Chapter 5

SOUTH-SOUTH GOODS AND SERVICES TRADE

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This chapter contributes to the debate on the development potential of South-South trade in goods and services. It uses descriptive statistics and gravity methodology to help understand past trends in world goods and services trade. The analysis of goods trade indicates that South-South trade barriers are still much higher than those for other types of trade and that South-South trade is severely constrained by distance-related trade costs. Econometric modelling also suggests that reducing South-South tariff barriers can have a major impact on trade flows whereas an equivalent reduction in North-North or North-South tariff barriers would have less impact. The analysis of services is a first attempt to identify key features governing the South-South dimension of services. Services trade between developing countries is predominantly regional and may reflect an increasing tendency to incorporate disciplines to liberalise services trade in regional trade agreements. It is estimated that cross-border South-South exports represent around 10% of world exports. While developing countries' exports to developed countries seem to be more important for most non-OECD regions, the opposite is true for developing Asian countries. The results suggest that there is further scope for increasing developing country services exports in general and for services trade between developing countries in particular.

Introduction

The question of the further development of trade integration between low- and middle-income countries – referred to in the literature as South-South[1] trade – is at the heart of the Doha Development Agenda (DDA) negotiations. Rapid economic expansion in a number of countries of the South (*e.g.* WTO, 2003; World Bank, 2005), as well as evidence of the relatively high trade barriers faced by intra-South trade, suggest that further opening by the South, particularly on a non-discriminatory basis, can contribute substantially to meeting the development objectives of the DDA. Welfare gains from South-South integration are also likely to be associated with less pronounced relative price changes and thus less severe structural adjustment (*e.g.* Fontagné *et al.*, 2004). This can open up possibilities for learning by doing and developing economies of scale to break into the North's markets for more technologically advanced products (Otsubo, 1998).

A rationale for trade integration of South-South goods and services can be made under both inward and outward-oriented development paradigms (*e.g.* Otsubo, 1998). Under the former, South-South trade is viewed as an alternative to North-South trade that would enable the South to reduce its dependence on the technologically dominant markets of the North and, through protection of "infant industries", break into higher value product markets. A political manifestation of this concept can be traced back to the mid-1970s and the beginnings of the Global System of Trade Preferences among Developing Countries (GSTP).

[1] The definition of "South" is not a stable one. This chapter uses the World Bank's classification of low- and middle-income countries with per capita gross national income not exceeding USD 9 075 in 2003 (see Table 5.A.1).

Under the outward-oriented development paradigm, South-South trade integration is seen as complementary to North-South trade as Southern markets, with their high growth potential, may offer attractive export opportunities. This type of South-South integration can be achieved through non-discriminatory integration in the multilateral GATT/WTO system or through non-discriminatory regional trade agreements. Indeed, rules-based South-South integration is undoubtedly one important reason for increasing the participation of low- and middle-income countries in the GATT/WTO.

Still, at the time of writing, the DDA negotiations (*e.g.* in the Negotiating Group for Non-agricultural Market Access – NAMA) are very much aligned along the North-South divide. The North, with its generally lower trade barriers, urges ambitious commitments on the part of the South. At the same time, the South continues to seek derogations from WTO rules and commitments on the grounds of their development needs (see Chapter 8). The reasoning is that their liberalisation may disproportionately burden these countries with additional short-term costs. It is also argued that, despite already low levels of protection in the North, the market shares of these countries and the associated potential for technology spillovers suggest that further liberalisation by the North would generate substantial gains in the South even without significant liberalisation by the South. Does this situation reflect a missed opportunity for development through expanded South-South trade or a coherent position given the potentially minimal gains from such trade?

Economic theory does not give a clear answer, as different assumptions provide rationales both for gains from North-South and for South-South integration. The balance of gains is ultimately an empirical matter. Perhaps surprisingly, notwithstanding the statistics on the expansion of markets in the South and shares of South-South goods trade – the evidence on South-South services trade is negligible – the literature offers very little in terms of analysis of underlying causes. As a result some of the most complex questions remain unanswered. They include: To what extent has the apparent surge in South-South trade been driven by macroeconomic growth, lowering of trade barriers, the evolving role of trade costs, and cultural and other factors? Is the impact of trade costs and trade policy barriers on North-South trade different from those on South-South trade? If so, why? What are the potential gains from unrealised South-South trade and how do they compare with North-South trade?

Existing theoretical analyses and policy discussions on the development potential of South-South co-operation have focused almost exclusively on the potential for promoting South-South trade in goods, even though in many developing countries services already account for about 50% of GDP and employment and contribute close to 15% of total exports. Among the most important reasons for this emphasis in the literature are the theoretical challenges relating to the applicability of goods trade theories to services trade, lack of data on services trade among developing countries, and difficulties in identifying and quantifying services barriers. However, discussions on South-South trade in services have recently begun to take place as a way of exploring new and dynamic ways of addressing developing countries' concerns.

This chapter contributes to the debate on the development potential of South-South trade in both goods and services. It is based on two recent OECD studies (Kowalski and Shepherd, 2006; Dihel, 2006) which use statistics and gravity methodology to help understand past trends in world goods and services trade with special focus on South-South trade.

South-South trade in the literature

Theory

Inquiries into the development potential of trade between low- and middle-income countries have to be seen as a sub-theme of research on the causes and effects of international trade. In recent

years, this theme has re-emerged in the context of the economic effects of the proliferation of regional trade agreements (RTAs), on the one hand, and, on the other, the potential benefits that developing countries might obtain from the Doha round of multilateral trade negotiations.

It is worth noting at the outset that South-South trade does not clearly have a vast development potential. At the theoretical level, the notion of comparative advantage indicates that the potential for trade and welfare improvements is higher for trade between countries that are relatively dissimilar in terms of endowments or technology. Within this paradigm, North-South trade would achieve higher gains. Similarly, the transfer of technology linked to trade in capital goods with more technologically advanced countries may hold better prospects for developing countries than trade with less advanced countries.

However, the so-called "new trade theory" emphasises the existence of scale economies and differentiated products and posits that gains can be obtained from an exchange of varieties of similar products by similar countries. Moreover, the theory suggests that gains from intra-industry trade (IIT) (*e.g.* among similar low-income countries) may be realised through less significant adjustments of factor rewards that imply less marked structural adjustment than inter-industry North-South trade. If the conditions for South-South intra-industry trade exist or can be developed, such trade could offer an opportunity for learning by doing in a less competitive market environment and for developing externalities or economies of scale to break into the North's markets for more technologically advanced products (Otsubo, 1998). Yet, the potential for trade based on economies of scale among the relatively small and poor economies of the South is uncertain. Additionally, some analysts argue that certain forms of integration between developing countries may result in divergence, not convergence, of per capita incomes (*e.g.* Venables, 1999).

At a more practical level, field research reveals that many developing country products are more diverse and complementary than normally assumed. These countries spend large amounts on importing goods from the North even though many of these products are available in other developing countries, often in the same region, on competitive conditions of price and quality (Agatiello, 2004). Indeed, the current structure of tariff barriers (see Tables 5.A.1 and 5.A.2 for a broad picture) suggests that, notwithstanding the progress achieved through unilateral, preferential or multilateral liberalisation, there is great potential for reforming developing countries' trade policies, even those regarding tariffs alone. Additionally, as compared to North-South trade, trade costs seem to be much higher for trade between developing countries. This suggests that, under certain conditions, there is significant potential for expanding South-South trade and for capturing associated welfare gains. The high growth rates in developing countries, which are likely to persist, add to the importance of South-South trade, although the prominent shares of developed economies in world trade indicate that developed countries' trade policies still play a central role.

What is special about services trade?

At first sight, the conceptual distinction between goods and services may seem relatively straightforward. Services are intangible, invisible and perishable, they cannot be stored or transported, and they may require direct interaction between consumer and producer. This last aspect of many services transactions creates the need for factor mobility. These characteristics-related definitions of services and the classic definition proposed by Hill (1977) have gradually led to a better understanding of the nature of services and services transactions. The fact that trade in services consists of transactions which can occur without the movement of factors of production or of the receiver and transactions which necessitate the movement of factors of production and/or of receivers is reflected in the four-mode typology of international service transactions that was adopted in the General

Agreement on Trade in Services (GATS) as a basis for liberalising trade in services and constitutes the generally recognised framework for the analysis of services.[2]

In spite of the ongoing debates concerning the applicability of goods theories to services trade, there is now widespread acceptance that the two main explanations for trade between countries apply to services trade as well as to goods trade. In a perfectly competitive environment, comparative advantage explains the pattern of services trade, while specialisation arising from increasing returns to scale and agglomeration effects explain the direction of trade in imperfect competition. Therefore, the characteristics that differentiate services from goods do not change the underlying economic rationale for trade and the applicability of the previous analysis on the development potential of South-South trade to international services transactions.

Still, some additional elements need to be considered in certain cases. For example, the factor mobility required to supply trade in some services introduces dimensions relating to the reasons for and implications of such movements for both home and host countries that are not automatically addressed in theories aiming to explain goods trade. In order to bridge this gap, recent theoretical work combines trade theories with factor mobility theories. For example, recent work on the integration of the theory of the multinational corporation (MNC) and foreign direct investment (FDI) into the theory of international trade are extremely relevant for trade in services via commercial presence. Therefore, discussion of the development potential of South-South services trade needs to connect trade models that capture increasing returns to scale and imperfect competition with frameworks that explain the reasons for MNCs to do business abroad (in general the advantages proposed by Dunning, *i.e.* ownership advantage, location advantage and internationalisation advantage) (Markusen *et al.,* 1996; Markusen, 2000).

The special characteristics of services – their heterogeneity as well as the prevalence of regulatory interventions to avoid market failure or to achieve non-economic social benefits – determine the nature of restrictions on services trade and the relative welfare gains that may be associated with liberalisation of South-South services trade. Restrictions on international services transactions typically take the form of non-tariff barriers and are designed to limit the access of foreign services, and particularly the access of suppliers or consumers, to the domestic market. Moreover, in addition to the presumably larger spectrum of barriers for services than for goods, services are characterised by a high level of regulation. Barriers to services trade rarely take the form of *ad valorem* taxes and consistent measurement is extremely difficult (OECD 2003a; OECD 2003b). Given the more restrictive initial barriers to trade in services than to trade in goods, the importance of services in an economy, and their significant role as intermediate inputs in all sectors, the potential for reforming South-South services trade and the associated gains from liberalisation are expected to be greater than those from South-South goods trade.

South-South goods trade

The empirical evidence on South-South trade is dominated by descriptive statistics on its evolution relative to other types of trade (*e.g.* Otsubo, 1998; WTO, 2003; DFAT, 2004; Fontagné *et al.*, 2004; UNCTAD, 2004). These contributions establish the so-called "stylised facts" about South-South trade – phenomena that have been observed in several contexts and are widely understood to be empirical facts which theories must take into account (see below) – but they do not attempt a more rigorous empirical analysis of underlying causes. Such studies broadly indicate that over the last two decades, the literature has established the following "stylised facts":

[2] The four modes include: cross-border supply of a service from one jurisdiction to another (mode 1); consumption abroad (mode 2); commercial presence (mode 3); movement of natural persons (mode 4).

- The share of South-South trade in world trade has increased.
- Economies of the South have grown much faster than those of the North.
- Tariff barriers have gone down in the major developing countries.
- The bulk of the observed expansion in South-South trade has been intra-regional (though not necessarily as part of an RTA).
- Manufacturing trade has played a leading role in South-South trade and now accounts for two-thirds of such trade.

More generally it is known that advances in information and telecommunications technology have affected certain trading costs including, perhaps, the costs of South-South trade.

However, such studies do not indicate whether the observed trends are linked through a causal relationship and, if so, what the parameters of such relationships are. For example, they cannot distinguish whether, or to what extent, the observed surge in South-South trade was driven by declining tariffs, the diminishing role of geographical distance or simply exogenous economic expansion of certain economies.

The two methods most commonly used in related quantitative research and which have as their objective to establish causality are the computable general equilibrium (CGE) and the gravity model approaches.[3] The former is based on economic theory and employs detailed information on the structures of selected economies as well as policy instruments and integrates them in a multi-country, multi-sector, market-clearing framework with a sophisticated representation of demand and supply relations. This approach is used for *ex ante* predictions of the future effects of a set of economic policies and enables a rich analysis of various trade liberalisation scenarios at both aggregate and sectoral levels. In addition, in contrast to the gravity approach, CGE analysis enables a direct assessment of welfare effects of trade reforms. Each result can be traced back to theoretical assumptions and the structural characteristics of analysed economies and as such is an implication of theory rather than an empirical verification.

The gravity approach which underlies the analysis of goods trade in this chapter is also to some extent an implication of theoretical assumptions (Anderson and van Wincoop, 2003, 2004). Nevertheless, in contrast to the CGE approach, it uses historical data to validate statistical significance and estimate the magnitude of the hypothesised causal relationships between trade and the various potential determinants predicted by the theory, including the effects of implemented trade policies.

The basic version of the gravity model relates the volume of bilateral trade flows to the economic size of trading countries as well as to measures of economic distance as measured by indicators of various trade costs. The attractiveness of the gravity models stems from their consistency with both the classical and new trade theories as well as their relatively high empirical explanatory power. This approach can help to understand historical trends and in particular to separate the impact of trade policy changes from other factors affecting trade volumes. Its shortcoming is that it is not directly useful for assessing the welfare implications or distributional aspects of trade policy changes: estimated trade impacts are only broad proxies for potential welfare effects.

[3] Note also the related *Special Focus* section in this volume, which draws on and expands upon this discussion.

While Kowalski and Shepherd (2006) appears to be the first application of gravity methodology to South-South trade, the approach has recently been employed to assess trade potential and its impediments in selected low- and middle-income countries and regions (Kowalski and Shepherd, 2006, has a survey of the relevant literature). By and large, the literature does not offer a comprehensive analysis of the factors behind the observed growth of South-South trade, nor does it offer a thorough assessment of the potential benefits of future trade policy reforms from multilateral, regional or unilateral liberalisation. In particular, it is uncertain to what extent the observed upsurge in South-South trade was driven by these economies' macroeconomic growth and to what extent it was driven by trade policy changes. The first part of this chapter reports the results of Kowalski and Shepherd (2006), which attempts to fill this gap by using a large number of gravity models, with around 400 regressions, to examine the bilateral trade flows of approximately 180 countries over the period 1985-2002, covering all income groups.

Stylised facts on South-South trade

Before turning to the discussion of the results of formal, model-based analysis, it is useful to set out the main "stylised facts" to be explained. The aim is not to provide an exhaustive description of South-South trade and its evolution over the last two decades but to give a broad picture of the following categories of information:

- Absolute levels of South-South trade over the period 1985-2002.
- South-South trade as a percentage of total trade over the period 1985-2002.
- Comparative growth rate of South-South trade over the period 1985-2002.
- Comparative commodity composition of South-South trade over the period 1985-2002.

To get an idea of what the data say about the relative evolution of South-South trade, the analysis starts from an aggregate level and a breakdown of total world trade by North-North, South-South or North-South.[4]

Table 5.A.3 makes clear that South-South trade has expanded considerably over the 1985-2002 period, albeit from a very small base: from 3% in 1985, it now makes up around 6% of world trade. Table 5.A.4, which presents average annualised growth rates, confirms this increase. Over the full sample period, South-South trade grew on average at the impressive rate of 12.5% a year, compared with 7% and 9.75% for North-North and North-South trade, respectively.

However, Table 5.A.4 reveals considerable heterogeneity over the nearly two decades considered. First, in the period 1985-90, South-South trade grew much more slowly than either of the other two flows. Yet, the pattern changed dramatically over the period 1990-95, with South-South trade growing at over 20% a year on average, compared with 15.25% for North-South trade and 5.75% for North-North trade. In the following period, South-South trade continued to grow more quickly than either North-North or North-South trade, even expanding comfortably in the period 2000-02 when North-North trade contracted mildly. The same is true when South-South trade is divided into more refined income groups. The fact that the three growth patterns are to some extent out of phase suggests that external factors affecting the other two groups of countries are unlikely to be the principal factors behind the development of South-South trade.

[4] North-South includes both Northern exports to the South, and Southern exports to the North.

Table 5.A.5 shows that between 1985 and 2002, South-South trade has become relatively more important as a share of total trade involving the South, rising from less than 10% to around 14%. Yet, North-South trade still accounts for the bulk of total goods trade involving the South. Even more refined data presented in Kowalski and Shepherd (2006) suggest that discussions of South-South trade mostly concern trade involving upper-middle- and lower-middle-income countries while low-income countries play a lesser role. This indicates that while the overall growth rate of South-South trade has been impressive over the last two decades, it has been quite heterogeneous across income groups, with South-South trade involving low-income countries generally growing more slowly than South-South trade involving upper-middle- and lower-middle-income countries.

More detailed results presented in Kowalski and Shepherd (2006) indicate that aggregate figures mask considerable heterogeneity across commodity groups in South-South trade. The breakdown of world trade flows by commodity is based on the 1-digit UN Standard International Trade Classification (SITC) (Revision 1).[5] For some commodities (*e.g.* Beverages and tobacco, Chemicals) the share of South-South trade increased from around 2% in 1985 to around 6% in 1990, largely in line with total trade. Nevertheless, in certain sectors the share of South-South trade was already higher at the beginning of the investigated period and continued to increase. For instance, the shares of South-South trade in Food and live animals increased from 5% at the beginning of the period to above 10% in 2002. Animal and vegetable oils and fats were characterised by exceptionally high shares of South-South trade, which rose from 15% in 1985 to 34% in 2002. The smallest shares of South-South trade were observed in Machinery and transport equipment (increasing from 0.8% in 1985 to 3.6% in 2002) and Miscellaneous manufactured articles (increasing from 0.7% in 1985 to 2.8% in 2002).

There are also significant differences in the product composition of South-South trade as compared to North-South and North-North trade. This presumably indicates differences in both supply- and demand-side factors. Compared to North-North and North-South trade, South-South trade seems to be relatively more concentrated in certain less-processed products such as Food and live animals; Crude materials, inedible, except fuels; Mineral fuels, lubricants and related materials; Animal and vegetable oils and fats; but also Manufactured goods classified chiefly by material. South-South trade is relatively less concentrated in Machinery and transport equipment and Miscellaneous manufactured articles. Shares of Chemicals and Beverages and tobacco in South-South trade are higher than in North-South trade but lower than in North-North trade.

Finally, as pointed out with reference to Table 5.A.1, South-South trade is generally subject to much higher barriers than North-South or North-North trade. Concretely, the barriers facing South-South trade are almost three times higher than those facing North-North trade. Table 5.A.2 nuances this analysis by showing that tariff rates are far from homogenous across the South. Speaking approximately, there is an inverse relationship between importer income level and average protection level. There is also a tendency – albeit a weaker one – for protection levels to increase as the exporter's income level decreases, although low-income exporters constitute an exception, as they generally face lower protection levels than other Southern exporters.

[5] This classification distinguishes between the following product categories: Food and live animals; Beverages and tobacco; Crude materials, inedible, except fuels; Mineral fuels, lubricants and related materials; Animal and vegetable oils and fats; Chemicals; Manufactured goods classified chiefly by material; Machinery and transport equipment; Miscellaneous manufactured articles; Commodities and transactions not classified according to kind.

Explaining the stylised facts on South-South goods trade using the gravity methodology

Methodology

Each of the "stylised facts" listed above begs one or more questions. What has given rise to the heterogeneity among developing country income groups in terms of their participation in South-South trade? Have higher tariffs had a significantly negative impact on South-South trade? Have globalisation and possible decreases in transport costs favoured the dynamism of South-South trade? Which of the determinants of South-South trade are shared with North-South and North-North trade, and which are of particular importance for intra-South trade?

The gravity approach is the one most commonly used for *ex post* analysis of such questions. The basic idea behind a gravity model of trade is that the value of one country's exports to another country is directly proportional to the economic size of the two countries – since this determines supply and demand – and inversely proportional to the distance between them – since trade costs probably increase with distance. The term "gravity model" reflects the fact that this idea bears some similarities to the Newtonian law of gravity, in which the force of attraction between two objects is inversely proportional to the square of the distance between them, but directly proportional to the mass of each.[6]

The approach adopted in Kowalski and Shepherd (2006) closely follows that of Anderson and Van Wincoop (2003, 2004). The basic specification used here explains exports using bilateral distance and a series of dummy variables designed to capture the impact of GDP and prices as well as particular cultural or historical links, such as a common language or a colonial past. This set of explanatory variables, while not exhaustive, is well supported by the existing gravity literature.[7] First, a separate model is estimated for each year in the sample (1985-2002). The sample is then split up into different groups according to trading countries' classification as South or North based on World Bank income groups, and the process is repeated. This approach makes it possible to gauge the evolution of each estimated coefficient in the trade equation over time, so as to see whether, for example, the elasticity of trade with respect to distance decreased from 1985 to 2002. Moreover, one can also investigate whether, for example, the elasticity of South-South trade with respect to distance is greater than the same elasticity for North-North trade.

Finally, additional models are estimated for 2001 which add detailed bilateral tariff information (including information on tariff preferences) to the explanatory variables previously used.[8] The estimation, even for a single year, makes it possible to see whether, for example, the elasticity of

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6 This insight has given rise to innumerable gravity specifications in the empirical trade literature over the last 40 years. Analysts have commonly included a variety of explanatory variables in addition to distance, based on their beliefs about the probable determinants of bilateral trade. More recently, Anderson and Van Wincoop (2003, 2004) have shown that it is possible to derive a gravity-like model from some fundamental, and reasonably general, propositions about the structure of consumer preferences and expenditure. Their "theoretical" gravity model is rapidly becoming accepted as a benchmark. Its principal innovation is, roughly speaking, to properly take account of the fact that it is relative prices and tariffs that matter for trade, not just prices and tariffs of one particular importer or exporter.

7 For a full description of methodology, variables and sources, see Kowalski and Shepherd (2006).

8 The tariff information comes from the ITC-CEPII MAcMap database (Bouët *et al*., 2004), which unfortunately is only available for one year; historical comparisons are therefore impossible. But the richness of the database more than compensates for this limitation: it includes applied tariffs, some non-tariff measures and, most importantly, it takes account of the complex web of bilateral and multilateral preferences that now govern world trade.

exports with respect to partner trade policy is the same for North-North as for South-South trade, and whether it is the same for exports of manufactured goods and agricultural products.

The approach is applied to both aggregate and sectoral export data at the SITC 1-digit level to see whether there are significant differences in the determinants of South-South trade at the sector level.

Discussion of results

Overall, the econometric methods employed in Kowalski and Shepherd (2006) process an enormous amount of data. Aggregate trade flows across all exporters, partners and years involve over 230 000 lines of data. When trade flows are disaggregated at the sectoral level, the number rises to nearly 1.5 million lines.

The assessment of trends in bilateral goods trade in the period 1985-2002 suggests that recent growth in South-South goods trade does not appear to have been brought about by the "death of distance",[9] as the impact of distance-related trade costs has not noticeably diminished over the period. Such costs continue to have a much more negative effect on South-South than on North-North trade: whereas a 10% increase in distance tends to reduce North-North trade by about 10%, the comparable figure for South-South trade is 17% (keeping all other factors unchanged). In both cases, the figures for 2002 are scarcely different from those for 1985.

There is evidence that the importance of a common language for South-South trade increased markedly in the early 1990s, but remained approximately constant for other trade flows. Hence, ethno-cultural links may have been one factor in the observed growth of South-South trade around that time.

While it has not been possible to conduct a comparative assessment of the impact of trade policy over time, the evidence currently available suggests that policy barriers are a much more important determinant of South-South trade than of other trade flows, in the sense that the elasticity of South-South trade is greater (in absolute value) with respect to trade policy than it is for other flows. On average, a 10% tariff cut is associated with a 1.6% increase in exports. This translates into an additional USD 5.7 billion in export earnings a year (based on 2002 data). Interestingly, the data indicate that an equivalent reduction in North-North or North-South tariff barriers does not result in an equally significant impact on trade flows. This suggests a considerable scope for trade policy to boost trade between (and potentially the welfare of) low- and lower-middle-income countries.

The sectoral specifications of the gravity model used show that there is considerable heterogeneity in tariff impacts across commodities and country groupings even though it is clear that South-South trade is much more sensitive to tariff-related costs than either North-North or North-South trade.

With the exception of Manufactured goods classified chiefly by material, where a 1% decrease in tariffs is associated with 0.10% increase in trade, North-North trade is estimated not to be significantly affected by tariffs. The tariff policy coefficients estimated for exports from North to South are negative and statistically significant for Food and live animals; Mineral fuels, lubricants and related materials; Chemicals; and Manufactured goods classified chiefly by material. Exports from South to North are

9 The "death of distance" summarises the large, and fundamental, fall in the cost of moving people, objects and ideas around the globe in the 1980s and 1990s (*e.g.* Disdier and Head, 2004).

impeded by tariffs on Beverages and tobacco; Crude materials, inedible, except fuels; and Animal and vegetable oils and fats.

The estimated impact of tariffs on South-South trade is, with the exception of Mineral fuels, lubricants and related materials, consistently negative across all products, and statistically significant and substantially greater in absolute value than the corresponding estimates for North–North and North-South trade. The most tariff–sensitive products include Beverages and tobacco; Food and live animals; Animal and vegetable oils and fats, for which a 1% decrease in South-South tariffs is associated with an increase of up to 0.29% in trade. The sectoral results reinforce the conclusion drawn from aggregate estimations: the high elasticity of South-South trade with respect to South-South tariffs suggests considerable scope for trade policy to boost trade and welfare in the South.

South-South services trade – stylised facts

Data and measurement issues

There are virtually no systematic analyses of trends in the structure of services trade among developing countries because of the numerous difficulties related to measurement of trade in services. Chief among them are the special characteristics of services and the fact that the four-part typology of international service transactions adopted in the GATS[10] as a basis for liberalising trade in services constitutes the generally recognised framework for the analysis of services:

- First, the current practice of gathering data on international services transactions is not consistent with the four-type classification of trade in services, as it does not recognise that a large part of services trade takes place in ways that are different from goods trade.
- Second, lack of partner country data for services trade between developing countries hinders quantitative analysis of South-South services trade.

Therefore, to shed some light on the nature and scale of South-South services trade, it is necessary to identify and analyse all possible sources of information and apply exploratory techniques to estimate the magnitude of services trade between developing countries.

The new *Manual on Statistics of International Trade in Services*, developed jointly by the International Monetary Fund (IMF), the OECD, Eurostat, the World Trade Organization (WTO), the United Nations and the United Nations Conference on Trade and Development (UNCTAD) provides a detailed analysis of measurement issues related to services trade. It also proposes a conceptual

10 The four-part typology of international services transactions adopted in the GATS encompasses: (1) *Cross border supply* of a service from one jurisdiction to another (mode 1). This mode of delivery is analogous to international trade in goods, in that a product crosses a frontier. The consumer does not move physically nor does the supplier establish itself abroad; instead they interact through postal or telecommunication networks. (2) *Consumption abroad* (mode 2) requires the movement of consumers to the supplier's country of residence. Tourism or students travelling abroad are good examples of this mode, involving the movement of (mobile) services consumers to (immobile) tourist or education facilities in another country. (3) *Commercial presence* (mode 3), in which case a service supplier establishes a foreign based corporation, joint venture, partnership, or other establishment in the consumer's country of residence, to supply services to persons in the host country (4) *Movement of natural persons* (mode 4), which involves an individual, functioning alone or in the employ of a service provider, temporarily travelling abroad to deliver a service in the consumer's country of residence. In general, individuals who are seeking access to the employment market of another country on a permanent basis or for citizenship or residency purposes are not included in this category.

framework for the further development of statistics on international trade in services, introducing modes of supply for the first time in the statistical context. While this framework constitutes a significant improvement, implementation is likely to take some time.

A more detailed discussion of various sources of services trade data is provided in recent OECD work concerned specifically with South-South trade in services (Dihel, 2006). Box 5.1 summarises this discussion, indicating the various sources of information that need to be consulted to collect information according to the various modes of services supply. The proposed allocation by modes of supply in Box 5.1 is based on the *Manual on Statistics of International Trade in Services*, which indicates that the main source of information for services trade data is given by balance of payments (BOP) statistics compiled on the basis of the fifth edition of the International Monetary Fund's Balance of Payments Manual (BPM 5). However, given the limited direct information on the GATS mode of supply in BOP statistics and other data sources, it should only be considered as an approximate estimate and treated with caution.

In addition to difficulties related to the measurement of services trade in general, any analysis of the South-South dimension of trade in services requires bilateral trade data. Unfortunately, there is a dearth of disaggregated and internationally comparable statistics on the direction of international services trade in general and on trade between developing countries in particular. While OECD countries have begun to collect information on services trade by partner countries, few developing countries report such information. Currently, the following sources of partner country data contain information that is useful in studying South-South trade in services:

- OECD database on trade in services by partner country (balance of payment statistics).
- UNCTAD database on FDI statistics.
- World Tourism Organisation statistics on number of visitors.
- International Air Transport Association (IATA) statistics provides some information on international passenger and freight trade flows by region.
- Migration statistics (imperfect proxies for trade in services via mode 4).

Based on these sources of information, used in Dihel (2006), essential features of the South-South dimension of services trade via the various modes of supply are briefly described in the next section.

Box 5.1. Statistical coverage of modes of supply

Mode	Statistical coverage
Mode 1 Cross border supply	BPM5: transport (most of), communications services, insurance services, financial services, royalties and licence fees Part of: Computer and information services; Other business services; Personal, cultural, and recreational services Sectoral statistics: telecommunications, air transport
Mode 2 Consumption abroad	BPM5: travel (excluding goods bought by travellers); repairs to carriers in foreign ports (goods) Part of: Transport (support and auxiliary services to carriers in foreign ports) Sectoral statistics: tourism
Mode 3 Commercial presence	Foreign Affiliates Trade in Services (FATS) statistics BPM5: part of: Construction services FDI statistics

Box 5.1. Statistical coverage of modes of supply (continued)	
Mode 4 Presence of natural persons	BPM5: part of: computer and information services; Other business services; Personal, cultural and recreational services; and Construction services FATS (supplementary information): foreign employment in foreign affiliates BPM5 (supplementary information): labour-related flows Other sources: International Labour Organisation (ILO) International Standard Classification of Occupations (ISCO 88) International Classification of Status in Employment (ICSE -93): classifications according to status of employment Immigration statistics Tourism statistics (business visitors) Statistics on number of work permits issued
Source: Adapted from the Manual on Statistics of International Trade in Services Statistics.	

South-South services trade – analysis of flows

Cross-border trade

Table 5.A.6 presents the estimated patterns of world and South-South cross-border (total) services trade in 2002 (based on reported BOP data on exports of services available to OECD countries and regions and mirror statistics).[11] It shows that South-South exports represent around 10% of world exports, while South-North exports seem to have a larger share of approximately 13% of total exports in both years. In terms of South-South and South-North differentiation, exports from Asian developing countries to other developing countries represent around 8% of world exports, accounting for more than half of their total exports (Table 5.A.7). In contrast, for developing countries in all other regions, exports to developed countries appear to be more important: for non-OECD European countries, they represented over 70% of total exports in 2002 and for developing countries in Africa and America over 80% of total exports. Intra-regional exports have the highest share in developing countries' total South-South exports.[12]

IATA's International Air Transport Statistics provide some information on international passenger and freight tonne flows by regions. The data in Tables 5.A.8 and 5.A.9 show that except for flows between Asia and other developing regions, exchanges of international passengers and freight tonne flows between developing countries are at extremely low levels, very often under 1% of reported passenger flows or total freight tonne flows. (The IATA data represent 90% of total passenger flows and 87% of scheduled freight tonnes carried.)

Consumption abroad

11 For the purpose of these estimations, "South" includes all non-OECD countries. The term "mirror statistics" refers cases where export data are not directly available for a given country and the corresponding partner countries' import figures are used instead.

12 As described in detail in OECD (2004), the table is primarily based on reported data on exports of services by partner country available to the OECD (75% of world exports). The use of mirror statistics as estimates brings the coverage to about 92% of world exports. It is worth noting however that mirror statistics may not always reflect the export that would be declared by the reporting country and may lead to some data inconsistencies. Information was complemented as necessary using the 1995 estimated shares from the services bilateral export matrix used for OECD's international macroeconomic model Interlink.

Table 5.A.10, compiled from World Tourism Organisation data, presents visitor arrivals by region in 2002 on a partner country basis for 208 countries. South-South exchanges represent approximately 20% of total visitors, South-North arrivals 9%, North-South arrivals 14% and North-North arrivals 57% of total visitor flows. Around 70% of visitors in non-OECD or developing countries come from other developing countries. Growth rates of these intra-regional flows between 1999 and 2002 (2003) suggest that South-South exchanges were the most dynamic with growth rates of 6.2%.

Commercial presence

Information on non-OECD countries' FDI in services or FATS flows on a partner country basis is scarce. Using data from sources such as the World Bank, the IMF, the OECD and UNCTAD, Aykut and Ratha (2004) estimate South-South FDI flows in the 1990s indirectly (Table 5.A.11).[13] They posit that by 2010, more than one-third of FDI in developing countries will originate in other developing countries, with India, China, Brazil and South Africa among the main sources. They also indicate that South-South FDI is driven by similar "push" and "pull" factors as well as similar structural, cyclical and policy factors. They note, however, that these figures should be interpreted with great care given the quality of data, the round-tripping problems (as in the case of China) and the impossibility of clearly distinguishing between North-South flows routed through locations in the South (*e.g.* Mexican affiliate of a United States company investing in Brazil) and genuine South-South flows.

Movement of natural persons for services provisions

Building on existing migration statistics, Parsons *et al.* (2005) constructed a database on the international bilateral migration stock for 226 countries. The database represents a first attempt to provide a general overview of current migration trends in terms of the overall magnitude of migrant stocks and regional migration patterns. Primary data sources are national population censuses, and migration statistics from the United Nations, the Economic Commission for Latin America and the Caribbean (ECLAC), Eurostat, the OECD, the Migration Policy Institute, the ILO and the Middle East Central Asia Databook constitute secondary sources. Dihel (2006) gives information on the proportion of all world migrants recorded bilaterally across selected sub-continental regions, on the percentages of immigrants hosted by other sub-continental regions, and on the percentages of emigrants sent from these states. However, the figures should be interpreted with care in the context of mode 4 trade in services given that migration stocks represent very imperfect proxies for trade in services via the temporary movement of natural persons.

Developing countries' participation in world services trade

This chapter and Dihel (2006) are the first attempts to rigorously identify the share of South-South services trade in world trade according to the four modes of supply. As opposed to goods trade, for which the evolution of trade is more easily documented, the empirical evidence presented here should be seen as a starting point for future analysis and should be treated with caution in light of the quality of the data and the potential underreporting. It can be further refined as more data become available. New information can also make it possible to analyse trends. However, the most important conclusion to emerge is that services trade between developing countries takes place predominantly at the regional level for all modes of supply.

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13 South is here defined as a group of 31 developing countries for which reasonably detailed FDI data are available. FDI data cover not only services, but also agriculture and manufacturing. Notwithstanding these limitations, these general indications on FDI flows among developing countries could be used for further sectoral and/or country-specific disaggregations.

Where then does South-South services trade stand in world services trade? It is rather difficult to find benchmarks against which to compare the figures derived here. However, given the dynamism of developing countries in world services trade, there appears to be a certain potential for developing South-South services trade.

As far as cross-border trade is concerned, the role of developing countries in international trade in services has increased on both the export and import sides. As a group, low- and middle-income countries' share in world services trade rose from 16% in 1990 to 23.5% in 2002. Their dynamism is reflected in an increase in their participation in all segments of services exports. Their exports now account for 23% of world exports of transport services, 30% of world exports of travel services and 20% of world exports of other commercial services.

As far as consumption abroad is concerned, travel and tourism appear to be the most dynamic sectors for most developing countries and the top currency earner for 40 developing countries. From a regional perspective, between 1990 and 2000, exports from low- and middle-income Asia, Central and Eastern Europe, and Latin America and the Caribbean grew at higher average annual rates than world services exports.

Commercial presence through FDI in services has expanded, with the world's inward stock of FDI in services quadrupling between 1990 and 2002, and the share of services in world FDI stock rising from 25% in the 1970s to about 60% in 2002. Developed countries remain the main source of outward FDI, but the developing countries' share has grown, from 1% in 1990 to 10% of global outward FDI services stock in 2002. On the inward side, developing countries' FDI has increased (to 25% of inward FDI stock in services), although developed countries remain the main recipients. In 2002, services accounted for about 55% of the total stock of inward FDI in developing countries and some 85% of the inward FDI stock of developing countries (UNCTAD, 2004b).

Finally, there are at present no reliable global figures on the size of mode 4 trade. Very rough estimates suggest that mode 4, valued at USD 30 billion in 1997, is the smallest of all modes of services supply defined in the GATS. This is likely to be a significant underestimate, however. Developing countries seem to be important exporters of services via mode 4 and there seems to be scope for further expansion of South-South mode 4 trade.

Is there further potential for South-South services trade?

Notwithstanding the limitations on data on trade in services, exploratory empirical analyses can be undertaken to identify services sectors with a potential for increased South-South trade. First of all, the extent to which international trade in various services sectors are intra-industry (simultaneous import and export of essentially the same services) or inter-industry can help understand the underlying forces that generate trade in the selected services sectors. For that purpose, the most widely used measure of intra-industry trade, the Grubel-Lloyd (GL) index, was employed.[14] A GL index that approaches zero implies low levels of intra-industry trade while a GL index that approaches 1 suggests high levels of intra-industry trade. Calculations were undertaken for all of the countries for which data were available in the IMF BOP database.

Computation of the index indicates wide diversity across sectors and countries. The results suggest that for all analysed sectors – transport, travel, insurance, other business services, construction

[14] The GL index is defined as: $GLij = 1 - \left| (Xij-Mij) / (Xij+Mij) \right|$
where Xij is exports of a service i by country j and Mij is imports of a service i by country j.

services – both intra-industry and inter-industry trade are important. While insurance services are in most cases a wholly intra-industry phenomenon, in other sectors two-way trade is common. The findings suggest that theories of both inter-industry and intra-industry trade may be complementary in explaining the observed trade flows.

To further investigate inter-industry trade, the so-called revealed comparative advantage (RCA) indices can be computed and compared. The most common RCA index was developed by Balassa (1965).[15] Calculation of RCA indices for all developing countries for which data were available reveals a relatively uniform pattern of specialisation in services: in general, developing countries seem to be relatively specialised in (low-skill) labour-intensive services (such as construction services) and (in some cases) natural-endowment-intensive services (such as transport or travel services). Recent evidence indicates that some developing countries are in the process of developing a comparative advantage in more sophisticated sectors, such as "Other business services". This is especially true for a number of more advanced developing countries such as China, India, Malaysia, Thailand, Mexico, Egypt and Brazil (Table 5.A.12).

These results have to be interpreted in light of the general evolution of developing countries' services trade. Given the dynamic growth in the share of low- and middle-income countries in world services trade and their increased participation in all segments of services exports, it can be expected that technological progress, together with business practices, will allow developing countries to develop modern services and acquire a competitive advantage in more advanced services sectors (Marchetti, 2004). Given the growing concentration of trade in some developing countries – in 2003, 12 more advanced developing countries were among the world's leading exporters of services and accounted for 71% of services exports of all developing countries, compared to 66% in 1998 – it is to be expected that intra-developing country services exports will be concentrated among these more advanced developing economies and, in a next stage, between them and poorer developing countries. While the results are subject to the stated caveats, these findings could mean that such developing countries may become aware of their comparative advantage in certain services and of the potential of South-South and North-South trade and may give their support to greater services trade liberalisation.

Reality check: Does previous qualitative evidence confirm our statistical findings?

Given that current statistical concepts and methodologies do not enable an in-depth analysis of South-South services trade, additional examples of successful exports of services between developing countries may contribute to a greater awareness of the extent of developing countries' current participation in trade in services and of the potential that exists to expand that participation. They might also provide a useful reality check on the quantitative results discussed above. An OECD study, "Services Trade Liberalisation: Identifying Opportunities and Gains"(OECD, 2003), identifies numerous examples of developing countries' exports to other developing and developed countries in sectors such as audiovisual and cultural services; business services; computer and related services; construction services; distribution services; financial services; health services; higher education and

[15] RCA indices of a service are defined as the ratio of exports of a "service" category to a country's total service exports, divided by the ratio of world exports of this "service" to total world service exports. The value of this index may range from zero to a very large number. If the index is greater than 1 this implies that the country is relatively specialised in the service concerned and has a comparative advantage in such exports compared with the world average. A value less than 1 indicates a comparative disadvantage. An RCA index is in many ways a crude measure of comparative advantage. For example, it does not take into consideration the presence of trade barriers; and, since it is based on BOP data, it does not give any indication of a country's comparative advantage in supplying services through commercial presence or the movement of individual service suppliers

training services; port and related services, and shipping services; professional services; telecommunication services; and tourism and related services. The examples provided in that study confirm the findings presented here and provide additional information on the determinants and potential of South-South services trade, in particular:

- The 2003 study also found that developing countries generally seem particularly successful in certain labour-intensive sectors (such as construction services) and natural-endowment-intensive services (such as port and shipping services as well as tourism).
- Also, the present findings reinforce those of the previous study that some developing countries are starting to develop a comparative advantage in highly skilled labour-intensive services and more sophisticated business services.
- Supplementing the statistical analyses, the 2003 study indicates that in sectors such as banking, insurance, or health services, developing countries were able to exploit market niche effects.
- In terms of modal issues, the 2003 study and additional empirical evidence suggest that in the context of the rapid expansion of FDI in services and the faster growth of South-South FDI flows as compared to North-South flows, South-South services flows via commercial presence seem to have an important potential for development, especially in poor countries. More advanced developing countries like China, Brazil, South Africa and India have become important source of FDI for poor countries. Regional trade agreements also contribute to growth in South-South FDI as well as to increased growth and capital liberalisation. This means that developing countries are more financially linked than one would think. A number of case studies indicate that transnational corporations (TNCs) from the South seem to invest in developing countries at lower levels of development because of their comparative advantage (UNCTAD, 2005; OECD, 2003).
- In terms of mode 4, the 2003 study points out that while permanent migration is mainly a South-North phenomenon triggered by wage differentials and the expectation of better living standards, temporary flows are mainly the result of bilateral agreements between governments wishing to encourage co-operation. Demographic complementarities between developing countries could be a good reason to utilise some countries' human resources without having to consider long-term immigration[16].

The importance of regional trade in the context of trade between developing countries is also highlighted by anecdotal evidence in the 2003 study. This also reinforces the results of the statistical analysis. An additional interesting finding concerning the pattern for the development of services trade is the development of a global domestic export capacity from imported services.

Conclusions

South-South trade in goods expanded rapidly, but unevenly, over the period 1985-2002. The first part of the chapter reports the results of econometric analysis by Kowalski and Shepherd (2006),

[16] For example, Asher and Sen (2005) demonstrate that there are important complementarities between India, on the one hand, and Singapore and China, on the other. India is entering a phase of demographic expansion over the next three to four decades, while the share of working-age population in China and Singapore will begin to decline around 2015. Following the model of businesses in OECD countries that experienced rapid ageing earlier, Singapore and China could substantially enhance their competitiveness by partnering with India in a variety of knowledge-intensive service activities. Therefore, contrary to the general belief, mode 4 is not only a developed versus developing country issue.

involving over 400 regressions and nearly 1.5 million lines of data, to examine this important, yet not well understood, phenomenon. The puzzling nature of the expansion of South-South trade stems from the following:

- South-South trade barriers are still much higher than those affecting other trade: 11.1% on average, compared with 4.3% for North-North trade.
- Far from experiencing a "death of distance", South-South trade is still severely constrained by distance-related trade costs: whereas a 10% increase in distance tends to reduce North-North trade by about 10%, the comparable figure for South-South trade is 17% (keeping all other factors unchanged). In both cases, the figures for 2002 are scarcely different from those for 1985.
- Econometric modelling also suggests that reducing South-South tariff barriers can have a major impact on trade flows: on average, a 10% tariff cut is associated with a 1.6% increase in exports. This translates to an additional USD 5.7 billion in export earnings per year (based on 2002 data). Interestingly, the data indicate that an equivalent reduction in North-North or North-South tariff barriers does not result in an equally significant impact on trade flows.

That South-South trade has evolved in the way it has in spite of these difficulties suggests that there are potentially significant gains to be reaped from a more pro-active and facilitating policy stance. The results suggest that further tariff liberalisation at the multilateral level, combined with efficiency gains in transport and trade-related services – including through concerted efforts at the multilateral level – would help South-South trade maintain its momentum and would spread its benefits more evenly across the countries involved.

The second part of the chapter reports on the results of an attempt to identify the key features governing the South-South dimension of services trade via the various modes of supply. The most important conclusion is that services trade between developing countries takes place predominantly at the regional level for all modes of supply; this may be due to the increasing tendency to incorporate disciplines to liberalise services trade within regional trade agreements. In terms of the magnitude of South-South services trade via different modes of supply, the estimates based on BOP statistics suggest that South-South exports via modes 1 and 2 represent around 10% of world exports. While developing countries' exports to developed countries seem to be more important for the majority of non-OECD regions, the opposite is true for Asian developing countries: their exports to developing regions represent more than half of their total exports. Except for Asia, air transport exchanges between developing countries seem to be negligible. In terms of mode 3, indirect estimates suggest that more than one-third of FDI in developing countries will originate in other developing countries. Around 19% of total FDI stocks from developing countries come from other developing countries.

These results also suggest that there is scope for increasing developing country services exports in general and services trade between developing countries in particular. In the first stage, differences in short-term comparative advantage are expected to provide the main rationale for services trade between more advanced and less advanced countries. However, in the medium-long term, it is technological knowledge that will determine comparative advantage and enable the development of more advanced services trade. There are already clear examples of developing countries exploiting market niche opportunities and developing firm-specific intangible assets, and there is a realistic potential for increased trade in know-how-intensive services between developing countries in the short to medium term.

ANNEX TABLES

Table 5.A.1. Simple average tariff rates, 2001, by exporter and importer groups

Exporter \ Importer	North	South
North	4.3819	9.8733
South	4.9597	11.0653

Source: Kowalski and Shepherd (2006), calculated from MAcMap data.

Table 5.A.2. Simple average tariff rates, 2001, by exporter and importer income groups

Percentages

Exporter \ Importer	High	Upper middle	Lower middle	Low
High	4.3819	8.3864	9.7195	11.7312
Upper middle	5.9429	8.5162	11.8285	13.7275
Lower middle	5.5675	9.4899	11.0647	14.2759
Low	3.627	8.7221	10.0112	13.3798

Source: Kowalski and Shepherd (2006) Note: Calculated from MAcMap data

Table 5.A.3. Breakdown of total world trade, by aggregate income group, 1985-2002

USD millions and %

	North-North		North-South		South-South	
	USD millions	%	USD millions	%	USD millions	%
1985	1 030 622.65	67.13	456 673.20	29.75	47 961.08	3.12
1986	1 178 530.53	71.62	426 028.31	25.89	40 910.30	2.49
1987	1 403 160.36	73.18	470 175.90	24.52	43 977.26	2.29
1989	1 639 259.97	73.40	544 295.70	24.37	49 710.53	2.23
1988	1 765 727.66	72.26	618 307.25	25.30	59 541.40	2.44
1990	2 010 638.03	72.12	713 047.55	25.58	64 150.04	2.30
1991	2 041 777.84	70.47	7880 72.21	27.20	67 370.75	2.33
1992	2 015 718.29	67.49	876 171.93	29.34	94 730.73	3.17
1993	2 024 834.86	63.88	1 035 814.36	32.68	108 982.92	3.44
1994	2 265 137.98	63.10	1 193 385.13	33.25	130 985.21	3.65
1995	2 657 577.01	62.02	1 449 030.83	33.82	178 466.23	4.16
1996	2 750 173.64	59.94	1 593 665.71	34.73	244 630.84	5.33
1997	2 765 668.31	57.90	1 735 381.46	36.33	275 306.90	5.76
1998	2 777 798.41	58.49	1 708 404.55	35.97	263 248.52	5.54
1999	3 166 493.66	60.17	1 837 534.77	34.91	258 931.53	4.92
2000	3 424 812.85	57.79	2 169 624.36	36.61	331 435.77	5.59
2001	3 251 804.04	56.52	2 150 747.03	37.38	350 739.36	6.10
2002	3 277 613.28	56.00	2 220 746.06	37.94	354 682.72	6.06

Source: Kowalski and Shepherd (2006).

Table 5.A.4. Average annualised growth rates of trade, breakdown by aggregate income group, 1985-2002

Percentages

	North-North	North-South	South-South
1985-1990	14.30	9.32	5.99
1990-1995	5.74	15.24	22.71
1995-2000	5.20	8.41	13.18
2000-2002	-2.17	1.17	3.45
1985-2002	7.04	9.75	12.49

Source: Kowalski and Shepherd (2006).

Table 5.A.5. South-South trade as a percentage of total trade involving the South, 1985-2002

Year	Percentage
1985	9.50
1986	8.76
1987	8.55
1988	8.37
1989	8.78
1990	8.25
1991	7.88
1992	9.76
1993	9.52
1994	9.89
1995	10.97
1996	13.31
1997	13.69
1998	13.35
1999	12.35
2000	13.25
2001	14.02
2002	13.77

Source: Kowalski and Shepherd (2006).

Table 5.A.6. Estimated pattern of world and OECD trade in services, 2002

% of total world exports

2002	World	Total OECD	NAFTA	OECD Asia and Oceania	EU	OECD Europe other	Total non OECD	Africa	America non OECD	Asia and Oceania non OECD	Europe non OECD
World	100.0	73.8	19.6	9.0	40.5	4.7	24.9	2.3	4.0	16.2	2.4
Total OECD	76.3	61.1	15.4	5.9	35.3	4.4	14.0	1.6	3.3	7.4	1.7
NAFTA	20.9	15.1	4.7	3.0	6.7	0.7	5.6	0.4	2.3	2.6	0.3
OECD Asia and Oceania	*7.2*	*4.7*	*2.3*	*1.0*	*1.3*	*0.1*	*2.5*	*0.1*	*0.2*	*2.1*	*0.1*
EU total	*42.7*	*36.4*	*7.5*	*1.7*	*23.8*	*3.4*	*5.2*	*1.1*	*0.8*	*2.5*	*0.9*
OECD Europe other	*5.5*	*4.9*	*0.9*	*0.1*	*3.5*	*0.2*	*0.7*	*0.0*	*0.0*	*0.2*	*0.4*
Total non OECD	23.6	12.7	4.2	3.1	5.1	0.3	10.9	0.8	0.7	8.8	0.7
Africa	*2.1*	*1.5*	*0.2*	*0.2*	*1.1*	*0.0*	*0.6*	*0.4*	*0.0*	*0.2*	*0.0*
America non OECD	*3.4*	*2.9*	*1.7*	*0.4*	*0.7*	*0.0*	*0.6*	*0.0*	*0.4*	*0.1*	*0.0*
Asia and Oceania non OECD	*15.4*	*6.6*	*2.0*	*2.4*	*2.1*	*0.1*	*8.7*	*0.3*	*0.2*	*8.0*	0.2
Europe non OECD	*2.7*	*1.7*	*0.2*	*0.1*	*1.2*	*0.2*	*1.0*	*0.0*	*0.0*	*0.5*	*0.5*

Notes: NA refers to estimates that could not be deducted taking into account the available data. Total World doesn't add up to 100% because of discrepancies in the original table! The 2002 table 1b was constructed with more information than was available in 2001 for table 1a*]. Due to data quality and inconsistency problems a comparison of the two tables for 2001 and 2002 may be in part an indication of the degree of robustness of the estimates as well as real changes.
Source: Derived from source: OECD (2003) & (2004), Statistics on International Trade in Services.

Table 5.A.7. Estimated pattern of world and OECD trade in services, millions USD and percentage, 2002

2002	World	Total OECD	NAFTA	OECD Asia and Oceania	EU	OECD Europe other	Total non OECD	Africa	America non OECD	Asia and Oceania non OECD	Europe non OECD
World	1 641 291	73.8%	19.6%	9.0%	40.5%	4.7%	24.9%	2.3%	4.0%	16.2%	2.4%
Total OECD	1 251 939	80.0%	20.2%	7.7%	46.3%	5.8%	18.3%	2.1%	4.3%	9.7%	2.2%
NAFTA	342 775	72.5%	22.3%	14.6%	32.0%	3.5%	26.6%	1.7%	11.0%	12.7%	1.3%
OECD Asia and Oceania	118 316	65.0%	31.4%	14.1%	18.0%	1.4%	35.0%	1.6%	3.1%	29.6%	0.7%
EU total	700 318	85.2%	17.7%	3.9%	55.8%	7.9%	12.3%	2.6%	1.8%	5.8%	2.2%
OECD Europe other	90 531	88.2%	17.2%	2.7%	63.9%	4.3%	11.8%	0.4%	0.7%	2.8%	7.9%
Total non OECD	387 533	53.8%	17.7%	13.1%	21.7%	1.3%	46.2%	3.2%	2.8%	37.2%	3.0%
Africa	34 048	70.8%	8.3%	9.2%	52.7%	0.5%	29.2%	18.5%	0.6%	9.0%	1.1%
America non OECD	56 486	83.2%	50.8%	11.6%	20.4%	0.3%	16.8%	0.2%	12.4%	3.9%	0.2%
Asia and Oceania non OECD	252 000	43.3%	13.3%	15.8%	13.6%	0.6%	56.7%	2.2%	1.2%	52.2%	1.3%
Europe non OECD	44 998	63.0%	8.2%	2.9%	45.1%	6.9%	37.0%	1.3%	1.2%	16.7%	17.8%

Source: OECD (2004), Statistics on International Trade in Services.

Table 5.A.8. International scheduled passenger flows by region as percentage of total, 2000

Thousands of passengers (2000)

	North America	Central America	South America	Europe	Middle East	Africa	Asia	South West Pacific
North America	0.03	0.05	0.02	0.11	0.00	0.00	0.05	0.01
Central America		0.01	0.00	0.01			0.00	
South America			0.01	0.01		0.00	0.00	0.00
Europe	0.37				0.02		0.05	0.01
Middle East					0.01		0.02	
Africa				0.04	0.01	0.01	0.00	0.00
Asia	0.09							0.03
South West Pacific	0.00							

Source: IATA (2004).

Table 5.A.9. International scheduled freight tonnes flows by region

Percentage of total

	North America	Central America	South America	Europe	Middle East	Africa	Asia	South West Pacific
North America	2.05%	2.18%	2.63%	17.88%	0.55%	0.12%	14.61%	0.66%
Central America		0.14%	0.14%	0.91%			0.06%	
South America			0.70%	2.07%		0.11%	0.05%	0.03%
Europe				9.15%	3.77%		16.36%	0.71%
Middle East					0.78%		2.06%	
Africa				3.89%	0.57%		0.38%	0.06%
Asia							13.61%	2.85%
South West Pacific								0.43%

Source: IATA (2004).

Table 5.A.10. Visitor arrivals by region

Percentages

Regions exporting (Reporter)	OECD Total	NAFTA	OECD Asia and Oceania	EU	OECD Europe other	Non OECD total	America non OECD	Asia and Oceania non OECD	MENA	Europe non OECD	Africa	Total
OECD total	80.6%	15.5%	2.3%	54.5%	8.4%	19.4%	3.8%	7.0%	1.4%	5.2%	2.1%	100.0%
NAFTA	79.2%	59.0%	2.2%	16.0%	2.0%	20.8%	12.1%	6.1%	1.0%	0.8%	0.8%	100.0%
OECD Asia and Oceania	49.9%	14.6%	17.0%	15.6%	2.7%	50.1%	0.7%	46.9%	0.8%	1.0%	0.8%	100.0%
EU	85.3%	3.1%	0.7%	72.0%	9.5%	14.7%	1.9%	3.0%	1.5%	5.6%	2.7%	100.0%
OECD Europe other	74.8%	3.4%	0.5%	49.8%	21.1%	25.2%	1.6%	1.8%	1.9%	17.4%	2.5%	100.0%
Non OECD Total	29.9%	3.5%	3.1%	11.9%	11.4%	70.1%	6.7%	22.9%	11.3%	20.3%	8.9%	100.0%
Non OECD nec	17.6%	0.3%	2.4%	13.3%	1.5%	82.4%	12.2%	18.3%	6.0%	23.8%	22.2%	100.0%
America non OECD	40.5%	20.4%	0.5%	18.7%	0.9%	59.5%	55.9%	2.0%	0.5%	0.5%	0.7%	100.0%
Asia and Oceania non OECD	21.4%	3.2%	8.7%	7.5%	2.0%	78.6%	0.2%	66.5%	8.2%	2.7%	0.9%	100.0%
MENA	15.3%	2.5%	0.4%	7.4%	5.0%	84.7%	0.4%	3.7%	69.8%	3.1%	7.7%	100.0%
Europe non OECD	44.3%	0.4%	0.5%	14.5%	29.0%	55.7%	0.3%	3.1%	1.9%	49.9%	0.5%	100.0%
Africa	16.7%	1.7%	0.7%	12.9%	1.4%	83.3%	0.3%	3.2%	10.1%	0.4%	69.3%	100.0%
TOTAL	65.5%	12.0%	2.5%	41.8%	9.2%	34.5%	4.7%	11.7%	4.3%	9.7%	4.1%	100.0%

Notes: OECD Europe Other may include non-OECD countries recorded under a general category "ALL C/E EUR" or "ALL EUROPE". "Non-OECD nec refers to "OTH.WORLD" and "N RESID ABRO". Covers 206 countries.
Source: World Tourism Organisation (2004).

Table 5.A.11. Estimation of South-South FDI flows, 1994-2000

USD billions

	1994	1995	1996	1997	1998	1999	2000
South-South flows	4.6	15.3	25	57.4	56.6	49.7	53.9
Share of total South -South FDI flows	6	16.2	22.3	38.7	36.8	31	36.4

Source: Aykut and Ratha (2003).

Table 5.A.12. Revealed comparative advantage, selected countries

	Transport			Travel			Insurance and financial services			Computer, information, communications and other commercial services		
	1990	2002	% change	1990	2002	% change	1990	2002	% change	1990	2002	% change
Argentina	1.77	0.58	-67.13	1.05	0.94	-10.75	0.00	0.01	-	0.22	0.30	40.85
Brazil	0.86	0.54	-37.10	0.72	0.50	-30.37	0.28	0.54	95.86	0.38	0.91	139.73
Chile	1.58	2.29	45.19	0.89	0.57	-36.09	0.73	0.27	-63.61	0.69	0.54	-21.36
China	0.89	0.37	-58.82	0.44	0.97	121.75	0.28	0.05	-82.89	0.24	0.48	96.45
Costa Rica	1.05	0.81	-22.76	2.39	2.82	18.01	0.37	0.20	-45.66	1.54	0.81	-47.69
Dominican Republic	0.42	0.21	-50.89	3.79	5.80	52.89	0.06	0.00	-100.00	1.41	0.26	-81.19
Egypt	6.52	4.87	-25.34	2.26	4.81	112.56	0.49	0.51	4.51	2.34	2.44	4.53
India	0.95	0.81	-15.26	1.17	0.71	-39.81	0.47	0.32	-32.26	1.35	3.40	152.39
Indonesia	0.06	0.39	604.35	1.30	1.44	10.31	0.00	0.00	0.00	0.15	0.04	-74.51
Jamaica	1.84	2.89	56.93	6.00	6.98	16.37	0.54	0.80	47.49	0.25	1.22	380.71
Malaysia	0.81	0.62	-23.26	0.86	1.14	31.77	0.01	0.12	1160.84	0.41	0.57	38.39
Mexico	0.42	0.16	-62.74	1.96	0.88	-54.95	0.59	0.44	-24.55	0.15	0.10	-35.26
Philippines	0.50	0.38	-24.68	0.72	0.76	6.06	0.11	0.11	-3.54	3.04	0.20	-93.35
Singapore	0.76	1.74	127.97	1.21	0.49	-59.61	0.12	0.30	163.01	1.36	1.13	-16.71
South Africa	0.59	0.71	18.96	1.16	1.38	18.62	1.12	0.44	-60.71	0.23	0.16	-30.03
Thailand	1.01	0.91	-9.96	2.51	1.62	-35.18	0.04	0.07	89.82	0.33	0.64	92.26

Source: Marchetti (2004).

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Special Focus: Trade, Investment and Development

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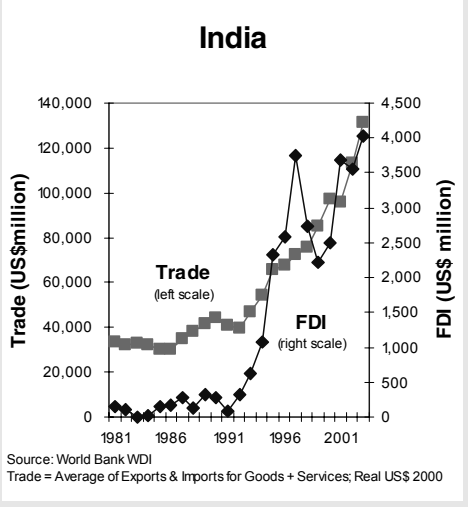
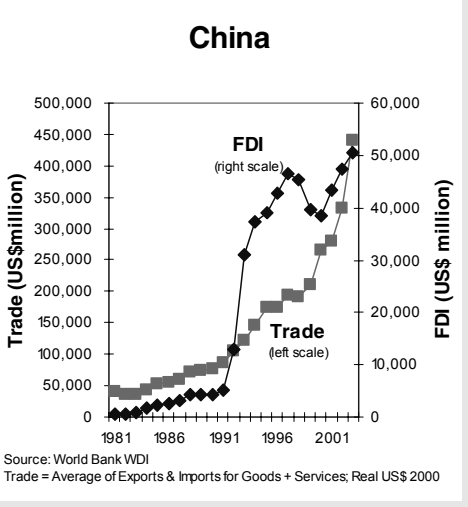
Trade policy is one of the main determinants of investment decisions by domestic and foreign firms. Trade liberalisation can not only encourage investment but also maximise its contribution to development, in particular by encouraging technology transfer and other linkages that induce growth.

The relationship between trade and investment

The relationship between international trade, domestic investment and foreign direct investment (FDI) is complex (OECD, 2005a). Trade can either substitute for or complement FDI. Market-seeking firms can serve foreign markets through export sales or through foreign subsidiaries. The latter effectively substitute FDI for trade. In turn, affiliates of foreign firms create new trade flows with their parent companies or foreign suppliers and may also export to third countries or back to the home country, thereby increasing trade. Trade can also draw attention to resources and markets and highlight opportunities for foreign investors. Hence, greater trade correlates with greater FDI flows, as exemplified by India and China (Figure 1).

Figure 1. The virtuous cycle between trade and FDI: India and China





Foreign investment, which is generally a small share of a country's total investment, can either substitute for, or complement, domestic investment. For a given project, domestic investment may be non-competitive with FDI, but it can also complement FDI, as in the case of joint ventures, or leverage FDI, as in the case of domestic debt. When domestic investment and FDI are complementary, economic activity tends to increase and induce more trade for a given amount of investment. Moreover, to the extent that investment (domestic or FDI) positively affects a host's economic growth, it can also have a trade-enhancing effect.

FDI (and to a lesser extent domestic investment) can induce imports in the short term. An investing firm building a new plant, for instance, may require capital items that are either only available or cheaper from foreign sources. A benefit of trade liberalisation is that it allows domestic

and foreign investors to access the most efficient inputs produced abroad and enhance the host country's international competitiveness.

Increasing intra-firm trade between developed and developing countries highlights the trend towards more trade-intensive foreign investment (World Bank, 2003). This reflects the new multinational enterprise (MNE) strategies of outsourcing and globalised production, with a network of subsidiaries in various countries creating a "global value chain" (UNCTAD, 2002), and mirrors a change in the determinants of FDI. Although market-seeking or resource-seeking investments still account for most FDI between developed and developing countries (*i.e.* investment seeking access to new markets or resources), efficiency-seeking motives, which take advantage of cost differences and scale economies and rationalise production, have increased over the past decade.

Spillovers and linkages: the growth impact of trade and investment

There is more and more evidence that trade liberalisation has a positive impact on growth (Wacziarg and Welch, 2003; Lee *et al*., 2004). Several channels of transmission between trade and growth involve interaction between foreign and domestic firms in the host economy and thus imply FDI. While domestic investment is the key to economic growth and development, FDI linked with trade can be a catalyst for innovation, improved productivity and sustained growth through linkages between a foreign firm and its suppliers (upstream or backward vertical linkages), its customers (downstream or forward vertical linkages), or its competitors (horizontal linkages) (see OECD, 2002, and Saggi, 2004, for a review of the available empirical evidence). Sectors with a high level of foreign involvement generally have higher productivity and faster productivity growth.

Backward linkages are considered the strongest and most consistent positive spillover (OECD, 2002; Javorcik, 2004). They can be defined as contracts between the foreign affiliates of a MNE and local suppliers of products or services used directly or indirectly by the foreign affiliate. Recognition of the importance of introducing new technologies and management skills through backward linkages has refined development thinking. Backward linkages may also include movements of people, demonstration effects and increased competition when MNEs encourage local capacity building.

The role of the services sector in the process should be emphasised (OECD, 2006). Key services, such as business services, telecommunications, financial services, higher education and training, and logistics services, can facilitate the transfer of knowledge between foreign and domestic firms. There is also evidence of a positive relationship between FDI in manufacturing and trade in services (OECD, 2005b).

Maximising the benefits of trade and investment for development

Countries with outward-oriented strategies and liberal policies in dynamic export sectors have tended to perform well in terms of growth. A new activity launched with the help of foreign investors is often subsequently dominated by domestic firms. Examples include India's software industry and business services sector, Chinese Taipei's electronics and semiconductor industry and Mauritius' textile industry. However, spillovers from trade and investment do not occur automatically. Some studies find that FDI has a negative impact on domestic firms (*e.g.* Djankov and Hoekman, 2000, on Czech manufacturing). In some cases FDI may be more market- or resource-seeking than efficiency-seeking, and there may be fewer interactions between foreign affiliates and domestic firms. Domestic firms may also lack the ability to absorb the technologies of foreign firms. Indeed, several studies point to the fact that without sufficient absorptive capacity – for example, enough human capital – a country will fail to increase its productivity through FDI (*e.g.* Xu, 2000).

To attract foreign investors, policy makers in developing countries need to create a healthy investment environment. They should aim to reduce costs associated with customs procedures, regulations and administration. It is also important to reduce policy uncertainty and encourage regional trade integration to create larger markets and enhance dynamic gains from trade. Experience shows that promotion of spillovers and linkages is best achieved when investors are free to source inputs competitively and to develop the sectors of their choice. Strategies aimed at "picking winners and losers" through trade policy have generally failed as they create anti-import or anti-export biases. With sufficient time, liberalising trade policies can be an incentive for investment (both domestic and FDI) and a catalyst for its positive effects on growth. Liberalising trade is not a panacea, but in conjunction with other policies, it is an integral part of attracting investment and utilising it effectively for growth.

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FOREWORD

Since the OECD published *The Development Dimensions of Trade* in 2001, the multilateral trading system has been buffeted by turbulent discussions on the potential shape of a negotiated package under the World Trade Organisation's Doha Development Agenda. Developing countries facing an increasingly competitive and complex global trading environment have challenged the system to deliver a package that will boost their development prospects. Yet, the situation of individual developing countries varies widely, as does the commentary on the impact of past liberalisation and the potential for future liberalisation to deliver substantial gains.

This publication seeks to shed light on some of the most pressing trade and development issues, presenting a new set of analyses grounded in empirical approaches and updated modelling techniques. It aims to disaggregate impacts of multilateral liberalisation and to consider the variation among and within the various developing economies, as well as related policy implications. In addressing a broad range of developing country concerns with respect to multilateral trade liberalisation, it draws on recent work from across the OECD and includes a special chapter with new modelling results prepared by a team from the World Bank. Beyond the main chapter themes, a set of short *Special Focus* features highlight related OECD research findings.

Douglas Lippoldt of the OECD Trade Directorate edited the publication. Jacqueline Maher of the OECD Trade Directorate handled the compilation and formatting of the various elements. The individual chapters and *Special Focus* segments were authored by members of several OECD directorates and the World Bank, whose names figure on the title pages of their contributions. The attention of readers is drawn to the notes and acknowledgements presented in the individual chapters, which are too numerous to reiterate here. A number of chapters draw on closely related OECD documents prepared in collaboration with additional experts; in such cases, these are recognised in the notes. This publication represents a team effort and the contribution of each participant is gratefully acknowledged by the OECD Trade Directorate, which had the lead in managing the project.

EXECUTIVE SUMMARY: A WORLD OF TRADE LIBERALISATION

Douglas Lippoldt, OECD Trade Directorate

In an April 2006 press release on world trade developments, World Trade Organisation (WTO) Director-General Pascal Lamy provided a succinct characterisation of the global trading system as undergoing a period of transition and being in need of a new multilateral trade accord (WTO, 2006):

> *"Shifting economic circumstances, major advances in technology and the emergence of new players on the global scene all underscore that we are on the cusp of big changes. Persistent imbalances, driven largely by macro-economic factors, continue to be a cause for concern in some major economies. In such a climate of uncertainty, one thing is certain, [WTO] Member governments must strengthen the global trading system by making it more equitable and relevant for those who trade in the 21st century. There can be no doubt that the best way to do this would be to conclude this year an ambitious agreement in the Doha round of global trade negotiations."*

Recent years have indeed witnessed striking changes in the global economic landscape, confirming the role of trade as a driving force in economic development and providing an indication of the potential for further trade liberalisation, under the right conditions, to benefit the global economy broadly. Given this situation, the OECD – with input from the World Bank – has undertaken to review recent work on trade and development and to examine in more depth selected trade issues faced by developing countries. This publication presents the results of this investigation.

Kym Anderson, in an article in the Journal of World Trade (2005), asks the question, "What Roles for Economists?" in setting the trade policy agenda. While providing a useful review of the post-World War II contributions of economists to understanding the economics of trade and advancing the trade policy agenda, the article's conclusions point to the important role played by trade policy analysts in bridging the gap between the research community and trade policy makers. The present volume was prepared with this in mind and aims to communicate the findings and conclusions in language that is accessible to trade policy makers, advisors and informed observers equipped with a basic understanding of economics. The intention is to help illuminate issues in the ongoing discussions on trade liberalisation by addressing key concerns and considering options that would permit a reduction in harmful distortions to the world economy that result from barriers to trade.

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The economic well-being of a nation is linked closely to the availability of resources and the productivity of its workforce. Trade operates in a variety of ways to support the development process. For example, it boosts competition and the associated impetus to innovation and specialisation, and it provides an important channel for international technology transfer.[1] Consequently, it is not surprising

[1] Increasing the stock of available technology is critical to development, because technology plays a central role in boosting output per worker and is an important determinant of income levels. See WTO (2002) for a discussion and bibliographic references.

that economists include trade among the classic drivers of economic growth.[2] The positive results from trade liberalisation are not automatic, and policy choices – including those with respect to complementary policies – do make a difference. Among the most fundamental is the establishment of an adequate system of economic governance, including institutions and rule of law, which are crucial for property rights and for lowering transaction costs, among other baseline conditions. Beyond the basic framework, other policies can be employed to boost the ability to adjust or strategically promote the conditions for development.[3] For example, a sound regulatory framework and appropriate labour market, macroeconomic and investment policies can help facilitate structural adjustment and the associated reallocation of resources to increasingly productive employment (OECD, 2005).

In view of the complexity of modern economies and the interplay among the various policies, care must be taken in assessing the relationship between trade and development. While it is clear that the impacts of further trade liberalisation will vary among countries according to the situation of each country, there will also be variation within countries. Changes in trade policies, such as import tariffs, may have consequences in various other policy domains, such as fiscal policy (relating to government revenue) or social policy (related to distributional concerns). The analyses presented in this volume are broadly framed and attempt to tackle some of the wider concerns raised by the prospect of further trade liberalisation. These analyses often point to policy options that can improve outcomes globally or address risks of negative outcomes for specific stakeholders. In some cases, international action may be required (*e.g.* building a particular approach into multilateral trade liberalisation), but in others a country's own reforms are critical in determining outcomes.

A key point confirmed in all of the analyses in the present volume is that trade liberalisation has the potential to contribute to improved economic welfare. Through modelling results, statistical assessments and concrete case studies, these chapters add to the growing body of literature that points to a positive relationship between a nation's openness or progressive integration into the world economy and its growth or economic development (*e.g.* OECD, 1998; 2001; WTO, 2003).

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This volume begins with two chapters containing broad assessments of the potential welfare gains from global liberalisation. These studies emphasise different assumptions and computable general equilibrium models and their conclusions differ as well; this is perhaps most evident in the contrasting findings concerning developing countries' potential gains from liberalisation of trade in industrial goods and those from liberalisation in agriculture. The discussion in these chapters includes some attempt to reconcile differences among the various modelling approaches used to consider the welfare implications of trade liberalisation for developing countries. Although differences remain, it is interesting that the range of aggregate gains is of roughly the same order of magnitude in both studies. Moreover, the estimates of gains are more modest than some that circulated at the time of the Uruguay Round of trade negotiations (1986-94). This is partly due to the trade liberalisation that has since occurred (*i.e.* the remaining barriers are now less onerous than those in place prior to the Uruguay Round). But it also reflects the growing sophistication of the models and associated data sets, which now take more dimensions of the actual trade policy landscape into account. For example, the extent

2 Timmer (2006), for example, summarises these conditions as trade and specialisation; investment in machines; and increasing returns to knowledge.

3 For example, policies to facilitate "moving up the value chain" can play a role in development. For examples in the textile and apparel sectors see OECD (2004). A more general study by Hausmann *et al.* (2006) examines the importance of the structure of exports in terms of value and productivity.

of regional and unilateral preferential trading relationships is now more fully incorporated into the analyses.[4]

The next three chapters examine particular concerns for developing countries with respect to trade liberalisation in the context of the multilateral trading system: preference erosion, possible government revenue losses due to tariff liberalisation, and realising the potential benefits from expanded South-South trade. These chapters make clear that developing countries as a whole stand to benefit from trade liberalisation. At the same time, there is significant variation in the extent to which each of these issues affects individual developing countries. In some cases, there is a potential for net losses if appropriate policy frameworks are not in place. Outcomes are influenced in part by the choice of liberalisation scenario and each country's complementary policy mix. Fortunately, these chapters also point to policy approaches that can assist in addressing the challenges while promoting new market opportunities through trade liberalisation. For example, developing countries that rely particularly on tariff revenue to fund the functioning of government can take heart from Chapter 4, which underscores the potential to mitigate negative impacts from liberalisation by developing alternative sources of government revenue and taking care in establishing the structure of post liberalisation tariffs.

The following two chapters consider separately trade liberalisation in services and in agriculture. In some ways, trade liberalisation may tend to be less advanced in these two sectors than in the industrial goods sector. While noting the potential for economic gains from liberalisation, these chapters also underscore important economic relationships among economic actors. In the case of the service sector, these concern the taxing effect that services trade barriers have on other sectors of the economy (especially industries for which services comprise an important input). The chapter on agriculture brings in a new dimension by considering the impact of agricultural liberalisation on households, as well as more aggregate impacts. The analysis at the household level underscores the complexity of the economic outcomes from trade policy reforms. Whereas further agricultural trade liberalisation is found to be generally beneficial at the aggregate level, outcomes across households vary. Some groups will be at risk of losing out, especially among those that are dependent on protected and non-competitive agricultural production. Developing country policy makers aiming for improved economic efficiency through trade reform in agriculture will face a challenge for putting in place complementary adjustment policies if they are to avoid negative welfare impacts on certain poor households dependent on agricultural activity.

The final chapter considers the role of special and differential treatment and aid for trade as complements to multilateral trade liberalisation. As underscored in *Trade and Structural Adjustment* (OECD, 2005), the requisites for successful trade liberalisation include an array of complementary policies and institutions. Owing to resource constraints and other impediments, developing countries sometimes face difficulties in adequately meeting these needs. Participants in the multilateral trading system have sought to address these difficulties via a number of initiatives, including special and differential treatment and aid for trade.[5] While the results of these initiatives to date have been mixed, the persistent nature of certain development challenges and the need to advance trade reform continue to drive efforts to enhance their functioning and effectiveness.

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4 For another example, see Chapter 1 of this volume for a discussion of modelling of liberalisation scenarios taking into account the difference in bound and applied tariffs.

5 In recent years, some economists have come to approach such measures with a degree of caution because of the potential for introducing further distortions into the global economy. Anderson (2005) provides some illustrations. Also, concerns about the effectiveness of trade-related development assistance are raised by Easterly (2005), Rajan and Subramanian (2005) and Sen (2006), among others.

Supplementing the main chapters are seven *Special Focus* sections that provide a window onto OECD work on related trade topics. Each delivers a snapshot of key messages from OECD research along with references for further reading. These sections reveal instances of progress made by certain developing countries seeking better integration into the global economy as well as areas for improvement or additional study. Some point to economic processes which, in conjunction with trade liberalisation, can work to transform economies and promote development. Examples include structural adjustment, technology transfer and innovation associated with improved intellectual property rights, and the interaction of trade and foreign direct investment. Other sections refer to more "traditional" trade policy issues including trade facilitation, export credits and customs fees or charges, which can have a significant impact on trade flows and, hence, the development impacts of trade.

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Overall, *Trading Up* has a positive story to tell. Trade can contribute to economic development. The impact of liberalisation can be enhanced by appropriate complementary policies, a point that applies both to maximising the gains from trade and reducing adjustment costs. Moreover, developing countries control many of the policy levers that can work to ensure positive outcomes for themselves; their own actions are critical in establishing the essential conditions for growth. Developed countries have an important role to play as well by improving market access, avoiding damaging actions (*e.g.* through barriers to trade or harmful market interventions), and provision of effective, targeted assistance.

The multilateral trading system plays an essential function in defending and promoting the interests of all trading nations, including developing countries. While regional trade arrangements can expand market access and integrate member countries, they are inherently discriminatory (World Bank, 2006). By starting from the principles of national treatment and non-discrimination, providing a forum for *global* market opening negotiations, and extending balanced treatment of member countries (including recourse in cases of violations of the rules), the WTO can help to ensure that trade works more broadly as an engine of growth and development. The conclusions from the analyses presented here support the pro-development case for the multilateral trading system, underscoring the economic value of further carefully crafted, ambitious, multilateral liberalisation.

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ACRONYMS

ACP	African, Caribbean and Pacific countries
AGOA	African Growth and Opportunity Act (US)
ANZCERTA	Australia-New Zealand Closer Economic Relations Trade Agreement
APEC	Asia-Pacific Economic Co-operation
ASEAN	Association of South East Asian Nations
ATC	Agreement on Textiles and Clothing (WTO)
BOP	balance of payments
CBI	Caribbean Basin Initiative (US)
CBTPA	Caribbean Basin Trade Partnership Act (US)
CEPII	Centre d'Etudes prospectives et d'informations internationales
CGE model	computable general equilibrium model
CRS	OECD Credit Reporting System (database)
CTDSS	Committee on Trade and Development in Special Session (WTO)
DAC	Development Assistance Committee (OECD)
DDA	Doha Development Agenda (WTO)
DDA GTF	Doha Development Agenda Global Trust Fund (WTO)
DSU	Dispute Settlement Understanding (WTO)
EBA	Everything But Arms initiative (EU)
ECLAC	Economic Commission for Latin America and the Caribbean (UN)
EFTA	European Free Trade Association
ERP	effective rate of protection
EU	European Union
FDI	foreign direct investment
GATS	General Agreement on Trade in Services (WTO)
GATT	General Agreement on Tariffs and Trade
GDP	gross domestic product
GNP	gross national product
GPT	General Preferential Tariff (Canada)
GSP	Generalised System of Preferences
GSTP	Global System of Trade Preferences among Developing Countries
GTAP	Global Trade Analysis Project
HS	Harmonised System
IATA	International Air Transport Association
IF	Integrated Framework for Trade-Related Technical Assistance to the LDCs
IFI	international financial institutions
ILO	International Labour Organisation

IMF	International Monetary Fund
ISCO 88	International Standard Classification of Occupations
ITC	International Trade Centre
IIT	intra-industry trade
JITAP	Joint Integrated Technical Assistance Programme
LDC	least developed country
LDCT	Least Developed Country Tariff (Canada)
MNC	multinational corporation
MFN	most favoured nation
MTS	multilateral trading system
NAFTA	North American Free Trade Agreement
NAMA	Non-Agricultural Market Access
NGO	non-governmental organisation
NIE	newly industrialising economy
NTB	non-tariff barrier
ODA	official development assistance
PSE	producer support estimate
Quad countries	Canada, European Union, Japan and the United States
RCA	revealed comparative advantage
RTA	regional trade agreement
ROOs	rules of origin
SACU	South Africa Customs Union
SDT	special and differential treatment
SPS Agreement	Sanitary and Phytosanitary Agreement (WTO)
TBT Agreement	Technical Barriers to Trade Agreement (WTO)
TCBDB	Trade Capacity Building Database (WTO/OECD)
TNC	transnational corporation
TRIPS Agreement	Agreement on Trade-Related Aspects of Intellectual Property Rights (WTO)
TRQ	tariff rate quota
TRTA/CB	trade-related technical assistance and capacity building
UNCTAD	United Nations Conference on Trade and Development
UNECA	United Nations Economic Commission for Africa
UR	Uruguay Round
VAT	value added tax
WITS	World Integrated Trade Solution
WTO	World Trade Organization

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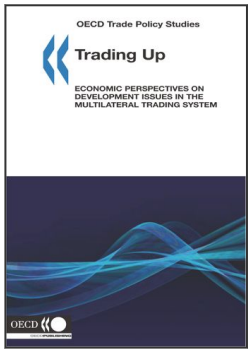

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