Trade, Debt and Finance

A Complex Agenda for the WTO

From an analytical perspective the link between trade and debt appears less straightforward than that between trade and finance, or at least less direct. Debt is only one of several instruments of external financing, along with foreign direct investment (FDI) and portfolio equity investment. It is important that borrowed funds should be used for productive investment that generates a return and economic growth, which is sufficient to cover debt repayment. However, a number of other factors may still constrain countries' ability to repay their debt and attract foreign capital for development.

The expansion of trade also depends on a reliable, adequate and efficient source of financing, both long-term (for investment in tradeable goods and services) and short-term (financial instruments that allow "real" transactions to be protected from instability in asset prices, and for trade-financing). An efficient domestic banking system plays a key role in providing financing as well as financial services related to trade.

The establishment of the Working Group on Trade, Debt and Finance (WGTDF), pursuant to paragraph 36 of the Doha Ministerial Declaration, offers an opportunity to reform international economic policies on the basis of an integrated developmental approach to trade, debt and finance.

I. The Doha Mandate

In the preamble of the Doha Declaration, trade ministers recognised that the "challenges Members face in a rapidly changing international environment cannot be addressed through measures taken in the trade field alone," and decided to "continue work with the Bretton Woods institutions for greater coherence in global economic policy-making." The Declaration introduces a binding mandate for Members to examine the relationship between trade, debt and finance in the WTO. To this end, ministers established a WGTDF, open to all Members, to operate within the permanent structure of the WTO. The agenda of the WGTDF consists of three core issues – the relationship between trade and finance; the relationship between trade and debt; and greater policy coherence between relevant institutions.

II. Current State of Play

As the demandeurs for the WTO involvement on debt and finance issues, several developing countries and groups have made submission before the WGTDF. Besides, the European Commission and major intergovernmental organisations like OECD, UNCTAD, World Bank, IMF and ADB have also contributed towards the discussion in the WGTDF. These international intergovernmental organisations have been granted observer status.

Developing Countries' Submissions

The African Group made one of the most useful submissions to the WGTDF (WT/WGTDF/W/16). No doubt, because of their high external indebtedness this issue is far more important to African countries as compared to any other country/regions of the world. The Group in its submission argues that the poor trade performance of African countries can be directly linked to their unsustainable debt levels as reduced export earnings from declining commodity prices hamper their ability to meet debt-servicing obligations.

The work envisaged for this working group, in essence, requires greater cooperation with the Bretton Woods institutions so as to contribute to achieving greater coherence in global economic policy-making in line with Art.III.5 of the Marrakesh Agreement establishing the WTO. Further, Part IV of GATT 1994 on Trade and Development provides an explicit mandate for the WTO's role on development matters under the rubric of global economic governance.

The African Group submission made some specific recommendations to the fifth Ministerial Conference. This includes review of the existing WTO Agreements with a view to addressing financial instability and external indebtedness, ways and means of diversifying African countries' exports, monitoring of the implementation of the "Monterrey Consensus" etc. Here, particular mention has been made of UNCTAD communication (WT/WGTDF/W/5), which contends that the external account imbalances of African countries stem from debt and debt servicing payments and not trade deficits.

The UNECA in its submission (WT/WGTDF/W/11) highlighted a number of important issues. It underlines the need for taking a holistic approach encompassing trade policy and development finance issues. Current debt rescheduling and re-negotiation arrangements leave much to be desired and provide "creditors" with greater leverage than "debtors". Accordingly there is a need to look for alternative arrangements which will ensure "neutrality" in the institutions adjudicating on such disputes.

There is a need to examine the provisions in other WTO Agreements, to determine whether they provide scope for dealing with the interrelationship between "trade and debt". These include the GATS Annex on "Financial Services"; GATT 1994 Article XVIII: B on Balance of Payments Provisions which acknowledges balance of payments difficulties for developing countries that could arise as a result of instability of their terms of trade; and the Agreement on Agriculture, in which a link is made between falling commodity prices and "unsustainable debt stocks".

UNECLAC made a submission to WGTDF on "Mechanisms to Deal with Debt Overhang" (WT/WGTDF/W/10), highlighting five issues for consideration by Members. They are increased market access, flexibility in the use of balance-of-payments restrictions for highly indebted countries, cooperation between the WTO and International Financial Institutions in terms of greater availability of trade financing and compensatory financing during debt crisis, use capital account restrictions for indebted countries and possibility of a scope within the WTO framework for mechanisms that would limit the use of contingency measures by third countries against the exports of countries experiencing debt overhangs.

.../...

Cuba in its submission (WT/WGTDF/W/18) listed several issues, which are essential for consideration in the 2003 agenda of the WGTDF. Some of the key recommendations made by Cuba include – addressing systemic problems; ensuring the gradualness, coherence and correct sequencing of the liberalisation process to enable LDCs to integrate into the world economy on a sustained basis. Further, trade policies need to be accompanied and reinforced by a broad reform agenda covering regulatory issues, institutional dispute-settlement mechanisms, sound macroeconomic management, and greater labour-market flexibility.

Developed Countries' Submissions

Among the developed countries, the European Commission's submission (WT/WGTDF/W/8) is most comprehensive. The EC feels that issues related to trade, debt and finance cover several policy areas and fall under the mandate of different institutions. Therefore, an important part of the work of the WGTDF will be to look at ways to strengthen the coherence of policies of the different organisations, whose mandate relates to the trade-debt-finance nexus.

One important means to improve coherence will be to ensure better synergy between different policy areas through transparency and strengthened co-operation between relevant organisations. In this context, the EC considers that the process of examining the interrelations and of considering possible recommendations for actions for the WTO could possibly bring to light the need for complementary actions and measures that fall outside the mandate and competence of the WTO.

The WGTDF should also build on progress made in other fora, such as the Monterrey Conference on Financing for Development. The EC agrees on the need to improve the relationship between the UN and the WTO on development issues, and to strengthen their capacity to provide technical assistance to all countries in need of such assistance, with a view to increasing the global economic system's support for development.

The EC wishes to underline a few issues that it considers of particular relevance for the work of the Working Group. They are impact of trade liberalisation on indebtedness, integrating trade in economic reform, addressing supply-side constraints, and indebtedness causing adverse impact on the flow of FDI.

The OECD's submission (WT/WGTDF/W/20) focuses on the role of trade policy in responding to financial crisis. First, it is critically important to resist protectionist pressures and to keep markets open, and for these efforts to be backed by a continued flow of trade finance; second, it is necessary to encourage regulatory reform and liberalisation of financial services; and third, it is necessary that sound trade policy be accompanied, and bolstered, by a broad reform agenda.

III. Discussions in the Working Group

The Working Group has held six formal meetings, four in 2002 (15 April, 11-12 July, 30 September, and 17 December) and two in 2003 (28 March and 5 June), under the Chairmanship of Ambassador Hernando José Gómez of Colombia.

The Relationship Between Trade and Finance

The discussions on the relationship between trade and finance emphasised the role of the WTO system in providing stability and economic security in periods of financial crisis. It further underlines the value of keeping markets open world-wide in periods of financial crisis, so as to ensure that crisis-hit economies are able to continue to count on exports for foreign exchange earnings and a source of income growth. The discussion also highlighted the work being carried out by the IMF and World Bank to strengthen financial systems and the negotiations being carried out by the WTO on financial services. Based on experience gained in Asia, there is a need to improve the stability and security of sources of trade financing, especially to help deal with periods of financial crisis.

The Relationship Between Trade and Debt

The discussions on the relationship between trade and debt were focused on market access restrictions, debt servicing capacity, and deteriorating terms of trade of poor countries. Market access restrictions impede the ability of indebted countries to earn the foreign exchange that they need to service their external debt and to avoid resort to further unsustainable borrowing. A global, non-discriminatory reduction of trade barriers especially in areas where distortions affect individual developing country exports, could make a significant contribution to a durable solution to the problem of external indebtedness of developing and least-developed countries.

At the same time, individual indebted countries could improve the debt servicing capacity of their economies by properly liberalising their own trade regimes. This could help boost their domestic growth, productivity and exports. Careful consideration needed to be given to the timing and sequencing of trade reform in this context, as well as to the cost of adjustment involved in such liberalisation and the assistance needed to meet these costs.

Trade policy reform in indebted countries needed to be supported by pro-growth policies that could involve, inter alia, raising domestic private savings and encouraging foreign direct investment. Further examination of the issue of the deterioration of the terms of trade was needed, as it affected the capacity of countries, despite notable domestic reforms underway, to service their debt and move away from commodity exports.

Towards Greater Coherence

Following a fruitful discussion, the themes and potential areas of interest that had been raised by Members on this agenda item, included, the effects of financial and exchange rate instability on trade, the examination and possible establishment of mechanisms and facilities to keep trade-finance alive in periods of financial instability; the need for better integrating the work of international organisations in the areas of capacity-building and trade infrastructure; and the issues of liberalisation of financial services.

IV. Conclusions

The issue of trade, debt and finance covers a vast area. It has also been realised that neither trade nor trade measures alone could solve a country's debt problems, but others felt that trade needed nonetheless to be seen as part of the solution. The chronic and increasing levels of debt experienced by developing countries are perpetuated and exacerbated by structural imbalances of the trading system, which includes: a deterioration in the terms of trade, lack of capacity and enabling conditions to diversify and upgrade their exports, serious trade distortions caused by developed countries' policies and the stagnation of export markets. All these combined together make it difficult for a country to honour its external debt commitments, causing financial instability and monetary disruptions, which, in turn, have a negative impact on growth and economic development.

Proposals and other documents can be found at http://docsonline.wto.org/ under WT/WGTDF/W/.*

CUTS-CITEE Issue Papers

No. 1 ..... Implementation Issues
No. 2 ..... Special & Differential Treatment
No. 3 ..... Movement of Natural Persons
No. 4 ..... Trade Remedial Measures
No. 5 ..... Trade and Environment
No. 6 ..... Competition Policy
No. 7 ..... Investment
No. 8 ..... Trade Facilitation
No. 9 ..... Transparency in Government Procurement
No. 10 ..... Non-agricultural Market Access
No. 11 ..... Trade, Debt and Finance

This Issue Paper is produced under the South Asian Civil Society Network on International Trade Issues (SACSNITI) Project with the support from International Development Research Centre (IDRC), Canada,
by CUTS Centre for International Trade, Economics & Environment, D-217, Bhaskar Marg, Bani Park, Jaipur 302 016, India.
Ph: 91.141.220 7482, Fx: 91.141.220 7486, Email: citee@cuts.org, Website: www.cuts.org