
**EXECUTIVE SUMMARY:
A WORLD OF TRADE LIBERALISATION**

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In an April 2006 press release on world trade developments, World Trade Organisation (WTO) Director-General Pascal Lamy provided a succinct characterisation of the global trading system as undergoing a period of transition and being in need of a new multilateral trade accord (WTO, 2006):

“Shifting economic circumstances, major advances in technology and the emergence of new players on the global scene all underscore that we are on the cusp of big changes. Persistent imbalances, driven largely by macro-economic factors, continue to be a cause for concern in some major economies. In such a climate of uncertainty, one thing is certain, [WTO] Member governments must strengthen the global trading system by making it more equitable and relevant for those who trade in the 21st century. There can be no doubt that the best way to do this would be to conclude this year an ambitious agreement in the Doha round of global trade negotiations.”

Recent years have indeed witnessed striking changes in the global economic landscape, confirming the role of trade as a driving force in economic development and providing an indication of the potential for further trade liberalisation, under the right conditions, to benefit the global economy broadly. Given this situation, the OECD – with input from the World Bank – has undertaken to review recent work on trade and development and to examine in more depth selected trade issues faced by developing countries. This publication presents the results of this investigation.

Kym Anderson, in an article in the *Journal of World Trade* (2005), asks the question, “What Roles for Economists?” in setting the trade policy agenda. While providing a useful review of the post-World War II contributions of economists to understanding the economics of trade and advancing the trade policy agenda, the article’s conclusions point to the important role played by trade policy analysts in bridging the gap between the research community and trade policy makers. The present volume was prepared with this in mind and aims to communicate the findings and conclusions in language that is accessible to trade policy makers, advisors and informed observers equipped with a basic understanding of economics. The intention is to help illuminate issues in the ongoing discussions on trade liberalisation by addressing key concerns and considering options that would permit a reduction in harmful distortions to the world economy that result from barriers to trade.

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The economic well-being of a nation is linked closely to the availability of resources and the productivity of its workforce. Trade operates in a variety of ways to support the development process. For example, it boosts competition and the associated impetus to innovation and specialisation, and it provides an important channel for international technology transfer.¹ Consequently, it is not surprising

¹ Increasing the stock of available technology is critical to development, because technology plays a central role in boosting output per worker and is an important determinant of income levels. See WTO (2002) for a discussion and bibliographic references.

that economists include trade among the classic drivers of economic growth.² The positive results from trade liberalisation are not automatic, and policy choices – including those with respect to complementary policies – do make a difference. Among the most fundamental is the establishment of an adequate system of economic governance, including institutions and rule of law, which are crucial for property rights and for lowering transaction costs, among other baseline conditions. Beyond the basic framework, other policies can be employed to boost the ability to adjust or strategically promote the conditions for development.³ For example, a sound regulatory framework and appropriate labour market, macroeconomic and investment policies can help facilitate structural adjustment and the associated reallocation of resources to increasingly productive employment (OECD, 2005).

In view of the complexity of modern economies and the interplay among the various policies, care must be taken in assessing the relationship between trade and development. While it is clear that the impacts of further trade liberalisation will vary among countries according to the situation of each country, there will also be variation within countries. Changes in trade policies, such as import tariffs, may have consequences in various other policy domains, such as fiscal policy (relating to government revenue) or social policy (related to distributional concerns). The analyses presented in this volume are broadly framed and attempt to tackle some of the wider concerns raised by the prospect of further trade liberalisation. These analyses often point to policy options that can improve outcomes globally or address risks of negative outcomes for specific stakeholders. In some cases, international action may be required (*e.g.* building a particular approach into multilateral trade liberalisation), but in others a country's own reforms are critical in determining outcomes.

A key point confirmed in all of the analyses in the present volume is that trade liberalisation has the potential to contribute to improved economic welfare. Through modelling results, statistical assessments and concrete case studies, these chapters add to the growing body of literature that points to a positive relationship between a nation's openness or progressive integration into the world economy and its growth or economic development (*e.g.* OECD, 1998; 2001; WTO, 2003).

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This volume begins with two chapters containing broad assessments of the potential welfare gains from global liberalisation. These studies emphasise different assumptions and computable general equilibrium models and their conclusions differ as well; this is perhaps most evident in the contrasting findings concerning developing countries' potential gains from liberalisation of trade in industrial goods and those from liberalisation in agriculture. The discussion in these chapters includes some attempt to reconcile differences among the various modelling approaches used to consider the welfare implications of trade liberalisation for developing countries. Although differences remain, it is interesting that the range of aggregate gains is of roughly the same order of magnitude in both studies. Moreover, the estimates of gains are more modest than some that circulated at the time of the Uruguay Round of trade negotiations (1986-94). This is partly due to the trade liberalisation that has since occurred (*i.e.* the remaining barriers are now less onerous than those in place prior to the Uruguay Round). But it also reflects the growing sophistication of the models and associated data sets, which now take more dimensions of the actual trade policy landscape into account. For example, the extent

² Timmer (2006), for example, summarises these conditions as trade and specialisation; investment in machines; and increasing returns to knowledge.

³ For example, policies to facilitate “moving up the value chain” can play a role in development. For examples in the textile and apparel sectors see OECD (2004). A more general study by Hausmann *et al.* (2006) examines the importance of the structure of exports in terms of value and productivity.

of regional and unilateral preferential trading relationships is now more fully incorporated into the analyses.⁴

The next three chapters examine particular concerns for developing countries with respect to trade liberalisation in the context of the multilateral trading system: preference erosion, possible government revenue losses due to tariff liberalisation, and realising the potential benefits from expanded South-South trade. These chapters make clear that developing countries as a whole stand to benefit from trade liberalisation. At the same time, there is significant variation in the extent to which each of these issues affects individual developing countries. In some cases, there is a potential for net losses if appropriate policy frameworks are not in place. Outcomes are influenced in part by the choice of liberalisation scenario and each country's complementary policy mix. Fortunately, these chapters also point to policy approaches that can assist in addressing the challenges while promoting new market opportunities through trade liberalisation. For example, developing countries that rely particularly on tariff revenue to fund the functioning of government can take heart from Chapter 4, which underscores the potential to mitigate negative impacts from liberalisation by developing alternative sources of government revenue and taking care in establishing the structure of post liberalisation tariffs.

The following two chapters consider separately trade liberalisation in services and in agriculture. In some ways, trade liberalisation may tend to be less advanced in these two sectors than in the industrial goods sector. While noting the potential for economic gains from liberalisation, these chapters also underscore important economic relationships among economic actors. In the case of the service sector, these concern the taxing effect that services trade barriers have on other sectors of the economy (especially industries for which services comprise an important input). The chapter on agriculture brings in a new dimension by considering the impact of agricultural liberalisation on households, as well as more aggregate impacts. The analysis at the household level underscores the complexity of the economic outcomes from trade policy reforms. Whereas further agricultural trade liberalisation is found to be generally beneficial at the aggregate level, outcomes across households vary. Some groups will be at risk of losing out, especially among those that are dependent on protected and non-competitive agricultural production. Developing country policy makers aiming for improved economic efficiency through trade reform in agriculture will face a challenge for putting in place complementary adjustment policies if they are to avoid negative welfare impacts on certain poor households dependent on agricultural activity.

The final chapter considers the role of special and differential treatment and aid for trade as complements to multilateral trade liberalisation. As underscored in *Trade and Structural Adjustment* (OECD, 2005), the requisites for successful trade liberalisation include an array of complementary policies and institutions. Owing to resource constraints and other impediments, developing countries sometimes face difficulties in adequately meeting these needs. Participants in the multilateral trading system have sought to address these difficulties via a number of initiatives, including special and differential treatment and aid for trade.⁵ While the results of these initiatives to date have been mixed, the persistent nature of certain development challenges and the need to advance trade reform continue to drive efforts to enhance their functioning and effectiveness.

⁴ For another example, see Chapter 1 of this volume for a discussion of modelling of liberalisation scenarios taking into account the difference in bound and applied tariffs.

⁵ In recent years, some economists have come to approach such measures with a degree of caution because of the potential for introducing further distortions into the global economy. Anderson (2005) provides some illustrations. Also, concerns about the effectiveness of trade-related development assistance are raised by Easterly (2005), Rajan and Subramanian (2005) and Sen (2006), among others.

Supplementing the main chapters are seven *Special Focus* sections that provide a window onto OECD work on related trade topics. Each delivers a snapshot of key messages from OECD research along with references for further reading. These sections reveal instances of progress made by certain developing countries seeking better integration into the global economy as well as areas for improvement or additional study. Some point to economic processes which, in conjunction with trade liberalisation, can work to transform economies and promote development. Examples include structural adjustment, technology transfer and innovation associated with improved intellectual property rights, and the interaction of trade and foreign direct investment. Other sections refer to more “traditional” trade policy issues including trade facilitation, export credits and customs fees or charges, which can have a significant impact on trade flows and, hence, the development impacts of trade.

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Overall, *Trading Up* has a positive story to tell. Trade can contribute to economic development. The impact of liberalisation can be enhanced by appropriate complementary policies, a point that applies both to maximising the gains from trade and reducing adjustment costs. Moreover, developing countries control many of the policy levers that can work to ensure positive outcomes for themselves; their own actions are critical in establishing the essential conditions for growth. Developed countries have an important role to play as well by improving market access, avoiding damaging actions (*e.g.* through barriers to trade or harmful market interventions), and provision of effective, targeted assistance.

The multilateral trading system plays an essential function in defending and promoting the interests of all trading nations, including developing countries. While regional trade arrangements can expand market access and integrate member countries, they are inherently discriminatory (World Bank, 2006). By starting from the principles of national treatment and non-discrimination, providing a forum for *global* market opening negotiations, and extending balanced treatment of member countries (including recourse in cases of violations of the rules), the WTO can help to ensure that trade works more broadly as an engine of growth and development. The conclusions from the analyses presented here support the pro-development case for the multilateral trading system, underscoring the economic value of further carefully crafted, ambitious, multilateral liberalisation.

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