Challenges facing the World Trading System

Speaking Notes of Pradeep S. Mehta, Secretary General of CUTS International for the ICC World Business Summit, Stockholm, June 12, 2008

Moderator, Excellencies, Ladies and gentlemen: As a challenger, with years of experience outside the ring in contrast to my eminent friend, Pascal Lamy, the Director-General of the World Trade Organisation, who has worked towards the same objectives with equal fervour inside the ring, the organisers have chosen to hear our contrasting and complementary views on the mentioned subject, from which a truly comprehensive world view might emerge. Our commonalities are that we believe in free and fair trade and more of it, rather than less of it. Both of us are aware of the inequities in the system and are continuously fighting them; sometimes our paths maybe different, but the goals are the same. We want more growth and poverty alleviation across the world.

One of the major challenges facing the world is poverty. Over 2.5bn people live on less than US$2 per day per capita. The international community has formulated and adopted the Millennium Development Goals to reduce poverty by half by 2015. Goal 8 asks for a better system of trade, aid and debt.

The Doha Round is a step in this direction, by ensuring development outcomes for all, in particular the poor countries. Alas, despite all the efforts in installing a more inclusive global trading system – the dismantling of tariff barriers and export subsidies, reduction of other import limits such as quotas, agreements to internationally enforce minimum standards for patents etc, extension of international trade law to services, opening up of foreign investment, changes in the trade dispute settlement mechanism etc – *the trading system still remains skewed with the share of the LDCs in total world trade amounting to just 0.74 percent. An average citizen of the LDCs has a share in world trade which is just one percent of that of a Euro Area citizen*. Naturally, immiserisation continues.

The last couple of decades have been marked by unprecedented efforts in globalising the world economy – in developing an easier movement of goods, services and capital that takes place to the mutual advantage of nations. Despite these developments and their enormous impact, certain barriers, both implicit and explicit, have reduced the transparency and the practical utility of the world trading regime. The rules of the game need to be made more universal, comprehensive, comprehensible and fair to all concerned. Many challenges remain but due to limited time I take up just four of the most important ones. What are these?

- Unequal trade barriers
- Lack of complementary regimes
- Ignorance of rules and opportunities
- Shackled human capital

<u>Barriers to trade</u>*:* Tariffs have been reduced in both developed and developing countries through successful multilateral liberalization. Yet their incidence remains unequal; *Cambodian exports to the US attract an average tariff of 17 percent while UK attracts only 0.7 percent. In 2007 each country paid $41mn in tariffs on its exports to the US but the value of exports differed vastly -- $57bn for UK as opposed to $2.46bn for Cambodia.* Significantly, Cambodia's tariff payments to the US, which are largely for labour intensive garment exports, constitute 8 percent of its GDP and can be seen as a major tax on its development and employment generation effort.

While the positive ripple effects of liberalisation undertaken over the past couple of decades will continue to propel the world on a path of increasing globalisation, some other changes will have to be made before the benefits from trade can be truly universalised. Non- tariff barriers to trade still exist and grow: sanitary and phytosanitary (SPS) measures and technical barriers to trade (TBT) have replaced tariff walls as protectionist instruments. Though these are motivated by health and quality concerns their application across countries has to be standardised in order to limit their use as strategic trade barriers, if not outright protectionist tools. For example, SPS measures can now be employed by any country as long as these can be justified as providing necessary protection for the national consumer; some members have even imposed SPS barriers that limit imports as a precautionary measure in the absence of adequate scientific understanding or justification. Thus, countries with a lead in research and its effective dissemination can build up a much more stringent system of barriers than others. The result is unequal benefits from international trade as an engine of world development. For instance, *consider the case of aflatoxin, a naturally occurring toxin, in groundnut: export losses, mainly felt by developing countries in Africa and Latin America, may exceed $450mn under the current EU regulatory standards and lead to employment losses of well over a million. According to an IDRC 2005 study, the higher European standards on aflatoxin as compared to the global standard set by Codex Alimentarius have only reduced the estimated risk of cancer by two cases per billion people annually. That translates to a perceived loss of life of less than one European citizen due to peanut consumption traded off against the loss of livelihood of perhaps hundreds of peanut exporters and thousands of peanut farmers.* Clearly, a single, neutral and international panel of scientists and policy makers should be asked to devise the rules of the game as far as SPS and TBT measures are concerned.

Coupled with such barriers placed at the border are other barriers which emanate from domestic policies – massive agricultural subsidies by developed countries of $1 billion a day, definitely in excess of 30 percent of production costs. This subsidy is in excess of 5 percent of the combined GDP per day of the world’s 140 developing countries and a mind boggling 50 percent of their daily agricultural GDP. These subsidies are not only barriers to imports from developing countries but also melt away any competition that indigenous substitutes in these countries can offer to imports from developed countries. It deserves to be highlighted that LDCs and emerging economies cannot afford such massive subsidies and therefore might see a deterioration of their shares in the world market for international trade in the future – an agreement on simultaneously and harmoniously cutting subsidies across the globe is thus in the interests of greater equality among all countries.

Complementary regimes: The universal availability of benefits from international trade and foreign investment to all is also impeded by unequal progress made by countries in designing and implementing a competition policy. The lack of such a policy can emerge as a binding constraint in benefiting from trade openness and foreign direct investment. Harmonisation of trade and foreign investment policy has to be followed by its harmonisation with competition policy both within and across countries.

Ignorance of rules and opportunities: Finally, the benefit from evolving more comprehensive rules of the game is diluted if countries sorely lack the capacity of understanding them and leveraging them to their advantage.

There are supply side problems too. Our recent research done at CUTS International in 13 developing countries showed that flanking policies are equally crucial for capturing gains from growth. *For example, both Vietnam and Pakistan showed good growth rates but poverty came down much faster in Vietnam as compared to Pakistan.* Flanking policies were either absent or poorly implemented.

Much work needs to be done in building up capacity in developing countries to facilitate their understanding of the rules of the game that govern international trade, their participation in constructive dialogue that gives shape to more comprehensive rules, and to enable them to improve their own economic governance to capture and share the gains. The international initiative of Aid for Trade, strongly supported by Pascal, is a progressive step in this direction. However, rules as per the Paris Declaration need to be followed, for such aid to be cogent, efficient and effective.

Shackled human capital: Narrow regional interests continue to restrict the movement of human capital from large well endowed developing countries to developed countries in which scarcities have been produced by demographic changes. Such human capital movements can lead to win-win outcomes – large remittances to the developing world and the enhancement of capacity for production in developed countries. *A 2003 study by Alan Winters et al for the Commonwealth Secretariat confirms huge gains from such mobility amounting to $150bn, shared equally between the developed and the developing world.*

The findings of this study sum up the nature of benefits from more liberal and more uniform rules of the game – a win-win outcome for the developing as well as the developed world.

In conclusion, the Doha Round was termed as the Development Round, but people have questioned whether it is really one. If one looks at the current contentious deliberations at Geneva, it continues to be a mercantilist debate, with hardly any voice to defend the development dimension….that will remain as the biggest challenge as we traverse along the arduous path of seeking equity, fairness and growth in a beggar-thy-neighbour world. Achievement of the Millennium Development Goals of halving poverty by 2015 might therefore get the short shrift.

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