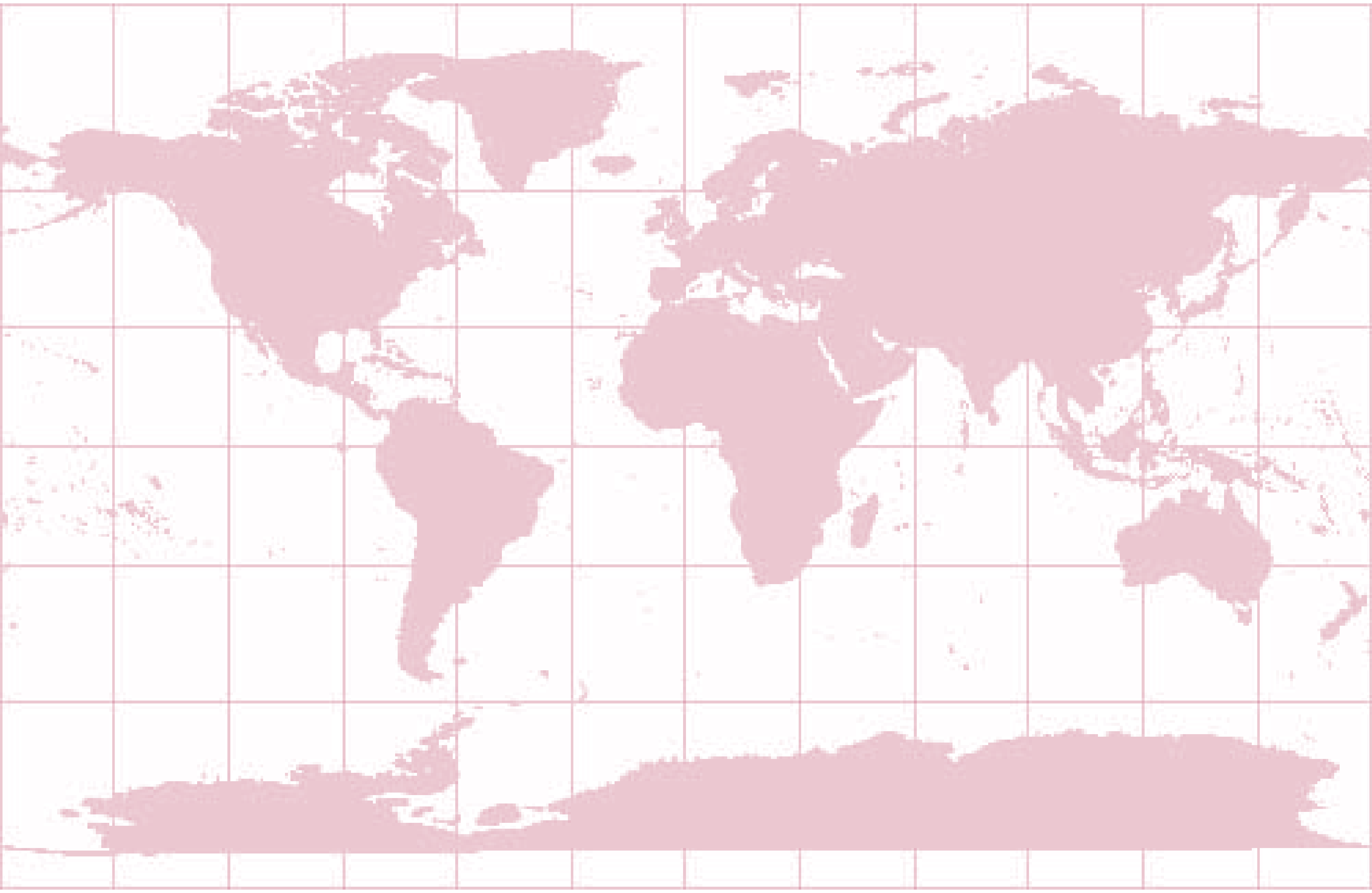
World Economic Situation and Prospects 2006



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Chapter II
International trade

Trade flows: trends and outlook

Growth of world trade decelerated in 2005...

Along with global output, growth of world merchandise trade decelerated moderately in 2005. After peaking at a growth rate of 11.0 per cent in 2004, the expansion in the volume of merchandise exports slowed to 7.1 per cent in 2005.[1] In dollar value terms, world trade increased by 12.9 per cent in 2005. Prices of merchandise exports grew by 5.5 per cent, mainly reflecting higher prices for primary commodities, as the average price of traded manufactures remained flat in the year.

...with marked divergence across countries

The deceleration of international trade was particularly evident in the developed economies. In contrast, many developing countries and economies in transition recorded relatively fast growing trade, albeit also in their case at a slower pace than in 2003 and 2004. According to the outlook, such divergences are expected to be reduced in 2006. Yet, the share of developing country exports in world trade will continue to increase. With the world economy anticipated to maintain its growth rate in the near future, the volume of world exports is expected to grow at the same pace in 2006 as in 2005—at 7.2 per cent (see table A.17). The growth in the volume of exports from developed countries is expected to strengthen to 6.0 per cent (up from 4.5 per cent), mainly owing to the anticipated rebound in business investment (see chapter I), which will increase global demand for capital goods. Demand for primary commodities will remain strong given sustained high output growth in a few large developing economies, particularly in East and South Asia. Growth in the volume of total merchandise exports of developing countries is expected to slow down to 8.7 per cent in 2006 from 10.9 per cent in 2005.

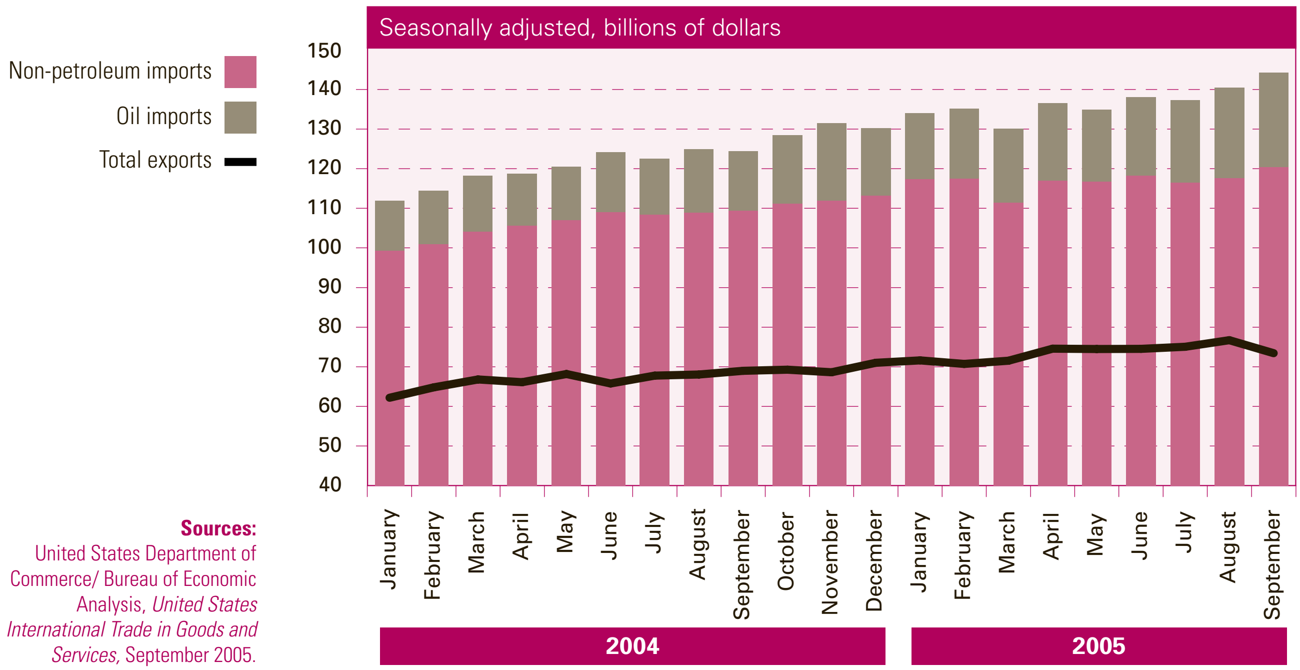
The ratio of the rate of growth of trade to the rate of growth in gross world product—estimated at 2.2 for 2005—is comparable to the average observed in the period 2001-2004. Yet, it continues to be below the average of 3 recorded during the 1990s, suggesting some moderation in the dynamics of the globalization process.

The United States merchandise trade deficit increased in 2005 and is forecast to expand further in 2006

The growth in the volume of imports decelerated in the United States of America as the economy slowed with the maturing of the economic cycle in 2005. Nonetheless, the merchandise trade balance of the United States recorded another record deficit despite faster export volume growth. The rising deficit is explained both by higher oil prices and an increase in the deficit in the non-petroleum trade balance. The oil trade deficit increased by $46 billion at the end of the third quarter of 2005 compared with the same period in 2004, while the non-oil trade deficit deepened by $42 billion. In the outlook, the expected weakening of the dollar in relation to the currencies of a few developing countries and the strengthening of investment (see chapter I) will sustain export growth by the United States, while import growth is likely to moderate further. The value of imports by the United States now doubles that of exports. As a consequence, exports must grow much faster than imports to make a dent in the trade deficit (see figure II.1). With the expected growth rates, the trade deficit will widen further in 2006.

1 Unless otherwise specified, trade figures refer to the merchandise exports. As can be seen from table A.17, growth rates for world imports and exports show some discrepancy owing to measurement errors in international trade. The discussion here is restricted to merchandise trade because of a lack of systematic and sufficiently detailed data on services trade worldwide.

Figure II.1.
United States: Merchandise exports, petroleum and non-petroleum imports, January 2004-September 2005



Sources: United States Department of Commerce/ Bureau of Economic Analysis, *United States International Trade in Goods and Services,* September 2005.

China has become a major player in international trade, absorbing about 6 per cent of world imports in 2005, up from 3.3 per cent in 2000. Dependence on Chinese markets is increasing on a worldwide basis. It is chiefly noticeable in East and South Asia, Japan, and in the least developed countries (LDCs) (see figure II.2). For the latter group of countries, China has become an important market for raw materials, notably crude oil.

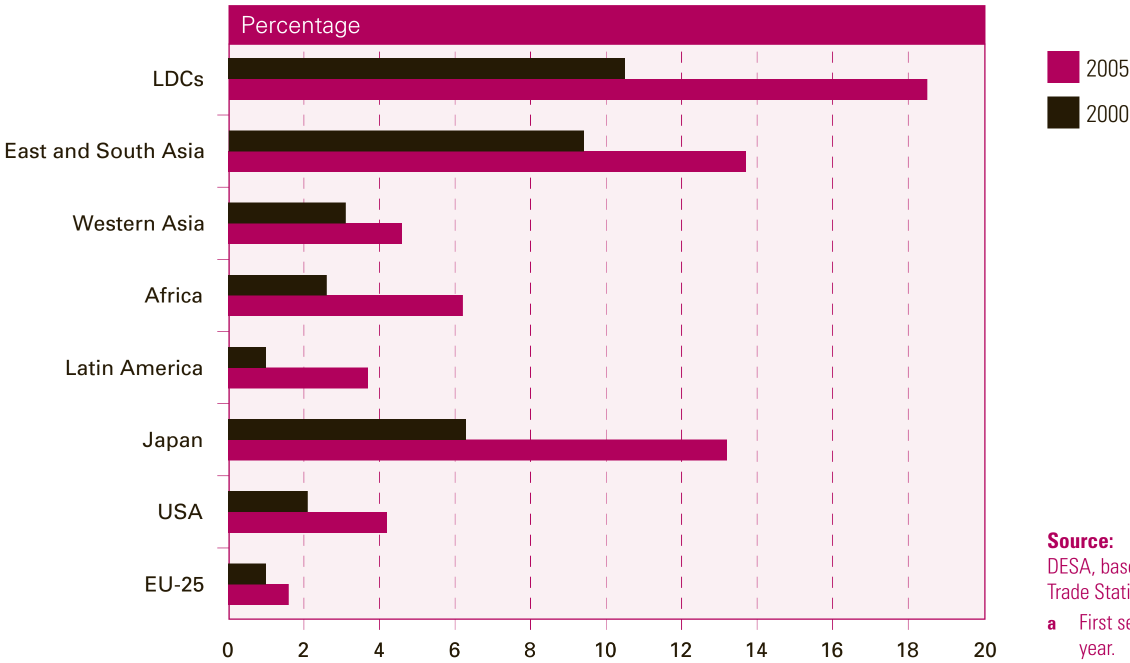
Import growth decelerated in China affecting intra-Asian trade

China's annual import growth declined in real terms from 31 to 18 per cent between 2004 and 2005. This deceleration was mainly due to weaker growth of investment in fixed assets and expectations of an appreciation of the renminbi, which led importers to delay purchases. Moreover, new manufacturing capacity came on stream, thus slowing imports of new machinery and equipment. Imports of raw materials held up better. Additionally, owing to China's insertion in international production networks (IPNs), a considerable share of the country's import demand is linked to final demand elsewhere. The deceleration of global demand thus also slowed the import demand of China. The pace of growth of intra-Asian trade moderated alongside that of China, particularly for trade in manufactures and/or semi-processed goods. The exports of Japan also felt the slowdown, as 13 per cent of the goods it ships abroad go to China.

Weak domestic demand conditions underpinned modest import growth in Western Europe

Western Europe absorbs about 40 per cent of world imports. Import demand decelerated in the euro zone in 2005, despite the boost brought about by the strength of the euro in the first half of the year. The deceleration in import volume growth in Europe was largely due to weak domestic demand in 2005 (see chapter IV). Import volumes are expected to pick up in 2006 as domestic demand strengthens in the course of the year. Japan registered similar—albeit somewhat less acute—developments with imports slowing down in real terms in 2005.

Figure II.2.
Selected regions and economies: share of merchandise exports to China in total merchandise exports, 2000 and 2005[a]



Source: DESA, based on IMF, Direction of Trade Statistics.

a First seven months of the year.

Import demand by oil exporters accelerated and helped to sustain growth in world trade

Partially offsetting the above trends, import demand by oil exporters such as Norway, OPEC members and the Russian Federation, among others, helped to sustain growth in trade. For example, African oil exporters increased imports as infrastructure investment and industrial projects were launched. Similarly, Venezuelan imports continued to swell as public investment grew. Meanwhile, imports by CIS countries accelerated in real terms because of the relaxation of the foreign exchange constraint, the rapid expansion of domestic demand and the appreciation of the currency in several economies. This notwithstanding, it seems that some governments have become more cautious than in the previous oil boom about how they spend the extra revenues. In the case of Western Asian oil exporters, a substantial amount of these resources is now going into stabilization funds and/or being used to reduce the public debt (see chapter IV). In the case of Norway, additional fiscal rules have been established according to which higher oil revenues are not allowed to lead to consumption increases but should add to public savings which have to be invested abroad.[2]

Among developing countries, import growth outpaced export growth in Latin America and South Asia in 2005, though the rate of growth was lower than in the previous year. The healthy gross domestic product (GDP) growth of South Asia led to increased import demand. Post-disaster reconstruction needs were also a factor, as in Sri Lanka after the December 2004 tsunami. Similarly, in Pakistan, reconstruction-related imports are expected to expand in 2006, after the earthquake in October 2005. African imports also increased strongly in real terms (at 11 per cent, up from 10 per cent in 2004) thanks to robust GDP growth, increased food imports in drought-affected countries and rising demand for capital goods.

2 Torbjørn Eika and Mette Rolland, *Country Report: Norway.* Paper presented at Project LINK meeting, Geneva, 31 October-2 November 2005, available from http://www.chass.utoronto.ca/link/meeting/ctryrep/norway200510.pdf.

Some economies, however, were able to sustain robust export growth

Despite slower import demand in major markets, a number of economies were able to record robust export growth, albeit with some deceleration from 2004. Exports of the new European Union (EU) members continued to grow in real terms at a relatively fast pace in 2005. This was in part due to solid gains in productivity and product quality following many years of strong foreign direct investment (FDI) inflows, relocation of production from the EU-15 to Eastern Europe and continued market diversification. Intraregional trade among the new members increased, as the remaining trade barriers fell in 2004 and their trade with South-eastern Europe and the Russian Federation also increased. Conversely, manufactured exports by the Caribbean, Central America and Mexico suffered from slower demand in the United States. Increased competition by China in the United States market has also played a role. Meanwhile, the strength of the euro contributed to restraining export growth for the euro area countries, with the region as a whole losing market shares. With only a modest upward drift in the euro assumed in the outlook, the currency is expected to be less of a drag to EU export performance in 2006.

China continued to be a formidable competitor in international markets, with its exports growing by 26 per cent in real terms in 2005. Exports of machinery and electronic products were strong for the year, while the country also gained market shares in clothing and textiles as a result of the termination of the Agreement on Textiles and Clothing (ATC). The impulse brought to Chinese exports by the ATC termination will likely lose steam in 2006 because of export restraints negotiated with major importers. Overall, export growth is anticipated to drop to 12.6 per cent in real terms in 2006 (see table A.17). The exchange-rate policy is also a factor underlying the forecast. The expectation of exchange-rate appreciation had encouraged Chinese firms to accelerate exports in order to maximize their profit margins. The incentive to further step up export growth, however, has weakened with the recent changes in the exchange-rate regime of China and the continued emphasis by policy makers that any further change will be measured.

Higher commodity prices underpinned growth of export revenues in developing countries

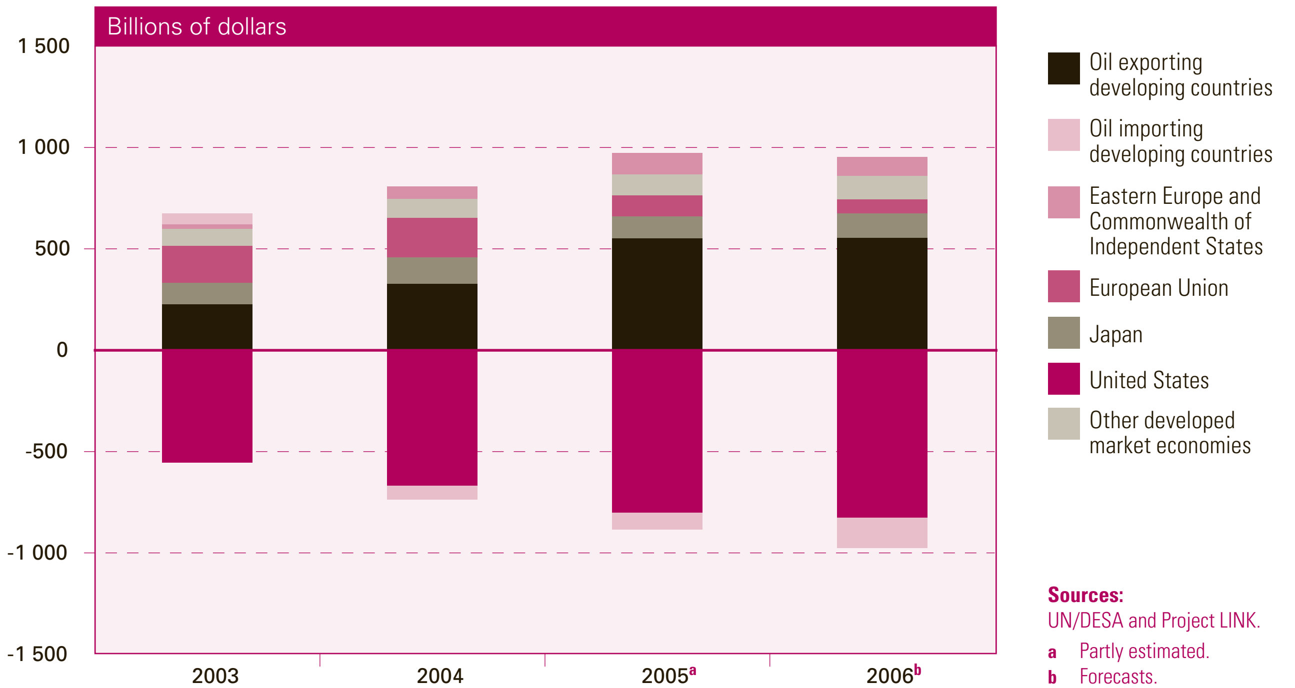
Commodity prices continued to increase in 2005, thereby boosting the export revenues of commodity exporters worldwide. Major gains were observed in the prices of metals and minerals and—to a lesser extent—in agricultural raw materials, while food prices, on average, registered modest increases. For example, export growth of Africa was largely driven by increased exports of minerals and metals in the Democratic Republic of the Congo, Ghana and Mali. Sustained demand for commodities and higher prices underpinned Latin American export performance, with exports by the South American subregion growing faster than elsewhere in the region. Developed countries such as Australia, Canada and New Zealand, and several of the CIS economies also benefited from the positive developments in commodity markets. In contrast, several non-fuel commodity exporters suffered terms-of-trade losses as oil price increases were higher than those of other commodities

Exports by Western Asian net fuel exporters expanded by almost 50 per cent in value terms. Volume growth was modest owing to the low rate of expansion of oil output as Gulf countries reached the limits of their production capacity. Similarly, higher oil prices supported growth in the value of exports by the Russian Federation. Meanwhile, Russian export volume growth decelerated because of lower output growth and increased export duties. In the outlook, growth in the value of exports from net fuel exporters will likely decelerate as oil prices stabilize (see below).

Higher oil prices contributed to widening trade imbalances across countries

Higher oil prices imply a transfer of income from fuel importers to fuel exporters and have contributed to changes in trade balances across countries. The aggregate trade surplus of net fuel exporters increased further in 2005, while net fuel importers saw a widening of their deficit (see figure II.3). In fact, the aggregated trade balance for developing

Figure II.3.
Selected economies: merchandise trade balance, 2003-2006



Sources: UN/DESA and Project LINK.
a Partly estimated.
b Forecasts.

country oil importers as a group switched from surplus to deficit after 2003. In the outlook, fuel prices are anticipated to remain high and cause a further widening of trade imbalances across countries.

World prices of manufactures remained flat in 2005

In contrast to developments in commodity markets, the average price of manufactures did not increase during the year. This was likely caused by a combination of three factors: an increasingly competitive environment, exchange-rate developments and lower growth in aggregate demand. Prices of some products dropped. For instance, semiconductor prices declined after sales had peaked by the end of 2004, and the market for microchips decelerated sharply in early 2005. A recovery seemed to be under way later in the year. Weakness in the global electronics market imposed a toll on the exports of some Asian countries, such as the Republic of Korea, Malaysia and Taiwan Province of China, among others. In the case of the latter, however, the relocation of production capacity to China—induced by lower labour costs—weakened export growth. Japanese exports were also affected by the downturn in the global electronics market. As a result, the rate of growth of Japanese real exports was cut in half in 2005 as compared to 2004 (see table A.17).

The end of the ATC led to changes in the textile and garment markets

The termination of the ATC brought considerable changes to the textile and apparel market. Many producers had not prepared themselves to cope with the end of trade preferences, despite the ten-year grace period (see below). The full liberalization of the textile and clothing markets led to increased competition in the sector, with the more productive producers gaining market shares at the expense of the less productive ones (see table A. 18). For instance, China managed to increase its share in import markets for articles of apparel and clothing accessories in both the EU and the United States. In the EU, China's share in total imports of textiles and apparel had jumped from 21.6 per cent in the period January-September 2004 to 30.1 per cent in the same period in 2005. In the United States, China's share went from 19 per cent to 27 per cent. India also increased its shares in both markets.

With few exceptions, LDCs and other low-income countries receiving preferential treatment faced difficulties in adjusting to the new regime

In general, high-cost producers such as Canada, Japan, Hong Kong Special Administrative Region (SAR) of China, the Republic of Korea and Taiwan Province of China suffered from the abolition of quotas and lost shares in both markets. It is also likely that these high-income economies, however, had already shifted productive capacity elsewhere and that their companies were exporting from new, less costly, locations. African textile exporters, including those receiving LDC preferential treatment, had more problems in coping with the new regime. Despite duty-free access, market shares were lost in both the United States and the EU, with only a few exceptions. African, Caribbean and Pacific (ACP) countries, which also receive preferential treatment, saw their exports to the EU market drop by over 20 per cent in both value and volume terms.

Other countries had different outcomes in different markets. For instance, Bangladesh and Sri Lanka held up well in the United States, increasing both the value and volume of their garment exports, but did not do so well in the EU market, where exports contracted slightly. This divergent outcome is probably caused by differences in quota allocation prevailing before 2005, as well as in product lines exported.

Many expected that the abolition of quotas would cause a sharp reduction in prices, especially for products from countries with tight quota restrictions, because of the elimination of costs associated with the quota system and the limited competition in the sector. Contrary to these expectations, the rate of growth of the total value of textile and garment imports was faster than the corresponding growth in volumes, thus indicating an increase in unit prices in both the United States and the EU. This was largely owing to the fact that, after the abolition of quotas, the export mix of various countries changed towards products that generally commanded higher prices, thereby increasing the average price. In fact, unit prices generally declined for the products that were imported in large quantities and were heavily restricted by quotas, such as cotton knit shirts for men and boys.[3]

Commodity prices and markets

Non-oil commodities

Non-fuel commodity prices continued to increase in 2005…

Commodity prices continued on an upward trend in 2005. After an increase of 20 per cent in 2004, non-fuel commodity prices, as measured by the UNCTAD commodity index, rose by a further 10 per cent, on average, during the first 10 months of 2005. Higher nominal prices were supported by demand from Asia, in particular from China, and emerging supply constraints in some commodity markets. In the course of 2005, however, the pace of price increases decelerated (see table A.15). In the outlook, non-fuel commodity prices are expected to stabilize, if not decline somewhat, as new productive capacity is brought on stream.

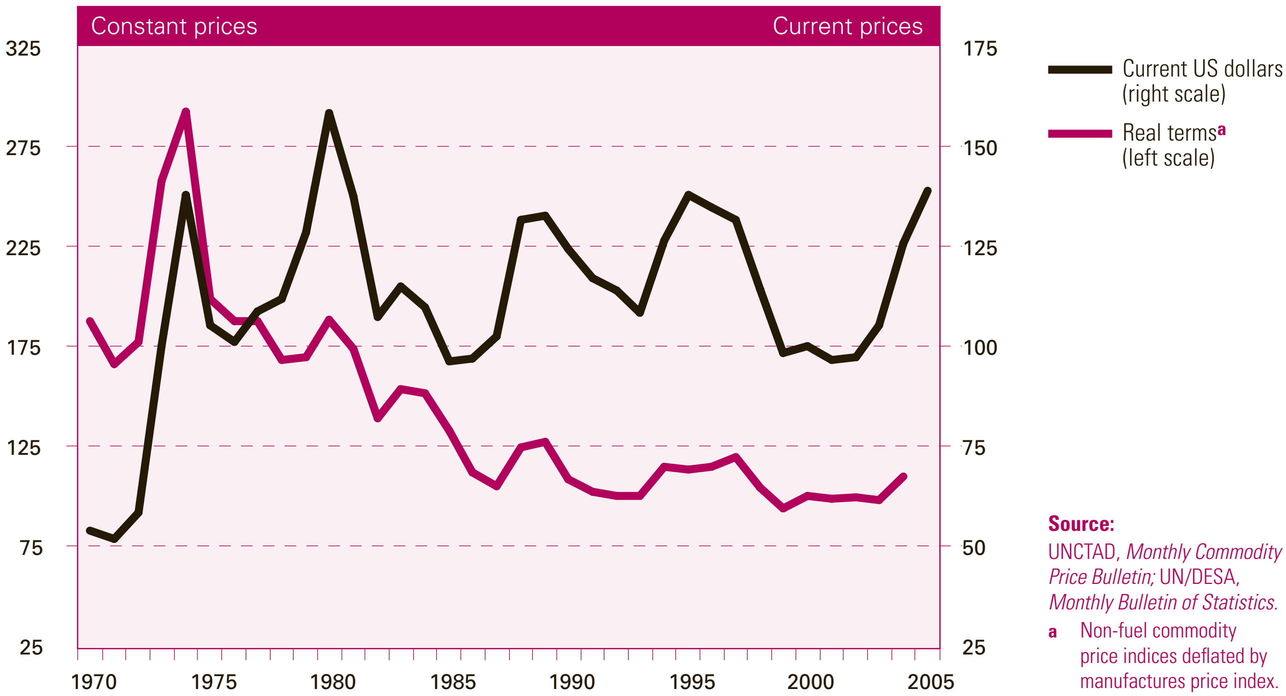
…but not enough to offset past price declines

The recent increases in commodity prices, however, have not been enough to offset the severe declines prices had suffered in the past. In the case of coffee, for instance, the rise in international prices has not been sufficient to make up for the fall in prices following the 1997 crisis. Expressed in current United States dollars, non-fuel commodity prices are still lower than what they were in the early 1980s (see figure II.4). In real terms, by the end of 2005, commodity prices were about 30 per cent lower than the average for the period 1975-1985.

Commodity price increases are also much less impressive when expressed in terms of other currencies, as the United States dollar depreciated during the period. When

3 For instance, the drop in export unit values was prominent for both Pakistan (13 per cent) and Bangladesh (8 per cent) in the EU market during the first three quarters of 2005.

Figure II.4.
Non-fuel annual average commodity price indices, 1970-2005 (2000 = 100)



Source: UNCTAD, *Monthly Commodity Price Bulletin;* UN/DESA, *Monthly Bulletin of Statistics.*

a Non-fuel commodity price indices deflated by manufactures price index.

measured in special drawing rights (SDRs), for instance, non-fuel commodity prices increased by just 13 per cent from 2002 to 2004, compared to an increase of 30 per cent when measured in dollars. Recently, however, the rebound of the dollar has reduced this gap (see table A.15).

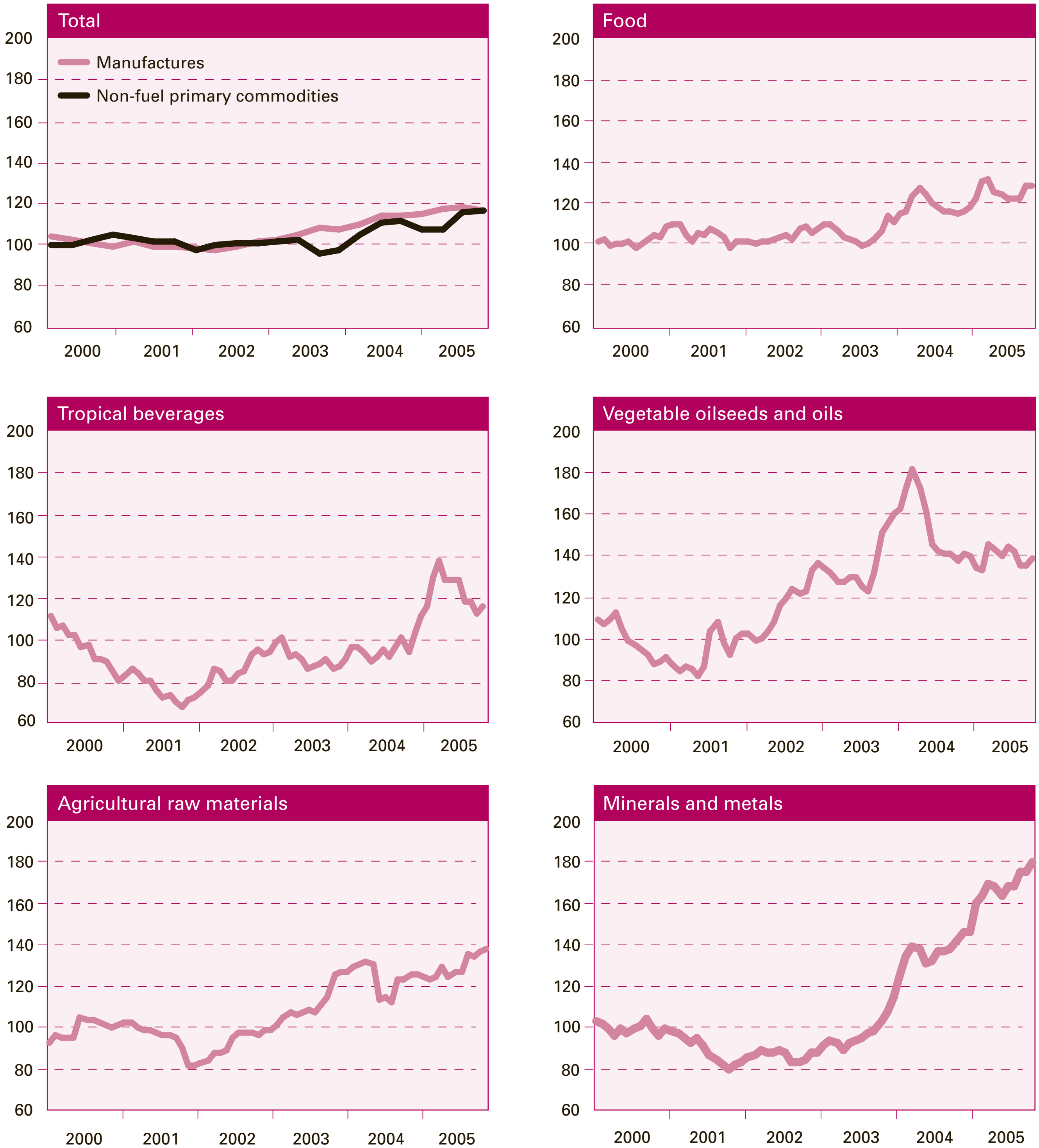
A large share of imports (including inputs to commodity production) of commodity exporting countries, especially in Africa, is paid in euros. These countries have been unable to take full advantage of increases in dollar prices. Lacking adequate access to risk management instruments, many countries have been unable to protect themselves against adverse exchange-rate movements. In the case of non-oil commodity sectors in Cameroon, for instance, the country would have earned an additional €37 million and €182.5 million in 2002 and 2003, respectively, had it been able to keep its dollar exchange rate at the 2001 level. The foregone export earnings in 2002 and 2003 correspond, respectively, to about 2.5 and 15 percent of the country's total merchandise export revenues

There was noticeable divergence in price trends across commodity groups

As is often the case, average price increases conceal considerable diversity across commodity groups. Most of the increase in non-fuel commodity prices in 2005 was driven by developments in the markets of minerals and metals. From December 2004 to October 2005, the prices of metals increased by 22.4 per cent. Prices of agricultural raw materials, food and tropical beverages also increased in 2005 but at more modest rates than metals and minerals (10.5 per cent, 9.3 per cent and 3.5 per cent, respectively). On the other hand, the price of vegetable oilseeds, which started to decline in 2004, remained relatively flat during 2005 (see figure II.5).

In fact, among the various non-fuel commodity groups, minerals and metals sustained the largest nominal increases, with prices doubling, on average, between January 2003 and October 2005. The increased demand brought about by the fast industrialization of China

Figure II.5.
Prices of primary commodities and manufactures, 2000-2005
(Indices of US dollar prices, 2000=100)



Sources: UN/DESA and UNCTAD, *Monthly Commodity Price Bulletin.*

and the recovery of manufacturing production worldwide caused this buoyant performance. Limited capacity to expand supply in the short- to medium-term was a factor for several metals as, for instance, in the case of nickel. Speculation also contributed to higher metal prices. During 2005, speculation was also a factor in the nickel market, where prices increased sharply during the first half of the year but retreated later on.[4]

Average prices of agricultural raw materials increased by 37 per cent between January 2003 and October 2005. Strong growth in demand from China was an important factor behind this upward trend. Among the various specific commodities that compose this group, natural rubber experienced significant price increases during the period (about 95 per cent). Next to excess demand, higher oil prices were also a factor in driving up the price of rubber as consumers switched from synthetic products to natural rubber. Tropical beverages increased by some 23 per cent in the same period. Yet, while the price of coffee recovered during the period and had regained some ground since its latest crisis in 1997, the price of cocoa declined by almost 30 per cent. Meanwhile, the recovery of food prices was relatively subdued, as prices increased by 18 per cent in the period January 2003-October 2005. It also started later than in the other commodity groups (except for tropical beverages, see figure II.5) owing to relatively weaker demand and continued supply overhangs in the early part of the global economic recovery.

A more detailed review of individual commodity market developments and prospects is presented in the annex to this chapter.

Institutional factors will also affect future price trends

The results of dispute settlement processes in the World Trade Organization (WTO) and the ensuing changes in trade policies and practices of major importing and/or producing economies will likely have an impact on prices of specific commodities and affect export earnings prospects of many countries. Of particular importance are the rulings on sugar and bananas that will generate changes in preferential access to the EU market by ACP countries, as well as the ruling on cotton subsidies (see box II.1). In the cases of sugar and bananas, ACP countries will be negatively affected, particularly the less competitive among them. The changes will benefit producers that had limited access to the EU market before. Losses in export earnings for the ACP producers have been estimated at around $500 million in the case of sugar and $100 million in the case of bananas.[5] The affected countries will require additional assistance to support their diversification efforts and help finance social adjustment costs.

Trends in the various commodity markets vary as they are driven by different factors. For instance, as indicated, rubber, and to some extent also cotton prices, are influenced by developments in the oil market owing to substitution effects between natural and synthetic products. Meteorological conditions and trade policies have influenced supply conditions for other cash crops. Global economic conditions also affect different markets in different ways from the demand side. For instance, the rapid pace of industrialization and income growth in China and elsewhere in Asia, has had a much stronger impact on the prices of industrial raw materials, particularly metals, than on food prices. This difference is likely to persist in the short-to-medium term, although food imports by China are likely to increase in the longer term, raising the likelihood of future price increases for agricultural commodities. It is unlikely, however, that the growing imports of primary commodities into Asia will lead to

4 Nickel prices increased by about 23 per cent during the period January-May 2005.

5 See Ian Gillson and others, "Report on Forthcoming change in the EU banana/sugar markets: A menu of options for an effective EU transitional package", Overseas Development Institute, 2005, available from http://www.odi.org.uk/iedg/Projects/EU_banana_sugar_markets/SUGARreport.pdf.

Box II.1

WTO dispute settlement and commodities

Bananas: Preferences for bananas from the African, Caribbean and Pacific (ACP) countries have existed in the European Union (EU) since its origin and are historically accountable for the growth of the banana industry in the Caribbean. The EU import regime essentially consisted of a concessionary tariff quota (TQ), initially of 2 million tons per year (originally at ECU 100 per ton), open to imports of bananas from all origins. The tariff for imports outside the quota was set at a prohibitive level. A fixed quantity of the TQ (up to 857,700 tons) was reserved for the duty-free import of bananas from the ACP States that had traditionally supplied the EU. Maximum quantities were allocated to each traditional ACP supplier on a historical basis. Specific shares of the TQ (49.4 per cent, collectively) were subsequently allocated to four Latin American countries that had challenged the regime, and 90,000 tons out of the TQ open to third country (dollar) bananas[a] were reserved for the duty-free import of ACP bananas.

The system was found to be incompatible with WTO rules, as the EU had allocated shares of its market to some banana suppliers, while not providing such access to others with similar or greater historical levels of trade. The EU licensing procedures were also found to be discriminatory under the General Agreement on Trade in Services (GATS) in that, even though there was no formal discrimination, de facto advantages were created for European operators while discriminating against service suppliers from Latin America. The dispute was resolved in 2001 through understandings with Ecuador and the United States. The understandings committed the EU to eliminate quotas and establish a tariff-only regime no later than 1 January 2006. The new import regime will include a duty-free annual quota of 775,000 tons for ACP bananas and a new import tariff of €176 per ton for most favoured nation (MFN) suppliers.

a Banana imports from any non-ACP source are known as “third country” bananas or “dollar” bananas since they primarily originate in the dollar zone (Latin America). See The EU banana regime, GATT/WTO challenges, and the evolving policy framework, available from http://r0.uncatd.org/infocomm/anglais/banana/ecopolicies.htm.

Cotton: On 27 September 2002, Brazil requested consultations with the United States regarding alleged prohibited and actionable subsidies provided to United States producers, users and/or exporters of upland cotton. The disputed measures included direct payments decoupled from production, assistance provided to producers in order to make up for losses sustained as a result of low commodity prices, payments to domestic users and exporters of domestically produced upland cotton when certain United States cotton pricing benchmarks were exceeded, and three types of export credit guarantee programmes for agricultural products.

Under the WTO Agreement on Subsidies and Countervailing Measures (SCM Agreement), the dispute settlement panel concluded the following: the export credit guarantee programmes and the price-contingent measures targeting exporters per se constituted prohibited export subsidies; price-contingent measures directed to domestic processors were import-substitution subsidies and therefore prohibited; and the mandatory price-contingent subsidy measures led to significant price suppression in the world market, constituting serious prejudice to the interests of Brazil. In the light of those conclusions, it was recommended that the United States eliminate the prohibited subsidies without delay and take appropriate steps to remove the adverse effects of the above mentioned price-contingent measures.

This case sheds light on the constraining impact of WTO law and jurisprudence on the design and implementation of domestic policy measures in the commodity sector. It is interesting to note in this respect that agricultural policy reform in both Europe (reform of the European Common Agricultural Policy) and the United States (the 1996 and 2002 Farm Acts) are heading in the direction of decoupled payments, that is to say, green box support, which is exempted from reduction commitments under the Agreement on Agriculture (AoA).

Cotton has also become a special issue in the Doha negotiations. Benin, Burkina Faso, Chad and Mali called for the speedy elimination of cotton subsidies and for compensation for the export earning losses caused by those subsidies. A Subcommittee on Cotton was created to look at cotton as a special issue within the framework of agriculture negotiations in WTO. At the Hong Kong Ministerial Conference, it was agreed that cotton export subsidies, which constitute only a small fraction of distortions affecting the sector, would be eliminated in 2006, and developed countries would give duty- and quota-free access to cotton exports from the least developed countries (LDCs). Duty- and quota-free access, however, is already available in some major

Box II.1 (cont'd)

markets (for instance, under the EU Everything But Arms and the Canadian Market Access initiatives), while Western African countries currently do not export cotton to the United States market.

It was also agreed that trade-distorting domestic support on cotton production would be cut deeper and faster than other trade-distorting subsidies. The Ministerial Declaration, however, does not specify either the amount or the schedule for the implementation of such cuts.

Sugar: The sugar case concerned the export subsidies provided by the EU in the framework of its common organization of the market for the sugar sector. The EU intervention price system guaranteed a minimum market price (three times higher than world market prices) for sugar produced within different production quotas (A and B quotas). The intervention price was valid for the domestic market and as a guaranteed minimum price to be paid by EU purchasers for (duty-free) imports of sugar from ACP States and India. Sugar produced in excess of the A and B quotas (so-called C sugar) could not be sold internally in the year in which it was produced: it had to be exported or carried over to fulfil the production quotas of the following year.

The complainants alleged that the domestic support provided to A and B beet sugar had the incidental effect of "cross-subsidizing" exports of C sugar, in excess of the EU reduction commitments' level. Another aspect of the dispute had to do with ACP and Indian sugar imported annually into the Community. The complainants maintained that the EU should have included the amount of ACP/Indian sugar that was then refined in Europe and re-exported to third countries in its export subsidy calculations. The panel concluded that the EU, through its sugar regime, had acted inconsistently with its obligations under the AoA by providing export subsidies in excess of the quantity commitment level and the budgetary outlay commitment level specified in its schedule of reduction commitments.

As a result, changes were introduced in the EU sugar policy. Major provisions include the following: the guaranteed price for white sugar will be cut by 36 per cent over a period of four years starting in 2006/07; farmers will be compensated on average 64.2 per cent of the price cut by a decoupled payment; the intervention price will be replaced by a reference price; ACP countries will be eligible for an assistance plan amounting to €40 million in 2006. The offer of assistance, while welcome, is only a fraction of the preferences enjoyed by ACP countries (see main text). Finally, it should be noted that a safeguard mechanism was drawn up for cases in which developing country exports to the EU jumped by more than 25 per cent a year.

a reversal of the long-term decline in real commodity prices.[6] More importantly, however, is that a sustained increase in the demand for commodities by these countries will continue to provide additional opportunities for increased commodity exports by developing countries.

World oil markets

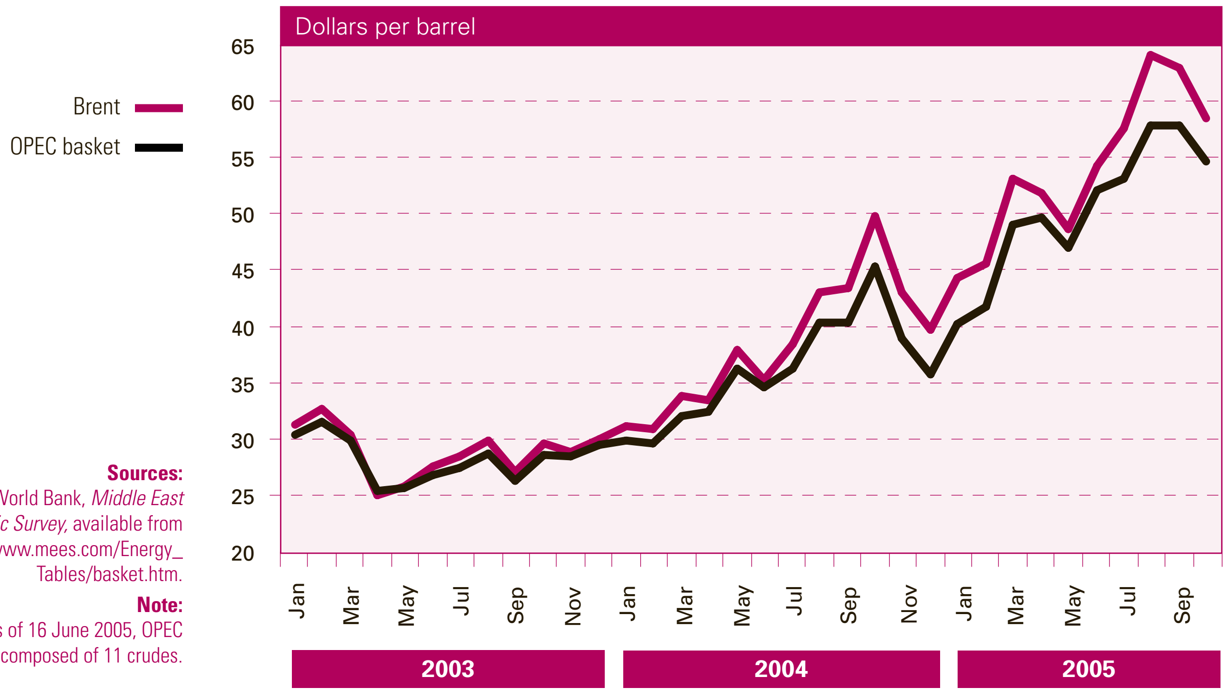
After reaching a peak in August 2005, oil prices declined. This decline reflected a deceleration of oil demand in 2005. Brent, one of the two key market references for light, sweet crude, was priced at $55 per barrel (pb) in late November 2005, down from $63 pb in late August, when Hurricanes Katrina and Rita provoked serious disruptions in an already tight market (see figure II.6).

Oil prices are expected to remain above a floor of $50 per barrel in 2006

Despite the recent decline, oil prices are still expected to stay above a floor of $50 pb during 2006 as global demand is expected to keep growing in 2006 and beyond, even though more moderately than in the recent past. Supply is expected to remain tight, with global spare production capacity staying low despite expectations of a modicum of growth in the medium run. In sum, high oil prices and potential supply disruptions may still pose a significant risk to global economic prospects in the medium run.

6 UNCTAD, *Trade and Development Report, 2005* (United Nations publication, Sales No. E.05.II.D.13), p. 76.

Figure II.6.
Oil prices, January 2003-October 2005



Sources: World Bank, *Middle East Economic Survey,* available from http://www.mees.com/Energy_Tables/basket.htm.

Note: As of 16 June 2005, OPEC basket is composed of 11 crudes.

Trends and outlook for world oil demand

Following strong growth of 3.8 per cent in 2004, the growth of world oil demand decelerated to 1.3 per cent in 2005, or by 1.1 million barrels per day (mbpd) in 2005.[7] This deceleration results largely from a slowing in oil demand growth in the United States, continued stagnation in Western Europe, as well as a strong deceleration in China. Global oil demand is expected to pick up moderately in 2006, growing by 2.0 per cent or 1.7 mbpd (see table A.16).

Demand growth decelerated in major markets in 2005...

Several factors were behind the slower growth in oil demand in the United States in 2005. These include the impact of the late summer hurricanes on the oil infrastructure, an apparent demand adjustment to sustained higher prices, as well as unusually mild weather at the start of the winter in the country's north-east. Yet, some of these factors are temporary, whereas there is little evidence of sustained shifts towards greater oil efficiency.

Oil import demand in China moderated in 2005, following steep growth in 2004. There are indications, however, that this slowdown may be somewhat artificial and temporary. Local refiners, which were facing lower profit margins as a consequence of controlled domestic prices, have apparently been exporting a growing share of their production, thereby artificially depressing net fuel imports. This effect may tend to disappear as domestic prices are gradually increased. This notwithstanding, there are signs that some of the factors underlying the surge in oil demand in 2004 faded in 2005 owing to an easing of electrical power shortages and more restrictive economic policies. A prolonged drawdown of domestic stocks

7 International Energy Agency (IEA), *Oil Market Report,* October 2005, available from http://www.omrpublic.iea.org/omrarchive/11oct05full.pdf .

in 2005, which were purchased at lower prices, was also a factor.[8] Thus, stock replenishment will support growth of oil demand in 2006 and beyond. Chinese oil demand is expected to increase by 7.6 per cent in 2006, accounting for around 28 percent of global growth, up from 3.1 per cent in 2005.

...but is expected to grow relatively quickly over the medium run

Throughout much of developing Asia, oil demand is expected to continue to grow in the medium run, albeit at a significantly slower pace than in 2004. Although governments in the region are adopting measures to bring domestic energy prices more in line with global prices (see chapter IV), prices remain relatively low. In addition, fast output growth will continue to support oil demand in the medium term.

Developments affecting supply

Higher prices reflect tight supply conditions in oil markets and strong demand. Low spare production capacity, including mismatches in available global refining capacity, is anticipated to remain a key factor affecting oil markets in the medium term.

Supply remains constrained by limited spare capacity...

Global spare capacity is expected to increase somewhat by end-2006, while Saudi Arabia announced plans to increase its production capacity by 1.5 mbpd by the year 2009.[9] Nonetheless, spare capacity will likely remain low in the medium run, particularly in the context of current growth in demand.

...geopolitical uncertainties...

The production of the Organization of the Petroleum Exporting Countries (OPEC) is also subject to uncertainties stemming from the continued inability to obtain substantial increases in Iraqi production because of the acute conflict and insecurity affecting production and exports in that country, as well as growing political uncertainties in the Islamic Republic of Iran. Furthermore, the crude production of the Bolivarian Republic of Venezuela remains below the levels prior to the 2002-2003 strike and lower-than-expected investments in recent years may compromise faster output growth in the near future.

Several factors will constrain faster growth in supply by non-OPEC producers. The impact of the 2005 hurricane season on output will be felt for a while as production of crude oil and refining in the United States Gulf Coast are not expected to fully recover to pre-hurricane levels until well into 2006. Meanwhile, production continues to decline in mature areas such as the North Sea. Furthermore, the increased uncertainty about the environment for investment and production and high taxes on extraction and exports have diminished the chances of any substantial production growth in the medium and long term in the Russian Federation. Finally, anticipated medium-term production levels in a number of Asian and African producers were recently revised downwards.[10]

...and limited investment in the sector in the past

Overall, the global oil sector is currently suffering from reduced investment in both upstream and downstream activities in the 1980s and 1990s, when prices were at an historical low in real terms. New upstream investment is constrained by the limited availability of drilling infrastructure, tightness in the specialized labour market and rapidly increasing costs throughout the entire production chain. Moreover, output capacity remains constrained in the refining sector worldwide, caused by low investment over the past decades as well as environmental considerations. This has resulted in high utilization rates of existing refineries, particularly the more sophisticated ones needed to refine heavy types of crude. In fact, the

8 Robert Kaufman, "The forecast for world oil market", paper presented at Project LINK meeting, Geneva, 31 October-2 November 2005, available from http://www.chass.utoronto.ca/link/meeting/papers/1031pm_rk.pdf.

9 Center for Global Energy Studies (CGES), *Oil Market Prospects,* vol. 10, No.10 (October 2005).

10 IEA, *Oil Market Report,* op. cit.

premium on the price of light crudes over heavier types increased significantly as markets became tighter, particularly since the end of 2004 (see figure II.7).

During much of 2005, the approach of OPEC was to steadily increase production. This in turn allowed for a build-up in crude oil stocks in OECD countries. By the end of 2005, total OECD stocks stood at somewhat higher levels than a year earlier. Stocks are probably still seen as insufficient in current market conditions, however, as spare supply capacity is at historical lows.

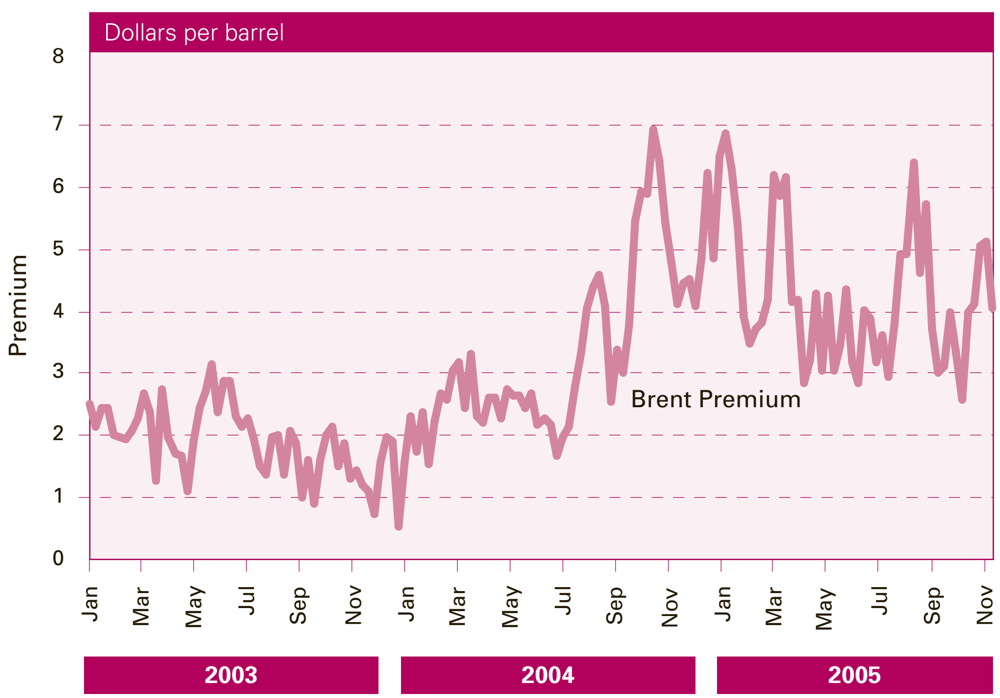
The outlook for oil prices

The decline in oil prices during the last quarter of 2005 largely reflects the response of the market to the deceleration in global demand growth. Yet, several factors point towards continued tight fundamentals that call for prices to remain above a floor of $50 pb over the outlook period. Oil demand is still growing at a significant pace, in spite of the recent moderation, particularly in some developing countries, while existing supply constraints will only ease off gradually. As a result, Brent oil prices will remain robust, but may lower somewhat over the forecast period, that is from an average of $54.7 pb estimated for 2005 to $59 pb in 2006.

Uncertainties surround the outlook for oil prices

The current outlook for prices is subject to uncertainties. On the upside, any major disruption of crude production or refining facilities because of adverse weather or political developments, which are difficult to forecast by their very nature, could have a considerable impact on prices for relatively extended periods. On the downside, uncertainties include the possibility of a stronger-than-expected correction of global oil demand growth—in response to high prices or as a result of a surge in inflation in the developed countries—and a faster-than-expected recovery of Iraqi oil production.

Figure II.7.
Brent oil: premium over OPEC basket, January 2003-November 2005



Source: United States Energy Information Administration.

Trade policy developments and trends

Doha negotiations: keeping the Round alive

The July package had renewed hopes the Round was back on track...

The adoption of the framework agreement of 1 August 2004 (the "July package")[11] brought renewed hope to the multilateral trade negotiations under the WTO Doha Work Programme. There was an overall perception that the negotiations were back on track after a number of delays. The package set out general frameworks for future negotiations in five core areas: agriculture, market access of non-agricultural products, services, development issues and trade facilitation. Negotiations would proceed to produce a package of detailed and specific negotiating modalities (an "end-game document") as the basis for negotiating outcomes to be adopted at the Sixth WTO Ministerial Conference in Hong Kong SAR in December 2005. The Round was set to be completed by the end of 2006. These developments have raised expectations that the development objectives of the Doha Ministerial Declaration, including substantial trade liberalization in areas of primary export interest to developing countries, would be delivered in time for making a positive contribution to achieving the Millennium Development Goals (MDGs) by 2015.

...but negotiations proved difficult on the road to Hong Kong SAR

Moving the negotiations forward has proven to be difficult, however. Despite visible efforts undertaken by participants throughout the year, it was finally recognized in November 2005, that progress was slow in all negotiating bodies. Moreover, the breadth of issues under negotiations and their complexity and sensitivity to different countries would not allow forging a consensus on negotiating modalities. The Hong Kong Ministerial Conference thus necessitated a "recalibration of expectations".

There were, however, some positive developments related to the attention given to concerns of developing countries in the area of intellectual property that contributed to a more favourable political environment leading to the Conference. The decision to extend the transitional period for LDCs for full implementation of the Agreement on Trade-Related Intellectual Property Rights (TRIPs) is a case in point. Another relevant decision was to amend the TRIPs Agreement to facilitate access to essential medicines for countries with no or limited production capacities.[12]

The Hong Kong Ministerial Conference

Results achieved were modest

The Sixth WTO Ministerial Conference concluded with the approval of the Ministerial Declaration.[13] Against the low expectations and even predictions of another failure, the results achieved could be qualified as modest and marginal, but nevertheless positive. The explicit commitment taken at this Conference "to complete the Doha Work Programme fully and to conclude the negotiations launched at Doha successfully in 2006", however, will require

11 World Trade Organization (WTO), Doha Work Programme: decision adopted by the General Council on 1 August 2004 (Document WT/L/579), 2 August 2004. For a discussion of the "July package", see *World Economic Situation and Prospects 2005* (United Nations publication, Sales No. E.05.II.C.2), pp. 33-37.

12 Some concerns were raised during the Conference. In particular, the WHO pointed out that in order to achieve "full public health benefits", it would be necessary to have a simple and workable approach in the interpretation of this amendment. See *World Health Organization (WHO), Statement Circulated by the WHO* (Document WT/MIN(05)/ST/52), 15 December 2005.

13 WTO, Ministerial Conference, Sixth Session, Doha Work Programme, *Draft Ministerial Declaration. Revision* (Document WT/MIN(05)/W/3/Rev.2), 18 December 2005.

considerable political will from the participants to make tough decisions and conclude negotiations within a very short time frame.

Ministers established new deadlines for 2006 as follows:

- 30 April: for establishing full negotiating modalities on agriculture and industrial market access;
- 31 July: for submitting draft schedules of concessions and commitments, including a revised offer in services, and recommendations on issues relating to the implementation of WTO Agreements;
- 31 October: for producing final draft schedules of commitments in services; and,
- 31 December: for concluding the Doha Round as a whole.

Among the main substantive decisions reached, three can be characterized as central in contributing to a positive outcome. These are:

- An agreement to eliminate all forms of agricultural export subsidies by the end of 2013 in a progressive and parallel manner. A substantial part of this elimination is to be realized by the end of the first half of the implementation period. This agreement, however, is conditional on a future agreement on full negotiating modalities, as well as on establishing multilateral disciplines on other forms of export competition measures, such as export credits, export credit guarantees or insurance programmes, trade-distorting practices of State-trading enterprises and food aid. Despite these caveats, this represents a substantial systemic advance by bringing further agricultural trade under the umbrella of general multilateral trade rules, which prohibit the use of export subsidies.
- A limited “development package” for LDCs consisting of several decisions, including the provision of granting duty-free and quota-free market access by developed countries and developing countries declaring themselves in a position to do so on “a lasting basis”. The preferences would extend to all products originating from all LDCs by 2008 or no later than the start of the implementation period in a manner that ensures stability, security and predictability. Preference-granting countries will have the flexibility to exclude from such benefits up to 3 per cent of products originating from LDCs, defined at the tariff level. In practical terms, the value of such treatment of exports from LDCs will directly depend on the inclusiveness of product coverage. If, for example, textiles and clothing (that is to say, products accounting for roughly 20 per cent of LDC exports) are excluded by some developed countries, the gains of such a decision could be marginal.
- A decision to eliminate all forms of export subsidies for cotton by developed countries in 2006 (see also box II.1). Moreover, developed countries agreed to grant duty- and quota-free access for cotton exports from LDCs from the beginning of the implementation period. This decision is expected to have limited economic impact in the medium term. Trade and production-distorting effects of domestic support measures in developed countries—the most important issue for Western African cotton producers—will be addressed in the context of overall negotiations on agriculture. Yet, the possibility of more ambitious cuts in these subsidies over a shorter period of time than would be generally applicable has not been ruled out.

Much detail is still to be negotiated

Some of the advances made in the main areas still need to be confirmed by a future agreement on full negotiating modalities. Regarding market access for agricultural products, for example, four sets of tariff bands were adopted for structuring tariff cuts, with deeper cuts expected to be applied to the higher tariff bands. Members, however, still have to agree on thresholds defining such bands and on the range of tariff cuts to be applied to each band. Moreover, there is still need to agree on the treatment of "sensitive products", that is to say, products subject to Tariff Rate Quotas, with some developed country members arguing that a percentage should be subject to lower tariff cuts. Negotiators indicated that developing countries will have the flexibility to designate "an appropriate number" of Special Products which will be exempt from tariff cuts in a manner to be agreed upon.[14] On domestic support, three bands were adopted to guide overall cuts in trade-distorting subsidies by developed countries, with the higher linear cuts in the higher bands. Again, although there has been some convergence on the range of cuts, negotiators are still to agree on the level of such reductions as well as on the schedule of their implementation.

With respect to the upcoming negotiations, an additional complicating factor is the introduction of an explicit link between negotiations on agriculture and non-agricultural market access (NAMA) products. The Declaration specifically instructs negotiators "to ensure that there is a comparably high level of ambition in market access for agriculture and NAMA", but in a balanced manner and consistent with the principle of special and differential treatment.[15]

On NAMA, a "Swiss tariff-cutting formula" was explicitly confirmed for the first time. The Swiss formula reduces higher tariffs more than lower ones. It will lead to larger cuts by developing countries which, on average, impose higher tariffs than developed countries on industrial products. All relevant details (for example, the magnitude and number of coefficients, treatment of unbound tariffs, concrete flexibilities for developing countries and so on) are still to be identified in the full negotiating modalities.

In contrast to the agreement on agriculture and NAMA, ministries expressed their determination to intensify negotiations on services under given guidelines and specific deadlines. While bilateral request-offer negotiations will remain the main method of negotiation, the negotiations should also be pursued on a plurilateral manner and their results extended on a most favoured nation (MFN) basis. Additional objectives for expanding the sectoral and modal coverage of future commitments were mentioned, including delinking offers on Mode 1 (cross-border trade, which includes outsourcing) and some categories of Mode 4 (presence of natural persons) from commercial presence.

Meaningful progress is still required for the Round to achieve its development objectives

In view of the developments highlighted above, difficult negotiations are still ahead and need to be pursued with renewed political will in order to guarantee a meaningful and equitable outcome of the Round. It is worth reiterating that the fulfillment of the declared development objectives of the Round requires meaningful progress to be made in all areas of these negotiations. This holds in particular for trade in agricultural products, where politically painful actions left over for decades are to be taken and implemented, mostly by developed countries in eliminating export and trade-distorting domestic subsidies. Enhanced and stable market access for the agricultural and industrial exports of developing countries should also be achieved by effectively reducing trade barriers worldwide, with full account taken of the General Agreement on Tariffs and Trade (GATT) rule providing "less-than-full reciprocity" for developing countries. Rapid progress must also be made to unleash the considerable development potential of trade in services by liberalizing the temporary supply of labour services and the cross-border supply of services via outsourcing and offshoring.

14 Special products refer to those agricultural products that are vital for food security, livelihood and rural development.

15 WTO, Ministerial Conference, Sixth Session, Doha Work Programme, *Draft Ministerial Declaration. Revision* (document WT/MIN(05)/W/3/Rev.2), 18 December 2005, para. 24, p. 5.

Flexibilities are needed for developing countries

The outcome of the Doha negotiations should be equally instrumental in treating any of the inherent and continued asymmetries in the WTO Agreements concerning developing countries, including differential supply capacity, economic size and power, and ability to subsidize economic sectors, through the provision of operational and commercially meaningful rules for special and differential treatment (SDT). These new rules should permit developing countries to undertake complementary policies (trade, production, technology, financial and social policies) that are considered essential to strengthen supply capacities, develop competitive networks of enterprises, innovate and improve the technology content of exports and expand employment opportunities. Furthermore, a meaningful Aid for Trade package (see below) would go a long way in enabling developing countries, especially LDCs, to meet adjustment costs, build trade-related infrastructure and supply capacity in order to benefit from opportunities that would be opened up by the Doha Round.

In all, a balanced outcome from the Round is urgently necessary not only to allow trade to contribute to growth and development worldwide but also to safeguard the health of the multilateral trading system and the interests of all countries in view of the increasing number of bilateral and regional free trade agreements (discussed below). These agreements have created a complex web of overlapping trading systems, which may not necessarily be in accordance with the goals and principles of multilateralism.

Accessions to the WTO

Out of WTO accession negotiations of 31 countries, those of Saudi Arabia and Tonga were concluded either before or during the Hong Kong Ministerial Meeting, thus making a further step towards the universal membership of the WTO. The accession terms of these countries are described in box II.2.

Box II.2

The accession of Saudi Arabia and Tonga to WTO

Saudi Arabia

Saudi Arabia became the 149th member of WTO on 11 December 2005, thus enabling it to participate as a WTO member in the Hong Kong Ministerial Conference.

Saudi Arabia had been negotiating its membership since July 1993. As a result of the negotiations, it agreed to undertake several important commitments to further liberalize its trade and investment regimes. Among the systemic commitments and obligations undertaken by Saudi Arabia are the following:

- The WTO Agreement will be applied uniformly throughout the customs territory of Saudi Arabia.
- Termination, no later than 31 December 2007, of the current practice that requires notarization, authentication or consularization of trade documents, including the fee charged for those services on all exports to Saudi Arabia.
- Elimination of any non-tariff measures that cannot be justified under WTO rules. The country maintains the right, however, to restrict the importation and exportation of a certain number of goods and services in order to safeguard the legitimate interests of the country. The list of banned imports is to be reviewed at least once a year.
- No export subsidies on agricultural products.
- Saudi Arabia will ensure that its producers and distributors of natural gas liquids (NGLs) will operate on the basis of normal commercial considerations, based on the full recovery of costs and a reasonable profit.

Box II.2 (cont'd)

- Full application, from the date of accession, of the provisions of the Agreement on Trade-Related Intellectual Property Rights (TRIPs), the Agreement on Technical Barriers to Trade, and the Agreement on Sanitary and Phytosanitary Measures.[a]

In the area of goods, Saudi Arabia has bound all tariffs levied on imports, with appropriate flexibility for the staged reduction of import tariffs—over a period of 10 years—for some products. At the end of the 10-year implementation period, average bound tariff levels will decrease to 12.4 and 10.5 per cent for agricultural and non-agricultural products, respectively. The individual tariff rates for agricultural products will range from 5 to 200 per cent, with the highest rates being applied to tobacco products and dates. Some 11 per cent of non-agricultural products will be imported duty-free, whereas the highest tariff rate will affect wood, as well as iron and steel products. Most tariffs (92.6 per cent) will be set at their final bound rates at the date of accession. The remainder will be implemented mostly in 2008 and 2010, but in no case later than 2015.
In service sectors, Saudi Arabia has undertaken a number of substantive commitments as follows:

- **Insurance:** Foreign insurance companies will be permitted to open and operate direct branches in Saudi Arabia. Commercial presence will also be permitted for insurers who establish a locally incorporated cooperative insurance joint-stock company, in which foreign participation is limited to 60 per cent. A three-year transition period will be given to existing foreign insurance providers to convert to either a Saudi cooperative insurance company or to a direct branch of a foreign insurance company.
- **Banking:** The commercial presence of banks will be permitted in the form of a locally incorporated joint-stock company or as a branch of an international bank. The foreign-equity cap for joint ventures in banking will be increased to 60 per cent. While financial services can be provided only by commercial banks, asset management and advisory services may also be provided by non-commercial banking financial institutions.
- **Telecommunications:** Within three years from accession, the commitments of Saudi Arabia will allow up to 70 per cent foreign equity ownership in the telecommunications sector. These commitments apply to both basic telecommunications services and value-added telecommunications services. Public telecommunications services will have to be provided by a joint-stock company.
- **Distribution:** Foreigners will be allowed to engage in wholesale and retail trade, including franchising, subject to some limitations: Foreign equity is to be limited to 51 per cent upon accession and to 75 per cent after three years from the date of accession. In the case of franchising, the foreigner should be authorized in his own country to practice franchising or be a partner in an authorized company for a period of no less than five years without interruption.

Tonga

The Sixth WTO Ministerial Conference approved Tonga's accession package on 15 December 2005, paving the way for Tonga to become the 150th WTO member. Tonga will have to ratify the accession terms and will become a full member 30 days after it has informed the WTO of its ratification. Tonga agreed to do this by 31 July 2006.

Tonga agreed to undertake a series of important commitments. In the goods area, Tonga committed itself to lowering its tariffs by 1 January 2007. All tariff lines will have an upper bound of 15 or 20 per cent. Similarly, Tonga committed itself to liberalizing all 11 sectors under the WTO services classification.

These constitute very far-reaching measures for a small island developing country, but are consistent with WTO rules (the so-called systemic obligations). Tonga will apply all mandatory WTO agreements, with only a few exceptions, from the date of accession and within short time limits. Tonga has been granted transition periods to implement the Customs Valuation Agreement and the Agreement on Trade-Related Aspects of Intellectual Property Rights until 1 January 2008 and 1 June 2008, respectively.[b]

a World Trade Organization, *Report of the Working Party on the Accession of the Kingdom of Saudi Arabia to the World Trade Organization* (document WT/ACC/SAU/61), 1 November 2005; WTO, *Schedule of Concessions and Commitments on Goods* (document WT/ACC/SAU/61 Add.1), 1 November 2005; WTO, *Schedule of Specific Commitments in Services, List of Articles II NFM Exemptions* (document WT/ACC/SAU/61 Add. 2), 1 November 2005.

b WTO, *Report of the Working Party on the Accession of Tonga to the World Trade Organization* (document WT/ACC/TON/17), 2 December 2005; WTO, *Schedule of Concessions and Commitments on Goods* (document WT/ACC/TON/17 Add.1), 2 December 2005; WTO, *Schedule of Specific Commitments in Services, List of Article II MFN Exemptions* (document WT/ACC/TON/17 Add.2), 2 December 2005.

Aid for Trade

Trade opening has been a key element in development strategies for the last 20 years, and further liberalization as a result of the WTO negotiations is generally seen to bring considerable long-term benefits. Trade liberalization, however, does not automatically translate into higher growth and development. The experience with the termination of the ATC discussed above demonstrates that trade liberalization may produce both winners and losers. In order to reap the benefits from greater trade opportunities, development policies need to complement changes in the trade regime.

Trade liberalization brings opportunities but also costs

Structural unemployment is perhaps the major social cost of adjusting to trade reforms. Most developing countries, however, do not have well-developed social safety nets, such as unemployment benefits, retraining programmes and portable pensions to address these problems. Other adjustments induced by liberalization include the need to deal with the fiscal cost of lower tariff revenues as protection is reduced; the likely losses of preferences in overseas markets as special rates for MFNs are lowered under multilateral liberalization; and intra- and intersectoral reallocation of resources in response to changes in the levels of protection.[16] Furthermore, liberalization *per se* will not necessarily lead to an expansion in trade. Developing countries should be able to translate improved market access and entry conditions into actual exports on the basis of improved and diversified supply capacity.

There is need to address adjustment costs and enhance the supply capacities of developing countries

The multilateral trade agreements of GATT/WTO were traditionally silent on the issue of adjustment. This approach is about to change, however, as the idea that multilateral trade agreements should be complemented by specific measures to deal with adjustment costs and supply capacity in LDCs and other vulnerable developing countries is gaining ground.

Recent proposals include the establishment of a temporary "Aid for Trade Fund", as proposed by the Task Force of the UN Millennium Project.[17] Additionally, Mr. Peter Mandelson, the EU Trade Commissioner, proposed in February 2005 the establishment of a special Trade Adjustment Fund to "help the poor to trade more effectively and ease the social costs of adjustment". Similar ideas were contemplated in the "Africa Commission Report" of the Government of the United Kingdom. This was followed by the 2005 Gleneagles G-8 Summit commitment for Africa and the announcement by the G-7 Finance Ministers in early December 2005 that spending on aid for trade would increase to $4 billion.

Aid for Trade gained prominence at the Sixth WTO Ministerial Conference

The Ministerial Declaration of Sixth WTO Ministerial Conference in Hong Kong SAR recognized that Aid for Trade should aim to help developing countries, particularly LDCs, to build the supply-side capacity and trade-related infrastructure that they need to assist them in implementing and benefiting from WTO Agreements, and more broadly, to expand their trade. It was also emphasized that Aid for Trade could not be a substitute for the development benefits that would result from a successful conclusion of the Doha Round, particularly on market access. It could be, however, a valuable complement to the outcome of these negotiations. If adequately funded and put into effect, it could help developing countries in the implementation of the new commitments made in the Doha Round and assist them in building up the required capabilities to take advantage of the new trade opportunities to be created upon completion of the round.

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16 For a detailed discussion of adjustment issues, see *Developing Countries in International Trade, 2005* (United Nations publication, Sales No. UNCTAD/DITC/TAB/2005/1), available from http://www.unctad.org/en/docs/ditctab20051_en.pdf.

17 UN Millennium Project, Task Force on Trade. *Trade for Development* (London: EARTHSCAN for United Nations Development Programme, 2005).

The Director-General of WTO was invited to create a Task Force that should provide recommendations on how to operationalize Aid for Trade. The Task Force would provide these recommendations to the General Council by July 2006. The Director-General would also consult with WTO members as well as with the IMF and World Bank and relevant international organizations, and the regional development banks, with a view to reporting to the General Council on appropriate mechanisms to secure additional financial resources for Aid for Trade, where appropriate, through grants and concessional loans.

There is a need to systematically monitor development gains from international trade

Trade plays an increasingly important role in shaping the economic and social performance and prospects of countries around the world, especially developing and least developed countries. The degree to which countries gain from trade varies depending on local circumstances, and the benefits of further trade liberalization are not always immediately clear. Trade negotiations and decision-making about commercial policies could benefit if informed by a more systematic monitoring of the development gains from international trade. The *Trade and Development Index* (TDI) of UNCTAD could be one useful step in that direction. It provides a quantitative measure of trading conditions and development performance of countries worldwide (see box II.3).

Box II.3

Monitoring development gains from trade: UNCTAD's Trade and Development Index

The Trade and Development Index (TDI), developed by the UNCTAD secretariat in response to the São Paulo Consensus, provides an integrated measure of country performance based on trade and development indicators.[a] It aims to serve as a diagnostic and policy tool for trade and development strategies. The TDI is a weighted composite of 11 components. These components comprise a total of 29 indicators. The eleven components are: human capital, physical infrastructure, financial environment, quality of institutions, environmental sustainability, economic structure, openness to trade, effective foreign market access, economic development, social development and gender equity. Each of these components and the underlying indicators are analysed and weighted through principal component analysis to allow for their aggregation into the TDI.

Out of a sample of 110 countries, the 20 countries with the highest TDI are all developed ones, except for Singapore, which has a ranking of 15. Denmark is at the head of the list, followed by the United States and the United Kingdom. Only three developing countries are in the top 30. These are, besides Singapore, the Republic of Korea (rank 25) and Malaysia (rank 28). At the other extreme, all of the bottom 20, excepting Pakistan and Papua New Guinea, are either least developed countries (LDCs) or African countries, or both. Only two African countries, South Africa (rank 41) and Mauritius (rank 47) are among the top 50 scorers.

An analysis by component shows that openness to trade contributes most to the TDI, explaining almost 15 per cent of the overall TDI score on average. Good performance on development indicators is strongly associated with trade performance. East Asian countries score highest among developing countries on the TDI, particularly owing to strong performance indicators for physical infrastructures and financial environment and, to a lesser extent, owing to relatively high market access indicators. Sub-Saharan African countries lag behind other regions for most components of the TDI. The region shows low scores for social development, financial environment, institutional quality and physical infrastructure. Weak performance in these areas appears to impede good trade performance and hamper countries from benefiting from greater trade openness.

Another important finding is that countries with high scores also show much less variability over time in the contribution of individual components to the TDI than those with low scores. This negative correlation is statistically highly significant and indicates that a reduction in the volatility in gains from trade is closely associated with a stable performance of structural development factors. This would suggest that trade policies should be developed hand in hand with long-term development policies.

a *Developing Countries in International Trade, 2005* (United Nations publication, Sales No.UNCTAD/DITC/TAB/2005/1), also available from http//www.unctad.org/en/docs/ditctab20051.en.pdf.

Bilateral and regional trade agreements

The proliferation of bilateral and regional trade agreements (RTAs) since WTO was established in 1995 has eroded the scope of application of MFN tariffs.[18] As originally conceived in the GATT, Article XXIV (which contains disciplines and provisions on RTAs) was not meant to cover exemptions from the MFN principle at the present unprecedented scale. Currently, trade between RTA partners makes up nearly 40 percent of total global trade.

The proliferation of RTAs has intensified recently

By the end of November 2005, the number of RTAs notified to the WTO amounted to 186.[19] Notification was unusually intense during the period January 2004-February 2005, when 43 RTAs were notified, making this period the most prolific in RTA history.[20] In addition, around 35 agreements were signed and awaited entry into force, while some 70 RTAs were in the negotiation/proposal stage. Although common to all regions, the proliferation of RTAs was especially noticeable in the Western Hemisphere and in the Asia-Pacific region.

New trends include interregional agreements and…

The new wave of RTAs bears some distinct features. Breaking with the past, when RTAs were often signed between countries of the same geographic region, there has been a noticeable rise in the number of interregional RTAs. Furthermore, North-South RTAs have become more common. A substantial number of developing countries have already entered into or signed RTAs with a developed country partner.

…reciprocal free trade agreements between developing and developed countries

In several instances, non-reciprocal trade preferences between developed and developing countries are being transformed into reciprocal free trade agreements. The ACP-EU negotiations for an Economic Partnership Agreement under the Cotonou Agreement and the Central American Free Trade Agreement (CAFTA) are cases in point.[21] These agreements have the advantage of "locking in" preferential treatment, thereby eliminating the uncertainties related to the renewal of such benefits. Yet, the granting of reciprocal treatment may imply additional challenges for concerned developing countries. These include the design of an appropriate package of trade liberalization reforms and the protection of prerogatives such as SDT, including the Enabling Clause, available under the WTO. In this context, a certain asymmetry of commitments and obligations, based on different levels of development, should be a crucial element in the architecture of North-South RTAs. Finally, in the case of trade disputes, the RTAs should recognize the supremacy of the WTO dispute settlement mechanism.

Liberalization is often beyond WTO agreements while agriculture is frequently excluded or partially liberalized

Another feature of North-South RTAs is their partial liberalization. Typically, most non-agricultural tariffs are drastically reduced or eliminated. On the other hand, many agricultural products are excluded; their liberalization is delayed or tariff changes are made dependent on developments at the multilateral level. Moreover, these agreements are often silent about agricultural domestic support measures. Therefore, the commercial benefits and development gains for developing countries from these agreements may be limited. Additionally, developed countries often want to go beyond market access. North-South RTAs

18 Luis Abugattas,, "Swimming in the spaghetti bowl: challenges for developing countries under the 'New Regionalism'", *Policy Issues in International Trade and Commodities Study Series,* No. 27 (UNCTAD, Geneva, 2004).

19 A complete list of RTAs notified to the GATT/WTO is available from http://www.wto.org/english/tratop_e/region_e/region_e.htm.

20 Jo-Ann Crawford and Roberto V. Fiorentino, "The changing landscape of regional trade agreements", *Discussion Paper,* No. 8, (Geneva, WTO, 2005).

21 CAFTA is an FTA between the United States, the Central American countries (Guatemala, El Salvador, Honduras, Nicaragua and Costa Rica) and the Dominican Republic, which participated in the Caribbean Basin Initiative. By the end of 2005, Costa Rica was the only integrating country that had not yet ratified CAFTA.

may thus include a selective list of liberalization commitments and disciplines beyond those agreed at the multilateral level ("WTO-plus") and agreement on areas such as government procurement, labour standards and competition policies that are not necessarily trade–related or disciplined by WTO agreements. The Free Trade Agreement of the United States with Chile and Singapore are cases in point. Only a handful of such RTAs (for example, Canada-Chile), however, take a radical approach in traditional areas, for example, by abolishing contingency protection measures such as anti-dumping.

As a result, two tracks of trade liberalization emerge

The inclusion of disciplines beyond those recognized by WTO can have serious systemic implications in as much as trade liberalization and policy reform under RTAs may not be coherent or consistent with what is the norm for the multilateral trading system (MTS).The practice also raises questions about the interrelationships between the two tracks of trade liberalization and points to the need for ensuring a coherent approach towards development and non-trade issues (for example, environment and labour standards) in both RTAs and WTO multilateral negotiations. Another concern refers to imbalances in bargaining power when such agreements are negotiated between partners having different levels of development.

A complex system of overlapping agreements is created

It is probable that the recent mushrooming of RTAs is associated with frustration with the slowness of the Doha Round and multilateral trade liberalization in general. RTAs however, create, an extremely complex system as a result of overlapping trade regulations, which is difficult to manage, particularly for developing countries. Each agreement has different tariff schedules and rules of origin, different periods of implementation, and may have different coverage extending to specific areas. The current pace, magnitude and growing complexity of RTAs in the absence of effective multilateral rules to govern them—and with unknown development implications—pose a big challenge for the future of MTS and for the interests of third countries. Multilateral liberalization is a simpler and better option with a far greater positive impact on development than RTAs. In this context, at the recent Asia-Pacific Economic Cooperation (APEC) Summit, it was agreed for the first time that only "high-quality" RTAs constituted important avenues to achieve free and open trade and investment and that transparency and broad consistency in RTAs should be pursued.[22]

Non-tariff barriers: a rising trend in world trade

The use of NTBs increased as tariffs declined

The decline of tariff rates as a result of eight multilateral trade negotiations raised the relative importance of non-tariff barriers (NTBs) both as protection and regulatory trade instruments. For instance, besides traditionally applied NTBs, such as anti-dumping (AD) and countervailing measures (CVM), government-mandated testing and certification requirements increased by seven times worldwide in the period 1994-2004.[23] NTBs imply significant additional costs for producers and exporters. They also have the potential to discourage trade as exporters are unable to meet legal, technical and sanitary requirements.

According to UNCTAD's Coding System of Trade Control Measures/Trade Analysis and Information System (TCMCS/TRAINS), technical measures as well as quantitative measures increased considerably during the period 1994-2004. The nature of most NTBs as actually applied, however, changed. The so-called "non-core measures"—largely

22 *Thirteenth Meeting of APEC Economic Leaders, Busan Declaration,* Busan, Republic of Korea, 18-19 November 2005, available from http://www.apecsec.org.sg/apec/leaders__declarations/2005.html.

23 UNCTAD, Report of the Expert Meeting on Methodologies, classification, quantification and development impacts of non-tariff barriers (TD/B/COM.1/EM.27/3), 8 November 2005.

intended to protect local consumers— increased, while "core measures"—meant to protect local producers—declined (see figure II.8). Among non-core measures, the use of technical measures increased, which suggests that behind-the-border measures will likely become the dominant means for restraining trade in the future.

A wide range of measures are used and several sectors are affected

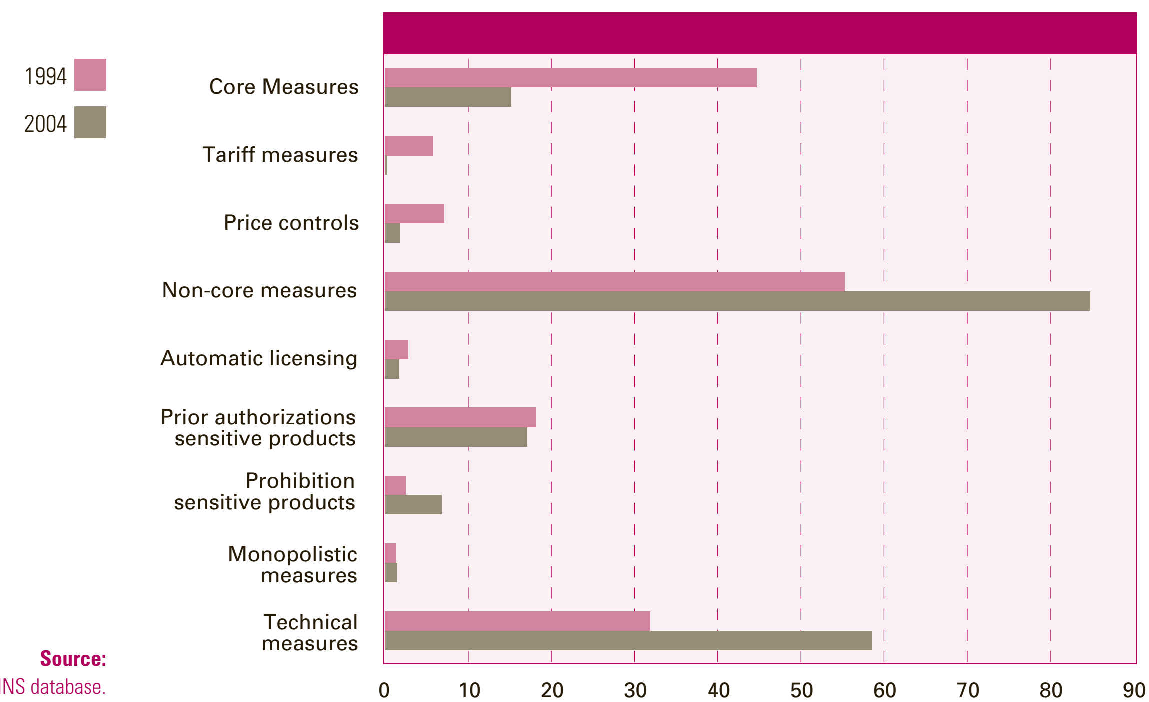
In the Doha Round, member States have submitted notifications of NTBs according to an agreed inventory.[24] Approaches and modalities on how to deal with NTBs are identified on the basis of five categories: (1) dispute settlement; (2) request/offer, bilateral, or plurilateral; (3) vertical or sectoral approaches; (4) horizontal or multilateral approaches; and, (5) tariffication of NTBs. By the end of November 2005, about 40 WTO member States had submitted around 250 notifications or proposals on NTBs—78 per cent of which were notifications by developing countries. Of the notifications or proposals, customs and administrative entry procedures (32.5 per cent), technical barriers to trade (21.9 per cent) and specific limitations, such as requirements for marking, labelling and packaging, quantitative restrictions, and export restrains (25 per cent) are among major concerns. On a sectoral basis, the top five sectors affected by NTBs are: chemicals (11.5 per cent), machinery and equipment (9.2 per cent), textiles and clothing (9.2 per cent), motor vehicles and parts (7.3 per cent) and fish/fishery products (6.1 per cent).[25] The results of OECD surveys with the business communities in several developed and developing countries (in 1995-2002), on the other hand, suggest that natural resource-based industries (for example, agriculture and food, mining, and textiles) are most strongly affected by NTBs.[26]

24 It is noted that this NTB classification is distinct, however, from UNCTAD's TRAINS.

25 WTO/Negotiating Group on Market Access, *Overview of Proposals Submitted, Non-Tariff Measures* (documents TN/MA/9/Rev.1, 29 October 2004 and Job(04)/62/Rev.7, 22 November 2005).

26 OECD, *Overview of Non-Tariff Barriers: Findings from Existing Business Surveys* (TD/TC/WP(2002)38/FINAL), (Paris, OECD, 2003).

Figure II.8.
Non-tariff trade barriers, 1994 and 2004



Source: UNCTAD TRAINS database.

NTBs and developing countries

Products of export interest for developing countries are often more affected than other products

Developing countries confront different types of NTBs when accessing different markets. In markets of developed countries, developing countries often face NTBs, such as conditions regarding technical specification of products, price controls and other NTB measures. In South-South trade, developing countries confront NTBs such as customs and administrative entry procedures, para-tariff measures (for example, import surcharges and other additional charges), as well as other obstacles, such as poor infrastructure, measures taken to protect intellectual property rights and inadequate governance. In this sense, the scope of NTBs becomes even wider in trade among developing countries. In general, export products of interest to developing countries, such as fisheries products, electrical equipment, pharmaceutical and textiles are more affected by NTBs than other products.

Increased use of measures by developed countries regarding the technical specification of products places additional costs and burdens on companies in developing countries in accessing markets. In general, costs arise from the translation of foreign regulations, hiring of technical experts to explain foreign regulations and adjustment of production facilities to comply with the requirements.

Applied standards are higher than international norms implying additional costs to exporters

In many developed countries, regulatory policy focuses on protection of the environment, public health and safety and often includes higher standards for the domestic market than existing international standards. While these regulations are legitimate from a legal point of view and are often in accordance with international norms, they entail greater compliance costs than would otherwise be the case. For example, it has been estimated that African banana exports could grow by $410 million a year if the EU used international standards for traceability requirements and regulations on pesticide residues for agricultural imports, instead of its own standards.[27] Overall, it is estimated that at least 10 per cent of export losses of all developing countries arise from Sanitary and Phytosanitary Measures and Technical Barriers to Trade (SPS/TBT) related measures.

WTO negotiations in this area are progressing slowly

From the above, one important challenge for the current WTO multilateral negotiations is to allow Governments to achieve their genuine regulatory objectives while preventing protectionist abuses. Negotiations on ‘behind-the-border’ policies, including NTBs, have proven to be complex owing to the difficulties in trading ‘concessions’ in this area. As a result, negotiations have focused on the identification of specific rules to be adopted at the multilateral and regional levels, which reinforces the need to generate equitable and balanced rules. For developing countries, it is vital that the Doha Round outcome on NTBs be both ambitious and commercially viable. Another challenge for the multilateral negotiations is to ensure that NTB rules in RTAs (both North-South and South-South) are coherent and compatible with the relevant WTO multilateral rules and disciplines. The Hong Kong Declaration, however, does not show evidence of any progress on these issues. It just takes note of the approaches being followed in the negotiations and encourages members to submit specific negotiating proposals “as quickly as possible”.[28]

Developing countries need to be proactive to avoid missing export opportunities because of NTBs

Furthermore, developing countries need to take steps to improve their legal and regulatory environment to support the participation of their national firms in international markets and enhance their competitiveness. Product standards and domestic sector regulations are areas that require attention. The modernization of standards systems, including

27 J.S. Wilson and V.O. Abiola, eds., *Standards and Global Trade—A Voice for Africa* (Washington, D.C., World Bank, 2003).

28 WTO, Ministerial Conference, Sixth Session, Doha Work Programme, *Draft Ministerial Declaration. Revision* (Document WT/MIN(05)/W/3/Rev.2), 18 December 2005, p. 5.

institutions and infrastructure for certification, is essential for operating in the current global trade environment. Meeting international standards for quality, safety, health, environment and consumer protection is increasingly becoming a precondition for competing in international markets. It has also become a major factor constraining many exporters, particularly in the LDCs, from benefiting fully from preferential access initiatives. Technical assistance for raising capacity to comply with regulations and standards should also be strengthened. Moreover, the participation of developing countries in international standard setting activities should be facilitated, including in the outcomes of the Doha Round. Finally, the promotion of mutual recognition agreements (MRAs) between developed and developing countries, as well as among developing countries, will also help substantively in reconciling frictions and disputes caused by different regulations between trading partners and lead to large cost savings for exporting firms worldwide.

Textiles and clothing: post-ATC developments

On 1 January 2005, the Agreement on Textiles and Clothing (ATC) ended, and all remaining quotas were abolished. The ATC expiration marked the end of the discriminatory trade regime of over 40 years, which targeted and restricted textiles and clothing exports from developing countries. As the expiration of the ATC approached, concerns were raised about potential negative consequences.

The end of ATC was anticipated to bring considerable changes to countries benefiting from quotas

Developing countries that had relied heavily on quota protection for market access of their textiles and clothing were expected to be seriously affected by the post-ATC competition. In addition, it was expected that preference-receiving developing countries could be adversely affected by the termination of the ATC because of their limited capabilities to adjust to the negative impact of preference erosion. Furthermore, there were concerns that the quota restrictions could be replaced by contingent protection measures such as anti-dumping actions and special safeguard measures.[29]

As anticipated, China increased its market share in both the United States and the European Union, which led to the re-imposition of quotas on some Chinese imports in these markets. In 2005, the EU and the United States concluded agreements with China to limit certain imports of Chinese textiles and clothing until the end of 2007 for the former, and the end of 2008 for the latter. The agreements were concluded separately from the WTO Accession Protocol on Textiles Specific Safeguard Clause in China. For those products not covered by the respective agreement, the EU and the United States can impose safeguards under the Textiles Specific Safeguard Clause.

While textiles and clothing importers in these two markets are again restrained by the quotas, the agreements provide them with a more predictable business environment than the disruptive safeguard regime experienced previously in the context of the WTO Accession Protocol on Textiles Specific Safeguard Clause in China. There is concern, however, that these agreements would prevent domestic textiles and clothing industries in both markets from making necessary adjustments.

29 *World Economic Situation and Prospects 2005* (United Nations publication, Sales No. E.05.II.C.2), pp.40-42.

Developments in the Generalized System of Preferences

Changes were introduced in the Generalized System of Preferences (GSP) schemes of both the EU and the United States to take into account the possible adverse impact of the quota elimination on LDCs and other small and vulnerable countries.

Developed countries have introduced changes in their GSP systems

The guidelines for the EU GSP scheme for the period 2006-2015, adopted by the European Commission in July 2005, address some of the post-ATC concerns of LDCs and other vulnerable countries. In this regard, a new graduation mechanism was established in the new EU GSP scheme which simplifies the existing mechanism and focuses the GSP benefits on those developing countries that are most in need. Graduation would take place when a "group of products" from a particular country exceeds 12.5 per cent on average of total EU imports of the same products under GSP over the last three consecutive years, with some exceptions. Under the new graduation mechanism, Chinese textiles, which benefited from the EU GSP, will be graduated.[30]

Conditionalities, however, remain stringent

Textiles and clothing exports from certain GSP beneficiary countries will be able to benefit from the "GSP-plus" provision, if certain conditions are met.[31] In order to secure this benefit, countries must ratify 27 key international conventions on sustainable development and good governance. "GSP-plus" preferences are immediately granted to countries that have ratified and effectively implemented the 16 core conventions on human and labour rights and 7 (out of 11) of the conventions related to good governance and the protection of the environment. Moreover, they must commit themselves to ratifying and effectively implementing the international conventions which they have not yet ratified, by 31 December 2008. The "GSP-plus" provision is also applicable for the countries that are classified as drug eradication countries. Yet, besides the latter, the only countries that benefited from the GSP-plus provision in 2005 were Georgia, Mongolia and Sri Lanka. This suggests that the conditions required are stringent and difficult to meet.

Rules of origin remain an issue in some GSP schemes for textiles and garments

The EU is also in the process of reforming the GSP rules of origin to increase the effectiveness of its GSP scheme. In many exporting countries, particularly LDCs and other low-income countries, the garment industry is not fully integrated into the local textile industry—or the countries lack capacity in textile production—and thus depend on imported inputs. Preferential treatment, however, applies only to those garments that use locally produced yarns or textiles. Consequently, only a few of these countries are able to take full advantage of the preference provided under the EU GSP scheme. But proposals to have less stringent rules of origin have been facing resistance by domestic EU producers.

In the United States, changes in its GSP scheme for textiles and clothing were considered under the Tariff Relief Assistance for Developing Economies Act of 2005 (TRADE Act of 2005). This Act proposes to extend the benefits given under the African Growth and Opportunity Act (AGOA) to 14 Asian LDCs and Sri Lanka. It also includes the special rule of origin for textiles and clothing, that is to say, the "third-country" fabric rule, which permits beneficiary countries to export clothing to the United States market duty- and quota-free regardless of origin of fabric and yarn. The TRADE Act of 2005 is set to expire on 31 December 2014.[32] Moreover, the Government of the United States has also initiated

30 Chinese clothing has been already graduated.

31 The countries are those for which the five largest sections of their GSP-covered imports to the EU represent more than 75 per cent of their total GSP-covered imports, and GSP-covered imports from them represent less than 1 per cent of total EU imports under GSP. The "GSP-Plus" benefits comprise duty-free access to the EU for around 7,200 products that include textiles and clothing.

32 AGOA, however, is set to expire on 30 September 2007. The LDCs concerned are: Afghanistan, Bangladesh, Bhutan, Cambodia, Kiribati, Lao People's Democratic Republic , Maldives, Nepal, Samoa, Solomon Islands, Timor-Leste, Tuvalu, Vanuatu and Yemen. For Sri Lanka, the benefits would be extended for economic emergency support in the aftermath of the tsunami disaster.

actions aimed at improving the effectiveness of its GSP scheme. The current scheme expires on 31 December 2006.

The Government of Canada also introduced reforms in its GSP scheme by extending duty-free access to imports from all LDCs, with the exception of some agricultural products, under its Market Access Initiative effective 1 January 2003. The most important addition under this initiative has been the granting of duty-free access to textiles and clothing articles with the beneficiary-friendly rules of origin.

Developments in the WTO on post-ATC adjustment

Within the WTO framework, post-ATC adjustment is being discussed in the Subcommittee on LDCs and the Council on Trade in Goods (CTG). The discussions in the CTG, however, have been inconclusive. Since the end of 2004, some countries have been pressing the WTO Secretariat to conduct a study on the post-ATC impact with a view to identifying adjustment-related measures that could be taken by the WTO.[33] Turkey, for instance, proposed the establishment of a "work programme" for textiles and clothing that would make recommendations to avoid the deterioration of trading conditions in the sector, including possible ways to stabilize prices.[34] The proposal, however, was rejected by major textile and clothing exporting countries who argued against the introduction of new exceptions for a sector that had just been fully integrated into WTO discipline. Instead, they suggested that post-ATC adjustments should be dealt with in the context of the overall trade adjustment issue. No convergence has emerged in this debate, and the discussions in the CTG will continue in 2006.

Overall assessment of the post-ATC situation

Adjustments are still taking place in textiles and clothing markets

Post-ATC developments present a mixed picture. Adjustments to the new framework would take several years. Trends need to be monitored continuously, as the impact of the end of the ATC could be particularly harsh for countries highly dependent on the sector which have not diversified into other economic activities.

Improvements in the effectiveness of the current GSP schemes could help ease the adverse impact of the termination of the ATC. In this regard, the initiatives mentioned above are steps in the right direction. Yet, problems remain with the GSP schemes, namely, not-user-friendly rules of origin, difficult conditionalities, uncertainty of benefits and uneven coverage of products and countries.

A managed trading system for textiles and clothing should be avoided

Textiles and clothing are now fully integrated into the normal WTO rules and disciplines. The legacy of protectionism still continues, however, in the post-ATC phase, as discussed above. Some WTO member States suggested the creation of what appears to be a managed trading system for textiles and clothing aiming at price and market share stability. The termination of the ATC marks the end of the discriminatory measures that targeted products from developing countries for so long and caused so much distortion in the international allocation of resources. It is thus crucial to ensure that international trade in textiles and clothing does not slip back to the protectionism of the past.

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33 WTO, Initial submission on Post-ATC Adjustment-Related Issues from Bangladesh, the Dominican Republic, Fiji, Madagascar, Mauritius, Sri Lanka, and Uganda (Document G/C/W/496), 30 September 2004. Also, "WTO Members Deadlocked on Impact of Jan.1 Elimination of Textile Quotas", *International Trade Daily,* 27 October, 2004.

34 WTO, *Issues related to trade in textiles and clothing. The perspective of Turkey on the issues involved* (Document G/C/W/522), 30 June 2005.

Annex
Developments in non-oil commodity markets

Agricultural commodities

After a 30 per cent decrease in 2004, the price of **wheat** recovered in 2005 and rose by 11 per cent between January and October. World wheat production in 2005 is estimated to have decreased by more than 2 per cent, mainly owing to weakening yields in the United States and in some European countries (for example, Italy, Poland and Spain). World wheat consumption is forecast to rise by 1 per cent, while global stocks are projected to decrease by 5 per cent. As a result, wheat prices are likely to be firm in the near future.

Maize prices increased by 6 per cent between January and October 2005, which was not sufficient to compensate for the large drop recorded in 2004. The increase was mainly the result of moderately bearish supply and demand conditions. World maize output is estimated to be at 672 million tons in 2005/2006 (compared with 706 million tons a year earlier), while global consumption is forecast at 670 million tons (below the record last year of 675 million tons).Yet, in addition to higher stock levels, concerns about avian influenza (see box IV.3), weighed negatively on price prospects, as nearly two thirds of maize is used for feeding, including in the poultry sector.

The **rice** market is definitely bullish. The recent revival in world production, which is expected to reach 606 million tons of paddy rice in 2005/2006, corresponding to 405 million tons of white equivalent, will not be enough to meet consumption needs, estimated to be at 414 million tons of white equivalent. Furthermore, Viet Nam has issued a trade directive recommending the suspension of new export contracts, because of lower output in its northern provinces, a situation which may influence the rice market. On the other hand, there has been a small increase in rice production in the EU, despite the reform of its common organization market (COM) for rice (with 50 per cent of the EU price cut being replaced by expanded direct-aid payments). EU rice trade, however, represents only about half a per cent of world trade.

Banana prices were volatile in 2005: prices increased by 79 per cent from December 2004 to February 2005, dropped through August (by some 55 per cent) and recovered thereafter. This situation was mainly driven by late arrivals in early 2005 and, subsequently, by a sudden return of shipments from Cameroon and Suriname, among others.

Despite increased world **sugar** output in 2005-2006, sugar prices skyrocketed with a 34.7 per cent increase during the first 10 months of 2005. The rise in production was mainly driven by Brazil, which reached a peak of 29 million tons, and by India, which increased its output to 19 million tons. The stock-to-consumption ratio declined and was one of the factors underpinning higher prices. This decline was not the main reason, however, but rather the increasing importance of ethanol in the sugar market both in sugar-producing countries—the development of flex-fuel vehicles in Brazil is a case in point—and elsewhere, owing to soaring oil prices. The world sugar market is likely to undergo a period of change as the new EU sugar regime comes into force in 2006/07 (see box II.1). In the near future, the sugar market may face a tighter supply situation and much will depend on the capacity of Brazil to meet future demand for sugar and ethanol.

The **coffee** composite price index increased by 6.2 per cent during the first 10 months of 2005, but this masks the duality that exists in this market: the price of Robusta increased by 28.7 per cent, while the price of arabica in October 2005 was only slightly above the level in December 2004.[a] Speculative funds have been the main driving force in this market, particularly during the first semester of 2005. World production in 2005/06 is expected to be around 108 million bags, compared with 115 million a year earlier. In comparison, world consumption amounted to 115 million bags in 2004 and 112 million in 2003. Several factors tend to confirm an upward trend in prices in the near future. These include, inter alia, the negative impact of Hurricane Stan on crops in Central America and Mexico, declining stocks, the recent growth of consumption in exporting countries as well as unusual weather conditions in Viet Nam related to the lack of rainfall in the main producing areas.

Cocoa prices decreased by 12 per cent from the end of 2004 to October 2005, despite a decline of 10 per cent in West African output in 2004/05 and a 6 per cent decline in overall world cocoa output. Global grindings increased by 3 per cent. The current production shortfall, however, has been limited to around 50,000 tons, while last season produced a surplus of 250,000 tons. A number of key features may influence cocoa prices in the near future. In the very short term, speculation may boost the price as hedge funds have taken massive positions in the New York Board of Trade (NYBOT), purchasing 15,000 lots equivalent to 150,000 tons of cocoa, or 5 per cent of world output.[b] Substantial supply disruptions are not anticipated in the long run, and thus prices may not increase abruptly. On the other hand, depressed prices may stimulate the demand for cocoa and cocoa products. In the near future, the arrival of Viet Nam as a new competitor in the market represents an additional challenge for traditional producers.

The price of **tea** increased, on average, during 2005 but a reversal in trend could be observed: the sharp increase in price in the first quarter of 2005 was followed by lower prices for the rest of the year. Traditional producers, such as Bangladesh, India, Kenya and Sri Lanka, account for the major share of world tea exports. In 2005, however, China, which had abolished an 8 per cent tax on tea production, emerged as an important exporter and is likely to overtake large exporters such as Sri Lanka and Kenya in the near future. Prices are expected to remain weak owing to current excess supply, which is likely to persist with the soaring production in China, India and Kenya. Recent initiatives may not be enough to offset demand-supply imbalances. For example, India decided in October 2005 to destroy substandard tea, and China established tea promotion policies.

After an historical peak in March 2004, average prices of **vegetable oilseeds and oils** declined and remained relatively stable in 2005. Trends were very divergent at the individual commodity level: cottonseed oil prices increased by almost 55 per cent from December 2004 to October 2005, while the price of soybean oil and palm oil rose by much less (around 4.5 per cent in both cases). Other commodities in this group, however, recorded steep price declines during the period: sunflower oil (11 per cent), groundnut oil (14 per cent) and coconut oil (11 per cent). Among the factors that may influence the vegetable oilseeds and oils outlook are weakening Brazilian soybean and cottonseed production and the record Russian sunflower seed output. The appreciation of the real, together with limited access to credit and higher transportation costs, is reported to have depressed Brazilian output. Demand growth is anticipated to be strong over the medium term, notably from developing

a International Coffee Organization, "ICO Indicator of Prices, Monthly and Annual Averages", available from http://www.ico.org/prices/p2.ht (accessed on 14 December 2005).

b Radio France Internationale, "Le marché du cacao sort de la léthargie", 22 November 2005.

countries, in particular China, for both oilseed and oilseed products for human consumption as well as oilseed meal for the expanding livestock sector.[c]

During 2005, **cotton** prices increased by 17 per cent owing to lower output in China and, to a lesser extent, in the United States. World cotton output in 2005/2006 is estimated at 25 million tons, which corresponds to a 5 per cent decline from the 2004/2005 harvest. World cotton demand is still quite robust and mainly driven by China, whose share in world imports is estimated to have jumped to 37 per cent in 2005/06 from 20 per cent in 2004/2005. The International Cotton Advisory Committee (ICAC) projected an Index A Cotton Outlook of $0.65 per pound on average in 2005/2006, which is 7.25 cents above the October 2005 price (a record level over the past 16 months).[d] On the other hand, stocks are likely to reach more than 11 million tons by the end of this season, the highest level in 20 years, which may put a brake on prices.

Owing to the rise in price of synthetic products, the price of natural **rubber** soared, increasing by about 40 per cent during the period January-October 2005 to peak at $2.91 per kilo in October 2005, the highest in nominal terms since November 1980. On the consumption side, there was a switch from synthetic to natural rubber, a trend likely to continue as long as oil prices remain under pressure. Sustained economic growth in major consuming markets was another important factor pushing up prices. China has a dominant role in the market: it is the largest world consumer, accounting for nearly one fifth of global rubber consumption. In this context, the recent decision of China to eliminate import duties on natural rubber is likely to boost imports further and support the current upward trend in prices. On the supply side, natural rubber production is constrained in the short term owing to low investment in the sector. Thus, in the outlook, the rubber market is expected to stay tight.

Minerals and metals

The **steel** market was expected to cool as demand fell in most parts of the world. While crude steel production in the rest of the world in the first ten months of 2005 fell by 1 per cent (when compared with the same period in 2004), production in China increased by 26 per cent, indicating that demand in that country held up well. Accordingly, the international steel market remains strong, and there is little reason to expect a “hard landing” in 2006.

The **iron ore** industry is experiencing an unprecedented boom as the commodity price witnessed a spectacular increase of 71.5 per cent in 2005. The explosive growth of demand for steel in China is driving this spectacular development.[e] China remained the largest importer of iron ore, accounting for roughly one third of world imports. In many countries, production underwent a process of vertical integration as producers tried to secure a stable supply of iron ore. The push for consolidation has been strongest in the fragmented iron ore mining sectors of China, the Russian Federation and Ukraine. Iron ore prices for 2006 are under negotiation and industry observers are forecasting another double-digit price increase for 2006. The price increase will again be driven by demand from China, which for the first time may play a pivotal role in the negotiations.

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c European Commission/Directorate General for Agriculture *Prospects for Agricultural Markets and Income 2005-2012,* July 2005 available from http://europa.eu.int/comm/agriculture/publi/caprep/prospects2005/index_en.htm (accessed 4 January 2005).

d According to OECD and ICAC projections, prices may increase slightly up until 2007, especially under the influence of an increasing demand from the spinning sector.

e UNCTAD, *Iron Ore Market 2004-2006* (Geneva, UNCTAD, May 2005).

Although **aluminium** prices remained at historically high levels, they increased at a more modest 4.3 per cent during the period January-October 2005. High energy prices have been a driving force in the aluminium sector, particularly since energy price increases have caused some producers to close down smelters. Aluminium output in the period January-October 2005 was about 3.3 per cent higher than in the same period in 2004, and industry inventories have not changed drastically,[f] while London Metal Exchange (LME) stocks of primary aluminium have been decreasing. The bullish trend is expected to be sustained as the market is moving slowly to deficit, with LME warehouse stocks of aluminium down to 6.5 weeks of global consumption and expected growth in production predicted to be 4.5 per cent in 2006, compared with an anticipated 5 per cent increase in consumption.[g]

Copper prices increased by 41 per cent in the period January-October 2005, indicating a sharp and firm upward trend. Late-year surges in the copper price, however, were not due to the interplay between fundamentals in supply and demand, but generated by speculative uncovered positions. It was reported that the State Reserve Bureau of China has had a large short position of 200,000 tons with delivery on 21 December 2005 and, as a consequence, speculators have entered the futures market with the expectation that China will have to cover the position it has assumed.

The high copper prices are likely to curb demand,[h] while supply is expected to grow in 2006. Thus, although prices are expected to remain high up to early 2006, a downturn can be foreseen thereafter, particularly as the market shifts to a situation of excess supply. Finally, it should be noted that Chile, the world's largest copper producer, entered into a free trade agreement with China, the leading copper-consuming country. The free trade agreement (FTA) is expected to come into force on 1 July 2006 and will provide, inter alia, tariff-free access of Chilean copper to China.

Next to copper**, zinc** was the best performer of the base metals in the last year as prices rose by 26 per cent during the first 10 months of 2005. The upward trend was mainly driven by supply disruptions, such as strikes at Teck Cominco's Trail operations, and by a demand upturn, particularly in the United States, which registered a significant increase in galvanized steel products. The increasing influence of China, which is emerging as a net importer, adds even more force to this bullish trend. Despite rising output, stocks are falling rapidly, albeit from very high levels, a situation that is expected to support the price in the near term.

In contrast, the price of **nickel** decreased by 10 per cent. The fall came after a period of high price instability and historically extremely high prices during the first three quarters of 2005, which were mainly driven by huge speculative positions estimated to be 30 to 40 times the level of annual consumption. The market correction may be sustained as LME stocks have been increasing both in Europe and in Singapore and demand has been lethargic. On the supply side, a modest growth of 3 per cent is forecast, and some industry sources are expecting a surplus in 2006 and 2007, despite the growing demand in China.

The price of **lead** has kept up its good performance with a 3 per cent increase in the period January-October 2005, reaching an historical peak on the LME (since the launch of the contract in 1993) with a monthly average of $1,005 per ton in October 2005. China overtook the United States as the leading consuming country in 2005 with a share of 25 per

f International Aluminium Institute (www.world-aluminium.org).

g Aluminium demand by China has been forecast to grow by an annual rate of 7.2 per cent until 2010. (*Diapason Monthly Report,* October 2005).

h Copper demand growth is expected to ease to 3.2 per cent in 2005 from 8.9 per cent in 2004. See "Speculation is main driver behind high metals prices", *Financial Times,* 30 November, 2005.

cent of global consumption, and it is also the main producer, accounting for 30 per cent of world output. Thus, China is the price maker, and its net position will influence the market. Worldwide mine output remains tight, however, while metal stocks are increasing,[i] making the outlook uncertain.

The **tin** price decreased towards the end of 2005 owing to rapidly rising LME stocks, notably in Singapore. The fall came after an upward trend during the first nine months of the year, caused by disruptions on the production side[j] and growing demand. China is a key tin supplier and drives the market. Recently, a decision was taken to control illicit tin mining operations, and this has restrained national production capacity. However, this limit on supply was insufficient to alter the bearish market conditions.

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i *Metal Bulletin Monthly*, London, October 2005.

j *Mining Journal,* London, 7 October, 2005