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Macroeconomic policy questions

International trade and development

Report of the Secretary-General

Summary

The current global financial and economic crisis has emerged after two decades of globalization, which deepened interdependence among nations. Coming after a series of recent development crises affecting financial systems, food and energy security, commodities, health, water and climate change, the crisis threatens to reverse progress made in the fulfilment of the Millennium Development Goals. The crisis has hit hard international trade, the dynamic growth of which had sustained a rapid growth in many parts of the world. Prevailing development models and export-led growth strategy requires careful rethinking. International cooperation within a coherent global governance framework is essential in addressing global challenges. The international trading system can play an important role in reinvigorating the role of trade as an engine of growth and development, including by delivering in full the development agenda of the Doha Round. The United Nations has a central role to play in catalysing a coherent global response to the crisis and beyond, involving all countries and supporting development.

* A/64/150.



I. Introduction

1. The present report has been prepared pursuant to General Assembly resolution 63/203, in which the Secretary-General, in collaboration with the secretariat of the United Nations Conference on Trade and Development (UNCTAD), was requested to submit to the Assembly at its sixty-fourth session a report on international trade and development.

II. Global development crises and global governance

2. An economic and financial crisis of a scale and magnitude unprecedented since the Great Depression in the 1930s has transformed the global economic landscape. The crisis emerged as the mortgage market in the United States of America collapsed in 2007. Failures and attempts to rescue major financial institutions in the United States and Europe since September 2008 led to a general loss of confidence in markets, which resulted in a severe shortage in credit and liquidity, as investors hurried to reduce their risk exposures and deleverage their portfolios. Many developing countries relying on external borrowing suffered from capital outflows, in some cases requiring balance-of-payments support from the International Monetary Fund (IMF). Household consumption and corporate investment receded rapidly worldwide as uncertainty prevailed. The rapidly shrinking global demand led to an abrupt, sharp and synchronized contraction of international trade, which transmitted the crisis globally.¹

3. The resulting economic downturn has undermined opportunities for jobs, growth, and economic and social well-being. While the crisis emerged in a developed economy, its effects are global and felt by developing countries, particularly least developed countries and countries with weak and vulnerable economies. The crisis has amplified the development crises that were already affecting basic human needs and that had undermined financial systems, causing poverty, resulting in food and energy insecurity and volatility of commodity prices, and posing a threat to access to essential services and infrastructure as well as health and environmental sustainability. The recent outbreak of the influenza A(H1N1) pandemic could further affect recovery.

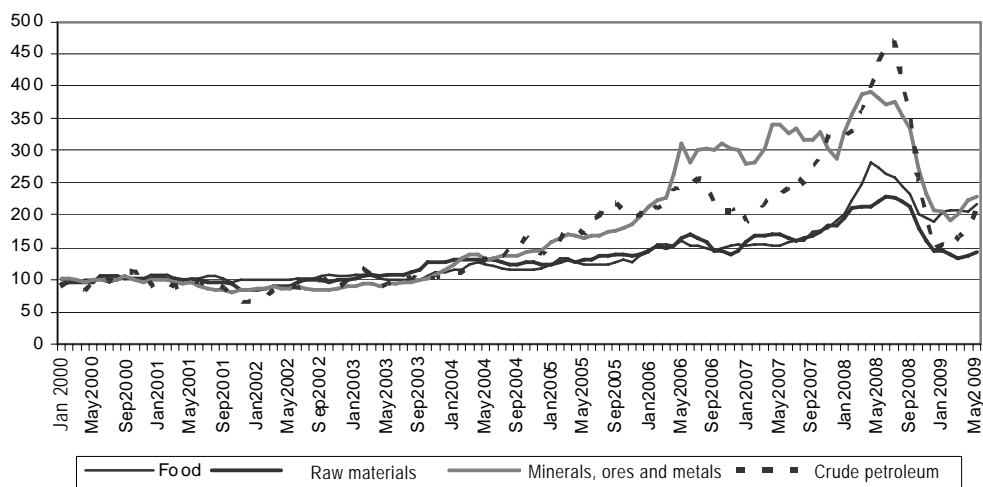
4. The crisis is expected to reverse hard-won progress towards the fulfilment of the Millennium Development Goal and poverty reduction targets for 2015. The World Bank estimates that the level of exposure to the effects of the crisis is high for over 40 per cent of developing countries and that in 2009, 55 to 90 million more people than previously expected will be living below the poverty line. The Department of Economic and Social Affairs of the United Nations Secretariat estimates that 105 to 145 million more people would remain poor or fall into poverty in comparison with a situation in which the pre-crisis growth would have continued. The strongest effects of the setback would be felt in East and South Asia, with from 95 to 132 million likely to be affected, about half of whom are in India. In Africa, 5 to 7 million more people and an additional 4 million in Latin America and the Caribbean would remain in poverty.

¹ See *The global economic crisis: systemic failure and multilateral measures* (UNCTAD/GDS/2009/1) and “Global economic crisis: implications for trade and development” (TD/B/C.I/CRP.1).

5. Increasing poverty and lower government revenue could lower public and private spending on social services, affecting other Millennium Development Goals. Such adverse effects could include: 200,000 to 400,000 more annual infant deaths between 2009 and 2015; an increase in the number of people living with chronic hunger from 960 million in 2008 to over 1 billion in 2009; reduced prospects for gender parity in tertiary education and other targets on the empowerment of women; serious adverse impacts on health and education outcomes; and increased financial constraints in building infrastructure, including those needed to mitigate climate change.

6. The persistent global food crisis has underscored in particular the significant risk of chronic hunger, malnutrition and adverse consequences related to health. Although agricultural commodity prices have declined from their peak in mid-2008, they remained at a historically higher level than pre-2007 averages (see figure I). Owing to factors that include demographic change, demand-supply imbalance, climatic conditions, biofuel production and high oil prices, it is estimated that real average prices for almost all food products in the coming 10 years will be considerably higher than those during the past 10 years.² Real prices for rice and wheat will be 10 to 20 per cent higher. High prices and shortages of food, coupled with decreasing household incomes, could have particularly adverse effects on the ability of the poor to access food. Reinvesting in agriculture in order to enhance productive capacities and improving access to food are important. The Group of Eight Summit agreed on the amount of \$20 billion to support the development of sustainable agriculture to increase food security, representing a shift from the provision of food aid, which adversely affected supply responses.

Figure I
Commodity price indices
(2000=100)



Source: UNCTAD.

² Organization for Economic Cooperation and Development — Food and Agriculture Organization of the United Nations, “Agricultural outlook 2008-2017” (Paris, 2008).

7. Recent fluctuations in energy prices have been a major factor affecting macroeconomic health in all countries. The price of oil rose from below \$40/barrel in January 2005 to its peak at \$147 in July 2008 before falling sharply to a five-year low of \$33 in December 2008, and is now traded at \$65 to \$70. Falling oil prices have been a stabilizing factor for net-energy importers suffering from higher import bills and inflationary pressures. Oil exporters have been confronted with negative terms-of-trade shocks and lost export revenue. While some exporters entered the crisis with better fiscal positions thanks to windfall revenue during the boom, others which rely heavily on oil exports have suffered from falling revenue, a deteriorated external balance and government spending cuts. Energy prices are expected to remain at a high level, especially given the continuing increase in demand in emerging economies. The key challenge remains to ensure access to sufficient and reliable energy sources.³

8. Global warming is a major challenge to humanity. In the short term, climate change mitigation and abatement measures aimed at de-carbonizing the economy and reducing greenhouse gas emissions could limit the ability of countries to produce and trade.⁴ With their relatively high emission intensity, developing countries would face significant costs for technological adaptation for higher energy, efficiency of materials and resources, investment in sustainable agriculture and renewable and sustainable energy. Countries implementing cap-and-trade systems for greenhouse gases may introduce carbon border taxes on imports from countries without similar commitments to offset differentials in competitiveness, which would necessitate a harmonization of norms under environmental and trade governance systems. Without global cooperation, emission-intensive production could be relocated to countries with weaker environmental regulations.

9. The unprecedented scope and severity of the current economic crisis, combined with the persistent and interconnected nature of recurrent global crises, points to the significant challenge of global governance facing the international community. The speedy transmission of the crises across the globe and increased income inequality and poverty across and within countries have raised concerns over the pace and nature of globalization. The fragmented governance systems over development, trade, finance, monetary policies, technology, labour and the environment are faced with the challenge of formulating a new, coherent paradigm conducive to realizing inclusive and equitable growth and development, guided by the internationally agreed development goals, in particular the Millennium Development Goals. The United Nations is being called upon to play a central role in catalysing such a paradigm.

III. Global financial and economic crisis

10. The causes and effects of the crisis are complex and manifold. Global macroeconomic imbalances accumulating over years of strong consumer demand in developed countries that were running large current account deficits, financed mainly by surpluses in East Asian and oil exporting countries, played a significant role in precipitating the crisis. Coupled with the extensive deregulation of financial markets and excess liquidity prompted by low real interest rates, those imbalances

³ See "Report of the Trade and Development Commission on its first session" (TD/B/C.I/5).

⁴ UNCTAD, Trade and Environment Review 2009 (to be issued).

encouraged leveraged excessive risk-taking in search of high profits without links to the real economy. Behind the strong saving-investment imbalance lay excessively high household consumption backed by borrowing. The crisis revealed that regulation and market supervision were inadequate.

Box 1

Regulatory and institutional dimension of financial services^a

The crisis exemplified the paramount importance of regulatory and institutional frameworks in infrastructural services. The financial market boom that preceded the crisis was not matched by adequate national and global market regulations. The regulatory failure in the new deregulated environment became manifest with regard to the control of product safety for complex and high-risk financial products, consumer protection, management of risks and leverage, regulation of non-traditional financial institutions, credit-rating agencies, assessment of systemic risk, capital adequacy regulation, moral hazard and incentive structure for compensation systems. Sound national regulations and institutional frameworks adapted to individual countries' conditions and capacities, and international regulatory cooperation, are essential in preventing future crisis.

^a Report of the Multi-year Expert Meeting on Services, Development and Trade: the Regulatory and Institutional Dimension on its first session (TD/B/C.I/MEM.3/3 and Corr.1. See also background note for the meeting (TD/B/C.I/MEM.3/2).

11. As the crisis spread to real economies, output slipped into unprecedented negative growth of -7.5 per cent for developed countries and -4.0 per cent for emerging economies in the fourth quarter of 2008. With a contraction of 2.6 per cent projected for 2009 from positive growth of 2.1 per cent in 2008, the world is confronted with the worst recession in over 60 years.⁵ An expected decline of per capita output in 2009 in countries representing three fourths of the global economy makes the recession truly global.

12. Developing countries are expected to see their growth significantly decelerating from 5.4 per cent registered in 2008 to only 1.4 per cent in 2009. While countries with emerging and larger developing economies, having access to the global capital market, were adversely affected by reduced credit availability, others were affected mainly through real economy channels, mostly by weak global import demand and concurrent falling commodity prices, and shrinking financial inflows through foreign direct investment and remittances. At the regional level, in 2009, the growth of gross domestic product (GDP) in Africa is projected to fall from 5.4 to 1.4 per cent, in sub-Saharan Africa from 4.7 to -0.1 per cent, in Latin America and the Caribbean from 4.0 to -1.9 per cent (from 3.9 to 0.7 per cent in the Caribbean), in East and South Asia from 6.2 to 3.2 per cent, and in Western Asia from 4.5 to 0.7 per cent. Economies in transition would see a reversal of growth from 5.3 to -5.1 per cent. Least developed countries could see their GDP fall from 6.1 to 2.7 per cent.

⁵ United Nations, *World Economic Situation and Prospects 2009* (updated as of mid-2009).

13. Reduced access to credit and falling levels of exports, in particular of manufactured products, have had an adverse impact on export-oriented economies in East and South-East Asia. Effects on larger Asian countries are less pronounced owing in part to their diversified and large domestic markets, which show a measure of decoupling. Falling commodity prices have had an adverse impact on commodity exporters. Sub-Saharan Africa has been hard hit by reduced demand and commodity prices, and lower remittances, tourism revenues and inflows of foreign direct investment. Countries with economies in transition have been severely affected by capital outflows and falling energy and mineral prices. Structurally weak, vulnerable and small economies, which typically have a high ratio of exports to GDP and depend on a few export commodities, tourism revenue and remittance, have been vulnerable to declining trade volumes, food prices and tourism and remittance inflows.

14. Global unemployment is projected to rise from 5.9 per cent in 2008 to a level of 6.5 to 7.4 per cent in 2009. The number of unemployed is expected to increase by 59 million compared with 2007 pre-crisis levels, from 180 million to 210 to 239 million. This increase is estimated to comprise 11 to 17 million in developed countries and 19 to 42 million in developing countries.⁶ Already in May and June 2009, the unemployment rate reached 9.5 per cent in the United States and 9.2 per cent in the European Union. In developing countries, job cutbacks have been greatest in export-oriented activities, in particular manufacturing, commodities and tourism, as well as in construction, giving rise to a reversal in rural-to-urban migration flows or the informal economy. The slower pace of adjustment of the labour market implies that the full social effects of unemployment remain to be felt and will endure even after production rebounds.

Policy responses

15. National crisis-mitigating measures were targeted to restore confidence in the financial sector and provide fiscal stimuli through expansionary counter-cyclical fiscal and monetary policies to boost aggregate demand. Fiscal stimuli implemented globally as of June 2009 could reach \$1.6 trillion, with \$1.3 trillion (3.6 per cent as a share of their GDP) pledged by developed countries and \$360 billion (2.8 per cent) by developing countries. Those packages include some particularly significant measures announced by China, Mexico, Spain and the United States. The sustainability of those measures poses challenges as interest rates approach zero and budget deficits require consolidation. Developing countries have found it difficult to conduct counter-cyclical policies due to fiscal constraints.

16. Large-scale expansionary market intervention marked a stark contrast with the pro-cyclical deflationary policies advised by international financial institutions and developed countries during the financial crisis in the past. It is now widely accepted that markets cannot self-regulate: the systemic dysfunction of financial markets seriously challenged the predominant neo-liberal economic doctrines built on the premise of a self-regulating market and underscored the urgent need to redefine States' role in regulatory and institutional frameworks. Developed countries have shifted away from free market-based forms of economic governance to exploring a bigger role for the State in economic management. Increasingly, governments are involved as "enabling and development States" in promoting sustainable and

⁶ International Labour Organization, *Global Employment Trends 2009*.

inclusive development by taking pro-active fiscal measures, improving regulation, institutions and incentives to encourage productive capacities, economic diversification and social safety nets.

17. International stimulus measures were considered important in increasing global demand as the fear of fiscal leakage and asymmetric fiscal positions have prevented some countries from increasing spending to a significant extent. In April 2009, the Group of Twenty Summit agreed, most significantly, to increase IMF resources with an immediate injection of \$250 billion and raise its capacity to \$750 billion; to ensure the availability of at least \$250 billion over two years to support trade finance; and to refrain from protectionism and support the conclusions of the Doha Round.

Box 2

Group of Twenty commitment on protectionism

At the Summit, held in London on 2 April 2009, members of the Group of Twenty reaffirmed and extended until the end of the year 2010 their commitment to refrain from raising new barriers to investment and trade and from imposing new export restrictions or implementing inconsistent measures of the World Trade Organization to stimulate exports. They further agreed to minimize any negative impact on trade and investment of domestic policy actions, including those taken to support their financial sectors, and to refrain from financial protectionism that might constrain global flows of capital, especially to developing countries.

18. The growing consensus on the need for a more inclusive global response led to the convening by the United Nations of the Conference on the World Financial and Economic Crisis and its Impact on Development from 24 to 26 June 2009 at Headquarters. The Conference agreed on a series of measures to address the current crisis and prevent future crises.⁷ The General Assembly will follow up on various issues through an ad hoc open-ended working group.

Prospects for recovery

19. With the emerging signs of stabilization, the timing of an exit strategy from extraordinary measures has become a salient policy issue. To restore confidence, national financial regulatory reform has been initiated to overhaul regulations and supervisions. A critical issue is the timing and speed of recovery. Various projections now point to a return to positive growth of the world economy in 2010 in the range of 1.6 to 2.0 per cent. The much-awaited “V-shaped” recovery depends on the effectiveness of policy actions and other underlying factors. Downside risks associated with a prolonged “L-shaped” recession include a continued demand gap associated with persistent high unemployment and risk aversion, ineffectiveness of fiscal and monetary policies, eroding credibility in debt sustainability, deflationary expectation and continued lack of confidence in financial systems. Experience

⁷ See General Assembly resolution 63/303, annex.

shows that the failure of the exit strategy could further prolong the recession and exacerbate the impact of poverty if adequate social safety nets are not put in place.

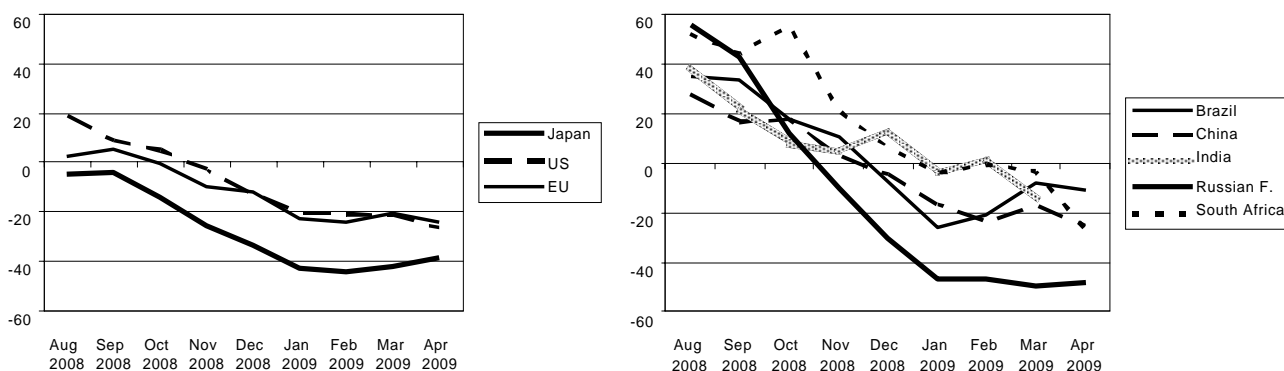
IV. Effects on international trade

Merchandise trade

20. The deep and synchronized contraction of international trade characterizes the current crisis. The rapid fall of demand for imports since October 2008 led to a corresponding drop in exports worldwide. The value of total merchandise exports of Organization for Economic Cooperation and Development (OECD) countries fell by 13 per cent in the fourth quarter of 2008 and by 30 per cent in the first quarter of 2009, including a deep decline of 43 per cent for Japan and 22 per cent for Germany, major exporters of manufactured goods, as compared with the same period of the previous year (year-on-year).⁸ With over half of their exports destined for those markets, developing countries were affected by contracting import demand. Declining import demand in the markets of major developing countries, including by 30 per cent in China, implied that growing South-South trade, representing 46 per cent of total merchandise exports of developing countries, has been severely affected.

Figure II

Year-on-year monthly change in the value of merchandise exports of selected economies



Source: Organization for Economic Cooperation and Development.

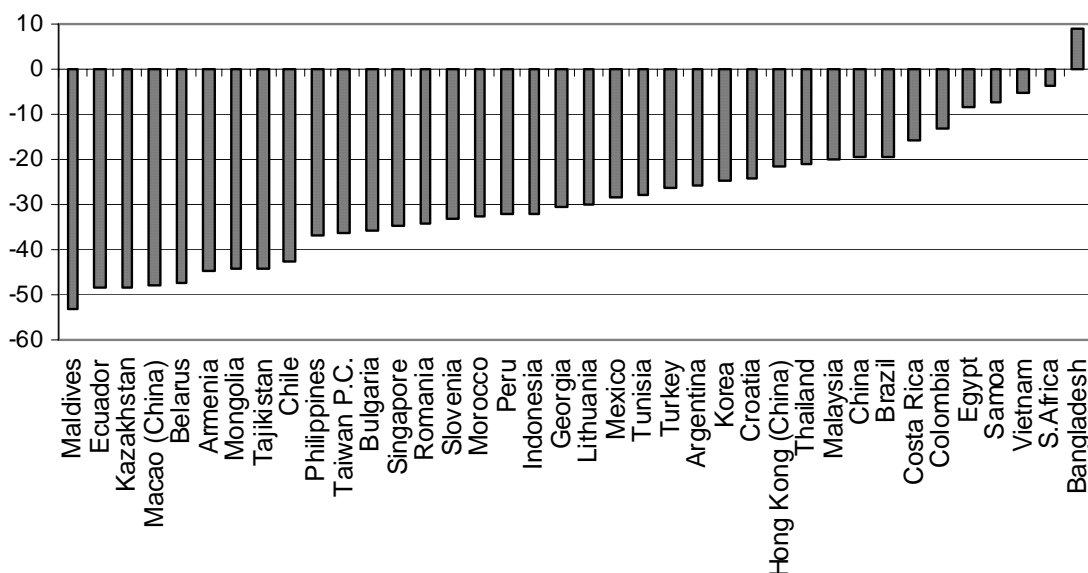
Note: No data are available for India for April 2009.

21. The magnitude and pervasiveness of effects of trade on developing countries became apparent in the first quarter of 2009. Brazil and China experienced a fall of 19 per cent in exports, while India and South Africa registered a less pronounced decline. The Russian Federation registered a significant decline of 48 per cent, which was associated with falling energy prices. Using published data for a sample of 38 developing and transition economies, UNCTAD estimates that their year-on-year merchandise exports fell by nearly 30 per cent on average in the first quarter of 2009. Several countries experienced a significant drop in exports exceeding 40 per

⁸ Organization for Economic Cooperation and Development statistics (extracts).

cent, including Maldives, Ecuador, Kazakhstan, Macao Special Administrative Region, Belarus, Armenia, Mongolia, Tajikistan and Chile.

Figure III
Year-on-year quarterly changes in the value of merchandise exports of selected economies (first quarter, 2009)



Source: UNCTAD, based on national sources.

22. The sectorally disaggregated United States import data, a market accounting for 21 per cent of exports from developing countries, indicate that United States imports of manufactured goods from developing countries fell by 19 per cent in the first quarter of 2009 on a year-on-year basis. Chemicals, industrial materials and machinery and transport equipment registered a steeper fall than light manufactured goods, including apparel and footwear. Agricultural imports remained relatively static, with their import value declining by only 3 per cent. The deepest decline of 49 per cent was registered in mineral fuels. Reflecting the concentration of export products on the market, imports from Africa declined by 50 per cent and those from least developed countries by 28 per cent. Imports by the European Union of merchandise from developing countries, representing 18 per cent of developing countries' exports, also declined in the first quarter of 2009, in particular for Botswana (81 per cent), as well as for Morocco, Brazil and Argentina (19-26 per cent).

23. Prominent in the initial phase of the crisis was an abrupt drop in import demand for transport, capital and other durable manufactured goods. The United States import contraction since October 2008 began with this sector. Demand for those products is cyclical, as shortages in corporate finance and consumer credit led firms and investors to defer purchases. Demand for those products also fell precipitously, as producers and wholesalers sought to adjust rising inventory levels. International fragmentation of production in global production chains contributed to a rapid contagion of export contraction across countries. As demand for

manufactured products drops, the shock is rapidly cascading throughout the product supply chain, thereby reducing cross-border trade in the parts and components used for the production of final goods. A sharp drop in the nominal value of exports for some countries was attributable to falling commodity prices, in particular for mineral fuels and industrial commodities.

24. Shortages in trade finance, used to transact over two thirds of developing countries' export of goods, have directly affected trade. Trade finance has become scarcer and costly, and remains so, as the banks involved in financing trade are experiencing liquidity constraints and seeking to limit risks over concerns of commodity price volatility, client creditworthiness, default risk and solvability. The limited availability and higher cost of trade finance continue to have a negative impact on export prospects, in particular for small- and medium-sized enterprises that rely on trade credit, including those that participate in global production chains. It is estimated there could be a \$100 billion to \$300 billion shortfall in 2009. An improvement in economic conditions remains essential for the availability of trade finance.

Trade in services

25. Cross-border commercial services exports as reported in balance-of-payments statistics contracted less severely than merchandise exports. The reason for the "resilience" of services exports may be that certain modes of supply, including through movement of natural persons or commercial presence, are not fully captured in balance-of-payments statistics. Commercial services exports of developed countries dropped by 12 per cent in the fourth quarter of 2008 on a year-on-year basis. In the first quarter of 2009, Japan registered a sharp drop of 13 per cent, but the euro area and the United States recorded modest declines (3 and 6 per cent, respectively). For selected developing and transition economies, too, some recorded a relatively significant fall in exports in the fourth quarter of 2008, including by 22 per cent for South Africa, but others, Brazil, India, Indonesia and the Russian Federation, registered limited contraction (6-9 per cent). Certain services were less susceptible to income change since unlike goods, services are not affected by inventory, and reductions in the demand for services occur less abruptly since contracts end gradually. Certain services (energy, health, education, telecommunications and some business and professional services) are regarded as necessities, so the demand is expected to be more inelastic.

26. Demand has contracted more in income-sensitive services, including tourism and travel, financial services, construction, retail and services related to merchandise trade, including transport. Some of those services account for a sizeable share of exports of developing countries; travel and transport account for 30 and 27 per cent, respectively, of such exports, and the effect on developing countries has been significant.

Box 3**Effects in selected services sectors**

Financial services: exports from the United States fell by 17 per cent in the fourth quarter of 2008. In Ireland, year-on-year exports were down by 50 per cent in the first quarter of 2009. Significant declines in exports in the fourth quarter of 2008 were reported in Argentina (34 per cent), Chile (31 per cent), the Republic of Korea (24 per cent) and South Africa (18 per cent).

Transport services: between mid-2008 and February 2009, container carrying capacity fell in Barbados (33 per cent), Chile (22 per cent), Angola (13 per cent), the United Republic of Tanzania (8 per cent), China (5 per cent) and India (2 per cent). In January 2009, port traffic decreased in Singapore by 19 per cent; Hong Kong Special Administrative Region (23 per cent); Long Beach, United States (14 per cent); and Le Havre, France (25 per cent). The Baltic Dry Index, a measure of the cost of shipping bulk cargo by sea, fell by 94 per cent between May and December 2008. By June 2009, the index had recovered to only 63 per cent of its May 2008 high. The International Air Transport Association indicates that air cargo traffic was down 20 per cent in December 2008 on a year-on-year basis, a trend confirmed for the first quarter of 2009; air freight volume fell 20 per cent, while passenger numbers decreased by 8 per cent.

Tourism: international tourist arrivals recorded a decline of 8 per cent between January and February 2009. The marked slowdown in developed countries is spreading to developing countries. World tourism is projected to decline by up to 3 per cent and employment in the tourist industry by 5 million jobs in 2009. Many least developed countries and smaller economies are susceptible to falling tourist arrivals. First quarter 2009 tourism arrivals fell by 14 per cent in Antigua and Barbuda, in Maldives by 11 per cent and in Seychelles by 14 per cent.

Trade expected to further slow down and contract 2009

27. The annual data for 2008 show a significantly decelerated growth in exports. On a volume basis, the World Trade Organization estimates that world merchandise exports have risen by only 2 per cent in 2008, significantly slower than 6 per cent achieved in 2007. Merchandise exports from Africa are estimated to have decelerated from 4.5 per cent in 2007 to 3.0 per cent in 2008, Asia from 11.5 to 4.5 per cent, including China from 19.5 to 8.5 per cent, India from 13.0 to 7.0 per cent and four newly industrialized economies from 9.0 to 3.5 per cent, and Latin America from 3.0 to 1.5 per cent.⁹ A contraction of world merchandise exports in absolute terms of 10 per cent is projected for 2009, with a decrease of 7 per cent projected for developing countries, and 14 per cent for developed countries. A conservative UNCTAD estimate shows that merchandise exports will decline in

⁹ World Trade Organization, Report to the Trade Policy Review Body from the Director-General on the financial and economic crisis and trade-related developments (JOB(09)/62).

developed countries by 8 per cent, in developing countries by 7 to 9 per cent and in least developed countries by 9 to 16 per cent.

Implications for developing countries

28. Lower export revenue, falling inflow of capital and higher loan premiums will exacerbate the already tight balance-of-payments position of many countries. An overall financing gap of \$350 billion to \$650 billion is estimated for developing countries in 2009. Preliminary UNCTAD estimates indicate the global inflows of foreign direct investment plunged by 54 per cent in the first quarter of 2009, and inflows of foreign direct investment to developing countries, after reaching \$549 billion in 2008, are expected to fall by 25 per cent in 2009.¹⁰ The World Bank estimates that total remittance flows to developing countries will fall by 7.3 per cent in 2009 from \$328 billion estimated in 2008. UNCTAD analysis shows that donor countries' official aid budget tended to decline by 30 per cent in the five years following the banking crisis. With the debt burden already standing at over 40 per cent of GDP for many countries, and 100 to 150 per cent for more than half of least developed countries, the possibility of yet another debt crisis cannot be excluded.

29. The fact that shrinking international trade has severely affected those countries most successful in export-led growth strategies in the past has called for a careful reassessment of the strategies. The increased contribution of exports to GDP in developing countries from 26 per cent in 1990 to over 43 per cent in 2007 reveals the increased openness and interdependence of economies. Increased interdependence means that negative shocks are more readily transmitted to domestic economies. Export sectors have played an important role in the development process through the growth of productivity and income, creation of employment and diffusion of technology. Their limited ability to absorb shocks through fiscal stimulus and safety nets has rendered the effects on developing countries particularly significant.

30. A simultaneous contraction of global demand limits countries' ability to use trade to boost recovery. In view of the weak demand for imports and expected slower growth post-crisis, the creation of domestic demand and formulation of demand-driven strategies can complement outward-oriented strategies. Bolstering domestic demand can help sustain national output and employment, particularly in those countries with a vibrant middle class. Small- and low-income developing countries, however, require special measures, including the creation of larger regional markets, as smaller markets and low income continue to hamper the creation of viable domestic demand.

31. It should be emphasized that international trade and global demand remain indispensable for sustained robust growth. The challenge is to make developing countries' economies more resilient to external shocks. Improving productivity and competitiveness and diversifying trade and production bases into dynamic new products and services by exploring new areas of comparative advantage and modern tradable activities, including through proactive industrial and other policy interventions supported by enabling and developed States, can generate greater retention of value added, forward and backward linkages, diffusion of technology and formation of capital. Export markets need to be diversified towards

¹⁰ UNCTAD, *World Investment Report 2009* (to be issued).

non-traditional and regional markets through a greater emphasis on South-South integration and cooperation.

V. Trade-related policy developments

32. While keeping markets open and trade fair has been of primary importance at a time of contracting demand, economic nationalism and protectionist sentiments have rapidly emerged. Various national crisis mitigation actions could have negative spillover effects on third countries. Those measures could alter competition conditions and future production locations. This has challenged the ability of the multilateral trading system in immediate crisis mitigation efforts. The adoption of a voluntary standstill pact under the auspices of the Group of Twenty was an attempt to partly offset the gap left between international commitments and legitimate national policy discretion. The protracted Doha Round has further constrained the ability of the system. Conversely, the much-feared spiralling of protectionism and retaliation, which could have further contracted trade, have been tempered by today's interdependence in trade, finance and migration, and the existence of a multilateral system on trade.

33. A novel feature of observed protectionism has been the prevalence of economic nationalism seeking to assign domestic preference as either an incentive or condition for government funding or purchases to “buy/lend/invest/hire” locally. Such a tendency arose from governments' desire to limit the leakage of stimulus measures to increased imports, further accentuated by the fact that stimulus was not coordinated globally. Since such measures are built up gradually, they could be expected to have had a modest impact on trade flows. However, some have exhibited a significant potential to distort trade owing to the prevalence of non-tariff, subsidy and fiscal measures, monitoring and evaluating the effect on the distortion of trade and ascertaining their World Trade Organization compatibility has been highly challenging, which points to the need for a scaled-up notification, transparency and monitoring exercise.

34. “Buy American” provisions in the stimulus bill of the United States, which requires the use of domestic steel, iron and manufactured goods in public projects, has raised concerns as they may involve discriminatory procurement practices. Government procurement was historically excluded from non-discrimination obligations, reflecting the fact that governments traditionally implement various “buy national” laws in order to promote local industries. The plurilateral World Trade Organization Agreement on Government Procurement¹¹ has extended non-discrimination among its 13 parties but not to non-parties to the Agreement. Government procurement has come to the forefront as a result of the crisis.

¹¹ See *Legal Instruments Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, done at Marrakesh on 15 April 1994* (GATT secretariat publication, Sales No. GATT/1994-7).

Box 4

Examples of trade-related measures**Automotive**

United States: loans to General Motors (\$13.4 billion) and to Chrysler (\$4 billion)

France: credit lines for the car industry of \$7.7 billion

Brazil: government credits (\$1.7 billion) for carmakers

China: reduction of sales tax on cars

Steel

European Community: anti-dumping duties on imports of certain iron or steel fasteners from China

India: increase in import duties on a range of iron and steel products from 0 to 5 per cent

Argentina: non-automatic import licensing requirements

Turkey: import tariff increase on a number of products

Footwear

Canada and European Community: initiation of anti-dumping investigation on imports from China and Viet Nam

Brazil and Argentina: initiation of anti-dumping investigation on imports from China

Ecuador: increase of tariff duties

Turkey: imposition of safeguard measures

Source. World Trade Organization, JOB(09)/62, 1 July 2009.

35. Governments' support to financial services has been a major part of the immediate response to the crisis to prevent systemic insolvency, implemented through the purchase of impaired assets, nationalization, promoting private takeovers, recapitalization and expanded government guarantees for banks' liabilities. Such measures are seen as generally covered by prudential carve-outs under the General Agreement on Trade in Services (GATS) and the Annex thereto on financial services, which allows for measures for "the protection of investors, depositors, policy holders ..., or to ensure the integrity and stability of the financial system", subject to the condition that measures not conforming to the GATS "shall not be used as a means of avoiding ... commitments or obligations under the Agreement". While no disciplines on subsidies exist in GATS, whether access to subsidies could be limited to domestic, as opposed to foreign-owned, financial services suppliers, is relevant to non-discriminatory national treatment commitments and most favoured nation status under GATS.

36. State aid has been granted to the automotive industry, which has been hit hard by the crisis, including through the provision of credit, tax cuts and direct loans, including to cover working capital. The World Bank estimated that the amount of subsidies provided in the sector could reach \$48 billion. Subsidies could distort competitive conditions, displacing efficient suppliers, and could affect the locations of producers. Reported conditions attached to the aid granted to maintain factories and employment at home were considered problematic. Under the Subsidies and Countervailing Measures Agreement, State aid could give rise to subsidies that are actionable, if not prohibited, should they have adverse effects on the interests of other countries. Subsidies covering operating losses and direct forgiveness of debt may more likely be found actionable. The risk of insolvency crisis that could have caused acute social problems appears to give certain justifiable grounds for those measures.

37. Concern over unemployment has pressured governments to retain employment opportunities domestically. Such measures could adversely affect certain service activities, including outsourcing or relocation of service providers. Fiscal disincentives against outsourcing abroad may have adverse effects on information technology outsourcing services exports in developing countries. Labour mobility and migration has equally come under scrutiny as various industries (tourism, finance or construction) have reduced jobs, in particular for foreign migrants and contractors. Conditions attached to the provision of State aid for firms to assign preference to the recruitment of local professionals could affect opportunities for professional services exports, which may be relevant to GATS mode 4 commitments.

38. The significance of increased border measures appears less pronounced. The relatively insignificant number of instances of tariff increases by developed countries points to the merit of the multilateral trading system as a guarantor of open trade. Tariff increase was used by some developing countries because their applied rates are lower than bound rates owing to unilateral liberalization, giving them a legitimate scope for tariff increase. Such flexibilities are considered important by them given that tariffs are often the only available instrument. Tariff increase was also utilized for balance-of-payments reasons consistent with World Trade Organization provisions, as was the case recently with Ecuador. Tariffs represent an important source of government revenue for low income countries, representing over 30 per cent of government revenue in several cases. The crisis has led to a reduction in imports and, hence, government revenue.

39. Increased recourse has been made to non-tariff measures, including standards, technical regulations and trade remedy measures. The number of new anti-dumping investigations increased by 28 per cent to 209 in 2008 from 163 in 2007. Most frequently affected is China, and the products targeted include base metals, chemicals, textiles and plastics. The number of anti-dumping investigations is expected to increase with declining economic growth. Other examples of non-tariff measures include discretionary, as opposed to automatic, licensing requirements for some products.

40. The fall in agricultural commodity prices in 2009 has caused an automatic/semi-automatic increase in agricultural subsidies in the form of a reintroduction of agricultural export subsidies and expected increased spending. The European Union reinstated an export refunds system for milk producers against

falling milk prices, a move that was recently adopted by Switzerland and the United States. The United States Overall Trade-Distorting Support, estimated at a historical low of \$6.5 billion in 2007, is projected to have increased to \$8.1 billion in 2008 and to \$9.9 billion in 2009 through counter-cyclical payments and loan-deficiency payment schemes.¹²

VI. Developments in the multilateral trading system

41. The significant challenge of effectively managing the Doha Round in a global crisis is confronting World Trade Organization members. The crisis itself, and related policy developments, would have effects on the outlook of the Doha Round. While it is considered that a successful conclusion of the Round would be important in boosting the world economy and sending a strong signal of enhanced international cooperation as well as in containing rising protectionist tendencies, the recession and the emerging social and development hardships, in particular unemployment, could discourage many countries from undertaking ambitious policy reform.

42. Various estimates of the welfare effects of the Round have used different assumptions and scenarios. The conclusion of the Round is reported by the World Trade Organization to inject \$150 billion as stimulus. A global welfare gain of \$100 billion from a realistic scenario is estimated from general equilibrium analysis. Although such gains are small compared with the global aggregate stimulus of \$1.6 trillion, the Round's conclusion could pre-empt the downside risk of potential welfare losses of \$130 billion to \$350 billion that could arise from spiralling tariffs in all countries. Benefits of the Round will accrue only if the right macroeconomic and enabling conditions, and flanking policies, are in place. It is important that the benefits of liberalization are distributed in a balanced and equitable manner across and within countries, with particular focus on developing countries, and that a sense of ownership and integration is shared by all.

43. The last major attempt to re-energize the Round was an informal ministerial meeting held in Geneva from 21 to 30 July 2008 to establish modalities for reduction commitments in agriculture and non-agricultural market access (NAMA) and advance services offers. The attempt failed on account of various issues, including the special safeguard mechanism in agriculture. National developments had a bearing on the negotiations, including the expiration of the United States Trade Promotion Authority, national agricultural policies and proliferating regional trade agreements. The revised draft modalities on agriculture and NAMA issued on 6 December largely incorporated progress since July 2008.

44. There are signs of re-engagement in the negotiations. A key question that remains is when will conditions become ripe for political engagement to work out a balanced, fair and equitable deal. This would require strong leadership by major countries. Recent changes in the leadership in some countries could lead to a redefinition of the national trade policy agenda. Possible target dates for conclusion are now proposed for the end of 2010. The renewal of the United States Trade Promotion Authority would facilitate progress.

¹² World Bank, "Trade Protection: Incipient but Worrisome Trends", Trade Note No. 37, Washington, D.C., March 2009.

45. A possible two-track approach to the negotiations was recently suggested whereby modalities negotiations would continue in parallel with a scheduling exercise for outcome testing for greater clarity on the use of flexibilities. Developing countries were wary of its possible adverse implications for the Doha mandate and modalities negotiations on agriculture and NAMA. Modalities negotiations could be conditioned on a scheduling exercise to secure key market access interest. They have reached a high level of sophistication and complexity, making assessment of the overall value of the package difficult. A return to more facilitated and simple approaches in future rounds merits consideration.

46. The biennial regular World Trade Organization Ministerial Conference, overdue since 2007, is scheduled to be held from 30 November to 2 December 2009 in Geneva to take stock of implementation of World Trade Organization agreements and to review the issues facing the Organization under the current global economic environment.

47. In the long run, the protracted negotiations and recurrent setbacks imply that the modus operandi of the trading system needs careful assessment, bearing in mind the imperatives of the Millennium Development Goals and the need for strengthened and operational special and differential treatment. Stabilizing the system after negotiating rounds, with sufficient time allocated for implementation, reviews and build-up of capacities, could help avoid a build-up of non-implementation risks and disputes, that could erode credibility. The World Trade Organization accession process, essential for its universality, could be redesigned so as to allow acceding countries legitimate policy flexibilities that are available to existing World Trade Organization members. Methods of conducting negotiations could be carefully examined. While a broader agenda under a single undertaking was expected to facilitate intersectoral trade-offs, it did not materialize on issues of vital importance and diverted attention from a core development agenda. Defining the boundaries of the trading system is a salient systemic challenge in the light of recent development crises. Various issues increasingly addressed in regional trade agreements, investment, competition, government procurement, environment and labour, might be proposed for inclusion, which would warrant careful examination given their significant implications for development.

Agriculture

48. The capacity of individual countries to absorb exogenous shocks arising from the crisis differs significantly, and the potential contribution of agricultural policy reform through the Round has concerned many. The vulnerability of the agricultural sector in developing countries has been exacerbated as a consequence of the structural adjustment programmes of international financial institutions and under international trade commitments, which weakened State-supported extension services, marketing boards and commodity stabilization funds for agricultural commodities and food staples as well as the ability of the State to support the sector. While the Round could stabilize the agricultural trading environment by reducing trade restrictive measures and subsidies, increased liberalization may lead to an increase in the dependency of countries on imports, in particular for net food-importing developing countries.

49. The special safeguard mechanism, the apparent cause of the setback at the World Trade Organization Mini-Ministerial meeting held in July 2008, remains a key outstanding issue. The special safeguard mechanism is designed to allow developing countries to increase tariffs in response to a surge in imports or a fall in prices. Recent volatility in commodity prices has rendered the special safeguard mechanism particularly significant, as countries seek to preserve local production in order to reduce reliance on imports. The key negotiating aspect has been by how much developing countries should be allowed to raise tariffs above the pre-Doha rates, and under which conditions. Proponents of the special safeguard mechanism argue that conditions should not be excessively onerous in invoking the mechanism. Agricultural exporters were concerned that an overly lax mechanism would effectively foreclose their export opportunities, including South-South trade.

50. The financial and economic crisis and commodity price reversal have hit the cotton sector. Persistently low cotton prices, caused partly by subsidies, have exacerbated income opportunities for cotton producers in Central and West Africa. The cotton price index has fallen by 40 per cent since its peak. The lower demand is causing a 27 per cent drop in imports in 2008/09. The share of the Cotton Four countries decreased to 5.8 per cent in 2008/09 from the 10-year average of 8.3 per cent. It is forecast that Cotton Four exports will fall in volume terms as well by 38 per cent in 2008/09. Those combined effects could be particularly severe since cotton accounts for 30 to 60 per cent of exports and 6 per cent of GDP for Cotton Four countries. Worldwide subsidies for cotton producers amounted to \$4.5 billion, and their removal could raise prices by 5 to 25 per cent. The Cotton Four countries seek to ensure deeper and faster cuts of cotton support. The crisis has added additional urgency to tackle cotton on a fast-track basis.

Non-agricultural market access

51. The crisis has affected manufactured products most severely. Manufactured products represent two thirds of developing countries' imports. While they are seeking to create a viable industrial sector to accelerate developmental transformation, developing countries are generally concerned over the abrupt opening of their industrial sectors to risk, causing de-industrialization. The crisis has underscored the need for the negotiations to be sensitive to such concerns. The "less than full reciprocity" principle, and translating the concept into operational parameters of the "Swiss formula", a tariff-cutting formula that reduces higher tariffs to a greater extent, has been a key issue for many developing countries. Securing real market access in larger developing countries has been a major interest for developed countries. In particular, the issue arose as developing countries applying the formula would make higher average cuts in bound tariffs than developed countries, even though they would maintain bound tariffs that would be higher than those of developed countries after the cuts.

52. Concern over real market access and the perceived ambiguity associated with the use of flexibilities by developing countries has led developed countries to propose an anti-concentration clause to prevent the concentration of excluded tariff lines in a certain sector under flexibilities. Sectoral initiatives for the harmonization and elimination of tariffs within specific sectors have become a major bone of contention as developing countries were requested to participate in key sectorals, including chemicals, industrial machinery and electronics, while it has been agreed that their participation would be on a voluntary basis.

Duty-free quota-free market access for least developed countries

53. The achievement of 97 per cent product coverage as early as possible by all developed countries and the progression towards 100 per cent coverage remain key issues in duty-free quota-free market access. Most developed countries have met the target of 97 per cent, and some developing countries (China and India) have taken significant steps in this direction. It is positive that the extension of World Trade Organization waivers for the United States preferential schemes, including the African Growth and Opportunity Act, and South-South least developed country preference has been approved. On rules of origin, least developed countries have called for the harmonization of rules to make them simpler and more transparent. The ongoing reform of rules of origin in the European Union is expected to address some concerns of the least developed countries. Easing the use of the rules remains key, including by improving administrative aspects.

Services

54. Well-functioning services sectors are essential in meeting the Millennium Development Goals, in particular the eradication of poverty. The financial and economic crisis poses major challenges to GATS negotiations, including in financial services as well as other essential and infrastructural services. Deregulation, inadequate regulations and precipitated liberalization in financial services, as well as capital account opening, have exacerbated the crisis. Financial services were subject to deeper liberalization under the Understanding on Financial Services, including commitments to permit foreign financial service suppliers to offer new financial services and to proscribe new barriers. The crisis has underscored the need for a careful approach to liberalization in the sector as it affects all segments of an economy. The continuing weakness of developing countries' services points to the need for their commitments to be flexible according to the maturity of specific sectors' policy, regulatory and institutional frameworks. Phase-in commitments or a possibility to roll back commitments could facilitate developing country participation.

55. At the Services Signalling Conference that was held in July 2008, an attempt was made to re-energize the request and offer process. A total of 71 initial and 31 revised offers have been submitted. Market access negotiations since the World Trade Organization Ministerial Meeting in Hong Kong Special Administrative Region in 2005 have been conducted in a plurilateral process in which 21 requests have been made. The signals exchanged covered most major sectors and the four modes of supply. Developing countries were concerned over the lack of value added in areas of interest to them, in particular modes 4 and 1. Despite some improvements, including expanded European Union mode 4 commitments on intra-corporate transferees and independent professionals, offers could be more commercially meaningful, consistent with the development objectives of Article IV of GATS.

56. Negotiations on domestic regulation aim to ensure that qualification requirements, technical standards and licensing requirements do not constitute unnecessary barriers to trade. A key objective is to strike a balance between the need for national regulatory autonomy, including the right to regulate, and disciplines to eliminate unjustifiable market access barriers, including for mode 4. Many consider the proposed necessity test to be a constraint on regulatory autonomy for pursuing

public policy and development objectives, including in ensuring universal access to essential services. The proposed regulatory reform agenda for the financial sectors highlights the importance of adequate regulatory space to effectively respond to evolving economic and social needs, in particular for infrastructural and essential services.

57. The crisis has re-emphasized the significance of GATS rules. Negotiations on emergency safeguard measures have evolved around proposals by eight South-East Asian countries. The proposals envisage that emergency safeguard measures would be applicable if domestic services suppliers incur serious injury or serious threat to the viability of domestic industry consequent to commitments. This would take the form of positive measures, including grants or differential tax regimes, with the possibility of suspending the commitments only as a last resort. On subsidies, GATS recognizes their role in relation to the development programmes of developing countries and takes into account their particular need for flexibility. Negotiations have centred around defining trade distortive and non-actionable subsidies and a balance between developing countries' development objectives.

Development

58. The financial and economic crisis has highlighted the role of governments and policies in regulating markets and strengthening economies' resilience to external shocks. Such a recognition points to the importance of special and differential treatment and flexibilities for developing countries. Strengthening special and differential treatment both in respect of existing provisions and new commitments, remains the key objective. For the former, progress has been largely limited to five least developed country-specific special and differential treatment provisions, especially duty-free quota-free market access for least developed countries. For the latter, a trend towards de facto differentiation among developing countries became apparent, marking a departure from the traditional notion of special and differential treatment. While such an approach has enabled specific individual needs to be addressed, it has had the effect of emerging larger countries receiving relatively less favourable treatment.

59. Aid for trade, which is aimed at building competitive supply capacities and trade-related infrastructure in developing countries, could be directly affected by the crisis, as donors could face tighter budget constraints, including in meeting a broader official development assistance target of 0.7 per cent of gross national income. Sustaining mobilization and delivery of aid for trade, including "additionality", remains key concern. Aid for trade stood at \$25.4 billion in 2007, which represented 32 per cent of total sector allocable official development assistance. The second Global Review of Aid for Trade, held in July 2009, led several donors including France, Japan, the Netherlands and the United Kingdom of Great Britain and Northern Ireland, to make new pledges. The enhanced integrated framework has become operational.

VII. Regional trade arrangements

60. Regional trade arrangements have proliferated worldwide, counting now over 220 operational agreements. The crisis has pointed to the possibility whereby some regional trade arrangements might have accentuated countries' vulnerability to the crisis by encouraging capital account liberalization, liberalization and deregulation of financial services with deeper commitments in respect of new financial products

or stricter prudential regulations. Developing countries seek to use regional trade arrangements as an essential instrument for development, and particularly so under the crisis. South-South and South-South-North trade integration and cooperation has exhibited a real potential with the emergence of dynamic South markets and capacities, including the Chiang Mai Initiative to address regional short-term liquidity and the Bank of the South to provide social and infrastructural lending.

61. The pattern of North-South regional trade arrangements has diversified, as they now embrace particularly low and vulnerable economies, including under ACP-EU EPA negotiations, and non-traditional partners of larger and dynamic countries. In those agreements, a key concern has been the design of reciprocal, yet asymmetric and flexible, liberalization commitments for developing countries in a manner consistent with World Trade Organization requirements. Certain North-South regional trade arrangements have introduced a new approach, including multilateralizing regional trade arrangements commitments through a third-party most favoured nation clause, which could have a potentially adverse impact on South-South agreements, and deeper commitments in services, investment, intellectual property or capital account opening. Deeper development cooperation has become a key component of regional trade arrangements to ensure fairer distribution of costs and benefits. As developing countries are engaged in parallel in subregional integration processes, the coordination and coherence of North-South regional trade arrangements with the subregional integration process, in order to avoid any “chilling effect” of the latter, became a concern across regions.

VIII. Conclusion

62. The global economy requires a course correction towards more sustainable and inclusive development, which necessitates addressing the root causes of the crisis. The current crisis, compounded by a series of global crises affecting basic human needs, have had a severe impact on developing countries, reversing the hard-won gains for the Millennium Development Goals. The financial and economic crisis has seriously challenged the prevailing economic doctrines, and underscored the need for a careful reassessment of development models and strategies and a redefinition of governments’ role in the markets as enabling and development States. The global governance system needs to provide a coherent paradigm to comprehensively address global crises and promote development. The United Nations plays a key role in this effort.

63. The task facing governments is to better adjust their economies to post-crisis realities and make their economies more robust to external shocks through diversification into new products, services and markets, including South-South trade, and through bolstering domestic demand. Sustainable production and consumption is important. This could be supported by proactive policies and sound regulatory and institutional frameworks, including the provision of social safety nets, and scaled-up international development support. Innovative approaches are required in the design of policy responses to ensure that post-crisis development is resilient and inclusive. International trade continues to be a driver of growth. The multilateral trading system could provide unique public good, including by addressing economic nationalism that could alter competitive conditions and production location in the future and by delivering the development agenda of the Doha Round.