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Unfair Trade Policies Damaging Growth Prospects in Developing Countries

High tariffs and subsidies divert billions from human development

United Nations, 7 September 2005—Unfair trade policies continue to deny millions of people in the world's poorest countries an escape route from poverty, and perpetuates obscene inequalities, says the *2005 Human Development Report*.

The Report argues that trade has the potential to act as a catalyst for human development and accelerated progress towards the Millennium Development Goals (MDGs). But it says that potential is being undermined by present trade policies, a failure to tackle national inequalities, and structural forces that exclude poor people from market opportunities. While the Doha 'development round' of trade negotiations has provided a unique opportunity to make trade a more effective force for poverty reduction, the Report argues that little of substance has been achieved after four years of negotiations.

"Trade has the potential to act as a more powerful force for human development than aid alone," said Kevin Watkins, the lead author of the Report and the Director of UNDP's Human Development Report Office. "But unless the Doha Round negotiations get serious, whole sections of humanity will be denied a share in the prosperity created by global integration."

The Report said that sub-Saharan Africa, despite modest gains in exports, has become increasingly marginalized in the world market. Today, with a population of 689 million people, the region accounts for a smaller share of world exports than Belgium, with just 10 million people. The Report found that if Africa had maintained its share of world exports that it enjoyed in 1980, its exports today would be some US$119 billion higher. The authors conclude that in terms of foreign exchange this amount would equal about five times the aid flow provided by rich countries since 2002.

While emphasizing the human development and wider economic gains to be made from trade, the *Human Development Report* challenges the claim that increased trade offers automatic benefits. It contrasts the success of Viet Nam in converting export growth into poverty reduction with the difficulties Mexico faces, where rapid import liberalization in agriculture has further marginalized the rural poor, in part due to high levels of initial inequality. Guatemala is cited as an example where extreme inequality has limited the potential for trade to support human development.

The Report also highlights the critical role of industry and technology policy in enabling countries to climb into higher value-added areas of world trade—an area in which East Asia has succeeded while Latin America has not. Although the *Human Development Report* acknowledges the benefits of import liberalization as part of a wider strategy for poverty reduction and increased growth, it provides new evidence challenging the claim that openness in itself is always good for growth. The design, pace and sequencing of reform is critical for a liberalization strategy to work, the report shows.

Need for rational global trade rules

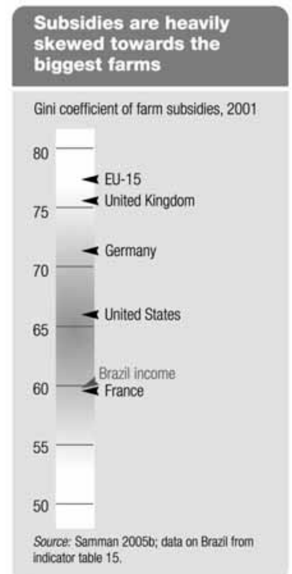
The UN World Summit provides a key opportunity to revitalize the Doha Round of negotiations, the Report says. While all WTO members have a role to play, the Report contends that donor countries have primary responsibility. "Rich countries are the primary Doha Round problem," Watkins said, adding that "the UN summit gives them a chance to become part of the solution."

Although rich countries have consistently pledged to reduce tariffs on imports from developing countries and to greatly slash their subsidies through programmes such as the US African Growth and Opportunity Act, the Report points out that neither goal has been achieved.

"The world's highest trade barriers are erected against some of its poorest countries," assert the authors. "On average the trade barriers faced by developing countries exporting to rich countries are three times higher than those faced by rich countries when they trade with each other." The Report found that poor countries account for less than one-third of rich country imports but for two-thirds of tariff revenues collected, and calls such tariffs a "perverse taxation."

Harmful farm subsidies

The Report contends that instead of keeping a promise made in the last round of world trade negotiations, developed countries have actually increased agricultural subsidies. These "subsidies for overproduction in developed countries," the Report asserts, have now reached $1 billion a day, compared with $1 billion a *year* for agricultural aid to developing countries.



While patterns of support vary, rich country taxpayers and consumers are paying for a system that largely supports rich farmers (see figure on the Gini coefficient of subsidy distribution) while hurting some of the world's poorest farmers. These farmers face some of the world's highest tariffs and they have to compete in global and even local markets against subsidized competition. In this way, the Report argues, rich countries have kept a stranglehold on their share of world agricultural exports (two-thirds of the total), a ratio that has not changed since 1980.

Today, developing countries lose about $24 billion a year from agriculture protectionism and subsidies. For every $1 lost in trade, there is a multiplier effect that causes losses worth an additional $3 from reduced investment and employment. This could put total losses at about $72 billion, an amount equivalent to all official aid flows in 2003

Conversely, the Report found that in Europe, farm subsidies have reached $51 billion, and although this sector accounts for less than two percent of the work force, it absorbs more than 40 percent of the European Union budget. European sugar farmers, it says, are paid four times more than the world market price and this, in turn, creates a four-million ton surplus of sugar which is dumped on the world market with the help of $1 billion in EU marketing support, making Europe the second largest exporter of sugar. This surplus, the Report says, has caused world sugar prices to tumble by about one-third, costing Brazil $494 million in lost revenues, $151 for South Africa, and $60 million for Thailand.

Cotton, the Report says, remains one of the most contentious issues in the Doha Round. In a finding that confirms the concerns of governments in Africa and elsewhere, the *Human Development Report* contends that US producers have captured the markets for about one-third of all world exports. In Benin, the Report found, the fall in prices in 2001 was linked to an increase in poverty from 37 percent to 59 percent.

"Behind the free market rhetoric and emphasis on the virtues of level playing fields, the hard fact is that some of the world's poorest farmers are being forced into a competition not with northern farmers, but with industrial country finance ministries. Comparative access to subsidies, not comparative advantage, remains the key to understanding agricultural trade," Watkins said.

Looking beyond market access and agriculture, the Report calls for a stronger Doha Round emphasis on areas in which developing countries stand to gain—such as the movement of labour—and less emphasis by rich countries on intellectual property, investment, and rapid import liberalization in poor countries.

Falling prices, failing development

Compounding the problem of unfair trade rules, the Report says, is that the value of primary commodities—more than 50 developing countries depend on agriculture for at least one-quarter of their export earnings—have fallen as a total world trade, from 15 percent to 10 percent since 1980. The steep and steady decline in global commodity prices, the

Report says, is now an entrenched crisis that threatens to derail progress made toward achieving the MDG targets by the year 2015.

The Report shows, for example, that in the late 1980s, coffee exporters received about $12 billion for their exports, but by 2003, they exported more coffee, but received less than half as much income, or $5.5 billion. Meanwhile, the Report found that the "coffee economy" in rich countries is booming, with retail sales now reaching $80 billion a year, compared with $30 billion in 1990 as low wholesale prices and high retail sales has greatly boosted profits for the world's six largest roasters who now account for 50 percent of the trade.

"Today, for every $1 worth of Arabica coffee from Tanzania sold in a coffeehouse in the US, a farmer now receives less than one cent," the authors said. In Ethiopia, they said, exports have increased by two-thirds since the mid 1990s, but earnings have fallen dramatically and consequently, income in coffee producing households has crashed. With a drop in prices from $1 per kilo in 1998 to $0.30 a kilo today, the Report estimates that the average decline in household incomes was $200 a year in Ethiopia—a huge loss in a country where more than one-third of the rural population lives on less than $1 a day—and which translates to a national loss of $400 million, or one-half the amount received through foreign aid.

Ensuring Doha is a development round

"Strengthening the links between trade and human development will require action across a broad front," the authors concluded. "The immediate priority is to consider trade policy as a central part of national planning for poverty reduction. The Doha Round, and the WTO itself, are an important part of this process." The next ministerial meeting of the WTO, in December 2005, presents a "critical opportunity," they said.

The Report suggests the following next steps to follow-up on the Doha Round:

- **Deep cuts in government support for agriculture and a prohibition on export subsidies**. Agricultural support, as measured by the OECD's producer support estimates, should be cut to no more than 5-10 percent of the value of production, with an immediate prohibition on direct and indirect export subsidies.
- **Deep cuts in barriers to developing country exports.** Rich countries should set their maximum tariffs on developing country imports at a ceiling no more than twice the level of their average tariffs.
- **Compensation for countries losing preferences**. While industrial country preferences deliver limited benefits in aggregate, their withdrawal has the potential to cause high levels of unemployment and balance of payments 'shocks' in particular cases. An adjustment fund should be created to reduce the adjustment costs facing vulnerable countries.
- **Protecting the 'policy space' for human development**. It is important that multilateral rules do not impose obligations to liberalize imports, or to restrict public policies aimed at reducing poverty, that are inconsistent with national poverty reduction strategies. Unless rich country trade polices are reformed, developing countries will be forced to protect their agricultural products against unfair competition from exports that are subsidized in rich countries.

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ABOUT THIS REPORT: Every year since 1990, the UNDP has commissioned the *Human Development Report* by an independent team of experts to explore major issues of global concern. A worldwide advisory network of leaders in academia, government and civil society contribute data, ideas, and best practices to support the analysis and proposals published in the Report. The concept of Human Development looks beyond per capita income, human resource development, and basic needs as a measure of human progress and also assesses such factors as human freedom, dignity and human agency, that is, the role of people in development. The *Human Development Report 2005* argues that development is ultimately "a process of enlarging people's choices," not just raising national incomes.

The *Human Development Report 2005* is published in English by Oxford University Press.

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