trade, 1970–2003.....	133
4.3 South-South trade in world trade, 1970–2003.....	134
4.4 South-South merchandise exports, by geographical region, 1970–2003.....	140
4.5 Top 10 economies in South-South trade, 2003.....	141
4.6 Importance of South-South trade for developing economies, 1990–2003.....	142
4.7 Export value growth and share in total South-South exports of the 30 most dynamic products, 1990–2003.....	149
4.8 Composition of developing-economy exports to developed countries, by broad product categories, 1980–2003.....	150
4.9 Composition of trade among developing economies, by broad product categories, 1980–2003.....	152

---

---

## List of figures

---

<b>Figure</b>	<b>Page</b>
1.1 United States current-account balance, relative GDP growth and real effective exchange rate, 1980–2004 .....	14
1.2 Merchandise trade balance of the United States, by country/region, 1980–2004 .....	18
1.3 Current-account balances of 10 OPEC countries .....	21
1.4 Crude petroleum prices, nominal and real, 1970–2005 .....	22
1.5 Oil import bill, OECD major oil-consuming countries, 1973–1978, 1979–1983, 1999–2005 .....	23
1.6 Changes in consumer prices and unit labour costs, OECD major oil-consuming countries, selected periods .....	24
1.7 Real interest rates and real effective exchange rates, selected Asian and Latin American countries, 2003–2005 .....	27
1.8 Productivity in the manufacturing and services sectors compared to overall productivity in China (1984–1993, 1993–2002) and India (1991–2000) .....	31
1.9 Productivity in the manufacturing sector in China (1984–1993, 1993–2002) and in the manufacturing and services sectors in India (1991–2000) .....	32
1.10 Evolution of private consumption in China, India, Japan and the Republic of Korea .....	35
1.11 Real interest rates in China and India, 1980–2004 .....	37
2.1 Intensity of metal use, selected metals and countries, 1960–2003 .....	48
2.2 Stylized representation of the relationship between intensity of metal use and per capita income .....	50
2.3 Intensity of energy use, selected countries, 1965–2003 .....	50
2.4 Resource combinations of countries/regions, 1960–2000 (at 5-year intervals) .....	53
2.5 China: consumption and production of oil and coal, 1965–2004 .....	60
2.6 Non-fuel primary commodity prices, nominal and real, by commodity group, 1960–2004 .....	71
2.7 Shares in world imports of selected primary commodities, China and India, 1990 and 2003 .....	74
2.8 Net trade by China and India and world prices, selected primary commodities, 1990–2004 .....	75
3.1 United States import and export price indices for selected electronics products, 1980–2004 ..	89
3.2 Terms of trade, export volumes and purchasing power of exports in developing economies, by region, 1980–2004 .....	93
3.3 Terms of trade of selected developing economies, by dominant export category, 2000–2004 ..	96
3.4 Contribution of different product groups to terms-of-trade changes, selected developing economies, 2000–2004 .....	98
3.5 Changes in gross domestic product, gross domestic income, gross national income and terms-of-trade indices, selected developing countries, 1996–2004 .....	105
4.1 Schematic illustration of the impact of production-sharing on the statistically recorded value of South-South trade .....	138
4.2 Triangular trade in manufactures between East Asia and the United States, 1990–2003 ....	139
4.3 Evolution of developing-country exports, by broad product category, 1976–2003 .....	148

---

---

**List of boxes**

---

<b>Box</b>		<i>Page</i>
1.1	Primary trade balance effects of changes in the United States GDP growth and in exchange rates .....	16
1.2	Income disparities in China and India .....	36
3.1	State income from extractive industries: a historical perspective .....	110
4.1	Towards a new structure of global maritime trade .....	144

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## Explanatory notes

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### Classification by country or commodity group

The classification of countries in this *Report* has been adopted solely for the purposes of statistical or analytical convenience and does not necessarily imply any judgement concerning the stage of development of a particular country or area.

The major country groupings used in this report follow the reclassification by the United Nations Statistical Office (UNSO). They are distinguished as:

- » Developed or industrial(ized) countries: in general the countries members of OECD (other than Mexico, the Republic of Korea and Turkey) plus the new EU member countries which are not OECD members (Cyprus, Estonia, Latvia, Lithuania, Malta and Slovenia).
- » The category South-East Europe and Commonwealth of Independent States (CIS) replaces what was formerly referred to as “transition economies”.
- » Developing countries: all countries, territories or areas not specified above.

The terms “country” / “economy” refer, as appropriate, also to territories or areas.

References to “Latin America” in the text or tables include the Caribbean countries unless otherwise indicated.

Unless otherwise stated, the classification by commodity group used in this Report follows generally that employed in the UNCTAD *Handbook of Statistics 2004* (United Nations publication, sales no. E/F.05.II.D.2).

### Other notes

References in the text to *TDR* are to the *Trade and Development Report* (of a particular year). For example, *TDR 2004* refers to *Trade and Development Report, 2004* (United Nations publication, sales no. E.04.II.D.29).

The term “dollar” (\$) refers to United States dollars, unless otherwise stated.

The term “billion” signifies 1,000 million.

The term “tons” refers to metric tons.

Annual rates of growth and change refer to compound rates.

Exports are valued FOB and imports CIF, unless otherwise specified.

Use of a dash (–) between dates representing years, e.g. 1988–1990, signifies the full period involved, including the initial and final years.

An oblique stroke (/) between two years, e.g. 2000/01, signifies a fiscal or crop year.

A dot (.) indicates that the item is not applicable.

Two dots (..) indicate that the data are not available, or are not separately reported.

A dash (-) or a zero (0) indicates that the amount is nil or negligible.

A plus sign (+) before a figure indicates an increase; a minus sign (-) before a figure indicates a decrease.

Details and percentages do not necessarily add up to totals because of rounding.

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## Abbreviations

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ATC	Agreement on Textiles and Clothing
ASEAN	Association of Southeast Asian Nations
bpd	barrels per day
CIS	Commonwealth of Independent States
CPI	Consumer Price Index
ECLAC	Economic Commission for Latin America and the Caribbean
EIA	Energy Information Administration (United States)
EIU	Economist Intelligence Unit
ESCAP	Economic and Social Commission for Asia and the Pacific
ESCWA	Economic and Social Commission for Western Asia
EU	European Union
FAO	Food and Agriculture Organization of the United Nations
FDI	foreign direct investment
FFE	foreign funded enterprise
f.o.b.	free on board
GDI	gross domestic income
GDP	gross domestic product
GFCF	gross fixed capital formation
GNI	gross national income
GSTP	Global System of Trade Preferences
GTAP	Global Trade Analysis Project (model)
ICT	information and communication technology
IEA	International Energy Agency
IMF	International Monetary Fund
IT	information technology
LDC	least developed country
MDG	Millennium Development Goal
MERCOSUR	Southern Common Market
MFA	Multi-Fibre Arrangement
NBTT	net barter terms of trade

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NIE	newly industrializing economy
NIIP	net international investment position
NPL	non-performing loan
OECD	Organisation for Economic Co-operation and Development
OEM	original equipment manufacturing
OPEC	Organization of the Petroleum Exporting Countries
PPP	purchasing power parity
R&D	research and development
RCA	revealed comparative advantage
REER	real effective exchange rate
RTA	regional trade arrangement
ROW	rest of the world
SARS	Severe Acute Respiratory Syndrome
SITC	Standard International Trade Classification
SME	small and medium-sized enterprise
SOE	State-owned enterprise
SPS	sanitary and phytosanitary
TDR	Trade and Development Report
TNC	transnational corporation
TRIPS	trade-related aspects of intellectual property rights (also TRIPS Agreement)
UN	United Nations
UN COMTRADE	United Nations Commodity Trade Statistics Database
UN/DESA	United Nations, Department of Economic and Social Affairs
UNESCO	United Nations Educational, Scientific and Cultural Organization
UNCDB	United Nations Common Database
UNCTAD	United Nations Conference on Trade and Development
VER	voluntary export restraint
WTI	West Texas Intermediate (price – reference price for standard crude oil)
WTO	World Trade Organization
Y2K	year 2000



## OVERVIEW

*Looking at recent trends in the world economy from the perspective of the Millennium Development Goals (MDGs), the good news is that in 2004 growth in the developing countries was rapid and more broad-based than it had been for many years. Strong per capita income growth continued in China and India, the two countries with the largest number of people living in absolute poverty. Latin America has seen a rebound from its deep economic crisis, and a return to faster growth, fuelled by export expansion. Africa again reached a growth rate of more than 4.5 per cent in 2004. Moreover, relatively strong growth in many African countries is envisaged in the short-term, owing to continuing strong demand for a number of their primary commodities. The bad news is that even growth rates of close to 5 per cent in sub-Saharan Africa are insufficient to attain the MDGs, and that the outlook for 2005, overshadowed by increasing global imbalances, is for slower growth in the developed countries with attendant effects on the developing countries.*

*Since the beginning of the new millennium, the performance of the world economy has been shaped by the increasingly important role of China and India. Rapid growth in these two large economies has spilled over to many other developing countries and has established East and South Asia as a new growth pole in the world economy. Their ascent has been accompanied by new features of global interdependence, such as a brighter outlook for exporters of primary commodities, rising trade among developing countries, increasing exports of capital from the developing to the developed countries, but also intensified competition on the global markets for certain types of manufactures.*

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## Global prospects and imbalances

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The slowdown in global output growth in 2005 is mainly due to a deceleration in the major developed economies and some emerging economies in Latin America and East Asia. The temporary weakness in the United States economy has not been compensated by stronger growth performance in the euro area and in Japan. Both continue to lack the dynamism needed to redress domestic imbalances and to contribute to an adjustment of the global trade imbalance. Indeed, beginning in the second half of 2004, output growth in the euro area and Japan has slowed down markedly, causing forecasts for 2005 to be revised downwards. While greatly benefiting from the global expansion over the past three years, and especially the Asian boom, neither the euro area nor Japan has managed to revive domestic demand.

Another reason for concern about global economic prospects is the increase in oil prices, which have doubled since mid-2002, to reach \$58 per barrel in July 2005, despite flexible supply adjustments on the part of oil producers. However, the much feared shock of surging oil prices on economic activity and inflation in developed countries, an impact of the kind witnessed in the 1970s, has so far not occurred, for two reasons. First, developed countries have become less oil dependent, as energy is being used more efficiently. At the same time, the share of services in their GDP has gained in importance at the expense of industry, where more energy is used per unit of output. Second, the recent oil price increase was not the result of a big supply shock, but of a gradual increase in demand. Under these conditions, the wage and monetary policy responses in the developed countries have been measured, and have not jeopardized price stability or output growth.

The recent surge in oil prices has a stronger impact on oil-importing developing economies, especially in countries where industrialization has led to greater dependence on oil imports. In Brazil, for example, the oil intensity of domestic production is 40 per cent higher than the OECD average; in China and Thailand it is more than twice as high, and in India almost three times as high as in the OECD countries. Therefore, it is primarily in developing countries where inflationary pressures resulting from further rising oil prices imply risks for the sustainability of the growth process. Even though inflation has so far been modest, monetary policy has already been tightened in some countries.

On the other side, not only oil exporters but also many developing countries exporting non-oil primary commodities benefited from increased demand and rising prices for their exports. Since 2002, strong demand from East and South Asia, in particular China and India, has been the main factor behind the hike in commodity prices. In the markets for some primary commodities, emerging supply constraints have also contributed to the strong price reaction. Asian demand for primary commodities, particularly for oil and minerals such as copper, iron ore and nickel, as well as for natural rubber and soybeans, is likely to remain strong, boosting the earnings of the exporters of these products. But further developments on the markets for primary commodities will also critically depend on how

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much additional supply capacity will be created by recent new investments, how fast this capacity will go on-stream, and how commodity demand from developed countries will be affected by the need to correct the existing trade imbalances.

Despite the increasing importance of the fast growing developing countries for international commodity markets, developed countries, which still account for two thirds of global non-fuel commodity imports, will continue to play an important role. It is unlikely that the growing imports of primary commodities by China and India alone will bring about a permanent reversal of the declining trend in real commodity prices. Indeed, in real terms, commodity prices are still more than one third below their 1960–1985 average. Moreover, the sharp fluctuations in commodity prices constrain the ability of many developing countries to attain a path of stable and sustained growth and employment creation that could benefit all segments of their population and allow them to reach the MDGs.

The large global current-account imbalances represent the greatest short-term risk for stable growth in the world economy. The United States trade deficit has continued to grow despite the depreciation of the dollar: it has lost 18 per cent of its value on a trade-weighted basis since February 2002. And the United States current-account deficit accounts for two thirds of the combined global surpluses. The deficit has increased in recent years vis-à-vis virtually all its trading partners; the increase has been the most pronounced in trade with Western Europe and China. On the other hand, China's trade is in surplus not only with the United States but also with many other developed countries. However, despite these surpluses, China's imports from these countries have also increased rapidly, as have its imports from neighbouring countries and other developing countries.

A well coordinated international macroeconomic approach would considerably enhance the chances of the poorer countries to consolidate the recent improvements in their growth performance. Such an approach would also have to involve the major developing countries and aim at avoiding deflationary adjustments to the global imbalances.

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## **East and South Asia as a new growth pole**

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Asia has been a region of economic dynamism over the past four decades, with different economies in the region successively experiencing rapid growth. The large size of the countries that entered this process most recently, China and India, has established the East and South Asian region as a new growth pole in the world economy. Due to the high dependence of these large Asian economies on imports of primary commodities for industrial output growth, in particular fuels and industrial raw materials, and the resulting linkages with other developing countries, variations in their growth performance will have strong repercussions on the terms of trade and export earnings of other developing countries. This inevitably raises the question of the sustainability of the pace of growth of these two economic powers in the medium and long term.

In terms of per capita GDP, both China and India still have a long way to go to approach the levels of the leading economies. Their potential for catching up is enormous. To realize this potential, it will be crucial for both countries to achieve further productivity gains in manufacturing activities

and ensure that all segments of their population participate in income growth. Broad-based income growth is essential for accelerating the eradication of poverty and gaining widespread social acceptance of the required structural changes; but wage increases throughout the economy in line with rising productivity are also a central pillar for the expansion of domestic consumption and, thus, the sustainability and stability of output growth. Fixed capital formation depends on favourable demand expectations in general, and not just on exports, which are subject to the vagaries of the world market and to changes in international competitiveness.

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## Shifting trade patterns in China and India

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Sustained rapid growth and rising living standards in China and India have been accompanied by a dramatic increase in Asia's shares of world exports and raw material consumption. Given the large size of the Chinese and Indian economies and their specific patterns of demand, changes in their structure of supply and demand have a much larger impact on the composition of world trade than did those of other late industrializers in Asia during their economic ascent. The impact of China's growth on international product markets and global trade flows is already apparent. India's merchandise trade structure may follow a sequence of changes similar to that of China, with a lag of one or two decades, if industrialization in India gains the same importance in its further economic ascent as it did in the other fast growing Asian economies.

Metal use in China – and to a lesser extent in India – has strongly increased over the past few decades, particularly since the mid-1990s. In China, growth in the use of aluminium, copper, nickel and steel now exceeds that of GDP. Part of this recent increase coincides with very high rates of investment, especially in infrastructure. However, this recent rapid rise in China's intensity of metal use, and the concomitant increase in its imports of minerals and mining products, may well slow down once investment growth, especially in construction and infrastructure, decelerates. By contrast, India's intensity of metal use has remained fairly stable over the past four decades, reflecting the country's slower pace of industrialization and the relatively small share of investment in infrastructure in its GDP.

China's energy use has steadily increased since the 1960s, but at a slower rate than its GDP. Its future energy use will depend on how opposing trends play out: on the one hand, continued rapid industrialization, higher living standards and improved transport infrastructure will tend to further increase energy use; on the other hand, there remains considerable potential for the adoption of energy-saving technologies. In either case, China's energy demand is likely to continue to outpace the future growth of domestic supply.

Agricultural imports will be determined by a number of factors. To the extent that imports of raw materials for industrial use are needed as production inputs for the expanding domestic market, import demand will grow further. This is likely to be the case for rubber and wood. On the other hand, imports of cotton, which to a large extent have depended on the production of textiles and clothing for export,

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can be expected to slow down as the composition of exports shifts to more technology-intensive products.

A continuous increase in average living standards and further progress in poverty reduction in China will also lead to higher demand for food and to a change in its dietary composition. So far, China has remained largely self-sufficient in all major food items. But with increasing consumption it is likely to become more dependent on food imports in the future, notwithstanding possible productivity and output growth in its domestic agricultural sector as a result of recent agricultural policy reforms. Given the size of its economy, even small changes in self-sufficiency ratios can have a considerable impact on China's agricultural imports.

Since the mid-1980s China has substantially upgraded its export basket, in which labour- and resource-intensive manufactures and, increasingly, electronics, have become dominant. China's exports still have a relatively high import content, but there are indications of a rise in the share of domestic value added in China's processing trade, particularly in the electronics sector. India has not experienced the kind of manufacturing export boom that has characterized the other rapidly growing economies in Asia. It has become a leading exporter of software and IT-enabled services, particularly to the United States, but it is highly uncertain whether their share in India's export earnings can rise much further. Over the next few years, the absolute value of these services' exports may continue to grow, but export dynamism in manufacturing is likely to become stronger.

The growth dynamics in China and other Asian economies have positive effects for many developed and developing countries. This is true for those countries that benefit directly from the surge in import demand from the fast growing Asian economies. It is also true for those that benefit indirectly through the positive growth effects in the economies of their main trading partners. Still others have achieved higher export and income growth as a result of the rise in commodity prices, even though their exports to the fast growing Asian economies are relatively small. But it also has to be recognized that China's increasing participation in international trade poses new challenges for many countries. Its weight in international markets due to the very large size of its economy may contribute to a fall in the export prices of manufactures that it produces and exports along with other developing countries, such as clothing, footwear and certain types of information and communication technology products. The rise of China's clothing exports, in particular, occurred at a time when several developing countries had adopted more outward-oriented development strategies, and many had developed production and export activities in the clothing sector partly in response to the quota regulations under the Multi-Fibre Arrangement.

There is little doubt that the pace of development in the populous Asian economies, and especially in China, requires accelerated structural change in many other countries – developing and developed alike. In some sectors, such as the clothing industry and, more generally, in activities at the low-skill end of the economy, the adjustment pressure is stronger than in others where there is less competition from low-wage producers with relatively high productivity. There are widespread fears in many countries that the pace of structural change could result in higher unemployment and lower output. Paradoxically, among the developed countries, those with large deficits in their trade balance, such as Australia, Spain, the United Kingdom and the United States, have performed much better in terms of domestic growth and employment than countries that have been recording large trade surpluses and greater competitiveness, such as Germany and Japan. Challenging the commitment of all countries to develop a global partnership for development and responding to the integration of large and poor countries by giving in to protectionist pressures would be counterproductive: most of the earnings of developing countries from their exports to the developed countries are translated into higher import demand for advanced industrial products, and thus flow back, directly or indirectly, to the latter.

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## The growing importance of South-South trade

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Trade among developing countries has sometimes been promoted as an alternative to the traditional trade pattern where developing-country trade relies mainly on primary commodity exports to developed countries in exchange for imports of manufactures. The rapid rise in the importance of South-South trade, particularly over the past two decades, reflects a number of factors. First, there has been an upswing following the downturn of such trade during the 1980s. Second, the move towards the adoption of more outward-oriented development strategies, along with trade reform and regional trade agreements, in a wide range of developing countries has significantly improved access to their markets, including for imports from other developing countries. But the most important reason for the rapid growth of South-South trade is that output growth in some large developing economies, particularly China, has been much faster than in the developed countries. Moreover, these countries' buoyant growth performance has been closely linked with increasing intraregional specialization and production-sharing.

While increased South-South trade is a fact, recent developments in the developing countries as a whole require a careful assessment of the statistical data. Indeed, such an assessment calls for a number of qualifications to the *prima facie* impression that trade among developing countries has grown massively over the past decade or so, and that exports of manufactures account for much of that rise.

The growing role of developing countries in world trade flows appears to be the result, above all, of the above-average growth performance of a few Asian economies, and the associated shifts in the level and composition of their external trade. A substantial part of the statistical increase in South-South trade in manufactures is due to double-counting associated with intraregional production-sharing in East Asia for products eventually destined for export to developed countries. It is also due to double-counting associated with the function of Hong Kong (China) and Singapore as transshipment ports or regional hub ports. The important role of triangular trade in the measured rise of South-South trade in manufactures implies that the bulk of such trade has not reduced the dependence of developing countries' manufactured exports on aggregate demand in developed-country markets. As long as final demand from developed countries – notably the United States, which is East Asia's most important export market – remains high for products for which production-sharing within East Asia plays an important role, triangular trade and, thus, South-South trade, will remain strong. On the other hand, the economic rebound in Latin America has improved the prospects for South-South trade in manufactures that is not related to triangular trade.

The rise of South-South trade in primary commodities appears more modest in trade statistics. However, it has involved a larger number of countries than the strong rise of South-South trade in manufactures. It has allowed Africa, as well as Latin America and the Caribbean to recoup some of the market shares in total South-South trade that they had lost in the 1980s. Indeed, the rise in South-

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South exports of primary commodities to the rapidly growing Asian developing countries is likely to evolve into the most resilient feature of what has come to be called the “new geography of trade”.

The promotion of South-South trade remains a desirable objective for a variety of reasons. First, sluggish growth in developed countries and their continued trade barriers against products of export interest to developing countries implies that developing countries need to give greater attention to each other’s markets to promote export growth in order to achieve their economic growth targets. Second, the vast size of the rapidly growing Asian economies reduces the need for developing countries to seek developed-country markets in order to benefit from economies of scale. Third, continued dependence on developed-country markets exposes developing countries to possible pressure that links better access to those markets with binding commitments to rapid trade and financial liberalization, protection of intellectual property and an open-door policy for FDI. More generally, it also entails the risk of increasingly narrowing the policy space for developing countries.

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### Terms of trade revisited

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The recent and ongoing changes in international trade, with respect to both product composition and direction of trade, is affecting developing countries in different ways, depending on the product composition of their exports and imports. On the export side, the impact differs according to the shares of manufactures and primary commodities, and on the import side, it is especially the dependence on fuels and industrial raw materials that determines the outcome for individual countries.

The same factors that improved the terms of trade of some groups of countries, especially the higher prices of oil and minerals and mining products, led to a worsening of the terms of trade in others. In some countries, particularly in Latin America, but also in Africa, the positive effect of price movements on the purchasing power of exports was reinforced by an increase in export volumes; whereas in others, gains from higher export unit values were compensated, or even over-compensated, by higher import prices. Since 2002, economies with a high share of oil and minerals and mining products in their total merchandise exports have gained the most from recent developments in international product markets. The terms of trade of countries with a dominant share of oil exports increased by almost 30 per cent between 2002 and 2004, and those of countries with a dominant share of minerals and mining products in their exports increased by about 15 per cent. Terms-of-trade developments have varied the most among economies where agricultural commodities have dominated total merchandise exports. This reflects large differences in the movement of prices for specific products within this category, differences in the shares of other primary commodities in their exports and the share of oil in their merchandise imports.

Developing countries for which manufactures are the dominant category of exports, and which are at the same time net importers of oil and minerals and metals have seen a deterioration in their terms of trade in the past two or three years. The deterioration, due to the combined effects of rising prices of imported primary commodities and stagnating or falling prices of their manufactured exports, could well become a longer term feature in their external trade. There are two reasons for this: first, there are indications that the prices for their manufactured exports are falling relative to the prices of

the manufactures they are importing from the developed countries; second, prices for primary commodities are likely to remain strong as long as industrial growth remains vigorous in the large Asian economies and the imbalances in the developed world can be settled without entering into a recession.

Indeed, the terms-of-trade losses of exporters of manufactures among the developing countries are partly explained by the pace of the catch-up process in some of these countries, particularly in China and India. This process has been driven by higher productivity in the export sectors, which has given them a competitive edge and led to higher import demand. The variations in the global pattern of demand and their impact on individual countries have resulted in a redistribution of income, not only between developed and developing countries, but also, and to an increasing extent, between different groups of developing countries. However, it is important to recognize that a change in the distribution of real income does not necessarily imply absolute losses. As long as output growth is strong enough, all countries can gain in terms of real income, with some gaining more than others, depending on the structure of their exports and the international competitiveness of their producers: a terms-of-trade deterioration can be compensated by rising export volume. The probability for this to happen is much greater if exports consist of manufactures, for which the price elasticity of demand is high, than if they consist of primary commodities.

The productivity gains in Asia have led not only to higher company profits, but also to higher wages; they have also benefited consumers at home and abroad through lower prices. Higher export earnings, despite lower export prices, have enabled Asian countries to pay higher prices for imported inputs, which, in turn, has represented terms-of-trade gains for many primary commodity exporters. Moreover, exports from Asia also benefit from rising demand in those developing countries that have seen their export earnings rise thanks to growing Asian demand for their commodities.

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## **Policies for managing the new forms of global interdependence**

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Although continuing growth in East and South Asia and recovery in other regions of the developing world are likely to sustain the demand for primary commodities, the basic problem of instability in these prices and their long-term tendency to deteriorate in real terms vis-à-vis the prices of manufactures, especially those exported by developed countries, remains unresolved. Therefore, it is imperative for developing countries not to become complacent about industrialization and diversification. There is a risk that the recent recovery of primary commodity markets could lead to a shift away from investment – both domestic and foreign – in the nascent manufacturing sectors of commodity-exporting countries in favour of extractive industries. While higher investment in that area may be beneficial in terms of creating additional supply capacity and raising productivity, this should not be at the expense of investment in manufacturing. Exporters of primary commodities that have recently benefited from higher prices and, in some cases, from higher export volumes, have to continue their efforts towards greater diversification within the primary commodity sector, as well as upgrading their manufacturing and services sectors. The recent windfall gains from higher primary commodity earnings provide an opportunity to step up investment in infrastructure and productive capacity – both essential for boosting development.

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At the national level, this raises the question of the sharing of export revenues from extractive industries, which has always been a central concern in development strategy. Higher global demand and international prices for fuels and mining products have been attracting additional FDI to these sectors in a number of developing countries, and this may increase the scope in these countries for mobilizing additional resources for development. However, government revenues from taxes on profits in these sectors have typically been very low, partly due to a policy since the beginning of the 1990s of attracting FDI through the offer of fiscal incentives. Such a policy risks engaging potential host countries in “a race to the bottom” which, clearly, should be avoided.

Additional sources of fiscal revenue from primary export-oriented activities may be royalties, the conclusion of joint ventures or full public ownership of the operating firms. However, efforts to obtain adequate fiscal revenue should not deprive the operators, private or public, of the financial resources they need to increase their productivity and supply capacity, or their international competitiveness. Recent upward trends in world market prices of fuels and minerals and mining products as a result of growing demand from East and South Asia provide an opportunity to review the existing fiscal and ownership regimes. Such a review – which is already under way in several countries – and possible strategic policy adjustments could be more effective if oil and mineral exporting countries would cooperate in the formulation of some generally agreed principles relating to the fiscal treatment of foreign investors. Moreover, a higher share of the public sector or consumers in the rent generated by extractive industries does not automatically enhance development and progress towards the MDGs; it has to be accompanied by strategic use of the proceeds for investment that would enhance productive capacity in other sectors, as well as in education, health and infrastructure.

At the international level, recent increases in the prices of some primary commodities and improvements in the terms of trade of a number of developing countries may not have changed the long-term trend in real commodity prices or altered the problem of their volatility. Wide fluctuations in primary commodity prices are not in the interest of either producers or consumers. This has also been recognized by the IMF’s International Monetary and Financial Committee, which, at its April 2005 meeting, *inter alia*, underscored “the importance of stability in oil markets for global prosperity” and encouraged “closer dialogue between oil exporters and importers”. Although primary commodities other than oil may be less important for the developed countries, they are nevertheless equally, if not more important for those developing countries that depend on exports of such commodities. And since in many of the latter countries extreme poverty is a pressing problem, the issue of commodity price stability is of crucial importance not only for the achievement of the MDGs but also for global prosperity in general. Consequently, in the spirit of a global partnership for development, the international community might consider reviewing mechanisms at the global or regional level that could serve to reduce the instability of prices of a wider range of commodities, not just oil, to mitigate its impact on the national incomes of exporting countries.

In the short term, however, the central policy issue concerns the correction of existing global trade imbalances. It is often argued that the decision of central banks in the developing world, and in particular in Asia, to intervene in the currency market is the main reason for these imbalances. Indeed, most of the intervening countries explicitly try to avoid currency appreciation that could result from speculative capital inflows, in order to ensure that the international competitiveness of the majority of their producers is not put at risk. Most of the East Asian countries adopted a system of unilateral fixing of their exchange rates following the Asian financial crisis, while most Latin American turned to managed floating. In both cases, the aim has been to maintain the real exchange rate at a competitive level while gaining a certain degree of independence from international capital markets.

In the absence of a multilateral exchange rate system that takes account of the concerns of small and open developing economies, such unilateral stabilization of the exchange rate at a competitive level appears to be an effective means of crisis prevention. Individual central banks do have the capacity

for successful and credible counter-attacks when their own currency is under “threat” or pressure to appreciate. By contrast, they are practically powerless to stabilize an exchange rate that has come under threat or pressure to depreciate, even if central banks have accumulated huge reserves of international currency. It would require multilateral cooperation and policy coherence to address this type of asymmetry. The premature liberalization of capital markets has seriously heightened the vulnerability of developing countries to external financial shocks. Moreover, it has become clear that strengthening domestic financial systems is not enough to significantly reduce that vulnerability.

For a smooth redressing of the global imbalances, it is essential to avoid a recession in developed countries – where growth has been depending excessively on the United States economy – and a marked slowdown in developing countries. A scenario which seeks to correct the global imbalances, and most importantly the external deficit of the United States, through massive exchange rate appreciation and lower domestic absorption in China and other developing countries in Asia, will almost inevitably have a deflationary impact on the world economy. It will not only jeopardize China’s attempts to integrate a vast pool of rural workers and, more generally, reduce poverty, but will also adversely affect the efforts of other developing countries towards achieving the MDGs.

By contrast, adjusting the global imbalances will be less deflationary if demand from the euro area and Japan grows faster. It should not be forgotten that much of the counterpart to the United States’ external deficit is to be found in the surpluses of other developed countries. The current-account surpluses of the euro area and Japan with the rest of the world are mushrooming – despite rising import bills for oil and other primary commodities. Indeed, Japan and Germany together accounted for \$268 billion or about 30 per cent of the combined global current-account surplus in 2004. This compares with an overall current-account surplus of \$193 billion in East and South Asia. China, the country on which revaluation pressure has been most intense, accounts for just over one third of this amount, or less than 8 per cent of the combined global surplus.

International initiatives to alleviate poverty and to reach the MDGs should not ignore the importance of a smooth correction of the global imbalances so as to ensure the sustainability of the “Asian miracle”. Indeed, further economic catch-up by China and India will have expansionary effects for most developing countries. Any slowing down or disruption of this process would carry the risk of intensifying global price competition on the markets for manufactures exported by developing countries, while weakening the expansionary effects resulting from the growing demand from Asia.



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