7 Chapter

Trade for Human Development: An Eight-Point Agenda

The Asia Pacific region has often performed spectacularly well on trade and made good progress in human development. But more recent trends are disturbing, with serious implications for the Least Developed Countries and even for the poorest people in the larger and more dynamic economies, where trade is accompanied by inadequate job creation and rising inequality. How can trade best serve human development? This chapter summarises the main policy recommendations of the Report for national governments and proposes an eight-point agenda.

The rest of the world sees the Asia-Pacific region as a key player when it comes to globalization. But these other countries, and particularly the richest, have a fairly single-minded view: that in a more liberalized trading environment the other global regions face a threat from Asia and the Pacific, which is emerging as the factory of the world and is capable of under-cutting the developed countries in the production of everything from clothing to footwear to electronic goods.

The picture looks different within the region. In one sense it mirrors the global one, though in this case it is the poorest countries of the region who look towards China with some trepidation – perceiving their giant neighbour as a strong competitor capable not just of capturing some of their export markets for textiles and garments, for example, but also of displacing even some of their humbler domestic industries. Nor do they see many offsetting opportunities for exporting to China – which mainly requires raw materials, machinery and high-tech equipment.

Within the region the trade flows also look much more complex, and in many respects even more crucial, because the new patterns of trade are not just directing flows of goods and money, they are also reshaping national development. Workers across the Asia-Pacific region, from Nepal to Nauru, are rapidly learning that the acronym WTO means something, for better or for worse, in their everyday lives.

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For the poorest people in the poorest countries, these are matters not just of strategy but of survival. A call-centre worker in the United Kingdom or the United States, say, whose job migrates to Delhi or Manila can be rapidly redeployed elsewhere or can use the cushion of the social security system to search for a suitable alternative job. But a Bangladeshi woman making shirts on piece rates for a garment manufacturer may have little or nothing to fall back on when told she is suddenly surplus to requirements.

That is why this Report has embedded human development concerns within the heart of international trade. First, pointing out the multiple ways in which trade shapes people's lives – affecting how they live, what they do and what they can be. Second, showing how human development and international trade have multiple links; in some senses a two-way street, in others a multi-lane intersection.

Some people wish to avoid this complexity by shying away from the subject altogether. At one extreme, there are those who would prefer to erect higher trade barriers and aim for national self-reliance; why depend on imports when you can make something similar yourself? At the other extreme are the proponents of free

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trade who would opt for no barriers at all; why try to manipulate trade flows when a free flow of goods or people would allow global production to reach its natural levels – letting the market dictate the most economically suitable location?

Neither extreme makes much sense. Total national self-reliance – autarchy – has an emotional appeal but soon runs into practical difficulties. Does this mean that every small country should have its own pharmaceutical industry or try to survive without vaccines for measles, or treatment for HIV/AIDS? People in the twenty-first century have social and economic rights that can only be met through international trade.

More seductive and plausible is the free-trade option. But this too is fallacious – for it involves trade between unequal partners. Perhaps it appeals because it has appropriated the trigger-word 'free'. Look more closely, however, and it is clear that this is freedom for goods and for money, not freedom for people. No small farmer in Indonesia who has been told that she will get 30 per cent less for the crop this year because free trade has let in unlimited quantities of subsidized rice from the US will feel any sense of liberation. Maybe 'unleashed trade' would be a more realistic description of a tariff-free world – indicating that for safety's sake at certain times the leash should be carefully in place.

That is why this Report has argued for policies more grounded in reality. It recognizes the value of the private sector as the main engine for economic growth but says that some of this energy needs to be harnessed or guided if it is to serve human development. This should come as no surprise in a region which in the latter part of the twenteeth century set the template for modern trade-led economic growth. Anyone tracing the footsteps of the 'Asian Tigers' will recognize that they took a very strategic position – choosing which infant industries to nurse and when to liberalize – before taking the world by storm with their flow of goods. And no need to select only Asian examples: look further back to the nineteenth century at the 'mercantilist' policies of the now-developed countries for a record of restrictions on trade, including on textile imports from Asia, which gave these countries the breathing space before their infant industries were mature enough to sell their goods across the world.

Trade has never been a matter for private industry alone. It has always been subject to active intervention from the State. This central role for the state may not seem an encouraging prospect. Can it be trusted? Trade regulation, after all, offers both politicians and public officials considerable authority and discretion. At the very least, this risks overloading people who have limited capacity or time to deal with complex commercial matters that are typically laden with impenetrable acronyms and jargon. At worst, it opens wider the doors to venality and corruption.

However, there are more promising signs. Civil society groups and the media at both international and national levels are now shedding greater light on trade negotiations that only a few years ago would have taken place behind closed doors. They rightly demand far greater transparency, consistency and fairness. There is still secrecy, and many of the doors remain closed, but at least nowadays trade officials who emerge blinking into the dawn from all-night negotiations know that they will frequently have to cope with the glare of television cameras.

Many people are now asking hard questions about the direction and momentum of international trade. If the developed countries are so keen on free trade why, for example, do the EU and the US persist with huge market-distorting subsidies on agriculture? Why are they enthusiastic about free flows of capital into poor countries but suddenly switch gears when discussing the opportunities for the flows of labour into their own? And why are they now becoming more reluctant to allow Asian countries to demonstrate the remarkable potential of the Internet to allow people all over the world to work together by outsourcing software production or call centres or back-office administration?

Meanwhile the new global trade regime is limiting the freedom of developing countries to manage their own economies. A decade or so ago, under the previous regime, the GATT, countries were more free to choose tariff levels and import quotas and apply foreign exchange controls. Now IMF conditions and the rules of the WTO have narrowed the options – especially for the newcomers to the WTO club, the LDCs, who remarkably have to sign up to an even more intrusive list of rules than the existing members.

This makes life much more difficult for the many countries that are now simultaneously trying to pursue export-led growth. Indeed, it raises the question of whether we may now be reaching the limits of a model that has served many Asian countries so well.

How should the countries of Asia and the Pacific respond in this demanding new environment? Clearly, there can be no standard blueprint – especially for such a huge and diverse region. Each country has its own priorities and will pursue its own agenda; in international negotiations countries may, therefore, have not just different priorities but even opposing interests. The food-exporting countries, for example, will see things differently from the food importers; Indonesia will take a different position from that of Thailand or Viet Nam. The more highly developed countries will feel more at ease with global competition than the poorer ones.

Nevertheless, there is a way of encompassing this diversity – by viewing trade issues through a human development lens. This helps focus attention on the issues that matter for the poorest people, and especially those in the Least Developed Countries. In earlier chapters, this Report has followed this philosophy as it has identified some of the detailed issues in agriculture, manufacturing and services. Some of these will appear common sense, and many will already be part of the human development consensus. Others may be less obvious, and apparently more technical, but could still make a huge difference to the lives of poor people. Rather than be driven by commercial lobbies, the centrality of human development should inform national priorities.[1] Eight that have some of the most general application are as follows.

1. Invest for Competitiveness

In a globalizing world, public investment needs to take into account both national and international considerations. Generally the type of investment will remain much the same, but it may need adjusting with an eye to boosting international competitiveness. Thus, when looking at basic infrastructure, governments will need to ensure that they have the roads, railways, ports and telecommunications systems that align with national needs and also with the requirement of getting goods and services quickly and cheaply to international markets.

The physical infrastructure is just as important as human capital. The most successful trading countries have invested heavily in human development – generating a healthy and well-educated workforce that has the stamina, the skill and the flexibility to cope with a changing trading environment. China, for example, long before it started opening up to the world at the end of the 1970s, already had good basic human development indicators. Education has to start with strong and universal primary schooling, but nowadays all countries need to make sure they have sufficient people with technical and managerial skills. India's success in selling IT services is a reward for heavy investment in

The most successful trading countries have invested heavily in human development technical education, almost all of it funded by the government. Few smaller countries will be able to match this, but at the least, all should be aiming at least at a balance of skills. People with good primary or secondary education can only make use of their potential for international trade if they have the support of others with higher levels of education, in engineering, for example, telecommunications, or accountancy. Men and women alike should have equal opportunities to realize their full potential.

At the same time, many countries will need to invest more in R&D that specifically addresses the needs of poor people. The Republic of Korea, for example, has reaped the benefits of a huge investment in technological infrastructure and by 2004 had the world's highest university enrolment rates. At the broadest level, R&D can include 'foresight studies', as have taken place in Thailand, for example, to anticipate future demands and link science and technology to economic and social needs. But competitive countries also need to continually explore the most appropriate current technologies that will capitalize on national strengths. Some of this can be carried out through public-private partnerships, perhaps combining venture-capital funds and government equity, though most of the R&D into opportunities specifically for the poor is likely to take place in the public sector.

2. Adopt Strategic Trade Policies

The essential requirement for engagement in international trade is that the process should be strategically planned and carefully sequenced

In a world of giant global players and fierce competition, no developing country now has the luxury of entering global markets and hoping for the best. Instead, just as the OECD states and those of the Asian tigers did before them, states have to identify a few sectors and industries that have long-term potential in international markets and guide enterprises towards them. Asia's miracle economies – as well as those of China or India, which are now being lauded as success stories – only liberalized after they had established the basis for diversified export industries.

The chosen industries will vary from country to country. But they could include, for example, those such as basic engineering goods that have the greatest potential linkages with other industries and will train more people in essential skills and thus have important spillover benefits for the rest of the economy.

Picking 'winners' is not, of course, a simple task and will demand much stronger capacity within a government. And it will be important not to foster collusion between public officials and company bosses – reproducing more of the 'crony capitalism' whose shallow foundations collapsed during the Asian financial crisis. Instead, the aim should be to achieve a transparent policy compact between government and the private sector, by using a carrot-and-stick approach.

The carrot will include the opportunity to operate behind tariff walls until companies are strong enough to compete internationally. China, for example, until it started to open up to the outside world had an average tariff rate of around 40 per cent. Tariffs should be low on essential imports such as raw materials and high-tech capital goods, higher on goods that compete with the selected strategic industries.

The stick is that such industries will be closely scrutinized to see that they are living up to their side of the bargain and developing steadily more competitive products and services for export. They will also be subject to a domestic competition policy designed to prevent them abusing a monopoly position.

The essential requirement for engagement in international trade, however, is that the process should be strategically planned and carefully sequenced. Thus, higher tariffs should be rigidly time-bound. In order to avoid creating cosy monopolies that never mature into vigorous export enterprises, tariffs should automatically be scaled down after a predetermined period.

3. Restore a Focus on Agriculture

Many countries with ambitions to boost their presence in international markets have concentrated most of their energies on industry in urban areas – leaving the rural areas to cope as best they can. A trade strategy based on human development, however, must have agriculture at its core. This is not because agriculture offers export opportunities, but because in many countries farming is still the primary source of income for the poor; so no trade strategy that undermines rural livelihoods can claim to be promoting human development.

For food-importing countries in particular, it will often make sense to maintain tariffs on food imports so as to protect poor producers. In WTO negotiations, therefore, developing countries should insist on the right to protect 'special products', including safeguard mechanisms that will be triggered when food imports reach certain prices or volumes.

This also has the strategic advantage of preserving national food security in a world that in just a few years down the line could be moving towards food shortages – precisely because larger developing countries like China have let agriculture stagnate and have become net importers. Tariff protection, or if necessary price support, should, however, be designed specifically to protect farmers rather than simply offer higher profits for traders or for the food industry. And if this results in higher prices that cause hardship for the poorest consumers, governments will need to prepare appropriate social safety nets.

As well as protection, farmers also need progress. In many countries investment in rural development has been on a steep downward curve. This has to be reversed, particularly through investment: for example, in irrigation, in village electrification and in farm-to-market roads.

4. Combat Jobless Growth

Most countries that embark on industrialization typically do so with labour-intensive production in industries like garments, textiles and footwear that take advantage of ample supplies of low-cost labour. But as industrialization proceeds, competitive pressures, greater ambitions and changing market conditions start to push them higher up the value chain. In addition, enterprises often prefer to mechanize if they find machines easier to cope with than people. As a result, the most successful trading countries, primarily in East Asia, are now creating jobs far more slowly – the phenomenon of 'jobless growth'.

To some extent, this process is understandable. Less comprehensible, however, is why governments should exacerbate this trend by maintaining low real interest rates – effectively giving capital preference over labour. That may seem like the best strategy for rapid growth, but it is storing up problems for the future. By all means allow enterprises to choose the lowest-cost option for production, but this choice should not be biased away from labour: interest rates should, therefore, reflect the real price of capital, not the rate that industrialists would prefer. In a similar vein, states should phase out fiscal incentives to enterprises; these may attract investment, but not necessarily in businesses that maximise human development potential because such tax breaks artificially raise the return on capital and again encourage capital-intensive investments.

Another reason why enterprises may be reluctant to take on new workers is that labour contracts can be too rigid. In rapidly changing markets, companies that find it difficult to predict future demands may prefer to invest in machinery rather than commit themselves to a larger permanent workforce. This creates a persistent duality – a small and protected group of 'insiders' with secure employment influenced by national regulations, and a large casual, and often exploited, workforce working on piece rates. Instead, more workers should steadily be absorbed into formal employment but on contracts sufficiently flexible that they can readily be deployed to other sectors or companies as trading conditions change.

Governments can assist in this process by providing some support to workers through health insurance and social security and by active labour market policies to encourage retraining and redeployment.

5. Prepare a New Tax Regime

Liberalization is a common prescription for economic success, but it has a debilitating side effect – it means foregoing a predictable and easy-to-collect source of government revenue. Many of the poorest countries have relied on customs duties for a high proportion of public income, in some cases up to 70 per cent. If they suddenly drop tariff rates, they will lose vital revenue.

Governments need to have an alternative tax regime in place before embarking on liberalization

It might be argued that economic growth itself would take care of this problem, as corporate and income taxes would automatically rise to fill the fiscal gap. But this is unlikely, and certainly not in the short term, when both local and foreign enterprises may have been given generous tax breaks as an incentive to invest. Instead, governments need to have an alternative tax regime in place before embarking on liberalization.

Care will need to be taken, however, to ensure that these new taxes are progressive and do not hurt the poor. Customs duties, for example, are often quite progressive since they are typically highest on the luxury items that are of greater interest to the rich. Corporate taxes too can be levied progressively, though many people escape the net since the lawyers of the largest corporations are skilled at techniques of tax planning, while most enterprises in the informal sector simply evade tax collectors altogether. Much the same is true for income tax, which tends to be paid more by middle-income workers in government or the formal sector.

Garnering more income from corporate or income tax will mean overhauling the tax codes to close loopholes and considering other options such as 'withholding taxes' at points where informal entrepreneurs have no choice but to provide documentation, as when commercially importing inputs.

Governments can also consider taxes on real estate or on capital gains. They can also adopt the value added tax (VAT), for example, which can generate quite high and predictable revenues but assumes a well-documented economy and needs to be developed with care; in any case, it should exempt food and other necessities of the poor.

The key point is that these new sources of revenue should be up and running prior to liberalization, or falling revenues could lead to severe cuts in public services that will harm human development.

6. Maintain Stable Exchange Rates

One thing that hampers international trade and discourages investment is a volatile exchange rate that makes it difficult for states or enterprises to plan ahead. It is important that the rate is realistic: too high, and it will jeopardize employment by penalizing exporters as well as farmers and other local producers who will face more competition from imports; too low, and there is a risk of a rise in the domestic price level, with adverse impact on the cost of living of the poor.

Exchange rates are likely to fluctuate, especially in small and open economies that are powerless against the rise or fall in international commodity prices. With floating exchange rates, these economies are also susceptible to the 'Dutch disease', in which inflows of capital without sufficient investment opportunities to absorb them can push the exchange rate to unrealistic levels. This can happen as a result of rising commodity prices, as with the oil price for Timor-Leste. But it can also be a consequence inflows of aid, for example, or as a result of the arrival of funds for disaster relief as with the tsunami.

Currency devaluations, while seeming to offer a short-term boost, have generally been ineffective. Most of the successful Asian trading countries, compared with those in Latin America, for example, have benefited from long periods of relative exchange rate stability based on active currency management.

Initially, rather than having a freely floating exchange rate, countries that are becoming more involved with international trade can consider a 'managed float' that permits their currency to depreciate slowly. Many countries have combined trade liberalization with a gradual depreciation of the currency that prevented an unsustainable buildup of trade deficits. The overall priority, however, is to ensure that the rate remains relatively stable and realistic.

7. Persist with Multilateralism

The slow pace of progress in the Doha Round of multilateral trade negotiations has discouraged many developing countries. They can see this 'development round' running into some familiar impediments, especially the resistance from the developed countries over agricultural subsidies. This is leading at best to pessimism, and at worst to a crisis of falling expectations that could cause the developing countries to abandon multilateralism altogether.

Despairing of the WTO negotiations, many countries are also seeking bilateral trade agreements with the developed countries. Some would argue that in terms of trade these are better because they give preferential access. But in terms of human development, they may impose high costs. Bilateral agreements typically involve much deeper tariff concessions from the developing countries and make demands on issues like intellectual property rights that go far beyond what WTO members require of each other – and can threaten the health and livelihoods of the poor.

Many countries of the region would do better to resist the immediate temptations of a bilateral embrace and build up slower, but ultimately more productive, multilateral relationships that can lead to more durable human development outcomes.

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8. Cooperate with Neighbours

Rather than seeking bilateral agreements, governments would do better to seek trade and other agreements with other countries in their region or subregion. These could include regional pacts such as the South Asian Free Trade Agreement, the ASEAN Free Trade Agreement, or the Pacific Island Countries Trade Agreement. These have the advantage of being quicker to negotiate than multilateral agreements while posing less of a risk to human development than bilateral ones. In addition, they dovetail well with the region's many integrated cross-national production systems and lead to trade creation.

Regional trade agreements can also be complemented by other forms of cooperation, particularly in the financial area. Many countries in the region have accumulated vast foreign exchange reserves – $1.9 trillion in total, half of which is in China – partly to protect themselves against another Asian financial crisis. These funds could be put to better use if they were pooled so that countries facing sudden balance of payments crises caused, say, by a spike in oil prices could draw on this shared Asian resource. Governments can also consider using the reserves to expand the Asian Development Fund, which could put resources to work for investment in large-scale infrastructure and in human development priorities such as health and education.

Reaching a Different Frontier

With or without new multilateral agreements, globalization will continue to power ahead. And millions more workers in the Asia Pacific region will find themselves producing goods for people on the other side of the globe – as well as buying at lower prices goods their parents could scarcely have dreamed of.

The main hazard, however, is that millions of others will fall by the wayside – abandoned in rural areas where agricultural economies have drifted into decline, or scratching a living on the fringes of Asia's mega-cities as a permanent underclass. Even those currently in work may find themselves later discarded from ever more sophisticated production systems. This not only denies people their basic rights to decent work and a reasonable standard of living; it also heightens the risk of future unrest. Globalization does not just distribute products but also disseminates new ideas and information that change people's expectations.

Asia and the Pacific will offer fresh lessons to the rest of the world

The countries of the Asia-Pacific region are renowned for the speed at which they have developed economically. Now they find themselves at a different frontier – trying to combine accelerated trade-driven economic growth with equally rapid poverty reduction and, more broadly, human development. In many ways, this is a more complex and difficult task, and just as before, they will need to work out their own solutions. Some of these have already been highlighted in this Report; others will only emerge in the light of experience. One thing is certain – that Asia and the Pacific will remain at the forefront of global development and will offer fresh lessons to the rest of the world.