The Trade Policy Context

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Trading opportunities and the economic and policy changes that affect them have acquired greater importance in development strategies in recent years. This is not principally because of the growing share of trade in world output: that share has always been high for many developing countries. It is partly because of the change in development models, towards a focus on markets rather than governments to determine patterns of growth and development. But it is also because many of the countries which are still poor and seeking the first steps towards development are small, and therefore particularly dependent on external markets rather than domestic demand. Thus it is increasingly necessary for producers to understand external markets and how they are changing.

At the national policy level, there is increased awareness on the part of governments in many developing countries (including Ghana, South Africa, Bangladesh and India) of the importance of trade policy. They no longer simply accept special, preferential access from developed countries; they are trying to change policy through participation in the WTO and also in regional arrangements, both among developing countries and with developed countries. A similar awareness of the impact of trade policy is increasingly necessary for producers.

Although India and South Africa have substantial domestic markets, four of the case studies in this book are from countries where domestic demand is too low to support a national market-based strategy (Bangladesh, Ghana, Mozambique and Samoa). Two of the initiatives are clear responses to changed trading opportunities: call centres in India are a response to the technological and organizational changes which allow the supply of services at a distance; and the growth of garment manufacture in Bangladesh is a response to policies which have given it an advantage in developed country markets. Two others are examples of long-established exports – cocoa from Ghana and fruit from South Africa. But Ghanaian cocoa producers have attempted to find a new place in the market, based on fair trade, so that also is a response to change. The examples of cashew, in Mozambique, and coconut, in Samoa, are different in that they are more 'supply-driven'; here the initiatives stem from national or group objectives – the entrepreneurs appear to have looked at the markets only after they had decided on what to produce.[1] If they now find that they face disadvantages of cost and scale (as in coconut), this is a risky strategy.

The trading system continues to present barriers to producers in developing countries. The clearest example of this in this book is the protection of dairy and sugar products which deters Ghanaian cocoa producers from moving directly into production of chocolate; but call centres and fruit producers also fear protection. The examples of cocoa production and garment manufacture show how some producers react to obstacles. While the cocoa producers have found ways to get around the protection (by taking a share of a company producing chocolate within Europe), the garment producers have exploited the protection against other countries. They are now aware of the threat from the ending of the Multifibre Arrangement which gave them that opportunity, and some producers in Bangladesh are actively planning for the changed environment. Both past and current strategies have been encouraged by government policy. Policies other than those on trade can also be an obstacle to producers. The high dependence of Samoa on aid and remittances, which is noted in the case study, suggests that any exports will face difficulties as these inflows of funds cause Samoa's exchange rate to be high and its exports to be less competitive. The cashew processors' activities in Mozambique are constrained by high interest rates.

This chapter will attempt to look at how the current situation and policy environment are likely to change and how this could affect the initiatives described in this book, as well as other potential exporters in developing countries. It will examine both the direct effects which policy changes may have on these products and the indirect effects, which may alter the relative advantages of different types of export.

1 New Economic Opportunities by Sector

That the demand for traditional commodities grows slowly, and that therefore their prices are likely to be depressed, has been well known in development analysis for over half a century. The conventional advice is that countries should diversify away from traditional exports of raw commodities like cocoa, coconuts or cashews. One strand of advice suggests moving into 'value-added' products based on these, as some of the producers who are the subject of this book have done, with fair trade cocoa, coconut oil products and processed cashew nuts; but the strategy which has been followed by many successful countries has been to move into new goods based on a reassessment of countries' comparative advantages. For many of the Asian countries, this meant moving into labour-intensive sectors, whether processing goods, as in the ready-made garment industry in Bangladesh, or supplying services, as in Indian call centres. In the 1980s, a third form of diversification, into new horticultural goods like South African fruit, was suggested, but this has never been more than a small part of countries' strategies.

Traditional commodities

While the negative forces, relatively slowly growing demand and increasing efficiency of production, often by new suppliers, continue to depress long-term expectations for the prices of traditional commodities, there are occasional reversals. In the past, these have been because of wars or exceptional growth periods in developed countries; a new factor is emerging at present – the emergence of China as a major importer. For many commodities, China has little production of its own. Its rapid growth has required massive imports, leading to significant shifts in the direction of trade and in world commodity prices. In the first quarter of 2004, the index of all non-fuel commodity prices was 25 per cent above its 2001 level, and for the two basic commodities represented here, cocoa and coconut oil, prices in the first quarter of 2004 were almost 50 per cent and 100 per cent higher than in 2001. These peaks need to be kept in perspective. The price of cocoa was 30 per cent lower in 2000 than in 1990, and the price of coconut oil and the average price for all commodities are still below their 1995 levels. As past experience suggests that it is only a rapid increase in demand, not continuing high demand, that raises commodity prices above their trend path, even if China continues to grow, a levelling off would be expected and any deceleration would lead to price falls. Nevertheless, this recent reminder that prices can go up as well as down indicates that value-added commodity products will not always have a strong advantage over traditional commodities.

Agricultural commodity prices may also perform better than trend over the next few years if there is reform of the highly protected regimes in the EU, Japan and the US. A combination of high barriers to imports and subsidies that hold their own domestic production well above economic levels have kept world demand for agricultural commodities from the rest of the world below its market level. This has depressed prices. The estimates that have been made of the effect of US and EU subsidies on cotton prices suggest that they could be 20 per cent higher in the absence of subsidies (Gillson *et al.*, 2004). A change in agricultural policy would not affect tropical commodities like cocoa and coconut oil directly, but in some developing countries it might lead to a shift back to the commodities that are now subsidized. Like the effect of Chinese demand, this modifies, rather than reverses, the rule that 'commodity prices fall'. The combination of these two forces, however, suggests that the arguments for shifting away from traditional commodities will become weaker in the current decade.

The cocoa production described in the chapter on Ghana is principally for traditional export, and this part of the output may therefore gain. Although the price guarantees and any premium on the price received because of the fair trade element may appear small by comparison, they are nevertheless very important for the farmers involved. In the longer term, the question that needs to be asked is whether the demand for fair trade cocoa will expand sufficiently rapidly (or whether the producers of fair trade products can market the concept to make the demand expand sufficiently rapidly) to counter the trend fall in basic commodity prices. For coconut oil, the same question must be asked about the demand for organic products, but the Samoan producers are perhaps less likely to gain from any uplift in prices because of their small-scale and weaker market power (in contrast, the cocoa study notes the way that Ghana has used its market position).

New or non-traditional commodities

Pineapple and prawns in the 1980s, and flowers and fruit in the 1990s, have seemed to offer the best of both worlds: high prices, because unlike traditional commodities they have a high income elasticity, and an easy transition for farmers who need to move out of commodities. The first caveat to these examples is that in no country are they a large-scale export. (In Kenya, where flowers and fruit have been frequently studied, they are around 5 per cent of exports.) Second, most of them can be, and now are, produced in a number of countries, so that while their prices may fall less rapidly than those of commodities for which demand is rising slowly, they still fall. And finally, as will be discussed below (and as is noted in the chapter on South African fruit), there are increasingly onerous barriers in the form of both government and private sector standards. As with any demand-driven and competing product, producers must continually innovate in the product and constantly reduce costs to meet new competition.

Processing traditional commodities

Whether this is a sensible route towards diversification depends partly on the relative cost of transport of the raw and processed goods. For a few commodities and countries, the choice may also be made for industrialization policy reasons: if processing offers access to technological or organizational learning that will have significant effects on a country's economic development. But in most cases, the choice depends mainly on whether a country which has the conditions that give it a comparative advantage in production also has these for processing. For many commodities, the conditions are very different, so that Bangladesh, for example, like many other developing countries, processes its garments using imported textiles. Although it produces some fibres, the intermediate stage of producing textiles is highly capital and technology intensive, so it specializes in the labour-intensive stages of growing cotton and making clothes. Changing ways of organizing production, such as the satellite production discussed in the study on Mozambique, can create the conditions for successful processing, and the growing experience of different ways of subcontracting production may offer increasing opportunities of this type.

The example of the Kuapa Kokoo Cooperative from Ghana taking a direct share in a chocolate production company in its European market is another case where changing organization increases the opportunities for a developing country to process its raw materials. The high barriers to milk and sugar, and therefore to chocolate which contains them, have deterred the processing of cocoa in developing countries, but by locating the processing within Europe, Kuapa Kokoo has overcome this barrier (and probably also reduced its vulnerability to unreasonable EU food standards).[2] This provides income to Ghana through profits rather than wages, but this income can also be used to increase employment. It is likely that innovations and improvements in how firms can organize their production at a distance will increase these opportunities, but producers should never assume that processing is the logical step.

Manufacturing

This is the traditional route to increased income and development, and the growth in demand for basic goods such as the apparel produced in Bangladesh, combined with increased awareness by developed country importers of the significant labour cost advantages of producing in developing countries, has led to large shifts of some products and some stages of production from developed to developing countries. The study of Bangladesh illustrates both the opportunities and the limitations of this pattern. The shift has increased the number of workers, including many women, who receive wage incomes, but the constraints caused by production conditions in Bangladesh has made it difficult to find opportunities to move to more value-added products. This type of opportunity is likely to continue to be available in new areas of production, as well as in those where it is already strong, but it requires countries (or entrepreneurs within them) to identify new opportunities that are often unrelated to its commodity resources (Bangladesh makes apparel from East Asian fabric, not its own cotton or jute; Malaysia processes integrated circuits, not rubber). These activities are, therefore, the opposite of the Samoan or South African examples, where existing products are being used.

Services

Although the share of services in world trade has not yet risen as strongly as it has in most national economies, they are an important export for developing countries, and this share is likely to rise faster in the future for the same reasons as it has nationally – demand for services increases faster than income. Tourism, for example, now has a higher share of world trade than cars or oil, and it is particularly important for many small and poor countries. The high labour intensity of most services makes them obvious sectors for India to exploit. The fall in the cost of communications and electronic technology which has permitted the emergence of call centres as an 'export opportunity' may not continue at its recent rate, but most types of company and service product have not yet adopted the technologies now available, so that this is likely to remain a major area of growing opportunities. Although, as with the transfer of jobs in manufacturing to developing countries, the initial organization is centralized, the same potential to reorganize and decentralize could allow these opportunities also to go to smaller groups and countries.

2 Changing Trade Policies

Until the 1970s, most developing countries did not actively promote their exports through international trade policy. Their traditional products normally faced low, if any, tariffs or barriers, except for a few such as dairy products and sugar, which faced apparently immutable barriers. Their new products usually faced low barriers in their principal markets because of preferences offered by developed countries to their traditional suppliers (extended to more countries by the Generalised System of Preferences in the 1970s); services were not yet on the horizon. Of the products described here, only fruit and coconut oil appear to face some tariff barriers. In the 1960s, countries which had active trade policies to promote development were more likely to be promoting production for domestic consumption by controlling imports than following an export-led policy.

The change in approach towards export strategies, combined with a reversal in the early 1970s of the generally liberalizing approach of developed countries, which increased protection in clothing and other manufactures where developing countries were starting to be successful, led to a change to a more active trade policy: first in the largest or most successful exporters (India and Bangladesh among those described here, followed by South Africa in the 1990s when it ceased to be under sanctions), and then in the others (Ghana and Mozambique in the last four to five years). Both governments and producers now not only are more interested in knowing how other countries' policies will affect them, but try to alter policies through multilateral and regional agreements. The study of Bangladesh notes that the shift to garment production came about because of policy changes in other countries (the quotas imposed by developed countries on other producers) and in Bangladesh (trade liberalization), as well as changes in technology.

Multilateral policy

The growing influence of developing countries in the WTO has already had an impact on some of the exports discussed here. In the Uruguay Round of negotiations, which concluded in 1994, it was agreed that the system of quotas for exports from the most efficient developing country producers of garments and textiles, the Multifibre Arrangement, would be ended, but with a ten-year adjustment period. This reflected the interests of the stronger producers, including India and the East Asian countries; the slow phase-out was a concession to the interests of those countries which, like Bangladesh, had benefited from not facing quotas. Developing countries also then began the process of bringing agriculture under multilateral disciplines; it seems increasingly possible, if not yet likely, that they will secure further reforms in a renewed Doha Round. These would, as discussed above, increase the share of developing countries in world trade in the currently restricted products, and increase the returns which they obtain. This could affect the products analyzed here by providing alternative opportunities.

Preferential arrangements

In the 1990s, developed countries appeared to be moving away from offering preferential treatment to imports from developing countries. They started to negotiate reciprocal trading arrangements (for example NAFTA and the EU Agreement with South Africa), and the Uruguay Round WTO settlement offered little in new special treatment for developing countries. Since then, however, preferences have come back into fashion. The EU allows all imports from least developed countries (LDCs), including Bangladesh, Mozambique and Samoa, without tariff or quota barriers (sugar, rice and bananas have transition periods). Until at least 2008, it also has virtually no restrictions (except on sugar, rice and bananas which are the sensitive agricultural products) on imports from the ACP countries, which include Ghana, Mozambique and Samoa). The US has offered new opportunities to most African countries under the African Growth and Opportunity Act – with exclusions for countries judged not to be acceptable on human rights grounds. The most striking increases have been in clothing, particularly in the small low-income countries, because the US has allowed these to continue to use imported fabric. Other developing countries such as India, together with East Asia and much of Latin America, face varying barriers in their export markets. South Africa benefits as an African country from AGOA, although under WTO definitions it is 'developed' (by its own choice). It seems likely that LDCs, at least, will retain a favoured position. Therefore countries that do have major preferential privileges, including the four discussed here, can use them as an additional 'advantage' in trade. However so far, of the cases discussed in this book, only Bangladeshi apparel is an example of this.

Regional arrangements

Most developing countries are now also members of regional trading arrangements, but not all of these have a significant impact on trade and it is notable that none of the producers discussed in this book appears to rely on these for its exports. However, for small producers of the type discussed here regional opportunities, even without strong links in a formal regional arrangement, may be important, as they do not need large export markets and may find regional neighbours more familiar and therefore easier to deal with. But it is not clear that there will be increased opportunities from stronger regional arrangements, and their future is uncertain. In the past, proposals for regional agreements have tended to emerge at times when multilateral trade negotiations were not happening or appeared to be stalled; but then they recede. The exceptions are groups which have a clear political, social or security interest in a long-term relationship, as well as an economic motivation. This matters because any economic reason for a region is likely to hold at least equally strongly for multilateral liberalization. It is regions with non-economic foundations that can overcome the sectoral, protectionist interests which impede multilateral liberalization. The 2003–2004 cycle of disillusion with the WTO after Cancún, followed by failure of the apparent regional substitutes (notably the Free Trade Area of the Americas, but the EU's negotiations with ACP regions are also going slowly), followed by a renewed effort at multilateral negotiations was unusually rapid, suggesting that regions may be attracting little support.

Rules and disputes

The Uruguay Round strengthened the enforcement provisions of the WTO by removing countries' right to refuse consent to a ruling (the old rules had required consensus), and the increased attention to rules in trade has increased interest in using the provisions. To the extent that this makes the trading system more predictable and less subject to arbitrary actions, particularly by the major traders, it makes exporting easier for all small producers. But there are also some potential direct effects on producers of the type described in this book.

Brazil has made the first successful (subject to appeal) challenge to agricultural subsidies – against the US on cotton. While there are both legal and practical obstacles to generalizing this case to all subsidies by all producers (different types of subsidies, the costs of litigation, the real possibility that losers, or potential losers, will bargain and 'settle out of court'), this judgment, in parallel with the impact of developing countries in negotiations, weakens the long-term prospects for subsidies.

There have been several disputes about what type of differential treatment countries can offer to either regional partners or countries receiving preferences. On regions, the decisions have tended to restrict countries' ability to increase barriers to countries outside the region in order to favour members, weakening the role of regions. On preferences, however, the most recent judgement, in a case brought by India against EU preferences that discriminated against it, appears to open up new scope for preferences. It suggests that while purely discretionary choice of beneficiaries is not allowed (so India won that case), transparent and clearly defined discrimination may be. This could legitimate special help for groups such as small islands (this would not directly help Samoa as it already receives help as a LDC), and could possibly allow special treatment for particular types of product. The EU's General Preferences give extra preference for sustainably produced tropical timber and to countries meeting core labour standards. If these, or standards of other types, such as fair trade or organic production, were made less discretionary, they might meet the new interpretation. Decisions in WTO disputes need not follow precedents, however, and this is a controversial decision, so any implications can only be speculative.

The 'outsourcing' of services, of the type found in the Indian call centre sector, has attracted opposition in some developed countries, notably the US. Some of the proposed measures to stop it, including discrimination by local governments against companies who outsource any of their activities, may be contrary to US commitments under the WTO. The dispute procedure might be used to protect India from such policies.

Private standards

The growing role of supermarkets in setting standards for products is particularly emphasized in the study of fruit workers in South Africa; this role of retailers in developed countries is also important in other areas, notably textiles and garments. It is also significant in services – standards for tourism and tour companies are already affecting developing country producers, and those for financial services could affect activities like call centres. Producers will need not only to meet these, as they need to meet any market requirement, but to find ways of negotiating on them, as they can be set without consulting suppliers. They are not official, so there is no direct recourse either to government-to-government negotiations or dispute procedures. The response of Ghana to a different problem, the concentration of market power in cocoa in a few buyers, i.e. taking a united national approach to selling to increase its own market power, is one possible remedy. Working with European producers, as in the Kuapa Kokoo investment, is another. Cross-national alliances of similar producers could be another. All the producers will need to find permanent systems, rather than relying on *ad hoc* responses.

3 Trade, Poverty and Gender

The case studies suggest that an informed view of external markets and trade policies can increase the likelihood of success. But they look only at the direct effects of trade on poverty and the opportunities for women. It is important to remember that what happens in trade is likely to be much less important for reducing poverty than the other national policy and economic conditions that influence how opportunities from trade are transmitted to different groups within the economy. On the other hand, the indirect effects of trade can allow a government which is committed to reducing poverty and increasing opportunities for women to do so, even if there is no direct link through production. This focus on direct effects may be valid when governments do not have the capacity to redistribute income if the country decides that immediate poverty reduction is more important than longer-term gains. But even direct poverty-reducing trade may not produce a favourable outcome if the government does not want to improve income distribution. If manufacture of chocolate in Europe is more efficient than in Ghana, given technical and policy conditions, either the company or the government can, through taxation, redistribute the profits to improve the incomes of the poor within Ghana. An alternative remedy for the concentration of income from cashew nuts exports in the hands of traders would be to tax them. Providing good social conditions for the poor in South Africa can be done directly, rather than through rules on labour. Governments must choose the most efficient combination of direct and indirect strategies to meet their objectives.

Notes

1 Although production and processing of cashews in Mozambique for the world market was encouraged in the 1960s and 1970s.
2 Other developing countries are also setting up processing companies in the EU and the US.

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