SOUTH-SOUTH TRADE

Winning from Liberalisation

Australian Government

Department of Foreign Affairs and Trade

Economic Analytical Unit

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SOUTH-SOUTH TRADE: WINNING FROM LIBERALISATION

KEY POINTS

- Developing economies have set about liberalising their trade over recent years, underpinning strong developing country trade growth. Average applied tariffs of developing countries were around 12 per cent in 2000, about one-third of their levels in 1983, but well above developed country rates.

- Average applied *ad valorem* tariffs are more than three times the level of those in industrial countries.

- Around 70 per cent of the tariffs faced by developing country exporters are applied by other developing countries.

- Developing countries also have a significant incidence of 'tariff peaks' - over one-quarter of developing countries have in excess of 40 per cent of tariffs at 15 per cent or higher. Significant welfare losses arise from the maintenance of tariff peaks.

- The World Bank estimates that developing countries stand to realise welfare gains of US$31 billion per year if other developing countries eliminated manufacturing tariffs and a further US$31 billion if they removed their agricultural trade barriers.

- Developing countries now account for around one-third of global trade. Intra-developing country, or 'South-South', merchandise trade has grown twice as fast as world trade over the past decade, and now represents over 12 per cent of global trade.

- An important development has been a major shift to trade in manufactures between developing countries, with developing countries becoming more enmeshed in global production chains as they lower their trade barriers.

- In keeping with developing Asia's rapid economic growth over the past decade and their more open trade policies, trade within Asia has grown faster than trade in other regions.

- Lower developing country trade barriers will enable developing countries to participate to their full potential in global production chains, which bring with them greater opportunities to engage in higher value added activities. Foreign investors will increasingly tend to bypass those countries with high trade barriers.

INTRODUCTION

Developing country trade patterns are changing. Intra-developing country, or ‘South-South’, trade now accounts for around two-fifths of all developing country trade compared with less than one-third a decade earlier. Trade between developing countries has grown faster than overall world trade over the past decade. Developing countries also trade more manufactures, making them less vulnerable to commodity price movements and terms of trade shocks.

Developing economies have set about liberalising their trade over recent years, both through their active participation in the Uruguay Round of trade negotiations and new accessions to the WTO, as well as through unilateral liberalisation measures. Developing country tariffs are now around one-third of their 1983 levels. Tariff reductions – coupled with high rates of economic growth in several developing economies – have already led to significant increases in trade flows between economies in the South.[1] The real growth opportunities for developing country trade is in the South, because these are the fastest growing economies.

Despite these improvements, developing countries still maintain high tariff barriers on average compared with developed countries. Developing country tariffs also often are higher on products that other developing countries are likely to export. Tariff peaks remain an issue. Over one-quarter of developing countries have in excess of 40 per cent of tariffs at 15 per cent or more. Around 70 per cent of the tariffs faced by developing country exporters are applied by other developing countries.

The welfare benefits for developing countries from trade liberalisation are substantial, with a large, if not majority, share of the benefits from multilateral trade liberalisation accruing to developing countries as a result of their high current protection levels. Developing countries stand to derive the bulk of the welfare gains arising from the reduction of manufacturing tariffs. Significant gains could also flow from reductions in agricultural protection. Developing countries’ exports stand to grow more strongly than those of industrial countries, with South-South trade the main beneficiary. Developing countries also can expect to be major beneficiaries of services trade liberalisation, with the benefits even greater than from the liberalisation of merchandise trade. This suggests there remains significant scope to increase trade between developing countries.

The following section looks at the barriers to South-South trade in goods and services. Recent developments in trade are canvassed in Section 3. Section 4 then assesses how developing countries can gain from further reductions in trade barriers, including a discussion on recent empirical work on this issue. Section 5 provides policy implications and Section 6 concludes.

[1] UNCTAD categorises developing countries and territories according to whether they are low, medium or high income. Newly industrialised economies such as Singapore and the Republic of Korea are included in their statistics, as are the transition economies of Central and Eastern Europe and the CIS. World Bank statistics distinguish between developing and industrial (high income OECD) economies. The Republic of Korea is included in the latter category. Within the WTO, developing countries are all those countries that nominate as such. They therefore include countries ranging from the least developed countries through to newly industrialised economies such as Singapore and the Republic of Korea, as well as transition economies. Note however that in its review of South-South trade developments, developing countries are defined by the World Trade Organization (2003) to exclude the transition economies. A degree of caution is therefore required when comparing statistics on developing countries from different sources.

BARRIERS TO SOUTH-SOUTH TRADE

Developing country tariff and services trade barriers remain significantly higher on average than those of developed countries. Developed country tariffs on agricultural products also are very high in some areas. Developing countries also have a greater incidence of tariff peaks than do the developed countries. Moreover, because of their export profiles, developing countries tend to face higher tariffs in other developing countries than do the developed countries.

SIGNIFICANT TARIFF BURDEN

The average applied *ad valorem* tariff for developing countries is 12.6 per cent, compared to just 3.4 per cent for industrial countries (Table 1). The average agricultural tariff is much higher for developing countries than for developed countries, a difference that becomes even more pronounced in the case of bound rates (on which multilateral trade negotiations are based – see Section 4 for more discussion on bound rates). However, it needs to be noted that these data are only a partial measure of agricultural protection, as they exclude non-*ad valorem* tariffs, and do not take account of quota regimes and farm support, all of which are heavily relied upon by the major developed countries. Developing country non-agricultural tariffs also are higher than those of developed countries, increasing prices of capital inputs for domestic producers.

Table 1

Developing Country Tariffs Higher than Developed

MFN Bound and Applied Tariff Rates, Simple Average[a]

Import markets		All products	Agriculture	Non-agriculture
Developing	Applied	12.6	17.2	11.8
	Bound	45.5	62.4	34.2
	Overhang[b]	*32.9*	*45.2*	*22.4*
Developed	Applied	3.4	4.3	3.3
	Bound	10.1	11.1	9.9
	Overhang[b]	*6.7*	*6.8*	*6.6*

Noes: a. Average tariffs for developed and developing countries are calculated by taking a simple average of the average tariffs of developed and developing countries respectively.

b. The difference between applied and bound rates – the greater the difference, the less will be the impact of formula cuts negotiated in bound rate terms.

Source: World Trade Organization, 2003.

The developing country average masks considerable differences in average tariffs between countries. On a Most Favoured Nation (MFN) basis, average applied tariffs range from zero in Hong Kong and Macao to 33.9 per cent for Tunisia in 2002 (World Trade Organization, 2003). In general, those economies with higher average tariffs also have the least number of duty free lines. Maximum tariffs applied on products also are markedly different across countries.

TARIFF PEAKS STILL AN ISSUE

'Tariff peaks' are an important indicator of the extent and significance of tariff barriers and addressing these is an important part of the WTO Doha round of multilateral trade negotiations (see Section 4). Tariff peaks on industrial products are most prevalent in textiles, clothing, footwear, leather goods and transport equipment. Like many developed countries, some developing countries also maintain high tariffs on a number of agricultural commodities. High developing country agricultural tariffs can also be a significant barrier to South-South trade. Korea, for example, has a 917 per cent tariff on cassava and Morocco a 339 per cent tariff on sheep and goat meat.

The heterogeneity of developing economies yields considerable differences in the extent of tariff peaks. Over one-quarter of developing countries have in excess of 40 per cent of tariffs at 15 per cent or higher. At the same time, 11 developing countries have no international tariff peaks, defined as a tariff that is 15 per cent or higher. National tariff peaks – defined as a tariff that is three or more times the size of the national average – are a less common problem, although two-thirds of developing countries have some national tariff peaks (World Trade Organization, 2003).[2]

Addressing tariff peaks will be more beneficial to developing countries than developed countries, because the products developing countries export tend to face disproportionately high tariffs. For example, tariffs imposed by South Asia on imports from developing countries often are five times as high as the rates imposed by developed countries, while countries in Sub-Saharan Africa typically levy high tariffs on imports from other countries in the region (World Bank, 2003a). For this reason, the World Bank advocates an approach that will require disproportionately greater reductions in higher tariffs. Quite aside from market access considerations, removing tariff peaks will be of greatest benefit to the liberalising country, as the economic costs of maintaining a tariff twice as high as the average tariff are four times as high as those of an average tariff (World Bank, 2003a).

TARIFF BARRIERS IMPACT MORE ON SOUTH-SOUTH TRADE

Around 70 per cent of the tariffs faced by developing country exporters are applied by other developing countries (World Bank, 2003a). The commodity mix of imports from developing countries attracts a higher level of protection than the range of goods typically produced in developed countries. In the case of manufactures, average tariffs facing imports from developing countries were 12.8 per cent in 1995, compared with 10.9 per cent on imports from developed countries (Table 2). This is because

[2] The World Trade Organization (2003) has more detailed country information on tariff peaks.

higher tariff items, such as textiles, clothing and footwear manufactures are more prominent in the profile of developing country imports from other developing countries while lower tariff items such as machinery and transport equipment are more prominent in their imports from developed countries. A similar bias is evident in the case of minerals and energy tariffs.

Table 3 presents data on the top 10 goods imported predominantly from other developing countries, and the top 10 goods imported predominantly from developed countries. Clothing and footwear imports attract some of the highest average tariffs levelled by developing countries – 21.3 per cent and 19.2 per cent respectively. In contrast, tariffs levelled on electrical machinery and transport equipment are 9.5 per cent and 15.1 per cent respectively.

Table 2

Developing Country Tariffs Biased Against Other Developing Countries

Estimated Trade Weighted Tariffs/Tariff Equivalents, by Commodity, Source and Destination, 1995

	Importing region		
	High-income	Developing	World
Exporting region	per cent		
Manufactures			
High-income	0.8	10.9	3.8
Developing	3.4	12.8	7.1
World	1.5	11.5	4.7
Agriculture			
High-income	15.9	21.5	17.5
Developing	15.1	18.3	16.4
World	15.6	20.1	17.1
Minerals/energy			
High-income	0.1	1.3	0.4
Developing	0.4	5.2	2.4
World	0.2	3.0	1.1
Services			
High-income	63.9	83.7	68.3
Developing	93.1	87.6	91.4
World	70.1	84.9	74.1

Source: Hertel and Martin, 2001.

Table 3

Composition of Trade Affects Average Tariff Levels

Developing Country Imports and Their Tariffs , by sector, 2001[a]

Chapter		Value $billion	Tariff
Imports predominantly from other developing countries[b]			
27	Mineral fuels, mineral oils and products of their distillation; bituminous substances; mineral waxes	46.9	6.5
61	Articles of apparel and clothing accessories, knitted or crocheted	5.8	21.3
95	Toys, games and sports requisites; Parts and accessories thereof	5.3	12.7
64	Footwear, gaiters and the like; Parts of such articles	4.4	19.2
62	Articles of apparel and clothing accessories, not knitted or crocheted	4.3	21.3
44	Wood and articles of wood; Wood charcoal	3.3	10.1
60	Knitted or crocheted fabrics	3.0	14.9
26	Ores, slag and ash	2.9	4.0
42	Articles of leather; Saddlery and harness; Travel goods, handbags and similar containers; Articles of animal gut (other than silk-worm gut)	2.8	17.9
15	Animal and vegetable fats and oils and their cleavage products; prepared edible fats; animal or vegetable waxes	2.4	14.7
Imports predominantly from developed countries[c]			
84	Nuclear reactors, boilers, machinery and mechanical appliances; Parts thereof	97.3	6.7
87	Vehicles other than railway or tramway rolling-stock, and parts and accessories thereof	53.4	15.1
85	Electrical machinery and equipment and parts thereof; Sound recorders and reproducers, television image and sound recorders and reproducers, and parts and accessories of such articles	32.4	9.5
90	Optical, photographic, cinematographic, measuring, checking, precision, medical or surgical instruments and apparatus; Parts and accessories thereof	29.5	6.6
88	Aircraft, spacecraft, and parts thereof	24.9	5.0
30	Pharmaceutical products	11.6	5.1
39	Plastics and articles thereof	10.2	10.0
29	Organic chemicals	9.5	5.4
38	Miscellaneous chemical products	8.8	7.0
73	Articles of iron or steel	7.6	11.4

Notes: a. Calculations are based on a sample of 60 developing countries for which tariff and trade data were available. Average tariffs are calculated by taking a simple average of tariffs across countries for a given product category. 2001 data was used where available, otherwise the latest information was used.

b. Difference between imports from developing and developed countries.

c. Difference between imports from developed and developing countries.

Source: World Trade Organization IDB.

The high tariffs on textiles, clothing and footwear maintained by many developing countries represent significant barriers to South-South trade given the importance of this sector to developing countries. Around one-half of developing country textile exports are to other developing countries and one-fifth of developing country clothing exports go to other developing countries (IMF and World Bank, 2002). Textiles also face quota restrictions under the WTO Agreement on Textiles and Clothing. Under this Agreement it is possible to limit imports from one country while simultaneously giving preferential treatment to other countries. This has potentially allowed inefficient textile producers to survive. However, this Agreement will cease to exist from 1 January 2005, bringing textiles and clothing into GATT 1994 rules and abolishing the current quotas. This has the potential to change significantly the structure of the current textile and clothing trading arrangements.

SERVICES TRADE BARRIERS

Services trade barriers are harder to quantify, as restrictions can apply on all modes of service delivery, not just cross-border supply.[3] Moreover, some restrictions can be quite justifiable from a regulatory viewpoint, and should not be viewed as trade barriers. Restrictions can be in the form of limitations on market access and limitations on ‘national treatment’ (that is, less favourable treatment for non-resident suppliers). Accordingly, gains from liberalisation can stem from enhanced competition from both domestic and foreign suppliers. Examples of restrictions include qualification requirements and procedures, technical standards and licensing requirements for the provision of business and professional services; coastal transport (cabotage) restrictions; restrictions on the entry of new firms; foreign ownership restrictions; and restrictions on the movement of people. Notwithstanding the measurement difficulties, empirical estimates of trade barriers on services tend to be higher than those applying on merchandise trade.

While many developing countries have implemented reforms over recent years directed at liberalising their services sectors, significant barriers typically remain. Different countries have considerably different regimes. For example, Brazil has implemented wide-ranging liberalisation of services, although it maintains restrictions on the entry of new firms into the banking sector and does not allow foreign ownership in the transport sector. By contrast, in India, foreigners cannot provide legal services, and significant foreign ownership restrictions apply in many areas, including insurance, telecommunications and banking (Mattoo, 2003). “Tariff equivalent” estimates of service trade barriers calculated in 1995 suggest maritime cabotage, air transport, postal services, basic telecommunications and life insurance are the most restricted sectors in both developed and developing countries, with reported rates of 200 per cent for most countries (Hoekman, 1995).

3 For more information on different methods to calculate services trade barriers, see Chen and Schembri, 2002; Hertel and Martin, 2001; Hoekman, 1995; Verikios and Zhang, 2001; Warren, 2000.

RECENT TRENDS IN DEVELOPING COUNTRY TRADE

Over the past decade, some significant shifts have occurred in trade patterns. South-South trade has assumed much greater importance for developing economies, now accounting for around two-fifths of all developing country trade, compared to less than one-third a decade earlier. Developing economies also have moved away from resource based exports to play a more central role in global manufacturing trade. Services exports also have assumed greater prominence for developing countries. Falling tariffs, the reduction or removal of other trade-distorting measures such as quotas and import licensing, and services sector liberalisation have contributed to these shifts. Rapid economic development in East Asia also had a role in the expansion of South-South trade and in the shift towards manufacturing exports.

In the two decades to 2000-01, developing countries increased their share of global trade from about one-quarter to one-third. Their share of global agricultural exports remained unchanged from the 1980-81 share (around 37 per cent), while their share of manufacturing exports reached 33 per cent (up from 19 per cent) (World bank, 2003a).

They also have increased their share of global exports of commercial services to over 23 per cent in 2001 (up from 18 per cent in 1990) (World Trade Organization, 2003). Their share of global exports of total services, which have grown more rapidly than global exports of merchandise, has similarly increased.[4]

DEVELOPING COUNTRY TRADE GROWTH GREATER THAN WORLD AVERAGE

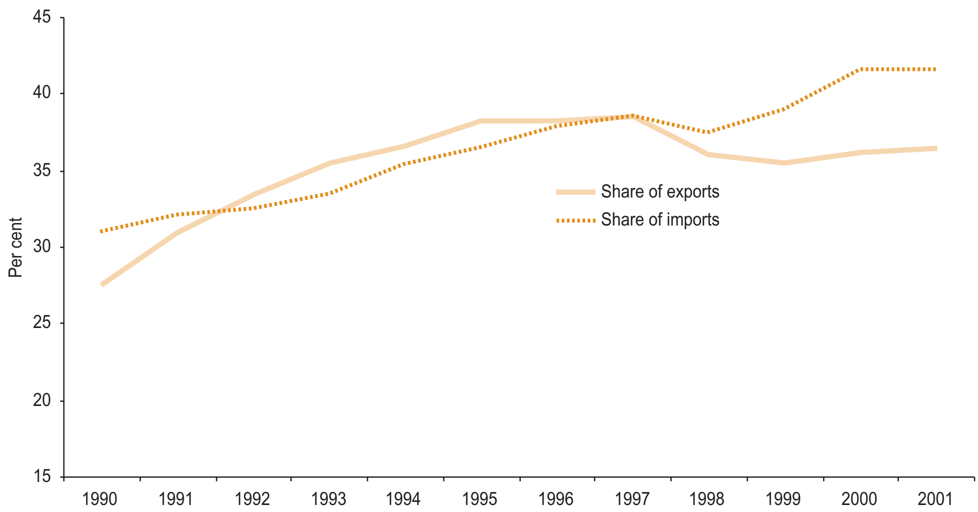
Stronger economic growth in developing economies compared to developed countries has increased demand for goods and services from other developing economies (Santos-Paulino and Thirlwall, 2004). South-South merchandise trade grew by 10 per cent per year between 1990 and 2001, twice as fast as world trade. South-South merchandise trade was worth US$768 billion in 2001, equivalent to 12.2 per cent of world merchandise trade and up from 7.7 per cent of world trade in 1990 (UNCTAD, 2003). On the export side, developing country exports to other developing countries have increased from 28 per cent of total developing country exports in 1990 to 37 per cent in 2001 (Figure 1). Imports are a higher proportion still, representing 41 per cent of developing country imports in 2001 compared with 31 per cent in 1990 (World Trade Organization, 2003).

[4] Based on balance of payments data, which cover cross-border supply of services and consumption of services abroad.

Figure 1

South-South Trade Increasing

Share of Developing Country Merchandise Exports and Imports Going to Other Developing Countries, 1990 to 2001



Source: World Trade Organization, 2003.

TRADE SHIFTING TO MANUFACTURES

The growth in developing country trade over the past decade has been associated with a shift in the trade profile from resources to manufactures. As incomes have grown, demand for manufactures have increased relative to demand for agricultural products. This is an important development, as it increases the potential for trade between developing economies and leaves them less vulnerable to commodity price movements and terms of trade shocks.

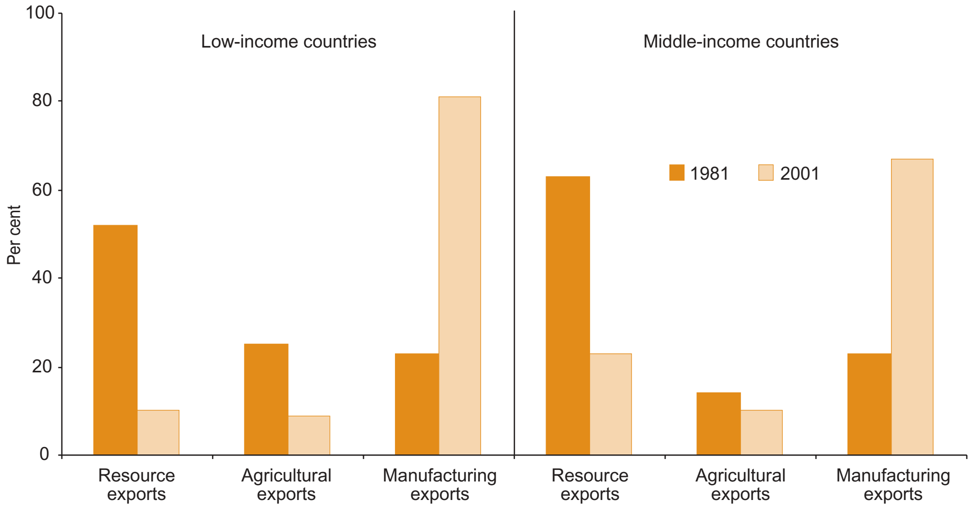
In addition, many developing economies have succeeded in becoming part of global production chains, which typically take advantage of the strengths of different regional economies to produce components and assemble completed products. The rise in the use of these production chains has been associated with increased foreign direct investment flows into developing countries. An illustration of this is China, which has emerged as a major assembler and exporter of manufactures using imported components (Economic Analytical Unit, 2003b). Successfully integrating into these production chains requires, among other things, low tariffs on imported components, so that businesses can be internationally competitive. With developing countries becoming more integrated with global production chains, their manufacturing sectors are now more dependent on imported intermediate inputs and so are typically much more vulnerable to the adverse effects of protection in developing countries than agricultural and resource-based activities (World Bank, 2003a).

Manufactures now account for a large portion of merchandise exports from developing countries, up from 53 per cent in 1990 to 65 per cent in 2001 (UNCTAD, 2003). By contrast, the share of agricultural exports had fallen from 15 to 10 per cent over the same time period. Low-income countries have experienced a particularly large shift in the pattern of exports, with around 80 per cent of exports now coming from manufacturing (Figure 2). Even excluding China and India, manufactures still make up over 60 per cent of exports from low-income countries (World Bank, 2003a).

Figure 2

Large Shift to Manufactures for Low-Income Countries

Share of Exports by Sector, 1981-2001, per cent



Source: World Bank, 2003a.

Examining trade by commodity grouping highlights how important some items of manufactures have become over the past decade for developing countries. Items such as data processing equipment, telecommunications equipment and passenger motor cars not only now account for a much larger share of exports, but export growth of these commodities has exceeded the corresponding world growth rates (Table 4).

Table 4

Manufacturing – a Growth Area for Developing Countries

Top 10 Developing Country Export Shares, SITC Revision 2 Group, 1990-91 and 1999-00

SITC group		1990-91 share of exports	1999-00 share of exports	Growth rate 1990-00	Difference from world growth rate
		%	%	%	Percentage points
333	Petroleum oils, crude and crude oils obtained from bituminous minerals	18.8	14.0	4.8	-0.4
776	*Thermionic, cold and photo-cathode valves, tubes and parts*	*2.7*	*6.5*	*19.9*	*4.8*
752	*Automatic data processing machines and units thereof*	*2.1*	*4.3*	*18.3*	*7.5*
334	Petroleum products, refined	4.3	4.0	7.7	2.5
759	*Parts of and accessories suitable for office machines and automatic data processing machines*	*1.3*	*3.6*	*20.7*	*9.6*
764	*Telecommunications equipment and parts*	*1.6*	*3.4*	*16.1*	*3.4*
781	*Passenger motor cars for transport of passengers and goods*	*0.8*	*1.9*	*19.1*	*12.8*
341	Gas, natural and manufactured	1.7	1.7	8.5	-0.2
843	Outer garments, women's, of textile fabrics	1.8	1.5	7.0	1.8
845	Outer garments and other articles, knitted	2.0	1.5	6.6	1.3

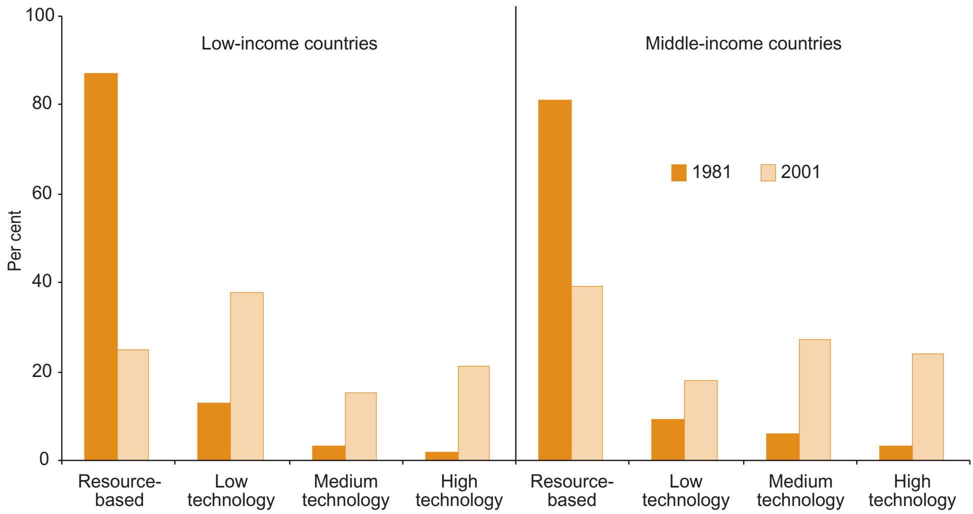
Source: UNCTAD, 2003.

Exports of low-technology manufactures such as textiles have come to prominence in the trade profile of low-income countries' trade over recent years, accounting for 36 per cent of their total exports in 2001. Higher technology exports also have gained in importance. Resource-based manufactured exports – which have been defined to include items such as meats, processed foods, alcoholic beverages and tobacco products – account for nearly two-fifths of middle-income countries' exports, although medium technology manufactures such as automotive components have grown to more than one-quarter of exports and high technology exports also have become significant (Figure 3).

Figure 3

Low-Income Countries Concentrating on Low-Technology Manufacturing

Share of Exports by Sector, 1981-2001, per cent



Note: Resource-based manufactures are defined to include meats, processed foods, alcoholic beverages, tobacco products and processed woods. Low-technology manufactures are defined to include textiles and clothing, toys, sporting goods and iron and steel products. Medium-technology manufactured products are defined to include automobiles and their components, process industry products and engineering products. High-technology manufactures are defined to include electronic goods, such as computers, televisions, and components.

Source: World Bank, 2003a.

Exports of manufactures from developing countries to other developing countries also have increased, from 58 per cent of their total exports in 1990 to 64 per cent in 2001 (UNCTAD, 2003). Machinery and transport equipment make up around half of manufactured exports from developing countries to other developing countries, and have been one of the fastest growing export items in South-South trade between 1990 and 2001 (Table 5). Within this grouping, office and telecommunication equipment exports have increased around 18 per cent per year between 1990 and 2001, followed closely by automotive products.

In contrast, agricultural products have experienced the lowest growth rates over the period, partly because of declining terms of trade for agricultural products, partly because of developing country trade barriers in agricultural products, and partly because with rising developing country incomes, the demand for manufactures has risen faster than the demand for agricultural products. Agricultural products accounted for less than 11 per cent of total South-South trade in 2001. Growth in South-South trade in agricultural products over the period has nevertheless resulted in developing countries' share of global agricultural exports being sustained.

Table 5

Machinery and Transport Equipment Stand Out

South-South Merchandise Exports by Product, 1990 to 2001, per cent

	Share 2001	Average annual change 1990-2001
Agricultural products	10.5	6
Food	8.6	7
Raw materials	1.8	3
Mining products	25.4	9
Ores and minerals	1.5	7
Fuels	22.0	9
Non-ferrous metals	2.0	10
Manufactures	63.1	12
Iron and steel	2.2	6
Chemicals	9.2	12
Other semi-manufactures	6.3	9
Machinery and transport equipment	32.2	16
Automotive products	2.5	17
Office and telecom equipment	19.1	18
Other machinery and transport equipment	10.6	12
Textiles	6.3	7
Clothing	2.0	11
Other consumer goods	4.8	8
Total merchandise exports	100.0	10

Source: World Trade Organization, 2003.

SERVICES GROWING

As incomes rise, services are assuming a greater share of output, accounting for 45 per cent of GDP in low-income countries, 48 per cent of GDP for lower middle-income countries and 60 per cent of GDP for upper middle-income countries (Table 6). Services provision, particularly of business services, typically relies on having a well educated workforce. Increasingly, economies such as India and the Philippines are taking advantage of their educated, low-cost, high-productivity workforces to supply services overseas. Indeed, Indian service exports account for around one-third of total Indian exports. In countries such as Tonga, Jordan, Samoa, Jamaica, Albania, Cape Verde, El Salvador, Yemen and Honduras, worker remittances account for more than 10 per cent of Gross National Income

(IMF, 2003).[5] To date, most developing country services trade has been with developed countries, in the form of travel and transportation services, information, communications and financial services, and migrant labour. Anecdotal evidence suggests services trade between developing countries has been strong in construction workers, tourism and domestic staff.[6] As the service sector of developing economies expands, so too should South-South trade in services.

Table 6

Services Becoming More Important

Developing Country Services as a Share of GDP and Share of Total Exports, by income group

	Share of total exports		Share of GDP	
Income group	**1990**	**2001**	**1990**	**2001**
Low-income	12	15	40	45
Lower middle-income	14	14	41	48
Upper middle-income	11	13	53	60

Source: Would Bank, 2003b.

SOME REGIONS DOING BETTER THAN OTHERS

The importance of developing country trade differs for each of the regions. For both the Middle East and developing Asia, exports to other developing countries accounted for around 40 per cent of merchandise exports in 2001 (World Trade Organization, 2002). Indian, Chinese and Korean trade with developing countries has grown by 14 per cent per year between 1990 and 2001 (World Trade Organization, 2003). In contrast, Latin American and African exports to developing countries were only around one-quarter of total exports.

Asia dominates trade between developing countries, accounting for two-thirds of all South-South merchandise exports and almost 70 per cent of South-South merchandise imports, in part reflecting sheer market size (Figure 4).[7] In keeping with developing Asia's rapid economic growth over the past decade and their more open trade policies, trade within Asia grew more than South-South trade in general between 1990 and 2001 (World Trade Organization, 2003).

5 Worker remittances are a 'mode 3' service, and are excluded from conventional – modes 1 (cross-border supply) and 2 (consumption abroad) – services trade statistics.

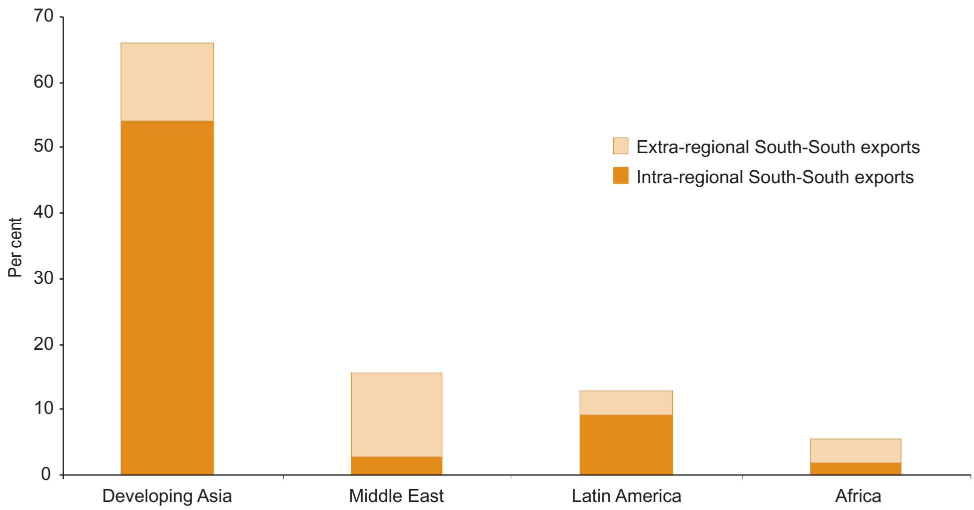
6 Balance of payments data on South-South trade in services are not available.

7 In 2001, developing Asian economies accounted for nearly half of developing country GDP and more than two-thirds of the population of developing countries (World Trade Organization, 2003).

Figure 4

Asia Drives Most Developing Country Trade

Merchandise Export Shares of Selected Regions, 2001, per cent



Source: World Trade Organization, 2003.

Success in the Asian region has been driven in part by Asia's capacity to respond to changes in world demand, increased competitiveness arising from lower output prices, and quality improvements (World Bank, 2003a). From the 1950s, East Asian economies have lowered tariffs, encouraged foreign direct investment, had high savings and investment rates, solid investment in education and infrastructure, sound macroeconomic policies, generally flexible domestic labour markets and reasonably efficient regulatory institutions. These open strategies attracted foreign investment into new areas of demand, enabling Asian developing countries to respond quickly to changing patterns of world demand. This, coupled with a growing urban labour supply, enabled a rapid expansion in labour intensive manufacturing and exports (Economic Analytical Unit, 2003c). Hong Kong and Singapore were the first economies to adopt more open strategies, and were followed in later decades by Taiwan, the Republic of Korea, Malaysia, China, Thailand, Indonesia and the Philippines.

Developing Asia's trade with the South is dominated by intra-regional flows (in significant measure, intra-industry trade), as is the case for Latin America. In contrast, most of the Middle East's trade with the South is outside its own region, in part because of the similarity of export profiles, that is, oil, between Middle Eastern countries.

SOUTH-SOUTH REGIONAL TRADE ARRANGEMENTS

Forty-three per cent of merchandise trade now falls under the umbrella of regional trade agreements (RTAs). Developing economies have established several regional trade groupings, with nine in Africa, four in Latin America, two in the Caribbean, and one each in the Baltic States, Middle East, North Africa, Pacific Islands, Central Asia, South Asia and South-East Asia.[8] Others have been established outside the respective regions, typically with developed countries. Many seek to go beyond simple trade liberalisation.

The evidence on the extent to which regional trade agreements increase or simply divert trade is unclear. WTO estimates suggest the share of intra-regional trade associated with developing country RTAs remained largely unchanged – at around 20 per cent of trade – between 1990 and 2001 (World Trade Organization, 2003). It is not possible to generalise about the effects of RTAs because they differ greatly in form, content and extent of liberalisation, encompassing, for example, free trade agreements and customs unions.

The following section looks at some of the reasons why developing countries have benefited from liberalisation efforts to date, and why additional liberalisation is going to be important for further deepening of developing country trade relationships.

8 For more detail on these trade groupings, see UNCTAD, 2003.

THE BENEFITS OF REDUCING TRADE BARRIERS BETWEEN DEVELOPING COUNTRIES

The two, not unrelated, outcomes from trade liberalisation that may help economies pursue their development goals are market access and efficiency gains. Hesitation in embracing liberalisation derives principally from the fact that the gains from liberalisation are typically spread over a wide section of the economy, including the majority of consumers, exporters and potential exporters, and any producers that use imports. The losers on the other hand typically are a much smaller subset of the economy. Although the total loss can be expected to be considerably smaller than the total gain, each person in this group is going to feel the loss more keenly. Therefore, they have an incentive to make themselves heard (Winters, 2002a).

TRADE LIBERALISATION

Trade liberalisation involves the simplification of, and reduction in, existing trade measures and barriers to reduce imposts on importers, reduce compliance costs for both importers and exporters, make trading requirements more transparent, and hence lower the distorting effects in the economy that trade barriers bring – essentially, policy reforms to make it easier for goods and services to move between countries.[9] Trade liberalisation can take place on a unilateral basis, where a country reduces its trade barriers regardless of what other countries do, or in concert, such as under free trade agreements or during the WTO multilateral rounds where countries reduce their barriers together, or a combination of the two.

Tariff cuts are of central interest when it comes to trade liberalisation. However, trade barriers can take other forms, including import quotas, export subsidies, import and export licensing, opaque or unnecessarily complicated customs procedures, sanitary and phyto-sanitary measures, technical regulations, services sector barriers and government procurement regulations.[10] *Ad valorem* tariffs – tariffs that are expressed as a percentage of the value of an imported good – are probably the most transparent of trade measures and are less distortive than non-*ad valorem* – or specific – tariffs. Non-*ad valorem* tariffs are tariffs that are expressed as a monetary amount per unit quantity of the goods, for example, $15 per tonne. These tariffs can, by their nature, act to discriminate against the typically lower value imports from developing countries. Most countries continue to have some degree of reliance on non-*ad valorem* tariffs (World Trade Organisation, 2002). Trade liberalisation can involve actions such as lowering tariffs, removing licensing requirements, converting non *ad valorem* tariffs to *ad valorem* tariffs, converting quotas to tariffs and measures aimed at expediting customs clearance.

[9] Non-tariff measures may be distinguished from non-tariff barriers. Non-tariff measures have been broadly defined by the OECD (1997) as “those border measures other than tariffs that may be used by countries, usually on a selective basis, to restrict imports”. These measures have some legitimacy as regulatory instruments. In contrast, non-tariff barriers are measures introduced with the explicit intention of protecting the domestic market from imports.

[10] Trade in services is recognised as occurring through four ‘modes of supply’: cross-border supply, consumption abroad (for example, of tourism, education or health services), commercial presence (by means of foreign direct investment), and movement of individuals (provision of services by individuals who establish a temporary presence in another country), and so liberalisation can occur via a freeing-up in any of these areas.

MARKET ACCESS

Improved market access for agricultural products, industrial products and services remains at the top of the multilateral trade liberalisation agenda and there are substantial gains to be had from further reduction in trade barriers (OECD, 2003). The market access agenda is not limited to a reduction in tariffs however. It also includes the addressing of non-tariff barriers to both goods and services trade. Addressing non-tariff barriers to services trade is vital, not just for the services industries, but also for the goods sectors given they are increasingly reliant on services inputs.

Market access is an important part of economic development, as exports generate the foreign exchange necessary to purchase required imports. Larger markets allow businesses to utilise economies of scale in production, something that may not be readily available by simply selling to the domestic market. Access to other markets also can mitigate the impact of any negative developments in a particular market.

There is evidence to suggest exporting firms are more productive, although the causality link is still unclear. In some cases, productivity growth may surge before entry into the export market because of specific efforts to prepare for and target the export market. In others, productivity may rise after entry into an export market because of the learning associated with exporting (Berg and Krueger, 2003). Economies of scale, noted above, also are a factor here.

EFFICIENCY GAINS

Trade barriers are essentially a tax on consumers and producers. Although taxes create revenue for governments to spend on essential services, they also can have a distorting effect on the economy. An outcome of trade liberalisation that is getting more attention is efficiency gains, which benefit the host economy regardless of what other economies do. It is perhaps the most important reason for unilateral trade liberalisation and is likely to deliver greater economic benefits than simply expanding markets for exporters. Exporters typically are a small section of the economy. Therefore, to give the greatest gains to the largest number of people within an economy, countries are better off lowering their own trade barriers, as exemplified by the experience of the newly industrialising countries of East Asia.

Reductions in services trade barriers are just as important, if not more important, as reductions in barriers in the goods market. Efficiently operating services systems and infrastructure are vital to the competitiveness of all sectors of the economy. In fact, as tariffs on goods are lowered, non-competitive services sectors can result in goods sectors facing negative effective rates of protection.

Consumers Gain

Tariffs inflate not only the price of imports but also the price that domestic producers can charge for competing products. Reducing or removing that tax lowers prices and means that, over time, consumers can buy the same quantity of goods and services for less of their income, leaving them with more to spend on other goods and services. Tariff reductions in developing countries are estimated to have reduced the price of imports to domestic consumers by an average of 12 per cent since the mid 1980s (World Bank, 2003a).

Consumers typically also have access to a greater variety of products. For the urban poor in developing countries, this is a particularly important point. For example, trade barriers and price supports for staple food production increase food prices for consumers who do not produce food, including the landless rural population and urban poor. In many countries these people comprise the bulk of the population living in poverty. In the Philippines, for example, efforts to increase local rice and corn production through price support actually threatened the food security for the urban poor (David, 1999). African economies on average impose import tariffs of 75 per cent on food, raising food prices for consumers and relegating food imports to a minor role in total food supplies (United States Department of Agriculture, 2002).[11] This hampers efforts to improve nutritional standards and food security, as countries find it difficult and expensive to import enough food to cover domestic shortfalls in production.

More Competitive Firms and Industry Also Gain

Lower tariffs for one industry generate benefits for businesses in other industries. One reason is that the extra consumer spending power may raise demand for other goods and services. Lower tariffs also can directly benefit businesses' 'bottom lines' through lower input costs. The majority of businesses rely at least in part on imported components for production. Lowering tariffs reduces the price of imported components for producers, making domestically produced goods less expensive, and making domestic producers more price-competitive on domestic and world markets, thereby improving their profitability. For example, when tariffs are lowered on farm machinery, farmers' costs decline, making them more competitive on export markets, and better able to withstand the volatility in commodity prices.

Limiting inputs just to those from domestic producers constrains the scope and quality of potential inputs. Lowering tariff or other trade barriers not only reduces prices but also increases domestic producers' access to better quality goods and the technology they bring, potentially boosting productivity. Trade openness potentially increases innovation, knowledge and productivity by encouraging firms to find new ways to compete. Firms also can benefit from the knowledge embedded in imports, particularly if the imported technology improves productivity through, for example, introducing a more efficient method of production (Schiff and Wang, 2004).

Protected inefficient producers in the traded goods sector are able to continue operating by charging higher than competitive prices, diverting resources from elsewhere in the economy. Trade barriers not only increase the price of the imported good, but also allow domestic producers to increase prices to a level that, while below the imported price, is nevertheless higher than would have been the case in the absence of the trade barrier.

11 Admittedly, high food tariffs are in part a defence against high developed country agricultural tariffs, production support and export subsidies that depress world prices, exposing African agriculture to unfair competition.

Greater Flexibility

Increased import competition puts pressure on businesses to examine and improve their operating efficiency, product ranges and pricing, as well as exposing them to international best practice. It also can help provide incentives for management and labour within the threatened industry to work cooperatively. Greater import competition means that firms and industry organisations that might otherwise have remained complacent about entrenched work practices and the high cost of inputs and utility services, can no longer pass these costs on. This in turn can generate political pressure for reform in these other sectors of the economy.

The main benefits of trade for a country come not from maximising export income, but rather from the improvements in domestic productivity, resource allocation and consumption that import competition brings. Thus, a country's own barriers to trade generally have a more distorting effect on the allocation of its resources and on incentives to be productive and innovative than the trade barriers of other countries (OECD, 2003).

TRENDS IN TARIFFS AND OTHER TRADE MEASURES

Tariff barriers have declined almost across the board in developing countries over the past couple of decades, resulting from multilateral, bilateral and unilateral liberalisation. Indicators of trade measures including tariffs, the average number of commodities subject to non-tariff measures as a percentage of total commodities, restrictions on payments for current account transactions and average black market premia all show that developing countries have become more open over the past two decades, albeit at differing rates between regions (Berg and Krueger, 2003; Dean *et al*, 1994). With the services sector having become significantly more important, in many cases a more important contributor to total output than the goods sector, developing countries also have undertaken significant reforms of their infrastructure and other services sectors over recent years.

Significant Reductions in Tariffs

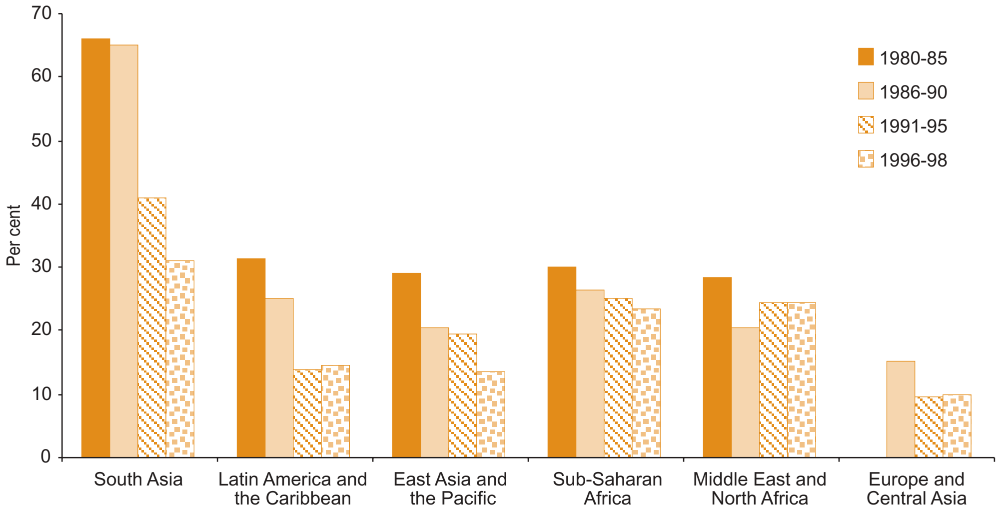
Average applied tariffs of developing countries were around 12 per cent in 2000, about one-third of their levels in 1983, in part the result of Uruguay Round commitments (World Bank, 2003a). The reductions across regions have differed widely (Figure 5). South Asian, Latin American and East Asian tariffs have more than halved on average since the early 1980s. Today, tariffs are lowest in developing countries in East Asia and the Pacific, Latin America and the Caribbean and Europe and Central Asia. Tariff dispersion also has declined, and at a faster rate than average tariffs (Table 7).[12] Highly dispersed tariff rates increase the cost of protection by increasing compliance and collection costs.

12 For selected country details on the decline in tariffs over the past couple of decades, see Berg and Krueger, 2003.

Figure 5

Developing Country Tariffs Falling

Average Unweighted Applied Tariff Rates by Region



Source: World Bank, 2001.

What the Uruguay Round Achieved

Large tariff cuts were generated by the Uruguay Round, although developed countries undertook greater cuts than developing countries. Agricultural tariffs were to be cut by an average of 36 per cent for developed countries and 24 per cent for developing. Individual tariff lines were subject to minimum cuts of 15 per cent for developed countries and 10 per cent for developing. It also was agreed that all agricultural tariffs would be bound (Department of Foreign Affairs and Trade, 1994a).

On industrials, developed countries agreed to cut average tariffs by 40 per cent while developing countries agreed to a 30 per cent reduction. Developing countries agreed to bind on average 72 per cent of their industrial product lines, up from 22 per cent, whereas developed countries increased on average their binding levels from 78 to 99 per cent (Department of Foreign Affairs and Trade, 1994b; World Trade Organization, 1994).

For the first time, services negotiations were conducted in the round in recognition of the significance of the services sector for developed and developing countries alike and the increasing importance of international trade in services. The result was the General Agreement on Trade in Services (GATS), which provides a legal framework for international trade in services and a basis for negotiations in future multilateral trading rounds.

Table 7

Tariffs Less Variable

Standard Deviation of Applied Tariff Rates, Selected Countries, 1990 to 2001

	1990-94	1995-98	1999-01
South Asia			
Bangladesh	114.0	14.6	13.6
India	39.4	12.7	12.4
Sri Lanka	18.1	15.4	9.3
Sub-Saharan Africa			
South Africa	11.3	7.2	11.7
Malawi	15.5	11.6	10.5
Zimbabwe	6.4	17.8	18.6
East Asia and Pacific			
Philippines	28.2	10.2	7.3
Thailand	25.0	8.9	14.3
Indonesia	16.1	16.6	10.8
China	29.9	13.0	10.0
Latin America and the Caribbean			
Argentina	5.0	6.9	7.2
Brazil	17.3	7.3	7.2
Columbia	8.3	6.2	6.2
Mexico	4.4	13.5	9.3
Middle East and North Africa			
Egypt	425.8	28.9	-
Tunisia	37.4	11.7	-
Turkey	35.7	5.7	14.7

Source: World Bank, 2001, 2003b.

A number of new agreements aimed at ensuring fairer and more predictable trade were also negotiated as part of the Uruguay Round, for example concerning subsidies and countervailing measures, technical barriers to trade, sanitary and phyto-sanitary measures and intellectual property.

While some significant tariff cuts were generated by the Uruguay Round in both developed and developing countries, the existence of large binding overhangs has reduced the extent of cuts in applied tariffs (see Box 2 for more discussion on binding overhangs). In addition, significant obstacles to trade continue to exist in areas such as production and export subsidies on agricultural products, quotas and licensing requirements. This underlines the need for an ambitious Doha Round outcome.

TARIFF BINDINGS

Tariff reductions agreed in multilateral trade negotiating rounds have been in terms of tariff 'bindings'. A country's bound tariff rate on a particular good represents the rate the country has undertaken not to raise its most favoured nation (MFN) tariff above. MFN tariffs actually applied – as well as any preferential tariff rates accorded – will typically be less than a country's tariff bindings. Industrial countries tend to have the vast majority of their tariffs bound and the gap between their bindings and applied tariffs (the 'binding overhang') tends to be small. In contrast, some developing countries have a significant percentage of tariff lines unbound and binding overhangs often are quite large.

Negotiated tariff reductions may or may not have an impact on the applied rate depending on the size of any overhang. For example, a tariff line in country *x* might have a tariff binding of 40 per cent and an applied rate of 20 per cent. If an agreement results in a 20 per cent reduction in the binding (that is, to 32), the applied rate is not affected. However, if an agreements results in a 75 per cent reduction in the binding (that is, to 10), the applied rate will need to be reduced to 10 per cent. Binding overhangs also introduce uncertainty as countries can in principle increase their applied tariffs to this bound rate.

Several different tariff reduction methods have been under discussion in the Doha Round negotiations, including the so-called Girard proposal in the 'industrials' (non-agricultural) negotiations and the Derbez proposal in the agriculture negotiations. The 'Swiss' formula for tariff cuts has also received a lot of attention in both the current and past negotiation rounds.[14]

The Doha Mandate[13]

On agriculture, the Doha negotiations are aimed at: "substantial improvements in market access; reductions of, with a view to phasing out, all forms of export subsidies; and substantial reductions in trade-distorting domestic support. …Special and differential treatment for developing countries shall be an integral part of all elements of the negotiations and shall be embodied in the schedules of concessions and commitments and as appropriate in the rules and disciplines to be negotiated, so as to be operationally effective and to enable developing countries to effectively take account of their development needs, including food security and rural development …"

The Doha negotiations on non-agricultural products aim to "reduce or as appropriate eliminate tariffs, including the reduction or elimination of tariff peaks, high tariffs, and tariff escalation, as well as non-tariff barriers, in particular on products of export interest to developing countries. Product coverage shall be comprehensive and without *a priori* exclusions. The negotiations shall take fully into account the special needs and interests of developing and least-developed country participants, including through less than full reciprocity in reduction commitments …"

[13] Excerpts from Doha Ministerial Declaration (WT/MIN(01)/DEC/W/1), Ministerial Conference, Fourth Session, Doha, 9 - 14 November 2001, adopted on 14 November 2001.

[14] For more detailed information on formulas, see WTO documents TN/MA/W/35/Rev.1 and JOB(03)/150/Rev.2, available online at www.wto.org.

The Doha negotiations on trade in services "shall be conducted with a view to promoting the economic growth of all trading partners and the development of developing and least-developed countries …"

The call for negotiations on trade facilitation is in recognition of "the case for further expediting the movement, release and clearance of goods, including goods in transit, and the need for enhanced technical assistance and capacity building in this area …"

EMPIRICAL ANALYSIS

World Bank analysis underscores the gains to be realised from unilateral trade liberalisation (World Bank, 2003a). It assesses that over the period since the mid-1980s, unilateral liberalisation by developing countries has been a more important driver of improved export performance than liberalisation undertaken by other developing and industrial countries. It also estimates that 88 per cent of the growth in developing country exports following tariff liberalisation has been the result of developing country liberalisation – the unilateral liberalisation effect combined with the market access benefits provided by other developing countries' liberalisation. Other estimates suggest that countries that have fully liberalised trade and investment in finance and telecommunications grew on average 1.5 per cent faster than other countries over the past decade (World Bank, 2002a).

Greater availability of data and better estimation techniques have increased the use of economic modelling to quantify *ex ante* the effects of further trade liberalisation on trade and economic growth (see, for example, Dee and Hanslow, 2000; Francois *et al,* 2003; Hertel *et al*, 2000; OECD, 2003; Robinson *et al*, 2002; World Bank, 2002b, 2003a). The estimates tend to be conservative, in that they are unable to capture effectively the feedback (dynamic) effects of increased competition on productivity. Estimates of the gains from trade liberalisation also can differ significantly, depending on underlying data sets and assumptions. Even so, the welfare benefits generally are assessed to be substantial, with a large, if not majority, share accruing to developing countries as a result of their higher current protection levels. Developing countries stand to derive the bulk of the welfare gains arising from the reduction of manufacturing tariffs. Developing countries' exports also stand to grow more strongly than those of industrial countries, with South-South trade the main beneficiary. Developing countries also can expect to be major beneficiaries of agricultural trade and services trade liberalisation. In fact, available studies suggest the gains would be significantly greater from services liberalisation than those that would derive from the liberalisation of merchandise trade.

The World Bank (2002b) estimates that developing countries stand to realise welfare gains of US$31 billion per year if other developing countries eliminated manufacturing tariffs and a further US$31 billion if they removed their agricultural trade barriers. Assuming the removal of trade barriers in both developed and developing countries, the estimated welfare gains to developing countries exceed $108 billion, representing over 40 per cent of the gains to all countries. Developing countries gain most from the removal of their own barriers. They also gain most from the removal of manufacturing tariffs – reaping over 70 per cent of the gains to all countries – reflecting the importance of manufactures trade to developing countries today. The World Bank points out that the estimates are conservative, in that they ignore benefits due to scale effects and dynamics; benefits from the abolition of other trade distorting measures such as anti-dumping duties, safeguards and excessive standards barriers; and benefits from liberalisation of trade in services.

Robinson *et al* (2002) estimate the gains to developing countries from a 50 per cent reduction in services trade protection across all countries could be as much as four times those that would derive from full goods trade liberalisation. Their model captures two types of gains from trade liberalisation. The first is from more efficient use of resources and the second is from total factor productivity increases due to technology transfer, which in turn arises from the importation of technology-intensive goods and professional services. Work undertaken by Dee and Hanslow (2000) estimates China's service sector would be nearly one-third bigger than otherwise as a result of the elimination of services trade barriers across countries, while Indonesia's services sector is estimated to be nearly 10 per cent larger.

POLICY IMPLICATIONS

While the rapid growth in trade experienced in recent years by many developing economies has clearly not resulted solely from trade liberalisation, the evidence overwhelmingly suggests that it has had a significant role to play. Continuing high tariff and services trade barriers nevertheless represent a significant impediment to sustained increases in incomes.

While further trade liberalisation is vital for sustained trade and economic growth, supportive domestic policies also are important. Countries with well functioning markets, policies and institutions, stand to gain more from trade liberalisation than those without. The specific conditions which individual countries face also need to be taken into account when examining trade and supportive domestic policy reform options.

FURTHER TRADE LIBERALISATION VITAL FOR GROWTH

Higher rates of economic growth in developing countries over recent years have gone hand-in-hand with greater trade orientation, with South-South trade experiencing the most dynamic growth. South-South trade now accounts for around two-fifths of all developing country merchandise trade and around 12 per cent of global merchandise trade. Trade liberalisation has been an important factor underlying growth in South-South trade, with average developing country applied tariff rates now around one-third of their 1983 levels. The more far-reaching trade and other reforms undertaken by some countries in East Asia and Latin America have helped underpin their more dynamic growth.

South-South trade stands to become increasingly important in the years ahead due to higher economic growth in developing countries compared to developed. The World Bank projects a real GDP growth rate for developing countries over the period to 2015 of 4.6 per cent, compared with 2.6 per cent for industrial countries (World Bank, 2003a).

The continuing high average tariffs, tariff peaks and services trade barriers that tend to be maintained by developing countries act as a brake on their development. Moreover, the trade profiles of developing countries is such that they tend to face average tariffs in other developing countries that are higher than those faced by developed countries. A further lowering of developing country trade barriers is vital if developing countries are to participate in global production chains to their full potential. The trend to global production affords developing countries greater opportunities to engage in higher value added activities. Foreign investors will increasingly tend to bypass those countries with high trade barriers.

The efficiency gains to be derived from unilateral reduction of trade barriers are well documented and substantial. The overall welfare gains arising from concerted tariff reductions by developing and developed countries are even more substantial, as indicated by empirical modelling, with developing countries likely to reap a large, if not majority, share.

As developing country markets become more important for developing countries, developing countries will need to examine closely their trade policies and their impact on trade outcomes, and also pay closer attention to the types of trade barriers they face in other developing country markets. It is notable that around 70 per cent of tariffs faced by developing countries are levied by other developing countries.

OTHER DOMESTIC POLICIES MATTER

There is general consensus that trade reform has positive spillover effects on other reforms and reinforces the contributions to growth that those reforms can have (Berg and Krueger, 2003). However, to maximise the benefits, trade liberalisation needs supportive domestic policies that encourage a stable macroeconomic environment, efficiently operating markets, and the ability of workers to move out of declining industries.

In a liberalised economy, prices, output and consumption react more quickly to policy changes than they would in a protected environment. Policy settings therefore assume greater significance, as the quicker response times mean bad policies can have larger negative consequences for economic growth.

Domestic policies that can help underpin trade liberalisation are varied (Winters, 2004). Complementary policies that ensure macroeconomic stability and encourage private investment allow business to take advantage of opportunities that trade liberalisation brings (Matusz and Tarr, 1999). Efficiently operating goods, services, labour and capital markets help consumers and producers respond to new opportunities and incentives. Effective and accountable institutions, secure property rights and contract enforcement provide a more certain environment for businesses looking to take advantage of new opportunities. Sound financial market and corporate regulation assist capital markets function effectively. Effective macroeconomic policy provides economic stability. Social and physical infrastructure such as education, health, transport and utilities are an important part of the production chain (Economic Analytical Unit, 2003c; Rodrik, 2002). Inefficiencies in telecommunications, transport, and financial services reportedly add more to export costs than the trade barriers of trading partners (IMF and World Bank, 2002). Countries also may be able to devise low cost safety net schemes to lessen the social impacts resulting from the loss of jobs in industries substantially affected by trade liberalisation (Economic Analytical Unit, 2003c).

The sequencing of reform – whether or not trade reform should proceed before supporting policies are established – is an often raised issue. However, to delay trade liberalisation while waiting for complementary policy reform runs the risk of never establishing a mandate for trade reform. It also would create incentives for vested interests to lobby for the status quo, even if there is a credible policy of gradual phasing in of reforms (Winters, 2002a).

Services liberalisation is more complex. Analysis to date suggests appropriate supporting policies and regulatory frameworks are considerably more important for services liberalisation to work, with suggestions that a flawed reform program has the potential to undermine the benefits of services liberalisation (World Bank, 2002b). For example, inadequate prudential supervision, limited competition and government interference in lending practices can have disastrous consequences for a country's financial system. Under these circumstances, a coordinated approach is desirable in order to ensure the benefits of reform are captured.

An important example of how it is possible to be left behind is the case of Africa. While much of the rest of the developing world has benefited from closer integration with the rest of the world, Africa has seen little improvement in conditions (Bigsten and Durevall, 2003). Weak governance, an unwillingness to implement other policies that complement trade reform such as secure property rights, and poorly operating economic institutions have resulted in African countries generally not benefiting from greater trade openness (Bigsten and Durevall, 2003). There are, however, some important examples of where trade reform, as part of a package of reforms, has boosted growth and reduced poverty. Uganda has been cited as a success story (World Bank, 2002b). Among other reforms, tariffs have been simplified to fall within three tariff bands (0 per cent for raw materials, plant and machinery items, 7 per cent for intermediate goods and 15 per cent for consumer goods); restrictions have been lifted on foreign direct investment; education policies have been such that gross school enrolment rates are considerably higher than the African average; and economic policies are now aimed at improving macroeconomic stability. As a result, exports of goods and services have increased by an average of over 10 per cent per year over the decade to 2001, real GDP growth has averaged over 6 per cent and numbers in poverty have been reduced by around 40 per cent (Economic Analytical Unit, 2003a; World Bank, 2002b).

DEVELOPING COUNTRIES A HETEROGENEOUS GROUP

Developing countries are not a homogeneous group. There are significant differences between countries on many levels, including population and labour force, size of economy, industrial and trade structure, levels of economic and social development, and income distribution. At one end of the spectrum are China and India, the world's most populous countries, with rapidly expanding industrial sectors based on labour intensive manufacturing. At the other end are countries of the Pacific and Caribbean and least developed African states, most of which rely extensively on primary commodities and tourism. Their ability to absorb the impacts of trade liberalisation typically is weaker than larger developing countries and therefore requires different policy responses to address these issues.

With such a diverse group, there is clearly no 'one size fits all' strategy that developing countries can adopt when it comes to policies to promote growth and reduce poverty. Nevertheless, trade liberalisation is an important policy reform and could realistically be a driver for other domestic reform. If it is accompanied by other reforms, the growth potential can be substantial.

REBUTTING ARGUMENTS AGAINST TRADE LIBERALISATION

Interest groups that for one reason or another are opposed to trade liberalisation have advanced several reasons why trade liberalisation is not in developing countries' best interests. Some developing country governments also have expressed legitimate concerns in the Doha Round market access negotiations on several fronts. These include the need for flexibility in further reduction commitments, the erosion of tariff preferences, the impact of tariff reductions on government revenue, the particular vulnerability of small economies and a call for voluntary participation in any sectoral initiatives. Some of the main arguments against trade liberalisation are considered below.

Argument 1: Tariff barriers help infant industries survive.

The infant industry argument has long been used to justify the use of tariffs, implying that competition from imports is somehow bad for the economy. The argument advanced is that tariffs should not be reduced until the industry is sufficiently well established to stand on its own two feet. In reality, this is rarely the case. Once the tariff system is in place, those businesses that profit from high tariff barriers, by being able to charge higher prices to domestic consumers, will lobby hard to prevent these tariffs from being removed or lowered. All tariff barriers do is make inputs more expensive for other industries in the economy. Experience suggests that those economies with import substitution policies are less able to deal with international economic shocks, putting pressure on their balance of payments and other macroeconomic policies (Kokko, 2002). Inward-oriented policies typically generate substantial costs to the economy through, for example, higher input and consumption prices and reinforcing bad macroeconomic policy, but yield very few dynamic gains (Berg and Krueger, 2003). Of course, infant industries should not have to deal with unfair competition in the form of dumping or subsidies, but anti-dumping and countervailing measures, in keeping with WTO disciplines, can effectively guard against such practices.

Argument 2: Tariffs are a source of revenue for developing economies.

It is difficult to determine the extent to which tariff revenue will decline as a result of trade liberalisation, as the outcome depends on the initial structure of tariffs, the depth of the cut, and how responsive imports are to changes in price brought about by the tariff cut (OECD, 2003). The tariffication and reduction of other forms of protection also will affect revenue.

Tariffs represent an inefficient way to raise revenues. Reducing tariff barriers may boost the tax take as cheaper imported consumables and inputs boost economic growth, thereby increasing revenue from other sources (OECD, 2003).

Some developing countries have successfully restructured their finances as tariffs have been reduced. Others continue to rely heavily on tariffs as a source of revenue, particularly small, least developed economies in the Pacific, the Caribbean and Sub-Saharan Africa. In such cases, international financial institutions such as the International Monetary Fund and the World Bank may be able to assist in the design of more efficient ways to raise revenue.

Argument 3: Trade liberalisation may adversely affect the poor.

The relationship between trade liberalisation and poverty is complex. Some positive effects may include cheaper consumables for the poor and the encouragement of government to maintain macroeconomic stability (Winters, 2002b). Most of the empirical evidence to date suggests trade liberalisation is poverty alleviating, on average, in the long-run (APEC Secretariat, 2000; Berg and Krueger, 2003; Dollar, 2001; Winters et al, 2002).

Between 1993 and 1998, the number of people living in absolute poverty in developing countries that opened themselves to trade declined by 14 per cent. In contrast, poverty in developing countries that did not open themselves to trade rose by 4 per cent between 1993 and 1998 (World Bank, 2002b). World Bank analysis indicates that a global reduction in protection could boost economic growth and reduce the number of people living in poverty by as much as 13 percent in 2015 (IMF and World Bank, 2002). Therefore, given the efficiency gains likely to arise from trade liberalisation, governments would be better off liberalising trade and, where possible, implementing measures to protect the livelihood of any particularly vulnerable communities.

Argument 4: Trade liberalisation will result in erosion of existing preferences

The erosion of existing developing country preferences as a result of trade liberalisation has gained some prominence in the Doha negotiations. However, it is not of particular significance in a South-South context, as few preferences are extended by developing countries to other developing countries outside of regional trading agreements. In the case of preferences extended by developed countries, they typically exclude sensitive products, often do not extend to sectors where the beneficiaries have a comparative advantage, and administrative requirements imposed to qualify for a developing country preference often result in many eligible products not entering under preference provisions (World Bank, 2003a). Moreover, by channelling resources into inefficient, higher cost sectors that depend on preference schemes, they distort resource allocation and result in sub-optimal production and income outcomes. The World Bank stands ready to expand its lending and technical assistance to help developing countries manage transitional costs associated with tariff preference erosion resulting from a Doha round outcome (World Bank, 2003a).

CONCLUSION

Trade liberalisation is a necessary condition for a sustained increase in incomes. The efficiency gains to be derived from unilateral reduction of trade barriers are well documented and substantial. The overall gains arising from concerted tariff reductions are even more substantial, as indicated by empirical modelling. It is the reform package that counts and trade policy is an important part of any reform agenda. Countries with well functioning markets, policies and institutions stand to gain more from trade liberalisation than those without.

Developing country trade barriers have been declining for a couple of decades in conjunction with an increase in developing country trade shares. South-South trade now accounts for around two-fifths of all developing country merchandise trade and around 12 per cent of global merchandise trade. Trade liberalisation has underpinned this development, with average tariff levels around one-third of their 1983 levels. The direction and composition of trade also has changed. More trade is done between developing countries, and more developing countries are now exporting manufactures. As developing country markets become more important for other developing countries, they will need to examine closely their trade policies and their impact on trade outcomes, and also pay closer attention to the types of trade barriers they face in other developing country markets. It is notable that around 70 per cent of tariffs faced by developing countries are levied by other developing countries.

Developing countries have quite different characteristics and circumstances and these need to be taken into account when examining trade and supportive domestic policy reform options. However, all developing countries stand to gain from trade liberalisation. The particular characteristics and circumstances faced by individual countries only affect the size of the gains and their distribution.

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