Adjusting to Trade Reforms

3

1. INTRODUCTION

In chapter 1, trade liberalization, represented by openness to the trade indicator of the TDI, was found to be the most significant driver of trade and development performance, especially in the case of developing countries. That gains from trade liberalization come about in the long run is widely accepted, at least in the absence of externalities, but there are often short- to medium-term adjustment implications. This is because as economies open up, imports use existing channels while new exports often come from different sectors that have to gear up production and find new markets. The structural unemployment that occurs as this transition takes place is perhaps the major social cost of adjusting to trade reforms. Other adjustments include the need to replace tariff revenues as protection is reduced; the likely losses of preferences in overseas markets as MFN rates are lowered under multilateral liberalization; and intra- and intersectoral reallocation of resources in response to changes in the levels of protection.

All these and other possible changes, by producing winners and losers, ultimately affect the level of well-being of people through altering their access to goods, services and opportunities. Particularly at risk are those that are least able to cope with the changes induced by trade reforms, including the poor, women, elderly, and unskilled and low-skilled workers. Unfortunately, most developing countries do not have well-developed social safety nets—unemployment benefits, retraining programmes, portable pensions, etc.—to address these problems. From this perspective, liberalization can pose some serious short- to medium-term implications for human development in developing countries, and these countries may need adjustment assistance going beyond implementation support to see them through this process.

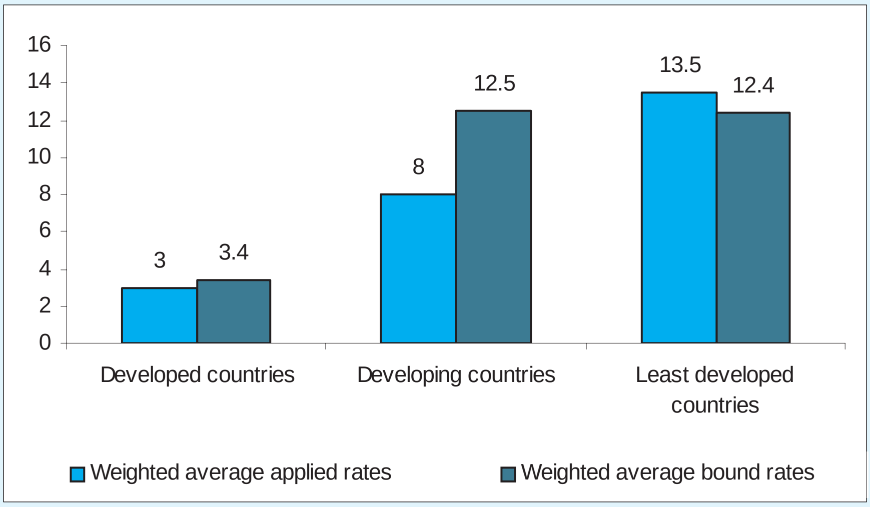
To gauge the possible developmental implications of trade reforms, an essential first step is to examine the kind and extent of their economic impact. To that end, this chapter looks at the experience of a number of developing countries that have undergone important trade reforms as well as the possible magnitude of further adjustments under the current WTO negotiations, drawing upon a number of country studies,[1] and CGE modelling of various proposals in the current WTO negotiations, supplemented by a review of a number of other studies on the adjustment process. This study on adjustments to trade reforms will be useful also in the further development of the trade and development index, especially by helping to design shocks in trade and trade-related processes and simulate resulting changes in development outcomes.

2. EXPERIENCES OF ADJUSTMENT TO TRADE REFORM

Developing countries have undergone major trade reforms in the last 10-15 years, often under World Bank/IMF lending programmes, regional trade agreements (RTAS)—mainly in the 1990s—commitments undertaken in the Uruguay Round, and in accessions to the WTO.[2] Tariffs are now low to moderate in most countries (figures 3.1 and 3.2), and the main question asked in this section is how these countries fared under the reform process.

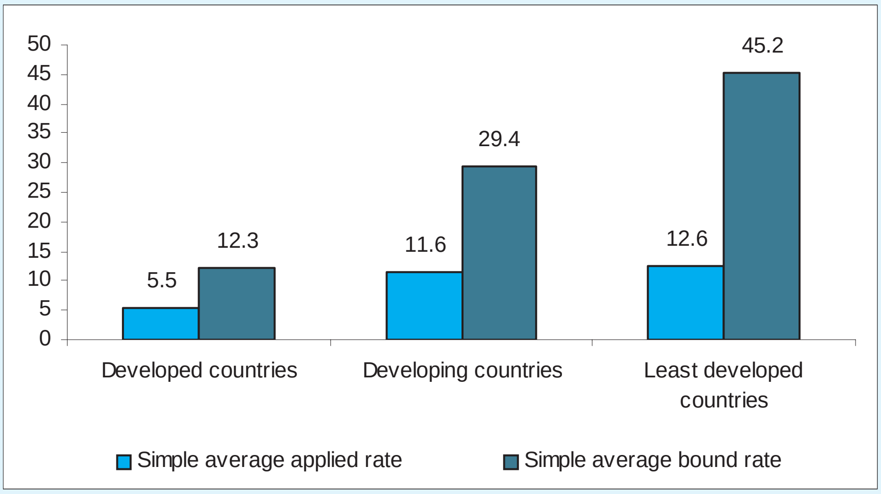
It is important to note that a number of countries had difficulties in generating a supply response in terms of alternative production process and exports. However, in a number of sectors, tariff peaks and escalation provide greater protection for sensitive sectors and for domestic processing, and these tend to be biased against developing countries' main exports (table 3.1, figure 3.3), making it harder for them

Figure 3.1. Trade-weighted bound and applied average industrial tariffs (per cent)



Source: Fernandez de Córdoba, Laird and Vanzetti (2004a).

Figure 3.2. Simple bound and applied average industrial tariffs (per cent)



Source: Fernandez de Córdoba, Laird and Vanzetti (2004a).

to expand into areas where they have comparative advantage when import-competing sectors face the challenge of increased competition under liberalization programmes. In addition, where markets were opened, additional problems of entry occurred, for example, because of the use of SPS/TBT measures, or developing countries were unable to capture the gains from trade because of the control of marketing channels by a few large intermediaries.

The country studies commissioned by UNCTAD covered Bangladesh, Brazil, Bulgaria, India, Jamaica, Malawi, the Philippines and Zambia – chosen to provide a sample from different regions, different sizes, and different stages of development as well as data availability.[3] As in the case of developing countries more generally, these countries undertook substantial trade reforms, of which tariff reductions were a major component, although the extent of the reductions varied widely (figure 3.4).

The overall results in terms of real economic growth in the period since the reforms varied widely, with strong growth in a number of cases, while growth faltered in other cases, and a number of countries saw an economic decline at the time of the Asian, Russian and Brazilian crises of 1997/98 (figure 3.5). Jamaica showed the most sluggish growth over the period, scarcely passing 2 per cent in any year. Malawi's growth rate declined almost steadily from 1995 to minus 4 per cent in 2001, but there was a weak recovery in 2002. In the sample, the most consistent results were growth of around 5 per cent for India and Bangladesh. The most remarkable reversal was that of Bulgaria, which went from minus 9 per cent in 1996 to over 4 per cent in 2002.

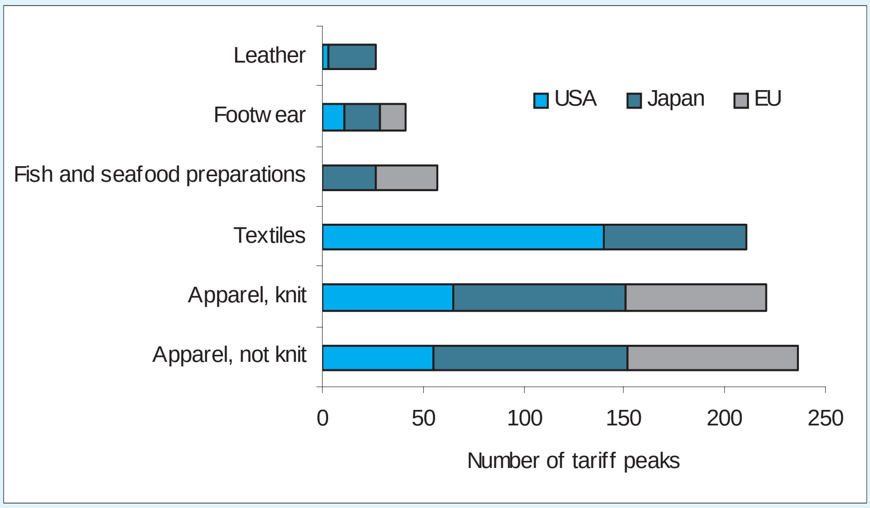
Obviously, economic growth depends on many factors, some of which are related to demand conditions in the rest of the world, and so it is difficult to explain the variations in growth entirely as a result of the reforms. Moreover, the range of possible explanations is so great in relation to the availability of data that obtaining a more precise explanation and identifying the role of specific factors by econo-

Table 3.1. **Average applied tariff rates by country groups (per cent)**

	Exporter		
	Developed countries	Developing countries	Least developed countries
Importer			
Developed country	1.31	2.12	3.05
Developing country	9.00	6.26	6.33
LDCs	10.88	14.79	9.95

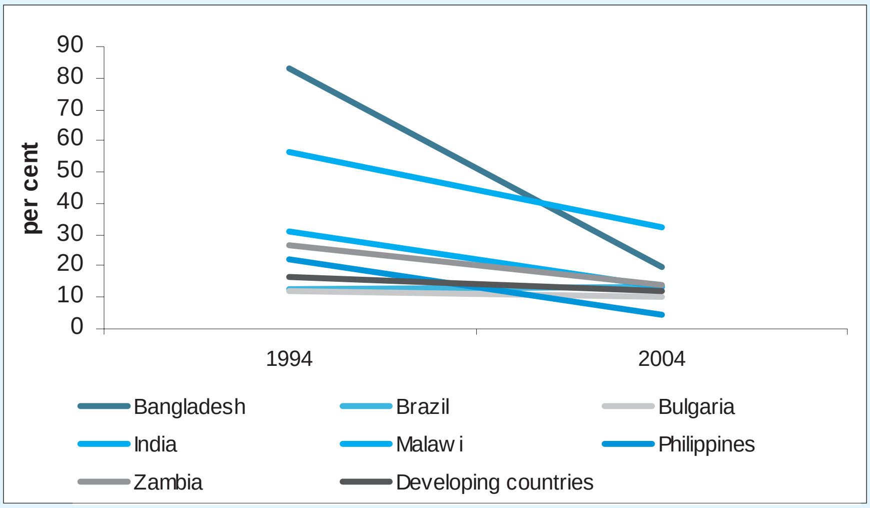
Source: Fernandez de Córdoba, Laird and Vanzetti (2004a).

Figure 3.3. **Number of tariff peaks among selected developed countries**



Source: Fernandez de Córdoba, Laird and Vanzetti (2004a).

Figure 3.4. Trade-weighted bound and applied average industrial tariffs



Source: Fernandez de Córdoba, Laird and Vanzetti (2004b).

metric means is practically impossible. The purpose of the case studies then was to try to apply a standard approach, using descriptive statistics and local knowledge to try to distinguish the important elements, positive and negative, in each case.

It is possible to draw some conclusions as to the lessons:

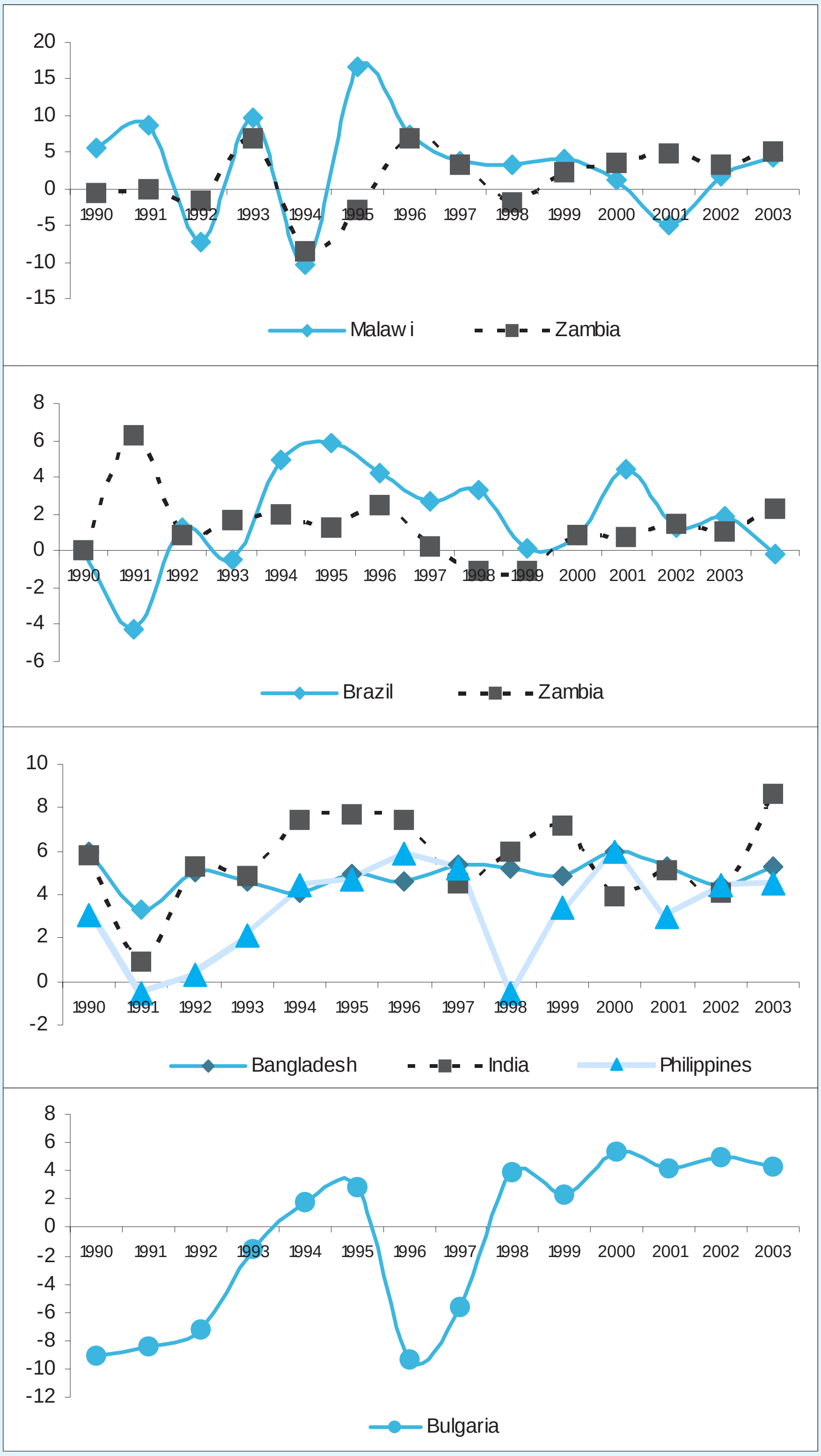
- Despite years of experience in reform programmes, there is no "cookbook" to ensure monotonically increasing levels of welfare as reforms are implemented, and serious mistakes are still being made on timing, sequencing, implementation and inclusion of all essential elements that are relevant in each case. Little account seems to have been taken of adjustment costs in the design of liberalization programmes.
- Many countries in the studies embarked on a process of switching from import-substitution industrialization towards more open economies. As they started import liberalization, there was initially more rapid growth of imports than exports, and, in the majority of cases in the studies, this had severe negative effects on domestic production and employment in import-competing sectors. In some cases, these negative effects have persisted for a number of years.
- Countries that opened first to investment[4] or obtained significant FDI inflows achieved a boost in economic growth that created new jobs for those displaced under the import liberalization.

  • Conditions for investment were not explored in detail but appear to include exchange rate liberalization, macroeconomic stability, and some trade liberalization in the form of easing import restrictions, including licensing, as well as tariff reductions or waivers for investment goods, and duty waiver or drawback schemes for imported materials and components for re-exports of finished goods.

  • The studies point to the importance of political stability, good institutions and labour supply.
- The functioning of capital markets is very important, especially for small and medium-sized enterprises that cannot easily tap international capital markets when domestic borrowing rates are high, as was often the case in the countries

Figure 3.5. GDP growth rate for country case studies

GDP growth (annual %)



Source: *World Development Indicators 2005*, World Bank.

under study. (Some form of development bank, such as Brazil's Development Bank (BNDES), which borrows at sovereign rates and re-lends with a margin to cover costs, may be a key option to consider).

- The studies point to the importance of the real effective exchange rate (REER), which is relative movements of prices at home and overseas, adjusted by the nominal exchange rate. If the REER is allowed to appreciate, export competitiveness is reduced. Some countries, with high rates of inflation, have used exchange rate policy to help control domestic inflation, but with negative consequences for domestic production and exports, unless productivity can be increased more rapidly than overseas.

- Trade reforms are usually proceeded by the reduction and elimination of non-tariff measures (NTMs), followed by the rationalization of tariff structures and reduced tariff rates. In some cases, the new tariff structures are still characterized by tariff escalation—adoption of a uniform tariff structure was not observed in the countries under study - and tariff peaks remain in sensitive areas. In the first phase, when NTMs were reduced, tariff revenues increased in some cases, but fell as tariffs were later reduced.

- In the case of Bulgaria, where reforms proceed relatively quickly partly because of preparations for WTO (1996) and eventual EU accession, considerable financial support was provided by the EU. That level of budgetary support was considerably less, but nonetheless very important, under Bank-Fund programmes.

- The larger countries in the studies (Brazil, India and the Philippines) had considerable options for diversification into alternative lines of production and were able to develop some intra-industry trade. In the smaller countries, it was more difficult to develop alternatives, for example when some industries disappeared (e.g. the textiles industry in Malawi).

- Overall income growth does not necessarily lead to a more even distribution of income.

- The larger countries had better institutions to cope with reforms, but are still lagging behind compared with industrial countries. Labour market rigidities tend to encourage the growth of the informal sector. (Other studies point to the importance of institutions as a key factor explaining performance–Rodrik, 1999).

- The larger countries became important users of anti-dumping measures, as they liberalized.

- Several studies underlined the need for complementary domestic policies, including industrial, educational, labour market and social policies.

- Brazil and India had some support policies, including subsidies, but in the countries under studies, such positive policies were lacking, for example such as those reportedly used by the Republic of Korea, Ireland and Singapore, to encourage certain industries or to facilitate cluster group formation. Export processing zones were important in the Philippines.

- The importance of physical infrastructure, especially in the transport area, was noted in a number of cases. This was particularly important in Africa, where two landlocked countries were examined. The need for complementary action on competition policy in the transport sector was noted in one study.

- The reduction of preferences as MFN rates are being reduced seems to be an issue for ACP countries, and was highlighted in the Jamaica study.

- Regional trade agreements, partly to negotiate improved access to foreign markets, have played an important role in further liberalization following autonomous reforms, and, particularly in the case of Bulgaria, in modifying a number of "behind the border" measures.

- The studies highlighted the importance of involving stakeholders in obtaining public support for reform programmes. The sense of ownership of the reforms, which were intended to increase efficiency and competitiveness, could overcome current difficulties, for example hyperinflation in Brazil in the early 1990s.

3. KEY ISSUES IN ADJUSTMENT

While the various studies often take different views of the nature of adjustment costs and use different methodologies, many studies conclude that the gains from trade liberalization are often less than the adjustment costs, particularly in the presence of rigid labour markets. The difference in treatment of social and private adjustment costs helps to explain some of the variations in the findings of some empirical studies, and highlights the importance of being prepared to face the adjustment process. However, it is also clear that there are a number of questions about definition and methodology. There is also the fundamentally political question about whether those negatively affected by changes in prior protection merit assistance or compensation (e.g. entrepreneurs, workers, etc.), and, if so, there remains the practical question of how to achieve this. Most authors are united in identifying changes in the labour market as the main area of concern.

An important issue raised in the literature is that adjustment arises not just from changes in trade policy at home (or abroad) but also from a wide range of causes, such as technological change, changes in demand/tastes, changes in national law, weather/natural conditions, political (in)stability or international agreements, including trade agreements. There is no agreement in the literature as to whether it is feasible or desirable to try to separate the causes of adjustment costs. Bacchetta and Jansen (2003) underline the importance of separating adjustment costs produced by trade agreements from other costs of adjustment, while they also recognize the difficulty of this objective. Rama (2003) says that it is neither desirable nor feasible to disentangle adjustment costs, arguing that globalization as a whole and not trade agreements *per se,* causes adjustment. That is, together with trade liberalization there is a myriad of phenomena such as changes in tastes and in demand (cultural homogenization) or movements in production inputs such as labour and financial capital, and thus it is not easy, nor perhaps necessary, to determine the cause of the process of adjustment. The key issue is to put in place policies and institutions that facilitate structural adjustment, whatever the source (other than negotiating for the elimination of measures by other countries that force adjustments at home, e.g. export subsidies that threaten the home or third country markets).

Unfortunately, there is a scarcity of literature on the costs of adjustment. *Ex-post* literature varies in approach, variously attempting to measure job loss, duration of unemployment, the wage changes of those that become unemployed and eventually find new jobs, and the total costs of adjustment. Magee (1972), focusing only on labour markets, estimated adjustment costs at 12 per cent of gains from trade during the first years after liberalization. Baldwin, Mutti and Richardson (1980), unlike Magee, do not restrict themselves to labour markets and take into account problems related to capital, although they use a similar approach to compute labour adjustment costs, which are estimated at some 4 per cent in the longer run.

These moderate results are mirrored in the *ex-ante* literature, which uses CGE models to estimate the likely effects of changes to trade reform. However, most CGE models until recently are comparative static in nature, and do not take account of the adjustment process, and there are also important assumptions about the operation of the labour market. More recently, Fernandez de Córdoba, Laird and Vanzetti (2004b) showed that, while the aggregate gains from a variety of scenarios being proposed in the WTO negotiations are moderate, these aggregate results conceal large sectoral variations, both positive and negative. This is discussed further in the next section.

The implication of the main body of studies is that the phasing-in of liberalization is strongly recommended. This may seem obvious, but the experiences in Chile with autonomous reforms and Greece prior to EU accession were often used as examples of highly successfully rapid reforms (Papageorgiou, Choksi and Michaely, 1992). Today, the main thrust of the literature is that it is important to determine an appropriate transition speed based on knowledge of the demographics of the population, distribution of skills, degree of government support for unemployed workers, and laws restricting involuntary separations (Matsutz and Tarr, 1999).

It is also widely accepted in the economic literature on adjustment to reform that trade liberalization policies have to be accompanied by social safety nets and other support measures. These measures are intended to help face the undesirable consequences of trade liberalization, which are concentrated in short periods of time and on concrete groups of people. Both equity and efficiency concerns require appropriate measures. However, most studies point out that achieving macroeconomic stability is a key policy. The emphasis on labour market issues (structural unemployment) highlights the key social issue surrounding trade reform, and clearly needs to be addressed if workers are to be persuaded of the long-term benefits of the reforms.

4. HOW CAN THE WTO PROCESS HELP?

4.1 Opportunities and challenges

The current negotiations in the WTO pose challenges and opportunities with respect to adjustment issues in the developed and developing countries. First, there are challenges in that the more ambitious scenarios seem to offer greater export possibilities and greater welfare, but also imply greater imports, greater intersectoral shifts in production and employment, and greater tariff revenue losses. Second, there are also opportunities in the negotiations to correct imbalances that result from the uneven evolution of rules and the removal of measures in previous negotiations that have left both a systemic bias in the system and higher barriers against developing countries' key exports.

4.2 Sectoral negotiations

First, as noted earlier, it is generally accepted that, at least in the long term, trade liberalization improves the efficiency in the allocation of scarce resources in an economy, lifts economic welfare and contributes to economic growth.[5] However, this relationship between openness and growth is essentially an empirical matter, as economic theory provides no formal linkage. Thus, other economists criticize the econometric evidence, and emphasize the importance of governance rather than openness *per se*.[6] It should be noted that "liberalization" does not necessarily mean free trade, even in tariffs, as there can be an economic case based on externalities for long-term intervention, as noted earlier, but rather a process of allowing the play of dynamic comparative advantage by making an economy more responsive to economic forces.

The various formulae proposals now tabled remove some of the latitude for the use of tariffs for development purposes, as envisaged by GATT Article XVIII: A (and as was practised by the major developed countries at the early stages of their own industrialisation).[7] However, some of the proposals presented imply a more rapid or deeper reform in trade policy than others.

Reductions in bound rates that also reduce applied rates (and non-zero preferential rates) will lead to changes in preference margins with possible consequent effects on trade flows (trade diversion). Developing countries whose margin of preference is eroded may face negative trade diversion (on a comparative static analysis) unless their exports are regulated by import quotas. On the other hand, they may gain from the erosion of preferences within RTAs and preference schemes of which they are not beneficiaries. LDCs and ACP countries with deep preferences most likely face negative trade diversion, but much depends on their utilization of such preferences. Where utilization ratios are low, possibly associated with the application of rules of origin, the gains from trade creation would be more important.

It is also important to take account of a number of other factors that can influence the outcome either way. First, if there is a general stimulus to trade and investment as a result of the current WTO negotiations, the dynamic effect on general economic growth may offset any possible negative effects from trade diversion. Second, much depends on the supply capabilities of developing countries to take advantage of preferences: it is widely accepted that more needs to be done to improve the supply capabilities of the developing countries, particularly the LDCs, to allow them to take advantage of trade opportunities. Third, the benefits received depend on rules of origin and other formalities, which are often restrictive, so that even LDCs, which often face zero preferential tariffs, may gain from MFN liberalization on many items. Fourth, the potential advantages of preferences are often offset by conditionalities imposed by the donors in relation to other social or economic conditions in the beneficiary countries. Fifth, most least developed countries are not participants in regional trade agreements and could likely gain from MFN liberalization in other developing country markets. Sixth, taking account of the above points, it may be preferable for most developing countries to obtain more secure MFN reductions on their key exports, rather than the preservation of preference margins on high MFN rates. To some extent, developing countries have been relatively quiescent about the barriers that the face, because they fear the possible loss of preferences. Finally, the large majority of preferences have been captured by relative few players and their overall value for many developing countries is quite small.

Tariff revenues are an important source of government revenue for many developing countries. IMF data indicate that the contribution of tariff revenues ranges greatly from virtually nothing in Italy to 75 per cent in Guinea. Less extreme examples are Cameroon and India, where tariff revenues represent 28 and 20 per cent of government revenues, respectively; these are still substantial shares in revenues to be replaced by alternative forms of taxation. Eliminating tariffs altogether implies that tariff revenues would be reduced to zero. However, while tariff reductions, short of elimination, reduce revenues from existing imports, these reductions may be wholly or partly offset by the increased demand for imports, creating a higher revenue base. Any revenue losses would need to be replaced with taxes on income, profits, capital gains, property, labour, consumption or non-tax revenues. This is a long-term process that can be expensive to implement. In small countries where most goods are imported, a sales or consumption tax could replace tariff revenues, but such important changes to fiscal systems are costly and take time to implement.

This gap between applied and bound tariffs that exists in many developing countries is, as noted earlier, a result of autonomous reforms, and varies widely, with Latin America typically having a tariff overhang larger than that other regions. One question regarding the various formulae being discussed is the extent to which the proposals will lead to reductions in applied rates. If developing countries are obliged to reduce MFN bound rates to levels that are below their applied rates, this would eliminate any flexibility that developing countries have to use tariffs for development purposes, as discussed earlier. Moreover, there would be an increased likelihood of resort to anti-dumping actions and other contingency measures that can be costly to apply and tend to be captured by protectionist interests.

On the other hand, if after the current negotiations, developing countries cut MFN bound rates, leaving applied rates as they are or only partly reduced, such MFN reductions should still be seen as affording increased security of access to their market. This would itself be considered a valid legal commitment in the negotiations in non-agricultural products, even where rates are set at ceiling levels, higher than applied rates, as was done in the Uruguay Round agriculture negotiations by many developed and developing countries.[8]

Assessing the impacts of across-the-board global liberalization is best undertaken with an applied general equilibrium model that captures both intersectoral and trade linkages. One study, cited in the US proposal, has estimated that developing countries could see welfare gains of more than USD 500 billion from duty-free trade.[9] Anderson (2003) computes welfare gains from complete liberalization in goods of the order of USD 250 billion of which USD 108 billion would go to low-income economies.

While these results, expressed in billions of dollars, seem impressive, the percentage changes in aggregate welfare and trade are relatively minor–often less than 1 per cent. However, these modest results in the aggregate conceal potentially important sectoral variations, as noted in some recent UNCTAD work (Laird, Fernandez de Córdoba and Vanzetti, 2003; Fernandez de Córdoba and Vanzetti, 2005). These recent studies, focusing on the negotiations on industrial tariffs, compute global annual welfare gains of the order of USD70 billion to USD110 billion–similar in order of magnitude to those in a number of other more conservative studies, including at the World Bank. However, these UNCTAD studies also examine more closely the likely effects on individual sectors, and these results indicate that, while some sectors are estimated to expand considerably in exports and production, others are likely to suffer large contractions of output and employment as imports increase. Estimates of the potential percentage changes in output in some key sectors are given in annex table A 3.1.[10] In absolute terms, the largest falls over the partial liberalization scenarios are in iron and steel (USD 2-4 billion) and petroleum and coal products (USD 5 billion).[11] Among the more significant increases is that in the output of services (USD 7-9 billion). If the tariff cuts are large enough to significantly reduce applied rates in developing countries, as in the so-called free trade scenario, there will be a big shift out of motor vehicles into services. The most significant reductions are estimated to occur in China (USD 2-3 billion).

Perhaps of greater interest are the regional changes in sectoral output. In the capping mechanism scenario, the largest fall in output is in excess of 20 per cent in the leather and petroleum and coal products sectors in Japan. The rest of the world (including the Russian Federation and Central Asia) and the rest of South Asia (i.e. excluding India) are projected to suffer a decline in the motor vehicles sector of 12 and 13 per cent, respectively. For the rest of South Asia (i.e. other than India), this erosion of output rises to 55 per cent under the WTO "Hard scenario" but falls back a little to 48 per cent under the free trade scenario (see annex table A 3.1), where reductions are spread more evenly. Indeed, the percentage cuts do not increase regularly across scenarios as the level of ambition rises, because the cuts in applied tariffs take effect unevenly, depending on the gap between bound and applied rates and the inclusion or exclusion of specific sectors under different scenarios.

On the plus side, the greatest changes in output following the capping mechanism scenario are around 30 per cent in Indonesian leather, and 25 and 13 per cent in the rest of Asia (mainly, the Republic of Korea and Taiwan Province of China) in lumber and petroleum and coal products, respectively. These changes are similar under a free trade scenario. In absolute terms, the largest positive effect is felt in the Japanese motor vehicles and chemicals, rubber and plastics sectors. The sector needing to make the most adjustment is the Japanese petroleum and coal products sector. This sector has high duties on these products, imported from the Middle East and the rest of Asia.

Among developing countries, the sectors likely to suffer most dislocation following the capping mechanism scenario are motor vehicles, chemicals, rubber and plastics and other manufactures in China, amounting to USD13 billion in forgone output. Of these sectors, the motor vehicles sector faces the most significant losses—16 per cent overall. In the sub-Saharan African region the changes are modest under the capping mechanism scenario, not exceeding 4 per cent in any sector. Under the Hard WTO scenario the percentage changes would rise to -22 per cent for leather and -8 per cent for textiles and apparel. The largest dollar value falls are in processed agriculture and petroleum and coal products. Almost all the gains are expected to be in services and transport equipment other than motor vehicles.

Perceived high adjustment costs may be one of the reasons for the hesitation of some developing countries to take on board some of the more ambitious liberalization proposals. However, as discussed in the previous section, there is relatively little documented evidence about the scale and nature of these costs or the adjustment process of local economies in the aftermath of trade liberalization, despite nearly two decades of unilateral reforms in developing and transitional economies. For informed policymaking, governments need a better understanding of the costs to their economies following changes in their tariffs.

Conceptually, adjustment costs may be defined as the cost of moving resources from one sector to another that occurs in the immediate period after changes in policies. Changes in relative prices, or regulations, make some firms or sectors uncompetitive, leading to a decline in output and, inevitably, use of inputs. In most sectors, labour is the major input, either directly or indirectly through its embodiment in intermediate inputs, which is output from other sectors. The problems in moving labour from one sector to another involve: (i) job search and relocation costs; (ii) retraining to provide the necessary skills; and (iii) temporary loss of income. These costs are mainly a function of the length of unemployment, which may be longer or shorter depending on the capacity of the local economy to adapt to trade liberalization and the ability of workers to find a new job. It is generally accepted, although evidence is indicative rather than conclusive, that adjustment costs are higher where intra-industry trade is relatively low because in these circumstances labour cannot merely switch within firms or industries (Azhar and Elliott, 2001). Moving capital from one sector to another is more problematic, and it is inevitable that some or all assets will be revalued downwards or written off altogether. It may also be easier to shift capital equipment from one unprofitable line of production to another in the same sector rather than between sectors.

4.3 Systemic issues

Apart from the specific sectoral negotiations aimed at removing market access barriers, domestic support, export subsidies and other restrictions on the trade of the developing countries, the second broad area where the WTO process can help arises from the opportunities in the current negotiations to correct a number of biases against the interests of developing countries as a result of past negotiations and past policies. In the past the GATT moved faster on areas that were relatively easy to tackle, liberalizing areas of export interest to the developed countries and tightening rules or the application of rules on subsidies, BOP measures, infant industry support, TRIPS and TRIMS, and so forth. While providing lacunae or exemptions of one form or another on agriculture, textiles and clothing, and making the provision of differential and more favourable treatment for developing countries into "best endeavours" clauses.

By creating new opportunities for the developing countries ahead of any new commitments that they may have to undertake, the economies of these countries should start to attract new investment and generate a supply-side response that should help them cope with the expected negative effect of the challenges posed by the conclusion of the current negotiations, whether through their own liberalization or the loss of preferences.

The developing countries need to be provided with flexible timetables for the implementation of new commitments. Pushing too hard, too fast could generate the kind of negative effect that has been identified in a number of countries as a result of prior episodes of liberalization. Any backlash from such effects could have negative consequences for longer-term liberalization.

Among the issues that need to be addressed include:

- Prioritized, improved access for developing countries' key exports in agriculture, manufactures and services;
- Policy space for developing countries consistent with received economic views on the importance of externalities and taking account of market imperfections;
- Realistic time frames and financial and technical support for implementation of any new commitments and support for structural adjustment (e.g. "Aid for Trade"). Such assistance should ideally be provided by the donor community, especially to the highly indebted countries, perhaps with technical support by the international financial institutions in their respective areas of expertise under the coherence arrangements without further conditionalities;
- Compensation for losses due to preference erosion, similar to that available within the EU CAP compensatory payments scheme;
- Assistance and adequate time for developing countries to restructure their fiscal systems to offset revenue losses where tariffs are reduced as a result of new commitments
- Special and differential treatment, including less than full reciprocity, in all areas of the negotiations, as identified in the Doha Ministerial Declaration.

These issues need to be resolved prior to the conclusion of the current WTO negotiations, in keeping with normal business practice that proposals should be costed, implementations should be realistically programmed and provision be made for financing. The failure to take account of similar issues, and the subsequent unexpected and often high costs, may well have led to the disillusion with the results of the Uruguay Round and to the failed WTO meeting in Seattle. Although it may take longer to strike a deal that takes account of such issues, such a deal would be more likely to retain the confidence of all WTO members in the multilateral system.

5. CONCLUSIONS

The developing countries have undertaken major trade reforms in the last 20 years and are facing further adjustments as a result of current negotiations in the WTO. These adjustments, positive and negative, are a consequence of their own liberalization affecting sectoral production and employment as well as aggregate revenues. The developing countries may also face adjustments as a result of changes in access to overseas markets, positive as barriers are brought down and negative as preference margins are eroded. All this has implications for their trade and development performance.

While some countries have done well from trade liberalization, the experience has been quite negative for a number of countries, and it is evident that there is as yet no standardized approach that guarantees success in all cases. Further work needs to be done in this area, but it is clear that both the stage of development the pre-existing institutional and policy framework are crucial. The pace and sequencing of reforms are also vital, and it would seem that while there remains uncertainty about the precise formulation of the entire package to ensure success, some caution needs to be exercised. Pushing too hard, too fast can even endanger the domestic support for reform. Much more work needs to be done on the human development dimension of adjustment, as well as on social safety nets and appropriate support policies.

Preliminary analysis from case studies and reviews of other experiences suggest that it would be desirable to anticipate such adjustment in a number of ways: encouraging domestic and foreign investment, including through legislation and institutions that are business-friendly; developing capital markets to provide access to finance especially by SMEs; providing social safety nets; introducing labour retraining and extending other skills-oriented education programmes; providing physical infrastructure, especially in the transport sector; trade facilitation; debureaucratization, helping developing countries meet SPS/TTB entry barriers in major markets; and encouraging cluster group formation. These measures should be pursued within a coherent strategy to improve trade and development performance.

The IFIs, with their considerable technical expertise in a wide range of projects, can play an important role in helping developing countries to implement or extend programmes in many of the ways outlined, and have already indicated their willingness to help, for example the IMFs' TAM. However, there is also a key role for the donor community, particularly where the affected countries are already heavily indebted.

The WTO process can also help by providing for meaningful liberalization by developed countries in areas where the developing countries have comparative advantage, ahead of the liberalization by the latter group of countries, so that jobs start to be created ahead of job losses in sectors that are likely to suffer from increased competition as their own barriers are lowered. The WTO could also usefully address systemic and rules-related issues to provide some policy space to allow the use of trade and trade-related policies for development purposes. This was partly envisaged in the original GATT, but it appears that such options, including the use of support policies in the presence of externalities, are increasingly being called into question.

APPENDIX 3

A 3.1. Change in output following the four scenarios (per cent)

	USA	Canada	Central America	Andean Pact	MERCOSUR	European Union	Other West Europe	Central and Eastern Europe	Middle East	North Africa	Sub-Saharan Africa	South Africa	China	Japan	India	Other South Asia	Indonesia	Other South-East Asia	Rest of Asia	Oceania	All other region	World
Free trade																						
Textiles	-1	-4	3	-1	-1	-1	-2	-4	-4	-6	-7	-1	2	3	3	1	5	3	6	-3	1	0.36
Wearing apparel	-2	-6	0	4	-1	-3	-2	-3	-3	2	-6	11	7	-2	15	23	12	15	2	-7	3	0.58
Leather	-1	-5	-3	-4	1	1	0	0	-13	-5	-14	-7	11	-13	10	2	21	14	5	2	-3	1.86
Chemicals, rubber and plastics	0	0	-2	-2	-1	0	0	-2	0	-4	-5	-1	-3	4	-2	-5	0	0	0	-1	-1	0.13
Motor vehicles	0	0	7	-23	1	0	0	2	-4	-25	21	-10	-18	5	-6	-47	-11	-12	3	-5	-11	0.05
Transport other than motor vehicles	-1	0	6	0	0	-2	-4	-1	0	1	20	1	2	6	-1	-19	4	1	2	0	-1	0.30
WTO Hard Formula																						
Textiles	-3	-10	3	-3	-2	-2	-5	-7	-5	-6	-8	-2	4	4	4	3	6	7	13	-8	3	0.61
Wearing apparel	-6	-19	1	2	-2	-8	-10	-8	-5	7	-9	30	18	-5	23	15	19	25	6	-15	10	-0.12
Leather	-7	-22	-6	-7	0	-1	-6	-1	-19	-11	-22	-24	17	-32	10	-8	49	18	16	3	-8	1.50
Chemicals, rubber and plastics	0	-1	0	0	0	0	0	-2	0	-1	-1	-1	-4	5	-1	-2	-1	-1	0	0	0	0.12
Motor vehicles	0	0	2	-21	-1	0	0	5	-4	-32	12	-16	-24	7	-7	-55	-8	-9	2	-5	-14	0.07
Transport other than motor vehicles	-1	1	4	0	0	-2	-6	1	2	11	33	4	1	7	0	-10	-1	-2	1	-2	0	0.09
WTO Soft Formula																						
Textiles	-4	-10	9	2	0	-3	-3	-6	-4	-4	-2	0	4	2	3	3	6	9	9	-8	5	0.62
Wearing apparel	-8	-18	9	4	0	-7	-6	-6	-7	-4	-1	17	16	-6	16	14	16	18	10	-16	14	-0.34
Leather	-9	-22	1	-1	0	-2	-3	2	-9	-2	-8	-14	14	-31	4	-11	45	11	12	-3	0	1.66
Chemicals, rubber and plastics	0	-1	0	0	0	0	0	-2	0	0	0	-1	-3	4	-1	-1	-1	0	0	-1	0	0.09
Motor vehicles	1	1	-4	-9	0	0	0	2	0	-15	1	-4	-20	5	0	-15	-1	-1	1	-3	-12	0.05
Transport other than motor vehicles	1	2	-1	-1	-2	0	-3	1	0	7	3	2	0	0	-1	-5	-4	-2	-2	-2	-1	0.08
Capping Mechanism																						
Textiles	-2	-5	8	0	0	-1	-1	-4	-2	-1	-1	-1	0	3	1	1	0	1	4	-3	2	0.09
Wearing apparel	-4	-8	11	1	0	-3	-3	0	-4	-1	-1	3	7	-2	6	6	1	2	2	-1	1	-0.15
Leather	-5	-10	3	-1	-1	1	0	3	-7	-1	-3	-10	8	-24	6	-5	29	-4	6	-3	-2	0.89
Chemicals, rubber and plastics	0	-1	0	0	0	0	1	-2	0	0	0	-1	-2	4	0	-1	0	0	0	-1	0	0.10
Motor vehicles	0	0	-4	-5	0	1	0	2	0	-7	-1	0	-16	3	0	-13	0	-1	0	-2	-12	-0.01
Transport other than motor vehicles	0	2	-2	-1	-1	0	-2	0	1	3	3	2	1	1	0	-3	-2	0	-2	-3	0	0.07

Source: Fernandez de Córdoba and Vanzetti (2005).

NOTES

1 These country studies were commissioned as part of a project funded by the United Kingdom Department for International Development, and are due to be published later in 2005 by Palgrave Macmillan, Ltd.

2 On the whole, liberalization in the developed countries has taken place as a result of GATT negotiations and RTAs, although Australia and New Zealand also undertook major independent reforms.

3 The drafts are available on the UNCTAD website at www.unctad.org/tab.

4 This was the case of India in the study and, reportedly, of China which was not covered.

5 See, for example, Sachs and Warner (1995).

6 Rodrik (1999).

7 Rodrik (2001).

8 In the Uruguay Round negotiations on agriculture, where all tariffs had to be bound by all participants, many developing countries set their new bound rates at 50 per cent.

9 Brown, Deardorff and Stern (2001).

10 Four liberalization scenarios are shown to highlight the spread of policy options. These four scenarios we call "free trade" (full tariff liberalization in the non-agricultural sector), "Hard and soft WTO" and "capping mecchanism". The free trade proposal was presented in December 2002 by the United States in the WTO Working Group on Non-Agriculture Market Access as the second phase of a two-stage implementation process, and may be regarded in a sense as a "benchmark" scenario. The second and third scenarios represent two variations of the proposals included in the Framework for Establishing Modalities in Market Access for Non-Agricultural Products (Annex B of the draft Cancún Declaration, a text by the Chairman of the WTO General Council, not agreed by WTO Members), which in turn draws on the draft text by the Chairman of the Non-agricultural Market Access (NAMA) Group. This framework text places the emphasis on a non-linear formula approach to tariff-cutting, to be supplemented by sectoral tariff elimination on products of export interest to developing countries and possibly also by zero-for-zero, sectoral elimination and request-and-offer negotiations. However, the Framework text lacks specific numbers, and here we analyse some possible variations in the key coefficient (B) in the NAMA Chairman's Draft, including the possibility of different coefficients (and hence different depth of cuts) for different groups of countries. The Hard scenario represents a more ambitious ("liberalizing") approach to the negotiations, while the Soft scenario introduces important elements of special and differential treatment that are not present in the Hard scenario. The "capping mechanism" draws from a uniform cut formula with a cap for tariff peaks and escalation. This capping element harmonizes tariffs and has an effect similar to the Swiss formula. It is therefore particularly useful in reducing tariff peaks and tariff escalation. The capping formula specifies that no tariff will be higher than three times the national average. This scenario does not include sectoral elimination of tariffs.

11 Absolute values depend on the degree of aggregation, which is necessarily somewhat arbitrary. The greater the disaggregation, the greater the likelihood of large percentage changes.

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