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Reforming the International Trading System for Recovery, Resilience and Inclusive Development

Abstract

For many observers, the best strategy to build back better after the Covid-19 crisis is to double down on pre-pandemic policies: at the domestic level through market disciplines to contain production costs, especially of labour and taxes; internationally, by reforming the WTO to further trade liberalization, secure intellectual property and contain state subsidies. This paper argues that this prescription is flawed by weak economic analysis and selective choice of data, and that a different reform agenda is urgently needed if developing countries (but also many in the developed world) are to recover better from the Covid-19 crisis, build resilience to future shocks and achieve transformative development that can deliver the SDGs. The agenda we outline is centred on a recovery strategy to boost domestic demand, jobs and household incomes and a diversification strategy into higher productivity sectors. The discussion focuses on developing countries.

Key words: WTO reform, hyperglobalization, structural transformation, policy space, intellectual property rights, Covid-19, recovery, resilience, Agenda 2030.



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Acknowledgements

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1. Introduction

The world economy is still reeling from the Covid-19 shock and the subsequent restrictions to social and economic activity. While in the developed world governments have been able to mobilize a massive arsenal of monetary and fiscal measures to prop up their economies, estimated at between 20 and 25 per cent of their GDP, the poorest developing countries have mobilized just one per cent of their output to mitigate the damage from a vicious cycle of capital flight, plunging trade and investment flows, collapsing output and tax revenues and, in some cases, soaring debt service (TDR, 2020; UNCTAD, 2021). While the global economy is now recovering, there are growing concerns that developing countries might face a lost decade and the aborted delivery of the sustainable development goals (SDGs).

For some observers, the sharp declines in trade and foreign investment flows caused by the Covid-19 crisis, along with a resort to export restrictions, are only the latest in a series of setbacks for the international trading system. In particular, a surge of “murky” protectionism following the global financial crisis has, it is argued, been compounded over the last decade by “populist” politics, typified by Brexit and the tariff wars launched by the Trump administration, and reinforced by deepening political rifts at the WTO. These hidden and more overt forms of protectionism have, it is claimed, not only distorted and slowed down global trade but also triggered a dangerous retreat from the post-war liberal international economic order (Baldwin and Evenett, 2020).

From this perspective, the best (indeed, only) hope of building back better from the current crisis comes from adopting policies at the domestic level to increase competitiveness and at the international level to deepen integration through reforms at the WTO, including further reductions in industrial tariffs, liberalization of services (particularly those linked to the emerging digital economy), stronger intellectual property rules, ending “unfair” state support and the alignment of trade rules with climate goals.

Such measures are tightly tuned to the demands of a hyperglobalized world and attached to the promise that supporting entrepreneurship, extending supply chains and strengthening competition will boost trade and investment and revive growth, particularly in developing countries. In reality, the revival of hyperglobalization after the global financial crisis, coincided with sluggish investment demand, a marked increase in market concentration and rising corporate rents, exacerbating income inequalities and squeezing domestic markets, all of which contributed to a slowdown of trade over the past decade.

These intertwining trends follow, in part, from many of the measures adopted to boost competitiveness (particularly through wage repression) which tend to weaken domestic demand (TDR, 2012, 2013), based on the illusion that all countries can be net exporters (a “fallacy of composition”). The more likely result has been a “race to the bottom” (TDR, 2014). But these trends were also associated with a prolonged period of trade (and financial) liberalization which had constrained the role of the public sector and narrowed the policy space needed both to respond to economic shocks (TDR, 2014, 2015) and to advance a transformative agenda for sustained and inclusive development (TDR, 2016). As a result, many developing countries have become even more dependent on attracting footloose capital inflows, on commodity exports or assembling low-skill manufactures (TDR, 2018) and on remittances, as sources of foreign exchange.

Despite this record, policymakers in many countries continue to see these same measures as the only route to the recovery of trade, and, by implication, economic

growth, and the basis on which reform of the multilateral system should advance after the pandemic. This paper argues that this diagnosis of the ills of the international trading system is flawed by weak economic analysis and selective choice of data, and that a different reform agenda is urgently needed if developing countries (but also many in the developed world) are to recover better from this crisis, build resilience to future shocks and pursue transformative development strategies that can deliver the SDGs. The agenda we outline is centred on recovery of domestic demand, jobs and household incomes in both developed and developing countries (TDR, 2019: 3), although the discussion focuses on the latter.

The paper traces the emergence and spread of free trade advocacy in support of hyperglobalization, resulting in rules and practices that privilege a small number of “winners”, perpetuating economic asymmetries and imbalances that hamper the prospects for inclusive and sustainable development, particularly in developing countries. It identifies key stylized trends in the modern trading system, neglected in much of the current debate on its reform, and outlines some alternative principles for rebalancing it. It sets out a recovery agenda for developing countries, focusing on reforms to the existing rules and structures of the trading system, which could help them recover faster and better in line with the Agenda 2030.

2. Free trade: destiny or dogma?

A system of unrestricted international flows of goods, services and factors of production has always been one of the principal aims of economic liberalism and, since the late 1970s, has been regarded by many as the essence of globalization. Arguments in its favour have often harked back to the “classical” liberal theme linking commercial activity to personal liberty through constraints on the potential abuse of state power and a view of unhindered commerce and trade as a “natural order”, oftentimes framed in theological terms.¹

The contemporary case for free trade has replaced Divine Providence with the rational representative agent beloved of neo-classical economic theory, taking key ideas of classical political economy out of historical context and promoting them again as natural laws. In particular, specializing according to their comparative advantage should allow countries to reap efficiency gains from moving to a production and trading profile that uses their relatively abundant resources to the full, importing goods that embody otherwise relatively scarce resources. Thus, countries with plenty of unskilled labour and land should produce and export primary commodities or basic manufactures, while importing machinery and sophisticated industrial products from countries where these happen to be plentiful. As such, a country’s factor endowments are taken as a state of nature rather than the result of social relations and action. Even countries which are lagging behind in all sectors would benefit by pursuing this logic through rapid opening up. This “win-win” logic is seen by advocates as “the deepest and most beautiful result in all of economics” (Findlay, 1991: 99), but also as an example of what Joseph Schumpeter called Ricardo’s vice, whereby radically simplified assumptions distort our understanding of economic reality (Keen, 2017; Rodrik, 2018).

Starting in the early 1980s, armed with abstract models of an ideal economy and fully exploiting the economic shocks that hit much of the developing world at that time, an

¹ According to one of the leading 19th century campaigners for “free trade”, Richard Cobden, “A Law which prevents free trade is a law which interferes with the wisdom of the Divine Providence and substitutes the law of wicked men for the law of nature”.

intrepid band of international economists set about correcting what they saw as decades of economic distortion (through high levels of protection, state subsidies and overvalued exchange rates) resulting from an (unnatural) government desire to accelerate industrialization through import substitution strategies. Rapid opening up to international business would, instead, expose local firms and farms to international prices and induce them to take up activities that would benefit from global competition. In essence, what was being offered was the realization of a self-regulating market order with the Bretton Woods institutions in the vanguard of “getting prices right” through dedicated adjustment programmes that subsequently became known as the “Washington Consensus” (Williamson, 1990).

The case for unleashing global market forces was bolstered by the apparent precision with which conventional economists claimed to be able to pinpoint the gains from trade liberalization (Cline, 2005). Computable general equilibrium modelling introduced a veneer of technical authority into the debates on the costs and benefits of openness while an endless stream of cross-country regressions provided empirical support for the “win-win” logic of a globalizing world. These exercises follow a standard format of measuring the size and statistical significance of coefficients relating a dependent variable (such as per capita income growth or the level of income) to a set of country-specific variables, including a proxy for openness. A positive coefficient on the latter is taken as sufficient evidence for rapid trade liberalization.

A tendency to exaggerate the gains from trade liberalization dates back to the early 1980s with debates about Northern trade agreements, such as the Canada-US free trade agreement and the single European market. It became commonplace during the Uruguay Round and reached new heights in the run-up to the 4th WTO Ministerial meeting in Doha when free-traders fell over themselves to promote the new Round as a panacea, post-9/11, for a whole range of conditions from global stagnation to terrorism.² The World Bank (2002) predicted between \$1.5 and \$7.5 trillion of additional cumulative income to developing countries from the liberalization of goods and services. Significantly, and with a good deal less fanfare, in the run-up to the Hong Kong Ministerial meeting in December 2005, the World Bank markedly scaled back its predictions of the likely benefits of significant tariff cuts and other liberalizing measures to below \$100bn and accepted that most of the gains would accrue to the richer countries.

These exaggerated claims reflect the fact that while the underlying model is much admired for its mathematical elegance, it rests on a set of severely restrictive assumptions whose distance from reality has troubled generations of leading economists beginning with Adam Smith, no less, who insisted that a universal system of free international trade was more a utopian ideal than a coherent blueprint for policy and that the costs of adjusting to it required that it be done “only by slow gradations, and with a good deal of reserve and circumspection” (cited in Panic, 1988:124). For others, the implausibility of a world populated by small firms, with perfect information about consumer tastes and available production technologies, untroubled by learning or scale economies, and where immobile factors of production are always fully employed, has

² The World Bank was quick out of the blocks with this type of analysis in its World Development Report in 1987, which classified 41 developing countries according to their openness to trade since the 1960s, reporting the highest growth in income per capita in the strongly outward-looking economies and the lowest in the strongly inward-looking ones. A subsequent slew of more academic studies followed, all reporting similar findings. The IMF (1997) and the WTO (1998) were soon promoting these as evidence that “policies toward foreign trade are among the more important factors promoting economic growth and convergence in developing countries”. Drawing from a growing body of academic literature that followed the same approach, the World Bank (2002:1) concluded that “Globalization generally reduces poverty because more integrated economies tend to grow faster and this growth is usually widely diffused.”

long cast a cautionary shadow over recommendations for rapid trade liberalization (Panic, 1988: 121–39). Indeed, both Smith and David Ricardo were fully aware of how freer trade might very well lead to widening income gaps among trading partners (Darity and Davis, 2005). Although the case for free trade still courses through the veins of most economics student and many trade bureaucrats, leading members of the profession have kept at least one sceptical eye on its “win-win” logic, as testified by “new trade theorists”, who modelled the growth of trade between similarly endowed countries with heterogeneous firms (Krugman, 1979; Melitz, 2003; Bernard et al., 2011), with an acknowledgement by some that “genuine harm” can result for some countries from “the roulette wheel of evolving comparative advantage” (Samuelson, 2004: 142).

In response, proponents of rapid liberalization have doubled down on their policy advice by setting aside the “static” gains from liberalization and emphasizing instead its potential “dynamic” gains. These include scale economies from enlarging the potential market through exports and from increasing the diversity of intermediate inputs, spillovers and learning effects that come with importing goods and hosting FDI, and a much faster pace of capital formation from easing an otherwise binding financial constraint (Srinivasan and Bhagwati, 2001: 31–32). From this perspective, trade liberalization mixed with measures to attract the right kind of capital is expected to act as a catalyst for productivity growth (Edwards, 1998), including through institutional improvements and better governance (Winters, 2004).

In practice, however, the task of measuring the impact of liberalization through these various channels still involves many implausible assumptions and most statistical exercises resort to an ad hoc mixture of partial and general equilibrium modelling, combining traditional assumptions with more modern insights. Winters (2004) acknowledges as much in his frequently cited review of the links between trade liberalization and economic performance, bringing in investment as a likely catalyst for why openness works in successful cases. More generally, as core principles have been abandoned, a good deal of the case for rapid liberalization appears to rest more and more on specific episodes of growth and integration, particularly in East Asia where countries have established a strong nexus between investment and exports. However, closer study of these experiences has shown that policy makers pursued trade liberalization as part of a strategy for industrialization rather than as an end to itself (and in a historical and geopolitical context very different from today's) with very different policy conclusions for how to make openness work for development (Wade, 1990; Rodrik, 1999; TDR, 1996; 2003; 2016).

3. Trade liberalization in the era of hyperglobalization

Beginning in the 1980s, the move to rapid trade liberalization in developing countries was pursued largely under the tutelage of the Bretton Woods institutions and pushed through the policy conditionalities attached to their lending programmes; three-quarters of the World Bank's Structural Adjustment Loans in the 1980s included demands for trade policy reform (Stewart, 1995) and remained a central component in subsequent iterations of the Washington Consensus (Birdsall et al, 2010; Babb and Kentikelnis 2020).

The Uruguay Round, launched in 1986 and completed eight years later, amplified this move and became the mothership for a new generation of trade agreements that introduced significant changes in the content of liberalization programmes (Davis, 2019).

These new agreements went beyond GATT's focus on tariff reductions to include a whole range of "trade-related" measures that had previously been regarded as the preserve of national policy, such as industrial development, government procurement and intellectual property laws.

This expanded agenda was taken much further in mega trade agreements pushed bilaterally or regionally by developed countries and which now underpin some of the envisaged pathways to WTO reform. As Dani Rodrik has shown, the underlying premise running through this new generation of agreements was "harmonization" in a broad swathe of public policies to ensure that they do not "distort trade" to the advantage of any party (Rodrik 2018). In practice, when applied in envisaged agreements between developed and developing countries, these types of provisions become severe impediments to developmental policies and programmes aimed at structural transformation and (e.g. in the case of TRIPS plus provisions) further entrenched the dominant (and increasingly monopolistic) position of developed-country corporations (Ostry, 2002).

While these changes in content reflected shifting ideological currents, they were also a product of systemic (and ongoing) shifts in the structure of global markets. International trade has always been dominated by big firms. However, in the decades following the end of the Second World War, markets remained contested, as new entrants emerged and as bargaining in the workplace, along with effective State regulations, constrained the power and reach of large corporations. Many of those constraints on corporate power have since been eroded in the era of hyperglobalization as capital became more mobile (and more footloose), technological changes reduced transaction costs and more countries opened up to international business. The resulting expansion of trade has been closely tied to the spread of global value chains (GVCs) governed by lead firms, principally headquartered in advanced economies (Milberg and Winkler, 2013; Kozul-Wright and Fortunato, 2020). These have allowed more developing countries to participate in the international division of labour by providing specific links in the chains, including in manufacturing sectors, drawing on their abundance of cheap unskilled labour. The promise was that such fledgling manufacturing activities, through a mixture of upgrading and spillover effects, would quickly establish robust and inclusive growth paths aligned to their comparative advantage.

Propelled by these changes, the number of trade agreements and other kinds of international economic treaties (such as bilateral agreements on investment protection, avoidance of double taxation, etc.) rose exponentially after 1990. Between 1990 and 2015, the number of trade agreements increased from 50 to 279, with many of them plurilateral. Bilateral investment treaties (BITs) grew almost tenfold from 238 to 2,239 over the same period. These legal changes certainly facilitated trade and cross-border investment (although trade and investment are driven more by global demand, than regulatory changes), but also expanded profit-making opportunities for large corporations through tangible asset acquisition, intangible asset shifting and financial speculation.

As a result, the main actors and beneficiaries of this metamorphosis of "trade" were not workers or States, but rather the largest corporate players that were involved in lobbying for and shaping the rules of international trade and finance. In this process, large international firms headquartered mostly in developed countries found themselves in a privileged position to influence rule making and to reorganize large swathes of world production, thereby creating possibilities of expanding their cost-minimizing strategies on a global scale.

Against this backdrop, talk of a rules-based order “as the only credible assurance against protectionism and the economics of destruction” (Sutherland, 1994), “levelling the playing field” (Lamy, 2006) and advancing “the great convergence” (*Financial Times*, 2007), does not reflect the actual workings of the international trading system and its impact on developing countries (Braunstein et al., 2019). In a world where large international firms dominate the organization of trade and production, advantages are created rather than given, and scale economies and learning are defining features of productive activities, first-mover advantages persist, market entry is likely to be slow and expensive, historical accidents can have long-run economic consequences, and “market forces do not select a single, predetermined outcome, instead they tend to preserve the established pattern, whatever that pattern may be” (Gomory and Baumol, 2001). In other words, free trade perpetuates technological and industrial imbalances favouring specialization in low productivity activities in developing countries and high-productivity activities in developed ones.

This environment is a very long way from the imaginary world of small firms in competition with each other and permanently providing full employment, where a lower tariff option is assumed to make everyone better off. And as Gomory and Baumol insist, given that the modern trading system is so different from the 18th-century, largely agricultural world in which the free-trade model was conceived, the analysis of how trade works needs to start from a very different set of stylized trends.

4. Stylized trends in the modern trading system

A number of features of the global economic landscape are key to understanding the workings of the contemporary trading system and set the scene for a reform agenda that can make that system work for more inclusive, resilient and stable outcomes, particularly for developing countries.

4.1 Trading more earning less

While developing countries have been trading more, including in manufacturing goods, the increase has been heavily concentrated in a small number of countries, principally from East Asia. Moreover, the developing country share of global value added has not risen in tandem with its share of exports and productivity growth has been weak even in countries that have raised their share of exports in GDP. The continued reproduction of the division of labour established under colonialism has meant that almost all developing countries are firmly integrated into some GVCs, but in subordinate roles - as providers of primary commodities and outsourced, low-wage assembly activities. Thus, the central challenge for many developing countries is not whether to integrate into GVCs, but rather to integrate in a way that does not compromise, or better favours, development. The main barriers to their industrial upgrading are not tariffs that cut them off from imports of essential intermediate goods (requiring, therefore, tariff elimination) but rather production capacity constraints such as access to technology and foreign exchange that need to be dealt with through active industrial and macroeconomic policies, which are curtailed under current rules as ‘trade distorting’ measures (TDR, 2014, 2016).

Part of the problem underlying this dynamic seems lies with a lopsided reliance on external demand, which carries with it the familiar dangers of overproduction and adverse price movements (TDR, 2002; Heintz, 2003). On its own, a small country can rapidly expand its exports in a given market with negligible impact on global supply and prices – the “importance of being unimportant” – but once a large number of countries or

just a few large ones (such as India and China) follow the same route, there is an increased risk of oversupply and declining terms of trade for the exporters.

This increased risk of falling prices, resulting from a “fallacy of composition”, now seems to be facing exporters of electronic products and other manufactured goods as a result of widespread efforts to replicate the successful experience of the Asian Newly Industrialized Economies (NIEs). Indeed, the fact that those efforts have been more and more confined to a limited number of links within global value chains has probably made price competition all the more intense. As was previously the case with primary commodities, such a risk becomes all the more present in each market when production is largely concentrated in a few countries.

Another contributing factor has been the difficulty many countries have faced in raising productivity by shifting resources to more dynamic sectors. Stalled industrialization or even premature deindustrialization have occurred, whereby the shares of manufacturing value-added and employment started to decline at levels of per capita income much lower than those at which developed countries and successful later industrializers started to shift to service activities (TDR, 2002, 2016). This lack of diversification is accompanied by stagnant or falling relative productivity levels.

Premature deindustrialization, in particular, has been the result of drastic policy changes in the direction of more restrictive macroeconomic policies, lower public investment in infrastructure and knowledge, and, more generally, reduced State intervention to support structural transformation, including by sustaining domestic demand. Large scale, and sometimes unilateral, trade opening, coupled with periods of currency appreciation, strongly affected the profitability and viability of important segments of the manufacturing sector, while a trend towards more regressive income distribution weakened private domestic demand.

4.2 Growing macroeconomic imbalances

Stalled diversification along with the pressure for labour market deregulation as part of trade agreements have weakened the prospects of full-time, formal employment in many developing countries and have put downward pressure on the wage share. This is the main causal factor in the global trend toward a skewing of income distribution which has seen the share of national income accruing to labour decrease, with a corresponding increase in the profit share. This approach to globalization, based on wage repression or “structural reforms”, undermines global growth and development (Capaldo and Izurieta, 2018). It is, however, absent from most narratives of poverty and poverty alleviation steeped in the free-trade tradition and bolstered by acclaimed techniques such as randomized control trials (Banerjee and Duflo, 2011).

Overall, aggregate demand has slowed down, as household consumption has been squeezed by stagnant labour incomes, with negative consequences on business investment and productivity growth, thus reinforcing the downward pressure on wage and employment growth. Financial crises have further undermined labour shares both by depressing employment and by paving the way for export-oriented, race-to-the-bottom policies as the only strategy for long-term growth. Indeed, as Matthew Klein and Michael Pettis argue, while trade tensions are often presented simply as a clash between national interests, a focus on countries obscures the primary conflict “between bankers and owners of financial assets on one side and ordinary households on the other — between the very rich and everyone else” (Klein and Pettis, 2020).

Downward pressure on labour costs has been ubiquitous but unequal across countries, providing trade growth with essential fuel. While falling wage shares have been a drag on consumption everywhere, particularly strong pressures on labour costs in developing countries provided an expanding flow of ever cheaper, often carbon-intensive, manufacturing exports to developed countries. As a result, under-consumption in developing countries and over-consumption in developed ones have been two faces of the same coin.

For the majority of developing economies, under-consumption is a direct effect of wages lagging behind productivity, which leads to an increase in the share of total income accruing to profits and rents (as tax shares are generally stable). One consequence of this redistribution is that total consumption falls since profit earners and rentiers tend to save more of their incomes (TDR, 2013). Adding to this, under-consumption can also result from households' precautionary saving, driven by the need to build financial buffers in the absence of strong social protection (Akyüz, 2012). In any event, households in developing countries are earning insufficient incomes to absorb the increased output of manufactured goods they are producing, which is consistent with the export specialization strategy.

In order to support consumption expenditure, the suppression of wage incomes can be compensated for by an increase in household debt, particularly in the context of financial deregulation and relatively low interest rates. This can generate a debt spiral among households and, particularly in developed countries, a boom in asset markets such as real estate and stocks, which in turn can have positive effects on consumption and investment. Such credit-driven bubbles eventually end, often with a hard landing, as in 2008–2009, leaving in their wake large income losses and massive debt overhang.

4.3 Rising market concentration

On several measures – such as market capitalization, corporate revenues and asset ownership – market concentration has been rising in the advanced economies and across the world, with the top 100 firms absorbing larger and larger shares. It has gone hand-in-hand with increasing mark-ups (de Loecker and Eeckhout, 2018) and rent extraction, linked, in particular to the ownership and control of intellectual property (Durand and Milberg, 2019) resulting in a “winner-takes-most competition” that has become a visible part of the corporate environment, most notably in developed economies.

In 1995 the average market capitalization of the top 100 firms was 31 times higher than that of the bottom 2,000 firms. By 2015, the ratio had grown to a staggering 7,000. And while these firms were amassing ever greater control of markets, their employment share was not rising proportionately. For example, the top 100's market capitalization rose fourfold while their employment share less than doubled. This lends further support to the view that hyperglobalization promotes “profits without prosperity” (Lazonick, 2014) and that market power generates income inequality splitting economies into a dynamic core and a stagnant periphery. As noted earlier this trend has also been reflected in the workings of the international trading system, including through unfavourable terms of trade and the cross-country distribution of value added in manufacturing output.

Recent firm-level data on non-oil merchandise exports show that the top 1 per cent of exporting firms, already a restricted circle in the business world, accounted for 57 per cent of country exports on average in 2014. The concentration, which is even more extreme at the top of the distribution, has increased under hyperglobalization. After the global financial crisis, the five (not five per cent) largest exporting firms, on average,

accounted for 30 per cent of total exports, and the 10 largest exporting firms for 42 per cent. This trend has accelerated with the fourth industrial revolution, the digital “revolution”. Profits of digital platforms and big-tech have sky-rocketed in the period 2011-2015, with profit-to-revenue ratios averaging 7 per cent in the top 2000 transnational corporations (TNCs) and 25 per cent in top eight big-tech firms. The market capitalization of Apple Inc in 2020 was USD 2 trillion-higher than the GDP of 82 per cent countries in the world. The sheer size of this power imbalance is reinforcing the gradual dilution of social and political accountability of large corporations to national constituencies and labour around the world.

In developing countries, the adverse impact of international trade on inequality has also resulted from the proliferation of special processing trade regimes and export-processing zones, which legalize and often subsidize the organization of low-cost and low-productivity assembly work by the lead firms in control of GVCs, with limited benefits for the broader economy. The mixed outcomes of policies to promote processing trade reflect large corporations’ power over GVCs, with intellectual property and other high-priced imports allowing for little value-added in developing countries (Selywn and Leyden, 2021).

This raises questions about the large bets made in many developing economies on the spillovers expected from processing trade. Unless developing countries manage to capture a larger part of the surplus created in the GVCs and reinvest it in productive capacity, immediate gains in output and employment are unlikely to translate into a dynamic move upward on the development ladder.

4.4 Booming (and busting) capital flows

In an interdependent world, important information on the health of an economy is provided by the balance of payments – the official record of cross-border transactions. Indeed, because in these transactions growth, structural change and integration are closely intertwined, the balance of payments has long been recognized as a potentially binding constraint on the development process and a persistent policy challenge for all countries.

The idea that, in an interdependent world, market forces could be left alone to bring about orderly payment adjustments in the face of erratic terms of trade, flagging global demand, exchange rates swings, and rapid liberalization rests on many of the same simplistic assumptions as “free trade”.

The relaxation of national controls on international capital mobility has led to an explosion of cross-border capital over the last three decades and has marked a fundamental break with the post-war Bretton Woods system. The highly volatile nature of these flows has had a direct bearing on the economic prospects of developing countries, including their insertion in international trade, through boom-bust cycles in international financial markets. The precise features of these cycles vary from country to country but their pattern, and accompanying vulnerabilities, are broadly shared (TDR, 2015; Akyuz, 2017).

In developing countries hoping to see significant economic gains from their participation in a more open economic system, financial liberalization and persistent instability have had an adverse impact on capital formation and the process of structural transformation. Stagnation of productive investment has favoured export strategies centred on cheap labour leading to rising inequality and weakening aggregate demand. Meanwhile tax erosion (oftentimes presented as a way to attract foreign capital) has undercut public

infrastructure projects and productive, long-term investment has been crowded out by speculative uses of funds (often borrowed abroad). Rapid increases in indebtedness of non-financial corporations have become a serious concern in many developing countries.

The adverse macroeconomic impacts of global as well as corporate financialization are increasingly visible. Sector-level data reveal how debt-fuelled investment has been concentrated in highly cyclical and natural-resources-based sectors – oil and gas, mining electricity, construction, real estate, and telecommunications -- that contribute relatively little to structural transformation and productivity growth.

5. Principles for rebalancing trade

As Rodrik has noted, in the hyperglobalization era, “Global integration has become, for all practical purposes, a substitute for a development strategy” despite its “shaky empirical ground” and the serious distortion it gives to policymakers’ priorities (Rodrik 2001). The reforms needed to “build back better” after Covid-19 will, instead, have to privilege an explicit development strategy, and rest on a stronger evidence base (as outlined above), more plausible view of the way economies adjust to shocks and policy changes and, overall, a different set of principles from those underpinning the free trade agenda.

At UNCTAD’s founding in 1964, member states agreed to a series of (fifteen) General and (thirteen) Special Principles to govern international trade relations and trade policies in support of development. While some of these Principles were specific to the moment, many retain their relevance. In this paper we focus on three key principles that were embedded in that earlier discussion and continue to resonate in light of the trends in today’s international trading system discussed above: policy space, special and differential treatment, voice and solidarity.

5.1 Policy space

Trade can be an important factor of economic recovery. However, as discussed above, trade is not an end in itself and should instead be seen as a means to achieve a wide set of ends. Economic security, personal and environmental safety, social justice and political representation are broadly valued but there is no universal blueprint for achieving them, and the institutions and policies that are required must be fashioned around local capacities, conditions and needs. Still, to the extent that markets and firms operate globally there are grounds for having global rules and regulations, such as international labour standards, tax rules and intellectual property regimes. As at the domestic level, these are needed to establish a degree of certainty and security in economic decision making and to curtail abusive and predatory behaviour.

In an interdependent world a sustainable balance between domestic and global rules revolves around States’ policy space: too little can make States incapable of responding to local needs and constraints, ultimately undermining the effectiveness of and trust in global rules. But national policy space should be tempered with the need for regional and global coordination toward sustainable development and other common goods. The rules and practices of international trade should be shaped accordingly.

The ultimate test of successful trade policy at the macro level should be whether it promotes economic diversification and upgrading without increasing inequality or

contributing to environmental degradation. The sustainable development goals provide a detailed benchmark and imply the challenge, critical for assessing trade policy, of progressing toward some goals without moving away from others. By these metrics, the current trading regime is falling far short of what is required. In many countries higher growth rates and an increasing share in global trade have proved ephemeral, while most are failing to achieve the structural transformation that is needed not only to improve the socio-economic circumstances of their populations but also to face our collective global challenges.

Different economic, social, environmental and political starting points mean developed and developing countries are not on a level playing field when it comes to trade impacts and development priorities. Recognizing these differences and compensating for them should be the mainstay of all international agreements engaging developed and developing countries, multilateral trade agreements being no exception.

In the Uruguay Round, developing countries accepted binding commitments on most of their tariff lines and made significant commitments in new areas of interest to the developed world such as intellectual property and services, while developed countries in exchange agreed to open up areas of interest to developing countries, namely agriculture and textiles and clothing. This has proved an asymmetric bargain for most developing countries with the benefits from TRIPS (the agreement on trade-related aspects of intellectual property) and TRIMS (the agreement on trade-related investment measures) enjoyed by developed countries and the costs borne by developing countries, and outweighing the gains to most developing countries from market access.³ In particular, TRIPS limited developing countries' flexibilities and raised their costs of using technologies or products patented in their territories, leading to a net flow of rents from the South to the North. Moreover, while developing countries' obligations under TRIPS were enforceable and could be challenged under the dispute settlement mechanism, their rights to technology transfer were not enforceable. TRIPS also provided a baseline for the developed world in all their future trade agreements, where they negotiated for 'TRIPS-Plus' commitments.

A broad recognition of this asymmetry helped launch the Doha Round in 2001 with a more development-focused agenda. But it has not yet been concluded, sidelined in favour of plurilateral negotiations on issues of special interest to advanced economies (Davis, 2019).

Developing countries should seek to preserve policy space in all trade rules whether at the bilateral, regional or multilateral levels and in all the issues under negotiation whether in relation to agriculture, fisheries, digital, investment etc. Such rules must enable developing countries to enhance their participation in global trade not only as suppliers of primary products but also expand and enhance their industrial capabilities. Furthermore, policy space is required to promote green industrialization to deal with and build resilience against climate change. Accordingly, developing countries should be cautious about premature tariff liberalization on environmental goods before building their own requisite capacities.

5.2 Special and Differential Treatment

While the GATT rounds were largely negotiated among advanced economies, its practices allowed some derogation for participating developing countries from the rules and commitments that were eventually agreed. With the wider and more engaged

³ Finger (2003); Rodrik (2018b)

participation of developing countries in the Uruguay Round and its adoption as a single undertaking, Special and Differential Treatment (SDT) was formally accepted as part of the outcome of the Round to facilitate implementation of the Agreements. This was extended to subsequent WTO Agreements.

SDT allows developed countries to treat developing countries more favourably than other WTO Members, gives developing countries special rights to ensure a more level playing field in international trade and helps them with implementation of multilateral trade agreements. But while SDT in principle safeguards the policy space of developing countries allowing them to better align their trade with their developmental priorities, the reality is that its specific application is contingent on the negotiating process and outcome in particular areas. In this respect, the view that SDT is singularly responsible for dysfunctional negotiations in the WTO is disingenuous.

More recently, developed countries have pushed to tighten the criterion for countries availing themselves of SDT and have, in particular, questioned the principle of self-declaration in the WTO. In so doing, developed countries are essentially seeking to put themselves in a position to decide which developing countries can avail themselves of SDT and how. At the most recent Ministerial Conference in Buenos Aires, the G90 group of developing countries proposed ten agreement-specific proposals to advance core areas of the Doha Round and ensure clarity and effectiveness on the scope of SDT, an initiative that was rejected by developed countries. A core question in this debate is whether the WTO, which is essentially a rulemaking organization with a mandate for trade liberalization, has the capacity to define and measure development, which involves many other areas of policy. Given that development is a moving process of many parts, policy makers in developing economies remain best placed to collect the requisite knowledge of their local conditions when deciding whether they should be categorized as eligible to avail themselves of SDT or not. Moreover, development is a process that involves catching-up with those already at the economic and technological frontier, which itself is not fixed, adding a further layer of complexity to the eligibility question that goes well beyond the ambit of the WTO itself.

Given the macroeconomic trends described above (and the diverging pressures unleashed by the pandemic), it is hard not to conclude that SDT remains at least as important today as it was when the Doha Round began. Not only are gaps in GDP per capita between developed and developing countries significant -- and have been increasing in absolute terms since 1995 when the WTO was created -- but on a multiplicity of criteria, the development divide remains as wide as ever and, while countries at different levels of income face their own distinct challenges, common obstacles and constraints continue to shape the economic possibilities of billions of people across the developing world (UNCTAD/DGDS, 2019).

UNCTAD has consistently emphasized the merits of multilateral trade rules and disciplines in global economic governance but has highlighted the need to apply these rules flexibly to all developing countries. It has drawn attention to the fact that even if in legal terms WTO rules are equally binding for all participants, in economic terms they are biased towards accommodating the requirements of developed countries (TDR, 2006) and increasingly, as discussed earlier, to the narrow interests of their large corporations. Indeed, in its current form, SDT has been insufficient to enable the sort of economic diversification and development enjoyed by developed countries before they rewired the rules of the global economy for the “free trade” era, and which now makes achieving resilience to shocks, such as the Covid-19 crisis, let alone any sort of green transition to halt climate change, next to impossible.

5.3 Voice and solidarity

Decisions in the WTO have always been taken by consensus and while this practice is reaffirmed, the Marrakesh Agreement also provides for voting when consensus cannot be achieved. Consensus emerges from selective consultations between sub-groups of the membership under the oversight of the chairpersons of the principal WTO bodies. The developed countries have so far continued to dominate the WTO agenda with their superior resources for negotiation and their greater capacity to follow bureaucratic and legalistic procedures.

In the original UNCTAD principles, promoting and extending solidarity largely involved advanced countries supporting developing country efforts to integrate more effectively into the international division of labour. However, South-south integration was recognized as a mutually beneficial source of bilateral and regional trade and payment arrangements as well as a means to strengthen the voice of developing countries in multilateral fora. Those efforts were integral to efforts to advance a new international economic order in the 1970s. Southern solidarity has subsequently ebbed and flowed.

The Covid-19 crisis has again exposed the vulnerabilities of the South to external shocks but it has also revealed the lack of a strong vision that unites developing countries, at all levels, around a shared international agenda. Since the outbreak of the pandemic, among developing countries, only some general statements (from the G77 and China and the BRICS countries) have emerged backing the common fight against Covid-19 and the required collective response, without any systematic and concrete action plans.

Beyond immediate relief packages, regional plans to build resilience in the South are needed. For example, regional projects such as the African Continental Free Trade Agreement (AfCFTA) should favour products of local enterprises – in public health value chains but also products of broader public interest - and in this way support regional industrialization. Any such initiative cannot substitute for effective multilateral action to ease the pressure on developing countries and drive a resilient recovery for all countries. But the multilateral system is currently weak and rudderless and opportunities for cooperation within the South should be capitalized on to drive needed reform of the wider multilateral system.

This includes reform of the existing trading system in a way that supports a common Economic Recovery Agenda for the developing countries and facilitates a faster, better and more resilient recovery from the pandemic. The pandemic has exposed the lack of capacity of most developing countries to recover on their own and the need for the South to show solidarity in the WTO as a means to harnessing the developmental benefit of international trade.

6. An economic recovery agenda for developing countries

In advanced countries the pandemic has led to deficit spending and calls for “strategic autonomy” and “reshoring”, after established views on fiscal and trade policy have been put on hold. According to Martin Sandbu, this “taboo breaking” mindset has also extended to the multilateral realm where the Washington Consensus has finally succumbed to the call for renewed state activism to prevent a divergent recovery (Sandbu, 2021). However, while the multilateral financial institutions have certainly adopted a more accommodative narrative in response to the expansionary fiscal

measures adopted in response to Covid-19, corresponding multilateral support measures have not matched the scale of the crisis and a suitable recovery plan for the global economy is still not on the table. Moreover, resistance, particularly from the international trade community, is beginning to emerge and the aftermath of the global financial crisis should serve as a reminder of the resilience of neo-liberal thinking in the face of its own stark failures (Galbraith, 2021).

In the context of the above trends and in the face of the biggest global recession on record, developing countries need a comprehensive recovery plan to revive their economies post pandemic and tackle the wider development challenges that have been neglected since the global financial crisis. Any such plan will need to address a triplet of inter-related challenges: recovering faster and more fairly, building resilience against future shocks and promoting structural transformation in line with the SDGs.

The macroeconomic component of such plans has been extensively discussed elsewhere along with the necessary international support and coordination measures (TDR, 2019; 2020). Financial support, targeted reforms and strengthened coordination will also be needed across the international trading system, including at the multilateral and regional levels.

6.1 Recovering faster

a. Securing adequate financial support

International trade plummeted during the initial months of the pandemic as countries locked down, leading to balance of payments pressures and debt distress in many developing and least developed countries. The procyclical nature of trade finance is likely to have been a contributing factor (Chor and Manova, 2012). While there has been a bounce back since, it has been uneven across countries, reflecting regional linkages and export composition.

In the face of tightening fiscal and balance-of-payments constraints, developing countries need significant external financial support to mitigate the economic damage from the shock and sustain recovery. However, the response to date has been wholly inadequate (TDR, 2020; UNCTAD, 2021). Emergency packages have fallen well short of the challenges posed by the Covid-19 crisis but have also lacked effective coordination which further dissipates their impact. Moreover, the future trajectory of the global economy remains uncertain. In the absence of appropriate financial support, further liberalization will only heighten existing stresses and inequities facing developing countries.

UNCTAD (TDR, 2020) has laid out a menu of possible options for the international financial system involving the scaling up of liquidity provision (through an appropriate injection of Special Drawing Rights by the IMF) and long-term financing (through grants and concessional lending by the World Bank and increased ODA flows) as well as substantial debt relief. The three regionally based multilateral development banks (MDBs), which have a high equity-to-loan ratio, also have considerable headroom to scale up lending without hurting their triple-A ratings. All these proposals have informed

the discussions in international financial institutions, including the G20, but action to date has been on an insufficient scale.⁴

Some encouragement can be taken from the evolution of Southern financial institutions over the course of the last decade. This has created a rich landscape of regional development banks and liquidity funds, ExIm banks and Sovereign Wealth Funds, which not only show a greater proclivity for counter-cyclical financing but are well positioned to support regional trade arrangements through more effective trade financing, including liquidity provision (Barrowclough and Gottschalk, 2019; UNCTAD, 2019). However, significant new capital injections will be needed, post Covid, if these institutions are to scale up their lending capacity in line with development goals (UNCTAD, 2020). In the interim, the G90 proposal to enable developing countries in balance of payments difficulties to take measures such as quantitative restrictions and tariffs until the emergency has been overcome is an important step.

There is an urgent need for a more regular discussion of the links between trade, finance and development in the relevant UN bodies as well as a reinvigoration of the work in the WTO under the Trade, Debt and Finance Working Group in accordance with its mandate.

b. Vaccine Access

The international community has recognized that nobody will fully recover until everybody recovers, which requires a coordinated, global strategy (Conte et al 2020). To eradicate the virus everywhere, the world needs additional vaccine manufacturing capacity at an affordable price to meet the unprecedented global demand.

COVAX, the vaccine pillar of the World Health Organization's (WHO) Access to COVID-19 Tools (ACT) Accelerator partnership, is aiming to have two billion vaccine doses available by the end of 2021 to vaccinate approximately 20 per cent of the population of every country participating in their facility, with a priority for health personnel. Approximately 1.3 billion of these doses are to be made available to developing countries. But there are several emerging problems with relying only on the COVAX Facility: a severe funding shortage of USD\$22.9 billion (WHO, 2021), an opaque financing mechanism, and ongoing distributional tensions between major economies which prevent doses from reaching their intended beneficiaries. Further, a 20 per cent vaccination rate is not the 60-80 per cent needed to prevent transmission (Bartsch et al., 2020). Some analysts say that with current projections, COVAX looks more likely to deliver closer to a quarter of their ambitions in 2021 (Nature, 2021).

At the same time, developed countries, representing less than one fifth of the global population, have reserved over 50 per cent of expected COVID-19 vaccine supplies through the end of 2021 (Oxfam, 2020). Switzerland - with a population of 8.5 million - has reserved 27.5 million doses (UNICEF, 2021). The US, EU, and UK have delivered more than 50 per cent of total global vaccinations so far despite making up only 10.8 per cent of the global population, while African countries make up only 1.5 per cent of vaccinations so far with 17.2 per cent of global population (Our World in Data 2021). While some vaccine-hoarding countries have offered to donate their excess doses to the facility (*The Telegraph*, 2021), it is unlikely that they will give them up any time soon when they are in the midst of their own vaccination programs and the pandemic continues. Absent a huge shift in funding, the COVAX effort is unlikely to make a dent in vaccination needs and has no approach to increasing vaccine manufacturing.

⁴ The announcement at the Spring IMF meetings of a new \$650bn allocation in SDRs is an important step in the direction but still short of what developing countries need.

So far, the timeline to vaccinate enough people to prevent future transmission is projected to extend over several years – enough time for the virus to grow resistance, mutate and reinfect with a more deadly or contagious strain. Ultimately, humanity will need to make billions of doses of several types of Covid-19 vaccines to have any hope of tackling the pandemic globally. Without drastically increasing production of viable vaccines now, we may find ourselves in a prolonged game of catch-up with the virus, forced to finance the development of more effective vaccines as more strains develop.

One way to ensure the adequate supply and equitable distribution of vaccines, medicines and medical technologies, is to remove some of the artificial barriers created by intellectual property rights in the area of technology transfer and to encourage manufacturers and research groups to work together towards a common goal. That way, multiple manufacturers can start producing viable vaccines simultaneously. A joint proposal by India and South Africa, and supported by the majority of developing countries, urges WTO to grant a time-limited waiver for the specific provisions of the TRIPS Agreement for the prevention, containment and treatment of COVID-19. These specific provisions include patents, industrial designs, copyright and protection of undisclosed information. This waiver will ensure that intellectual property rights do not restrict rapid scaling up of manufacturing and do not hinder an equitable and affordable access to vaccines and treatments throughout the globe.

It is also important that the South opposes the export ban on certain products which are used as raw materials in production of vaccines. Recently, the US government has invoked the Defense Production Act causing difficulties for vaccine producers in developing countries in importing from the US products – such as cell culture medias, raw material, single-use tubing assemblies and some specialty chemicals from the US – which are needed to manufacture Covid-19 vaccines. Such vaccine nationalism will hinder faster recovery of developing countries from the crisis.

6.2 Recovering better

Active government policies for recovering faster are not only important for emerging from the crisis but are also needed for building resilience going forward (Mazuccato, 2021). However, it is essential that the rules of the trading system do not obstruct those efforts.

As discussed above, macroeconomic trends and the reality of trade negotiations indicated that calls to ‘reglobalize’ are the wrong approach to building resilience, particularly in developing countries. What is needed now is an enhanced role of the state in terms of employment, social protection and climate action for a better recovery than the one that followed the last global crisis. Increased public investment, minimum wages reflecting living costs, stronger collective bargaining institutions and universal comprehensive social protection are needed at the same time as rapid decarbonization. But this will not happen unless better multilateral governance promotes and coordinates a global programme of redistribution and recovery.

The new administration in the United States has insisted that its trade policy will not be pursued independently of its commitment to build a stronger industrial base or ignore the employment and environmental impacts of international trade.⁵ Meanwhile, the European Union has signalled the intention to put in place a new industrial strategy that would increase state powers to scrutinize and potentially block takeover bids in strategic

⁵ See “In Washington, ‘Free Trade’ Is No Longer Gospel”, New York Times, March 17, 2021; Rana Farooqar “Why manufacturing matters to economic superpowers”, Financial Times, April 12.

sectors of the economy. The South also needs to protect its vulnerable communities, industries and firms from excessive foreign competition in order to speed its recovery and build a more diversified economy which is a prerequisite for resilience to future shocks. In all cases, the shift in emphasis implies a move away from free trade to strategic integration.

a. WTO Peace Clause for Emergency Response

Not only do the developing countries need to recover faster, they have to recover better by correcting the bias in the current trading system in favour of large firms and their collection of monopoly rents. This will require effective measures against the use of restrictive business practices along the lines advocated by UNCTAD in the 1980s but it will also require that countries can provide substantial financial as well as non-financial support to their small and medium-size firms. However, the WTO Agreement of Subsidies and Countervailing Measures (ASCM) restricts developing countries' freedom to extend industrial subsidies curtailing the policy space they need to revive their manufacturing sector.

UNCTAD has proposed the introduction of a "Peace Clause" in the ASCM which will suspend restrictions on policy space during peacetime economic emergencies, such as the Covid-19 pandemic and its fallout, allowing State support of small and medium enterprises in export-oriented sectors (TDR, 2020). A temporary WTO Peace Clause would enable use of industrial subsidies for reviving industrial and trade growth in the South and would also enable countries to overcome barriers related to intellectual property and data ownership.

A permanent exclusion of all proceedings and actions against government measures implemented in the context of Covid-19 is also required in all relevant fora to help create the necessary policy space for recovery. An immediate moratorium on ISDS cases by international corporations against governments based on cross-border investment treaties is also needed, alongside a longer-term approach to ensuring investment protection measures in BITs and FTAs do not undermine or hold back broader public interest policies such as necessary labour regulation and climate action (TDR, 2015).

b. Building Resilient Health

The unprecedented challenges posed by COVID-19 are also opening an important window of opportunity for a *South-South cooperation initiative in health, health research and related areas* that can help build resilience to future pandemics (UNCTAD 2020). Developing countries should urgently develop a regional response strategy for the current as well as future health emergencies by strengthening regional value chains and intra-regional trade and investments in health and health related areas.

Epidemics are a powerful reminder of the value of medical and scientific research. Medicines and medical discoveries which are instrumental to preservation of human life need to be shared universally, and more readily with the most vulnerable countries and communities. This highlights the importance of *supporting the TRIPS waiver in the WTO as well as making the TRIPS moratorium* ("TRIPS Non-Violation and Situation Complaints" -WT/MIN (13)/31) *permanent*, prohibiting non-violation complaints on IP rights (Article 64.2 of the TRIPS Agreement).⁶

⁶ "Non-violation" complaints refer to cases where a WTO member believes that the actions of another member deprived it of an expected benefit, even if no WTO agreement was violated.

Within a regional health initiative, *collective R&D efforts in medical research* should have priority. They should involve undertaking collaborative research, sharing results, methodologies and testing best practices that can prepare countries in the South to fight pandemics. It should also aim at viral strain identification and creation of the basis to build further medical and vaccine research. Emerging economies with more advanced medical research capabilities, as India, could take the lead and make a strong call for common action and resource pooling. Enhancing manufacturing capacities of vaccines in as many developing countries as possible can be an important way forward in protecting against future pandemics.

Another line of action involves *strengthening regional health-related value chains and other public interest products and services*. As the events of the past year are indicating, self-sufficiency in medical equipment, health-related and other public interest products is critical. Very few developing economies currently have the capacity to lead on these value chains and operate the most complex activities. Regional pooling of resources, financial as well as human, can facilitate the development of complete value chains at the regional level for guaranteed provision of needed products and equipment, especially in cases of emergency. *Regional Emergency Funds* could be established to provide countries with financial resources in times of crisis.

Regional trade pacts can be used to prevent export bans on key products in times of global and regional shortages, as is the case in the ongoing health emergency. According to the Global Trade Alert, as of 21 March 2021, 54 governments had introduced export curbs on key medical supplies since the beginning of the year. The new EU export controls on medical items such as gloves and protective garments, for example, can create significant disruptions in many economies in the South. Further, the export ban by the US on products which are used as raw materials by the vaccine manufacturers can hinder production in the developing world. Regional trade pacts among developing countries for emergencies with complementary production structures may serve as a cushion and guarantee uninterrupted access to key products, such as medical supplies.

It is therefore critical that WTO members agree to a mechanism under the TRIPS Agreement to prepare for future pandemics with a framework to be agreed by MC12. Such a framework should ensure a ready to trigger mechanism that will foster sharing of technologies, know-how and patents in times of global emergencies.

c. Achieving Food Security

Food supply independence is another source of resilience. Most developing countries are well placed to develop regional collaboration in agricultural value chains as their economies present significant complementarities in this respect but rents, transport costs and coordination problems often prevent the development of these chains. This underscores the need for developing countries to work together to improve regional coordination in food production and distribution.

There is an inherent asymmetry in WTO's Agreement on Agriculture whereby developed countries such as the US provide vouchers to eligible people, in the order of \$90bn in 2020, to purchase food at market prices. On the other hand, developing countries, being cash-strapped, must build stocks of food products and subsequently release them at administered prices to the target population. But stockpiling too is subjected to restrictions, which are being challenged at the WTO.

With food security being high on the priority list in many poor developing countries, efforts to revive agricultural reform processes at the WTO should prioritize a substantial reduction in the massive levels of trade distorting domestic support in developed countries as a prerequisite for further discussions on tariff liberalization. In the Doha Ministerial Declaration in November 2001, ministers had agreed for the developing countries to effectively take account of their development needs which would require rules and disciplines in food security. In this context, the G33 group proposed that acquisition of stocks of foodstuffs by developing countries, with the objective of supporting vulnerable producers would not be accounted for in the Amber Box subsidies. This would provide a necessary instrument for developing countries to meet their food security needs.

With the threat of food shortages and rising levels of hunger caused by the Covid-19 crisis, the survival of billions of people also requires strong public distribution systems. Expanding policy space and South-South coordination could ensure the flexibility needed by countries in procuring and distributing food, especially at times of crisis. Developing countries are allowed to use various measures that fit into the developmental category to encourage agricultural and rural development under Article 6.2. These include investment subsidies, agricultural input subsidies generally available to low-income or resource-poor producers and domestic support to producers to encourage crop diversification. This support to development of agriculture needs to be preserved in any discussion on disciplines of domestic support.

d. Building environmental resilience

Although there is currently no explicit linkage between trade and climate change under the WTO agreements, nor is climate change a part of the WTO's work programme, sustainable development and protection and preservation of the environment are two of the basic objectives set out in the Marrakesh Agreement establishing the WTO. The Committee on Trade and Environment is the standing forum for dialogue between Members on the interaction of trade environment policies. With a shrinking timeline to stabilize the climate at the same time as advancing the SDGs, it is crucial that all countries find ways to discipline trade and investment in the pursuit of these higher ambitions without undermining other development goals. The coherence between SDT and the UNFCCC principle of 'common but differentiated responsibilities' offers a starting point for understanding a development-sensitive approach to the trade-climate nexus.

In the past, integration of climate concerns in trade has led to adding non-binding environment chapters to trade agreements. Occasionally, these have enshrined the advantage of wealthy countries with adequate fiscal space and strong regulatory frameworks already in place. With the stock of atmospheric emissions largely resulting from 150 years of their carbon-intensive economic growth, developed countries have the largest responsibility in reducing it. Although emissions per capita in the developed world are declining, the levels continue to far outstrip emissions from the developing world. As an example, per capita CO₂ emissions in the US (16 tonnes) are more than seven times that of Indonesia (2.28 tonnes), and about 230 times that of Chad (0.07 tonnes) (Our World in Data 2021). Historically, the US has contributed 25 per cent of the global carbon dioxide stock. With the exclusion of China (22.3%), that is more than Asia, Africa and Latin America (Our World in Data 2021). Higher individual incomes are linked to higher emissions, with the richest 10 per cent of people in the world generating around half of all emissions, and the poorest 50 per cent of the world conversely responsible for only 10 per cent (Oxfam 2020). These numbers should not be a reason for inaction in the South but highlight the responsibility of wealthier economies to cut and offset their

emissions and use the prosperity they have achieved through carbon-intensive industrialization and colonialism to ensure a safe future for all.

While in per capita terms developing countries' emissions remain well below those of advanced countries, their total economic output is currently more carbon-intensive than developed countries' (TDR, 2019: 3). But in a world where value chains are global, and even more in a hyperglobalized world, developed countries' relative energy efficiency is not independent of developing countries' relative inefficiency. Decades of outsourcing and financial liberalization have led to a massive transfer of production activities to the South and a concentration of financial and intangible assets in the North. As a result, income from energy efficient corporate activities in the North is generated through carbon-intensive production activities in the South (Schröder and Storm, 2020). Thus, any discussions on responsibilities for emission reduction of developed and developing countries must take into account emissions embedded in international trade. In order to sustainably industrialize, developing countries must invest in the necessary technology which is, predominantly, held and protected, by corporations in the North. This must be made accessible and financed through a multilateral arrangement that reflects the commitment to "shared responsibility".

A limited Climate Waiver of WTO trade and investment rules combined with preferential space and financing for developing countries could be a first start. A narrowly defined waiver would give countries the assurance they need that they will not face disputes for climate and development-friendly initiatives such as prioritizing a transition to renewable energy, green procurement, and green jobs programmes. The ambition should be for developing countries to leapfrog carbon-intensive industrialization and for advanced economies to sustainably accelerate their transition to renewable energy use. Depending on its design, such a Waiver could also help to tackle the policy chill resulting from mechanisms such as ISDS which serve to disproportionately expand the rights of investors over the public policy-making process, often at the expense of climate and development-friendly initiatives.

At the moment, initiatives linking trade and climate are not development-sensitive and tend to be market-led approaches to nudge consumption emissions lower, thus lacking a real strategy to keep warming below 1.5C. The acceleration of negotiations on reducing tariffs on 'Environmental Goods and Services' and the related programme on reducing plastics have the potential to distract from the required bolder action while damaging producers in the South. High-emitting plastic supply chains are key industries in the Global South, which stand to lose most from the necessary consumption shift away from these products, as is the objective of the higher tariff barriers, without a considered transition. Further, there is reason to be suspicious of the green credentials of the list of 'environmental goods and services' which includes incinerators and steam generators that are used in carbon energy generation, and public utilities such as waste disposal that would be consequently liberalized. Liberalizing these services could in fact accelerate environmental and climate destruction. For example, the companies overseeing England and Wales' liberalized water system were responsible for 3000 overflows of raw sewage into the sea in 2020 alone (*Financial Times*, 2020).

Given this, promoting emerging circular economy technologies and lower tariffs for green goods without expanded support for the South will disproportionately benefit industrialized economies who have the resources to innovate and subsidize such industries. Further, this ignores the reality that much of the Global South has long been engaged in the business of sufficiency and eliminating the wasteful use of resources and that even the highest emitters such as India and Brazil have nowhere near the per capita emissions of developed countries. These initiatives only deepen North-South

asymmetries if they do not simultaneously tackle the imbalances facing Southern WTO members and reduce high-emitting overconsumption in advanced economies.

Intellectual property rules as they are currently conceived are another hurdle to advancing climate action globally. The TRIPS Agreement and TRIPS+ measures make the green technological upgrading that must accompany any climate-friendly industrialization difficult and need to be urgently reformed to recognize key technologies as public goods. The current strict regime can negatively impact the green transition by discouraging new R&D and keeping patented technology prohibitively expensive. Removing such restrictions is vital for Southern countries to be able to benefit from low-emissions technology and indeed to develop their own green technologies, products and services. The international community should support initiatives to transform intellectual property rules, such as a WTO Ministerial Declaration on TRIPS and Climate Change, in order to expand TRIPS flexibilities for Southern countries in relation to climate-related goods and services. Other initiatives could support this agenda, for example open-sourcing key green technologies as global public goods, South-South cooperation on low-emission research and design, and green investment strategies that include technology transfer.

Recently, a discussion has begun in the EU and in the US on Border Carbon Adjustment (BCA), which would essentially impose a tariff on carbon embedded in imports. There is an ongoing debate on the specific contours of such a new tariff regime – how it would be calculated and how it would comply with WTO rules. What must not happen is that such an issue is taken out of the multilateral rules-based system and decided between a small group of developed economies, undermining the trust of Southern WTO members who stand to be most impacted, as was the case with the Joint Statement Initiative pertaining to digital trade. Moreover, any such measures must be sensitive to the historic reasons why developing countries have been locked into carbon-intensive and extractive industrialization. Reforming the WTO to advance climate commitments must be a multilateral effort to have any chance of success, which for developing countries, will require a coherent framework for expanding SDT to enable climate action.

If such a negotiation on carbon tariffs does proceed, it would best serve the interests of development and climate commitments by building in a redistributive mechanism that redirects new tariff revenue to ringfenced financing for green transitions in developing countries. Any requirement on governments in the Global South must be contingent on the more effective policies of green technology transfers and new sources of financing to avoid a catastrophic impact on development initiatives. Incentive-based approaches should also be considered, for example optional preference schemes that provide ringfenced climate financing additional to ODA. Considering the fiscal pressures facing many developing countries, such an approach – expanded policy space, green technology transfers, and additional sources of financing – is a more coherent package to keep warming below 1.5C than simply reducing tariffs on an arbitrary collection of goods and services.

6.3 Promoting Structural transformation

a. Revisiting the industrial and trade policy nexus to level the playing field

The profits of big tech firms and financial giants have multiplied manifolds during the pandemic, while scores of SMEs have been forced out of business. While massive financial subsidies are being rolled out in the North to sustain its businesses, developing countries, who cannot afford comparable bailouts, will need to revive strategic trade and industrial policies to manage the stresses resulting from the pandemic and its aftermath.

This will mean a rethink of the restrictions on policy space that have accumulated over recent decades through the aggressive agenda of ‘deep’ integration.

Furthermore, to revive their domestic production and trade, levelling the playing field for their SMEs has become a crucial policy objective for the developing countries post pandemic. SMEs constitute a large proportion of firms in developing countries, exceeding 90% in many cases⁷. Of these, many have shut down during the pandemic, especially those lacking digital connectivity and skills. The policy instruments which can help levelling the playing field include concessional financial support for digital upgrading, along with qualified tariff protection.

The importance of providing subsidies as an additional support for industrial recovery during a crisis has been widely recognized. Industrial subsidies – including financial support to specific industries, tax credits, rent rebates to small and medium enterprises, export subsidies and debt forgiveness – are important policy instruments which will be needed by developing countries to provide additional support to their domestic producers during and post pandemic. These subsidies can enable the rebuilding and upgrading of labour-intensive and export-oriented industries, such as textiles and clothing, which have been hit hard in the South.

Apart from industrial subsidies, tariffs are one of the most effective tools in the hands of the governments in the South for generating revenues, regulating the imports of luxury items (which compete with critical productive inputs and other goods for foreign exchange) and providing a level playing field to their domestic small producers. There is a need for developing countries to reassess their existing agricultural and industrial tariffs to help mitigate the damage from the crisis and build domestic capacity. Moreover, recent suggestions to address over-capacity in some industrial sectors need to be treated with great caution in order to avoid further closing off the policy space needed by developing countries for their industrialization.

Promoting innovation is vital for industrialization and all the more so given the threat of climate breakdown. Encouraging and widening access to innovation may require a review of the balance between rules on IPR protection and technology transfer. This matter could be part of the discussion on WTO reform as part of the broader effort at structural reform, economic recovery and fostering more equitable growth and development across the world. Principles on technology transfer along with supportive multilateral mechanisms were part of previous efforts in UNCTAD to develop a Code of Conduct on Technology Transfer. Revisiting those initiatives would seem timely as we enter a new technological era with the potential to widen inequities across the global economy.

b. Building Southern-led Global Value Chains

Covid-19 may reshape existing global value chains. The announced desire of the European Union to achieve “strategic autonomy” is indicative of a wider move to forge

⁷ There are different criteria used to define small and medium sized enterprises (SMEs) in different countries. The most common criteria to define SMEs include the size of capital investments and number of people employed. However, based on this criterion, there are huge differences in firms categorized as SMEs in developing countries as compared to the developed world. The European Commission defines SMEs as those enterprises employing less than 250 persons that have a turnover of less than 50 million euros and/or a balance sheet total of less than 43 million euros, while in developing countries SMEs are defined as those employing less than 100 workers (ITC 2018).

new supply relations in the North to strengthen local resilience. Furthermore, automation and digitalization will in all likelihood assist the developed countries in this regard. In this uncertain landscape, developing countries will need to re-engineer their existing production and distribution systems to strengthen local resilience and their own 'strategic autonomy'. This will be ever more challenging if the recovery from the crisis in developing countries diverges from that in advanced countries.

In the face of falling exports, increasing domestic consumption using expansionary policies to boost domestic demand will be urgently required by developing countries and will work hand-in-hand with expanded space for industrial strategies. However, given the constraints that many, particularly smaller economies in the South face, regional integration, and more generally South-South trade, can be an important complement to domestic-demand-led growth strategies providing new markets, encouraging complementary investment flows and technological upgrading and, with appropriate financial arrangements, reducing pressure on the balance of payments (TDR, 2014). As such, strengthening intra-regional trade and regional value chains for diversifying export markets needs to be prioritized in the South.

c. Promoting Trade in Services via Mode 4

International trade in services, especially via Mode 4 (temporary movement of people as service suppliers) has huge potential to contribute to economic growth in developing countries. Not only will it generate additional remittances, it will also facilitate technology transfers along with skill upgrading. However, this mode of supply of services has been restricted, while trade in services via Mode 1 has been promoted. Severe shortage of medical and health care personnel in the developed world during the pandemic is an evidence of the adverse impact of restricted global trade in services via Mode 4. But it is the trade in services used in e-commerce which are being promoted (Banga, 2021). Kozul-Wright and Banga (2020) estimate net exports via Mode 1 for 200 countries using WTO-TIMOS dataset and finds that most of the developing countries are net importers of these services (Banga 2020). To encourage trade in services via Mode 4 it will be important for developing countries to show solidarity in the WTO and promote effective regulation building their competitiveness in trade in services via Mode1.

d. Bridging the Digital Divide

Covid-19 has boosted electronic commerce, both in developed and developing countries, making it necessary to examine its developmental impact. Only 35 per cent of the population in developing countries and 19 per cent in LDCs have internet access as compared to 87 per cent in the developed world (ITU, 2019). As a result, many countries were not even able to provide basic information on combating Covid-19 where it was most needed.

Given the existing digital divide, which is exacerbating global inequalities especially in the times of Covid-19, it is important for WTO members to ensure that global e-commerce delivers inclusive development. The growing digital monopolies and concentration of rents in the hands of few digital platforms, which pay little taxes to the governments of countries where they operate, make it urgent for developing countries to agree to tax these digital platforms and ensure that their products sold via e-commerce also face customs duties to level the playing field with the exporters of physical products. The WTO e-commerce moratorium which has continued since 1998 provides a special and differential treatment for the big digital platforms which do not face customs duties for their exports. The removal of WTO E-Commerce moratorium will ensure that the exporters of physical products from developing countries are not outcompeted by the

exporters of electronic transmissions which are mainly from developed countries (Kozul-Wright and Banga, 2020).

Intellectual property has also become an increasingly important tool of rent extraction, particularly from developing countries, leading to huge financial drain. There has been an historic rise in digital patents in Industry 4.0, especially in digital technologies such as robots, artificial intelligence and 3D printing. The European Patent Office reported that for the first time in more than a decade, digital technologies took the lead in patent applications filed with a rise of 20 per cent patents filed in digital communications and 10 per cent rise in patents filed in computer technology (EPO, 2020). A handful of countries, mostly developed countries, have a dominant share of filed digital patents, while the share of developing countries and LDCs together is minuscule. Patents limit the extent of technology transfers making them extremely expensive without contributing to innovation (Stiglitz, 2014; Baker et al., 2017). Rising digital patents become a constant source of drain on financial resources of developing countries in their process of bridging the digital divide.

The above discussed challenges highlight that the gains from the growing global e-commerce will not be automatic for developing countries. This will require strategic interventions at all levels, including at the national and international levels. Policy and fiscal space will be required by the developing world to rebuild their economies and revive their declining trade competitiveness and falling exports. This is more important than ever considering the potential for a more balanced digital trading system to support decarbonization.

e. Re-invigorating the Work Program on E-Commerce

Under the Work Program on E-Commerce, which was established in 1998, members had decided to examine all trade-related issues relating to global electronic commerce, considering the economic, financial, and development needs of developing countries. The Committee on Trade and Development was specifically tasked to report on the development implications of electronic commerce, including in relation to SMEs; challenges to and ways of enhancing the participation of developing countries in electronic commerce; financial implications for developing countries; assess possible impact on the traditional means of distribution of physical goods and the role of improved access to infrastructure and transfer of technology.

However, to date no comprehensive assessment of developmental impacts of global e-commerce focusing on exports and export-oriented development of developing countries has been undertaken. Instead, a group of countries under the Joint Statement Initiative have started negotiations among themselves on e-commerce rules undermining and fracturing the multilateral track instituted under the WTO.

Instead of focusing on how to deliver gains from growing global e-commerce to developing countries and building their digital capacities to increasing their exports, as mandated by the DDA, some countries are negotiating digital rules under Joint Initiative Statement on E-Commerce. Not only will these digital rules, if agreed, have high cost of compliance for the developing countries but will severely restrict their digital policy space (Banga 2021). More importantly, this plurilateral initiative is fracturing the multilateral process and diverting attention from the E-Commerce work program instituted within the WTO.

The e-commerce work program needs to be reinvigorated by focusing on building awareness of the members on the development implications of growing global e-commerce and the ways of increasing the export competitiveness of their SMEs.

Further, strategic and selective trade integration in the digital era will depend to a large extent on the digital capabilities of developing countries. Given the growing digital divide, there is an urgent need for developing countries to pool human and financial resources at the regional level to build their digital infrastructure and skills. UNCTAD (2018) has proposed a ten-point South-South digital cooperation agenda which can be implemented at the regional level for boosting industrialization and integration among countries in the South. This agenda includes south-south cooperation on a data economy; building cloud computing infrastructure; strengthening broadband infrastructure; promoting e-commerce in the region; promoting regional digital payments; progressing on single digital markets in the region; sharing experiences on e-government; forging partnerships for building smart cities; promoting digital innovations and technologies; and building statistics for measuring digitization.

7. Regaining trust: Fulfilling the objectives of Marrakesh Agreement

To recover quickly and build resilience, industrial and trade policies will have to complement macroeconomic efforts, simultaneously targeting employment generation, wage growth, strengthened public services and decarbonization. The COVID-19 crisis has revealed the vulnerability created by the over-concentration of productive capacity in strategic health products in too few locations and too few corporations. Similar patterns are evident in other products and technologies, including those shaping the future such as "green technologies" and products and processes associated with the fourth industrial revolution. A key lesson is to reduce vulnerability with more inclusivity, solidarity and building regional resilience with greater diversification of production processes.

The confluence of an economic, health and climate crisis offers the context to revive multilateralism in a way that reasserts the importance of these goals and recovers the deficit in trust that has hampered its effectiveness over recent decades. For this, both developed and developing countries will need adequate policy space in the existing trade and investment agreements tuned to their existing conditions.

Given the serious tensions hampering the workings of the international trading system, now is an ideal time to establish an independent commission to examine whether the WTO's 25 year negotiating record has fulfilled the principles of the Marrakesh Agreement. The preamble to this agreement, which laid the basis for the WTO's creation in 1995, bears the unmistakable signs of a pact as yet unfulfilled. It speaks of "ensuring full employment", and the importance of "sustainable development" consistent with different levels of development. It is time to reflect on why the world has not lived up to those ideals and revive their quest in the common interest. Trust will likely be further eroded if moves away from multilateralism in the WTO by changing current rules deepen fragmentation in the trading system. Doing so will have a further chilling effect on international cooperation more generally in support of global public goods and the global commons.

The WTO reforms should aim at restoring the trust in the trading system with a commitment to special and differential treatment as a prerequisite for ensuring a fair outcome. Moving forward, concluding the Doha Round and delivering on the Doha Development Agenda in the WTO can help build trust.

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