

## **Policy Options to Promote Reform in Non Agricultural Market Access (NAMA) in an Era of Falling Demand, Rising Protectionism and Economic Uncertainty**

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### **Summary of key points**

**Ms Kristen Bondietti**

#### **1. The policy environment for trade reform**

Reform of trade policy has taken on new importance in the current environment of rising protectionism, falling demand and economic uncertainty.

Challenges to trade reform pose risks for renewed competitiveness and economic recovery. They threaten progress in the WTO Doha negotiations. New and improved efforts are required to advance liberalisation and support open markets which underpin growth in the Asia Pacific region.

#### ***Trade reform challenges: “creeping” protectionism, uncertain Doha***

A new paradigm in international trade has emerged in the wake of the global economic downturn. Governments around the world have sought to increase trade protection to assist domestic producers hard hit by the financial crisis. Tariff and non tariff barriers to trade have risen as demand and growth has fallen. To date there has not been resort to levels of “high intensity” protection, but “creeping” protectionism is evident.

At the same time, challenges to reform of trade policies are being externally driven by demands in international trade negotiations. While preferential free trade agreements have proliferated, the outcome of the WTO Doha negotiations remains unclear. Non agricultural market access (NAMA), among other areas, has been problematic; in particular low ambition to liberalise trade in industrial products among developing countries. It was a key driver of WTO member’s failure to reach an outcome in 2008.

#### ***There are risks for trade, competitiveness and growth***

The current environment is dynamic. While economic conditions now seem to be improving, recovery will be slow. Demand for exports of industrial products in major markets will likely continue to fall, affecting trade in individual products in different ways. Resort to trade restrictive policy measures and regulatory intervention can be expected to increase. The tendency of governments to erect measures to cushion the impact on producers will intensify.

Creeping protectionism creates risks for trade, competitiveness and recovery. It could see the winding back of many of the historic trade reforms of the 1980s and 90s which have underpinned high levels of growth in the Asia Pacific region.

Resort to trade barriers and reluctance to further reform trade policies impact on momentum for a successful conclusion to the Doha Round. The costs of foregone Doha, in terms of welfare gains, are significant.<sup>1</sup>

### ***Trade reform has taken on new policy importance***

Within the current environment, reform of trade and support for open markets, including in the WTO, has taken on a new policy importance. APEC Leaders have recognised this. Governments have repeatedly affirmed the need to resist protectionist trade measures in the face of increasing economic uncertainty. They have committed to a successful result from the Doha Round.

Even so, greater efforts must be made to inform policy makers of the benefits of using open market reform tools to respond to current economic challenges. There is a need to assist policy makers to re-engage in the Doha Round in a meaningful way.

Better understanding of both international and domestic policy options which support trade reform enhances the prospect for delivery of growth and development over the longer term. This will help underpin growth both in the APEC region and globally.

### **2. The importance of open markets for growth**

The crucial role that open markets play in maintaining and enhancing economic growth and development is not often fully understood by policy makers.

Trade in industrial products is an important source of trade and growth in APEC economies. Barriers to this trade are generally higher in developing rather than developed countries. Their removal or reduction offers significant economic benefits.

### ***Trade in industrial products matters for developing countries***

Manufacturing trade is important for developing countries: exports are large generators of GDP and major sources of employment. Many developing economies tend to be relatively trade dependent and vulnerable to negative impacts from falls in demand and rises in trade barriers for exported products.

Declines in export growth can have significant impacts. Although developing economies have experienced a smaller drop in their exports than industrialised ones during the economic downturn (and there are now signs of recovery, particularly in Asia), they have not escaped the crisis. In the second part of 2008, exports of the most trade dependent developing countries fell by a staggering 33 percent - vastly surpassing the losses by major developing countries like China and India.

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<sup>1</sup> Refer footnotes 4 and 5.

### ***Low barriers to trade are crucial for growth and development***

Barriers to industrial trade tend to be higher in developing countries than advanced economies. There are economic gains to be had from reducing barriers where they are highest, not from raising them to protect domestic producers. An important lesson from experience of the 1930s is that raising trade barriers merely compounds recessionary forces and risks pushing the economy into a prolonged recession.

Economists point out that it is contradictory to implement measures that restrict trade which tax production and incomes and at the same time pursue policies to overcome the economic crisis which are geared to expanding aggregate demand. A better policy approach is to reduce trade restrictions to cut costs and prices worldwide, in conjunction with financial and fiscal stimulus.

There is also a risk that measures taken temporarily to protect jobs and business profits from the effects of the crisis will create a legacy of uncompetitive industries and sectoral overcapacity. This could generate protectionist pressures as economic activity picks up again. Trade distorting state aids and subsidies can prolong the operation of uncompetitive or insolvent firms, which deny market share to more efficient producers, including foreign suppliers.

In the 1970s and early 1980s, faced with very difficult economic conditions, governments resorted heavily to trade restrictions and subsidies to support ailing industries and sectors. This slowed down structural adjustment and the correction of problems of global overcapacity. It led to protectionist measures to support sectors that were not internationally competitive but in which too much had been invested to allow them to be abandoned easily.<sup>2</sup>

### ***Further liberalization offers significant economic benefits***

Competition is a key driver of growth and competitiveness; liberalisation is about increasing competition in the economy and making it more efficient. Benefits flow from further liberalization, not just in the form of increased market access and export opportunities, but from making the domestic economy more efficient.

Trade liberalisation offers significant potential welfare gains, whether it is undertaken domestically or through international trade agreements.

The potential welfare gains for both developing and advanced economies from successful conclusion of a Doha packages to reduce trade barriers have been documented. The WTO for example notes that the market access package currently on the table (both agriculture and industrial goods) is equivalent to a new stimulus package for consumers of over US\$150 billion in terms of global GDP. Other elements of the Round – services, trade facilitation, could more than double that.<sup>3</sup>

Likewise, the costs of not concluding the round, and resorting to protectionist measures, are high - in the order of \$US1.064 billion. The International Food Policy Research Institute (IFPRI) has estimated that failure of negotiations could prevent a US\$336 billion increase in world trade that would otherwise have come from a reduction in tariffs and domestic

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<sup>2</sup> WTO (2009), *Report to the TPRB from the Director-General on the Financial and Economic Crisis and Trade-related Developments*, WT/TPR/OV/W/2, 15 July 2009.

<sup>3</sup> WTO (2009) *Report to the TPRB from the Director-General on the Financial and Economic Crisis and Trade-related Developments*, WT/TPR/OV/W/2, 15 July 2009

support and that worldwide resort to protectionism could contract trade by over US\$700 billion.<sup>4</sup>

The Peterson Institute has estimated that the boost to global exports from concluding the Doha Round could range between US\$180 billion and US\$520 billion annually, depending on the level of ambition. The potential GDP gains are significant - between US\$300 billion and US\$700 billion annually - and well balanced between advanced and developing countries. Over \$65 billion of additional world exports annually and roughly US\$100 billion in annual world GDP gains could come just from the agriculture and NAMA negotiations. The reason GDP gains are so large is that *both* imports and exports contribute to economic efficiency and income growth, and world *two-way* trade gains are more than double export gains alone.<sup>5</sup>

### ***But it is politically difficult to achieve***

Trade reform opportunities, and their impact on the economy, are not just analytic issues: they can also be major political issues. Governments face various obstacles to trade reform which can make it difficult to achieve.<sup>6</sup>

The costs of reform tend to be concentrated on particular groups, whereas the benefits are more diffuse. Companies adversely affected by trade reform can be vocal in opposing it. The potential winners tend to be (rationally) poorly informed about the tradeoffs and can be reluctant to actively support it.

Bureaucratic structures within government can be typically aligned with particular sections of the economy or community, which make it difficult to sell the wider benefits. Moreover, the costs of reform tend to be front-loaded, whereas the benefits arise over time. Multiple jurisdictions increase the difficulty of achieving nationally consistent approaches.

Change is uncomfortable; companies affected by trade reform will find it a challenge to improve efficiency to survive. This discomfort may be exacerbated during a recession. Market conditions may be affected by reversions to protectionism. And the capacity to adjust is always harder when the economy is not growing.

But improvements in the capacity of companies affected by trade reform to adapt and improve as a result of it is likely to also improve their ability to adapt to other challenges; such as externally imposed supply price shocks, and technological breakthroughs by others that affect relative prices.

### **3. Approaches for liberalising industrial trade**

Trade reform is driven by both internal and external pressures, the intensity and complexity of which are compounded in times of economic difficulty. Trade responses by governments to these pressures are domestic, through the policy agenda at home, and international, through legal instruments such as bilateral and multilateral trade negotiations.

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<sup>4</sup> Bouet and Laborde (2008) 'The Potential Cost of a Failed Doha Round,' *International Food Policy Research Institute Issue Brief* 56, December 2008.

<sup>5</sup> Adler, Brunel, Hufbauer and Schott (2009) 'What's on the Table? The Doha Round as of August 2009' *Peterson Institute for International Economics*, Working Paper 6/09, August 2009.

<sup>6</sup> See G. Banks (2005), 'Structural reform Australian style: lessons for others?', presentation to the IMF, World Bank and OECD, May 2005.

Approaches to trade reform may be multilateral through the WTO negotiations, preferential through bilateral or regional trading arrangements or as a result of unilateral policy action. Different countries adopt different approaches: core to deriving gains from the approach chosen is understanding how it works, the opportunities and benefits it is capable of generating and the elements required to underpin its successful delivery.

### ***WTO Doha negotiations offer significant development benefits***

Multilateral trade liberalization offers significant development benefits (some of which have been addressed above). Although the estimated gains will differ substantially depending on what is actually negotiated, the level of ambition matters most. It suggests trade reforms need to be ambitious to have a major impact on growth and poverty.<sup>7</sup>

There is considerable scope to reduce trade barriers to expand market access, improve domestic efficiency and “lock in” economic reform for industrial products through further progress in the Doha negotiations.

The complexity of issues to be managed by policy makers in the negotiations however can be challenging. A major difficulty is negotiating outcomes at the international level which are welfare enhancing and which contribute to reducing poverty and expanding growth. Another involves managing a multi-issue negotiating agenda which includes not only liberalisation of industrial products, but also agricultural products, services and other issues, such as rules for anti-dumping and standards to name a few. Furthermore, many poorer developing countries lack the competitiveness and supply capacity to benefit from freer trade arrangements after they are negotiated. Addressing these issues effectively demands considerable resources and requires commitment to complementary policies for trade reform.

### ***APEC FTAs PTA liberalization is important in APEC***

While Doha has stalled, preferential FTAs have proliferated. This has particularly been so in the Asia Pacific region.

The scope and degree of liberalization among agreements varies. In many cases they are more aptly termed economic integration agreements, as they seek to liberalise trade in goods and services, the movement of people and capital flows. In others, very few commitments to liberalisation have been made.

The contents of PTAs affect the results they deliver – those which comprehensively liberalize trade among the parties in areas where they are globally competitive are more trade creating than those which liberalize little or which discriminate against other trading partners in areas where they are competitive. The wider the country and sectoral coverage of the agreement, the greater the gains from removing barriers tend to be.

An issue of concern is dealing with the differing array of obligations PTAs create among different trading partners and their implications for multilateral liberalisation. Generally, consistency of commitments minimizes discrimination and maximizes the benefits.

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<sup>7</sup> Estimates of trade and GDP growth from liberalisation in the Doha Round are greater, the higher the level of liberalising ambition achieved. Refer footnotes 4 and 5.

PTAs are more likely to increase national incomes over time if they pursue a strategy of “open regionalism” which means extending the benefits in one agreement beyond the parties to others.

However, the best way to minimise the discriminatory and trade diverting effects of PTAs is to bring down the high tariffs that create discriminatory benefits offered to preferred countries – in other words, liberalise trade barriers through multilateral agreements.

***Unilateral reform is not dependent external policy drivers***

Benefits arise from reduction of one’s “own” trade barriers as well as those of others. Reducing trade barriers in the domestic economy will maximise wealth and growth.

Unilateral trade reforms are not dependent on reform by trading partners, nor the state of multilateral or bilateral trade developments. Unilateral reform does however require strong political commitment at home in order to be successful (see below for further discussion).

***Trade reform outcomes depend on the nature of the reform process and the economy involved***

The impacts of trade reform on growth and development vary. Outcomes depend on a range of factors: the nature and scope of the agreement negotiated and the depth of liberalisation commitments made; the economic composition and level of development in the liberalising economies; their macroeconomic and political situation, and; the timing, implementation and management of the reform process. All affect how and to what extent an economy will benefit from international trade liberalisation regardless of the approach taken.

Each economy must respond according to its particular needs, and does. The experience of South Korea for example, shows that international trade reform can be used in combination with broad-ranging domestic policy reform. Korea undertook significant unilateral trade policy reform following the Asian currency crisis in the late 1990s which it has continued with to the current day. At the same time Korea has actively pursued trade liberalization in the WTO, in combination with an impressive bilateral and regional trade negotiation agenda. The strengthening of the investment and business climate has been core to the reform process. Continued political commitment has been required to sustain it. The challenges for policy makers are ongoing.

The Philippines’ experience with broad ranging tariff reform, both through WTO, AFTA and unilaterally since the early 1990s, raised a wide range of political and economic issues for policy makers. A core lesson to be gleaned from its success was the need to engage appropriate tools and stakeholders to support the process. Another was the dynamic nature of the reform process and the need for approaches to adjust to changing economic and political circumstances.

The case of New Zealand, which undertook wide ranging trade reforms from the early 1980s, underscores the point that unilateral trade reform benefits the economy undertaking it. In fact, liberalising FTAs and economic crisis can even support, rather than deter reform. Business is responsive to changing economic circumstances and can benefit from those induced by policy actions.

Australia implemented significant trade liberalization reforms in the 1980s as part of wider structural reform of the economy. The benefits of the process were directly related to the

management, timing and features of the reforms. They were driven by government and supporting institutions, were sustained over time and were comprehensive in scope.

#### **4. Improving growth and competitiveness through trade reform- the domestic reform process**

Deep global trade reform at the international level is the first step toward promoting growth through trade. As important is the need to manage the process so as to benefit from opportunities created.

Trade reform must be supported by a sound domestic policy agenda, commitment to broader structural and economic reform, and a planned program of implementation. Consideration of sound policy options which achieve their desired results to support open trade and enhance growth and competitiveness become paramount in this respect.

#### ***Trade reform affects the whole economy***

Trade liberalization is only one element of trade reform: it affects the whole of the economy. Trade reform instruments are wide. They include tariffs; (including the management of selective concessions, preferential trade arrangements, and rules of origin complexities); quantitative restrictions, (including quotas which may be priced or unpriced); non-tariff barriers, including domestic preferences and quarantine; subsidies, for exports and production, as well as; export facilitation, including export finance.

Trade reform needs to be conceived of as broadly as possible. Otherwise reform in one area may have perverse effects on another. For example, if tariff reductions focus on only a narrow range of items, resources will switch into the still protected areas of the economy which are less efficient. Moreover, if still protected firms benefit from reductions in input costs (when tariff reductions include their inputs), their effective protection will in fact increase.<sup>8</sup>

Trade reform needs to be cast in a wider structural reform context. This will help spread the benefits and make adjustment costs more manageable.

#### ***Key strategy for success: explain the benefits, recognize the costs<sup>9</sup>***

Because trade reform can be difficult, the strategy employed by governments to implement it successfully needs to explain the benefits and recognize the costs.

The benefits have many elements, not all of which are obvious: for example, most of the benefits of tariff reductions accrue to the domestic economy, not importers. Costs should be acknowledged, because it is understandable that firms and institutions will defend the status quo. Not all costs are immediately apparent, such as wider adjustment costs for employees and regions.

The key mechanism underpinning the benefits of trade reform is increased competition. Competition promotes efficiency. Increased efficiency translates into higher productivity. Higher productivity provides for higher incomes, higher consumption, and increased community welfare.

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<sup>8</sup> See "Core Elements of Domestic Trade Reform" Paper prepared for the training course by Economic Consultant Robert Kerr. See course training materials at [www.aepc.org.au](http://www.aepc.org.au)

<sup>9</sup> This section summarises content from the above paper.

Benefits for consumers arise from lower prices, giving them higher real incomes, to be spent on other goods and services. They also enjoy more choices in their spending. For producers, there are lower input prices and greater production choices. The knock-on effects include increased demand for services, especially transport and utilities: these increase domestic employment.

The disruptive effects of trade reform usually give rise to expected winners and losers. It is understandable that people and firms will try to defend their current interests. Institutions will do the same, for example government departments that are aligned with particular industry sectors. These concerns need to be respected, not dismissed.

A further reason for understanding the costs is to prepare plans for adjustment policy. The adjustment possibilities will depend on a variety of circumstances, such as the location and skills of employees.

Apart from loss of market share and profits in affected firms, and the associated employment consequences, there will be expected knock-on effects in supplier firms. Lower tariffs will have revenue effects for government, and social welfare needs may give rise to increased demands for government expenditure, for example.

#### **5. Policy for managing reform of trade in industrial products – the role of government**

The success of trade reform depends on action by government. Government plays a core role in trade reform in the creation and implementation of sound policy to support it.

Notwithstanding this, managing trade reform effectively is challenging. It requires government to assess and evaluate a myriad of issues and consider a range of policy options to address them.

This includes developing a national agenda based on sound research; communicating the benefits or “selling” reform; recognizing the costs and providing for structural adjustment; leading and committing to the process, and; engaging all stakeholders.

#### ***Explaining the benefits of reform<sup>10</sup>***

In explaining the benefit of reform, local circumstances, informed by previous experiences, are important. General reference points however can apply in most cases.

Three elements are necessary for explain the benefits of trade reform. The first is good information. This includes data on affected industries and price information on the domestic market for example. Information needs to be translated into robust analysis, involving central economic institutions. In some counties, institutional capability may need to be built or enhanced. A third element is communication strategies which involve explanations to industries, investor presentations, consumer groups, and academics.

Possible actions governments can take are wide. They include:

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<sup>10</sup> This section summaries content from “Core Elements of Domestic Trade Reform” Paper prepared for the training course by Economic Consultant Robert Kerr. See course training materials at [www.aepc.org.au](http://www.aepc.org.au)

- Aligning the constituencies of beneficiaries - consumers, importing industries, service industries and the finance sector.
- Identifying categories of benefits for every sector of the economy - higher incomes and expenditures can benefit all, and the dynamism of change creates many opportunities.
- Coordinating government bodies - internal government communication can be important to prevent discordant behaviour, and to identify consequences of higher economic growth.
- Engaging trading partners and relevant international bodies - these may include trading partners on whom impacts may be evident, and institutions such as the WTO and APEC.

### ***Responding to the costs***

A first step in responding to the costs of trade reform is to provide information on them and analyse their possible impacts. Only after that can governments adequately act to address them.

As a general point, any discussion of costs should always be related to expected benefits, even if these are more delayed. The intended efficiency effects need to be given time to work and this needs to be explained.

The costs should be spread by wider structural reforms. One sector's adjustment cost can be another sector's benefit. For example, infrastructure reforms can reduce input costs. So some costs will be offset. The process of change will also open up new business opportunities.

Decisions need to be made about how fast reforms should proceed and how much time is allowed for adjustment. Businesses respond better if there are no policy surprises. Incremental change, with a predictable timetable, gives better adjustment opportunities.

Consideration should also be given to adjustment assistance. Generally, adjustment assistance should be efficiency friendly (i.e. it should not erect new impediments which would negate the original purpose of the trade reforms). For individuals, assistance may involve retraining or relocation help to improve reemployment prospects. For firms, R&D support and new market development may be warranted.

### ***Proposed policy actions to promote reform***

With the above discussion in mind, there are several principles which can guide policy actions by governments to deliver the benefits from trade reform of NAMA in an era of falling demand, rising protectionism and economic uncertainty.

Sound policy options include those which:

- Avoid new discriminatory measures;
- Advance progress for liberalisation in the Doha round and in PTAs;
- Engage and implement domestic policy reform to keep the economy growing;
- Lock in reforms already implemented;
- Secure and maintain political commitment to market openness, and
- Build regional integration to further trade reform efforts.