The Challenge of

Reducing Subsidies and Trade Barriers

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The challenge

- Government intervention in markets for goods and services distorts international trade

- Distortionary policies harm most the economies imposing them, but the worst of them – in agriculture and clothing – are particularly harmful to the world's poorest people

- Subsidies and trade barriers have been reduced considerably over the past 20 years, but many remain

Outline

1. Arguments for reducing trade barriers

2. Opportunities for reducing trade barriers

3. Recommendation of best solution

Why remove trade barriers?

- Exploit comparative advantage ->Domestic industries become more productive
- Static gains are largest for small countries and particularly where economies of scale have not been fully exploited
- Dynamic gains from trade: link between trade and economic growth, e.g. knowledge embedded in products traded, attract more investment, competition spurs innovation -> productivity growth
- Strong empirical evidence that open economies grow faster

Why, then, are countries protectionist?

- Trade barriers are imposed for a number of reasons: infant-industry assistance, unemployment prevention, tax revenue raising, protection of environmental or labour standards, etc.

- In almost all cases a lower-cost domestic policy instrument can meet each of these objectives

- Political economy explanation for their persistence: Even though aggregate income is expected to grow when trade distortions are reduced, not everyone will gain -> transfer mechanisms

Opportunities

1. Multilateral trade liberalisation following the WTO's current round of negotiations, the Doha Development Agenda (DDA)

2. Regional or preferential trade agreements involving a subset of the world's economies

3. High-income countries offer least developed countries duty-free access to their markets

Doha Round

- 2001 – 2003 – 2005 - present

- Key elements of a prospective Doha agreement
  - o Agriculture: market access, domestic support, export subsidies
  - o Non-agriculture: market access
  - o Services: slow progress

- Little real agricultural reform globally unless WTO members are willing to make substantial cuts to bound tariffs and domestic farm subsidies. Eliminating agricultural export subsidies easier

- WB study (2006) using a global CGE model examines various options

Doha Round (cont.)

- Most realistic scenario yields a global gain of $96 billion per year by 2015 = 0.2 % of global GDP (0.3% of GDP for developing countries)
  NOTE: This is just 1/3 of what could be achieved globally and 1/5 of what developing countries could achieve from full liberalisation!

- No developing countries/regions would suffer a decline in agricultural net income, despite lowering own agri. tariffs because a larger share of developing country agriculture is exportables that do not need to be protected from imports.

- South-south concessions also important, but developed countries must lead the way!

Doha Round (cont.)

- This scenario is a conservative or lower bound estimate of possible comparative static gains from DDA.

- Results from other studies suggest that these gains could be many time greater, depending on the extent to which service trade and investment is liberalised, the strength of imperfect competition and economies of scale.

- Upper bound is set at 5 times the lower bound, i.e. 1.0% of global GDP (1.4% for developing countries)

Regional (preferential) trade agreements

- Frustration over unsuccessful multilateral negotiations, exert greater bargaining power in multilateral negotiations

- Stepping stones or stumbling blocks?

- Potential gains from regional trade agreements are only a small fraction of those obtainable from multilateral negotiation

- Even gains from the largest and most ambitious – Free Trade Area of the Americas (FTAA) – are estimated to be just 1/25 of that from a full multilateral trade liberalisation

Removing developed country barriers to LDC exports

- Idea to expand EU's recent Everything But Arms (EBA) initiative to the US, Canada and Japan.
- EBA: Sounds liberal, but includes safeguard provisions in addition to normal anti-dumping measures, gradual phase-in of sensitive markets
- Involves only very small volume of global trade
- Issues: For specific products there may be trade diversion from other non-LDC developing countries, complex rules-of-origin, uncertain / weak legal foundations

Economic costs of trade reform

- Adjustment costs not included in CGE model estimates
- Private costs: Adjustment for firms and workers as some industries downsize or close, while others expand
- Social costs: Social safety net provisions for losers from reform, e.g. unemployment payments, retraining of displaced workers
- For CBR calculations assume adjustment period 2008-2015 with adjustment costs = 15% of annual comparative static benefits in high gains case and 5% in low gains case

Recommended solution and CBR

- Best solution available:

Multilateral trade liberalisation following the Doha Agenda

Net present value of benefits and costs
to 2100 (in 2005 $) (US$ billion)

	6% discount rate			
	Low gains		High gains	
	Benefit	Cost	Benefit	Cost
World	9011	134	38338	396

Benefit/cost ratios

	6% discount rate	
	Low	High
World	67	97

Recommended solution and CBR

- Best solution available:

Multilateral trade liberalisation following the Doha Agenda

Net present value of benefits and costs to 2100 (in 2005 $) (US$ billion)

	3% discount rate			
	Low gains		High gains	
	Benefit	Cost	Benefit	Cost
World	27867	150	115320	442

Benefit/cost ratios

	3% discount rate	
	Low	High
World	186	261

Trade liberalisation should rank highly

- Clearly a very high payoff activity: small costs can make a significant impact in this area
- By ensuring a better allocation of the world's resources and reducing government outlays, trade reform will allow citizens to spend more on other global problems, thereby contributing *indirectly* to the other challenges
- Trade reform is also likely to *directly* alleviate poverty and thereby reduce environmental degradation and address other challenges such as communicable diseases, conflicts, education underinvestment, corruption, migration, malnutrition, and hunger.