Trade, Growth and Poverty Reduction

Least Developed Countries, Landlocked Developing Countries and Small States in the Global Economic System

T N Srinivasan

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— T.N. Srinivasan

Acronyms

AFT	Aid-for-Trade
CDP	Committee for Development Policy
CHOGM	Commonwealth Heads of Government Meeting
ECOSOC	Economic and Social Council of the United Nations
EPAs	Economic Partnership Agreements
FDI	Foreign Direct Investment
FTA	Free Trade Agreement
IF	Integrated Framework for Trade-Related Technical Assistance to Least-Developed Countries
IFSC	Integrated Framework Steering Committee
IMF	International Monetary Fund
GATT	General Agreement on Tariffs and Trade
GATS	General Agreement on Trade in Services
GSP	Generalised System of Preferences
GDP	Gross Domestic Product
GNI	Gross National Income
LDCs	Least-Developed Countries
LLDCs	Landlocked Developing Countries
MFN	Most-Favoured-Nation
MFA	Multi-Fibre Arrangement
NBER	National Bureau of Economic Research
ODA	Official Development Assistance

OECD	Organisation for Economic Co-operation and Development
PRSP	Poverty Reduction Strategy Paper
PTAs	Preferential Trade Arrangements
POA	Programme of Action (of UNCTAD)
PPP	Purchasing Power Parity
R&D	Research and Development
ROW	Rest of the World
SPS	Sanitary and Phytosanitary
SIDS	Small Island Developing States
SVE	Small Vulnerable Economies
SVS	Small Vulnerable States
SDT	Special and Differential Treatment
SSM	Special Safeguard Mechanism
TA	Technical Assistance
TOR	Terms of Reference
TFP	Total Factor Productivity
TNC	Trade Negotiating Committee
TRIPS	Trade-related Aspects of Intellectual Property Rights
UN-OHRLLS	United Nations Office of the High Representative for Least-developed Countries, Landlocked Developing Countries and Small Island Developing Countries
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
WTO	World Trade Organization

Overview

The global economic system—consisting of international trade in goods and services, flows of capital, finance, ideas, labour and technology—is becoming increasingly integrated, with more and more nations participating in the system. However, in the integration process, developing countries in general and groups of developing countries in particular—such as least-developed countries (LDCs), landlocked developing countries (LLDCs), small island developing states (SIDS) and small vulnerable states (SVS)—are widely presumed to face special challenges and problems to varying degrees. Work programmes and operational documents of the World Bank, WTO and others describe their proposed actions in support of LDCs. In particular, the declaration of the Ministerial Conference of the WTO in Doha, Qatar, in 2001, which launched the Doha Round of multilateral trade negotiations (the 'Development Round') explicitly refers to development issues, and in particular to those relating to the integration of LDCs and small economies into the global trading system. Other declarations include those on the Millennium Development Goals, adopted at the Millennium Summit of the United Nations General Assembly in 2000 and the Monterrey Consensus on Development Assistance, adopted at the International Conference on Development Assistance at Monterrey, Mexico, in March 2002. At best these could be viewed as articulating desirable goals and aspirations and at worst as lofty, but empty rhetoric, since none of them credibly commit their signatories and hold them accountable for taking concrete actions in support of the rhetoric. Indeed, going beyond the desires, goals and action programmes, whether the various countries (be they developed or developing, including LDCs) themselves have made concrete and credible efforts and commitments to achieve them is an open question. The book explores this question, along with the scope for strengthening the links between trade, growth and poverty reduction though cooperation between the developed and developing (including LDCs) nations, including cooperation that goes

beyond multilateral trade talks and regional trading agreements. It argues that a coherent analytical framework is essential for thinking both about the possible mechanisms of the interaction between trade, growth and poverty reduction, and, importantly, about their presence or absence (and their strength, if present) in the specific context of each country so as to assess the scope of public policy at national and international levels. By subsuming the process of liberalisation of foreign trade and capital flows under the broader process of globalisation, it suggests a possible framework by distinguishing the influence of globalisation on growth, growth on poverty reduction, and globalisation on poverty reduction by drawing on economic theory and empirical evidence across countries as well as individual country experiences.

Plausible links in the globalisation-growth-poverty reduction chain can be postulated in theory. Yet the reality is far more complicated, and many links could be absent in some countries at some points in time and may vary in their strength over time, even if present. Not all links need be unidirectional—thus, it is possible that in some links, globalisation influences growth positively, but the character of that growth increases poverty. This being the case, it is important not to focus selectively on some aspects of globalisation, while ignoring those other processes besides globalisation in explaining the observed outcomes; in this way misleading assertions about the role of globalisation can be avoided. Globalisation can reduce poverty directly by accentuating the mechanisms that raise the returns to the resources of the poor (and by attenuating those that lower the returns) or indirectly through influencing other processes, such as growth, that play an instrumental role in reducing poverty.

Globalisation influences growth by positively contributing to each of the three sources of growth: growth in inputs of production; improvements in the efficiency of allocation of inputs across economic activities; and innovation that creates new products, new uses for existing products or brings about more efficient use of inputs. Domestic resources are allocated more efficiently when the economy can specialise in those activities in which it has comparative advantage. By being open to capital, labour and other resource flows, an economy is able to augment relatively-scarce domestic resources and use part of its abundant resources elsewhere, where they earn a higher return. Clearly, efficiency of resource use in each nation

and across the world is enhanced by the freedom of movement of resources. Finally, the fruits of innovation anywhere in the world become available everywhere in such an open world. Moreover, theory also suggests that globalisation and growth have a self-reinforcing relationship, in that higher growth spurs a larger volume of trade flows.

The instrumental role of growth for poverty reduction works through the effects of growth both on demand (domestic and global) for goods and services in which the poor are involved, either as self-employed producers themselves or workers in their production. These effects depend on the competitiveness and efficiency of the markets for such goods and services, as well as on the access of the poor to those goods (e.g., seeds, fertiliser and water) and services (education, health and insurance). Globalisation, by reducing the barriers to trade, particularly in labour-intensive goods and services, reduces poverty by raising the returns to labour. Also, by accelerating the process of removal of domestic distortions that perpetuate poverty, globalisation could reduce poverty permanently. Since the mechanisms through which globalisation influences poverty directly and indirectly necessarily operate in the context of domestic and global institutions and policies, dysfunctional domestic institutions (which are ubiquitous in developing countries) such as those that limit flexibility of labour use, segment markets and fail to provide an adequate and solid economic, political and social infrastructure, could attenuate considerably or even reverse the beneficial effects of globalisation on poverty.

Potentially many domestic policies could reduce poverty, including redistribution of income and assets to the poor. Lessening market distortions has a dynamic effect in that it not only increases the value of present resources, but also encourages greater investment and future accumulation. Redistribution policies often fail because they are not well targeted and are highjacked by the non-poor. Even if they do not fail, their success is short-lived unless redistribution is continued indefinitely. Greater integration with global financial markets would increase the efficiency of financial intermediation, and thereby have large and long-term benefits for the poor by facilitating their investment in both physical and human capital. Integrating domestic product and factor markets by reducing transactions cost and increasing investment in transportation and communication infrastructure, so that the poor are not only able to

compete in larger and more competitive markets, but also have up-to-date market intelligence, is also important. Above all, institutional reforms have to be undertaken for correcting massive failures of governance, particularly by seriously addressing endemic corruption.

International policies that influence the trade-growth-poverty linkages include the access to the world markets for goods, services, technology and capital by poor countries. Protectionist policies in rich countries, such as higher-than-average tariff rates on imports of goods and services exported by the poor countries, domestic support and export subsidies on goods in which they and the poor countries compete in world markets, adversely affect poor countries and especially the poor in those countries. Protection of agriculture (a sector upon which much of the poor in developing countries depend for their livelihoods) in the United States and European Union is an egregious example of such barriers. In addition, tariff escalation in rich countries, in the sense of lower tariffs on unprocessed goods exported by poor countries in comparison to tariffs on processed goods, adversely affects the potential for manufacturing by discouraging processing in poor countries, thus limiting the movement of labour from low-productivity primary activities to higher-productivity manufacturing. Another important aspect is whether or not rich countries deter bribing of foreign bureaucrats and politicians by their multinational companies. Policies that encourage, rather than stand in the way of, mutually beneficial off-shoring of manufacturing and services by rich country firms would benefit some, if not all, developing countries by increasing the demand for their skilled labour. Of course, domestic policies in poor countries have to be accommodating in the sense of encouraging skill accumulation, and making it more attractive for such labour to work at home rather than emigrate. Encouraging foreign direct investment (FDI) in poor countries could facilitate productivity gains and technology transfers. FDI in the financial sector, as well as integration of global financial markets by reducing costs of financial intermediation, encourage productive use of credit for investment. On the other hand, financial opening could increase the risks of a financial crisis if a country's domestic financial institutions are not adequately developed. Balancing the benefits from increased expected returns and increased risk from financial integration would depend on individual country institutions and other characteristics.

The analysis in this book of domestic and international policies for strengthening the trade-growth-poverty linkages leads to one very important conclusion, namely, that the primary constraints on such strengthening are largely domestic and basically of political economy. This is not to say that external constraints are absent or unimportant, but only that they are secondary to the domestic ones. Indeed, external constraints such as volatility and instability of the global markets for goods, services and capital could erode the benefits of global integration for the developing world. The ongoing crisis in international financial markets is a dire example of instability induced by policy and institutional failures as well as outright fraud. The book surveys relevant empirical studies dating from the late 1960s to the present. It finds that the more careful among the cross-country studies that use appropriate econometric techniques, do find a strong association, not only between trade and growth, but also between growth and poverty reduction. They also find that this association is tempered by the presence of domestic policy distortions, thus emphasising the conclusion that removing domestic constraints arising from policy distortions brought about by political economy is a crucial step for maximising the benefits from trade liberalisation.

Individual country studies also support the findings of cross-country studies. For example, studies of China and India, in which an overwhelming majority of the world's poor live, show that both experienced faster growth and greater poverty reduction only after both opened their economies significantly to foreign trade and investment (in China 1978; and in India, in the mid-1980s, in a limited manner, and then more systemically and broadly after 1991). A very recent study of 13 countries (8 Asian and 5 African), finds unsurprisingly that countries that undertook domestic reforms along with trade reforms succeeded most in poverty reduction; and wherever domestic reforms of dysfunctional land and labour market policies, as well as reductions in support to capital-intensive industries, did not accompany trade liberalisation sufficiently, the resulting poverty reduction was limited. Thus, the findings of cross-country and individual country case studies strongly support the conclusion that if trade reform is to be effective in reducing poverty, it has to be part of the broader package of reforms that relax domestic constraints. This has the further implication that the focus of poverty-alleviation policies and programmes

has to be broad and go beyond helping developing countries in integrating themselves with world markets and building a global partnership for this limited purpose, into the arena of domestic political economy and reform.

The book also examines whether groupings of countries into LDCs, LLDCs, SIDS and SVS has the rationale that countries in each group share some common characteristics and face some common problems that are not only distinct from those faced by other groups, but also relevant for formulating some common solutions for addressing them. The criteria that have been used in defining these groups (other than their being landlocked and/or remote from the 'centre of gravity' of world trade and finance) do not appear to be founded on such a rationale. Instead, they are based on observed outcomes, such as low gross national income, weak human assets and high economic vulnerability. Such outcomes are the joint effects of two sets of factors: those that are exogenous being beyond the control of policy-makers (e.g., endowments such as land, minerals and climate) and those that are endogenous and within their control (e.g., social and economic institutions, and resources such as human and physical capital endowments and technology choice). It is crucial for policy analysis, not only whether a country is put in a particular group largely because of exogenous factors or because of endogenous factors that are under its control, but also whether for countries in each group there is a substantial degree of commonality among such factors (exogenous and endogenous). Based on observed outcomes only, it is hard to distinguish empirically whether exogenous or endogenous factors were largely determining a country being put in a group. The required methodology is complex and the results are not very robust. For this reason, conclusions such as that a country's small size or being an island or landlocked *per se* are inhibiting factors in accelerating growth through global integration, or that classical theory of comparative advantage being a fundamental determinant of trade patterns is not valid for them and so on have to be re-examined taking into account the fact that such country groupings classified through outcomes-based criteria are analytically unsound.

The literature on LDCs reviewed in this book, first seems to confound the exogenous and the endogenous factors that are relevant in determining a country's LDC status. Second, this confounding, compounded by the problem of robustly distinguishing between such factors from available

methodology and data, presents a serious dilemma for the rest of the world in the formulation of policies, particularly of resource transfers, to help LDCs. Should the rest of the world or should it not impose conditionalities so that the recipient countries do not put the resources transferred to uses other than for mutually agreed purposes? Third, in the literature on small and vulnerable countries there is a tension between theoretical studies that point to the sub-optimality of small size for sustained growth and development, because their structural disadvantages of small size and remoteness outweigh their advantages, and empirical studies that do not find any strong evidence for disadvantages of small size. This suggests that countries are able to more than offset any disadvantages of their small size by suitably designing and effectively implementing policies that foster growth. Fourth, reminiscent of the early development literature that argued that the institutions and problems of developing countries are so vastly different from those of the developed ones that the same economic theory cannot be used for analysing both, there are contemporary arguments that claim that trade patterns of SIDS cannot be explained by conventional trade theory based on comparative advantage. These arguments appear to be just as invalid as those of early development literature. Fifth and last, the literature indicates that the tendency to focus on trade preferences and trade protection as the preferred means for offsetting permanent or temporary cost disadvantages of SIDS in particular, or LDCs more generally, seems unwarranted.

Proposals for cooperation between developed and developing countries for strengthening the trade-growth-poverty links have to recognise several facts. First, not all such links, direct and indirect, need to be unidirectional. Second, there is enormous heterogeneity across countries, and over time, on both the presence or absence of specific links and their strength where and when present. Third, given this heterogeneity, a 'one-size-fits-all' approach to strengthening the links is infeasible and would be inappropriate, even if feasible. Fourth, an essential prerequisite for cooperation is an understanding by both groups of countries of the efficacy of the links, and their operation in a manner that is beneficial to both. However, there are growing doubts in developed countries, particularly in the United States and in some members of the European Union, of the traditional belief that international trade is one of mutually beneficial exchange, and about

the feasibility and efficacy of addressing distributional conflicts (from trade liberalisation) through domestic policy instruments. If unaddressed, these doubts will undermine any efforts to foster cooperation between developed and developing countries. The ongoing global financial crisis has increased such doubts.

This book documents the historical ambivalence of developing countries, which constitute an overwhelming majority of WTO membership, towards the General Agreement on Tariffs and Trade (GATT)/ WTO and the process of trade liberalisation. It contends that many developing countries did not participate in this process during most of the GATT era (1947-1995) and in accelerating the growth of their trade, mainly because they were driven by the then-dominant faith in inward-oriented, import-substituting industrialisation as the appropriate development strategy. They erected and maintained relatively high barriers to foreign trade. Of the eight rounds of multilateral trade negotiations under the auspices of GATT, up to the conclusion of the sixth (the Tokyo Round, concluded in 1979), many developing countries perceived that GATT promoted the interests of developed and industrialised countries and that it had frustrated several their attempts to have their concerns addressed. 'Concessions' granted to developing countries, such as the inclusion of Part IV on trade and development and the Tokyo Round's enabling clause on special and differential treatment, were mostly rhetorical, and others, such as the Generalised System of Preferences (GSP), were always heavily qualified, and their benefits small. In sum, from the perspective of many developing countries, the GATT was unfriendly, if not actively hostile, to their interests. It is debatable whether or not the frustrating experience of developing countries in seeking greater access to the markets of developed countries was a consequence of their relentless, but misguided, pursuit of the import-substitution strategy of development, and their opting out of the GATT. Had they participated fully, vigorously and on equal terms with the developed countries in the GATT, and had they adopted an outward-oriented development strategy, they could have achieved far faster and better-distributed growth. The experience of East Asian countries that adopted outward-oriented strategies of development from the mid-1960s onward, and also that of China and India since the mid-1980s, supports this assessment.

However, even when developing countries actively participated with cohesion, as they did in the Tokyo Round (1973-1979), the outcomes were not in their long-term interests, primarily because their demands continued to be driven by the import-substitution ideology. Their special, differential and more favourable treatment—including not being required to reciprocate tariff 'concessions' by the developed countries—was triply damaging: once directly, through enabling them to continue their costly import-substitution strategies; a second time by allowing the developed countries to retain their own GATT-inconsistent barriers (in textiles) against imports from developing countries; and a third time by allowing the industrialised countries to keep higher-than-average most-favoured-nation (MFN) tariffs on goods of export interest to developing countries.

Nonetheless, there has been a significant and welcome shift on the part of developing countries away from ambivalence, towards a more receptive attitude towards trade openness and a rule-based trading system, since the conclusion of the Uruguay Round and the establishment of the WTO. This is in part due to the success of China and India in accelerating their growth and reducing their poverty after they began seriously integrating their economies into the world economy. Yet some vestiges of the past, such as the demand for non-reciprocity and for relaxation, if not a complete waiver, of rules applicable to all other members of the WTO persist.

Reviewing the recent experience of LDCs, this book finds that their annual percentage growth in per capita gross domestic product (GDP) nearly tripled from 1.3 during 1990-2000 to 4.0 in 2000-2006 and further to 4.3 in 2007 (UNCTAD, 2008, Table 1 and Statistical Annex, Table 1). However, the extent of this improvement that is sustainable in the long term because of improvements underlying fundamentals, such as total factor productivity growth, and the extent of it that is not sustainable because of reversible short-term favourable factors such as, for example, the improvement in terms of trade of commodity exporters, has yet to be explored. UNCTAD (2008, Table 5) shows that LDCs' merchandise exports more than doubled to US$99 billion in 2006 from US$43 billion in 2003. However, exporters of oil exports accounted for US$52 billion of US$99 billion and mineral and agricultural exports of non-oil exports accounted for another US$77 billion. Thus, LDCs continue to depend heavily on oil

and primary commodity exports. UNCTAD (2008: 11) points out that the increase since 2004 in LDC exports was largely attributable to rising international commodity prices. The price index of food rose by 49 per cent, agricultural raw materials by 52 per cent, and mineral and ores by 178 per cent and crude petroleum by 128 per cent during 2000-2006 (UNCTAD, 2008, Table 7). These favourable price trends may be reversed in the near future. However, the gross domestic savings of LDCs increased from 12.8 per cent GDP in 2000-2002 to 20.7 per cent in 2006 and gross domestic capital formation increased modestly from 19.8 per cent of GDP to 22.2 per cent during the same period (UNCTAD, 2008, Table 4). If sustained, these trends are conducive to future increases in growth. Thus, there is evidence of short-term favourable, but reversible, factors in improved growth performance; however, there is no evidence of the problem of long-term sustainability of growth of LDCs either disappearing altogether or even declining in its severity.

The LDCs, particularly small countries, are deemed to have little voice in the international organisations of which they are members and have no influence in their decision-making processes. However, voice and influence depend not only on characteristics of members (such as the size of their population and economy), but also on rules of membership and decision-making in the organisations themselves. International organisations vary significantly in both respects. The geopolitical and economic configuration of the globe has changed vastly since the approval of the UN charter in 1945. Yet newly-emerging powers such as Brazil, India and also Japan have had little success in achieving their aspirations for permanent membership of the Security Council. This is deplorable, though understandable: no state would voluntarily agree to its percieved power being reduced. In the World Bank and the IMF, which also date back to the end of the Second World War, there is weighted voting with the weight (i.e., quota in the parlance of the two organisations) of each member roughly corresponding to its economic size at the date of the last revision of quotas. Here again, although the relative economic sizes of its members have been changing, the process of revision of quotas has been a contentious issue, though some revisions have taken place periodically, most recently in April 2008.

Thus far, a convention has been followed that decisions of consequence in the GATT/WTO have to be made by consensus, so that in effect every member has a veto in such decisions. In principle, LDC members of the WTO therefore, have a strong voice in its decisions if they choose to exercise it. However, there are many practical constraints in doing so. Historically, collective action by groups of developing countries in GATT/WTO has not been particularly effective mainly because their share in world trade was small when GATT was signed in 1948, and has not grown enough since. Although the shares in world trade of some countries of East Asia have grown significantly since they opened their economies in the mid-1960s, and China's share has grown spectacularly since its opening in 1978, still such growth has not been enough to offset the declines in the shares of Africa and South and Central America.

The dominant constraint in acquiring a voice is what is usually termed 'inadequate capacity', a broad term that covers a range of inadequacies: small size, meagre resources, lack of knowledge (and difficulty in acquiring such knowledge) about negotiating issues, lack of skilled personnel and so on. The ongoing Doha Round, like all such negotiations, involves complex issues and the negotiating positions of members and also the process of negotiations is labyrinthian. The trade-offs involved are difficult to evaluate, even for a very well-informed and skilled individual. A small and poor developing member country is severely handicapped in such negotiations. The need for capacity building is recognised in the WTO, and several rich countries have contributed resources for this effort. Much more can be done, and this is an area in which developed countries, as well as better-placed developing countries, can contribute.

There are several programmes of action for helping the LDCs, of which the three prominent ones are: the Integrated Framework (IF) for Trade-Related Technical Assistance to LDCs, the Programme of Action (POA) of the UNCTAD and the Aid-for-Trade (AFT) of the WTO. This book briefly reviews the experience of each, although those of the POA and AFT are much too short to come to definitive judgements about their efficacy. The IF has been evaluated twice, and the report of the second evaluation was published in 2003 following six years of its operations. Yet this evaluation concluded that it could not achieve its purpose of an assessment of the results of the IF, primarily because it was still too early

to look for measurable results. Instead it confined itself to an anlysis of alternative processes for the operation of IF and making recommendations on them. An IF manual was published in 2005, after the evaluation.

The non-availability of any measurable results did not deter the Development Committee of the World Bank and the IF to decide in September 2005 that the Integrated Framework should be enhanced, provided with additional resources and that a task force on enhanced IF should be established. The task force reported in June 2006, concluding that the IF had failed to 'mainstream' trade into the Poverty Reduction Stratgegy Papers (PRSPs) process in large part because of its weak country 'ownership', and that the response of the donor community had been inadequate. It came up with predictable recommendations: strengthen country ownership, assign responsibility for implementation and increase funding and make it predictable. In 2007, an independent scholar reviewed the trade and diagnostic studies carried out in 11 LDCs through the donor-funded IF to assess the effectiveness of IF in addressing trade-related needs, with the objective of poverty reduction as the centre of the analysis. He found that although these studies present much of use to the countries in promoting export development, they neglect key areas of significance to poverty-reduction efforts.

All these negative findings on the performance of the IF should not be surprising for three reasons. First, the primary objective of IF is vague: the 'mainstreaming' of trade into development plans has little operational content and even less of any identifiable and measureable links to development goals. Although technical assistance (TA) and its coordinated delivery as goals could be made operational, unless the IF itself has clear and well-defined objectives, TA in support of it cannot be made operational. Second, the concept of 'country ownership' is elusive, as noted in UNCTAD (2008, Box 4), and too difficult to be meaningful (Buiter, 2005). Moreover, it unnecessarily confuses the conventional (but increasingly irrelevant) concept of 'sovereignty', meaning that a sovereign country is one which has complete control over its domestic affairs, with a country having control over how externally provided resources are to be utilised for development and poverty reduction. It is not so much country ownership of a programme of external aid that matters, but whether or not the programme is well defined to deliver the objectives that the country

itself wishes to achieve with the resources, regardless of who designed the programme. The aid and TA under the IF are funded by donors: it makes no sense to exclude them from having a say in the objectives that aid to a recipient is meant to achieve, and how the aid funds are to be used for this purpose. However, it is reasonable to insist that donors and recipients jointly decide on the intended uses of aid and on ways to monitor the process of actual use. Calling this joint decision-making 'country ownership' is counterproductive. Third, the most serious and almost fatal defect of the IF is a failure to understand that development and poverty reduction are complex tasks. Greater integration of a country with the world economy, while it certainly will contribute significantly to both, is not the only determinant of either. Moreover, the constraints on development, poverty reduction and the use of greater integration with the world economy for helping with both, involves consideration of domestic political economy. Unless this is clearly understood, redesigning the IF at the margin is unlikely to help this programme deliver greater integration or poverty reduction to any significant extent.

In 2006, UNCTAD comprehensively reviewed the state of development of the LDCs and also the achievement of its Programme of Action (POA). More recent data from UNCTAD (2008) confirm the disturbing findings of UNCTAD (2006), although it makes only a very brief reference to the POA):

- Only 8 out of the 50 LDCs[1] met or exceeded the POA target of growth of 7 per cent per annum between 2000 and 2004. In 2006, growth rates of 14 countries exceeded 7 per cent. Ten out of 35 LDCs met the investment target of 25 per cent of GDP during 2001-2004. In 2006, 14 met the target.
- Nineteen out of the 50 LDCs were unable to achieve per capita growth rates of more than 1.0 per cent per annum during the period 2000-2004, which is far too low to have a serious effect on the extreme poverty in which about half the population of LDCs live. Moreover, progress towards human development goals is very mixed.

1. The 50 include Cape Verde, which graduated from being an LDC in 2007.

- Although the recent improved growth performance in some LDCs noted above is certainly encouraging, a closer analysis shows that out of 40 LDCs, only 7 have experienced steadily sustained growth. All the other LDCs have experienced economic contractions of varying duration and severity since achieving political independence. Of the 33 LDCs which have experienced economic crises with major output losses, there are only 12 whose real GDP per capita is now higher than it was at its peak in the 1970s or early 1980s.
- Capital formation was still only 22 per cent of GDP in the LDCs as a group in 1999-2003. It was 22.2 per cent in 2006, with domestic private investment particularly weak. Actual rates of human capital formation in the LDCs in the 1990s were slower than in other developing countries. The inadequate rates of capital formation reflect weaknesses both in domestic resource mobilisation and in the way in which external capital inflows are supporting domestic processes of capital accumulation.
- For the LDCs as a group, there has been little structural change since the early 1980s, though there are significant differences among LDCs.
- The productivity gap is widening. Labour productivity in the LDCs as a group in 2000-2003 was just 12 per cent higher than in 1980-1983, whilst it increased by 55 per cent on average in other developing countries.
- The goods and services which the LDCs can supply competitively to world markets are ultimately limited by the goods and services which they can produce and how efficient they are in producing them. Limits on productive capacity and efficiency, rather than external barriers to their exports, are the basic sources of the marginalisation of the LDCs in world trade.
- The most important way in which labour has found productive work within LDCs over the last 25 years has been through agricultural land expansion. However, this is becoming more and more circumscribed.

This assessment by UNCTAD (2006) is highly unlikely to be changed in any significant respects by the experience of LDCs after 2004. It leaves no doubt that the task of development of LDCs (and of developing countries more generally) is a daunting one. A narrow focus on one or a few of the many contributory factors to development, be it trade, physical and human capital accumulation, or correction of market failures, dysfunctional governance, insurgencies and ethnic conflicts and related political economy issues, would be inappropriate. Of course, not all problems could be effectively addressed at the same time. A prioritisation among them, based on an understanding of the development process heterogeneity among countries, is essential. In such an exercise, the removal of domestic constraints is most likely to emerge as the task of highest priority.

The brief history of Aid-for-Trade (AFT) launched at the Hong Kong ministerial meeting of the WTO in December is not very encouraging. AFT was meant in large part to address two related concerns. One is the assistance that some WTO members will need to help them implement the results of current multilateral trade negotiations, and to cope with certain adjustment costs that may be incurred. The second, broader set of concerns, is the insufficiency of trade-related capacity in many WTO members to allow them to benefit from the opportunities the multilateral system creates. AFT was reviewed in 2007 and a road map for it was approved by the WTO Committee on Trade Development in early 2008. However, the road map was short on concrete and specific actions and long on general actions.

The basic premise of AFT is that successfully completing the Doha Development agenda, though necessary, is not sufficient for increasing trade opportunities of developing countries and LDCs. Put differently, to avail of the opportunities that a successful completion opens up would require relaxing the constraints that these countries face in doing so. This in turn would require not only identification in specific country contexts what these constraints are, but equally important what actions those countries and other WTO members could take in relaxing them. The constraints so identified (e.g., general capacity constraints) would be critical, not only for availing of trade opportunities, but also for development (and its overarching goal of poverty reduction) in general. If this is the case, for AFT to be a complement to official development assistance (ODA),

it would have to be targeted at relaxing those constraints that are inhibiting availing of trade opportunities only, and not any that constrain development as well, since these would be the targets of ODA. However, whether doing so is a cost-effective use of AFT resources is a separate issue. After all, availing of trade opportunities has only an instrumental value, and not an intrinsic value, as development and poverty reduction do. It is possible, therefore, that use of general purpose aid such as ODA, rather than AFT linked to trade, could achieve the relaxation of constraints that limit development as well as availing of trade opportunities more cost effectively. In addition, credible commitment from concerned officials is essential to undertake the actions needed and to provide incentives for the private sector to take complementary actions (and to avoid actions that limit the efficacy of public-sector actions) for expanding trade-related investment and production. It is possible that AFT has the potential to realise its objectives, but not only is this potential yet to be set out in realistic and concrete terms, but few specific actions to achieve the potential are described in the large and accumulating literature on AFT.

The ministerial declaration of 14 November 2001 that launched the Doha Round of multilateral trade negotiations referred to small economies and LDCs and their influences in several paragraphs. The Doha Agenda and Work Programme of the WTO spelled out the goals of the negotiations from the perspectives of developing countries and LDCs, with respect to each item of the negotiating agenda. The items of the agenda, other than provisions for technical assistance and capacity building, could be divided into two broad categories. The first can be described as exhortations and good faith efforts urged on developed countries. Almost all of these items are essentially voluntary. Without minimising the value of exhortations, moral persuasion and ongoing voluntary efforts, it has to be recognised that it is impossible to set time limits for their fulfilment, let alone set punishments for not fulfilling them.

The second category, which constitutes a majority of agenda items, consists of special and differential treatment of developing countries in general and in particular, LDCs, small economies and other groups. These items included, for example, lower rates of required reduction of bound tariffs by developing countries, or exempting LDCs altogether from any reduction, or a longer time schedule for meeting commitments and so

on. All these items respond to the demands of developing countries and LDCs for concessions and non-reciprocal commitments. This book takes the view that giving developing countries a reasonably longer time for meeting the same commitments as developed countries is an entirely appropriate way of taking into account their being at a lower stage of development. However, allowing them to retain higher barriers to trade until the subsequent round of negotiations, with no commitment whatever to reducing them or reducing them to a lesser extent than is required of developed countries, is not in their interests in any way. It sustains developing countries' mistaken belief that trade restrictions and trade policies are effective instruments for achieving non-trade related and broader goals of development. This is not to deny that poor countries, particularly if they happen to be poorer than others because of factors beyond their control, could benefit from some unconditional resource transfers, mostly in the form of grants. Nonetheless, the WTO is not a resource-transforming agency. By agreeing to demands of developing countries for 'concessions' in the commitments and obligations with which they are to comply, developed countries are able to avoid making any resource transfer commitments. This is counterproductive.

The Doha negotiations have dragged on for more than six years. A set of revised negotiating texts, with their modalities for agricultural and non-agricultural products, were circulated on 19 May 2008. These were rejected by India and other developing countries as indaquate. An informal meeting of the Trade Negotiating Committee (TNC) opened on 21 July 2008 to consider the latest (July 2008 package) negotiating texts. As of 25 July 2008, on some of the key issues positions are yet to converge. The WTO Director General, Pascal Lamy, saw the situation as "critical, edging between success and failure" (*WTO News*). The negotiations collapsed on 29 July 2008. Although the proximate reason for the collapse was the irreconcilable difference in the positions of China and India on the one side and the US on the other on the special safeguard mechanism (SSM) for developing countries on agricultural imports, it was evident that there were significant gaps among WTO members in other areas that would have made it difficult to arrive at final modalities even had there been agreement on SSM. As is to be expected, negotiators blamed each other for the collapse while claiming their commitment to conclude the Doha Round.

The prospects for a resumption of negoatiations and concluding the Round soon seem unlikely. The presidental elections in the US are to be held on 4 November 2008. Parliamentary elections in India have to be held before the end of May 2009. A new European Commission will take office in Spring 2009. If the Republican Party administration in the US is succeeded by a Democratic Party administration, which most polls of voters in mid-October 2008 (two weeks before the elections) suggest is likely, going by the rhetoric of Mr. Barack Obama, the Democratic presidential candidate, it seems unlikely his administration would push for resumption of the Doha negotiations. Even if he did, he would insist on inclusion of labour and environmental standards, which have so far been kept out to WTO agreements, as part of the final Doha agreement. The coalition government led by Prime Minister Manmohan Singh of India, an ardent trade liberaliser, could be replaced by another that could be far less enthusiastic about further opening of India's markets. The new European Commission could be more responsive to protectionist forces, particularly in agriculture in France and Poland and some other member countries.

Be that as it may, the July 2008 package seems to go a long way in delivering much of what was promised in the Doha Declaration and agenda by way of special and differential treatment of developing countries in general and of LDCs in particular. Whether this and any further improvements in the texts will lead to their 'enhanced and beneficial' participation in world trade will depend on what the basic constraints are in the first place that reduce effective participation. These constraints are mostly in the domestic arena, primarily of domestic political economy and society, and will not disappear even if the July 2008 texts are adopted.

Even with their adoption, dramatic improvements in trade performance cannot be expected. For example, WTO data show that even after the removal of systemic biases against trade and the dismantling of barriers since the mid-80s, India's share in world merchandise trade increased by only half of one per cent over two decades, from 0.5 per cent in 1983 to 1 per cent in 2006. Moreover, in 1948, soon after the conclusion of GATT, India's share was much higher at 2.2 per cent. More generally, the total share of world merchandise trade for Mexico, South and Central America, the Middle East, Africa and Asia (excluding Japan, Australia and New Zealand), which together broadly cover the developing world, was

31.4 per cent in 1948, 26.8 per cent in 1983 and 35.4 per cent in 2006. However, the trend in these shares of world merchandise trade does not reveal the divergent trends among sub-groups. For example, if we exclude South East Asia, which has been much more open since the 1960s, and China, which opened in 1978, the share of the remainder of this group was 27.1 per cent in 1948, 19.8 per cent in 1983 and 19.6 per cent in 2006. World Bank data also broadly suggest a similar recent trend: the share of low- and middle-income countries in world merchandise exports increased from 19 per cent in 1995 to 30 per cent in 2006. However, excluding East Asia and the Pacific, the share of the remaining countries increased by less, from 12 per cent in 1995 to 18 per cent in 2006. It is clear that although the period after 1980 is one of growing integration of the developing world with the world trade—certainly it resulted in halting the decline in, and has in fact raised, the export share of the developing world—the gain in export share has largely been in China and South East Asia. Africa and South and Central America have experienced a steady decline in their share of world trade ever since 1948. This suggests that other constraints restricted them from gaining export shares.

It is doubtful that a meaningful global partnership for development exists at present. The feasibility of even putting one together is very difficult, for several reasons, the primary one being that development is multidimensional. Reasonable people could, and often do, disagree not only on its contents, but more importantly, on the relative importance of its many components for each of the many heterogeneous set of developing countries. Indeed one could go further and point out that the multidimensional character of development raises problems even in defining a developing country, since a country could be developed in some dimensions and not in others. Even if there was universal agreement on the relevance and relative importance of a sub-set of dimensions, such as those included in the Millennium Development Goals, such agreement is very unlikely to extend to the actions that each partner should undertake in promoting them. It would seem that it is futile to talk about a hypothetical partnership for development in all its aspects. It is better to start from the reality that many, by no means all, developed and developing countries (more precisely the governments in power in them) have common interests in some aspects of development. So too have a whole host of multilateral

institutions, non-governmental organisations (national and trans-national) of various political hues. While it is appropriate to exploit the existence of such common interests for furthering development, it would be far-fetched to the point of being meaningless to call this a 'global partnership for development'. There is no denying, however, that often a large number of such interests come together in promoting particular aspects of development. If this is a reasonable approximation of ground-level reality, one has to focus on a considerably more modest objective of how to make existing groups interested in development (some cohesive enough to be called coalitions if not partnerships, and others much looser) more effective. Since such groups are likely to be issue-specific, it is impossible to make concrete recommendations for making them more effective.

The book concludes with several recommendations. The World Bank should be reconstituted into a smaller institution that caters only to the needs of those among developing countries that do not have access to world capital markets. These countries would certainly include LDCs (other than those with petroleum and natural resources) and a few others. A large majority of these countries will be in Sub-Saharan Africa. A similar reform of regional development banks, including the possibility of closing ones that have not been effective, if any, should be considered. Certainly, the successes of the IMF in its forays into structural adjustment have been limited. Its current intrusion into poverty alleviation through requiring PRSPs as foundations for its involvement with a developing country is totally unwarranted. The role of the IMF should be confined to responsibility for the stability of the global financial system and for providing advice on macroeconomic, exchange rate and financial sector policies to its members, through its mandated consultation with them under its Article IV. The weighted voting in the decision-making of the IMF and World Bank needs to be reformed beyond what was accomplished recently in April 2008. The outmoded convention that the US nominates the president of the World Bank and the EU nominates the managing director of the IMF should be abandoned in favour of a choice mechanism that results in the most qualified candidates being appointed.

The reform issues relating to the WTO are less complicated than those relating to the World Bank and the IMF. As long as the convention

that its decisions will be made by consensus continues, with every member having an equal voice in principle in its important decisions, its advice potentially has greater credibility, provided that voice is exercised. However, exercising such a voice requires capacity in several dimensions, which LDCs in particular lack. Capacity constraints in LDCs restrict not only their effective participation in the WTO, but also their interaction with other international institutions and the rest of the world. Capacity building is firmly on the agenda of the WTO, with several rich countries already contributing resources for the effort. Capacity-building efforts have to be multidimensional and the assistance to such efforts has to be much broader-based than in the WTO or World Bank only. Again, such assistance has to be coordinated, focused and flexible to respond appropriately to the enormous diversity of the LDCs.

The body that makes the rules of the WTO is the ministerial conference. Changes in existing rules emerge out of the agreements concluding each round of multilateral trade negotiations. Not only are the rounds initiated after long intervals of time, but once initiated, each round can take a long time to conclude. With no equivalent of a parliament or legislature that makes laws, amends them and repeals them where appropriate, WTO rules could remain on the books for a long time after they have become irrelevant or are in urgent need of amendment. A way out of this, such as making the WTO Council (in which all members are represented) a legislative body and perhaps restricting the consensus convention only to such decisions that the Council deems appropriate should be considered. The ultra legalistic dispute settlement mechanism of the WTO was a drastic shift from the political one of GATT. The WTO legalistic system in effect penalises the poorer members of the WTO, which have limited capability to identify violation of commitments by others and argue their case before the panels and appellate bodies. Going back to the GATT system, although it has its own problems, may be better from the perspective of LDCs and other poor members of the WTO. This is worth considering.

The attempts to use multilateral trade agreements as devices to intrude into non-trade-related domestic regulatory arenas began at the WTO Singapore Ministerial Conference of 1996. These domestic regulatory

issues, since then known as 'Singapore Issues', include investment, competition policy and transparency in government procurement and trade facilitation. These issues should remain outside the WTO.

Regional and other preferential trade arrangements (PTAs) have been suggested as a way for LDCs, particularly SIDS and SVS, to overcome constraints on their integration with world trade. It is claimed that contemporary PTAs go beyond trade liberalisation and involve 'deeper integration' of members in other areas, including in particular investment and technology transfer. The empirical evidence on the benefits from PTAs is contradictory—the conclusions depend on the empirical methodology, database used and the countries and time periods included in the analysis. The ambiguous empirical evidence and the strong theoretical presumption in favour of multilateral, rather than preferential, trade liberalisation, together strongly suggest that LDCs should avoid getting into PTAs and economic partnership agreements (EPAs). Rich countries of any global partnership for development should not offer such disabling PTAs and EPAs with non-trade provisions to the developing countries of the partnership and to persuade them not to enter into ones offered by others. The partnership should focus its efforts exclusively on multilateral agreements and work towards concluding the Doha Round satisfactorily and soon.

The WTO should remain an organisation whose members consist only of nation states (or groups of them) and independent customs areas within states (e.g., Hong Kong). The somewhat heated debate on the so-called 'democratic deficit' in WTO is fundamentally devoid of content. As long as universality of membership of the WTO is the goal, as in the United Nations, any state willing to undertake the obligations of membership in the WTO should be free to apply for membership. These obligations are mostly in the arena of trade, and arise from various agreements to which the members are parties. Extending the obligations to the political arena of democratic participation in each member state is inappropriate.

A concern has been expressed about preference erosion arising from the fact that preferential access by way of lower tariffs applicable to exports from developing countries has become less 'valuable' as tariff barriers in their export markets fall. The value of the preferences, such as the Generalised System of Preferences (GSP), is vastly exaggerated. Given

the dismal experience with GSP, retaining it and linking the levels of preferential access to tariff levels in export markets is counterproductive. It would blunt the incentives of developing countries to reduce the higher domestic costs that limit their exports. These high costs were the rationale for tariff preferences in the first place. Any global partnership should focus on reducing these costs permanently through effective support for capacity-building efforts in the LDCs, rather than perpetuate the counterproductive, preferential access through GSP.

1 Introduction

It is widely presumed and perhaps accepted that countries in overlapping groups of least-developed countries (LDCs), landlocked developing countries (LLDCs), small island developing states (SIDS) and small vulnerable states (SVS) face special problems and challenges in a world economy that is increasingly integrated in trade of goods and services, technology, finance and movement of people and ideas. The United Nations Office of the High Representative for the LDCs, LLDCs and SIDS (UN-OHRLLS) was established by the UN General Assembly in 2001. It lists 49 countries as LDCs and provides data on them[1] (*www.un.org/special-rep/ohrlls/ldc/list.htm*, accessed 28 July 2008). Table 1.1, below, gives the composition of LDCs, LLDCs and SIDS along with their overlap. Although the UN-OHRLLS does not list SVS, their composition can be put together from the communiqué of the ministerial meeting in 2005 of small vulnerable economies (SVEs) that are members of the WTO (WT/MIN105/22). There are 24; surprisingly, none of them are in the list of LDCs compiled by the UN-OHRLLS.

Around 2005, the countries in each of these groups varied enormously in terms of the size of their populations, levels of their gross national income (GNI) per capita in nominal and purchasing power parity (PPP) exchange rates, growth rates of GNI per capita, and their integration with the world economy (Tables 1.2, 1.3, 1.4 and 1.5). For example, other than (objectively speaking) all of them being landlocked (or islands), the LLDCs (or SIDS) are so heterogeneous in other characteristics, some of which are subjective, that one might legitimately raise the issue whether they constitute meaningful groups for analytical purposes and for policy formulation. The criteria for admission to or graduation from the group of LDCs also raise analytical issues, which are discussed in Sections 3.1 and 3.2.

1. Prior to April 15, 2008 there were 50 LDCs. In 2007, Cape Verde graduated from being an LDC. The graduation of Samoa was due to be decided in 2008.

Table 1.1

Composition of LDCs, LLDCs and SIDS

Geographical Region	*LDCs*	*LLDCs*	*UN Membership*	*SIDS*
I. Africa	33	15	I. UN members	37
of which LLDCs	12	12	of which LDCs	11
SIDS	3	-	Small vulnerable states	16
II. Asia	15	10	II. Non-UN members	14
of which LLDCs	3	3	of which LDCs	0
SIDS	7	-	Small vulnerable states	0
III. Latin America & The Caribbean	1	2	TOTAL	51
of which LLDCs	0	0	of which LDCs	11
SIDS	1	-	SIDS	-
TOTAL	49	27	Small vulnerable states	16
of which LLDCs	15	15		
SIDS	11	-		
SVS	0	0		

Sources: (i) LDCs *www.unohrlls.org/en/ldc/related/62* [accessed 28 July 2008]
(ii) SIDS *www.unohrlls.org/en/sids/44/* [accessed 30 July 2008]
(iii) LLDCs *www.unohrlls.org/en/lldc/39/* [accessed 30 July 2008]

The notable feature of the data in Tables 1.2-1.5 is the obvious diversity among LDCs around 2005: their populations vary from 100,000 in Kiribati to 156 million in Bangladesh, and their gross national income per capita at PPP exchange rates vary from $260 in Liberia to $8,510[2] in Equatorial Guinea. Their integration into world trade is very modest (on average) and except for natural resource-based economies, integration in world investment flows is modest as well. These features are important for analysing the feasibility of these countries' further integration with the world economy, and the potential contribution the rest of the world could make for ameliorating their special problems, meeting their particular challenges and reducing their vulnerability.

Table 1.1 shows that 33 out of 49 LDCs and 15 out of 27 LLDCs (though only 5 out of 37 SIDS who are members of the UN) happen to be in Africa, including islands off its coast. This fact raises the causal question of whether the particular problems of LDCs and LLDCs are largely due to their African location or is it the other way around, so that some, if not most, of the development problems of African countries arise from many

2. Data from: *www.unohrlls.org/EN/SIDS/WW/*

of them being LDCs and/or LLDCs. Unfortunately most of the empirical analyses based on cross-country regressions reported in the literature are described at best as analyses of association or correlation, rather than of causation, and therefore, do not establish or reject one or both these causal mechanisms. In his well-received best seller Paul Collier (2007: 99) argues that "a group of countries with nearly a billion people have been caught in one or other of four traps: conflict trap, the natural resource trap, trap of being landlocked with bad neighbours and the trap of bad goverance…From time-to-time they have broken free of the traps, but the global economy is now making it harder for them to follow the path taken by the more successful majority. As a result, even when free of traps they sit in limbo, growing so slowly that they risk falling back into the traps before they reach a level of income that ensures safety." Collier does try to use econometric techniques for addressing the issue of two-way causation. Without delving deep into his analysis, it could be argued that of some of the 'traps', such as the natural resource trap, are not inevitable as a trap, but depend on the policy response to resource availability. Since some of the characteristics of LLDCs or SIDS are often claimed to be in the nature of traps, the relevance of Collier's analysis for them is evident.

Table 1.2

Least-Developed Countries

		Country	*Value*
Population	Min.	Kiribati	0.1
(2006, in millions)	Max.	Bangladesh	156
GNI per capita	Min.	Burundi	100
(2006)	Max.	Equatorial Guinea	8,510
PPP GNI per capita	Min.	Liberia	260
(2006)	Max.	Equatorial Guinea	16,620
Growth GDP per cap.	Min.	Equatorial Guinea	-7.8
(2005-06)	Max.	Maldives	21.5
Trade: merchandise	Min.	Central Afr Rep	24.1
(2006, as % of GDP)	Max.	Lesotho	144.5
Trade: services	Min.	Bangladesh	5.9
(2006, as % of GDP)	Max.	Gambia	36.4
FDI: net inflow	Min.	Liberia	-13
(2006, as % of GDP)	Max.	Equatorial Guinea	19.3
FDI: net outflow	Min.	Guinea-Bissau	-2.8
(2006, as % of GDP)	Max.	Angola	0.4

Table 1.3

Small Vulnerable Economies

		Country	*Value*
Population	Min.	St Kitts and Nevis	0.048
(2006, in millions)	Max.	Guatemala	13
GNI per capita	Min.	Solomon Islands	690
(2006)	Max.	Trinidad & Tobago	12,500
PPP GNI per capita	Min.	Papua New Guinea	1,630
(2006)	Max.	Trinidad & Tobago	16,800
Growth GDP per cap.	Min.	Grenada	-0.8
(2005-2006)	Max.	Trinidad & Tobago	11.6
Trade: merchandise	Min.	Guatemala	50.8
(2006, as % of GDP)	Max.	Guyana	166
Trade: services	Min.	Guatemala	8.7
(2006, as % of GDP)	Max.	Mauritius	47.2
FDI: net inflow	Min.	Papua New Guinea	0.6
(2006, as % of GDP)	Max.	St Kitts and Nevis	42.3
FDI: net outflow	Min.	Trinidad & Tobago	-2.3
(2006, as % of GDP)	Max.	Jamaica	0.9

Table 1.4

Landlocked Developing Countries

		Country	*Value*
Population	Min.	Montenegro	0.601
(2006, in millions)	Max.	Ethiopia	77
GNI per capita	Min.	Burundi	100
(2006)	Max.	Botswana	5,570
PPP GNI per capita	Min.	Zimbabwe	170
(2006)	Max.	Botswana	11,730
Growth GDP per cap.	Min.	Zimbabwe	-6
(2005-2006)	Max.	Azerbaijan	33
Trade: merchandise	Min.	Central Afr. Rep	24.1
(2006, as % of GDP)	Max.	Swaziland	160.9
Trade: services	Min.	Zambia	8.3
(2006, as % of GDP)	Max.	Mongolia	32.2
FDI: net inflow	Min.	Azerbaijan	-2.9
(2006, as % of GDP)	Max.	Serbia	16
FDI: net outflow	Min.	Rwanda	-0.6
(2006, as % of GDP)	Max.	Azerbaijan	3.6

Table 1.5

Small Island Developing States

		Country	Value
Population	Min.	Palau	0.02
(2006, in millions)	Max.	Cuba	11
GNI per capita	Min.	Guinea-Bissau	190
(2006)	Max.	Singapore	28,730
PPP GNI per capita	Min.	Guinea-Bissau	460
(2006)	Max.	Singapore	43,300
Growth GDP per cap.	Min.	Timor-Leste	-6.7
(2005-2006)	Max.	Maldives	21.5
Trade: merchandise	Min.	Haiti	44.5
(2006, as % of GDP)	Max.	Singapore	386.2
Trade: services	Min.	Trinidad & Tobago	9.5
(2006, as % of GDP)	Max.	Singapore	91.6
FDI: net inflow	Min.	Tonga	-0.91
(2006, as % of GDP)	Max.	St Kitts and Nevis	42.3
FDI: net outflow	Min.	Guinea-Bissau	-2.8
(2006, as % of GDP)	Max.	Singapore	6.5

Several international meetings have been held and declarations made at their conclusion on LDCs, SVS and SIDS, and international agencies publish reports on these countries periodically. For example, the United Nations Conference on Trade and Development (UNCTAD) publishes reports on LDCs, the most recent one being in 2008. The Commonwealth Heads of Government Meeting (CHOGM) held in Malta during 25-27 November 2005 made a statement on SVS, which *inter alia* stated "…Small states have well-recognised vulnerabilities, and they are now confronted by new challenges. These include faster-than-anticipated erosion of preferential trade access arrangements; rapidly growing debt burdens; additional responsibilities and compliance costs associated with global efforts to combat terrorism; increased environmental risks associated with more frequent and severe natural disasters; the spread of HIV/AIDS and its impacts; and rising levels of youth employment" (see: *http://www.thecommonweath.org/Template/Internal.asp?nodiID=1*, accessed 28 July 2008). The statement acknowledges earlier declarations and reports, such as Mauritius International Meeting of January 2006 and its Mauritius Strategy for SIDS and the Commonwealth Secretariat/World Bank Task Force Report of 2000.

A ministerial conference of landlocked and transit developing countries and donor countries and international financial and development institutions on Transit Transport Cooperation was held in Almaty, Kazakhstan, from 25-29 August 2003. It adopted the Almaty Declaration and the Almaty Programme of Action. Predictably, the action programme emphasised policy improvements relating to customs bureaucracy, fees and delays at borders of the landlocked countries, improvement in transportation infrastructure, more trade preferences, and technical and financial assistance for landlocked countries.

The Mauritius Declaration of 2005 on SIDS noted that the implementation of the programme of action for sustainable development of SIDS, adopted at Barbados 10 years earlier, was disappointing at best, having run into several problems due to inadequate internal cooperation, external resources and technology. Although the SIDS had done their part, their activities were hampered by the same problems, as well as their own capacity limitations to undertake what was needed to be done. The absence of sufficient international awareness of the specific social, economic and vulnerabilities of SIDS was a serious matter of concern. Noting that major challenges identified at Barbados still remained, while new challenges such as AIDS have emerged, it concluded that the agenda for SIDS has become even more urgent and daunting, but also that good progress was possible with crucial partnerships with regional organisations and civil society, and essential involvement of the private sector.

In 2001, the Third United Nations Conference on LDCs in Brussels adopted a programme of action for the least-developed countries for the decade 2001-2010. Its progress was reviewed in 2006 by UN-OHRLLS. A statistical profile on measuring progress in the LDCs was published in the same year jointly by UN-OHRLLS and the World Bank (World Bank, 2006). The author has drawn on the data and other information in this and the reports cited earlier.

The Doha Ministerial Declaration (WT/MIN(01)/DEC/1) of 14 November 2001 that launched the Doha Round (or the Doha Development Round) in paragraph 35 on small economies agreed to a work programme to examine issues relating to small economies with an objective "to frame responses to the trade-related issues identified for the full integration of

small vulnerable economies into the multilateral trading system *and not to create a subcategory of WTO members*" (emphasis added).

Paragraphs 42-44 of the Doha Declaration dealt with LDCs and acknowledged "the seriousness of the concerns expressed by the least-developed countries (LDCs) in the Zanzibar Declaration adopted by their ministers in July of 2001"; recognised "that the integration of LDCs into the multilateral trading system requires meaningful market access, support for the diversification of their production and export base and trade-related technical assistance"; endorsed "the Integrated Framework for Trade-Related Technical Assistance to Least-Developed Countries (IF) as a viable model for LDCs trade development"; reaffirmed "that provisions for special and differential treatment are an integral part of the WTO"; and agreed "that all special and differential treatment provisions shall be reviewed with a view to strengthening them and making them more precise, effective and operational." Apart from these specific paragraphs relating to LDCs and SVS, other paragraphs relating to development are also relevant for these countries. Section 5 returns to the questions of how far the protracted and yet-to-be-concluded negotiations over six years of the Doha Round have met the goals set in the declaration of 14 November 2001 at Doha.

Several volumes (as well as numerous individual papers) on the special problems of LDCs and island economies, and the vulnerability (and indexes of measuring it) of small economies, have been published in a literature that extends back several decades. A comprehensive bibliography is not provided in this book. However, a few recent publications that were found most useful in writing this book and which also include references to and analyses of the findings in the literature are UNCTAD (2006); Briguglio *et al.* (eds., 2006); Briguglio and Kisanga (eds., 2004); Grynberg (2006); Kisanga and Danchie (2007); Winters and Martins (2004); and Commission on Growth and Development (2008).

The terms of reference (TOR) to this book were:

1) To assess the impact of the failure of the Doha Round negotiations on LDCs and small vulnerable states and the prospects for achieving their enhanced and beneficial participation in world trade.
2) To discuss the scope of cooperation between developed and developing (including least-developed) countries, apart from

multilateral trade talks and regional trading arrangements, in order to strengthen the link between trade, growth and poverty reduction in the developing world.

3) To identify the scope for and measures that may be adopted by developed and the more advanced developing countries for playing a fuller and more effective role to advance growth and development in the rest of the world (particularly in the poorer world), i.e., beyond their national borders and regional economic groupings.

4) Based on the above, to formulate recommendations for making the global partnership for development more effective.

These TOR are wide ranging in their scope, both in terms of country groups (SVS, LDCs and developing countries in general) and in terms of topics (world trade, growth, poverty reduction and development in general). Different sections of the book address different TOR. The first TOR is more of a factual assessment of the current state of the Doha Round negotiations, since the negotiations have not been formally declared to have failed as yet. For meeting the other three, one has to have some coherent framework for considering, first, the possible mechanisms of the interaction of trade, growth and poverty reduction in the developing world on the one hand, and their presence or absence as well as their strength in the specific context of the LDCs on the other; and second, the scope for public policy at national and international levels. Since the observed development, growth, poverty and trade outcomes are the result of domestic and international policies (economic, political and social) and natural as well as other resource endowments, without a coherent framwork it is impossible to sort out the issues involved, particularly the issue of identifying causation from association. In what follows, Section 2 explores issues relating to a possible framework. This section reviews liberalisation of foreign trade as one component of a broader process of integration into the world economy of developing countries in terms of their trade in goods and services, in investment, in finance, in technology flows and in terms of migrations. This process usually, though not precisely, is summarised by the word globalisation. Section 3 is devoted to the institutional and other relevant contextual features of LDCs. In particular, it will attempt to distinguish between those features that might be reasonably viewed as exogenous and upon which the policies have no influence, and those

that are endogenous and amenable to influence by policies. Also, where appropriate, distinction will be drawn between national (and also purely domestic policies of the national government) and international policies (and those that are not domestic, e.g., trade, exchange rate and foreign capital flow policies of the national government). In Section 4, the author addresses the second and third terms of reference. Section 5 is devoted to an assessment of the current state of the Doha Round (the first TOR). Section 6 concludes the book by responding to the fourth and last TOR.

2 Trade, Growth and Poverty Reduction[1]

'Globalisation' is now the widely-used word to describe the process over time of the integration of individual economies with the world economy, through international trade in goods and services, international flows of capital, finance and knowledge (including technology). It is widely, though not universally agreed, that there were two waves of globalisation, "the first ended with World War I and the second started at the end of World War II, while the years in between were ones of anti-global backlash" (Williamson, 2002).

The achievement of the first wave, before it ended with the outbreak of the First World War in August 1914, was eloquently described by John Maynard Keynes (albeit from the perspective of an upper-class Londoner).[2] Keynes was referring not only to freedom to trade in goods, but also to engage in foreign investment in equities and bonds, and freedom of travel (both for pleasure and work, temporarily and permanently, although he did not explicitly mention this aspect). Keynes' emphasis that those freedoms were deemed "normal, certain and permanent", and expected

1. This chapter draws heavily on Srinivasan and Wallack (2004).
2. "What an extraordinary episode in the economic progress of man that age was which came to an end in August 1914! …The inhabitant of London could order by telephone, sipping his morning tea in bed, the various products of the whole earth, in such quantity as he might see fit, and reasonably expect their early delivery upon his doorstep; he could at the same moment and by the same means adventure his wealth in the natural resources and new enterprises of any quarter of the world, and share, without exertion or even trouble, in their prospective fruits and advantages; or he could decide to couple the security of his fortunes with the good faith of the townspeople of any substantial municipality in any continent that fancy or information might recommend. He could secure forthwith, if he wished it, cheap and comfortable means of transit to any country or climate without passport or other formality, could dispatch his servant to the neighbouring office of a bank for such supply of the precious metals as might seem convenient, and could then proceed abroad to foreign quarters, without knowledge of their religion, language or customs, bearing coined wealth upon his person, and would consider himself greatly aggrieved and much surprised at the least interference. But, most important of all, he regarded this state of affairs as normal, certain and permanent, except in the direction of further improvement, and any deviation from it as aberrant, scandalous and avoidable" (Keynes, 1919).

to improve, underscores the fact that the abrupt end to these freedoms during the inter-war period was not at all anticipated. The attempts after the Second World War to restore them succeeded only partially, with migration, for example, not yet free and unlikely to be free in the near future. However, it is also important to note that, for example, two of the world's largest developing countries (in terms of population and the number of poor), China and India, have succeeded in raising millions of people above their modest poverty lines *only since* both began taking advantage of available opportunities by integrating themselves with world markets. Their experience and that of other countries—that globalisation has been associated with acceleration in their growth and with poverty reduction—does not necessarily imply that there is a causal link between globalisation, growth and poverty reduction. It is no surprise, therefore, that distinguished economists (e.g., Jagdish Bhagwati and Joseph Stiglitz) as well as policy-makers could be found asserting or questioning the link.

Distinguishing mere association from deeper causation requires an appropriate theoretical and empirical framework or model for several reasons. Several plausible links in the globalisation-growth-poverty reduction chain can be postulated in theory, yet the reality is far more complicated and many links could be absent in some countries at some points in time. Agènor (2003), for example, finds that globalisation may have a U-shaped effect on poverty: while extensive integration reduces poverty, small amounts of globalisation may hurt the poor.[3] Even in theory, not all links need be unidirectional—thus, it is possible that in some links, globalisation influences growth positively, but the character of that growth increases poverty. This being the case, it is easy enough to blame the process of globalisation for any observed or imagined deterioration in the condition of the poor, rather than look for the missing links or for other factors that could have muted or outweighed the beneficial effects of globalisation. It is equally easy to argue that observed outcomes deviate from globalisation's predicted contributions to poverty reduction only because globalisation has not gone far enough. By focusing selectively on some aspects of globalisation, while ignoring that other processes besides

3. The paper presents a variety of theoretical reasons for this finding. The composite index of 'globalisation'—a weighted average of trade and financial openness—is difficult to interpret, however, in the context of his cross-country study.

globalisation could explain the observed outcomes, it is possible to assert or deny the role of globalisation.[4]

In theory, greater international integration should play an important part in reducing poverty around the world. In practice, it has had mixed effects due to domestic policy shortcomings, continued industrial country protectionism and limited labour-market integration across countries. Many of the ways in which globalisation is perceived as harmful to the poor are not intrinsic aspects of global integration. They reflect, rather, domestic policy failures such as segmented and distorted internal markets, as well as industrial country protectionism and limited labour-market integration across countries.

To sort out the issues in a systematic fashion, the following discussion is divided into four subsections: (i) globalisation and growth; (ii) growth and poverty reduction; (iii) globalisation and poverty reduction; and (iv) globalisation for the poor. The first subsection summarises the underlying theory and empirical evidence for the globalisation-growth linkage, while the second discusses empirical evidence for the connection between growth and the poverty reduction sequence. While there are many mechanisms in theory for expecting greater integration to increase growth and reduce poverty, the theory is not without caveats and the empirical evidence is not conclusive. The effect of globalisation on inequality, in particular, is ambiguous. The third subsection provides a conceptual analysis of how globalisation could be expected to reduce poverty by reducing market distortions that disproportionately affect the poor. It is argued in the last section that remaining industrial country protectionism, particularly in agriculture, as well as continued restrictions on international labour mobility are key areas for reform.

This division simplifies the discussion of the effects predicted by economic theory and the policy changes needed to achieve these effects. There are clearly additional links among the three phenomena, and all three are endogenous outcomes of the varying economic and social processes in the countries analysed.

4. Deardorff (2003) goes so far as to suggest that globalisation's critics are motivated by a different understanding of how the world works as compared to the understanding globalisation's supporters have.

For most of this book, the author defines the "poor" as those whose income or standard of living is below what the society in which they live deems a minimum that all its members ought to have.[5] These standards vary widely across nations and the poorest in a rich country may be well-off from the perspective of an average person in lower-income countries. The author focuses on those whose resources are below country-specific poverty lines, rather than those below a global poverty line (such as $1 a day), because the latter poverty line suffers from serious conceptual and measurement problems.

The author also distinguishes here between absolute poverty and relative deprivation, or inequality. Inequality can rise, even as the numbers in absolute poverty decline. Understanding globalisation's effects on relative deprivation is important for understanding some of the obstacles to further integration, but the focus here is on how globalisation affects national poverty.[6]

2.1 Globalisation and Growth

The terms 'globalisation' and 'growth' lump together several different phenomena. Globalisation in its comprehensive sense includes capital market integration, goods and services market integration, migration agreements and cultural interchange, or some combination of all of these. This book refers to these separately. It similarly distinguishes between forms of growth in the discussion of theory, though the empirical section does not distinguish between steady state (long-run) growth, and growth during transitions to a steady state.

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5. Operationally, this social minimum is often identified with the value of a specific bundle of goods and services that can be obtained through home production, market purchases and public provisions. Defining a poverty bundle for individuals is difficult enough, but extending the definition to households with many members and differing age-sex compositions is fraught with additional difficulties. Valuation is also difficult: Deaton (2001), for example, shows that using a price index based on prices actually paid by households rather than an official consumer price index, 'reduces' the number of the poor (as measured by the proportion of the population consuming less than the poverty line) in urban India in 1999-2000 from around 254 million to 181 million.

6. More generally, however, the effects of poverty on human well-being include peoples' feelings of deprivation relative to those around them. Sen (1981, Chapter 2) discusses these and other concepts of poverty. Tinbergen (1971) long ago suggested that the intensity of peoples' feelings about what others around them are consuming as compared to their own consumption could affect their welfare.

2.1.1 Theory

There are essentially three sources of economic growth: growth in inputs of production; improvements in the efficiency of allocation of inputs across economic activities; and innovation that creates new products, new uses for existing products or brings about more efficient use of inputs. The combination of changes in these three dimensions that brings about higher long-run growth (as opposed to short-run transition effects) depends on the economy's characteristics. Whether or not a change in rate of accumulation of a factor of production or the efficiency of factor allocation, for example, has long-run or only transitional effects on growth depends in part on the technology of production. An exogenous change in the rate of investment or opening the economy to foreign trade has only a transitional effect on growth in a two-factor (capital and labour) constant-returns-to-scale growth model if the marginal product of capital declines to zero as capital increases indefinitely relative to labour. On the other hand, if the technology is such that the marginal product of capital is bounded away from zero, transitional as well as steady-state growth effects could arise from an exogenous change in investment or foreign trade policy (Srinivasan, 1995).

Being open to trade and investment contributes to each of the three sources of growth. Domestic resources are allocated more efficiently when the economy can specialise in those activities in which it has comparative advantage. By being open to capital, labour and other resource flows, an economy is able to augment relatively scarce domestic resources and use part of its abundant resources elsewhere, where they earn a higher return. Clearly, efficiency of resource use in each nation and across the world is enhanced by the freedom of movement of resources. Finally, the fruits of innovation anywhere in the world become available everywhere in such an open world. Empirical studies (e.g., Coe *et al.*, 1998) suggest total factor productivity (TFP) in poor countries, which do not have domestic R&D capacities, is higher when their trade with industrialised countries (who account for the bulk of R&D in the world) is greater.

Theory also suggests that globalisation and growth have a self-reinforcing relationship, in that higher growth spurs a larger volume of trade flows. While the decision to alter policies to further integration

is a policy change that harnesses trade as an "engine of growth", trade also serves as the "handmaiden of growth" once policies support freer interchange of goods and services.[7]

Dysfunctional domestic institutions, however, can offset the contributions of liberalisation to growth by limiting labour flexibility, segmenting internal markets and failing to provide the social infrastructure for education. The traditional argument about static factor price effects and gains from trade, for example, assumes that resources move smoothly and costlessly from import-competing to exporting activities. Obviously, if resources cannot or do not move (as is arguably the case in LDCs), exporting industries would not expand, while import-competing industries would still contract because of increased competition from imports after trade liberalisation, thus creating unemployment. This somewhat extreme but elementary argument has been raised by Stiglitz (2002: 59) against trade liberalisation, when he says that: "It is easy to destroy jobs, and this is often the immediate impact of trade liberalisation, as the inefficient industries [those created under protectionist walls] close down under pressure from international competition." Since he assumes that no new, more-efficient jobs would be created, he concludes that "moving resources from low-productivity uses [in inefficient industries] to zero productivity (to unemployment) does not enrich any country…." True, but neither does keeping factors in less productive uses forever.

A case can be made for developing countries credibly committing to phase in trade liberalisation over a period of time, while at the same time removing impediments to mobility of labour and other resources; such a case can certainly not be made for postponing liberalisation indefinitely, as is sometimes argued. Credibility of commitment of developing country members of the WTO would be considerably enhanced if they, instead of asking for a waiver from or for lower levels of commitment to reductions in trade barriers as compared to other members, commit themselves to the same levels of reduction, but ask for a longer, though definite, period for reaching these levels.

Globalisation's effect on short-term growth also depends upon the exact forms of globalisation and pre-existing market distortions. Removing

7. The phrases "engine of growth" and "handmaiden of growth" are associated with Dennis Robertson (1940) and Irwin Kraving (1970), respectively.

barriers and controls on financial capital flows, for example, may improve resource allocation and give more people access to better-functioning credit markets in the long run. In the short term, on the other hand, it can lead to crisis and lower growth in countries with fragile domestic financial sectors. Capital controls have been advocated by many in the wake of the Asian financial crisis, and some have found that controls were useful in helping some countries recover from adverse shocks faster than those that had freer capital movements.[8] The ongoing global crisis in financial and credit markets has reinforced these views. On the other hand, it could be argued that financial crises often arise not from free capital movements *per se*, but from such freedom co-existing with domestic institutional (particularily regulatory) failures. Capital controls, if they are effective and not evaded, could at best help in providing time for eliminating institutional failures through reforms.

To sum up, there is no reason to presume that the effects of globalisation on growth have to be the same everywhere and at all times, or even if they are similar, that they operate with the same intensity. This variation in country experiences is as important as the expected positive effect of globalisation on growth.

2.1.2 Empirical Evidence: Cross-Country Analyses[9]

Theoretical formulations of a trade-growth linkage are the foundations of the globalisation-growth links. Empirical demonstrations of the linkage go back to the careful and nuanced cross-country studies in the late 1960s and 1970s sponsored by the Organisation for Economic Co-operation and Development (OECD) (Little *et al.*, 1970), and the National Bureau of Economic Research (NBER) (Bhagwati, 1978; Krueger, 1978). More recent studies based on simple cross-country regressions such as Sachs and Warner (1995) and many, many more since then asserting the same linkage

8. Mussa (2000). See Kaplan and Rodrik (2001) on the second point.

9. The author will not discuss analysis of effects of trade liberalisation using simulations from partial and general equilibrium models. Hess and Cramon-Taubadel (2008) mention 1,200 studies of which they could include only 110 for their meta-analysis for various reasons. They are able to explain the enormous variation in simulated welfare changes from trade liberalisation through a meta-regression using variables that describe the liberalisation experiment, the characteristics of the model used and the database employed. They find that their estimates of quantitative impacts of liberalisation to be significant and to have plausible signs of magnitude.

have been controversial for good reasons (Rodrik, 2008), though often, though not always, the questions are more about the magnitude than the existence of the linkage between trade and growth.[10] Wacziarg and Welch (2002) find that Sachs and Warner's cross-sectional results are somewhat weaker when the sample period is extended through the 1990s. However, their estimates show that openness has positive effects on growth and investment rates within countries.

Nevertheless, the positive effect of trade and growth emerging from the earlier studies appears to be robust when carefully evaluated using more recent data. Dollar and Kraay (2000a) attempt to respond to some, though not all, of Rodriguez and Rodrik's econometric criticisms in evaluating the trade-growth linkage for countries—mostly developing countries—that liberalised after 1980.[11] They relate decadal changes in trade volumes (which they see as a better—though not perfect—proxy for changes in trade policy) and decadal changes in growth. Their focus on changes mitigates the effect of geography on growth (and trade) through channels other than trade policy, while their inclusion of 'time dummies' controls for shocks common to all countries included in their analysis. By focusing on within country changes in trade and growth, they find a strong positive relationship between the two, and no systematic relationship between changes in trade and changes in household income inequality.

Individual country experiences bear out these cross-country trends. China and India have enjoyed historically unprecedented average annual rates of growth of GDP since 1981, as the two countries engaged in opening their economies to foreign trade and investment. To be sure, the effect is not entirely attributable to 'globalisation,' as both countries also engaged in domestic economic reforms to varying degrees, allowing a greater role for markets and the private sector in the economy, but integration

10. Rodriguez and Rodrik (2000) are the most trenchant critics, though Warner (2002) refutes their critique. He essentially argues that their finding, that the effect of trade openness on growth is not statistically robust, is due to the fact that the forms of protectionism vary across countries, so that any single indicator of openness will not describe the effective level of integration for all countries.

11. Whether or not a country is defined as a 'globaliser' is based on the decline in trade-weighted average tariffs and the increase in constant price value of trade (exports plus imports) relative to real GDP. Among the top 40 countries, according to each of these two criteria, 16 (including Brazil, China and India) appear on top in both. Unsurprisingly, none of the African countries is among them, though Ghana and Uganda, two African economies that came closest to their threshold, were included in the analysis.

no doubt played a large role. Growth rates not only accelerated, but the proportion of their populations below national poverty lines declined with the acceleration. Their growth rates and poverty ratios since 1980 are shown in Tables 2.1 and 2.2.

Table 2.1

Growth Rates for China and India

	China	*India*
1980-1990	10.3	6.1
1990-2000	10.6	5.9
2000-2006	9.8	7.4

Source: World Bank (2005, 2008, Table 4.1).

Table 2.2

Poverty Ratios for China and India (per cent)

China (rural)		*India*	
1978	30.7	1977-78	51.3
1990	9.5	1983	44.5
1998	5.0	1987- 88	38.9
		2004- 05	27.5

Source: China: Park and Wang (2001); India: Datt (1998, 1999), Government of India (2007).

2.2 Growth and Poverty Reduction

Aggregate growth is undoubtedly an instrument for poverty reduction, and it is associated with improvements in the minimum standard of living over some time horizon. The estimates of Besley and Burgess (2003) for the elasticity of poverty[12] with respect to income per capita vary widely across country samples, but all are negative, implying that growth reduces poverty. This association between growth and poverty reduction, however, could take a long time to be seen.

Inequality, which is different conceptually and empirically and measured in different ways, need not necessarily decline with faster growth. Although the poor may be becoming better off over time, the rich

12. There are analytical and empirical problems in estimating and using the elasticity of poverty—see Subsection 2.4.

could gain even more. There are many possible mechanisms through which aggregate growth could affect, positively or negatively, poverty at national or sub-national levels on the one hand, and on the other, how levels and trends in poverty could influence growth, again in either direction. The basic mechanisms behind growth and poverty reduction do not fully overlap, and some policies meant to encourage growth will have little or a negative effect on the poor in the short run. These lags can affect the political feasibility of reforms.

It is clear, however, that poverty reduction requires growth, particularly in lower-income countries. The available resources may not, in some cases, provide adequately for all, no matter how the country's income is distributed. An early blueprint for development in India, put together in the late 1930s by a National Planning Committee of the Indian National Congress under the chairmanship of the future Prime Minister Jawaharlal Nehru, for example, clearly recognised the instrumental role of growth for poverty reduction and specifically estimated the extent of growth necessary to meet a minimum standard of living for all. Indian policy-makers were by no means unique in seeing rapid income growth as the major instrument for poverty reduction—statements similar to those of the Indians could be found in development plans of many other countries.

A positive association between growth and reduction in poverty is seen in several large countries with a high incidence of income poverty, such as China, India, Indonesia (until the financial crisis) and the Philippines. Angus Deaton (2001) estimated the proportion of poor in India's rural (urban) population in 1987-88 to have been 39 per cent (25 per cent). Annual data for earlier years suggests that the rural and urban poverty proportion fluctuated with no downward trend until 1977-78, when it was 51 per cent. It is no coincidence that significant reductions in poverty since 1980 were associated with a near tripling of per capita GDP growth to an average of around 4 per cent per year during 1980-1990, as compared to 1.25 per cent during 1950-1980, and even higher since 2000. Latest official estimates of poverty in 2004-05 are 28 per cent in rural and 26 per cent in urban India. According to Park and Wang (2001), official data for China show that rural poverty has been virtually eliminated in China—falling from 31 per cent of rural population in 1979 to 10 per cent in 1990, and further to 5 per cent in 1998.

A few small sub-Saharan African countries, such as Botswana, Lesotho and Mauritius, also enjoyed high growth resulting in a reduction in those nations' poverty. The association with income growth of non-income facets of poverty (caution: association should not be confused with causation) is also evident (Table 2.3): there has been a general improvement of life expectancy, rates of infant and child mortality, educational attainments and so on, although some of the gains achieved are being threatened by the AIDS epidemic in some countries of sub-Saharan Africa and Asia. Also, developing countries experienced significant growth only during the 1990s, a time period too short to see significant reductions in poverty.

Table 2.3

Development Outcomes in the 1980s and 1990s, by Growth Class (Unweighted Means)

			High Growth	*Moderate or Improved Growth*	*Low Growth*
Poverty	Per cent with less than $1 a day	1990s	24.1	31.4	36.9
		1980s	31.0	32.1	30.2
Infant mortality	Per thousand	1990s	29.2	54.3	60.7
		1980s	41.0	66.6	71.0
Illiteracy	Per cent	1990s	17.2	31.2	31.4
		1980s	22.9	37.6	38.8
Life expectancy	Years	1990s	70.0	62.9	59.8
		1980s	66.8	60.6	58.4
Carbon dioxide emissions	Tonnes per capita	1990s	2.4	2.3	1.7
		1980s	1.5	2.3	1.8
Deforestation	Per cent per year	1990-95	0.83	1.05	1.11
		1980-85	1.08	0.65	1.15
Water pollution	Kilograms per day per worker	1990s	0.16	0.21	0.21
		1980s	0.18	0.21	0.21
GDP growth	Per cent per year	1990s	5.3	4.2	0.3
		1980s	6.5	2.3	2.1
Number of countries			13	53	39

Source: World Bank (2000, Table 1.2).

While these specific cases suggest that growth reduces poverty, systematic statistical results are limited.[13] Dollar and Kraay (2000b) is

13. Since there are too few observations to do an econometric analysis of the growth-poverty-reduction experience over time of individual countries, cross-country regressions are the only option.

perhaps the most careful (econometrically) study.[14] They define the poor as "the bottom one fifth of the population" so that poverty goes down from their perspective if and only if the mean real income of the bottom 20 per cent goes up.[15] Their data on incomes of the poor and mean incomes relate to 80 countries covering four decades, providing 236 episodes for evaluating the link between aggregate income growth and poverty reduction. They estimate variants of a basic regression of the logarithm of per capita income of the poor on the logarithm of average per capita income, control variables and a country fixed effect.[16]

Their results suggest that, notwithstanding the variation around the estimated relationship, the positive effect of growth on incomes of the poor is the same in rich and poor countries. Other findings include that: the incomes of the poor do not fall more than proportionately during economic crises; the poverty-growth relationship has been stable in recent years; policies that promote overall growth also benefit the poor; good rule of law and fiscal discipline benefit the poor as much as the rest of the population; and inflation is more harmful to the poor than for others. Finally, they find no evidence that formal democratic institutions, as well as public spending on health and education, have systemic effects on the poor.

2.3 Growth and Inequality

The lags between sustained acceleration in growth and poverty reduction can create political problems, for the reason that horizons of politicians are almost surely shorter than the lags. Policy-makers in India, for example, a country whose development plans explicitly stated that efforts to increase growth were essential instruments for its goals of reducing poverty, debated the extent to which the poor benefited from growth. As early as in 1960, at the end of the Second Five-Year Plan, the question of whether growth

14. They allow for measurement errors and endogenously of control variables as well as for the omission of possibly relevant control variables. They also test for over-identifying restrictions.

15. This relative definition of poverty precludes any simple comparison of their results with those of other studies using an absolute definition based on national or international (e.g., $1 a day) poverty lines.

16. Their control variables include proxies for openness, capital account restrictions, rule of law, democratic institutions, inflation rate, government consumption and expenditures on social sectors as a proportion of total government spending, and primary school enrolment.

of the previous decade had improved the lives of the poor was raised by a skeptical socialist member in the parliament.[17]

Rising inequality can also accompany periods of growth. In contrast to trends in indicators of absolute poverty, those relating to measures of inequality are ambiguous. The data from China and India, for example, suggest that, although poverty at the national level decreased during the period of their globalisation and growth, not all of the regions or groups grew at the same rate, nor did they experience poverty reduction to the same extent. This is not surprising, since a change that raises everyone's income and reduces the proportion of the poor in a population, could nonetheless increase inequality if the rise in income accrues first to those with the higher skills and resource bases, which allow them to take advantage of the change.

There is some evidence that regional disparities widened in China and India as these nations liberalised their foreign trade and introduced other reforms. To a certain extent this is natural: those regions (and individuals) that are better placed initially to take advantage of the opportunities opened up by reforms or, for that matter, by any other factor, such as, for example, the information-technology revolution, are likely to grow faster (and richer). For example, India's phenomenal success in software was, until recently, confined to a few cities in the south and west. The real issue is not one of increasing regional disparities and even disparities between households and individuals, but whether the socio-economic system would enable the initially disadvantaged regions and individuals to catch up. If it does not, the social and political consequences could be serious and could lead to serious domestic conflicts. A participatory democractic political system and a transparent governance structure free from corruption will contribute to a peaceful resolution of emerging disparities.

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17. Prime Minister Nehru responded to this question in introducing the Third Five-Year Plan in Parliament and said:

> Again it is said that the national incomes over the First and Second Plans have gone up by 42 per cent and per capita income by 20 per cent. Now a legitimate query is made—where has this gone? To some extent, of course, you can see where it has gone. I sometimes do address a large gathering in the villages, and I can see that they are better fed and better clothed, they build brick houses and they are generally better off. Nevertheless, that does not apply to everybody in India (Government of India, 1964, p.1).

Nehru followed up his response by appointing a committee to enquire into the distribution of income and standards of living.

Whether widening disparities are temporary and would be reversed, or are permanent and entrenched is an interesting and important issue. At the aggregate level, one approach to this issue is to ask: do regions converge over time to the same level and rate of growth per capita income in the long run, without conditioning on any characteristics of the regions other than their initially different levels of income? This is the so-called 'absolute' convergence hypothesis. It is to be contrasted with the 'conditional' convergence hypothesis, which suggests that each region converges to its own steady state or long-run level and growth of per capita income, which, in turn, depends on the region's characteristics such as its savings rate, rate of labour-force growth and the rate of exogenous technical progress and initial levels of human capital. Under either hypothesis, a region further from its steady state grows faster than when it is closer to that state.

There is a growing literature on testing the hypotheses of absolute and conditional convergence in both China and India. Demurger *et al.* (2002) and Dayal-Gulati and Husain (2002) find support only for conditional convergence in China. In India, Cashin and Sahay (1996, 1997) found evidence of absolute convergence. Rao and Sen (1997) suggest that, in fact, the findings of Cashin and Sahay should be interpreted as supporting conditional convergence. Clearly, a finding of conditional convergence, since it is consistent with regions growing at different rates in the long run, could mean growing disparities across regions. Coupled with the fact that the incidence of poverty is higher and the share of the country's population larger in the latter states, there has been legitimate concern that if sustained in the future, these growth disparities will threaten the stability of India's federal democracy.

2.4 Globalisation and Poverty Reduction

Some individuals or groups in a society may be poor and remain poor because they are disadvantaged in the social and political processes of their society. Social institutions such as the caste system in India or forms of racism elsewhere have denied equal access to socio-political processes to lower castes and racial minorities. Using economic policy instruments for addressing social and political problems is unlikely to be efficient and in cases where the instruments conflict with incentives at the level of individuals or social groups, could even be counterproductive. The economic

mechanisms for alleviating poverty could be divided into two broad categories: increasing the resources held by the poor through redistribution, and affecting the economic environment that perpetuates poverty. This book focuses primarily on several ways in which globalisation affects the latter category, as these economic changes have far deeper impacts on reducing poverty over the long run.[18] While critics focus on globalisation's sometimes negative effects on redistribution, they overlook its potential to reduce economic constraints that continue to limit the prospects of the poor.[19] Market integration and increased migration could limit the extent of poverty-alleviating redistribution in several ways, but their effect on removing the market distortions that perpetuate poverty over the long run far outweighs the consequences (that market integration and migration may have). Their advantage as mechanisms for poverty reduction is that they do not disrupt, but rather shift the existing equilibrium.

In the developing world, market distortions are ubiquitous, and their impact on the extent and depth of poverty is often serious. Whether an individual (or a household) has adequate resources to purchase the poverty bundle of goods and services at the relevant prices at a point in time depends, of course, on what she or he (or her/his household) can earn from her/his assets (land, financial and physical capital) and most importantly from her/his (allowing for skills and educational attainments) labour. The functioning of asset and labour markets, as well as product markets for goods and services bought or sold, obviously influences the earnings from assets and their purchasing power.[20] From this perspective, the central issue is not simply to alleviate poverty with transfers, but to eradicate it by tackling the more difficult issue of lifting the poor above poverty permanently—that is, by removing obstacles the poor face in trading, saving and investing in their assets for a higher standard of living.

Critics of globalisation point to some forms of exploitation of workers in developing countries, such as the frequent use of child

18. Besley and Burgess (2003) discuss the poverty-reduction benefits of a similar set of policies, though they do not address the link with globalisation.

19. Critics often associate globalisation with a reduction in the state's ability to redistribute income. This point is discussed further in the next subsection.

20. Clearly, if there are no distortions in all these markets and all individuals and households face the same prices, the extent of poverty would be determined by the distribution of assets and labour in the economy.

labour, the damage that a rapid exposure to global agricultural markets can cause for developing-country farmers and other aspects of the increasingly-integrated global economy. However, these are not intrinsic or permanent consequences of globalisation. They often reflect, rather, domestic institutional policy failures in poor and rich countries and continued industrial-country protectionism with the respect to imports of labour-intensive manufactures from developing countries and, above all, in agriculture. A backlash against off-shoring to developing countries is another major political obstacle. Even in the absence of policy failures, the fact is that the most powerful forces for alleviation of poverty take time to work.

2.4.1 Country Studies

A very recent study of 13 (8 Asian and 5 African) individual country experiences with trade-development-poverty linkages is that of the Consumer Unity & Trust Society (CUTS, 2008). The introductory chapter of the study states that the project "was intended to study the country cases closely to understand the nature and dynamics involving trade and poverty linkages…The project has examined the overall country experiences as well as experiences associated with two chosen sectors within each country" (p.1). Interestingly, the countries included large ones (China and India), small ones (Sri Lanka, Nepal and Zambia), landlocked ones (Nepal, Uganda and Zambia) and an island country (Sri Lanka). Six of them were least-developed countries (Bangladesh, Cambodia, Nepal, Tanzania, Uganda and Zambia). The remaining seven were China, India, Kenya, Pakistan, South Africa, Sri Lanka and Vietnam. The whole of South Asia (except Bhutan and Maldives), accounting for an overwhelming majority of the world's poor, was covered. South Asia is the region in the developing world that is least integrated with the world economy. Thus, the range of countries covered included some of the most relevant ones for studying trade and poverty linkages.

The introductory chapter of the CUTS study also reports some cross-country regressions relating to developing countries in general, and also to the 13 project countries. Since the author is skeptical of the usefulness of such regressions for drawing policy lessons, he will not comment on them. The study estimates what it calls the 'growth elasticity of poverty'

in the 13 countries and found it ranged from negative values for Kenya and Pakistan (i.e., the poverty situation has deteriorated in these countries, even though there was positive rate of GDP growth in the 1990s), zero in South Africa (no change in the poverty situation) and positive values for the rest, with India estimated to have the highest elasticity 0.8, implying that a 1 per cent annual growth in GDP is associated with a 0.8 per cent decline in poverty ratio. The data for India covered the decade ending in 1990-2000. As pointed out earlier, the relatively low poverty ratio for 1999-2000 is not comparable to that of other years and could have influenced the high elasticity estimate.

Leaving aside the measurement biases and errors in both poverty and growth data, there is an analytical and empirical problem with the use of growth elasticities. Simply put, both the observed growth and poverty outcomes are endogenous joint outcomes of exogenous and endogenous determinants, most importantly policies (including, in particular, trade, investment, labour-market and other policies). Relating one endogenous outcome, namely, poverty ratio to another endogenous outcome, namely, growth, to derive the elasticity of one with respect to the other is conceptually flawed. Its empirical magnitude tells us nothing about the operation of the relevant policies that influence both variables. This dubious elasticity concept is widely used, including in Besley and Burgess (2003), discussed in Subsection 2.2.

The main lessons learned from the project are reported to be:

(i) Countries (e.g., China and Vietnam) that have undertaken domestic reforms have succeeded most in poverty reduction. It is arguable, however, whether adoption of domestic reforms and the effectiveness of their implementation can be equated, as the study does, with 'country ownership' of policy regimes, an amorphous catch-all phrase that is bandied about in the literature. In any case, it does not follow directly from the analysis. However, the study is almost surely right in concluding that poverty reduction strategies that "in the first place were developed to secure financial support from the donors, greatly undermine the point of any home-grown initiative". This conclusion is particularily relevant, given that Poverty Reduction Strategy Papers (PRSPs) are now being pushed as prerequisites for funding from the IMF and the World Bank.

(ii) There is overwhelming evidence to suggest that export response to trade liberalisation is weak. This should not surprise anyone. Obviously, the exports of a country represent the difference between its domestic supply and domestic demand. For most of the products exported by the project countries, their exports constitute a very small fraction of world imports and, as such, lack of world import demand at world prices is most unlikely to be a constraint on exports. Trade liberalisation, by reducing distortions in the prices realised by exporters at the country's border, to the extent it raises domestic prices of exportables, influences their domestic supply and domestic demand. However, if either changes in border prices are not passed through to domestic prices, or the non-price factors that influence domestic supply are dominant, or both, then the supply response to price increases will be limited, at least in the short term when the non-price supply constraints cannot be relaxed significantly. This is a well-known phenomenon. Nonetheless, the lesson from it is not that trade liberalisation is ineffective, but only that non-price domestic supply constraints have to be addressed for its full effectiveness to operate.

(iii) A predictable and altogether unsurprising finding is that countries which had less unequal distribution of the relevant resource endowments (e.g., land, and human and physical capital) also did better in reducing poverty. In some project countries (e.g., China and Vietnam), the better endowment distribution was achieved through domestic reforms: the abolition of collectives and the introduction of the household-responsibility system in China, and property rights reforms in agriculture in Vietnam. It could be argued that these two countries, with authoritarian communist parties in charge, are exceptions and that it is rare to find drastic redistribution of land and other assets through the non-revolutionary peaceful means of enacting laws and implementing them effectively. Be that as it may, almost surely the potential for reform of access to, if not ownership of, relevant endowments is substantial in other project countries, such as Bangladesh, India and South Africa.

(iv) The study characterises trade-reform measures, such as tariff reductions and simplification of tariff structures, removal of

quantitative restrictions, liberalisation of exchange-rate regimes and export-promotion measures, as 'easy' reforms. The reform of domestic institutions needed to reap the full benefits from 'easy' reforms are deemed 'difficult'. Perhaps a more useful and general characterisation would distinguish between 'enabling policy reforms' and 'institutional reforms', to highlight the fact that the former enable beneficial outcomes to be realised, while the latter ensure that they are in fact realised. However, why some, if not all, of the latter are more difficult to implement than the former cannot be understood without analysing the domestic political economy. The study does not go into political economy issues in any depth.

(v) The finding that there is no systematic relation between the level of tariff protection and growth is not at all surprising. In general, tariff is one, and not the only, measure for protection of domestic production. When more than one protection measure, such as tariff and an import quota, is being used simultaneously, the tariff level need not be the binding constraint on the quantity of imports. As the choice of protectionism measures used could and often does vary across countries and over time, there is no reason to presume any systematic relationship between tariffs, imports and growth in the first place.

(vi) The last, again unsurprising, finding is on the role of the agricultural sector in poverty reduction. In many of the project countries, a large majority of the poor happen to be rural residents, dependent on agriculture and primary activities for their earnings, either as wage-workers or as self-employed. It is a fact that the import-substituting industrialisation strategy, implemented in South Aisa for example, by insulating producers from domestic and import competition through trade and domestic policies until the 1980s, discriminated against agriculture in general and agricultural exports in particular. Trade liberalisation, by removing one source of discrimination, could be expected to contribute towards raising agricultural output and exports. However, if the reform of other relevant domestic policies, as well as of institutions relating to land and labour markets, is either not undertaken at all or does not go far enough if undertaken, the effects of trade liberalisation would be clearly limited. This is

> what the study finds. In particular, the reform of labour-market and other policies that favour capital-intensive industries are slow to be implemented. The traditional mechanism for lifting millions of poor employed in agriculture and other primary activities in rural areas out of poverty and into gainful employment in more productive off-farm employment, operates through expansion of labour-intensive manufacturing for supplying domestic and foreign markets. This mechanism was prevented from operating by domestic policies of encouraging urban capital-intensive industries. This is what happened in most of the project countries, except for in China and Vietnam.

It seems evident that the 13 country case studies confirm that the constraints on acceleration of growth and reduction of poverty are primarily domestic and involve domestic political enomony. This is not to minimise in any way the importance of a development-friendly regime for external trade, finance, capital and technology flows and migration. The proposals in the CUTS (2008) study on priorities for further domestic reforms (particularily institutional reforms) and reforms of the global trading and financial system in a development-friendly direction are appropriate.

2.4.2 Redistribution

Critics of globalisation generally point to a decline in state spending on price supports and services for the poor as countries become more internationally integrated. Clearly in a globalised economy subject to the discipline of international capital markets, fiscal deficits are not sustainable, and taxation of mobile factors will induce their flight. On the other hand, the fact that in most developing countries the tax base is often narrow and the tax structure is likely to be dominated by taxes that are easier to collect, such as import tariffs, not only makes trade liberalisation but also fiscal correction, difficult political issues. Again, if the growth-accelerating effects of globalisation are strong, the revenue expansion (with a buoyant fiscal system) from growth would enable financing of the necessary services for the poor and avoidance of taxing mobile factors. However, buoyancy of the fiscal system depends in large part on domestic factors including, importantly, tax compliance.

Increased flow of immigrants is often thought to reduce domestic demand for redistribution, as the original non-immigrant population may not want to finance services for new immigrants to their country. The rise of nationalist parties, as well as anti-immigrant violence in several industrial countries, reinforces this perception. Razin (2002) shows that immigration generally moves the political voting equilibrium toward less redistribution, unless the new migrants join forces with existing low-income voters in their destination country. Be that as it may, the fact remains that trade in services through temporary migration (or the movement of 'natural persons' in the terminology of the General Agreement on Trade in Services [GATS] of the Uruguay Round), is still not liberal. Whether the Doha Round, if it resumes, will liberalise such migration significantly remains to be seen. From the perspective of developing countries, further liberalisation is absolutely essential.

The ramifications of less redistribution for poverty, however, are small relative to potential gains in other areas. Government-led redistribution is one of the more direct, but generally less effective, means of reducing poverty in the long run. It has limited effectiveness as a means of affecting the resources that poor households command. It will reduce poverty in the short-run if individuals are poor, because the assets they own are meagre. Unless redistribution of income is sustained indefinitely, its poverty-reduction effect will be temporary if the conventional belief that the marginal propensity to consume of the poor is close to unity is correct. On the other hand, if credit markets are absent so that investment is constrained by resources owned and marginal returns to investment diminish, the rich would have a lower marginal return to investment than the poor if assets are unequally distributed. A redistribution of resources to the poor from the rich would raise the average rate of return to investment, and hence the rate of growth of the economy.[21]

Subsidy policies may not even achieve the short-term goals of providing more resources to the poor, as subsidies are seldom targeted at the poor and there is hijacking of subsidies intended for the poor by the non-poor. The cost of transferring a dollar to the poor through subsidy schemes (particularly poorly-targeted ones) often exceeds that dollar by a

21. For surveys of relevant analytical and policy issues, see Aghion *et al.* (1999) and Bénabou (1996).

substantial margin. The Indian public distribution system (PDS), through which fixed amounts per person of foodgrains and a few other essential commodities are sold at subsidised prices, for example, has a negligible impact on rural poverty and the Central government alone spends four rupees to transfer one rupee worth of resources to the poor.[22]

2.4.3 Raising the Productivity of the Poor

Lessening market distortions, in contrast, has a dynamic effect in that it not only increases the value of present resources, but encourages greater investment and future accumulation. The chief asset of the poor is their labour. Raising productivity to create a sustained increase in real returns to labour in wage and self-employment would contribute significantly to poverty alleviation. Domestic public policy has a large role to play: increasing the human capital endowments of the poor—perhaps by providing incentives for private investment in human capital or through public expenditure on, and improving the access of the poor to, public education and health-care programmes—raises the productivity of their labour.

Globalisation also contributes to this goal in several ways. First, the growth associated with globalisation will generally create an outward shift in the domestic demand for wage labour and for goods and services produced by the self-employed. Second, returns to the abundant factor, which in most poor countries is unskilled labour, will rise with trade liberalisation, both in developing and developed countries.[23] Multinational companies naturally take advantage of a less-developed country's abundance of unskilled workers at a wage less than what they would have to pay similar workers in their home countries. However, the more relevant comparison is that these wages are often higher than the wages paid by domestic companies in the host countries. Third, more integrated labour markets are important to ensure that workers receive the best return for

22. Rao and Radhakrishna (1997) analysed India's PDS from the national and international perspective. They found that in 1986-87, PDS and other consumer-subsidy programmes accounted for only about 3 per cent of the per capita expenditure of the poor, and their impact on poverty and the nutritional status of the poor was minimal.

23. There are, empirically, important exceptions to this general theoretical expectation: Harrison and Hanson (1999) present evidence that trade openness in several Latin American and Asian countries has been associated with an increased return to skilled labour relative to unskilled labour.

their work.[24] This last aspect of globalisation has not yet been realised, in fact, leaving aside global integration, even national integration of markets for goods, services and labour is still limited by poor infrastructure, explicit restriction on labour movement (as in China) and dysfunctional labour laws, as well as by linguistic differences across regions in India. Unlike commodities, the cost of whose movement within and between countries is primarily determined by costs of transportation and insurance, the cost of mobility of labour involves difficult-to-remove social and legal barriers, as well as economic ones.

2.4.4 Opportunities for and Returns from Accumulation of Physical and Human Capital

Globalisation can also benefit the poor by creating strong competitive pressures for improved financial intermediation. More efficient financial intermediation would have large and long-term benefits for the poor, by facilitating their investment in both physical and human capital. Although this is again partly a matter for domestic policy-makers, international capital market integration may provide an added incentive to move financial sector reforms faster. Banks facing international competition in their traditional markets may be faster to move into micro-lending or services for small depositors. Similarly, the competition for investment under globalisation encourages governments to focus more closely on providing better opportunities for investment in human capital.

The share of savings used to finance direct investment in physical assets depends in large part on the functioning of the financial system and access to it, which together influence the cost of financial intermediation. The costs faced by the poor are high, and a large share of savings and investment by households in developing countries is currently in the form of physical assets, which they finance on their own without involving formal financial intermediaries. This share could be as high as 80 per cent, as in Ghana, or around 50 per cent, as in India. These assets include

24. Wage labour market policies are obviously not a solution for all poverty. Only a small part of the labour force in many developing countries (less than 20 per cent in India and South Asia, for example) is in formal wage and salary employment. An overwhelming majority of the labour force is in self-employment (often in subsistence farming, in handicraft activities and household-based production for local markets). For them, it is not so much the functioning of labour markets, but that of product and credit markets that could be more relevant.

mostly those related to their production activities and also dual-use (i.e., production and consumption) assets.

Even though the poor do not save enough to invest in financial markets (particularly in equity markets), they do invest their meagre financial savings in the form of deposits in commercial banks, purchase of life insurance policies and also lending in informal credit markets. Clearly, the returns they realise on such investments depend on the functioning of the financial sector, including the banking system.

The more important effect of improved financial intermediation—via domestic policy changes or spurred by international competition—would be in providing greater opportunities for financing education. Just as labour is the major asset owned by the poor, it is investment in accumulation of human capital that is likely to be the major component of their investment. Although poverty limits the poor's saving and investment in any form, it is particularly limiting when it comes to human capital accumulation. Indeed, a major reason that the incidence of child labour is so high in many poor countries of South Asia and sub-Saharan Africa is the poverty of the parents of working children. Such parents cannot afford to forego the income from the work of a child (directly from paid work or indirectly in terms of unpaid contributions to the household's farm or non-farm enterprise). The out-of-pocket costs to the parents of sending their children to school are often substantial.[25]

Lack of investment in education has three serious consequences. First, the earning prospects of uneducated (or less-educated) children in their adult working life would be less compared to their competitors in labour markets. Second, unless labour-market conditions improve in their adult life as compared to those that prevailed in their childhood, they are likely to end up as poor as their parents were and, as such, unlikely to educate their own children. The prospect of perpetuation of poverty across generations in such circumstances cannot be ruled out. Third, since some minimal education is often needed for an individual to participate effectively in political and social processes that make decisions affecting

25. National and international attempts to eradicate child labour, through restrictions on imports or consumer boycotts of goods produced by children, are not likely to succeed unless the basic cause of child labour, namely the poverty of parents, is addressed.

his/her social and economic prospects, these individuals may be in effect unable to exercise their right to participate.

Some of the serious constraints on the accumulation of human capital through education, as well as job experience, are domestic. As the evidence from South Asia and also other countries amply domonstrates, the delivery of educational as well as health services through the public sector has been both inadequate and deficient in quality. The ailments of the system have been well documented in the literature. Yet the response has often been to attempt to raise public expenditures on education and health, rather than address deeper problems of delivery. In addition, the allocation of resources within the education sector among primary, secondary and tertiary levels, and in the health sector between curative and preventative, is unbalanced. Meanwhile, in some of the larger countries discouragement of labour-intensive manufacturing through domestic and trade policies (at least until the 1980s) has precluded growth of productivity through on-the-job learning.

Apart from its beneficial effect on investment in human capital through improved financial intermediation, globalisation has a direct effect on the demand for skilled labour in poor countries through off-shoring by industrialised countries of manufacturing activities (a practice that has been going on for a long time), and of some service activities more recently. Already, China and India have benefited from this. However, there is a protectionist backlash in the United States against off-shoring. The ongoing presidential campaign in the US is discouraging in that, no matter who wins, the new president appears most likely to cave in to opposition to further trade liberisation, as well as off-shoring. One glimmer of hope is a recent statement attributed to Mr. Barack Obama, the nominee of the Democratic Party for the office of the president, that "Revolutions in communications and technology have sent jobs wherever there's an Internet connection, that have forced children in Raleigh and Boston to compete for those jobs with children in Bangalore and Beijing... We live in a more competitive world, and that is a fact that cannot be reversed." He concluded that America's challenges on the economic front cannot be overcome by building "protectionist walls", and the country needed to focus on improving the situation of the middle class and investing in education.

(See: *http://www.thehindu.com/2008/06/12/stories/2008061260791300.htm,* accessed 29 July 2008).

2.4.5 Product Market Efficiency

Product market efficiency, affected by domestic policies as well as international integration, determines the 'terms of trade' the poor face in attempting to exchange their production for consumption and investment. Needless to say, the extent of integration of national markets and also the competitiveness of exports in world markets depends in large part on whether or not transport and communications infrastructure exists, and functions efficiently, to minimise costs of transportation and of acquiring market intelligence. Insufficient integration would mean the existence of price differentials across markets that cannot be arbitraged away. Also, given the uncertainties, not only about harvests, but also about the prices that will rule at harvest time or at any time thereafter when the harvested output is to be sold, it is important whether national markets for forward transactions exist and how costly it is to store commodities for later sale.

Globalisation could have a particularly significant impact on poverty by affecting the prices farmers in developing countries receive for their products and pay for inputs. There are currently two obstacles: lack of competition among intermediaries who aggregate primary products for international trading; and continued industrial-country subsidies and protection for their farmers.[26]

2.4.6 Economic Institutions

Globalisation can be helpful in mitigating, or even overcoming, the institutional and market failures that affect the poor adversely. Below are a few examples.

Governance quality. Tackling corruption is a major challenge of governance in developing countries, as processes of adoption, enforcement and effectiveness of policy interventions are often distorted by endemic corruption. Inefficient and corrupt bureaucracies raise transactions costs in asset markets that are important for the poor. Land and tenancy markets, for example, have higher transactions costs than other asset markets,

26. See McMillan *et al.* (2002) on how domestic-market imperfections limited farmers' benefits from liberalisation of the cashew sector in Mozambique.

because of the difficulty in establishing a claim of ownership in land when records are poorly maintained and officials with authority to certify ownership are corrupt. This is a phenomenon that has been around for ages. The *Arthashastra*, a Sanskrit treatise on statecraft dated to fourth century BC, India (Kangle, 1972), not only lists more than 50 ways in which officials could be corrupt, but also advises the King to pay officials adequately for inducing them to be less corrupt.[27]

Any extra impetus that globalisation provides toward more transparent institutions will contribute to poverty reduction. The prospect of losing out in the race to attract international capital flows, for example, can act as an important impetus to curb corruption. Wei (2000a) finds that corruption's effects on international investment are as if governments were imposing a tax—investors are significantly less likely to invest in more corrupt countries. The direction of causation between corruption and globalisation, however, is likely to go in the opposite direction for trade: corrupt bureaucrats' bribes act as tariffs limiting imports and exports (Wei, 2000b).

Insurance and credit. Limited access to domestic credit and insurance markets exposes the poor to substantial uncertainty and potentially to consumption volatility. Domestic financial markets in many developing countries are simply not efficient enough to find it worthwhile to extend services to the poor, because it is costly relative to returns to provide small loans to many poor people in contrast to providing large loans to a few rich ones. As mentioned previously, globalisation can create an impetus to improve financial markets and offer such credit and insurance opportunities to the poor.

In addition to being dependent on agriculture, the rural poor also have to cope with uncertainties, some of which relate to the environment for production and consumption (e.g., weather or disease vectors) and others that are idiosyncratic (e.g., health and mortality shocks to humans and livestock). Further, the agricultural production process is one in which inputs have to be committed in advance of the realisation of an uncertain

27. On the other hand, China, a country in which corruption is thriving, has attracted large flows of investment, particularly from overseas Chinese, who apparently are better at operating in a corrupt system! Corrupt practices by trans-national enterprises, often with the connivance of the governments in countries of their origin, have received attention in the literature.

harvest, while the process of consumption is more certain and evenly paced over time. In an economy that is closed to international agricultural commodity markets, particularly to futures markets, (domestic and international) shocks to domestic output and demand have to be absorbed through price changes in spot markets, thus making prices more volatile. To the extent such shocks are not highly correlated across economies, world output and consumption would be more stable than their domestic counterparts, thus making world prices less volatile than domestic prices. Thus, integration with world markets, leaving aside concerns (often ill-informed and exaggerated) about speculation, would in effect provide insurance against the price effects of domestic shocks, though not necessarily against their income effects.

It is clear that, even if production and consumption processes were to be free of any risk and uncertainty, still the lack of synchronisation between the two would require some means for smoothing consumption over time. It is also clear that achieving such smoothing would be less expensive, compared to each individual holding inventories of inputs and consumption goods, if access to smoothly and efficiently functioning credit markets is available. The need for credit is enhanced also if purchased inputs (e.g., fertilisers and pesticides, energy and fuels, hired labour, etc.) account for a large share of production costs, as in the case of the cultivation of the so-called 'Green Revolution' varieties of crops. With well-functioning insurance markets, insurable risks would be addressed. However, uninsurable (or, more precisely, insurable only at a high cost) risks are also significant in rural areas of poor countries.

For well-known and well-understood reasons of moral hazard, absence of collateralisable assets, and poorly-functioning legal systems for enforcement of contracts and the seizing and sale of whatever collateral that has been pledged, formal credit and insurance markets in poor countries are either virtually absent or costly, if not altogether out of reach, of the poor. On the other hand, informal arrangements substitute in part for transactions in formal markets (Townsend, 1994; Udry, 1993). However, the cost of informal transactions is not necessarily low and, in any case, informal arrangements are nowhere near adequate to substitute fully for the incomplete and imperfect functioning of credit and insurance markets. The growth of micro-finance institutions, following

the pioneering Grameen Bank in Bangladesh established by the visionary Nobel Laureate, Muhammad Yunus, and their role in providing access to credit for the poor, particularly women, and other self-help groups through innovative lending, has helped fill the absence of credit from commercial banks and other formal institutions. However, whether micro-credit is cost-effective is yet to be settled.

Providing insurance against damages from natural disasters and catastrophies is a challenging task for several reasons. Some or all the catastrophies are very low probability events, but with severe damages when they do occur. Others are of greater signficance for a few countries with small populations such as many small island developing states, so that the market for such insurance is likely to be small. Recently, in his address to a meeting of Pacific Island developing states in Bangkok on 23 April 2008, the UN High Representive for LDCs, LLDCs and SIDS, Mr. Cheick Sidi Diarra, called for an insurance scheme to aid SIDS in times of a natural catastrophy. Mr. Diarra did not himself offer any specific proposals. Whether or not a cost-effective and feasible scheme could be developed and, if developed, whether a large enough market would emerge for such a scheme, are open questions.

2.5 Globalisation for the Poor

The globalisation discussed in the last section looks substantially different to the partially-integrated goods, capital and factor markets that we have today. The most notable departures, and those with the largest negative effects on the poor, are continued industrial-country protection of agricultural and other markets and restrictions on legal migration. For example, Porto (2003) estimates that tariff reforms in industrial countries leading to a 15 per cent price increase in world prices of Argentina's agricultural exports would lead to a 2.5 percentage point decrease in the proportion of Argentines in poverty.[28] The impact domestic subsidisation of a few cotton growers in the US on the livelihoods of thousands of cotton growers in Mali and elsewhere in Africa is well known. The recently-passed Farm Bill by the Congress of the United States is an egregious example of

28. The paper points out that although domestic trade reforms in Argentina have larger marginal poverty-reduction effects, the scope for lowering foreign tariffs is much greater and therefore, the overall poverty reduction possible from industrial-country trade reform is greater than that achievable from domestic reforms.

not only continued farm protection, but also of the utter disregard by the US lawmakers of the adverse impact of such protection on the prospects of resuming and concluding the Doha Round. President George W Bush's veto of this bill has been easily over-ridden by the US Congress.

Industrial-country protectionism has been a constant part of this most recent wave of globalisation. The fiasco at the ministerial meeting of the World Trade Organization at Cancún, Mexico, in 2003, driven in part by the refusal of the US and the EU to engage the developing countries on agriculture (particularly on subsidies to cotton growers in the US), and the continuing stalemate in the Doha Round, is a testimony to industrial-country protectionist attitudes still persisting. This is not to say, of course, that protectionism in developing countries, particularly on imports from other developing countries, is either absent or unimportant, but only to say that given their vast power in the global economy, rich countries have an obligation to move away decisively from their protectionism.

The industrial countries' practice of protecting vulnerable markets may be thought of as politically difficult to change, but that does not justify its acceptance. The answer may be to devote more attention to monitoring the practice of trade protection as an instrument to address the vulnerability problem, and devise less-distortionary means of addressing that problem through international institutions such as the WTO, IMF and others having some responsibility for policy-making and setting standards in relevant markets.

Labour-market integration has been similarly under-emphasised in the current wave of globalisation. Freer migration is an effective tool for achieving the goal of reducing disparities in wage levels across the world, but the issue has not even been on the agenda in most international trade talks. The cost of providing an adequate standard of living to a few people in remote islands while keeping them there could be far higher than the cost, if any, to host countries of allowing them to immigrate permanently. Rodrik (2002) argues that this is the area with the most significant consequences for developing countries. He estimates that a temporary visa scheme that allowed migration from developing to developed countries of up to 3 per cent of rich countries' labour force would "easily yield" $200 billion annually for developing-country citizens.

As if these two changes were not substantial enough, it is also important to emphasise that globalisation alone will not bring about the reforms in the economic and institutional environment that are most effective for reducing poverty. It creates additional pressure for such reforms, but these are ultimately domestic decisions.

3 Salient Characteristics of Least-Developed Countries

3.1 Criteria for Addition to and Graduation from the List of LDCs

According to UNCTAD (2006: iii), the list of LDCs is reviewed every three years by the Economic and Social Council (ECOSOC) of the United Nations in the light of recommendations by the Committee for Development Policy (CDP). The latest review, in 2006, used three criteria:

- A low-income criterion based on a three-year (2002-2004) average of $750 for additions to the list and $900 for graduation from the list;
- A 'human assets' criterion based on a Human Assets Index, which is itself a composite of indicators of nutrition (percentage of population undernourished), health (child mortality rate), school enrolment (gross secondary school enrolment rate) and literacy (adult literacy rate); and
- An 'economic vulnerability' criterion involving the Economic Vulnerability Index, which is a composite of indicators of natural shocks (index of instability of agricultural production and share of population displaced by natural disasters), trade shocks (index of instability of export of goods and services), exposure to shocks (share of agriculture, forestry and fisheries in GDP, merchandise export concentration index), economic smallness (population in logarithms) and economic remoteness (index of remoteness).

For all three criteria, different thresholds are used for addition to, and graduation from, the list of LDCs. A country will qualify to be added to the list if it meets the three criteria and does not have a population greater than 75 million.[1] A country will qualify for graduation from LDC status

1. The 75 million limit on population applies only to new additions to the list of LDCs. For Bangladesh, which had a population of 156 million in 2006, the limit is not applicable since it was on the very first list of LDCs.

if it has met the graduation thresholds under at least two of the criteria in at least two consecutive reviews of the list. After a recommendation to graduate has been made by the CDC and endorsed by the ECOSOC and the General Assembly, a graduating country will be granted a three-year grace period before graduation takes place. Thus, a minimum of nine years has to elapse before a country actually graduates from the first review at which it met the graduation thresholds in at least two of the criteria.

3.2 Implications of the Criteria

The developing countries identified as least developed, 49 in all as of June 2008, have low income as measured by its gross national income (GNI) per capita, weak human assets and a high degree of economic vulnerability. All these, at least as they are defined in the three criteria, are based almost wholly (with the exception of remoteness) on outcomes. The observed income of any country is the joint outcome of its exogenous natural resource endowments (e.g., land, minerals, climate) and endogenous resources, such as physical and human capital, technology, institutions and policies. Institutions and policies influence innovation, including the creation and adoption of technology, as well as the efficiency of the allocation of resources and their productivity. This being the case, whether a country has a low income, primarily as a result of poor exogenous resources or primarily because its institutions and policies are not conducive to accumulation of endogenous resources and their productive use, or both, would matter in mapping out feasible options to raise their status as LDC, for example. Similarly, the indicators of shocks that enter into the economic vulnerability index are also shocks to outcomes, such as, for example, agricultural production, rather than the weather or crop disease or other shocks that could result in variations in production, if not mitigated. Thus, one country's agricultural production could be more unstable than another's in spite of both undertaking mitigation strategies, because either policy-makers in one have different attitudes towards risk as compared to the other or the underlying weather and other shocks are more severe in the case of the former. It is also possible that the differences in the degree of instability of production between the countries arises from one country not adopting mitigation strategies as needed compared to others, even though both countries faced underlying shocks of the same severity. Thus,

the use of outcomes-based criteria in determining a country's LDC status confounds exogenous factors that are outside a country's control (e.g., weather shocks) and those that are within its control (e.g., whether or not to adopt mitigating strategies), and does not allow for possible differences in the preferences of policy-makers.[2] Given required data that are reliable and unbiased (which often is not the case), were it simple to distinguish the operation of exogenous from endogenous factors, this problem would not be serious. However, it is not. The required methodology for such distinction is complex, and the results often not robust.

The confounding of exogenous and endogenous factors and the difficulty of robustly distinguishing between them from available data presents a serious dilemma for the rest of the world (ROW) in their formulation of policies to help LDCs. Suppose it were the case, say, in a country that is currently in LDC status, that sustaining a modest standard of living is virtually impossible given its exogenous resources, even with the most productive use of technology, foreign trade and investment because, for example, it is a small, vulnerable and remote island country. Then the only two options for the ROW are either a permanent income transfer to the island's residents or to allow them to move permanently out of the island to a better location. By contrast, were it to be the case that a country, currently in LDC status, with the possibility (though impossible to ascertain with certainty) that its position is mostly of its own doing, the ROW faces the difficult decision whether to mount a programme to help that LDC and, if it is mounted, how to design it with some conditionalities to ensure that the country undertakes domestic reforms so that any resources transferred as part of the programme are effectively used for the purposes intended. As is well known from experience with conditionalities in other contexts (e.g., in IMF structural adjustment programmes), unless appropriately designed in terms their scale, scope and intrusiveness into

2. Briguglio and Kisanga (2004) in their introductory chapter refer to the paper of Briguglio (1995) that made the distinction conceptually between inherent and self-inflicted vulnerability, which is close to the distinction between exogenous and endogenous factors. Briguglio categorises countries into four groups: countries that are (i) not economically vulnerable relatively speaking; (ii) vulnerable, but have adopted policies to cope with or withstand their vulnerability; (iii) not vulnerable, but have adopted policies which adversely affected their resilience leading to self-inflicted vulnerability; and (iv) vulnerable and have adopted policies that exacerbated their vulnerability. Briguglio uses his conceptual categorisation to construct his economic vulnerability index. The author would argue that, while the conceptual distinctions are clear, empirically implementing them is much more difficult.

domestic sovereignty, conditionalities could be counterproductive. It is not surprising that all developing countries, including LDCs, prefer programmes such as their special and differential treatment (SDT) in the World Trade Organization, that are unconditional one-way concessions for which they do not have to reciprocate in any way. This book comes back below to the issue of whether SDT that is by definition non-reciprocal, is in the interest of developing countries.

Small size of a country, and its being an island, are two exogenous factors that in theory are deemed suboptimal for growth and development for several reasons (Read, 2001): their small domestic market, limited domestic resource base and for both reasons their inability to exploit scale economies, if any; and the narrow structure of domestic output, exports and export markets arising from remoteness. The suboptimality is seen even after allowing for potential advantages of being small, such as size-induced openness to trade and internal social cohesion.

According to Read (2001: 18) several early studies asserted that "the economic disadvantages facing small states are so great that they are not viable as independent states" (just as the hypothetical LDC discussed earlier, with so poor exogenous resources as to preclude the sustainability of even a modest level of living). Their non-viability leaves few policy options other than being absorbed by a larger state or into a federation. However, this theoretical presumption of suboptimality is not borne out by empirical evidence. Read (2001) points out not only that many small states have achieved sustained economic growth and relatively high levels of per capita incomes, but also that disproportionately fewer small states (those with a population of less than 3 million) are found in the World Bank's lowest-income category. Even after normalising for the level of development, several studies find country size to be statistically insignificant in explaining growth, while specific tests on the effects of size on economic growth have failed to find any systematic adverse impact of small size on growth.

Small states and autonomous regions in Europe seem to have outperformed other comparable regions in the European Union. Read (2001: 99) is careful to note that most of the empirical studies "suffer from significant methodological shortcomings and small data samples,

compounded by the lack of comprehensive, harmonised data sets." He adds, however, that "nevertheless, more studies using stratified sample data and more extensive, although non-harmonised data sets still find no systematic negative relationship." Read's (2001: 19) conclusion is balanced and apt: "…many small states have in fact been relatively successful in securing sustained economic growth and increasing per capita incomes, while many larger states, notably other LDC/LDCs, have performed relatively poorly. This suggests that additional economic factors play a critical role in relative growth performance, in particular the design and effectiveness of policies to foster economic growth."

3.3 Classical Theory of Comparative Advantage and Small and Vulnerable States

The relevance of the classical theory of comparative advantage as a determinant of trade openness and patterns of trade for small and vulnerable states has needlessly become contentious because of a profound misunderstanding of the theory. One example is enough to illustrate this misunderstanding. Grynberg (2006, Ch.1) argues that "the theory of comparative advantage if it is to be general in nature, it must apply to all cases… Indeed the smallest, most disadvantaged and remote of the micro-states of the Central and Western Pacific, e.g. Tuvalu, Kiribati and Niue, constitute a fascinating test of Ricardian trade theory, for they provide examples of states which do not consistently trade in either goods or services and maintain existing consumption levels from migration, remittances and aid…Those who are wedded to Ricardian theory of trade…would explain the observations from the remote islands of the South Pacific as merely a case of high transaction costs stemming from transport and the absence of economies of scale. At least two of these countries have in the past had a comparative advantage in the production of copra, but now do not trade as prices are too low to compensate for the disadvantages of scale, isolation and dispersed pockets of production… What this chapter attempts to do is to explain trade patterns not within the Ricardian tradition, but within the tradition of economic theory of rents and quasi-rents."

Grynberg (2006, Ch.1) has completely misunderstood the Ricardian theory of comparative advantage and its application to international trade.

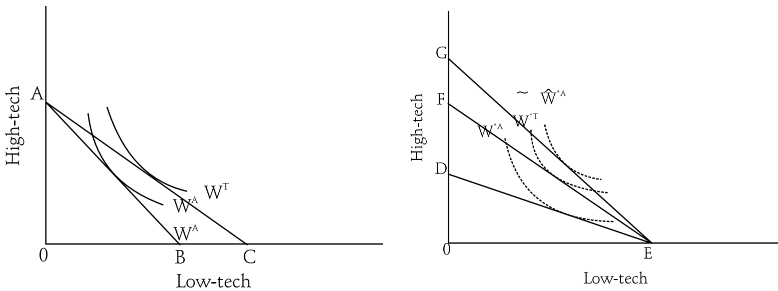
Comparative advantage in the theory, as originally put forward by David Ricardo in the 19th century, refers to comparative labour productivity advantage in the sense that the commodities in Ricardo's theory (just two) can be ranked in order of the relative (in one country relative to the other in the two-country world of Ricardo) labour productivity in their production, assuming labour productivity is independent of the scale of production, i.e., constant returns to scale prevails. The next step of the theory is to note that a potential exists for mutually-beneficial trade between the two countries, based on the pattern of comparative productivity advantage. However, whether that potential would be realised or not would depend on transportation and other transactions costs. As long as these costs are not so high that both countries find it welfare maximising to remain autarkic, some mutually-beneficial trade among countries will take place in a subset of commodities (in a general multi-commodity, many-country model) in a pattern corresponding to productivity advantage, while the remaining commodities will not be internationally traded. The distribution of gains from trade between the trading partners cannot be determined from comparative advantage alone—all that can be concluded is that in the post-trade equilibrium, no voluntarily trading nation will be worse off compared to its situation in the autarky equilibrium, given that domestic lump sum redistribution (or alternatively, a complete set of commodity and factor taxes) is feasible and used. For a rigorous modern exposition of the multi-commodity, one-factor, two-country Ricardian theory, see Dornbusch *et al.* (1977). For a rigorous exposition of gains from trade in a multi-commodity, multi-factor, many-country, general equilibrium model, see the chapter on gains from trade in Dixit and Norman (1980) and also Grandmont and McFadden (1972).

It is also well known that that the pattern of comparative productivity advantage can shift over time, for example, due to technical change in any country. Samuelson (2004) has recently drawn attention to this fact: suppose India and the US trade two goods, high-tech and low-tech. Initially the US has a comparative advantage in high-tech, exports it to India and imports low-tech, in which it has a comparative disadvantage, from India. Suppose, say, Indians learn to produce high-tech better so that their initial relative productivity disadvantage disappears, and the productivity of Indian labour in high-tech relative to low-tech equals that of the US. With

relative productivities being the same, there is no more potential for any gain from trade. Thus, with the technical improvement in India, the US loses the initial gain it had from trade with India as compared to autarky and returns to its autarky welfare level. On the other hand, India's welfare increases, with the earlier gain from trade with the US being more than replaced by the gain from the improvement in labour productivity in high-tech. See Figure 3.1 for an illustration.

Figure 3.1

Gains from Trade over Time: An Illustration

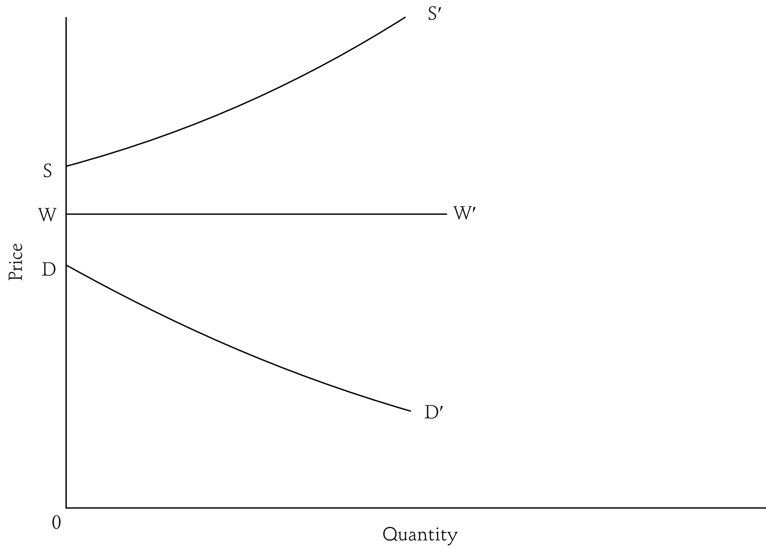


Legend:

	USA			India
OB OA	Autarky relative price of high-tech	<	OE OD	Autarky relative price of high-tech before Indians learn to produce high-tech better
OC OA	Relative price of high-tech after trade with India before Indians learn to produce high-tech better	=	OE OF	Relative price of high-tech after trade with US
OB OA	Autarky relative price of high-tech	=	OE OG	Autarky relative price of high-tech after Indians learn to produce high-tech better
W^A:	Autarky welfare		W^{*A}:	Autarky welfare before Indians learn to produce high-tech better
W^T:	Welfare after trade with India before Indians learn to produce high-tech better		W^{*T}:	Welfare after trade with US
	$W^T > W^A$		$\hat{W}^{*A}$:	Autarky welfare after Indians learn to produce high-tech better
				$\hat{W}^{*A} > W^{*T} > W^{*A}$

Figure 3.2

Domestic Demand, Supply and World Prices: An Illustration



Legend:

DD’: Demand curve

SS’: Supply (marginal cost) curve

OD: Maximum demand price

OS: Minimum supply price

OW: World price

OD < OW < OS: Market fails to come into existence

Grynberg’s description of the trade of the Pacific Islands and the disappearance of copra from the export basket not only does not contradict Ricardian theory, but in fact is fully consistent with it. Even if the transportation and transactions costs that are barriers to trade remained unchanged over time, a fall in the world prices could eliminate some of their earlier exports. Incidentally, Grynberg does not note that in trade theory factor movements are substitutes for trade in commodities. As such, the islands depending on migration and remittances rather than commodity trade, once again is consistent with classical trade theory.[3]

3. Grynberg’s attempt to explain trade patterns “within the tradition of economic theory of rents and quasi-rents”, starts from his observation (p.12) that “the inherent structural characteristics of smallness, isolation and physical dispersion, and poor human resource development… render otherwise competitive industries, structurally uncompetitive”. Presumably this means that

contd...

A somewhat misleading distinction is between comparative and competitive advantage. The latter, or to be precise competitive disadvantage, is the cost-disadvantage discussed by Grynberg of SIDS, SVS, LDCs or more generally developing countries in some of their exports. Grynberg, and to a considerable extent the literature on LDCs as well as policy-makers, assume that offsetting the cost-disadvantage through trade preferences for such countries or allowing them to provide trade subsidies if their revenues enable them to do so, would necessarily be appropriate. This need not be the case in general. First, if the cost disadvantage is permanent, offsetting it permanently through trade preferences or subsidies would be justified only if there are enough other social benefits from the participation in trade of countries experiencing such disadvantage. On the other hand, if there are enough social benefits to production that is being encouraged by the offset, then the offset will have to be in the form of production subsidies, and not trade preferences or subsidies. In either case, there have to be sufficient net positive externalities and other social benefits either from participation in trade or from production to justify policy intervention by the country itself or by the ROW. If there are none, then the only argument for policy intervention has to be the perceived social cost, either to the country itself or to the ROW, of allowing the population of the country to emigrate permanently.

Policy intervention to offset a presumed temporary cost disadvantage can be rationalised on less stringent grounds. The age-old infant industry

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contd...

domestic supply price (marginal cost) of output exceeds the demand price (See Figure 3.2 for an illustration) at home or in world markets. Clearly, unless the excess of domestic supply price over demand price is met somehow, "costs would not be covered, but, more significantly, capital and entrepreneurship could not be induced to enter the market. Thus what would normally be deemed to be rent in other larger and less advantaged economies is, in the context of such remote high-cost countries an *offset payment for the inherent disadvantage of location*", (Grynberg, p.12, emphasis added). To deem the offset a rent, i.e., payment to a factor, in excess of its opportunity cost seems inappropriate—it is not an excess of payment to a factor over its opportunity cost, but a compensation for the shortfall of the payment from the market that a factor owner would receive were he or she to supply it to the market, compared to its opportunity cost. In other words, offset merely ensures that factors are paid their opportunity costs. Grynberg calls *de jure* rents on an ongoing basis, such as from trade preferences, tax concession and sovereignty (significant for the smallest micro-states) as rents, and those on a temporary basis or on the expectation of monopoly as quasi-rents, an example, of which is a boom in some sector that temporarily raises its price over cost. As far as the author can see, calling a "rent" the compensation of the cost excess for inducing production, does not make it a theory of trade based on rents, analogous to Ricardian theory of comparative advantage. It only means, that the observed trade pattern, given that a necessary condition for trade is production, will correspond to those of the potentially many high-cost commodities for which compensation is being paid.

argument for trade protection was in fact rationalised by the argument that for various reasons (scale economies, high domestic cost of capital, 'learning-by-doing', etc.), an infant industry (that is, one at initial stages of operation at low levels of output) would have high costs which will go down enough to make it competitive in world markets as the industry matures. Not offsetting initial high costs would preclude the industry from getting established at all, even though it would be a competitive industry in the long run. Although this argument has been traditionally used to justify trade preference and protection, it is in fact an argument not for trade policy interventions, but for interventions at the source of high-initial costs. For example, if initial high costs are due to the work force not being sufficiently trained in the production process and by learning-by-doing, they would become more experienced with the production process so that costs go down (as in the famous model of Arrow) with cumulative output. In this case, an output subsidy, and not a trade subsidy, would be the appropriate intervention. On the other hand, if it is the high cost of domestic factors such as capital or skilled labour, a cost that is expected to go down once domestic capital markets develop and human capital accumulates, then the appropriate policy intervention would be a capital-use subsidy or skilled labour-use subsidy. In any case, since the social benefits from the industry becoming competitive accrue in the future, while the social costs of the subsidy are incurred in the present, unless the social discount rate is sufficiently low, subsidisation would not be socially optimal.

In concluding this section, the author briefly recapitulates its main points: First, policy debate on LDCs seems to confound the exogenous factors, which are outside a country's control, and the endogenous factors, which it can control, in determining its LDC status. Second, this confusion, compounded by the problem of robustly distinguishing between them from available data, presents a serious dilemma for the rest of the world in its formulation of policies to help LDCs. Third, the literature on small and vulnerable countries points to a tension between theoretical studies that point to the suboptimality of small size for sustained growth and development, because the structural disadvantages of small size and remoteness outweigh their advantages, and empirical studies, which do not in fact find any strong evidence for disadvantages of small size. This

suggests that countries are able to more than offset any disadvantages of their small size by suitably designing and effectively implementing policies that foster growth. Fourth, reminiscent of the early development literature that argued that the institutions and problems of developing countries are vastly different from those of the developed ones, and that the same economic theory cannot be used for analysing both, there are arguments that claim that trade patterns of SIDS cannot be explained by conventional trade theory based on comparative advantage. These arguments appear to be just as invalid as those of the early development literature. Fifth and last, that the tendency to focus on trade preferences (the book returns to the limited effectiveness of the Generalised System of Preferences in Section 6.2) and trade protection as the preferred means for offsetting permanent or temporary cost disadvantages of SIDS in particular or LDCs more generally, seems unwarranted.

4 Cooperation between Developed and Developing Countries to Strengthen the Links between Trade, Growth and Poverty Reduction

4.1 Temporal and Spatial Heterogeneity of the Links and their Strength

The book concluded in Section 2 that links between trade (or more generally globalisation) and poverty reduction could be usefully distinguished into two categories: direct and indirect. The direct links reduce poverty by eliminating (or accentuating) those characteristics of an economy that disproportionately affect the poor unfavourably (or favourably). Most ubiquitous among those that affect the poor unfavourably are domestic market distortions. Equally, if not more important, are the indirect links through the effects of globalisation on aggregate growth (e.g., growth of GDP) and the effects of growth on poverty reduction. It was emphasised that not all links, direct and indirect, need be unidirectional and, moreover, there is enormous heterogeneity across countries and over time on both the presence or absence of specific links and the strength of the links where and when present. Given the heterogeneity across countries and time, both in the presence of the links and, importantly, the variation in their strength, obviously a 'one-size-fits-all' approach to strengthening the links between trade, growth and poverty reduction is infeasible and inappropriate, even if feasible.

4.2 Growing Doubts on the Benefits of Globalisation in Developed Countries

An essential prerequisite to cooperation between developed and developing countries to strengthen the links, is an understanding by both groups of

the efficacy of the links and their operation in a manner that is beneficial to both. Yet doubts are growing in developed countries, particularly in the United States and in some members of the European Union, about the traditional belief that international trade is not a zero-sum game, but one of mutually-beneficial exchange, and that any domestic distributional conflicts that globalisation (trade liberalisation) induces can and should be addressed through domestic policy instruments. If unaddressed, these doubts will undermine any effort to foster cooperation between the groups.

Recently, in his two articles in the influential *Financial Times* (FT), one entitled "America needs to make a new case for trade" (27 April 2008) and the other, "A strategy to promote healthy globalisation," (5 May 2008) Lawrence Summers, former Secretary of the Treasury of the United States, former President of Harvard University and a distinguished economist, argued that the international economic policies of the US need to be coupled more closely to the interests of its workers. His arguments were endorsed and augmented in an article (21 May 2008) by the distinguished columnist of the *Financial Times*, Martin Wolf. Wolf, while conceding that the argument that increases in income of the poor [globally] offset equivalent losses for the rich is morally compelling, noted that because politics is national, unless or until a global political community emerges, politics will respond only to perceptions of national interest. In turn, Wolf's article generated comments from many economists, notably from the economic historian Kevin O'Rourke and Jagdish Bhagwati. O'Rourke questioned the point raised by Summers that globalisation implies "a race to the bottom" in terms of regulation, corporate income taxes and the ability of states to maintain fiscal policies benefiting ordinary workers. He pointed out that the first wave of globalisation during 1850-1914 was the origin of the welfare state, with freer trade and government intervention in other spheres being positively related, during the late 19th and early 20th centuries, with the introduction of a wide range of labour-market regulations, old-age, sickness and unemployment insurance and other schemes that benefited workers. There was no evidence of a race to the bottom then. Agreeing with Wolf's scepticism of the death of the nation state and, with it, the arguments about the appropriate role and size of government, O'Rourke concluded that as long as this is clearly understood

by [and explained to] voters, they will have one less reason to oppose economic openness.

Jagdish Bhagwati points out that the answer is manifold to Martin Wolf's question as to how to deal with domestic anxiety over globalisation and the fear that trade with poor countries and immigration (legal and illegal) of low-skilled workers from them is driving down wages. He argues that there is little empirical evidence for the hypothesis, that either trade and/or immigration is the cause of "wage compression" in the US. To the contrary, they may have moderated such compression from other causes such as skill-biased technical change. Those who believe that sound public policy decisions have to be based on rigorous theoretical and empirical analyses, should not give up arguing against erroneous beliefs contrary to theory and empirical evidence, because of pessimism that such beliefs (e.g., globalisation harming workers) are so deeply held that no analysis will dispel them. Arguing that strong political leadership has been lacking, and politicians as well as news media are driven too much by opinion polls on free trade, Bhagwati argues for a holistic response to the real anxiety over wages and jobs. Such a response will focus on the two factors that feed into that anxiety, namely, the shifts in patterns of comparative advantage that makes specialisation volatile, and the rapid and deep labour-saving technical change. It will require a holistic revision of institutional and policy frameworks.

4.3 Historical Ambivalence of Developing Countries towards Trade Openness and Multilateral Trade Agreements

The growing doubts in the United States about the benefits of globalisation and the importance of a liberal global trading system are particularly disturbing, since in the post-Second World War era the US has been the force behind establishing a rule-based global trading system. The conclusion of the General Agreement on Tariffs and Trade (GATT) in 1947 was entirely an US initiative. The eight successive rounds of multilateral trade negotiations for reductions in trade barriers under the auspices of GATT were also actively pushed by the US (Srinivasan, 1998). Moreover, after being a staunch supporter of multilateral and non-discriminatory liberalisation of trade, the US embraced preferential,

and hence discriminatory, trade liberalisation through bilateral, regional and plurilateral preferential trade agreements (PTAs), many of which are euphemistically called free trade agreements (FTAs). This embrace, which began in the early 1980s as the start of the Uruguay Round was delayed and later stalled after its start in 1986, was initially halting. It was expected that once the Uruguay Round was successfully concluded, the US would give up this position and return to its traditional role as a staunch supporter of multilateralism. However, this did not happen and the US began to pursue PTAs and FTAs aggressively.

Developing countries have always been ambivalent in their attitudes towards GATT and trade liberalisation. Of the original 23 contracting parties of GATT, at least 11 were developing countries. GATT was intended as the commercial policy chapter of a charter for an International Trade Organization (ITO), which was signed in March 1948 by 53 countries, including the contracting parties of GATT, at the conclusion of a United Nations Conference on Trade and Employment in Havana, Cuba. However, the ITO was stillborn, since not enough countries, including most importantly the US, ratified the charter, although the charter was based on a draft prepared by the US (Srinivasan, 1998, Chapter 2).

At the Havana conference, the debate was most heated on trade and development. India deemed the imposition of direct control on foreign trade necessary for the promotion of rapid and large-scale industrialisation. According to Wilcox (1949), Latin American participants at the conference were even more extreme in their views.[1] Wilcox points out that more than three-fourths of the chapter on economic development in the ITO charter: "is devoted to an elaboration of methods by which underdeveloped countries may obtain release from commitments assumed in trade agreements and under the charter with respect to commercial policy."

1. It is worth quoting Wilcox (1949: 32) in full on this: "wealth and income…should be redistributed between the richer and the poor states. Upon the rich obligations should be imposed; upon the poor, privileges should be conferred. The former should recognise it as their duty to export capital for the development of backward areas; the latter should not be expected to insure the security of such capital, once it was obtained. The former should reduce barriers to imports; the latter should be left free to increase them. The former should sell manufactured goods below price ceilings; the latter should sell raw materials and food stuffs above price floors. Immediate requirements should be given precedence over long-run policies, development over reconstruction, and the interests of regionalism over world economy. Freedom of action, in the regulation of trade, must be preserved. The voluntary acceptance by all states, of equal obligations with respect to commercial policy must be rejected as an impairment of sovereignty and a means by which the strong would dominate the weak".

The non-ratification stillbirth of the ITO charter meant that GATT rules governed the global trading system until GATT itself was subsumed by the World Trade Organization. The eminent scholar of International Trade Law, John Jackson (1989: 9) points out: "The GATT has limped along for nearly 40 years with almost no "basic constitution" designed to regulate its organisational activities and procedures.' The only substantial formal amendment to the GATT was the 1965 protocol to add Part IV, dealing with trade and development.[2]

Even so, under GATT's auspices, eight successful rounds of multilateral negotiations for reducing barriers to trade were concluded. The liberalisation of trade barriers under successive rounds resulted in remarkably rapid growth, at nearly 8 per cent a year on average, in the volume of world trade between 1950 and the first oil shock in 1973. In the roughly two decades thereafter (1973-1990), which included the second oil shock of 1979 and the debt crises of the 1980s, average trade growth slowed to around 4 per cent a year.[3] Since 1990, it has grown at an average of slightly less than 6 per cent a year (WTO, 2007 and 2008). In all these periods, trade grew faster than output, so that the share of trade in output increased substantially.

However, many developing countries did not participate significantly in either reducing trade barriers or in accelerating the growth of their exports. First, this was because most developing countries chose to remain outside GATT. Some elected not to become contracting parties of the agreement (for example, Mexico did not become one until 1986), and others chose not to participate actively as contracting parties in multilateral trade negotiations until the Tokyo Round of 1973-1979. Driven by the then-dominant faith in inward-oriented, import-substituting industrialisation

2. Jackson (1989: 89). According to Dam (1970), this step was also a reaction to the preparations already in progress for the first United Nations Conference on Trade and Development (UNCTAD). The proposed amendments were approved in 1964 and became Part IV of the GATT, entitled "Trade and Development". Dam concludes that apart from its symbolic importance in sensitising the contracting parties to the new role of the GATT in development, less developed countries achieved little by way of precise commitments (and even these were highly qualified).

3. Although the debt crisis is often referred to as the Latin American crisis initiated by the Mexican default threat in 1982, Poland had earlier run into problems in 1981 with its borrowing from German and other European banks. Other countries having problems in the 1980s with their foreign borrowing included Korea, the Philippines and Turkey, as well as countries in Sub-Saharan Africa. Nicholas Hope drew my attention to these facts.

as the appropriate development strategy, they erected and maintained relatively high barriers to foreign trade. The only exceptions were countries in East Asia, which chose to move away from an inward-oriented to an outward-oriented development strategy from the mid-1960s on.

The second, and no less important, reason for this lack of participation is that—partly because developing countries were not involved in the bargaining over reciprocal reductions of tariffs (or exchange of tariff concessions, to use GATT terminology) in GATT—trade barriers in commodities of export interest to these countries were not reduced to the same extent as trade barriers in commodities mostly traded among developed countries. After each round of multilateral trade negotiations, developed countries retained higher barriers against imports from developing countries than against imports from other developed countries. Agriculture, a sector of great interest to developing countries, largely remained outside the GATT framework until the Uruguay Round. Trade in textiles and apparel, meanwhile, had been exempted from GATT rules since 1961; the initial short-term arrangement covering cotton textiles was quickly converted to a long-term arrangement in 1962, and 12 years later this was expanded into the multi-fibre arrangement (MFA), which covers trade in textiles made from almost all natural and manufactured fibres![4] The MFA had been a particularly egregious exception to GATT rules: apart from being an outright violation of the fundamental non-discriminatory most-favoured-nation treatment (MFN) enshrined in Article I of GATT, it also permited the use of bilaterally negotiated trade quotas on an item-by-item basis between each importer and exporter. One cannot imagine a worse way of segmenting and heavily distorting markets. The MFA expired only on 1 January 2005.

Up to the conclusion of the Tokyo Round in 1979, many developing countries perceived that GATT promoted the interests of developed and industrialised countries and that it had frustrated several attempts

4. It is interesting to note that the short-term arrangement was introduced mainly to limit cotton textile exports from Japan to North America and Western Europe. When Japan became a leading exporter of automobiles in the late 1970s, 'voluntary export restraints,' another discriminatory trade policy measure (which technically was GATT-legal, because it was 'voluntary', though it violated GATT norms), were negotiated in 1981. Complaints about the undervalued yen, Japan's huge bilateral trade surplus with the US and the high Japanese savings rates were also raised. It is no surprise that as China emerged as the fourth largest exporter in the world, similar whining by the US about China's exchange rate, high savings rate and huge bilateral trade surplus is heard now, loud and clear.

by developing countries to have their concerns addressed. 'Concessions' granted to developing countries, such as the inclusion of Part IV on trade and development and the Tokyo Round's enabling clause on special and differential treatment, were mostly rhetorical, and others, such as the Generalised System of Preferences (GSP), were always heavily qualified and their benefits small. In sum, from the perspective of developing countries, the GATT was unfriendly, if not actively hostile, to their interests.

It is a matter of debate whether or not the frustrating experience of developing countries in seeking greater access to the markets of developed countries was a consequence of their own relentless (but misguided) pursuit of the import-substitution strategy for development, which in effect led them to opt out of the GATT. Had they participated fully, vigorously and on equal terms with the developed countries in the GATT, and had they adopted an outward-oriented development strategy, they could have achieved far faster and better-distributed growth.[5] The experience of East Asian countries, which adopted outward-oriented strategies of development from the mid-1960s onward, and also that of China and India since the mid-1980s, supports this assessment.

Nonetheless, even when developing countries actively participated (and with cohesion) as they did in the Tokyo Round (1973-1979), the outcomes were not in their long-term interests, primarily because their demands continued to be driven by the import-substitution ideology. The formal incorporation at the Tokyo Round of their demands for special, differential and more favourable treatment (SDT)—including not being required to reciprocate tariff 'concessions' by the developed countries—triply hurt them: once directly, through enabling them to continue their costly import-substitution strategies; a second time by allowing the

5. It is sometimes argued that because of GATT's origins in the US proposals and because of the stillbirth of the ITO—in large part due to non-ratification by the US—the rules of GATT were determined by the US and stacked against the developing countries from the outset. Hence, there was no way in which the rules would have changed to become fairer, even with active participation by developing countries. This argument is not plausible: first of all, the US proposals were circulated to all countries of the world. The original 23 contracting parties of GATT, including 11 developing countries, were also among the 53 signatories of the ITO charter. Thus, developing countries had ample opportunities to express their concerns in the GATT negotiations in Geneva and in the Havana conference, and indeed they did so. If they were not satisfied with either the GATT or ITO charters, they would not have signed them. In any case, no country, developing or developed, even if it is a member of GATT/WTO, need remain a member if to remain so is no longer in its interests; all it needs to do is simply to withdraw from membership after giving six months notice.

developed countries to retain their own GATT-inconsistent barriers (in textiles) against imports from developing countries; and a third time by allowing the industrialised countries to keep higher-than-average MFN tariffs on goods of export interest to developing countries. Unfortunately, SDT has been accepted as an integral part of multilateral trade agreements since the Tokyo Round.

4.4 Developing Countries in the WTO

Since the conclusion of the Uruguay Round and the establishment of the WTO, there has been a significant and welcome shift on the part of developing countries away from ambivalence towards a more receptive attitude towards trade openness and a rule-based trading system. The author attributes this in large part to the success in accelerating growth and reducing poverty by China and India after they began seriously integrating their economies into the world economy. Yet some vestiges of the past persist—such as special and differential treatment that concedes the demand for non-reciprocity and for relaxation, if not a complete waiver, of rules applicable to all other members of the WTO.

The author argues that past excessive emphasis by developing countries on non-reciprocal concessions from developed countries is even more the case now, particularly in the face of skepticism about the benefits of globalisation and the resultant rise in protectionist sentiments by developed countries. Developing countries should recognise that they are not the only ones that need to re-allocate resources, relocate them and undertake institutional changes and domestic reforms to realise the benefits of globalisation in full, and these changes would necessitate costly adjustments. The adjustment costs and benefits of globalisation are not necessarily uniformly distributed across socio-economic groups within the population of developing countries. However, developed countries also face similar changes, adjustment costs and the uneven distribution of costs and benefits. It is true that developed countries are usually better placed to face the adjustment costs, both because they are richer and also because of their better-developed safety nets. Nonetheless, this does not mean that the adjustment problems and their political impact in developed countries are unimportant and irrelevant from the perspective of international

negotiations on development issues, be they on problems of LDCs, the Doha Development Round, Millennium Development Goals or whatever.

Having flagged the desirability on the part of developing countries of a shift away from excessive emphasis on non-reciprocal concessions in the context of the growing doubts about globalisation and the threat of rising protectionism in the US and other developed countries, the author now turns to the policies and approaches for addressing the special problems (perceived and real) of LDCs in a spirit of constructive cooperation between developed and developing countries. The somewhat overlapping discussion is organised around the issues of:

- Accelerating and sustaining LDC growth, since growth, though certainly not an intrinsically valued objective, has been (as discussed in Section 2.2)—or could potentially be—instrumental for achieving objectives that are, such as an escape from drudgery and poverty, making economies less vulnerable and more resilient and more broadly development, as defined by Amartya Sen, as freedom;
- The effective participation of developing countries in world trade, as well as in the decision-making of multilateral organisations such as the WTO, World Bank and the IMF; and
- Progress in programmes of action specifically designed to help LDCs. The focus is on three: the Integrated Framework for technical assistance to LDCs initiated in 1997; a new Programme of Action (POA) for the LDCs for the decade 2000-2010, as agreed at the Third United Nations Conference on LDCs in 2001; and Aid-for-Trade (AFT), launched in December 2005 at the Hong Kong Ministerial Meeting of the WTO. The POA was intended as "a framework for a *strong global partnership* to accelerate sustained economic growth and sustainable development in the LDCs to end marginalisation by eradicating poverty, inequality and deprivation in these countries, and to enable them to integrate beneficially into the global economy" (UNCTAD, 2006: 29, emphasis added).

4.5 Accelerating and Sustaining Growth in LDCs and Small Economies

At the outset it is worth noting that the average annual growth rate of real GDP per capita in LDCs nearly tripled from 1.1 per cent during 1990-

2000 to 3.0 per cent in 2002-2004. Most of the acceleration (from 0.5 per cent to 2.8 per cent) was accounted for by LDCs other than the large one of Bangladesh, whose growth rate accelerated only modestly from 3 per cent to 3.6 per cent. The growth acceleration in African LDCs was remarkable, from no growth at all during 1999-2000 to 3.1 per cent in 2002-2004 (UNCTAD, 2006, Table 1, p.4). In 2004, only 12 of a set of 46 LDCs had real GDP growth (not per capita GDP growth) below 3 per cent; 19 had growth rates between 3 per cent and 6 per cent; and as many as 19 had growth rates exceeding 6 per cent. Thus, the recent growth record of LDCs as a group shows enormous growth improvement compared to the decade of the 1990s.

However, to what extent this improvement is from long-term underlying fundamentals, such as total factor productivity growth, and is hence sustainable, and to what extent it is simply a reflection of short-term factors such as, for example, the improvement in terms of trade of commodity exporters, has to be explored. The reason is that nearly 65 per cent of total LDC exports during 2000-2003 consisted of primary commodity exports, of which fuel exports alone constituted 25 per cent. The price of crude oil, around $130 a barrel in mid-June 2008, is double its level two years ago (chart on p.13, *Financial Times*, 13 June 2008). Price indices for food, agricultural raw materials and minerals have also shown substantial increases during 2002-2004 (UNCTAD, 2006, Tables 6 and 7, pp.11-12) and also subsequently. Thus, improvements in prices prior to 2004 of commodity exports must have contributed significantly to the short-term growth performance of LDCs. This conclusion is reinforced by the fact that gross domestic capital formation and savings as a proportion of GDP did not change much or declined (savings rate) between 2000 and 2004. The difference between the two, defined as the resource gap to be filled in part by external capital inflows, increased by nearly 4 per cent (UNCTAD, 2006, Table 3, p.6). Clearly there is no evidence of the problem of sustainability of growth in LDCs either disappearing altogether or even declining in its severity.

The Commission on Growth and Development (2008), hereafter the Commission, submitted its report on 21 May 2008.[6] The Commission notes

6. For a critical comment on the report, see William Easterly, *Financial Times*, 29 May 2008.

in its comments on the 50 small states (each with a population of less than 2 million and in total of 20 million) that they are interesting in their own right and for illustrating the role of size, if any, on their growth and growth strategy, and the potential of regional integration to overcome the disadvantages of size. While recognising the three distinct disadvantages of small states (absence of scale economies, vulnerability to shocks and remoteness), it confirms the earlier conclusion of Read (2001) that small states, in spite of their disadvantages, do not have lower average incomes or slower growth than other countries. Their external environment has become both more hospitable, with a range of services becoming tradeable, but also less hospitable, in that the value of tariff preferences that they enjoyed in their access to rich country markets had eroded, with average tariffs having fallen.

The Commission (2008) rightly emphasises that most small states are very young, having become independent nations only after 1970, and have not long assumed responsibility for providing through their own local services institutions, such as security, justice and regulation of economic activity, as well as diplomatic and negotiating services. Financial systems and services is a notable example of such recent assumption of responsibility for provision. The Commission finds that small states have shown great ingenuity in pooling their resources and outsourcing public services, and cites some examples such as multi-country central banking as in West Africa. The Commission (2008: 79) concludes: “In sum, small states should seek to pool their markets, through regional economic integration, and to spread the burden of public services, through partial political unions. Good governance is an important foundation on which regional co-operation and multi-national integration can build.” The Commission is rightly cautious that dealing with risk is more difficult, although in principle having a diversified portfolio of financial assets (particularly foreign assets) will mitigate risk even in a specialised (i.e., not diversified) economy in production. However, as the ongoing crisis in global financial and credit markets illustrates, risk mitigation through portfolio diversification can fail if all, or most, of the assets in the portfolio experience common shocks.

4.6 The Voice of LDCs in International Organisations and Negotiations

The Commission notes that small size translates into a relatively weak voice in international organisations and negotiations. Since the Commission measures a country's size by the size of its population, and since the 50 of them analysed by the Commission together had a population of 20 million (as compared to the population of the world of over 6.5 billion) in 2008, it is unlikely they can have a strong voice in the global arena. However, population is a very crude measure of size and voice; it should also depend on rules of membership and of participation in decision-making of organisations. International organisations vary significantly in both. For example, membership in the United Nations is in principle universal, with membership open to the original signatories of the United Nations charter and all other peace-loving states which accept the obligations contained in the charter and, in the judgement of the organisation, are able and willing to carry out their obligations. A country becomes a member of the UN, if the General Assembly votes to admit it upon the recommendation of its Security Council, which in turn requires the unanimous assent of its permanent members who have a veto on the Council's decisions. In practice, entities that meet the criteria of membership have not necessarily been recommended by the Security Council for membership. Until the General Assembly revoked through resolution 2758 Taiwan's membership of the UN and permanent membership of its Security Council, Taiwan was a member, but the People's Republic of China was not! In general, each member has one vote in the General Assembly in decision-making procedures. Presumably, the membership in any of the UN family of organisations is also universal.

In the UN Security Council, the five permanent members, which have veto powers, are a distinct category dating back to their role in the victory over Germany and Japan in the Second World War. The geopolitical and economic configuration of the globe has changed vastly since the approval of the UN charter in 1945. Yet the newly-emerging powers, such as Brazil, India and Japan, have had little success in achieving their aspirations for permanent membership of the Security Council. This is deplorable though understandable: no state would voluntarily agree to its percieved power being reduced.

In the World Bank and the IMF, which also date back to the end of the Second World War, there is weighted voting, with the weight of (i.e., 'quota' in the parlance of the two organisations) of each member roughly corresponding to its economic size at the date of the last revision of quotas. Here again, although relative economic sizes of its members have been changing, the process of revision of quotas has been a contentious issue, though some revisions have taken place periodically. On 28 April 2008, the Board of Governors of the IMF adopted far-reaching reforms of its governing structure, including a significant shift in the representation of dynamic economies, with an increase in the voting shares of 135 of its 185 members. Also the basic votes for each member will triple, the first such increase since the IMF's inception in 1944, thus resulting in an increase in the voice and representation of emerging markets and low-income countries. The African countries will get additional alternate executive directors on the IMF's Executive Board (IMF Press Releases 08/93 of 29 April 2008 and 08/64 of 28 March 2008).

The World Trade Organization is analogous to a club whose current members decide whether or not to admit an applicant for membership. An applicant is required to come to an 'accession agreement' with each of the club's existing members, an agreement that quite often requires an aspiring member to undertake commitments which existing members do not have to! The negotiation for accession can take very long—for example, China (PRC) applied in 1986 in order to assume the membership of GATT vacated by Taiwan. The membership of GATT decided to treat it as a *de novo* application, and China was finally admitted in 2001 after GATT had been subsumed by WTO in 1995—the last country to sign an accession agreement with China was Mexico in 2001!

The rules of membership of the European Union and various regional groupings with respect to trade, security and other matters vary enormously. Grynberg and Joy (2006) describe the process of accession as consisting of two stages. The first stage is multilateral, at which existing members collectively examine the conformity of an aspiring member, with the latter having no recourse of review of any adverse finding. The second is the bilateral stage of negotiations, as described above. The accession process, according to Grynberg and Joy, is "power" based rather than "rule" based and is subject to abuse.

The rules of the WTO that its members subscribe to are multilaterally negotiated, and so are the commitments that members undertake as part of the agreement concluding any round of multilateral negotiations initiated by a decision of the members themselves. Preferential trade agreements (PTA) are exceptions to the WTO's fundamental principle of non-discrimination embodied in its Article I, which requires most-favoured-nation (MFN) treatment by each member of all other members. The grant of waiver from MFN for members of PTAs, such as customs unions (CUs) and free trade areas (FTAs), is governed by Article XXIV. The waiver has to be approved by the members of the WTO. Recent FTAs involving the US as a member require their members to undertake commitments, such as in the areas of intellectual property protection and investment, which go beyond their corresponding commitments, if any, in the WTO. The process of approval of waiver under Article XXIV has notably failed. To take just one egregious example, the customs union (CU) status of the European Union has never been found formally to be consistant with Article XXIV.

Although it is not a requirement, thus far, decisions of consequence in the GATT/WTO have been made by consensus, so that in effect every member has a veto on such decisions. In principle, therefore, LDC members of the WTO have a strong voice in its decisions if they choose to exercise it. However, there are many practical constraints on doing so.

Before turning to the factors that in practice constrain the effective participation of LDCs in the WTO, the following briefly touches on collective action by developing countries as subgroups of members in WTO negotiations and the role of power *versus* rules. Until China opened its economy in 1978, increased its share of world merchandise exports to over 8 per cent in 2006 (from 1.2 per cent in 1983) and became the second-largest exporter in the world, the share of developing countries as a group in world exports in 1973 was modest (less than 25 per cent) and in manufactured exports was even less. This being the case, it is to be expected that the 'rules of the game' of world trade, so to speak, were set by those who had a large stake in global trade, namely the rich industrialised countries. In addition, as noted in Section 4.3, until the Tokyo Round concluded in 1979, the developing country members of GATT chose not to participate effectively in bargaining over trade rules and liberalisation (Srinivasan, 1998, Ch.3). However, during the run-up to the start of the

Uruguay Round and the Punta Del Este ministerial meeting that launched it, a group of 10 developing countries (GT) led by Brazil and India was pitted against a group of 40 (GF), which included major industrialised countries and also 20 developing countries.

According to Winham (1989), the Punta Del Este meeting began with three competing texts for the ministerial declaration, without a single agreed-upon text from the Preparatory Committee: "The main contention was between the GT and GF texts. The former reflected the resistance of some developing countries to the US demand to include new issues: services, intellectual property and investment measures. But the GT position eroded, and a growing consensus emerged around the US position once the United States in effect gave an ultimatum that it would withdraw from the conference altogether if these issues were not included."

Winham (1989: 64-65) concludes that the process "succeeded in the end because of the widely-held perception that failure to begin a new negotiation would have harmful consequences for the GATT regime and for the prospects for continued liberalisation of international trade. Thus crisis avoidance was an important motivation during both, the early pre-negotiation period and the Punta Del Este session. However, once the momentum in favour of a new negotiation had developed, the main motivation behind each delegation's activities became even more sharply focused as a fear of being isolated and blamed for the failure of the special session. For example, most of the G-10 [i.e., GT] developing countries abandoned their hard-line opposition to a services negotiation during the Punta Del Este session, until only India and an increasingly-uncertain Brazil were left. In the end, India found it impolitic to be isolated and it acquiesced. The same explanation accounts for the 11th-hour acceptance by the French of a negotiation on agriculture". Although it seems very unlikely, it is not inconceivable that a similar realisation—that letting the Doha Round fail would irreparably damage the rule-based and liberal global trading regime represented by the WTO—would ultimately convince all members to compromise and conclude the round in the near future. Unfortunately with the collapse of negotiations at the informal meeting of the WTO ministerial in Geneva 21-29 July 2008, it seems that the members of the WTO are not yet ready to compromise.

In comparison to the ineffectiveness of GT at Punta del Este, the so-called Group of 20 (G-20) developing countries, again led by Brazil and India but now including China, has been far more effective since it was first formed at the Cancún ministerial meeting of 2003. Brazil, India and South Africa, prominent members of G-20, had been invited to the so-called G-8 summit of rich countries to present developing-country perspectives. The three and Russia recently met to discuss global issues of mutual interest. Another group of four, consisting of Brazil, the European Union, India and the United States, have met periodically to advance the Doha Round. Thus, some leading developing countries and groups of developing countries that they represent have come to acquire a more effective voice in trade negotiations than they had before. Goldman Sachs has coined the word "BRIC" to denote Brazil, Russia, India and China and has issued two reports on their future prospects. Nonetheless, all this international attention to some leading developing countries by no means implies that the problem of a voice for individual countries in the groups of LDCs and small states in international organisations and negotiations has been solved.

The dominant constraint in acquiring a voice is what is usually termed 'inadequate capacity', a broad term that covers a range of inadequacies: small size, meagre resources, lack of knowledge (and difficulty in acquiring such knowledge) about negotiating issues, lack of skilled personnel and so on. For example, consider the case of a WTO member who wants to bring a complaint against another member whose action it believes violates a WTO commitment and thereby damages its interests. To do so, the member not only has to have knowledge of relevant WTO rules and commitments of all members, but also has to have the ability to argue its case in the dispute settlement process, through its various stages from initial consultation with the other member, then presenting the case to the WTO panel if consultation fails, and finally before the appellate body if the panel rules against it. The entire process not only requires resources, but also skilled personnel. This is just one example. The ongoing Doha Round of negotiations, like all negotiations, involve complex issues and the negotiating positions of members are also complex. The trade-offs involved are difficult to evaluate, even for a very well-informed

and skilled individual.[7] A small and poor developing country member is severely handicapped in such negotiations. Fortunately, the need for capacity building is recognised in the WTO and several rich countries have contributed resources for this effort. Much more can be done, and this is an area in which developed countries as well as better-placed developing countries can contribute.

It will also be helpful if groups of developing and developed countries, before they crystallise their negotiating stances, consider not only the impact on their own group of their stances, but also on the other groups. All said and done, 'real politick' cannot be wished away. The more powerful, which have the resources, will try to divide the weaker and poorer groups. Building cohesion and resisting pressures to deviate from common positions is not that easy. For example, the offers of the EU to exempt developing countries in Africa from having to make any liberalising commitments at all in the Doha negotiations could be seen as a way to split the ranks of developing countries.

4.7 Programmes of Action for the LDCs

4.7.1 Integrated Framework (IF) for Trade-Related Technical Assistance to LDCs

Established in 1997, the IF is a joint undertaking of the IMF, International Trade Centre, the United Nations Development Programme (UNDP), UNCTAD, the World Bank and the WTO. The IF (2008) has two main objectives: (i) to 'mainstream' trade into the national development plans, such as the Poverty Reduction Strategy Papers (PRSPs), of the LDCs; and (ii) to assist in the coordinated delivery of trade-related technical assisance in response to needs identified by the LDCs. The IF is built on the principle of country ownership and partnership.

7. It is hard to understand, let alone rationalise, the labyrinthian process of WTO negotiations, which is in three stages. The first involves agreeing on a framework for negotiations that delineates the objectives of the negotiations and issues to be negotiated. At the second stage, modalities for achieving the objectives are agreed. They determine the shape of the final outcome of the negotiations by laying out, for example, the possible ranges within which an eventual agreement will be with respect to tariff reductions and also formulae for linking initial levels of bound tariffs to their final levels at the end of the implementation period of the agreement. The modalities also specify any special and differential treatment to be accorded to developing countries, LDCs and other groups. The last stage consists of each negotiating country committing to its particular commitments within the broad range relevant to it, as laid out in the modalities. Under the 'single undertaking' procedure, until everything is agreed, nothing is agreed!

Other key elements of the IF are:

- Improved governance structure, with the establishment of the Integrated Framework Steering Committee (IFSC) and the expanded IF Working Group (IFWG) for better coordination amongst donors, beneficiary LDCs and the agencies;
- The establishment of the IF Trust Fund, which finances mainstreaming work, led by the World Bank, but also follow-up activities from the studies; and
- Improved coordination of the delivery of trade-related technical assistance amongst bilateral and multilateral donors within a coherent policy framework.

The implementation of the IF comprises three broad stages. First, preparatory activities, which would typically include: an official request from a country to participate in the IF process; a technical review of the request; the establishment of the National IF steering committee; and, to the extent possible, the identification of a lead donor. Second, once the request has been approved, the process moves on to its diagnostic phase, resulting in the elaboration of the Diagnostic Trade Integration Study (DTIS). Finally, follow-up activities start with the translation of the diagnostic phase's findings into the elaboration and validation of an action plan, which serves as a basis for trade-related technical assistance delivery.

An IF manual: *Integrating LDCs into the International Trading System*, was published by the United Nations in 2005. The IF Steering Committee (IFSC) published its sceond evaluation of the IF in December 2003. The evaluators had only half of the seven months initially contemplated for their evaluation, and had to do their best in a short time. Although the primary purpose of the evaluation was the assessment of results, it became evident that it was too early to look for measurable developmental results in terms of poverty reduction attributable to trade and economic growth. The evaluation focused, therefore, on operational results and even for these there was a lack of measurable goals and objectives, and hence performance indicators. In sum, the evaluators ended up analysing alternative processes for the operation of the IF and making recommendations. On the whole, the exercise was very disappointing.

Nonetheless the Development Committee of the World Bank and the IMF at their meeting in September 2005 concluded that the IF should be enhanced and provided with additional resources. As a follow-up to this decision, the IFSC set up a framework Task Force on an Enhanced IF (TFEIF) to report no later than 2 December 2005. It submitted a report with its recommendations on 19 June 2006 (WT/IFSC/W/15).

The report begins with a short history of the IF, the number of its evaluations as of 2004 and the findings of an IF simulation held in Addis Ababa in September 2005. While noting (without really providing any convincing evidence in support) that "IF has provided a good framework for helping the LDCs enhance their trade development capacity and facilitate adjustment and integration in the multilateral trading system", it found also that "there are still significant shortcomings in the process" (pp.2-3). The shortcomings identified by the Task Force were (p.3):

- The IF has generally failed to mainstream trade into the Poverty Reduction Stategy Paper (PRSP) process and has not provided adequate financial and human resources to the LDCs to deliver the intended outcomes…there is an implementation gap; priorities identified in the Diagnostic Trade Integration Study (DTIS) process are not being picked up in mainstream investments.
- Country ownership has been weak. The national IF structures have generally not worked to integrate trade into the development process and there is often still a lack of awareness of the importance of trade at the national level. Capacity to take the integration process forward is generally inadequate and the capacity-building support that has been provided through the IF has been inadequate to the task.
- The donor community has generally not responded adequately to the needs identified in the DTISs…Trade is inadequately seen, by both donors and recipients, as an intergrated aspect of economic development and poverty reduction, so does not figure high enough on their priorities.

Given its identification of the shortcomings, the Task Force's recommendations to improve the effectiveness and efficiency of the IF are predictable (p.15):

- There needs to be much stronger ownership of the IF by the LDCs and the donors…Capacity needs to be developed and strengthened in LDCs to facilitate greater ownership. Similarly, donors need to give much greater prominence to these issues and to provide more resources.
- The gap between the diagnostics and submission of 'bankable projects' needs to be filled.
- Responsibility for management and implementation must be more focused. Currently…everyone, yet no one, is responsible.
- There is a need for adequate funding, provided in a predictable manner to meet the objectives of the IF.

Rabinowitz (2007) reviewed the trade and diagnostic studies carried out in 11 LDCs through the donor-funded IF to assess the effectiveness of the IF in addressing trade-related needs, with the objective of poverty reduction as the centre of the analysis. He found (p.1) that "although these studies present much of use to the countries in promoting export development, they neglect key areas of significance to poverty-reduction efforts. Food crop trade receives minimal attention; there is limited attention to the constraints facing small-scale producers in agriculture and elsewhere; there is limited focus on and ambition for services and industrial development; and analysis of the impact of trade reforms on poverty is weak and poorly linked to the discussion on trade capacity building needs".

The author of this book argues that the problems with the IF, as well as its enhanced version, are fundamental, even if it is as yet too early to look for measurable outcomes of its performance. For several reasons, the programme is unlikely to show better results once enough time elapses and its development results have been measued, nor is its probable failure entirely due to its neglect of key areas of significance to poverty reduction.

To begin with, the objectives of IF are utterly vague. The word 'mainstreaming' of trade into development plans has little operational content and even less of any identifiable and measureable link to development goals. It is no more than a buzz word. Although technical assistance (TA) and its coordinated delivery as goals could be made

operational, unless IF itself has clear and well-defined objectives, TA in support of it cannot be made operational. After all, the capacity limitations of LDCs mean that leaving such countries in the main to identify what is needed by way of TA in their context would be limiting in any case.

The phrase 'country ownership', in the author's view, unnecessarily confuses the conventional (but increasingly irrelevant) concept of 'sovereignty', meaning that a sovereign country is one that has complete control over its domestic affairs, with such a country having control over how externally-provided resources—be they technical assistance of the IF or more generally any other form of external aid, including official development assistance (ODA)—are to be utilised for development and poverty reduction, both of which are quintessentially domestic responsibilities. It is not so much country ownership of a programme of external aid such as TA under the IF that matters, but whether or not the programme is well defined to deliver the objectives that the country wishes to achieve with the resources, regardless of who designed that programme. The aid and TA under the IF are funded by donors: it makes no sense to exclude them from having a say in the objectives that aid is meant to achieve, and how the aid funds are to be used for this purpose. However, it is reasonable to insist that donors and recipients jointly decide on the intended uses of aid and on ways to monitor the process of actual use. Calling this joint decision-making 'country ownership' is counterproductive.

The author argues further that the most serious and almost fatal defect of the IF is a failure to understand that development and poverty reduction are complex tasks. Greater integration of a country with the world economy, while it certainly would contribute significantly to both, is not the only determinant of either. Moreover, as has been repeatedly argued in this book, the constraints on development, poverty reduction and the use of greater integration with the world economy for helping with both, involves consideration of domestic political economy. Unless this is understood, redesigning the IF at the margin is unlikely to make it deliver greater integration or poverty reduction to any significant extent.

4.7.2 Programme of Action of UNCTAD

The Programme of Action (POA) (UNCTAD, 2006: 29) is intended as "a

framework for a strong global partnership to accelerate sustained economic growth and sustainable development in LDCs, to end marginalisation by eradicating poverty, inequality and deprivation in these countries, and to enable them to integrate beneficially into the global economy". The POA envisages concrete action in the following seven areas by global partnership founded on mutual commentments by LDCs and their development partners:

(i) Fostering a people-centred policy framework;
(ii) Good governance at national and international levels;
(iii) Building human and institutional capacities;
(iv) Building productive capacities to make globalisation work for LDCs;
(v) Enhancing the role of trade in development;
(vi) Reducing vulnerability and protecting the environment; and
(vii) Mobilising financial resources.

In contrast to the vagueness of the IF, the POA is better defined, but also covers some crucial dimensions of a development strategy. This is not to say that it does not have its share of vagueness—for example, 'fostering a people-centred policy framework'. However, its emphasis on building capacities is indeed appropriate. After all, it is the lack of capacity in a variety of dimensions that distinguishes the group of LDCs from other countries, developing and developed. Having said this, let it be re-emphasised that understanding and addressing the domestic political economy-based constraints is just as important for the success for the POA as it is for the success of the IF.

UNCTAD (2006) is a comprehensive review of the state of development of the LDCs as of 2004, and not so much of the actions taken and yet to be taken on the seven areas identified in the POA. This book ignores the standard staples of such documents—such as the "need for a paradigm shift," "to start and sustain a virtuous circle in which the development of productive capacities and the growth of demand mutually reinforce each other, and there is a transformation of productive structures towards more skilled and technology-intensive systems consistent with higher value-added activities and strong productivity growth," and instead cites some of its extremely sobering findings:

- Since 2001, there is now a stronger engagement of development partners than in the 1990s with respect to aid, debt relief and market access. During the 1990s, many LDCs engaged in significant and far-reaching economic reforms, including extensive trade liberalisation, financial liberalisation and privatisation. Although trade fell by 45 per cent in real per capita terms between 1990 and 1998, this trend has now been reversed, with aid inflows doubling in nominal terms since 1999.
- Economic growth and investment rates are higher than in the 1990s in many LDCs. However, only six out of the 46 LDCs for which data are available met or exceeded the POA target of growth of 7 per cent per annum between 2001 and 2004. Ten out of 35 LDCs for which data are available met the investment target of 25 per cent of GDP during 2001-2004.
- Eighteen out of the 46 LDCs for which data are available were unable to achieve per capita growth rates of more than 1.0 per cent per annum during the period 2001-2004, which is far too low to have a serious effect on the extreme poverty in which about half the population of LDCs live. Moreover, progress towards human development goals is very mixed.
- The recent improved growth performance in some LDCs noted above is certainly encouraging. However, closer analysis of the year-to-year changes that have occurred in the LDCs shows that historically many LDCs have experienced short periods of rapid growth, but these have been followed by economic crises in which there are often quite severe output losses and economic recoveries of varying strengths and completeness. Of the 40 LDCs for which data are available, only seven have experienced steadily-sustained growth. All the other LDCs have experienced economic contractions of varying duration and severity since achieving political independence. Of the 33 LDCs which have experienced economic crises with major output losses, there are only 12 whose real GDP per capita is now higher than it was at its peak in the 1970s or early 1980s.
- Despite improvements in the 1990s, capital formation was still only 22 per cent of GDP in the LDCs as a group in 1999-2003 and domestic private investment was particularly weak. A further

concern is that actual rates of human-capital formation in the LDCs in the 1990s were slower than in other developing countries. The inadequate rates of physical- and human-capital formation reflect weaknesses in domestic-resource mobilisation to finance capital formation, as well as weaknesses in the way in which external capital inflows are supporting domestic processes of capital accumulation.

- For the LDCs as a group, there has been little structural change since the early 1980s, although there are significant differences between LDCs.
- The evidence shows that, on average, it required five workers in the LDCs to produce what one worker produces in other developing countries, and 94 LDC workers to produce what one worker produces in developed countries in 2002-03. Worse still, the productivity gap is widening. Labour productivity in the LDCs as a group in 2000-03 was just 12 per cent higher than in 1980-1983, whilst it increased by 55 per cent on average in other developing countries.
- The goods and services that the LDCs can supply competitively to world markets are ultimately limited by the goods and services they can produce and how efficient they are in producing them. This is the basic source of the marginalisation of the LDCs in world trade. Even if the LDCs exported all their output, their share of world exports of goods and services would only be 2.4 per cent, even though their share of the world population is over 10 per cent.
- The most important way in which labour has found productive work within LDCs over the last 25 years has been through agricultural-land expansion. However, this is becoming more and more circumscribed.

This assessment by UNCTAD leaves no doubt that the task of development of LDCs (and of developing countries more generally) is a daunting one. A narrow focus on one or a few of the many contributory factors to development, be it trade, physical-and human-capital accumulation, or correction of market failures, dysfunctional governance insurgencies and ethnic conflicts and related political-economy issues, would be inappropriate. Of course, not all problems could be effectively

addressed at the same time. A prioritisation among them, based on an understanding of the development-process heterogeneity among countries, is essential.

4.7.3 Aid-for-Trade

It is not so long ago that spokespersons for developing countries demanded greater access to developing country markets with the slogan 'Trade, Not Aid', in part as a response to the stagnant aid flows, but in part also to emphasise that greater trade results in two-way flows of benefits as compared to the one-way flow of resources that aid from rich to poor countries represents. The slogan is no longer 'Trade, Not Aid', but 'Aid-for-Trade'. The Hong Kong Ministerial Conference of the WTO in December 2005 provided the WTO mandate on Aid-for-Trade (AFT) with the aim of helping developing countries, particularly LDCs, to build the supply side capacity and trade-related infrastructure that they need to assist them to implement and benefit from WTO agreements, and more broadly to expand their trade. It invited the Director-General, Pascal Lamy, to create the AFT Task Force to provide recommendations on how to operationalise AFT. The Task Force was set up by Mr. Lamy on 8 February 2006, with Ambassador Mia Rantzien of Sweden as its chair and with Barbados, Brazil, Canada, China, Columbia, the European Union, Japan, India, the United States and the coordinators of the ACP, the African Group and the LDC Group as members. The Task Force was asked to provide recommendations to the General Council of the WTO by July 2006 on how to operationalise AFT and how it might contribute most effectively to the development dimensions of the Doha Development Agenda.

The Task Force, together with multilateral donors, helped Mr. Lamy outline a plan for mobilising and monitoring AFT. It involved global tracking of financial flows, self-assessments by partner and donor countries, three high-level regional meetings and a series of 'periodic reviews' in the WTO Committee on Trade and Development. These various threads were to be woven together in a Global AFT Review and debated in the General Council.

A background paper (WT/AFT/W26) of 29 May 2007 on WTO's work programme on AFT, circulated five months prior to the first Global Review in November 2007 by the Secretariat of the WTO, noted that a

comprehensive AFT package needs to respond to two related concerns. One is the assistance that some WTO members will need to help them implement the results of current multilateral trade negotiations, and to cope with certain adjustment costs that may be incurred. The second, broader set of concerns is the insufficiency of trade-related capacity in many WTO members to allow them to benefit from the opportunities the multilateral system creates. The first Global Review had the objectives of taking stock of what was happening by drawing it together into a coherent picture; identifying what should happen next by moving from analysing needs and priorities to their implementation by donors, agencies and partner countries; and finally to discuss how the processes of monitoring and progress evaluation could be improved.

In his report to the Global Review meeting, Mr. Lamy said that although AFT is a complex subject with a multitude of players having a multitude of policies, with each country having its own needs priorities, some common themes have emerged from the first year of monitoring AFT. These were:

- 'Ownership'—No grand plan to expand trade capacity will ever work unless developing countries want it, unless they 'own' it and unless it addresses their interests.
- Priority setting—the challenge for countries is to decide on the projects that matter most and that will deliver the biggest return on investment. Having 100 priorities is having no priorities.
- Thinking regionally—since many capacity and connectivity problems are regional in scope.
- Increased and predictable financing.
- Mobilising the private sector.

Mr. Lamy mentioned another and perhaps the most-important theme that ran throughout the preceding year's discussions. It was that trade, investment and domestic reforms are the main drivers of economic growth and development. AFT can and must be an important complement to a successful Doha Round, with development as a central pillar. However, Mr. Lamy was frank, clear and emphatic that AFT is only a complement, and in no way a substitute for official development assistance (ODA).

In some ways the list of common themes, except the last and most important one, is almost banal. For example, the need for priority setting, for increased and predictable financing, and for thinking regionally by recognising heterogeneity across countries and regions, could all be cited as relevant for almost any policy discussion on development. Indeed the evaluation of the IF cited them as well. This book has already pointed out that the notion of 'ownership' has its limitations.

The author of this book could not find in Mr. Lamy's speech any specific set of actions in order to realise the implied objectives of the various common themes. Such a set would assign responsibilities to the stakeholders involved for each action in the set, along with a credible mechanism for holding each stakeholder accountable for undertaking and completing the tasks that the stakeholder commits to do.

Mr. Lamy got the green light for his 2008 AFT roadmap from the WTO's Committee on Trade and Development at its meeting of 25 February 2008. The roadmap has three objectives: (i) increasing developing-country ownership; (ii) shifting emphasis to monitoring implementation, with a focus on country, regional and sectoral priorities; and (iii) launching a work programme to develop perfomance indicators and to strengthen self-evaluations.

The strategy for achieving these objectives is short on concrete and specific actions in the above sense, and long on general actions, such as working with the OECD to implement an AFT 'knowledge' network; encouraging early establishment of regional AFT networks comprised of key stakeholders to assist countries and sub-regions in identifying priorities and performance indicators; and strengthening self-evaluations and holding more reviews and meetings, such as, for example, holding an expert symposium on evaluation.

There is nothing inherently wrong or objectionable in any of the actions proposed in the 2008 AFT roadmap. Yet they are not specific enough in the sense described earlier to address some critical issues already identified in the WTO Secretariat's background paper of 29 May 2007. These critical issues are that:

- AFT must be a complement to, and not a substitute for, ambitious results for the Doha Development agenda. Increasing trade

opportunities for developing countries, and in particular LDCs, remains by far the most important contribution that the WTO, consisting of all members, developing and developed, can make to development.

- AFT must not have to compete for existing official development assistance flows with other development and poverty reduction priorities.
- The case for attracting AFT to implement WTO agreements and build trade-related capacity more broadly must have the commitment of trade, development and finance ministers in developed and developing countries and LDCs and the support of private business if it is to live up to its promise of catalysing their trade-related investment and production.

Implicit in the Secretariat's identification of critical issues for AFT is the idea that successfully completing the Doha Development agenda, although necessary, is not sufficient for increasing trade opportunities of developing countries and LDCs. Put differently, to avail of the opportunities that a successful completion opens up would require relaxing the constraints that these countries face in doing so. This in turn would require not only identification in specific country contexts of what these constraints are, but equally important what actions those countries and other WTO members could take in relaxing them.

It is most likely that some of the constraints so identified (e.g., general capacity constraints) will be critical, not only for taking advantage of trade opportunities, but also for development (and its overarching goal of poverty reduction) in general. If this is the case, as the author believes it to be, clearly for AFT to be, strictly speaking, a complement to ODA, it would have to be targeted only at relaxing those constraints that are inhibiting availing of trade opportunities only and not any that constrain development as well, which would be the target of ODA. However, whether doing so is a cost-effective use of AFT resources is a separate issue. After all, taking advantage of trade opportunities has only an instrumental value, and not an intrinsic value, as development and poverty reduction do. It is possible, therefore, that use of general-purpose aid, rather than AFT linked to trade, could achieve the relaxation of constraints that limit

development as well as availing of trade opportunities more cost effectively. The second issue is to ensure that donors do not substitute AFT for ODA in their aid budgets.

Turning to the third objective, the lack of coordination among ministers with different portfolios and its deleterious effects have already been discussed in an earlier section. In addition to coordination, their credible commitment is essential to undertake the actions needed and to provide incentives for the private sector to take complementary actions (and to avoid actions that limit the efficacy of public sector actions) for expanding trade-related investment and production.

In sum, it is possible that AFT has the potential to realise its objectives, but not only is this potential yet to be set out in realistic and concrete terms, but few specific actions to achieve the potential are described in the large and accumulating literature on AFT.

5 Doha Round and the Least-Developed Countries

In the introduction the author referred to paragraph 35 on Small Economies and paragraphs 42-44 on least-developed countries in the Doha Ministerial Declaration of 14 November 2001. To repeat briefly, paragraph 35 promised to examine trade issues relating to small economies; paragraph 42 committed the ministers to the objective of duty-free, quota-free market access for products originating in LDCs, to facilitate and accelerate negotiations with acceding LDCs and to reaffirm commitments consistent with the mandate of the World Trade Organization that had been undertaken as part of other declarations, and agreed that in designing its work programme for LDCs, the WTO should take into account the Brussels Declaration and Programme of Action. It instructed the subcommittee on LDCs to design such a work programme and report to the General Council by 2002. Paragraph 43 endorsed the Integrated Framework for Trade-Related Technical Assistance to Least-Developed Countries (IF) as a viable model of trade development of LDCs, and requested the Director-General to provide an interim report to the General Council in December 2002 and a full report to the Fifth Ministerial Conference (in Cancún in 2003) on all issues affecting LDCs. Paragraph 44 reaffirmed that provision of special and differential treatment is an integral part of WTO agreements. Except paragraph 44, none of the others strictly speaking, set targets against which the success or failure of Doha Round as a 'Development Round' could be assessed.

The Doha Agenda as described in the WTO's document "Understanding the WTO" (*http://www.wto.org/english/theWTO_e/whatis_e/tif_e/tif_e.htm*, accessed 4 August 2008) included:

- In agriculture: rural development and food security for developing countries and the needs of least-developed and net food-importing countries;

- In sanitary and phytosanitary (SPS) measures: more time for developing countries to comply with other countries' new SPS measures, developing countries' participation in setting SPS standards, financial and technical assistance;
- In textiles and clothing: consideration of favourable quota treatment for small suppliers and LDCs;
- In technical barriers to trade: technical assistance to LDCs, a possible six-month 'reasonable time interval' for developing countries to adapt to new measures, and efforts to help developing countries to participate in setting international standards;
- In anti-dumping: developed countries to give 'special regard' to the situation of developing countries when considering applying anti-dumping measures;
- In subsidies and counter availability measures: sorting out the test for determining whether some developing countries meet the test for being allowed to pay export subsidies, and reaffirming that LDCs are to be exempted from the ban on export subsidies;
- In trade-related aspects of intellectual property rights (TRIPs): technology transfer to LDCs; and
- In cross-cutting issues: clarifications of mandatory and non-mandatory provisions on special and differential treatments, making provisions more effective, methods for incorporating such treatment in new negotiations, and urging developed countries to grant preferences in a generalised and non-discriminatory manner.

The Director-General of the WTO was urged to give priority to provide technical assistance to developing countries to help them implement existing WTO obligations and to increase their capacity to participate more effectively in future negotiations. Technical assistance to developing countries and LDCs for capacity building figures are in several articles (21, 24, 26, 33). However, in the author's view, the WTO has chosen the Integrated Framework (IF) as the primary means for articulating and implementing technical assistance programmes. As discussed in Section 4.7, this framework has not worked well thus far and is most unlikely to perform better in the future.

Apart from technical assistance, the other items of the Doha Agenda relating to developing countries, including LDCs, could be divided into two broad categories. The first can be described as exhortations and good faith efforts urged on developed countries, almost all of which are essentially voluntary. Without minimising the value of exhortations, moral suasion and ongoing voluntary efforts, it is nonetheless impossible to set time limits for their fulfillment, let alone to set punishments for not fulfilling such items. The second category of items, which constitutes a majority, consists of special and differential treatment of developing countries in general and, in particular, of LDCs, small economies and other groups. These items included, for example, lower rates of required reduction of bound tariffs by developing countries, exempting LDCs altogether from any reduction, allowing a longer time schedule for meeting commitments and so on.

This second category responds to the demands of developing countries and LDCs for concessions and non-reciprocal commitments. In the author's view, giving developing countries a reasonably longer time for meeting the same commitments as developed countries is an entirely appropriate way of taking into account their being at a lower stage of development. However, allowing them to retain higher barriers to trade until the subsequent round of negotiations, with no commitment whatever to reducing them, or reducing barriers to a lesser extent than is required of developed countries, is not in the interests of LDCs in any way. It sustains their mistaken belief that trade restrictions and trade policies are effective instruments for achieving non-trade related and broader goals of development. This is not to deny that poor countries, particularly if they happen to be poorer than others because of factors beyond their control, could do with unconditional and limited resource transfers. In fact, by agreeing to the demands of developing countries for 'concessions' in trade-related commitments and obligations, developed countries are able to avoid making any resource-transfer commitments. This is counterproductive.

There are several reports by the WTO committees and the Secretariat on the state of play in the Doha Round on LDCs. There is also a voluminous record of proposals based on various items of the Doha Negotiating Agenda by individual members and groups of members. Rather than delve into

this ocean of documents, this book will instead mention two that give a flavour of the current situation.

On 1 December 2006, a report (WT/COMTD/58) was published covering the work of the Committee on Trade and Development, in its regular and dedicated session on small economies and its subcommittee on LDCs. The principal themes addressed at the regular session were largely the standard ones of market access for developing and least-developed countries, and its implications for the development of primary commodity exporters, paragraph 51 of the Doha Declaration for identifying and debating developmental and environmental aspects of the negotiations and so on. This report is simply a factual record of the topics discussed and proposals made, not so much a record of progress made, work remaining to be done or any interim achievements.

A more recent, longer and a more informative report is by the WTO Secretariat (WT/COMTD/SE/W/22 Rev.1) dated 26 November 2007. As a document prepared under the Secretariat's own responsibility, it does not prejudice the right of any member of the WTO to raise its concerns about the work programmes on small economies. However, it attempts to reflect the current state of play of the issues relating to small economies so far discussed in the negotiating and other bodies. Nearly half the report is devoted to the current situation on modalities on market access in agricultural and non-agricultural products. These modalities have since been revised, with the revised negotiating texts circulated in May 2008. The state of play as recorded in the Secretariat's report on domestic regulation, services rules, subsidies and countervailing measures, trade facilitation, and Aid-for-Trade is likely to be revised if and when the negotiations resume. On the whole, and on all these issues from modalities to trade facilitation, the state of play seems to indicate that the obligations and commitments that LDCs, small economies and developing countries more generally will undertake, will be considerably weaker than the corresponding ones that developed countries are to undertake. This is not to say that the countries concerned have agreed to the commitments as stipulated in the draft modalities, etc. It is only to say that the gaps between developed and developing countries in their positions on modalities have narrowed significantly as compared to earlier drafts; whether those that remain are still too large to bridge, or could be bridged in a compromise deal closing

the Doha Round, is too soon to tell. The collapse of the negotiations at the informal ministerial meeting in Geneva during 21-21 July 2008 suggests that they are still too large.

Turning to the current state of Doha Negotiations, the Director-General, Pascal Lamy, in his statement of 20 May 2008 said that "these revised negotiating texts illustrate where a convergence lies among the WTO members and where we have more work to do. Very soon our negotiating process will intensify…We are getting closer to our end game." As is to be expected, given his official position, he is optimistic. The author hopes that he is not unduly optimistic, though the history of the negotiations would suggest that he is (as does the current breakdown in talks).

Would the revised negotiating texts of May 2008 with their modalities for agriculture and non-agricultural products, if they are adopted, contribute to enhanced and beneficial participation of LDCs and SVS in World Trade? The fact that India, a major developing country and a leading member of G-20, as well as several other developing country members of the WTO including Brazil, Mexico and South Africa, already rejected them does not augur well for its adoption.[1] The term of the Bush administration in the US is ending in January 2009, and if it is succeeded by a Democratic Party administration, going by the rhetoric of Mr. Barack Obama, the Democratic presidential candidate, it seems unlikely he would push for a resumption of the Doha negotiations. Even in the unlikely event that he does, he would insist on including on the negotiating agenda labour and environmental standards, which have not been on the agenda thus far. Be that as it may, the author's reading of the negotiating texts suggests that they go a long way in delivering much of what was promised in the Doha Declaration and Agenda by way of special and differential treatment of developing countries in general and LDCs in particular. Whether this will lead to their 'enhanced and beneficial' participation in world trade depends on what the basic constraints are in the first place that reduce effective

1. The Indian Commerce Minister, Mr. Kamal Nath, while disagreeing that only India had differences with the US on farm subsidies, made an offer to close a deal (i.e., to resume Doha negotiations) if the US were to make a symbolic gesture to its farm subsidy by just one dollar. It is likely that he was just making a debating point, and not a serious offer. See: *http://www.hinduonnet.com/thehindu/thscrip/print.pl?file=2008061855781700.htm*&date=2008/06/18/&prd=th& [accessed 4 August 2008]

participation. To repeat, these are mostly in the domestic arena, primarily of domestic political economy and society.

The Doha revised negotiating texts, if adopted, at best could help developing countries to improve their trade policies and thus help them increase their participation. However, dramatic improvements in trade performance cannot be expected. For example, even after the removal of systemic biases against trade and the dismantling of barriers since the mid-80s, India's share in world merchandise trade increased by only half of one per cent over two decades, from 0.5 per cent in 1983 to 1 per cent in 2006. Moreover, in 1948, soon after the conclusion of GATT, India's share was much higher at 2.2 per cent. More generally, the total share in world merchandise trade of Mexico, South and Central America, the Middle East, Africa and Asia (excluding Japan, Australia and New Zealand), which together broadly cover the developing world, was 31.4 per cent in 1948, 26.8 per cent in 1983 and 35.4 per cent in 2006, but the trend for these shares does not reveal the divergent trends among sub-groups. For example, if we exclude South East Asia, which was much more open from the 1960s, and China, which opened in 1978, the share of the remaining countries was 27.1 per cent in 1948, 19.8 per cent in 1983 and 19.6 per cent in 2006 (WTO, 2007, Tables 1-6). This shows that although the period after 1980 is one of growing integration of the developing world with world trade—certainly it reversed the decline in the export share of the developing world as a whole from 1948 to 1983—the gain in export share has largely been in China and South East Asia. Africa and South and Central America have experienced a steady decline in their share of world trade ever since 1948. This suggests that other constraints restricted them from gaining export shares following trade liberalisation. It also confirms that trade liberation *per se* is not the most effective or first best instrument for achieving distributional objectives or for easing domestic political economy constraints. Quite the contrary: domestic politics is likely to inhibit the adoption of trade liberalisation policies, primarily because of its fear of the short-run adverse distributional consequences trade liberation could have.

6 Making Global Partnership for Development More Effective

Some Recommendations

6.1 Is there a 'Global Partnership for Development'?

UNCTAD (2008) devoted Chapter 3 to a discussion of changes in development partnership. Its finding (p.93) that "the fundamental priority of LDC governments is to formulate and implement national development strategies that effectively promote development and poverty reduction" is certainly unexceptionable, if not altogether banal. This book argues (something the UNCTAD report does not refer to at all) the major constraints on the LDC governments in delivering the suggested development strategies are of domestic political economy. UNCTAD's recommendations for what it calls 'development partners' relate to foreign aid, trade and investment, and these recommendations place a great deal of importance on country ownership, a concept which UNCTAD (2008) itself deems elusive. This book finds country ownership to be less important, but emphasises the contents of development assistance and its uses. However, the discussion in UNCTAD (2008, Chapter 3) presumes the existence of a partnership. Does one indeed exist or can one be put together if it does not?

Any partnership necessarily involves, first of all, some shared objectives that are well defined. Second, there has to be a clear understanding among partners, not only on the set of actions that will further the shared objectives, but also an agreement on the actions that each of them is responsible for implementing and the shares of each in the cost of financing such actions. The shared objectives as well as the set of actions are quintessentially inter-temporal, more often than not involving fairly long time horizons. This being the case, sustaining the partnership over a long enough time horizon, so that the shared objectives are attained,

requires that the commitment of each partner to the partnership and the actions and cost shares that the partner is responsible for are credible, which is a difficult task to accomplish. For example, in the development context, the so-called 'aid fatigue' and the failure to reach the aid target of 0.7 per cent of GDP (even after several decades), let alone increasing that target, is an indicator not only of the lack of credible commitment of aid donors in the partnership, but also of their rethinking of their not-so-credible, earlier commitments.

Some might even deny the existence of a meaningful global partnership for development in the sense of the last paragraph, and the feasibility of ever putting one together. This is for several reasons, the primary one being that development is multidimensional and reasonable people could, and often do, disagree not only on its contents but, more importantly, on the relative importance of its many components for each of the many heterogeneous set of developing countries. Indeed, one could go further and point out that the multidimensional character of development raises problems in defining a developing country, since a country could be developed in some dimensions and not in others. Even if there was universal agreement on the relevance and relative importance of a subset of dimensions, such agreement is very unlikely to extend to the actions that each partner should undertake in promoting them.

In the author's view, it is futile to talk about a hypothetical partnership for development in all its aspects. It is better to start from the reality that many, by no means all, developed and developing countries (and more precisely the governments in power in them) have common interests in some aspects of development. So too have a whole host of multilateral institutions and non-governmental organisations (national and transnational) of various political hues. While it is appropriate to exploit the existence of such common interests for furthering development, it would be far-fetched to the point of being meaningless to call this a 'global partnership for development'. However, there is no denying that often a large number of countries and organisations come together in promoting particular aspects of development. If this is a reasonable approximation of ground-level reality, one has to focus on a considerably more modest objective of how to make existing groups that are interested in development—some of which may be cohesive enough to be called

coalitions, if not partnerships, while others are much looser—more effective. Since such groups are likely to be issue-specific, it is impossible to make concrete recommendations in order to make them more effective. Instead, this book starts with existing groups or categories (though some happen to be analytical categories and not necessarily ones that have formed around an objective or course of action) and asks whether they could become more effective (and if so how)? At the same time it recognises the potential achievements of such realistic groups will be issue-specific, not necessarily coordinated in their actions and together will not span development in all aspects, so will necessarily fall considerably short of what could be achieved by a group that not only covered all aspects, but had a coordinated programme of action. Still, such a comparison is meaningless, since realistically there is no chance of forming the latter such group.

6.2 Some Recommendations

The book concludes with the following recommendations, in no particular order of priority or relative importance. It begins with intergovernmental international organisations that provide financial assistance of various kinds to developing countries, such as the IMF and the World Bank and others, such as UNDP, the UN Children's Fund (UNICEF), the UN Industrial Development Organization (UNIDO), the World Health Organization (WHO) and others of the UN family that carry out some financing. In addition to these, individual country governments and non-governmental groups also provide development finance. An issue that is well known, and also commented upon in several documents of aid agencies and by NGOs engaged in development,[1] is the problem of coordination among aid providers so that the potential benefit to developing countries is maximised. The growing literature on aid ineffectiveness, at least that part which sees no hope ever of making aid more effective, also cites coordination failure among providers as a source. The coordination problem is repeatedly mentioned in the discussion on assistance to LDCs, SIDS and SVS, and attempts are made to address it in some way through collaboration among

1. Two of the most felicitous phrases coined by Paul Collier (2007) are "Development Bliss", consisting of agencies doling out aid and the companies and individuals they contract in aid projects, and "Development Buzz", which consists of rock stars, celebrities and NGOs.

agencies—for example in the IF for technical assistance. Yet the problem continues to be a serious one and is not easy to eliminate.

Even within the bureaucracy of a single national government, coordination among different ministries and departments is difficult. One oft-cited example is that the trade or commerce minister (or their civil servants) of a government participate in WTO ministerial meetings and high-level international trade negotiations, while finance ministers participate in meetings of the World Bank and the IMF. The positions of commerce and finance ministers on an issue that comes up at such meetings are often not coordinated. The problem is particularly acute for LDCs and small economies, where a relatively small number of competent politicians and bureaucrats have to deal with a plethora of aid agencies, both official and private. Clearly the problem of coordination has to be addressed if an effective global partnership is to be formed (assuming it can be). The chances of this are not high.

Institutions such as the World Bank and the IMF have assumed roles that have gone way beyond their original mandates. To some extent, such 'mission creep' in these organisations (as it is derisively called) is understandable for good and bad reasons. Their mandates were set in the late-1940s when they were founded, and some such mandates may no longer be relevant in a rapidly changing global environment. A classic example of irrelevancy is that of the UN Trusteeship Council, which still exists long after its function ceased to exist—the reason being that it cannot be abolished without amending the UN Charter! Since such charter amendments and mandate revisions, like changing constitutions, are difficult and time-consuming, it is natural that institutions do not attempt them, but instead creatively respond by reinterpreting old mandates to fit new circumstances.

On the other hand, the vast bureaucracy of such organisations will (in its own self-interest) resist changing mandates it is accustomed to addressing, particularly if such change would potentially reduce its perquisites and size! In the author's view, both the IMF and the World Bank have gone way beyond creative responses. With far more capital available now from the global private market, and relatively more advanced developing countries, including emerging markets having access to such

capital at reasonable terms, there is no need for the World Bank to lend to such countries (e.g., China, Brazil, India and others) or to have field offices there. Certainly, these countries could benefit from any tried and tested policy advice from the Bank based on its experience. However, there is no reason for lending to be linked to the provision of such advice.

A first step in the formation of a global partnership that includes the World Bank would be to reconstitute the Bank into a smaller institution that caters only to the needs of those developing countries that do not have access to world capital markets and/or attracting significant capital inflows. These countries would certainly include LDCs (other than those with petroleum and natural resources) and perhaps few others. A large majority of these countries will be in sub-Saharan Africa. A similar reform of regional development banks, including the possibility of closing ones that have not been effective, should be considered.

The IMF has also gone way beyond its mandate. Its forays into structural adjustment (which were a consequence of the slow response of the World Bank to mount such programmes after the oil crisis of the 1970s) have been limited in their success. Its current intrusion into poverty alleviation, through requiring PRSPs as foundations for its involvement with a developing country, is totally unwarranted. It is certainly the case that the task of keeping the global financial system, including financial markets, stable needs a global institution, and the IMF already has this mandate—although its influence on its richer members is considerably weaker that on its borrowers. This imbalance needs to be addressed. Moreover, the fact that many developing countries have accumulated a vast stock of exchange reserves since the East Asian Financial Crisis of 1997 (China's reserves exceeding $1.7 trillion currently, is a spectacular example) illustrates that they feel the need to 'self-insure' themselves, because they have lost faith in the ability of the IMF to reduce the probability of severe shocks to global financial markets and provide assistance if shocks occur. The author would argue that building confidence in a reformed IMF is essential. For this task, it is essential to ensure that the mandate of the IMF does not extend beyond keeping the global financial system stable and whatever is needed for this purpose. A second step in making a global partnership that includes the IMF is to make the primary mandate of that institution the responsibility for the stability of the global financial system.

The IMF should continue providing advice on macroeconomic, exchange-rate and financial-sector policies to its members through its mandated consultation with them under its Article IV.

The ongoing crisis in financial markets, which began August 2008, has already led to demands for reforming the global financial architecture, including reform of the IMF. The British Prime Minister, Gordon Brown, was the first to propose on 15 October 2008 a summit of global leaders to discuss the global financial architecture with a view to rebuild the IMF for the purposes of the modern world, including an early warning system. The next day the leaders of the EU Summit adopted the Brown proposal. President Bush has invited the leaders of G-20 nations, which include the developing countries Brazil, China, India, Indonesia, South Korea, Mexico, Saudi Arabia, South Africa and Turkey, for an international meeting on the global economy. The broad agenda for the meeting will invite the leaders to agree on a common set of principles for reform of the regulatory and institutional regimes for the world's financial sectors (*New York Times*, October 23, 2008). It is to be hoped that proposals for long-term reform are not distorted by the need to resolve the current crisis.

This book has already referred to the weighted voting in the decision-making of the World Bank and the IMF. Of course, the convention (it is only a convention and not an article in their founding charters) that the president of the World Bank is nominated by the US, while the managing director of the IMF is nominated by Europe, no longer has any rationale if it ever did. It should be replaced by transparent mechanisms that would select the most qualified candidates for these posts, this together with reform of the decision-making apparatus of the two institutions, including their executive boards and voting (as noted earlier, the quotas governing voting rights have been revised recently). These reforms would be the third step and a prerequisite for making global partnership more effective.

The reform issues relating to the WTO are well known and less complicated than those relating to the World Bank and the IMF. First, the WTO, unlike the Bank, IMF and other agencies, does not dispense financial resources to its members. Not being able to 'put money where its mouth is', to use a cliché, could potentially limit the adoption of its advice. Nonetheless, as long as the convention (and not a rule) that its

decisions are made by consensus continues, with every member having an equal voice (in principle), its advice potentially has greater credibility, provided that voice is exercised. However, exercising that voice requires capacity in several dimensions, which LDCs in particular lack. Capacity building is firmly on the agenda of the WTO, with several rich countries already contributing resources for the effort. Meanwhile, however, capacity constraints in LDCs restrict not only their effective participation in the WTO, but also their interaction with other international institutions and the rest of the world. For this reason, the fourth step has to be effective capacity-building efforts in LDCs. These efforts should be multidimensional and the assistance to capacity-building efforts must be much broader based than only in the WTO or World Bank. Again, such assistance has to be coordinated, focused and flexible to respond appropriately to the enormous diversity of the LDCs, including with respect to their weaknesses in various dimensions of capacity.

Unless the LDCs themselves willingly undertake capacity-building efforts and create an environment in which assistance to those efforts can be utilised effectively, such efforts will fail. However, the notion that reluctance to undertake such efforts on their own is due to lack of 'ownership' on the part of LDCs is exaggerated. The more severe constraints on development are of domestic origin and involve difficult issues of political economy, including issues of political and administrative corruption and governance. In addition, domestic armed conflicts, including ethnic conflicts and insurgencies, some of which have escalated into almost full-scale civil wars, plague many countries. If the conflicts that are severe and of long duration continue, and if distributional and other conflicts of interest among social groups are not addressed peacefully through participatory domestic political processes, a sustained development process is unlikely to start, or to be continued even if it does start. To what extent external partners of a global partnership can help resolve such issues of domestic political economy and conflict is an open question, since attempting to do so will invariably infringe on sovereignty. However, current rethinking of sovereignty in situations where many human lives (millions in some situations) are threatened by a particularly brutal regime, offers the possibility that a similar rethink could be extended to cases where respect for sovereignty is keeping many humans in an extremely

poor state of development. Unfortunately, rethinking has not led to taking action in recent cases that clearly call for such action. For this reason, and because it is an extremely sensitive issue that involves possible misuse, the author would tentatively list as a fifth step for consideration, infringing sovereignty, if needed, in order to help millions living in a poor state of development, with international agreement and proper safeguards against misuse. However, he would reject attempts to adopt a universal charter of rights to development, analogous to universal human rights, and make it obligatory on states to ensure its observance, for the reason that such rights are not only incoherent, but certainly not universal as states could legitimately differ on their relevance and content.

Within the WTO, the rule-making body is the ministerial conference, while changes in existing rules emerge out of the agreements concluding each round of multilateral trade negotiations. Not only are the rounds initiated after long intervals of time but, once initiated, each round can take a long time to conclude. For example, it took seven years to conclude the Uruguay Round, and the Doha Round, initiated seven years ago in 2001, is yet to be concluded. The dispute settlement body of the WTO pronounces its findings on disputes between members based on existing rules. Thus, with no equivalent of a parliament or legislature to make, amend or repeal laws, WTO rules could remain on the books for a long time after they have become irrelevant or are in urgent need of amendment. A way out of this should be considered, such as making the WTO Council, in which all members are represented, a legislative body, and perhaps restricting the consensus convention to only such decisions that the Council deems appropriate. The author is suggesting this as the sixth step for making a global partnership that is effective in trade issues.

In the author's view (Srinivasan, 2007) the ultra-legalistic dispute settlement mechanism of the WTO is a drastic shift from the political one of GATT. It has involved, in particular, the reversal of the consensus required in the GATT to approve the appointment of panels to hear disputes and, if appointed, their recommendations. Although in general a legalistic dispute settlement system based on law and rules protects the weak (and in the WTO, the developing countries are the weaker members) better than a political system, which is susceptible to manipulation by the politically powerful, in the author's view the WTO system actually

penalises the weak. In the WTO system, the appointment of panels is automatic if the consultations between the plaintiff and the defendant failed to resolve their dispute. The decisions of the panel, and of the appellate body if they are appealed against, can be overturned only by a consensus of the WTO Council. This retrograde shift came about in the Uruguay Round, largely at the insistence of the developed countries (particularly the US) who wanted it because, in their mistaken view and against the evidence, the GATT system had failed to resolve disputes. The WTO legalistic system in effect penalises the poorer members of the WTO, because they have limited capability to identify violation of commitments by others or to argue their case before the panels and appellate bodies. Although it has its own problems, going back to the GATT system may be better from the perspective of LDCs and other poor members of the WTO. The author puts this as the seventh step worth considering.

Thus far, labour standards have been kept out of the WTO and firmly in the mandate of the International Labour Organization (ILO). However, the US and the EU are pushing labour and environmental standards as part of any preferential trade and economic cooperation agreements (ECAs) they conclude with developing countries. The US is also pushing TRIPS-plus clauses in such agreements. Already the mutual consistency of international agreements on trade and the environment is on the WTO work programme, the responsibility of a specific committee.

Attempts to use multilateral trade agreements as devices to intrude into the non-trade-related domestic regulatory arena began at the WTO Singapore ministerial conference of 1996. These domestic regulatory issues, since then known as 'Singapore Issues', include investment, competition policy, transparency in government procurement and trade facilitation. After the Cancún ministerial meeting of 2003, of the Singapore Issues only trade facilitation remains on the Doha negotiating agenda. It is arguable whether the success of the developing countries in keeping labour standards and Singapore Issues (other than trade facilitation) from the WTO is only a temporary one. The author's eighth step is for the global partnership to preclude these issues from ever being raised in any future WTO negotiations.

Regional and other preferential trade agreements (PTAs) have been suggested as a way for LDCs, particularly SIDS and SVSs, to overcome

constraints on their integration with world trade. It is claimed that contemporary PTAs go beyond trade liberalisation and involve ‘deeper integration’ of members in other areas including, in particular, investment and technology transfer. The classic analysis of Jacob Viner long ago noted the trade creation (i.e., increasing trade among members) and trade diversion (i.e., diverting trade away from low-cost non-members to higher-cost trade among members) effects of CUs and FTAs. Whether the beneficial trade creation is more than offset by the loss from trade diversion would depend on the characteristics of particular agreements and their membership, and whether or not they include non-trade provisions.

The empirical evidence on the benefits from PTAs is contradictory—the conclusions depend on the empirical methodology, the database used, the countries and the time periods included in the analysis. Adams *et al.* (2003) examined both theoretically and empirically, the effects of the trade and non-trade provisions of PTAs on the trade and foreign direct investment (FDI) flows of member and non-member countries of those PTAs. They found that of 18 recent PTAs, 12 (including the EU, the North American Free Trade Agreement [NAFTA] and the Common Market of the South [MERCOSUR]) have diverted more trade from non-members than they have created among members. Although, they also found that FDI responds significantly to non-trade provisions of PTAs, the economic costs of trade provisions of PTAs are magnified by greater capital mobility, so that the benefits from increased FDI could be offset by the losses from trade diversion. De Rosa (2007), on the other hand, using a different variant of the Adams *et al.* (2003) gravity model of trade flows, comes to the opposite conclusion that the majority of the current PTAs are trade creating.

The author used just the coefficients for logarithms of GDP and for geographical distance from the paper of Adams *et al.* (2003) to predict the bilateral trade flows for 2005 for 164 countries, of which 38 were LDCs. Since the other possible explanatory variables of trade flows are excluded from this prediction exercise, one would expect the predicted trade flows to fall short of their actual values. Table 6.1 presents the results of the exercise. It shows that it is indeed the case that for non-LDCs an overwhelming majority—101 out of the 126—their actual trade flows exceed their predicted values from the gravity model. Interestingly,

however, the opposite is true for the LDCs: for an overwhelming 31 out of 38, their actual trade flows fall short of their predicted values. This seems to confirm that constraints other than low income and remoteness from their trading partners (capacity constraints, for instance) are far more significant in restricting their trade. It is extremely unlikely that entering into a PTA or EPA will alleviate these constraints. Moreover, if a country becomes a member of more than one PTA, the task of devising their complicated rules of origin would be beyond the capacity of these countries to address. On the other hand, domestic efforts, particularly in addressing political economy constraints, augmented by effective multilateral efforts (particularly through the WTO) could help.

Table 6.1

Actual Trade Flows—Predicted Trade Flows for 2005

	Positive (>0)	*Negative (<0)*	*Number of observations*
LDC	7	31	38
non-LDC	101	25	126
TOTAL	108	56	164

Source: Predictions based on the gravity model of Adams *et al.* (2003).

The author concludes from the ambiguous empirical evidence and the strong theoretical presumption in favour of multilateral, rather than preferential, trade liberalisation, that LDCs should avoid getting into PTAs and EPAs. The ninth step would require rich countries of the global partnership not to offer such disabling PTAs and EPAs with non-trade provisions to the developing countries of the partnership, and to persuade them not to enter into ones offered by others. The partnership should focus its efforts exclusively on multilateral agreements and work towards concluding the Doha Round satisfactorily and soon.

In the author's view, the WTO should remain an organisation whose members are entirely states and independent customs areas within states (e.g., Hong Kong). The somewhat heated debate on the so-called 'democratic deficit' in the WTO is, in his view, fundamentally devoid of content. The concept of participatory democracy is not easily extended to inter-state organisations. This not to say, of course, that rules of membership and of decision-making in such organisations do not matter—they do, as discussed

in Section 4.6. However, participatory democracy is a meaningful issue for individual member states and not for the WTO. As long as universality of membership of WTO is the goal, as it should be, and is in the United Nations, any state willing to undertake the obligations of membership in the WTO should be free to apply for membership. These obligations are mostly in the arena of trade, and arise from various agreements to which the members are parties. Extending the obligations to the political arena of democratic participation in each member state is inappropriate. For this reason, the author is sceptical of the utility of observer status in the WTO already granted to NGOs. It is perhaps impossible to reverse it. The tenth step for the global partnership should be to oppose firmly and decisively any extension of participation, beyond submission of *amicus curiae* briefs to private parties and NGOs in the dispute settlement process, as well as to ensure that the current status of membership and processes of the WTO remain.

This book has already alluded to the concern about preference erosion arising from the fact that preferential access, by way of lower tariffs applicable in some rich countries to exports from developing countries, is becoming less 'valuable' as tariff barriers in the rich countries fall. The value of the preferences, such as the generalised system of preferences (GSP), is vastly exaggerated. In a paper for the Inaugural Conference of the Society of International Economic Law in Geneva during 15-17 July 2008, Dowlah (2008) concludes: "There can be little doubt that the available GSP schemes have largely been a failure in respect to LDCs. None of the professed objectives, which legitimised the adoption of such schemes in the first place—such as industrialisation, exports and economic growth through trade rather than aid—has materialised in the context of the LDCs. Three major factors can be held responsible for such an abysmal performance of GSP schemes: the unilateral and arbitrary character of GSP programmes; built-in as well as discretionary lapses which conditioned GSP schemes over the decades; and crippling supply constraints in the LDCs." He proposes some remedies to overcome the utter failure of GSP and ends with a plea: "In the end, the world community must come up with a bold and pragmatic plan to revamp GSP schemes on the one hand, and remove the supply constraints on the LDCs on the other, to lift the

LDCs from the morass of poverty and helplessness." The author of this book is not persuaded that such a plan can be devised.

In the author's view, retaining GSP and de-linking the levels of preferential access to tariff levels in export markets is counterproductive. It will blunt the incentives of developing countries to reduce the higher domestic costs that limit their exports. These high costs were the rationale for tariff preferences in the first place. The global partnership should focus on reducing these costs permanently through effective support for capacity-building efforts in the LDCs, rather than perpetuate counterproductive, preferential access through GSP. This is the eleventh step.

The author concludes this book with one final thought about what Brown and Stern (2005) call "Fairness of the Global Trading System", as embodied in GATT/WTO, and its relevance. These authors judge fairness on the basis of two criteria: equality of opportunity and distributional equity. These criteria are well defined in assessing the fairness of a system that defines opportunities available to individuals in a society and the fairness of the distribution of incomes or wealth that result from those opportunities. The authors extend their assessment to trade negotiations and agreements under GATT/WTO among countries, and argue that equality of opportunity for members prevails "when there is reciprocity in the reduction of trade barriers, when there is adherence to most favoured nation (MFN) treatment, when any biases in initial conditions are removed, where the rules supporting market access are not only seen as equivalent, but also consistent with national preferences within countries, and when procedural justice is respected, especially in such matters as dispute settlement and the use of trade remedy measures". On the other hand, they find meaning for distributional equity in only one sense in the context of the global trading system, which is "whether the trading system gives preference to the efficient growth of production…through sales in foreign or domestic markets, the reason being the global trading system is not a vehicle for income transfers across countries."

The use of individual-based standard concepts of equity and efficiency for assessing the fairness of the global trading system, in the author's view, is analytically confusing. Nation states are aggregates and not individuals, and as such, fairness among aggregates would remain

a problematic notion unless diverse preferences of individuals within a nation can be meaningfully aggregated so that each nation is treated as an individual with the aggregated preference. As is well known, such aggregation is possible only under very strong and unrealistic conditions. Moreover, even with a well-specified aggregate welfare, whether or not the welfare actually attained is the maximum attainable given the governing rules of the world trading system, would in general depend not only on these rules, but also on the domestic system of resource allocation. Be that as it may, deep philosophical issues arise in attempting to extend a theory of justice developed in the context of a given society or people to societies and peoples. A less-widely discussed work of John Rawls than his justly-celebrated book *A Theory of Justice* (Rawls, 1971) is his much later short book *The Law of Peoples* (Rawls, 1999), which attempts such an extension. Not being a philosopher, the present author cannot evaluate the success of his effort. However, it is fair to say that the attempt drew more extensive and significant critical comments from other philosophers than his *Theory of Justice*. This suggests that the extension that Brown and Stern (2005) propose of fairness and equity concepts across individuals in a society to a global trading system consisting of nation states needs careful reconsideration.

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Why have the least developed countries, and other poorer countries, failed to grow as fast as other economies during the recent period of globalisation?

Professor Srinivasan explores the broad links between growth in income, globalisation, and poverty reduction. He argues that past domestic and international policies have failed to serve the interests of the poorest countries, and suggests that the current array of international institutions, in their unreformed state, are ill-suited to bring about the changes required.

Finally he makes recommendations on needed reforms to the institutions that manage the global economic system.

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