In chapter IV it was seen that greater liberalization in the South coupled with slower growth in the North has resulted in increased external resource needs for developing countries. The increase in the import content of growth, together with the continued decline in their terms of trade, means that growth in developing countries is now associated with higher current-account deficits than in the past, necessitating greater inflows of foreign capital. On the other hand, the analysis in chapter V shows that the surge in capital inflows in the 1990s constitutes a recovery from the depressed levels of the 1980s, rather than signalling a new trend which could offset the structural rise in external deficits. The increased inflows have also been highly concentrated in a small number of emerging markets, and so the majority of developing countries have been bypassed. Moreover, the proportion of the net capital inflow that has been used to finance real resource transfers needed to support production and capital formation has been falling – a counterpart to the growing proportion absorbed by capital outflows by residents and by reserve accumulation required to safeguard against financial instability.

Given the speed at which global conditions can change, it is not easy to project the external capital flows to developing countries in the medium to long term; indeed, as discussed in chapter III, even short-term projections are subject to large margins of error. Nevertheless, on recent trends, the level and composition of net capital flows received by most developing countries are inadequate to meet their external financing needs. Even if these trends are maintained, the scenarios examined in chapter IV suggest that the flows will be insufficient to enable a sustained annual growth of 6 per cent to be achieved. Even under relatively optimistic assumptions, the external financing needs of developing countries can be estimated to exceed recent net capital inflows by over 40 per cent. The gap would be greater if growth in industrial countries remains sluggish and the terms of trade of developing countries continue to decline. If the recent trends in capital outflows by residents and reserve accumulation were to persist, net capital inflows required to sustain an average 6 per cent growth in developing countries would be no less than an estimated 8 per cent of their combined GNP, compared to some 5 per cent during the 1990s.

In the light of the above, development thinking and policies need a radical review if developing countries are to be assured better growth prospects, narrow the income gap with the advanced industrial countries, and remove the scourge of widespread and persistent poverty. They will need to manage better their integration into the global economy if they are to overcome the imbalances and instabilities associated with international flows of goods and capital. This calls for a re-orientation of their policies in order to regulate capital flows and establish competitive industries that would not only increase exports but also reduce the import content of growth. However, action by developing countries alone cannot be
the complete answer. Serious attention should also be given to the systemic biases and asymmetries in the workings of the international trading system which limit their growth prospects. The successful pursuit of outward-oriented policies also requires greater openness of markets in industrial countries to their exports, all the more so in view of the current “aid fatigue” and the failure of private financial markets to provide adequate development finance. Without considerably increased aid or trade opportunities, developing countries will face a Herculean task.

B. Developing countries: managing integration

1. Exchange-rate management

Developing countries need to improve the management of their exchange rates if they are to benefit from greater integration into the international trading system. They must not only sustain competitive rates over the longer term but must also retain policy autonomy to make orderly adjustments when faced with exogenous shocks. The question is not so much one of designing an appropriate exchange-rate regime as of managing and regulating capital flows; no exchange-rate regime can ensure the stability and autonomy needed for successful trade performance unless destabilizing capital flows are brought under control.

Recent debate on exchange-rate policies in developing countries has concentrated on the connection between exchange-rate regimes and financial crises, rather than on the implications of alternative regimes for trade and competitiveness. Pegged exchange rates have fallen out of favour on the grounds that financial and currency crises in emerging markets have often been associated with such regimes. Accordingly, developing countries are increasingly being advised to choose one of the two extremes: either to float freely or to lock in their exchange rates with one of the major currencies, often the United States dollar, through such arrangements as currency boards or even simply adopting the dollar as their national currency. However, when capital is completely mobile, neither of these extremes is likely to provide better protection against currency instability and financial crisis than nominal pegs, or to allow the exchange rate to be tailored to the requirements of trade and competitiveness.

An examination of recent bouts of currency crisis in emerging markets suggests that two kinds of problems are associated with nominal pegs. First, they tend to give rise to real appreciations, thereby undermining competitiveness and leading to unsustainable current-account deficits. This problem is particularly acute when the exchange rate is used as a nominal anchor to bring down inflation; since prices of non-traded goods do not come down as rapidly as those of traded goods, real appreciation is inevitable. While this was the case in all episodes of crisis in Latin America in the 1990s, there was no serious overvaluation in most of the crisis-hit economies in East Asia.

The second problem is more serious, since it involves stock disequilibrium and relates to external financial fragility. As examined in TDR 1998, stable nominal exchange rates, combined with interest-rate differentials, create one-way bets for speculators seeking to benefit from international arbitrage, and provide a strong incentive for domestic firms and banks to reduce their cost of finance by borrowing abroad. To the extent that the peg is successfully implemented, borrowers feel no need to hedge against the currency risk. In consequence, and quite independently of how the real exchange rate or the current account moves, the economy becomes vulnerable to capital flight. When capital inflows are reversed, the currency collapses and hikes in interest rates are often unable to check this process. Throughout this boom-bust cycle the nominal exchange rate first stays stable for prolonged periods, while the...
real exchange rate shows a tendency to rise. This is followed by a collapse of the nominal rate and the overshooting of the real rate. Subsequently, the nominal exchange rate tends to recover, while the real rate may show some tendency to rise—a pattern which effectively mimics the behaviour of reserves examined in chapter V. Such gyrations in exchange rates create considerable uncertainty, raising the risk premium on investment in traded goods sectors, and thereby undermining trade performance and growth.

Abandoning a nominal peg without a “crash landing” is not easy, particularly if the peg has been maintained over a long period and the real exchange rate has been allowed to appreciate significantly. Similarly, introducing exchange-rate uncertainty as a way of discouraging arbitrage flows by signalling to markets that the peg may be changed suddenly could simply precipitate currency attacks. For these reasons, a freely floating rate is often suggested as a better way out. Floating is expected to bring about a more cautious attitude to lending and borrowing by private actors and banks, encourage financial risk management and improve access to different instruments designed for this purpose. It would also give policy makers greater autonomy in monetary policy since they would no longer be defending a particular exchange rate.

However, the experience of the major industrial countries with floating rates since the breakdown of the Bretton Woods system does not support these considerations. This experience has been characterized not only by persistent currency misalignments among the major reserve currencies and by large trade imbalances, but also by gyrations in exchange rates over relatively short periods, with movements of 20 per cent or more in a matter of weeks. Similarly, the notion that floating rates give greater policy autonomy has also proved to be illusory. It is no longer possible to ignore the consequences of exchange-rate changes for domestic policy objectives when their influence on stability and growth is greatly enhanced by the increased integration of markets.

The experience of developing countries with flexible exchange rates points in the same direction. Recent World Bank research has shown that over the past three decades countries with floating currencies have actually become more vulnerable to financial crises, leading the Bank to conclude that “crises are as likely to occur under flexible exchange rates as under fixed exchange rates.” Indeed, flexible exchange rates provide no more guarantee against real appreciation than fixed rates, since they may add nominal exchange-rate gains to interest differentials and reinforce rather than temper capital flows, thus aggravating unsustainable payments positions. As discussed in chapter V, in most episodes of financial crisis in emerging markets the boom phase is characterized by inflows of capital in excess of current-account needs, and by sharp increases in reserves. Under these conditions, leaving the exchange rate to markets could simply lead to appreciations and to higher arbitrage profits, attracting even further inflows of capital. Although appreciations would also heighten currency risks, markets tend to ignore them when they are driven by herd behaviour. For instance, it is probable that if currencies in East Asia had been allowed to float in the early 1990s, the result would have been further appreciations, thereby encouraging further inflows and aggravating external financial fragility.

Locking exchange rates in through currency boards or outright adoption of a reserve currency as the domestic currency provides no more viable a solution for most developing countries. It effectively implies abolishing the central bank, discarding discretionary monetary policy and subordinating all other policy objectives to that of maintaining a fixed exchange rate. Ironically, the key factor for the success of a currency board is essentially political: credibility derives from the willingness of the Government to be firmly disciplined by external forces. Thus, as Martin Feldstein has recently argued, the success of such arrangements “depends on market confidence that the Government will let interest rates rise as long as foreign exchange reserves dwindle, no matter how much damage those high rates do to the economy”. In this respect, currency boards mimic the workings of the gold standard, and, much like the gold standard, such regimes do not insulate economies from external shocks and instability, since the impact of capital flows is transmitted via liquidity to economic activity and to prices of goods and financial assets. Sustaining such an arrangement despite high costs is only possible where there is “exceptional distrust of discretionary monetary policy”.

Speculative attacks against a currency can occur in a currency board system just as in any other exchange-rate regime. Again, as noted in
chapter III, a currency board cannot ensure that domestic interest rates remain at the level of the country to which the currency is pegged. A good example is the experience of Argentina during the Mexican crisis and that of Hong Kong (China) during the Asian crisis. In both cases, interest rates had to be raised dramatically, and the pegs could be maintained only at the expense of sharp declines in output, reaching 6 per cent. It thus appears that the costs of maintaining pegs in these instances were no less than those incurred by countries experiencing currency turmoils.

For the same reason currency boards cannot guarantee the stability of the banking system. As in Argentina, the cost of preventing devaluation can be a severe banking crisis as well as a devastating shock to the real economy. That reserves are sufficient to cover the monetary base provides no protection to the banking system. Each unit of currency withdrawn from circulation results in a greater reduction of the liquidity of the banking system through the money multiplier, forcing banks to recall loans. Thus, contrary to the underlying principles of currency boards, the central bank is often forced to provide some liquidity to the banking system in order to prevent collapse.

More importantly, currency boards can lead to costly exchange-rate misalignments in developing countries if domestic adjustment is not rapid. For obvious reasons a combination of developing and industrial countries does not constitute an optimal currency area: they have different economic structures and price and productivity dynamics; labour mobility between them is limited; and they are subject to asymmetric shocks since, while most developing countries are commodity exporters and debtors, most industrial countries are commodity importers and creditors. These asymmetries could have serious costs in terms of output, employment or price stability. The problems would also be confronted in adopting a reserve currency as the national currency, particularly when there are no institutional arrangements for monetary cooperation and the monetary policy of the reserve-currency country is conducted without regard to its implications for the country or countries concerned.

Thus, under free capital mobility no regime of exchange rates will guarantee stable and competitive rates; nor will it combine steady growth with financial stability. Differences among systems of pegged, floating and fixed exchange rates lie not so much in the extent to which they can prevent volatility of capital flows or contain their damage to the real economy as in how the damage is inflicted. Damage can only be prevented or limited if there is effective regulation and control over destabilizing capital flows. While that may not be without cost, the cost is likely to be small compared to that of currency instability and misalignment and financial crises. Managing nominal exchange rates in a flexible manner in order to minimize fluctuations in the real exchange rate, in combination with controls on destabilizing capital flows, thus remains the most plausible option for most developing countries.

It is precisely those countries that have been most successful in managing their exchange rates that have retained the widest array of policy instruments, including measures to influence and control capital movements. Most European countries employed measures to control capital flows in the turbulent years that followed abandonment of the Bretton Woods System, and the United States deployed a wide range of measures to reduce capital outflows in the 1960s. As the experiences of China and India show, such measures can serve to deter speculative flows without prejudice to capital for productive investment. More recently, Chile and Colombia have used prudential measures to influence the maturity of their capital inflows, and Malaysia has been able to return to currency stability and increase its FDI inflows.

It is important to recognize that the main objective of controls in a world of integrated capital markets is to prevent the cumulative build-up of foreign liabilities that can be easily reversed. Consequently, controls on capital inflows should be a permanent feature of policy, to be used flexibly and in the light of circumstances. The techniques available to control inflows are well known and have been discussed at length in past issues of TDR. A distinction needs to be made between direct restrictions (e.g. on banks’ net external positions, borrowing abroad by non-banks, or foreign equity participation in domestic firms) and market-based disincentives that leave discretion to lenders and investors (e.g. non-interest-bearing reserve requirements on foreign liabilities or taxes designed to reduce the international arbitrage margin). Both sets of measures have been used in various industrial and developing countries. Their success depended on the extent to which the underlying economic conditions and policies were sustainable.
The exchange rate can also be used to deter arbitrage flows. A crawling exchange-rate band which is clearly targeted to avoid persistent real appreciation provides information to the market about the policy being followed and allows plans to be made accordingly, while the width of the band creates a modicum of uncertainty which allows the central bank to intervene selectively in the traditional manner to smooth fluctuations in capital flows and limit their impact on the exchange rate. In no case should the width of the band plus the announced adjustment margins be less than the forward discount on the currency (adjusted for the appropriate period). Otherwise, the band system becomes similar to a pegged exchange-rate system and invites speculative attack. However, direct intervention in the market should be supported by adjustments in control measures, such as changing the implicit or explicit tax on inflows. Such adjustments could be just as frequent as direct intervention. The goal should be to substitute changes in controls for the use of reserves and to free interest rates for domestic policy objectives.

Even where reversible capital inflows are deterred by various means, dollarization of an economy would pose a potential threat to exchange-rate stability, since it effectively eliminates the difference between residents and non-residents in the determination of the profitability of their investments and their ease of access to foreign assets. Thus, discouraging dollarization should also be part of the overall regime for capital controls.

The need for controlling outflows would be reduced to the extent that speculative inflows can be prevented and dollarization avoided. Nevertheless, no developing country is immune to a currency crisis, particularly if it limits its control over capital movements to market-based measures and prudential regulations. As discussed in TDR 1998, if all else fails, debt standstills accompanied by temporary exchange controls over all capital transactions, by residents and non-residents alike, including transfers involving deposits and investments in securities and stocks, provide an effective and equitable response to speculative attacks and self-fulfilling debt runs.

2. Establishing competitive industries

Effective exchange-rate management is clearly essential to overall economic stability in developing countries, and the benefits obtainable through growth and exports are generally recognized. Under some circumstances, and particularly when a period of currency appreciation has led to a loss of markets, devaluations can also provide a palatable alternative to nominal wage cuts in an effort to boost export performance. However, any sustained improvement in the external balance of developing countries can only come about through productivity growth and technological upgrading, which can be achieved both by augmenting the existing stock of physical and human capital and by shifting existing resources away from traditional low-productivity activities.

For many developing countries, any initial expansion is likely to be concentrated in sectors with a high resource and/or unskilled or semi-skilled labour content. Such sectors tend to be technologically less demanding and can quickly absorb large numbers of workers from the more traditional primary and tertiary sectors. Under favourable global economic conditions, developing countries can expect to see strong export growth in these same sectors. However, in some of them, particularly the larger economies, a more diversified production and export profile incorporating capital goods might be possible, even at earlier stages of development.

There is now a much greater appreciation by policy makers in developing countries of the need to secure a rapid growth of exports in order to expand investment and output. As discussed in chapter IV above, an export-investment nexus can capture the wider and mutually reinforcing linkages between trade, investment and economic growth. Because such a dynamic interaction is not a spontaneous outcome of market forces, pragmatic trade, financial and industrial policies remain a sine qua non for sustainable growth.

While emphasis on exporting is desirable for a variety of reasons, it may not alone remove the balance-of-payments constraint on growth. A sophisticated infant-industry programme designed to reduce the import content of growth also needs to be part of the policy arsenal available to developing countries. The current aversion to such programmes reflects a misreading of the reasons for the failure of an earlier generation of import-substitution policies. A careful review of past experience shows that design and implementation problems, and not misguided logic, were the main source of failure. Moreover, the success of the
East Asian and other fast-growing developing economies shows that an export push often followed the build-up of domestic production capacity for the replacement of imports. In view of the evidence that the import content of growth in developing countries is now an even greater constraint on sustained economic growth than in the past, a rethinking of this issue is an urgent necessity in many developing countries.

The mix and sequencing of trade, industrial and technology policies that successfully combined export promotion with import substitution in East Asia are well known and have been discussed extensively in past issues of TDR and elsewhere. The lessons from this experience have lost little of their relevance. However, the post-Uruguay Round trading regime has circumscribed the scope in most developing countries for replicating some of the policy measures which contributed to East Asian success. The possibilities are greater for the least developed countries, but in some cases, such as the use of subsidies, most are not able to exploit them. Nevertheless, there remains a need for more policy advice and technical assistance to developing countries in designing strategies to help promote competitive industries, rather than an emphasis simply on what is no longer possible under existing trade rules.

More importantly, in view of the growing pressure on countries to push domestic producers into world markets, the concept of infant industries needs to be extended beyond the earliest stages of manufacturing and include nourishing more advanced competitive industries through appropriate protection and support. Developed countries cannot, on the one hand, justify protecting and helping mature producers in their agricultural and high-technology sectors and, on the other, deny such possibilities to developing countries facing their own particular problems. If existing multilateral rules are indeed impeding the learning and upgrading process in the industrial sectors of developing countries, then a re-examination is called for. Such examination is particularly desirable in respect of Article XVIII, sections A and C, of GATT 1994, where the compensation requirements are so onerous that they are likely to nullify the very intent of the article, which is to allow developing countries to promote new industries. Part IV of GATT 1994, together with the 1979 Tokyo Round Enabling Clause, which lay down broad principles and objectives of differential and more favourable treatment, could provide a good starting point, although their best-endavour status is not adequate in the light of the remaining biases and asymmetries in the international trading system. The shift in approach during the Uruguay Round, away from differential treatment allowing developing countries to protect their own industries and preferential access to northern markets and towards an ad hoc array of special terms on implementing agreements and on technical assistance to help developing countries integrate into the world economy, does not, however, in the light of the findings of this Report, represent a positive step forward. According to one recent review of the issue, the old approach, based on the existence of endemic balance-of-payments problems in developing countries and support for infant industries, was simply ignored by the proponents of conventional neoclassicism (whether because of a one-sided interpretation of the East Asian experience or of a general distrust of policy makers in developing countries) who came to dominate the intellectual scene in the trade negotiations of the mid-1980s. The economics behind the old approach remains nonetheless valid. Serious attention should now be given to how special and differential treatment could be integrated into the contractual obligations of the rule-based trading system.

On the other hand, many of the policies needed to establish dynamic domestic firms are not directly governed by multilateral agreements, and there is much greater scope in this respect than has been exploited in many developing countries. There is considerable freedom in the choice of financial, fiscal and macroeconomic policies that can help create the basic conditions for faster capital accumulation and channel investment to areas consistent with broader development objectives. But at the core of any successful development experience lies a series of institutional ties and more informal individual networks that connect the public and private sectors, allowing information to flow between business and the public sector without compromising the ability of policy makers to propose and pursue development goals. In many developing countries, the capacities of the private and the public sectors in this respect have been steadily eroded, and the time needed to rebuild them may in some cases be considerable.

Attracting FDI to obtain foreign technologies and secure other advantages associated with the international production network of TNCs can offer a faster route to the establishment of com-
petitive industries. However, the benefits from hosting TNCs are not automatic and the policy objectives of the host country in such matters as local content, technological upgrading and balance-of-payments stability may clash with the commercial interests of the corporations. As discussed in the preceding chapter, replacing the high import content of TNC activities in manufacturing with domestic production remains an important objective in many countries. Equally, the potential technological and other spillovers, particularly for middle-income economies and in sectors where specific knowledge and capital equipment are closely knitted together, still require that host Governments preserve their ability to bargain effectively with TNCs.

Again, the objective of policy makers should not be to attract FDI under any conditions but to create a domestic economic base which can benefit from the presence of foreign firms. Thus, while TNCs can be important agents to help build or improve a country’s competitive advantages, the terms on which this is done should remain variable. As was the case with successful experiences in the past, all trade and industrial policies must be designed and implemented so as to reflect differences in levels of economic development, resource endowments and macroeconomic circumstances. In both export orientation and import substitution there are easy and difficult stages, and Governments must be ready to make timely shifts in the incentive structure as their economies graduate through different stages of industrial and economic development.

3. Fallacies of composition

There has been some concern that what worked in the past for a small group of economies will not work if a large number of developing countries pursue the same strategy simultaneously. Indeed, export prospects could be weakened for manufactures with low elasticities of demand, particularly with slower global growth and the danger of proliferation of new forms of protectionism in the North. Any gains in volume under these conditions would be eroded by price declines. These were not the conditions that prevailed when the East Asian NIEs adopted their export-oriented strategy.

As noted above, there is some evidence that the relative price of manufactured exports from developing countries has fallen during the past two decades alongside the rapid expansion of their volume. Moreover, simulations by the UNCTAD secretariat undertaken in the context of a North-South trade model suggest that a widespread attempt by developing countries to increase exports of labour-intensive, low-elasticity manufactures to northern markets could lead to a collapse of their terms of trade. However, such an outcome depends on how quickly northern producers move out of such low-skill activities as clothing, on market access conditions in the North, and on the pace at which newly industrializing countries diversify their own production structures away from low-skilled exports.

Already, with the rapid industrialization achieved by a number of East Asian and some other developing-country exporters of manufactures, dependence for growth on exports to industrial countries has weakened somewhat. Greater South-South cooperation in trade could help overcome the problem associated with inadequate growth of and access to markets in the North. Again, successfully reducing the import content of growth could alleviate the balance-of-payments pressures arising in developing countries. Still, the South needs to look to the North for capital and intermediate goods and to gain access to technology. Consequently, both the growth of northern markets and access to them are vital.

The fallacy of composition argument is not confined to trade relations but extends to other components of the global economy. Much of the rationale for developing countries to liberalize their regimes governing FDI and extend incentives to potential investors lies in the hope of replicating the success of some countries in Asia and Latin America, such as Chile and Malaysia, which by attracting TNCs were able to launch export-oriented industries. However, UNCTAD secretariat calculations have shown that the scale of FDI flows from the North implied by a general replication of these experiences is unrealistic.
1. Beyond the playing-field metaphor

Low average duties resulting from the Uruguay Round have led some to a belief that a level playing field is being rapidly established in the international trading system, but that is far from being the case. Trade liberalization in developed countries was a gradual process which unfolded over eight rounds of multilateral trade negotiations under GATT auspices, and through the participation of those countries in regional trade agreements and customs unions. Exceptionally strong growth during the post-war years underpinned this liberalization process. By contrast, the large and active participation of developing countries in recent multilateral trade negotiations occurred at a time of sluggish growth, when many of them were implementing difficult adjustment programmes to address the payments difficulties associated with the debt crisis of the 1980s. Those programmes involved extensive liberalization measures, notably the removal or relaxation of quantitative import restrictions and exchange controls, as well as significant reductions in tariffs which were to a large extent bound in their concessions in the Uruguay Round; whereas for developed countries tariff bindings were increased from 96 per cent to 99 per cent, for developing countries the increase was from 14 per cent to 59 per cent. At the same time, negotiations in many areas of interest to developing countries did not advance very far.

(a) Tariffs

As a result of the Uruguay Round, the average MFN tariff rate in the major advanced industrial countries should fall to between 3.7 per cent (United States) and 7.1 per cent (Canada), once the negotiated reductions are fully implemented. However, as noted in chapter II, both the level and the frequency of tariffs remain a matter of concern in a number of key sectors of direct interest to developing countries. Over 10 per cent of the tariff universe of the Quad countries (Canada, European Union, Japan, United States), made up of 4,000 tariff lines, will continue to face peak tariffs, i.e. tariffs in excess of 12 per cent ad valorem. One fifth of the peak tariffs of the United States, 30 per cent of those of Japan, one quarter of those of the European Union and about one seventh of those of Canada exceed 30 per cent. Even after all concessions are fully implemented, frequent tariff peaks and significant tariff escalation will continue to provide high levels of import protection for a sizeable cross-section of northern producers.

Such peaks are frequent for agricultural products, particularly dairy products, sugar and cocoa products and canned fruit and vegetables, but are also common for many low-technology manufactures (table 6.1). A recent study by UNCTAD/WTO has shown that among agricultural tariff peaks excessively high rates (i.e. exceeding 70 per cent) are mainly applied to products that had been recently tariffed as a result of the Uruguay Round commitments. They include: frozen bovine meat, grape juice, fresh bananas, milk, maize and raw sugar cane in the European Union; stemmed tobacco, shelled or roasted peanuts and peanut butter in the United States; milled rice, shelled peanuts, milk, and prepared pork hams in Japan; and dairy products in Canada. All these products are generally considered to offer a potential for export diversification in developing countries.

Although tariff peaks are not as high in traditional low-technology manufactures as in agriculture, northern producers continue to benefit from protection. Clothing and textile producers are still protected both by high tariffs and by stringent quantitative restrictions on imports from developing countries, and they will continue to enjoy high tariff protection even when all quota restrictions are removed in 2005. The preferential rates for clothing under EU’s GSP scheme amount generally to 11.9 per cent. The United States ex-
includes most textiles and clothing products from its scheme, and its MFN tariffs range from 14 per cent to 32 per cent for most synthetic, woollen and cotton clothing. Canada applies MFN rates of about 18 per cent and the GSP rates of Japan range from 6 per cent to 11 per cent.

Developing countries also continue to face extremely high tariff barriers in footwear, leather and leather goods. Neither the United States nor Canada accords preferences for these products under their GSP schemes, and MFN rates range from 38 per cent to 58 per cent for certain sports, rubber, plastic and textile shoes in the United States and from 16 per cent to 20 per cent for all footwear in Canada. Tariffs on footwear in EU are generally at 11.9 per cent for GSP beneficiaries and 13 per cent for other suppliers. Japanese MFN tariffs reach 30 per cent for leather; for leather shoes the tariff is equivalent to 140 per cent for a pair priced at $25; GSP imports are subject to a stringent ceiling. Even some capital-intensive goods, such as trucks, buses and ships, face relatively high peaks in some northern markets. In high-technology sectors which involve largely unskilled labour in the production of components, such as TV receivers and tubes, video recorders and watches, MFN tariffs are also high and the major exporters are excluded from GSP treatment.

Although tariff escalation has decreased as a result of the Uruguay Round, rising tariffs from raw materials to intermediate products and sometimes peaking for finished industrial products continue to restrict export opportunities and hamper

### Table 6.1

<table>
<thead>
<tr>
<th>Product group</th>
<th>United States</th>
<th>Canada</th>
<th>European Union</th>
<th>Japan</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>19</td>
<td>15</td>
<td>48</td>
<td>42</td>
</tr>
<tr>
<td>Meat</td>
<td>8</td>
<td>14</td>
<td>62</td>
<td>41</td>
</tr>
<tr>
<td>Fish and crustaceans</td>
<td>0</td>
<td>0</td>
<td>37</td>
<td>3</td>
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<tr>
<td>Dairy products</td>
<td>55</td>
<td>70</td>
<td>84</td>
<td>87</td>
</tr>
<tr>
<td>Fresh fruit and vegetables</td>
<td>12</td>
<td>8</td>
<td>34</td>
<td>19</td>
</tr>
<tr>
<td>Cereals and flour</td>
<td>0</td>
<td>26</td>
<td>72</td>
<td>61</td>
</tr>
<tr>
<td>Vegetable oils</td>
<td>6</td>
<td>9</td>
<td>10</td>
<td>13</td>
</tr>
<tr>
<td>Canned meat and fish</td>
<td>4</td>
<td>14</td>
<td>56</td>
<td>32</td>
</tr>
<tr>
<td>Sugar and cocoa products</td>
<td>29</td>
<td>12</td>
<td>79</td>
<td>73</td>
</tr>
<tr>
<td>Canned fruits and vegetables</td>
<td>17</td>
<td>24</td>
<td>80</td>
<td>63</td>
</tr>
<tr>
<td>Other food products</td>
<td>33</td>
<td>18</td>
<td>59</td>
<td>81</td>
</tr>
<tr>
<td>Beverages and tobacco</td>
<td>18</td>
<td>16</td>
<td>37</td>
<td>48</td>
</tr>
<tr>
<td>Other agriculture</td>
<td>1</td>
<td>2</td>
<td>14</td>
<td>5</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>10</td>
<td>15</td>
<td>18</td>
<td>12</td>
</tr>
<tr>
<td>Leather and leather products</td>
<td>12</td>
<td>4</td>
<td>0</td>
<td>22</td>
</tr>
<tr>
<td>Textiles</td>
<td>21</td>
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<td>1</td>
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<tr>
<td>Clothing</td>
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<td>93</td>
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<td>0</td>
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<tr>
<td>Footwear</td>
<td>42</td>
<td>67</td>
<td>0</td>
<td>71</td>
</tr>
<tr>
<td>Glass products</td>
<td>10</td>
<td>5</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Vehicles</td>
<td>4</td>
<td>1</td>
<td>8</td>
<td>0</td>
</tr>
</tbody>
</table>

**Source:** UNCTAD secretariat, based on United Nations Statistics Division, Trade Analysis and Information System (TRAINS) database.

*Defined as tariff rates which exceed 12 per cent *ad valorem*; see text, note 26.
vertical diversification and industrialization in developing countries. This remains a very important obstacle to their agricultural diversification.\textsuperscript{29} Traditional low-skill industries such as textiles, footwear and clothing and resource-based industries such as rubber and wood products are also vulnerable.\textsuperscript{30} As these markets are very large, a decline in tariffs for the processed products would significantly increase market access for exporting countries.

(b) Non-tariff measures

With the entry into force on 1 January 1995 of the Marrakesh Agreement Establishing the World Trade Organization, some trade measures are losing their importance as barriers. The Agreement on Agriculture requires the elimination of quantitative restrictions and other frontier non-tariff measures. The Agreement on Safeguards renders resort to voluntary export restraints virtually impossible, although similar measures are being applied in the guise of “understandings” on subsidies. On the other hand, the threat of market penetration by southern producers has prompted northern industries to seek other protectionist measures consistent with the various WTO Agreements. Such measures can have a significant impact on access to northern markets; according to one recent study, the true average protection rate of European industry rises from 5.1 per cent if only tariffs are included and to 9 per cent if tariff and non-tariff barriers are considered together.\textsuperscript{31}

Among the various contingency protection measures (often termed “trade remedies”) allowed under GATT 1994, anti-dumping action is a widely exercised option.\textsuperscript{32} This is partly due to the nature of the Agreement on anti-dumping (formally the Agreement on Implementation of Article VI of the GATT 1994), which, while setting out a series of procedural guidelines aimed at reducing the scope for arbitrariness and uncertainty, still contains many ambiguities and “loopholes”. Sectors that have been the main targets for anti-dumping actions are metals and metal products, chemical products, machinery and electrical equipment, plastics and plastic products, textiles and clothing, pulp of wood or of other fibrous cellulosic material, prepared foodstuffs and beverages, stone and plaster products, other manufactured products, footwear and headgear. Although many such actions relate to conflicts between developed countries, the majority involve complaints against exporters from developing countries, sometimes by other developing countries. In 1997, out of 239 cases initiated in WTO, 143 concerned developing countries and countries in transition. As noted in chapter II, technical, health and safety standards and regulations, which may reflect the legitimate concern of consumers in industrial countries, also risk becoming tools for disguised non-tariff protection, especially in respect of agricultural products. Also, a major concern of developing countries is that linking labour market and environmental standards or the treatment of investors to trade obligations would open the door to a proliferation of “trade remedies”.

Subsidies pose a major obstacle to exports from developing countries. During the Uruguay Round, for the first time an effort was made to establish effective disciplines on industrial subsidies, and a distinction between prohibited, actionable and non-actionable subsidies was also made.\textsuperscript{33} The Agreement also contains important provisions on differential and more favourable treatment. However, the very broad definition of non-actionable subsidies, which includes those for research and development, regional development and environmental purposes, gives developed countries much latitude in continuing to use subsidies to obstruct market access, especially in agriculture. Although the Uruguay Round resulted in limits being set to agricultural subsidization, total annual levels of support for agriculture in OECD countries averaged $350 billion in 1996–1998, a figure which compares with total agricultural exports from developing countries of $170 billion. Although the bulk of this support is accounted for by Japan, the United States and major producers in Europe, the highest level of support per farmer is to be found in a number of smaller countries, including Switzerland, Norway and Iceland.\textsuperscript{34} Direct export subsidies account for around one sixth of total EU agricultural subsidies.\textsuperscript{35} According to a recent study commissioned by UNCTAD, over 80 per cent of all agricultural export subsidies in 1995 and 1996 were granted by the European Union, compared with under 2.5 per cent by developing countries.\textsuperscript{36}

The effect of this agricultural support, whether in the form of direct export subsidies, processing subsidies or direct payments to farmers, is to allow agricultural products to be sold on domestic and world markets at below production cost. The impact on producers in developing countries can
be significant not only by precluding their entry into northern markets but also through unfair competition in their own markets. In dairy production, for example, subsidies in EU countries range from 40 per cent to over 100 per cent of the world market price of the products. Consequently, although EU producers are among the world’s highest-cost producers of dairy products, they have a 50 per cent share of the world market. There is evidence that agricultural support in EU countries has been highly detrimental to production in Latin America and Africa.37

Northern industry is generally thought to be less subsidized than agriculture. Nevertheless, in the case of industrial subsidies there appears to be a strong bias against developing countries in the Agreement on Subsidies and Countervailing Measures. The “non-actionable” categories of subsidies, as defined by that Agreement, are those which form part of industrial policy in developed countries, while subsidies of key importance to developing countries fall within the “actionable” category. Furthermore, the non-actionable nature of the R&D subsidies permits firms in developed countries to subsidize the development of new products, for which they can subsequently gain protection under the TRIPs Agreement. In addition, fiscal incentives by developed countries, for example to attract investment, are often granted at sub-national levels and are not effectively disciplined.

2. Trading opportunities for developing countries

Analysis by the UNCTAD secretariat of the evolving trade structure of the fast-growing East Asian economies since the mid-1960s identified a group of industries where rapid entry into world markets could be achieved with relative ease in the early stages of industrial development and where strong export expansion would be essential to their subsequent growth. The industries include traditional labour-intensive ones such as footwear, leather goods, travel goods and handbags, textiles, toys and sports equipment, as well as more capital- and resource-intensive industries, such as clothing, wood and paper products, rubber and plastic products and fabricated metal products.38 In addition, some sectors classified as high-technology, such as the electrical machinery sector, use low-skill labour and could successfully export, using the production network of TNCs either through subcontracting arrangements or directly through production by affiliates.39

Thanks to low unit labour costs relative to the United States and other developed countries, many developing countries are becoming increasingly competitive in such low and medium-technology sectors (table 6.2).40 In most of these sectors a large majority of the developing countries covered in the table have a competitive edge over the United States and even more so over other industrial countries (e.g. Sweden). While some (e.g. Brazil, Chile, India, Indonesia, Republic of Korea and Turkey) are strongly competitive in almost all sectors, others can compete only in certain sectors. Such differences reflect not only wage and exchange-rate policies but also the success in raising productivity in specific industries and the general level of development reached.

As discussed in the previous section, these same sectors are among those most exposed to higher average tariffs, tariff peaks, tariff escalation and non-tariff barriers, which have had a fairly direct impact on their exports to northern markets. From chart 6.1 it can be seen that in general the growth of exports of developing countries to industrial countries is inversely related to the degree of tariff protection in the latter. During the first half of the 1990s developing countries achieved yearly export growth rates to the north above 15 per cent in products such as office machines, telecommunications equipment, power-generating machinery and automotive parts, where tariff and non-tariff barriers are relatively low (the weighted average MFN tariff in these dynamic sectors in the Quad countries was below 5 per cent). Their export growth was much slower in sectors such as clothing, textiles and footwear, where they have a competitive edge but face relatively higher levels of protection.

Recent assessments of liberalization measures agreed to in the Uruguay Round suggest that the gains to developing countries in terms of export growth will be small relative to the total size of the markets involved.41 By focusing on the details of the negotiated outcomes of the Uruguay Round, such exercises provide a sobering reminder of what more needs to be done if developing countries are to obtain significant benefits from any future negotiations. However, because such studies tend to concentrate on de jure trade barriers, they can lose sight of the wider potential market
opportunities which might be forthcoming under more favourable conditions.42

In TDR 1996 the UNCTAD secretariat examined the potential trading opportunities in one particular industry, namely clothing, where developing countries have traditionally had difficulties of market access. It was estimated that if northern producers immediately opted for a more open trading regime in line with agreements made during the Uruguay Round and adopted a more progressive approach to moving out of these low-skill and low-wage “sunset” industries (along the lines, for example, of the German and Swedish clothing industries), then during the 10-year period dictated by the phasing out of the Multi-Fibre Arrangement annual clothing exports from developing countries could triple to around $180 billion.43

The characteristics of this particular industry, namely that significant production remained in the North behind high tariff and non-tariff barriers and that domestic demand in those countries was likely to remain fairly robust, are such that a significant expansion in southern clothing exports could take place without running into the danger of fallacy of composition. It was also the case that developing countries already had significant capacity in this industry or that such capacity could be quickly generated to meet any increased demand; clothing imports from developing countries, as a share of apparent consumption in the major northern markets, had already more than doubled from 1980 to 1994.

Clothing is only one among several industries where developing countries could gain a much greater share of northern markets. Table 6.3

Table 6.2

UNIT LABOUR COSTS IN SELECTED DEVELOPING ECONOMIES AND INDUSTRIES, 1995
(Ratio to the United States level)

<table>
<thead>
<tr>
<th>Economy</th>
<th>Footwear</th>
<th>Textiles</th>
<th>Clothing</th>
<th>Metal products</th>
<th>Wood products</th>
<th>Rubber products</th>
<th>Plastic products</th>
<th>Electrical machinery</th>
<th>Leather and fur goods</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hong Kong, China</td>
<td>1.75</td>
<td>1.38</td>
<td>1.70</td>
<td>1.35</td>
<td>1.24</td>
<td>1.33</td>
<td>1.40</td>
<td>1.23</td>
<td>1.44</td>
</tr>
<tr>
<td>Republic of Korea</td>
<td>1.03</td>
<td>0.81</td>
<td>0.91</td>
<td>0.79</td>
<td>0.83</td>
<td>0.74</td>
<td>0.58</td>
<td>0.59</td>
<td>0.78</td>
</tr>
<tr>
<td>Singaporea</td>
<td>1.67</td>
<td>1.25</td>
<td>1.84</td>
<td>1.02</td>
<td>1.28</td>
<td>1.33</td>
<td>1.28</td>
<td>1.02</td>
<td>1.36</td>
</tr>
<tr>
<td>Taiwan Province of China</td>
<td>2.21</td>
<td>1.45</td>
<td>1.29</td>
<td>1.71</td>
<td>1.81</td>
<td>1.86</td>
<td>1.85</td>
<td>1.80</td>
<td>2.30</td>
</tr>
<tr>
<td>Brazila</td>
<td>..</td>
<td>0.47</td>
<td>..</td>
<td>0.59</td>
<td>0.61</td>
<td>0.58</td>
<td>0.63</td>
<td>..</td>
<td>..</td>
</tr>
<tr>
<td>Chile</td>
<td>0.69</td>
<td>0.83</td>
<td>0.79</td>
<td>0.75</td>
<td>0.61</td>
<td>0.69</td>
<td>0.75</td>
<td>0.93</td>
<td>0.72</td>
</tr>
<tr>
<td>Egypta</td>
<td>..</td>
<td>1.50</td>
<td>0.50</td>
<td>0.85</td>
<td>0.48</td>
<td>1.50</td>
<td>0.93</td>
<td>..</td>
<td>..</td>
</tr>
<tr>
<td>Indiaa</td>
<td>0.99</td>
<td>1.01</td>
<td>0.49</td>
<td>0.97</td>
<td>0.91</td>
<td>0.88</td>
<td>0.88</td>
<td>0.85</td>
<td>0.90</td>
</tr>
<tr>
<td>Indonesia</td>
<td>0.85</td>
<td>0.47</td>
<td>0.95</td>
<td>0.55</td>
<td>0.53</td>
<td>0.72</td>
<td>0.64</td>
<td>0.76</td>
<td>0.65</td>
</tr>
<tr>
<td>Kenya</td>
<td>1.13</td>
<td>1.61</td>
<td>1.17</td>
<td>0.91</td>
<td>1.20</td>
<td>0.61</td>
<td>0.63</td>
<td>0.56</td>
<td>1.36</td>
</tr>
<tr>
<td>Malaysia</td>
<td>1.08</td>
<td>0.73</td>
<td>1.42</td>
<td>0.83</td>
<td>0.85</td>
<td>0.76</td>
<td>0.92</td>
<td>0.97</td>
<td>1.19</td>
</tr>
<tr>
<td>Mexicoa</td>
<td>1.62</td>
<td>0.96</td>
<td>1.20</td>
<td>0.76</td>
<td>0.76</td>
<td>0.96</td>
<td>0.83</td>
<td>0.83</td>
<td>..</td>
</tr>
<tr>
<td>Philippines</td>
<td>1.36</td>
<td>0.69</td>
<td>1.12</td>
<td>0.79</td>
<td>0.90</td>
<td>0.71</td>
<td>0.69</td>
<td>0.84</td>
<td>1.44</td>
</tr>
<tr>
<td>Thailanda</td>
<td>1.23</td>
<td>0.87</td>
<td>1.70</td>
<td>0.71</td>
<td>0.57</td>
<td>0.56</td>
<td>0.83</td>
<td>0.65</td>
<td>0.92</td>
</tr>
<tr>
<td>Turkeya</td>
<td>0.69</td>
<td>0.42</td>
<td>0.38</td>
<td>0.46</td>
<td>0.96</td>
<td>0.57</td>
<td>0.34</td>
<td>0.51</td>
<td>0.62</td>
</tr>
<tr>
<td>Zimbabwe</td>
<td>0.95</td>
<td>0.56</td>
<td>1.26</td>
<td>0.99</td>
<td>0.73</td>
<td>0.74</td>
<td>1.36</td>
<td>1.05</td>
<td>1.39</td>
</tr>
</tbody>
</table>

Memo item:

Swedena                | 1.53     | 1.23     | 1.40     | 1.10           | 1.05          | 1.18            | 1.38              | 1.45                 | 1.13                |

Note: Unit labour costs are estimated by taking the ratio of wages per employee to value added per employee.
a Ratio in 1994.
provides a summary of consumption, production and trade data for a number of other low- and medium-skill industries. For most of these industries the share of imports from developing countries in apparent consumption in the North is still very small even though, as shown in table 6.2, developing countries are competitive in these sectors. Textiles and footwear are the sectors that come closest to the clothing example. They are generally low-skill industries in which developing countries have already built up export capacity, and where tariff barriers in developed countries are relatively high (chart 6.2) and non-tariff barriers further restrict market access, allowing northern producers to remain competitive. However, in the case of textiles, the diversity of products which make up the industry raises a series of complex policy questions on how to achieve competitiveness even at this level of skill requirement.

How much might developing countries benefit under more favourable market access conditions for the products of these industries? Table 6.4 sets out the results of UNCTAD secretariat calculations under three alternative scenarios. Under the first (baseline) scenario, footwear and textile exports of developing countries are assumed to grow at the same rate as (apparent) consumption in industrial countries, so that their share in consumption (market penetration ratio) remains unchanged. Markets for these products are not growing particularly fast (they are assumed to grow by 5.2 per cent and 2.1 per cent, respectively, from 1995 to 2005): with the present geographical distribution of production, annual textile and footwear exports from developing countries are projected to grow from $35.1 billion in 1995 to $48.6 billion in 2005. Thus, the critical issue is how fast producers in industrial countries move out of these sectors. If it is assumed that in the developed countries output remains constant at the 1995 level and that the increase in apparent consumption in those countries is met entirely by developing countries (scenario II), the latter would secure an additional annual gain in export earnings of $24.4 billion in footwear and $47.3 billion in textiles by 2005 (i.e. over and above the gain in the baseline scenario). They would then account for 52.5 per cent and 18.9 per cent, respectively, of apparent consumption of industrial countries in these two industries. Arguably, these figures still significantly underestimate the export potential for such industries. In the United States, for example, the share of developing countries in apparent consumption of footwear rose from 17 per cent in 1982 to around 60 per cent in 1995, and domestic production dropped by one third. Assuming similar falls in output in other industrial countries over the period 1995–2005, footwear exports from developing countries would rise to around $60 billion by the end of the period, representing a share of apparent consumption of around 68 per cent (scenario III).

As noted above, the textile industry is more diversified and import penetration ratios vary considerably for different products and for different
northern markets (table 6.5). However, it would appear that in the traditionally more open markets of Europe, such as Sweden and the Netherlands, penetration ratios for some textiles are already quite high, suggesting that under the right conditions sizeable export gains are achievable. A significant reduction in the frequency of non-tariff barriers in the Swedish textile industry, for example, coincided with a drop in domestic production of around 25 per cent from 1988 to 1994, allowing such gains to take place. Assuming that similar action was taken by other industrial countries and their output fell by 25 per cent from 1995 to 2005, annual exports from developing countries could reach $154 billion by the end of the period, and so account for nearly 40 per cent of apparent consumption in the industrial countries (scenario III of table 6.4).

Comparable consumption and production data are not available for leather goods, travel goods and toys and sportswear, but in those sectors, too, a doubling or tripling of exports could be expected, generating increases in annual export earnings of $20–60 billion by the year 2005.

A second area of interest to developing countries includes resource-based manufactures, such as metal, wood, rubber and plastic products, which often have a fairly wide and diverse product range. During the 1990s they exhibited relatively strong growth in industrial countries behind moderately high levels of protection. For particular product lines and particular countries, peak tariffs are still high and core non-tariff measures can constitute further protectionist obstacles. Thus, although many developing countries have already built capacity in these sectors and have shown quite strong export performance in world markets in the 1990s (see table 6.3), their share of apparent consumption in the North is still low.

A continuation of present trends in these industries would see an increase in annual exports by developing countries of $25 billion by 2005. However, under the assumptions of scenario II

Table 6.3

LOW- AND MEDIUM-SKILL INDUSTRIES: OUTPUT AND CONSUMPTION IN DEVELOPED COUNTRIES a AND IMPORT PENETRATION BY DEVELOPING COUNTRIES (1995)

(Billions of dollars and per cent)

<table>
<thead>
<tr>
<th>Industry</th>
<th>Output 1995 ($ billion)</th>
<th>Apparent consumption 1995 ($ billion)</th>
<th>Share of developing countries in 1995 (Per cent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Footwear</td>
<td>41.5</td>
<td>52.6</td>
<td>5.2</td>
</tr>
<tr>
<td>Textiles</td>
<td>320.0</td>
<td>320.5</td>
<td>2.1</td>
</tr>
<tr>
<td>Metal products</td>
<td>697.9</td>
<td>694.1</td>
<td>5.7</td>
</tr>
<tr>
<td>Wood products</td>
<td>216.5</td>
<td>227.1</td>
<td>5.2</td>
</tr>
<tr>
<td>Rubber products</td>
<td>113.5</td>
<td>111.5</td>
<td>4.9</td>
</tr>
<tr>
<td>Plastic products</td>
<td>405.6</td>
<td>410.7</td>
<td>8.6</td>
</tr>
<tr>
<td>Beverages (manf.)</td>
<td>238.5</td>
<td>234.8</td>
<td>7.0</td>
</tr>
<tr>
<td>Tobacco (manf.)</td>
<td>113.0</td>
<td>107.8</td>
<td>6.0</td>
</tr>
<tr>
<td>Total, above industries</td>
<td>2 146.5</td>
<td>2 159.1</td>
<td>4.9</td>
</tr>
</tbody>
</table>


a Refers to the Quad countries (Canada, European Union, Japan and United States).
c Imports of the Quad countries from developing countries as a share of apparent consumption.
d Products of the beverage industries, excluding coffee and cocoa products.
they would double their share of apparent consumption in industrial countries and their exports would rise to $112 billion, an additional gain of $56 billion on the baseline scenario. Even more optimistic would be a move in a direction similar to that already experienced in the electrical machinery industries, which operate under low tariff barriers and where imports from the South account for 10 per cent of northern apparent consumption. This proportion has already been reached in some resource-based products, such as rubber in the United States and plastics in Sweden. Assuming that a similar proportion could be reached for all these resource-based industries, annual exports from developing countries would be higher by $97.8 billion for the metal industries, $26.4 billion for wood, $12.4 billion for rubber, and $77.8 billion for plastics (scenario III).

A final group of export interest to developing countries includes products such as beverage and tobacco manufactures. Markets for these products are growing rapidly in the industrial world, behind very high levels of protection. Growth of exports from developing countries has been sluggish, averaging under 7 per cent, for example, for manufactured tobacco, and their market penetration is particularly low; even if the share of developing country exports in northern consumption in these two product groups tripled, that would only generate an additional $6.6 billion in annual export earnings by 2005. Under more liberal import regimes in the North it might be possible for developing countries to secure the same share in those markets as they do in world markets (table 6.3). This would yield additional annual export revenue to the South of $103 billion for beverages and $21 billion for manufactured tobacco.

All in all, there are thus considerable potential export opportunities for developing countries in respect of the industries covered by tables 6.3 and 6.4. In the baseline scenario, where the share
## Table 6.4

### DEVELOPING-COUNTRY EXPORTS TO DEVELOPED COUNTRIES AND MARKET PENETRATION: PROJECTIONS FOR MAJOR EXPORT INDUSTRIES ON ALTERNATIVE ASSUMPTIONS

The table provides projections for exports from developing to developed countries in 2005, under three different scenarios:

- **Scenario I (baseline)**: Import penetration ratios in 2005 are unchanged from 1995.
- **Scenario II**: Northern production of footwear and of textiles remains unchanged in 2005 from 1995; the import penetration ratio doubles for metal, wood, rubber and plastic products and triples for beverage and tobacco manufactures.
- **Scenario III**: Northern production of footwear falls by one third and of textiles by one quarter from 1995 to 2005; market penetration reaches 10 per cent for metal, wood, rubber and plastic products, 23 per cent for beverage manufactures and 10.9 per cent for tobacco manufactures.

### Projections for exports from developing to developed countries in 2005

<table>
<thead>
<tr>
<th>Industry</th>
<th>Exports to North in 1995 ($ billion)</th>
<th>Trend estimate of northern consumption in 2005 (Per cent)</th>
<th>Annual growth rate (Per cent)</th>
<th>Export value ($ billion)</th>
<th>Market penetration ratio (Per cent)</th>
<th>Gain in value ($ billion)</th>
<th>Annual growth rate (Per cent)</th>
<th>Market penetration ratio (Per cent)</th>
<th>Gain in value ($ billion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Footwear</td>
<td>12.9</td>
<td>87.3</td>
<td>5.2</td>
<td>24.5</td>
<td>21.4</td>
<td></td>
<td>13.5</td>
<td>52.5</td>
<td>24.4</td>
</tr>
<tr>
<td>Textiles</td>
<td>22.2</td>
<td>394.5</td>
<td>2.1</td>
<td>6.9</td>
<td>27.2</td>
<td></td>
<td>12.9</td>
<td>18.9</td>
<td>47.3</td>
</tr>
<tr>
<td>Metal products</td>
<td>13.2</td>
<td>1 208.2</td>
<td>5.7</td>
<td>1.9</td>
<td>23.0</td>
<td></td>
<td>13.3</td>
<td>3.8</td>
<td>22.9</td>
</tr>
<tr>
<td>Wood products</td>
<td>6.9</td>
<td>377.0</td>
<td>5.2</td>
<td>3.0</td>
<td>11.3</td>
<td></td>
<td>12.6</td>
<td>6.0</td>
<td>11.3</td>
</tr>
<tr>
<td>Rubber products</td>
<td>3.5</td>
<td>179.8</td>
<td>4.9</td>
<td>3.1</td>
<td>5.6</td>
<td></td>
<td>12.2</td>
<td>6.2</td>
<td>5.5</td>
</tr>
<tr>
<td>Plastic products</td>
<td>6.8</td>
<td>937.2</td>
<td>8.6</td>
<td>1.7</td>
<td>15.9</td>
<td></td>
<td>16.7</td>
<td>3.4</td>
<td>16.0</td>
</tr>
<tr>
<td>Beverages (manf.)</td>
<td>1.3</td>
<td>461.1</td>
<td>7.0</td>
<td>0.6</td>
<td>2.8</td>
<td></td>
<td>20.4</td>
<td>1.8</td>
<td>5.5</td>
</tr>
<tr>
<td>Tobacco (manf.)</td>
<td>0.2</td>
<td>193.0</td>
<td>6.0</td>
<td>0.2</td>
<td>0.4</td>
<td></td>
<td>19.6</td>
<td>0.6</td>
<td>0.8</td>
</tr>
<tr>
<td>Total, above industries</td>
<td>67.0</td>
<td>3 838.1</td>
<td>4.9</td>
<td>2.8</td>
<td>107.6</td>
<td></td>
<td>13.7</td>
<td>6.3</td>
<td>133.7</td>
</tr>
</tbody>
</table>

### Source

As for table 6.3.

### Note

- **a** Assumption: Import penetration ratios in 2005 are unchanged from 1995.
- **b** Assumption: Northern production of footwear and of textiles remains unchanged in 2005 from 1995; the import penetration ratio doubles for metal, wood, rubber and plastic products and triples for beverage and tobacco manufactures.
- **c** Assumption: Northern production of footwear falls by one third and of textiles by one quarter from 1995 to 2005; market penetration reaches 10 per cent for metal, wood, rubber and plastic products, 23 per cent for beverage manufactures and 10.9 per cent for tobacco manufactures.
- **d** Assuming continuation of the annual average growth of apparent consumption in 1990–1995.
- **f** Gain over export-value projection in baseline scenario.
- **g** Products of the beverage industries (ISIC 313), excluding coffee and cocoa products.
of apparent consumption remains unchanged, the additional annual export earnings by 2005 are only some $40 billion. On the more favourable assumptions of the second scenario there would be a further gain of $134 billion. On the most optimistic assumption (scenario III), where northern output actually declines in low-skill industries and southern exporters make more significant gains in the other industries, export earnings would grow by 25 per cent per annum and by 2005 would be over $500 billion above the baseline projection. Although that may appear ambitious, such growth has been achieved by developing countries in some high-technology sectors in the 1990s, including valves and tubes, office machines and electrical machinery and apparatus, and was achieved over sustained periods by the successful East Asian NIEs in the 1960s and 1970s.

If allowance is made for prospects for the clothing industry that were reviewed above, as well as for leather and other low-technology industries, the export potential rises to around $700 billion by 2005, implying a 75 per cent increase in the export earnings from manufactures over the 1995 level. Perhaps more significantly, in the light of the findings elsewhere in this report (see chapter IV), this is approximately four times the annual average private foreign capital inflow in the 1990s. It corresponds to some 12 per cent of the combined GNP of developing countries but to no more than 3 per cent of that of industrial countries.

Agriculture is another area with considerable export potential for developing countries. With annual exports of some $168 million, these countries accounted for 29 per cent of world agricultural exports in 1997. However, although the Uruguay Round eliminated most non-tariff barriers, liberalization by developed countries has been slow and, as noted earlier in this chapter, peak tariffs remain prohibitively high for some producers in developing countries.

The results of recent efforts to assess the overall impact of the Agreement on Agriculture on developing countries are not encouraging. In a number of products with strong export potential protection has prevented them from benefiting to the extent otherwise possible, particularly with respect to cereals (in the EU and Japanese markets), sugar, fruit and vegetables, meat and meat preparations. Again, modelling exercises of the negotiated outcomes of the Uruguay Round find little encouragement for developing countries, with gains heavily concentrated on a small group of exporters. These results contrast sharply with the expected gains to developing countries if real efforts were made to open these northern markets.

There are considerable disparities among developing countries in their capacity to exploit potential market opportunities in industry and agriculture, due to differences in resource endowments and levels of economic development. Moreover, trading opportunities in some sectors are more readily exploited than in others. However, the very fact that markets are protected strongly suggests that developing countries have indeed the potential to compete. A strong investment drive could, under the right conditions, put
most of them into a stronger competitive position by raising productivity and reducing unit labour costs.

An opening of markets in labour-intensive and resource-based products in industrial countries would not only alter the volume and pattern of trade between North and South; it can also be expected to affect the division of labour among developing countries themselves. Rising labour costs in some of the most successful NIEs (Hong Kong, China; Singapore; and Taiwan Province of China – see table 6.2) have already begun to erode their competitiveness in these same sectors; if they move out of these sectors, there will be further trading opportunities for a new generation of developing-country exporters. Such a shift of course depends on their being able to continue on the path of technological upgrading and structural transformation.

3. Adjustments in the North

The striking coincidence over the past two decades of declining manufacturing employment in the North, high levels of unemployment and widening wage and income inequality, along with a sharp increase in manufactured imports from the South, has revived concerns over destructive links running from trade to labour markets. However, a detailed examination of such links in TDR 1995 showed these concerns to be greatly exaggerated. Indeed, the main difference between today and the 1950s and 1960s, when Japan and the newly industrializing economies of Southern Europe made a strong initial entry into the markets of their richer neighbours, is the lack of expanding industries and highly-paid service jobs in the North to absorb any displaced workers. The report showed that the rise in “structural unemployment” in the North since the mid-1970s was related to a slowdown in investment, which in turn was linked to restrictive macroeconomic policies and deregulation of financial markets. There has been little over the past few years to invalidate this conclusion, which quite to the contrary has recently been endorsed:

There is little evidence that reducing employment protection is a solution to high unemployment although active labour market policies may help people to find work. Virtually every fall in unemployment in western Europe in the last two decades or so has been accompanied by an easing of macroeconomic policy (either fiscal expansion, or lower interest rates, or devaluation, etc.) .... Lowering unemployment will therefore need stronger demand, but to be sustained there will also need to be more investment. 46

However, in the light of the projected increase in exports from developing countries, most industrial countries will need to make a much more determined effort to expand employment, if the danger of a protectionist backlash is to be avoided. Moreover, since for well-known reasons no single country will to that end embark on expansionary macroeconomic policies alone, any response will need to be internationally coordinated.

Notes

4 For an assessment of the experience in the 1980s see UNCTAD secretariat, The exchange rate system, and Akyüz Y and Dell S, Issues in international monetary reform, both of which are contained in UNCTAD, In-


6 Counterfactual simulations over the pre-crisis period in East Asia show that alternative currency arrangements would not have reduced the risk of overvaluation and currency attacks; Ohno K, op. cit.


8 Eichengreen B, op. cit.; 109.


11 See, in particular, TDR 1994, annex to chapter II; and TDR 1998, chap. IV, sect. C.

12 For a review of the evidence on the link between the exchange rate and trade see Helleiner GK, Trade, trade policy and industrialization reconsidered, World Development Studies no. 6, UN/WIDER, Helsinki, 1995.

13 The term “non-traditional” is often taken as referring to industrial activities. The links between industrial growth and overall productivity are indeed particularly strong but, as discussed in greater detail in TDR 1998, chapter IV, the term should be more broadly defined to include certain primary and service activities.


15 Helleiner GK, op. cit.


20 Whalley J, op. cit.: 40–44.

21 The ECE secretariat has made much the same point for transition economies in recent years, in its annual economic surveys, when it identified an “institutional hiatus” as one of the main obstacles to recovery and sustained growth in many of these economies.


26 This peak rate refers to applied tariffs less all presently applied tariff suspensions, including GSP concessions to developing countries, in 1996–1997.


28 Following the Uruguay Round, developed countries substantially expanded their product coverage for all GSP beneficiaries, and also made additional improvements in favour of LDCs. However, in certain preference-giving countries many agricultural and food industry products and textiles and clothing are excluded from the GSP scheme or are subject to ceilings. Some advanced developing countries have been graduated from the GSP, and an increasing number of products exported by particular countries are excluded, as they are deemed to be competitive.


Two types of subsidy are prohibited under the Agreement: those contingent on exports and those provided to domestic industry for the use of domestic inputs. Permissible subsidies are those which are not specific to particular industrial units or sectors or which are specifically for research and development, for disadvantaged regions or for environmental purposes. Subsidies which are neither prohibited nor permitted can also be given, provided they do not harm the industry and exporting capacity of another country. If harm is caused, the affected country can take action to have the subsidy removed or impose countervailing duties on the subsidized product.


Fokker R and Klugkist J, Coherence in EU policies towards developing countries, Eurostep Dossier on CAP and Coherence, Brussels, April 1999.


This analysis was based on a classification of exports into five broad categories of goods taking into account the mix of different skill, technology, capital and scale requirements. See TDR 1996, Part Two, chap. II, sect. C.3.

This was the strategy adopted in some second-tier South-East Asian NIEs. On the pros and cons of this strategy see TDR 1996, Part Two, chap. II.

Competitiveness vis-à-vis the United States is determined by relative wage costs in dollar terms and relative productivity (output per worker). High wages in dollar terms in developing countries may reflect high real wages or overvaluation of the domestic currency. In general, 1995 was a year when the dollar was weak, and for a number of countries in table 2 overvaluation is likely to have been a major factor undermining their competitiveness.


Some of these additional export opportunities may benefit transition economies rather than developing countries.

See Thomas H and Whalley J, eds., op. cit.

OECD has also belatedly discovered that there is no link between employment protection laws and either employment or unemployment in its member countries. OECD Employment Outlook, June 1999.