





# Using International Trade to Promote Human Development

Deeper integration with international markets can boost economic growth and generate millions of new jobs. But it also brings new risks – of further marginalizing the Least Developed Countries and undermining the most vulnerable communities. The challenge is to build a trading regime that is not just more balanced and equitable but also actively combats poverty and promotes human development.

The early years of the new millennium have witnessed a robust expansion in world trade. In 2004, global merchandise trade recorded its best performance since 2000, growing in volume by 9 per cent and in value by 21 per cent.<sup>1</sup> Manufacturing took the lead: although global manufacturing output grew by only 4 per cent, an increasing proportion of this output is traded internationally, and as a result the volume of manufactured exports rose by 10 per cent.

Nevertheless, trade in agricultural products also grew in value, by 15 per cent. At the same time, there was a substantial increase in trade in commercial services, which increased in value by 18 per cent. These figures build on an already creditable growth performance for 2003.

An increasingly integrated world has clearly been expanding the opportunities for global trade. But what contribution can trade make to development? The dominant view has been that engagement with international markets is not just unavoidable but also beneficial: that trade can facilitate, promote and sustain the development process. Indeed, for individual nations trade is seen as a prerequisite for sustained growth. Governments taking that view have therefore devised policies to promote trade, and to shape the nature and degree of national engagement with the international economy. The larger developing countries in the Asia-Pacific region (Box 1.1) have also made the greatest impact, but the smaller ones too have been

exploiting new opportunities for trade in services, through tourism, for example, the migration of workers and the outsourcing of business processes.

This Report argues, however, that trade need not be – indeed, should not be – an end in itself. Rather, it should realize a broad range of human development objectives, and especially in the poorest and Least Developed Countries (LDCs) it should help to alleviate poverty and reduce human deprivation. Human development in this sense refers to expanding people’s choices and enabling them to lead longer and healthier lives: by ensuring that they are well-nourished

*Trade need not be – indeed, should not be – an end in itself*

## BOX 1.1

### COUNTRY CLASSIFICATIONS USED IN THIS REPORT

This Report gathers data from a range of sources that often use different groupings for regions and subregions. For consistency, the following classification has been used in this Report. Overall, the region is referred to as Asia and the Pacific or, for stylistic purposes, the Asia-Pacific region. The main subregions are South Asia, the Pacific, and East Asia. Where appropriate, East Asia is subdivided into South-East Asia and North-East Asia. The countries within these subregions are as follows.

*North-East Asia.* China, Democratic People’s Republic of Korea, Mongolia, Republic of Korea.

*South-East Asia.* Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Timor-Leste, Thailand, Viet Nam.

*South Asia.* Afghanistan, Bangladesh, Bhutan, India, Iran, Maldives, Nepal, Pakistan, Sri Lanka.

*Pacific.* Cook Islands, Federated States of Micronesia, Fiji, Kiribati, Marshall Islands, Nauru, Niue, Palau, Papua New Guinea, Samoa, Solomon Islands, Tokelau, Tonga, Tuvalu, Vanuatu.

*Trade can certainly enhance human development but it can also hinder it. There is a two-way causation: from trade to human development and back*

and have access to safe drinking water, sanitation facilities and shelter; by providing them equal opportunities to participate in economic activity through education and decent work; and by affording them the freedoms to exercise these choices and fulfil their potential.

Trade can certainly enhance human development, but it can also hinder it. Trade is, after all, a profit-driven activity, and there are many examples from history that demonstrate what happens when commercial gain takes precedence over human well-being – for example, slavery, colonialism and apartheid. Today too the drive to export and import more goods and services typically triggers a series of complex and dynamic processes that produce both winners and losers. For just as trade liberalization can increase the opportunities for exports, it also exposes

local producers to foreign competition that, particularly in poorer countries, they may be unable to withstand. So as well as creating new opportunities, particularly in the modern sector, it can also destroy the livelihoods of people working in basic manufacturing or in agriculture.

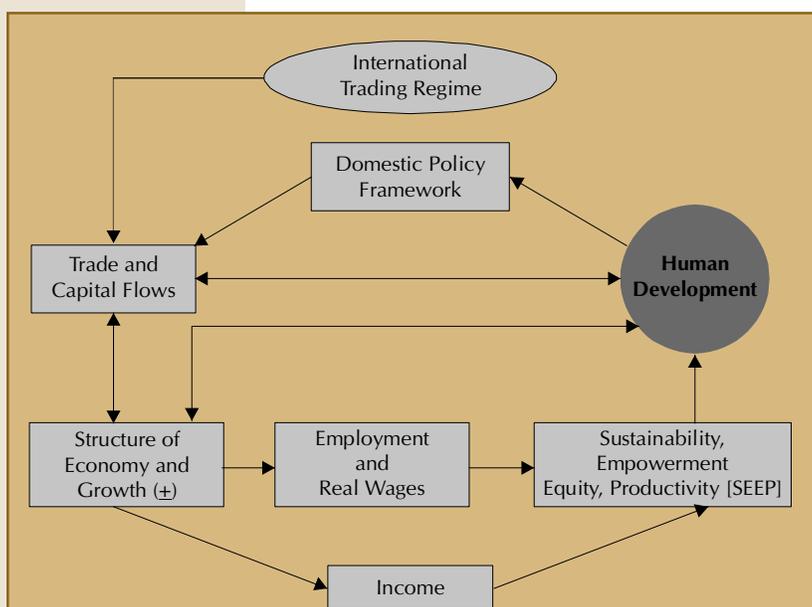
These implications and the links between trade and human development are summarized in Figure 1.1. There are three basic building blocks in the diagram: trade, human development and the links between the two. The hypothesized chain is: trade → growth → human development → trade. There is thus a two-way causation: from trade to human development and back.

### Balancing Growth and Human Development

Trade can fulfil its potential for alleviating poverty and advancing human development, but only if economic structures, domestic and international, are refashioned and governments of both developed and developing countries show the necessary determination and commitment.

One of the main tasks is to shape the character of economic growth. Experience has shown that growth can translate into higher levels of human development. But not necessarily. Much depends on the nature of growth. In some cases the human development outcomes may be limited, or even negative. Indeed, some Asia-Pacific countries that have had high growth driven by trade give cause for concern: industry and services are growing much faster than agriculture; agricultural workers are being displaced on a large scale; rural-urban and interpersonal inequalities are widening; manufacturing growth is not creating enough new jobs, and much of the existing work is becoming more casual or informal.

Most policymakers who seek to change these patterns know that they are not dealing with a static environment. The relationship



**Figure 1.1: Trade and human development – a schematic view**

Trade changes the structure of the economy as well as the rate of growth, which, in turn, has implications for employment both of labour and capital. Trade tends to reward skilled labour more highly than unskilled labour and can lead to the adoption of capital-intensive technologies and thus deepen inequality. However, public policy can be used to ensure that trade benefits human development. There is also a feedback loop from human development to trade, which operates directly or is mediated through the domestic policy framework. Feedback affects work through higher income, higher technical competence and skills or through the power of advocacy on policymakers. Finally, human development can also have a direct influence upon the structure of the economy, the rate of growth and trade itself.

between growth and human development is dynamic, and it works both ways. On the one hand, economic growth provides the resources to permit sustained improvements in human development; on the other hand, human development improvements raise people's capacities to boost economic growth.

But there are two alternative paths – 'lopsided' and 'balanced'.<sup>2</sup> Lopsided strategies can prioritize either economic growth or human development. Neither strategy is sustainable. 'Human-development-first' strategies can run into fiscal constraints and balance of payments crises, while 'growth-first' strategies can be constrained by inadequate domestic supply of skilled labour or by political instability. Far better to take a more balanced approach. But of the two lopsided approaches, the 'human-development-first' is the least unsatisfactory, since societies pursuing this strategy at least have a much better chance of weathering economic crises and getting back on track.

### **Pursuing Growth through Trade**

Even if policymakers accept the need for balanced growth, is boosting trade a good way to achieve this? The answer is typically: 'yes'. Proponents of trade liberalization argue that nowadays autarchy is not an option – that pursuing a growth strategy that relies on producing local substitutes for imports will eventually run into limits because for many products the national market will be too small to justify local manufacture.

Trade liberalization that involves reducing protective tariffs can therefore lead to a more efficient outcome – by delinking domestic supplies from domestic production. A country aiming for growth may find itself short of capital, for example, or of specific intermediate goods, or of skilled labour that it does not have locally. One way to overcome these bottlenecks is to import the requisite commodity from

abroad. But doing so without triggering a balance of payments crisis will require sufficient foreign exchange. Thus, it may be crucial for a country to engage in trade merely to earn the foreign exchange to finance imports. Even China, which has seen rapid increases in exports over a long period, did not until recent years run a trade surplus – indeed, occasionally recorded deficits – because it used export revenue to finance its growing import bill, particularly for oil and machinery.

Trade liberalization should also enable the poorer developing countries to make better use of their comparative advantage – an abundant supply of unskilled and inexpensive labour. They can thus at the outset specialize in the production and export of agricultural products and simple manufactured goods such as textiles and clothing. This should also increase the demand and wages for unskilled workers and thus help to reduce poverty.

But beyond these 'static' gains from trade liberalization, there should also be more dynamic benefits that become evident over time. For example, enterprises that are more exposed to foreign competition and markets will be forced to increase their levels of efficiency. They can also benefit from foreign investment that might initially be attracted by cheap labour but will also bring with it new technology and production processes. Ideally, therefore, trade liberalization should help to boost productivity, increase exports, stimulate more rapid economic growth, and lead to increases in real wages, especially of unskilled workers.

Unfortunately, many countries have fallen short of this ideal. Markets often fail, and in particular, in developing countries they may not be sufficiently flexible to reallocate workers or capital smoothly to the more productive sectors. As a result, liberalization will fail to create the hoped-for export enterprises while risking a flood of cheap imports that put local enterprises out of business.

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Moreover, even if the new export industries emerge, there is a risk that these will become steadily less labour-intensive. Enterprises that want to enhance their competitive edge may try to do this by shedding excess labour and use automation to produce high-quality products to international standards. Thus, rather than employing more unskilled workers the export industries may instead further polarize ‘dual labour markets’ – consisting of a small formal sector where wages are influenced by government regulations and collective bargaining, and a much larger informal economy where wages tend to be linked to a subsistence level of income.

### The Potential for State Action

It might be thought that a balanced approach that would enable trade to promote human development could be achieved by a clear division of responsibilities: let free and liberal markets take care of economic growth while governments address market failure and take

responsibility for social concerns and human development priorities.

However, this ignores the symbiotic relationship between economic growth and progress in human development, and in particular, that policies aimed at maximizing growth may also constrain the potential for public action. Trade liberalization, for example, will reduce trade-related taxes, which in many countries account for a significant share of government revenue. In South Asia overall, as a proportion of revenue, taxes on trade fell between 1990 and 2003 from 27 to 19 per cent.<sup>3</sup> Pakistan is a striking example. During the 1990s, import taxes fell by almost 4 per cent of GDP. This was partially offset by a rise of 1 per cent of GDP in revenue from income tax; nevertheless, the overall loss in tax revenue of 3 per cent of GDP clearly has adverse implications for human development. In the Pacific Island countries customs and other duties can provide up to 70 per cent of government revenue.<sup>4</sup> Bangladesh, on the other hand, has been able to offset losses, from reduced tariff rates by rising volumes of imports and by introducing new sources of tax revenue such as VAT (Box 1.2).

A second objection to this clear-cut division concerns sequencing—since human development may be needed to advance economic growth. In the short run, countries may have to devote resources to human development, even at the expense of growth, because they believe that higher capabilities will, in the longer term, lead to more sustainable growth. Successful industrialization requires not only capital and technology but also a capable labour force – one that can manage that capital and technology and display the discipline demanded by factory production. That capability is directly related to literacy, education, and status of health. In the now-advanced countries, for example, social programmes in health and education helped to buttress industrial development and raise productivity. If growth limits or reverses human

#### BOX 1.2

##### RECOVERING REVENUE LOSSES FROM TRADE LIBERALIZATION IN BANGLADESH

Bangladesh undertook trade liberalization in the early 1990s and over the decade virtually halved its effective rate of import duties. But revenue losses were limited to less than 0.5 per cent of the GDP. There were two reasons for this. First, because as import duties fell the volume of imports increased – 17 per cent annually over the decade, in local currency – on the back of fast-growing exports, especially of textiles. Moreover, the tax base widened as export industries expanded. Second, Bangladesh developed VAT and supplementary excises which, given a broader tax base, produced rapidly growing revenues. Also, special efforts have been made in recent years to raise revenues from taxes on income and profits, primarily by curbing evasion (Table 1).

Table 1: Tax to GDP ratio in Bangladesh (%)

	1993-94	1999-2000	2003-04
VAT and supplementary excise	3.1	3.6	4.2
Customs duties	2.2	1.8	2.1
Tax on income and profits	1.3	1.0	1.4
Other taxes	0.6	0.4	0.6
Total tax revenue	7.2	6.8	8.2

Source: IMF 2006.

development gains, then growth itself may not be sustainable.

Most governments have, therefore, felt the need to intervene in order to achieve trading success – a process with deep historical roots (Box 1.3). A good outcome from international trade is thought to depend on three kinds of State action. First, the State must create the capacity to engage successfully in trade: enhancing the quality and competitiveness of the domestic labour force; easing the cross-border movement of commodities and services; and investing in the market development that allows for the entry and growth of competitive players.

Second, the State needs to protect the vulnerable. Enhanced trade generates both winners and losers: those who get left behind may lose their livelihoods or see their incomes drop or suffer from greater food insecurity. This erosion of human development is not only unacceptable in itself, it may also undermine the social consensus needed to pursue a strategy of enhanced trade engagement. The State must, therefore, also create the safety nets needed to protect the vulnerable.

Third, the State should be able to guide industrial strategy. With its broader vision, it should be able to assess the international context and changes in the global production system. It should therefore be able to identify niche areas, encourage entry into these and invest in the Research and Development (R&D) needed to build competitiveness in emerging sectors.

These three functions are indeed crucial. But they may not be sufficient. In a developing country, the State may also need to find ways of counteracting the imbalances in international markets. It will need to take account, for example, of the sharp differences in national trading capabilities, the substantial disparities in the size, market presence and reserves of competing partners, and the control exercised by a small group of players from a few developed countries on various frontline technologies.

Faced with these imbalances, some governments experiencing ‘export pessimism’ have retreated from the unequal struggle and concentrated on producing for the home market behind high tariff barriers. This may have been understandable, but it is unsustainable; no country can successfully pursue capitalist industrialization while insulated from world markets. Instead, as part of the strategy of growth, developing countries must consciously engage with those markets.

### *A Proactive Approach*

Engaging with international trade does not mean passively integrating. To address the inequalities in the world trading system, developing countries need to take a more proactive stance. But to do so they need to distinguish between overall policies aimed at a ‘greater involvement in trade’, such as reduce transport costs, and those concerned simply with ‘openness’, such as reducing tariff barriers. These pose two different questions. The first is: ‘does international trade boost economic growth?’, to which the answer seems to be generally ‘yes’. The second is: ‘do countries that reduce trade barriers grow faster than others?’ – a question on which there is considerable controversy over the evidence.<sup>5</sup>

This suggests a more complex package of measures – and a more deliberate and less

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#### BOX 1.3

##### STATE INTERVENTION IN TRADE – AN AGE-OLD PHENOMENON

In around AD 60, a trader coming from what is now Dhaka, Bangladesh, arrived in Rome from Jeddah carrying fine muslin. He provoked a near-riot and was plied with coins, gold and silver and was even offered equally valuable horses. The Emperor, Tiberius, became worried because the demand for these goods was annually depleting the Roman coffers by almost 50 million sesterces, the trading bullion. So he banned the sale of ‘woven air’ – the finest muslin. Indeed, he was so concerned that he deployed soldiers to keep the fabric out of Rome. The flow of commerce across national borders is an age-old phenomenon – but so too are State policies to control trade for public purposes.

*Source:* Bandyopadhyay 2005.

haphazard approach to removing trade barriers (Box 1.4). One of the most important objectives should be to encourage and protect domestic producers in certain strategic sectors – affording them the time and space to expand production for the domestic market while strengthening their capacity to compete internationally. This strategy, which is essentially the one previously followed by Western countries, will typically mean limiting the import of some finished goods while allowing imports of crucial capital, raw materials, and intermediate goods that will allow local producers to match the foreign competition. Countries pursuing this type of strategy will, therefore, need to resist pressures to converge their tariffs, either across commodity groups or between themselves and the rest of the world. At the same time, the State can apply appropriate antidumping duties and ensure that, wherever possible, it procures its own requirements from national producers. It will be important, however, to ensure that such protection does not simply breed slothful domestic monopolies geared to skimming the domestic market.

Then the State needs to encourage exporters. Exports cannot constitute the only basis for

growth, but in an interdependent world they are vital for financing essential imports. Initially countries will look to fairly simple manufactured goods that take advantage of lower wage costs – and perhaps of a less codified legal framework or where labour rights are more restricted, as in export trade zones (Box 1.5). All the successful late industrializers, including the ‘newly industrialized economies’, pursued this kind of ‘mercantilist’ strategy – pushing out exports at whatever cost to establish footholds in international markets.

Measures to promote national industries also need to be accompanied by a degree of discipline. When offering industrialists incentives, the State must be in a position to enforce compliance and, where appropriate, to be able to influence the choice of product – for example, the technology used, the scale of production and the prices of goods.

### *The Need for Investment*

Gradually, however, industrialists can start to move up the value chain. This will require substantial investment, not just to expand

#### BOX 1.4

##### STRATEGIC INTERNATIONAL INTEGRATION IN A GLOBALIZING WORLD

The global environment within which developing countries must upgrade the productivity of their people is radically different from the time when ‘industrial policy’ was successfully applied in the now-industrialized countries. Developing countries must contend with new forms of industrial organization, rapid technical change, and diminished economic distance. Lall (2005) lists the following elements that are critical in the current context:

- *Selectivity* – Picking on a few sectors at a time to develop, as opposed to indiscriminately promoting all industrial activities.
- *Technology and linkages* – Emphasizing activities that have the greatest technology spillovers and linkages with other industries.
- *Early entry into world markets* – Assisting enterprises to participate in international markets early.
- *Private sector lead* – Assigning the lead role to private enterprises with support from public enterprises.
- *Skill creation and infrastructure* – Investing in skills demanded by sectors which have been selected for promotion.

- *Selective use of FDI* – Encouraging foreign direct investment to help build local capabilities and to gain entry into high-technology value chains and foreign markets.
- *Good governance* – Strengthening the ability of public agencies to adapt public policies to changes in international markets and to technological advance, by working closely with the private sector.

Each country will have a different industrial development strategy consistent with its inherited natural and factor endowments, geographic location, and governance capabilities. The heavy hand of the government of the Republic of Korea in imposing export obligations on favoured enterprises is well known. Singapore relied heavily on FDI, but never tied its development to the performance of any particular multinational. Successful countries applied strategic liberalization of imports at specific phases of development to improve access to intermediate inputs and technology and to create competitive pressures. Some countries directed the allocation of credit and inputs to the preferred sectors.

## BOX 1.5

### EXPORT PROCESSING ZONES

Export processing zones (EPZs) have played a significant role in creating productive and remunerative employment in several Asian economies, including Taiwan (China), Republic of Korea, Indonesia, Malaysia, Thailand and the Philippines, and more recently in China, Viet Nam, Bangladesh and Sri Lanka.

In China, EPZs account for more than 55 per cent of total exports and have created 40 million jobs (Fong 2006). In Bangladesh and Sri Lanka, EPZ-created employment now accounts, respectively, for 6 per cent and 10 per cent of manufacturing employment.

In January 2006, UNDP undertook a primary survey of three of the largest EPZs in India – Mumbai, Noida and Chennai – interviewing 229 workers. The survey and related secondary data indicate the following (Aggarwal 2006):

*Women.* Women constitute only about 46 per cent of the workers in Indian EPZs, a share that is on the decline as EPZs embrace more advanced technologies.

*Training.* Indian EPZs have already evolved into the second phase, where there is a greater demand for skilled workers. Nevertheless, only half the respondents had been given any formal training.

*Labour Laws.* Labour laws say that no worker shall be required

to work in a factory for more than 48 hours in any week or for more than nine hours on any given day. In general, this has been found to be the case.

*Health Facilities.* Over 90 per cent of the firms surveyed reported that they provided health facilities some 70 per cent said they had been given equipment to protect themselves from hazards.

*Working Conditions.* Most workers said they joined the zones for better working conditions and higher salaries, and 70 per cent were satisfied with the conditions. In general, employers do not provide accommodation for their workers, but most firms in the zones allow their workers casual, medical and earned leave.

*Wages and Incomes.* Wages in EPZs are not higher than those outside the zones, according to the survey, but incomes, which includes perks, are – and most workers said they were satisfied with these.

*Poverty.* While living conditions of workers in EPZs have improved, the impact on poverty reduction has been marginal because backward linkages with the rest of the economy were very weak.

Surveys in Pakistan and Sri Lanka in 2006 had broadly similar findings (Kemal 2006; Marga Institute 2006).

output but also to restructure and modernize the production base. A convenient measure of progress in this direction is the ‘investment rate’, which is the ratio of investment to national income; higher investment should lead to a higher rate of economic growth.

One analysis of the experience of 25 developing countries over the period 1968-88 found a close correlation between the investment rate and the growth in output.<sup>6</sup> In addition, the same study found a close correlation between the investment rate and the growth in exports.<sup>7</sup> Why should greater investment lead to a higher volume of exports? For developing countries, this is primarily because they can use investment to reform the structure of production and exports – moving from commodities, in which world trade is fairly stagnant, to manufactured goods, in which trade is growing more rapidly. The higher the investment ratio, the faster the transformation of the production – structure and

hence, the greater the ability to participate in the more dynamic end of world trade.

As well as encouraging investment, however, the State also needs to act as a coordinator, ensuring that investment is directed to priority areas where it can be used to increase levels of technology and achieve economies of scale, and thus enhance international competitiveness. Economies like Japan, the Republic of Korea and Taiwan (China), though in different ways, followed this type of strategic industrial policy – anticipating future opportunities and guiding investment in the most promising directions. Interestingly, it was only when they were dismantling these industrial policy frameworks that they ran into financial crises.

### *Macroeconomic Policies and Exchange Rates*

Strategic intervention may also be required in the realm of macroeconomic policy, and in

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particular for managing the exchange rate. The world is now experiencing rapid cross-border flows of capital. In periods of economic boom, rapid capital inflows can push up the exchange rate and undermine competitiveness, while rapid outflows, even if they do not lead to a full-fledged currency crisis, can result in a liquidity crunch.

In the initial stages of liberalization, the balance of trade is likely to worsen because, typically, imports rise faster than exports. Trade liberalization should, therefore, be supported by a number of complementary reforms, including management of domestic demand and the exchange rate. Rather than having a freely floating rate, developing economies are more likely to benefit from a managed float.

In the early stages of liberalization, the rate

should, if necessary, be allowed to depreciate. This will curb demand for imports and stimulate exports; it also forestalls a precipitous fall in government revenue and can broaden the tax base, even if it lowers the effective tax rate. This should improve the trade balance – though the overall effect on the economy will depend on other factors such as the export supply response, structural rigidities and sound fiscal and monetary policies. The exchange rate experience of a number of countries in the region is summarized in Box 1.6.

### Multilateral, Regional and Bilateral Action

Governments can take many of the choices on trade liberalization unilaterally: ultimately, the

#### BOX 1.6

##### THE REAL EFFECTIVE EXCHANGE RATE: REGIONAL EXPERIENCES

In the initial stages of liberalization, the balance of trade is likely to worsen because imports typically rise faster than exports. Trade liberalization should, therefore, be supported by management of the exchange rate. In fact, the empirical evidence suggests that, rather than having a freely floating exchange rate, developing countries are more likely to benefit from a managed float. A number of countries in the region have followed a variant of this strategy.

*South Asia.* Based on the data in Annex Table 4.4, it appears that the real effective exchange rates of most South Asian countries have, more or less, moved in synchrony with each other, but the cycles seem to be getting shorter – that is, the real effective exchange rate (REER) has moved up or down more frequently. Thus, the REER for Bangladesh, Pakistan and Sri Lanka appreciated during the first half of the 1990s and then depreciated until 1998. Thereafter, cycles appeared shorter: the REER depreciated during 2000 and 2001 and then appreciated during the next two years. India is an exception, with a real depreciation of the currency for most of the decade of the 1990s. Fluctuations in the REER appear to be a reflection of underlying changes in the balance of payments position. Averaging over the cycles, the long-term trend is one of depreciation of the REER in India, Nepal and Pakistan, appreciation in Sri Lanka, and stability in Bangladesh.

*East Asia.* During the financial crisis of the late 1990s, most countries in East Asia witnessed significant depreciation of their currencies except Malaysia, which implemented a fixed exchange

rate regime in the post-crisis period. Nevertheless, since trade fundamentals remained sound, depreciation quickly improved the trade balance, stabilized the balance of payments and enabled countries in the subregion to recover in a relatively short time from the financial crisis. The subsequent switch to a managed float has allowed the currencies of these countries to depreciate at a faster rate compared to previous periods. The upshot was that East Asian countries have built up massive foreign exchange reserves and are now showing symptoms of the “Dutch disease” currency appreciation resulting from the massive accumulation of foreign exchange reserves. Between 2001 and 2003, the extent of appreciation in REER was 7 per cent in China, 34 per cent in Indonesia, 10 per cent in Malaysia and 15 per cent in Thailand.

The relatively limited appreciation of the Chinese yuan in the presence of a massive buildup in foreign exchange reserves has raised the question: Is the Chinese currency undervalued? In July 2005, China ended its hard peg to the US dollar. The yuan immediately appreciated by 2.1 per cent, and since February 2006 has been appreciating (against the US dollar) at an annual rate of 4 per cent. At this rate, the currency could attain a realistic and sustainable level by the end of 2008.

Accumulating reserves too rapidly carries certain risks. It raises the fiscal costs of sterilizing the implied increases in money supply, fuels speculation in real estate and may exacerbate weakness in the banking system. Steady appreciation, on the other hand, will prevent a continuing large increase in foreign exchange reserves while avoiding shocks to employment if exports fall too drastically.

*Many people feel that the WTO has not proved as favourable to poor countries as promised*

decision to raise or lower tariff or other barriers to trade is a national one. Indeed, the majority of liberalization measures from developing countries have been the product of unilateral action, even if under the aegis of IMF-led or other programmes of structural adjustment.

Nowadays, however, most of the attention has shifted to reciprocal relationships – as countries agree multilaterally or bilaterally to reduce trade barriers to their mutual advantage. The principal multilateral forum is the World Trade Organization (WTO) and its ongoing Doha round of negotiations. Initially there were grounds for optimism since the developed countries appeared to recognize the specific needs of developing countries and duly characterised this as the ‘Doha Development Round’.

Since then, ambition seemed to have been scaled down substantially. Many people feel that the WTO has not proved as favourable to poor countries as promised<sup>8</sup> – indeed, that it puts greater demands on developing countries and narrows their options for pursuing their own human development objectives.

Faced with the potential failure of the Doha Round, a number of developing countries have been looking for alternatives. In many cases they have reached bilateral agreements, typically with the developed countries. Thailand, for example, has signed bilateral agreements with Australia, Japan and New Zealand, and has also been conducting lengthy negotiations with the United States. Whether bilateral agreements are superior to multilateral ones from the point of view of human development is open to doubt since they often demand even greater concessions than multilateral ones while providing greater access.

At the same time the countries of Asia and the Pacific have been promoting trade between themselves through a series of regional trade agreements (RTAs). This is part of a global phenomenon: nearly all countries in the world belong to at least one type of RTA (Box 1.7). Between 1990 and 2005 the number of agree-

ments notified to the GATT/WTO increased from 27 to more than 180 and the figure seems likely to rise further. Both bilateral trade agreements (BTAs) and RTAs are likely to become increasingly important, for a number of reasons:

*Doubts about Multilateralism.* Many countries are looking for alternatives to multilateral agreements. Regional ones are easier to achieve, and they and BTAs may also serve as a threat to force unwilling parties to negotiate in earnest at the multilateral level.

*The Domino Effect.* Once an RTA starts to become effective, neighbouring non-members will be attracted to join, so as not to be excluded from trade flows.

*Market Access for Developed Countries.* The developed countries are competing for market access in developing countries. The European Union (EU) was the first to do so and has already signed several agreements with Eastern European, Mediterranean, African and Asian countries. Now the US too is expanding Free

#### BOX 1.7

##### VARIETIES OF REGIONAL TRADE AGREEMENTS

Depending upon their level of integration, the basic form of regional cooperation, viz., Regional Trade Agreements (RTAs), can be broadly divided into five categories: Preferential Trade Agreements (PTAs), Free Trade Agreements (FTAs), Customs Unions (CUs), Common Markets, and Economic Unions. A PTA is a union in which member countries impose lower trade barriers on goods produced within the union, with some flexibility for each member country on the extent of the reduction. An FTA is a special case of a PTA where member countries completely abolish trade barriers (both tariff barriers and non-tariff barriers) for goods originating within the member countries. It should be clarified here that in most cases countries do not abolish trade barriers completely even within FTAs. Most agreements tend to exclude sensitive sectors.

A Customs Union is seen as ensuring deeper integration than an FTA because unlike FTAs, where member countries are free to maintain their individual level of tariff barriers for goods imported from non-member countries, in a CU member countries also apply a common external tariff (CET) on goods imported from outside countries. The CET can vary across goods, but not across union partners. Overall, however, PTAs, FTAs and CUs are identified as ‘shallow integration’ arrangements in the trade literature.

Both bilateral trade agreements (BTAs) and RTAs are likely to become increasingly important. However, the consensus seems to be that regionalism and multilateralism could be complementary

Trade Agreements (FTAs) rapidly – and has a foothold in Asia through the Asia Pacific Economic Cooperation (APEC) agreement. Developing countries are also contributing to this by seeking asymmetric deals with onerous commitments, for example in IPRs, in return for preferential treatment for limited export interests.

*Reactions to Regionalism Elsewhere.* Asian exporting countries worry that they are becoming increasingly vulnerable to the discriminatory practices of trade agreements in other regions – in the EU, for example, or the proposed Free Trade Area of the Americas. They are thus responding with greater integration within their own region.

*Opportunities for Deeper Commitment.* Developed countries can use BTAs to achieve greater influence over partner countries than is possible

with the WTO. They can thus both choose their partners and also require higher investment, labour, environmental and competition standards.

Some people argue that RTAs form the building blocks for subsequent multilateral agreements. Since RTAs can be negotiated more quickly, they offer government officials the opportunity for ‘learning by doing’ and pioneer new ideas that can later appear in multilateral treaties. Others see them more as stumbling blocks that do not promote additional trade but simply divert existing flows, strengthening protectionist lobbies that will then oppose multilateralism. They can also divert the energies of overstretched officials who have to cope with a ‘spaghetti bowl’ of overlapping tariff schedules and rules. However, the consensus seems to be that regionalism and multilateralism could be complementary.

#### BOX 1.8

##### ESTABLISHED REGIONAL TRADE AGREEMENTS INVOLVING ASIA-PACIFIC COUNTRIES

RTA	Name, and year of enforcement	Member countries
AFTA	ASEAN Free Trade Area (1993)	Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand and Viet Nam.
SAFTA	South Asian Free Trade Area (2006)	Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka
PICTA	Pacific Island Countries Trade Agreement (2001)	Cook Islands, Fiji, Kiribati, Nauru, Niue, Pappua New Guinea, Samoa, Solomon Islands, Tonga, Tuvalu and Vanuatu

*The ASEAN Free Trade Agreement (AFTA).* This has sought to reduce intra-regional tariffs on all manufactured items of ASEAN countries to 5 per cent or less and to remove quantitative restrictions and non-tariff barriers. This did strengthen intra-ASEAN trade, particularly during the 1990s. Between 1990 and 1995, for member countries the share of their exports going to ASEAN-10 countries increased from 20 to almost 26 per cent, though following the Asian crisis had fallen to 24 per cent by 2002.

*South Asian Free Trade Area (SAFTA).* Regional trade cooperation in South Asia has been slow to develop. It was not until 1995 that the ministers agreed the SAARC Preferential Trading Arrangement (SAPTA). This was very limited and gave only minor concessions so that by 2001 intra-regional trade still accounted for less than 5 per cent of the members’ total trade. In

January 2006, SAPTA was effectively replaced by the South Asian Free Trade Area (SAFTA). SAFTA’s Trade Liberalization Programme calls for a reduction in import duties to 20 per cent by 2006 and to 0.5 per cent by 2013, or 2015 for the Least Developed Countries. This too is limited and may not offer much more than the WTO.

*Pacific Island Countries Trade Agreement (PICTA).* This is a free trade agreement that should lead to the establishment of a free trade area. Over a period of 10 to 12 years following its ratification in 2001, PICTA envisages tariffs on all ‘originating goods’ falling to zero – with more rapid concessions for the two largest countries, Papua New Guinea and Fiji. PICTA should bring a number of advantages; creating a market of some 7 million people, it will permit economies of scale and encourage investment.

Regional organizations in a region as vast and heterogeneous as Asia-Pacific tend to be based on subregions. These include the ASEAN Free Trade Area (AFTA), South Asian Free Trade Area (SAFTA) and Pacific Island Countries Trade Agreement (PICTA) (Box 1.8).

### The Human Development Imperative

Many countries in the region are thus deeply engaged in trade issues. But too often the discussions are restricted to the economic implications. Instead, the countries of the region need to consider trade through a wider-angle, human development lens. Decisions on trade need to be considered not just on economic criteria but on what the implications are for human development – for improving people’s lives and widening their choices. Some questions of interest are:<sup>9</sup>

Are the benefits *sustainable*? From the viewpoint of their environmental implications, to what extent, for example, does trade increase the pressure for marketization of agriculture and fisheries? Could this lead to intensive cultivation and mono-cropping? More broadly, to what extent can the benefits be sustained over time, in view of, for example, technological change, dynamic comparative advantages or intergenerational considerations?

Are the benefits *equitable*? Do some have more opportunities than others? Which groups benefit more than others? Are there losers, and if so, are they the relatively worse off? Does trade contribute to reducing or widening of inequalities? How do Least Developed Countries and those that face trade-related vulnerabilities fare? When people and countries at different starting points engage in trade, do the better-off benefit more? Do policies and institutions have to be ‘unequal’ to promote equity, for example, through special and differential treatment provisions?

Are the implications *empowering*? Does the ‘agency’ of some groups get compromised or

enhanced? Can people lead more dignified and empowered lives, say, through better or new employment opportunities, for example, through the offshoring of business processes? To what extent does more open trade destroy jobs, say, for farmers or garment workers of Asia? Are the new ideas and experiences empowering?

Are there *productivity* effects? Does the exchange of goods, services, money and ideas contribute to technology improvements? Does this happen more in the already more profitable sectors, as against in sectors that employ lower-end workers? Does more income in people’s hands lead to better health, with less absenteeism, less down-time? Do people invest more in education as they see its benefits? Are educational choices influenced by market opportunities?

*Sustainability – Equity – Empowerment – Productivity.* Does human development ‘SEEP’ to the bottom? There are also tradeoffs, between productivity, for example, and equity. While these dimensions do not encompass all of human development, they serve as a tool to assess international trade on human terms.

In these circumstances, the market alone cannot deliver a trade regime that promotes human development. The State needs to inform, guide and protect. But this should not just be a matter for ministries of trade or commerce; trade should receive close attention from most departments of government: First, because more productive trade will require stronger human capabilities – hence, the need to involve social sector ministries, such as health or education. Second, because the repercussions of more liberalized trade are felt across all sectors and will demand action from different ministries, whether to provide safety nets for those who lose their livelihoods or to reshape education and training systems to meet the needs of a new economic structure.

At the same time, the State needs to gather broad public support from both the private

sector and from civil society. Governments need to build a stronger political consensus for trade reform. Many individuals and organizations, at both national and international levels, have become more aware of the implications of new trade regimes and will oppose measures that disadvantage the poor.

### **The Contours of the Report**

The following chapters in this Report examine these and related issues in greater depth – looking at the evidence and identifying the kinds of policies that promote a positive relationship between trade and human development, while also protecting those who are likely to lose out from the disruption caused by new trade regimes.

**Chapter Two.** This chapter looks at the evidence from 20 years of trade liberalization – its impact on economic growth, and particularly on how it has affected human development through employment.

**Chapter Three.** Agriculture accounts for a high proportion of employment in developing countries and is one of the most contentious areas in multilateral trade negotiations. This

chapter looks at the impact of the expansion of international agricultural trade on poverty and explores the policies that can be adopted to ensure that such trade advances human development goals.

**Chapter Four.** Another sector of direct interest to the poor is textiles and clothing. This chapter examines how the abolition of quotas is affecting some of the poorest exporting countries, such as Bangladesh and Cambodia.

**Chapter Five.** This chapter looks at the trade in services and specifically at the international migration of workers, digital outsourcing, and the flows of international tourists. It examines the potential of these activities and the actions governments can take to ensure that they best fulfil their promise.

**Chapter Six.** The rapid expansion of international trade affects all countries in the region, but some of the greatest concerns are for the Least Developed Countries. This chapter considers their best path to trade integration.

**Chapter Seven.** The final chapter presents an eight-point agenda that developing countries of the region could consider in order to use trade integration to achieve human development gains.