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International Trade and the Bottom Billion: Designing the Helping Hand

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In *The Bottom Billion*, Paul Collier stresses the importance of increasing international trade and urges the poorest countries to liberalise their trade regimes, in contrast to the position of many civil society organisations and governments in developing countries. He proposes providing new trade preferences for exports from Bottom Billion nations to rich countries and a revamping of the World Trade Organisation (WTO) to deliver such preferences. His diagnoses are compelling, but his proposals are not. Preferences have a poor track record, and divert policy attention from other measures to improve access to markets in developed countries such as investment in infrastructure and harmonising standards. His proposal for expanding the role of the WTO is likely to destabilise rather than strengthen the institution.

We agree with Collier's diagnoses, but are sceptical of his idea for expanded preferences. They have been a minor contributor to export success in the past, and more focus on preferences in the future might threaten to take the political wind out of attempts to provide a more useful and far-reaching package of policies to facilitate trade. On revising the role of the WTO, we see more risks than returns.

Collier on trade

In *The Bottom Billion* Collier observes that:

- Stronger trade performance is necessary for the Bottom Billion countries to escape from poverty, and much contemporary commentary is unhelpful because it rejects this premise
- Trade performance is mainly determined by the Bottom Billion's own policies, not those of their trading partners
- There is much to do apart from trade policy.

He then makes two proposals to help the Bottom Billion's trade performance:

- Provide tariff- and quota-free access for Bottom Billion exports to the rich countries, coupled with revised rules of origin
- Extend the mandate of the WTO to create a new 'transfer round' of negotiations to provide such preferential access before the regular reciprocal round commences between other parties.

The trade policy challenge

Since 1970, the developing world has seen a huge increase in international trade and, partly as a result, in prosperity. The expansion in East and Southeast Asia has been breathtaking, fuelled by expanded intra-regional trade, increased trade in intermediate inputs and final goods, and fragmentation of production processes (value chains) within the region. Collier's Bottom Billion countries 'are concentrated in Africa and Central Asia, with a scattering elsewhere' (Collier 2007: 3). They are 'stuck at the bottom' and, falling further behind 'an increasingly sophisticated world economy, [their] integration will become harder, not easier' (Collier 2007: 4). Two questions arise: can Bottom Billion countries play in this new game, integrating into a global economy

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characterised by the fragmentation of production processes and increased productivity through specialisation. And if they cannot, how can they compete with countries that do? Collier proposes two major initiatives:

- **Export diversification into manufactured goods:** He argues that this is needed for sustained productivity growth in the Bottom Billion and requires protection from Asia, which means preferential access to markets in rich developed countries, members of the Organisation for Economic Co-operation and Development (OECD). To be effective, preferential access needs to be accompanied by relaxed rules of origin, which define when a Bottom Billion export is considered to contain enough Bottom Billion inputs to qualify for the tariff preference. The idea is to allow Bottom Billion firms to buy imported inputs required to produce exports that can then be exported to markets in developed countries. The preferences also need to be time delineated, perhaps until 2015, so that Asian countries would be more likely to agree, and there would be an incentive for the Bottom Billion countries to act before the preferences are eroded.
- **Rethinking the position of the Bottom Billion in the WTO:** Collier proposes creating a ‘transfer round’ of trade negotiations, in which the WTO Secretariat negotiates preferential tariff reductions in OECD countries on behalf of, but unreciprocated by, the Bottom Billion. This would then be followed by a traditional reciprocal bargaining round, essentially without Bottom Billion participation. The ‘transfer’ concessions would, however, be conditional on the successful conclusion of the bargaining round, which would give poor countries an incentive to facilitate the negotiations.

While superficially appealing, there are problems with both these initiatives.

Preferential trade agreements

Collier’s first proposal is a new infant industry argument for providing trade preferences, focusing on manufacturing. However, there are difficulties with this approach:

- **The focus on manufacturing:** Experience indicates that there are many opportunities for productivity growth, expanded trade, and synergies between them in services and high-value agricultural products, including horticulture (Arnold *et al.* 2006; Hoekman and Mattoo 2008).
- **The focus on tariffs:** Accessing markets in developed countries requires far more than just lowering trade barriers against exports from the Bottom Billion. For example, issues of achieving and certifying quality and safety standards, investment in trade-facilitating institutions and infrastructure, as well as behind-the-border policies in the rich countries (e.g. European Union agricultural subsidies) are at least as important as tariffs.
- **Preferences seem unlikely to generate significant new industry:** Eight years is too brief a period for serious investment, and expanded access might be undermined by safeguards, anti-dumping actions or existing standards in the rich countries.
- **Strict Rules Of Origin (ROO):** ROOs need to be relaxed, not only for Bottom Billion countries individually, but also collectively to allow the Bottom Billion to count inputs purchased from each other as ‘local’ in the determination of whether there is enough local content to qualify for preferences (Gasiorek *et al.* 2008).
- **Being generous with other people’s money:** The goods that the Bottom Billion produce are rarely produced within the OECD countries, so expanded imports from Bottom Billion countries will simply displace imports from other (perhaps only slightly less) poor countries and poor people (Winters 2001).
- **Trade preferences have created very few export booms:** Unfortunately, however, they have preoccupied policymakers for forty years, usually at the expense of attention to more important issues such as reforming the Bottom Billion’s own policies or addressing non-tariff aspects of policies in OECD countries (Finger 1991). They threaten to do so again.

Trade negotiations

Collier’s proposal to revamp the way that trade negotiations are conducted under the auspices of the WTO is intriguing. There is a strong case for providing aid to assist trade expansion in the poor countries, but Collier proposes to provide ‘aid’ in the form of higher export prices (basically rents), not hard cash, negotiated through the WTO. This proposal will create additional and difficult questions:

- A ‘transfer round’ will force the WTO Secretariat to make difficult political trade-offs, seeking to achieve a package that treats all their developing country members ‘evenly’ – an impossible task.

> Trade preferences have created very few export booms, but unfortunately have preoccupied policymakers for 40 years.

The problem is that trade policy affects all the countries exporting a good, and so cannot be easily targeted compared to aid provided to particular countries.

- Should OECD countries offer concessions on a good in the transfer round or the negotiating round? If they offer a preference in the transfer round, that preference may be eroded if they then negotiate liberalisation on a most-favoured-nation (MFN) basis.
- The United Nations Conference on Trade and Development (UNCTAD) has a long history of trying to persuade, cajole and/or embarrass OECD countries into providing unreciprocated trade concessions. Its poor success hardly suggests that another similar body is needed or would do any better.
- Having WTO negotiations focus on providing trade preferences and unreciprocated concessions detracts from its central role in establishing global rules of the game that encourage the expansion of trade. Members have broadened the WTO's mission greatly in recent years and, as a result, it is struggling to fulfil its core mission. Adding further complexity and a new role would likely undermine the institution. The Bottom Billion's role in the WTO needs reform, but not this reform.

Regional integration, trade agreements and aid

Collier argues that growth is substantially a regional phenomenon: poor countries in strong regions (e.g. Cambodia, Papua New Guinea) will catch up because they are embedded in a dynamic regional economy. Bottom Billion countries in Africa are not found in strong regions, and so will not catch up. Collier rejects, however, attempts to create regional dynamism through Regional Trade Agreements (RTAs), arguing that combining many tiny slow-growing economies simply creates a small and slow-growing regional economy (Collier 2007: 16–46). Moreover, as Venables (2003) shows, regional integration between poor countries can increase divergence and regional tensions, not the reverse.

These concerns certainly characterise 'shallow regional integration' – lowering barriers to the movement of goods across borders. Creating a regional free trade area with high external tariffs is likely to lead to significant trade diversion rather than trade creation, and thus reduce welfare (Schiff and Winters 2003; World Bank 2005). This is exactly the criticism made of the recent Economic Partnership Agreements (EPAs) under negotiation between the European Union (EU) and poor ACP (Africa, Caribbean and Pacific) countries (Winters 2001; Gasiorek *et al.* 2006).

The dynamism of the East and Southeast Asian regional economy is based on synergies between economic integration, expanded trade, increased productivity and regional growth (Evans *et al.* 2006). But East and Southeast Asian integration involves more than lowering trade barriers. It includes 'deep integration' – the formulation of policies and investment in institutions behind the border that facilitate trade such as: harmonising product norms and standards; testing procedures and certification of goods destined for regional markets; and regulatory processes and standards. Investment is required in infrastructure to facilitate trade, such as testing laboratories, ports, roads, communications, and border crossings. Legal and commercial institutions need to be created or improved to manage trade, including dispute resolution mechanisms, contract enforcement, and market regulation, including regulation of the financial system.

Policy implications

If the Bottom Billion countries are to enter value chains, expand into higher value products and take even the first step along the path followed by East and Southeast Asia, they will need far more than additional trade preferences. They will need to stimulate investment, including via deep integration, which, in turn, will need assistance from donors, international institutions and, possibly, from regional agreements that can establish deep integration policies at a regional level. One opportunity at hand is the EU-ACP EPAs. In addition to market access commitments for both ACP imports and exports, these should also offer:

- Trade-related assistance to allow the ACP countries to facilitate the structural adjustments needed to benefit from increased imports and expanded export opportunities
- Support for behind-the-border institutions that facilitate trade, including commitments to make EU procedures reasonably open and penetrable.

As Collier notes, facilitating trade helps to boost export competitiveness and hence avoid the problem of aid-related Dutch Disease – exchange rate appreciation that hurts exports. As deep integration, it also chimes with his observation that most of the necessary agenda is domestic. And we all agree that engaging more effectively with the world economy rather than withdrawing from it is the way forward

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for the Bottom Billion countries.

Collier has provided an incisive analysis of trade in the world's poorest countries. We would tweak some details and urge the world to go further than he does, but we honour him for rising to the challenge of the Bottom Billion.

Credits

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