

Trade, Aid and Security

An Agenda for Peace and Development

Chapter 1: Designing Conflict-sensitive Trade Policy

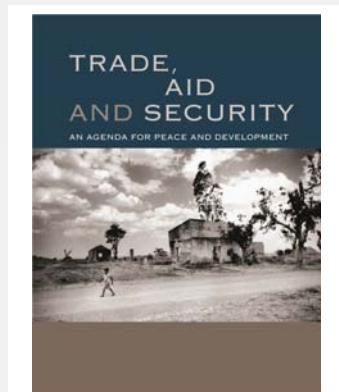
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Chapter 1

Designing Conflict-sensitive Trade Policy

Mark Curtis

Introduction

Designing trade policies that do not increase the likelihood or longevity of conflict is a critical task for the international community. Trade policies that limit market access, increase the volatility of commodity prices, unfairly subsidize developed country exports and constrain the trade policy flexibility of the developing world affect those countries' stability and security as well as their overall economic well-being.

In short, the current system of international trade is fundamentally unfair and biased towards rich countries and the corporations based in those states. Restrictions on market access and continuing domestic subsidies by rich countries consign many developing countries to reliance on the export of primary commodities. Over the past five decades these commodities have suffered from declining and volatile prices – a trend that is strongly correlated with political instability and conflict.

At the same time, developing countries are being pushed to adapt to an increasingly liberalized global trading system, from which many barely benefit and some are losing out, often reducing government revenues and undermining livelihoods – serving to increase the prospects for political instability and competition over scarce resources.

This chapter outlines some of the ways in which trade policy affects conflict and recommends how trade policies could be more conflict sensitive. It is noticeable that in much of the discussion on global trade policy, the potential impact of trade on conflict has featured very little. This was the case even in the run-up to the WTO ministerial in Hong Kong, and is surprising given that both advocates and critics of trade liberalization often argue that the impact of

trade liberalization is large, and also that many of the countries and regions worst affected by conflict are also at the centre of debates on trade liberalization. In short, conflict-sensitive trade policy is a relatively new area of analysis that has not received sufficient attention on the part of the international community.

Policies in these areas therefore need to be very carefully considered, indeed changed, by OECD states as well as international institutions such as the WTO. For this to occur there needs to be a clear understanding of the links between trade policy and conflict as well as the political will to change course.

Trade and conflict

The international trading environment, and specifically the trade policy of the rich countries, is a significant determining factor of economic well-being in poorer countries. The latter currently have little influence over global commodity prices; they suffer from major terms of trade disadvantages and have in reality had little say in the global trade liberalization agenda of the past decade.

There is considerable evidence of a link between economics and conflict. One study of 40 sub-Saharan African countries between 1983 and 1999 showed a strong correlation between economic growth and the incidence of civil conflict: a negative growth shock of five percentage points increased the likelihood of major civil conflicts by over one half (Miguel et al, 2003). Another analysis points out that ‘economic studies of civil war have successfully identified an empirically robust relationship between poverty, slow growth and an increased likelihood of civil war and prevalence’ (Sambanis, 2003).

History and bitter experience have demonstrated that low-income countries are particularly prone to conflict. Poverty undermines human security and creates the conditions for conflict to turn violent. The United Nations Conference on Trade and Development’s (UNCTAD) analysis is that low-income countries are particularly conflict prone, with the proportion of low-income countries experiencing civil conflict in the period 1990–2001 more than twice that of middle-income countries. It points out, however, that low income levels alone are not a sufficient condition for the onset of civil conflict; rather, what appears to be important is the interaction of low income levels with other adverse conditions such as economic shocks, stagnation or recession. Most Least Developed Countries (LDCs) in which civil conflict broke out in the 1990s experienced either negative or sluggish growth rates in the 1980s, suggesting that the events of the 1990s were a reaction to the economic experience of the 1980s (UNCTAD, 2004, p164).

The link between economics and conflict is explicitly recognized, to one extent or another, by most governments and international institutions. For example, the UK’s Department for International Development (DFID) notes that ‘continuous economic decline plays a major part in state collapse and conflict’, and that sections of the populations become ‘disillusioned,

marginalized and frustrated' as a result of the economic decline, which in turn brought about by massive debt and unfavourable terms of trade. DFID notes that 'economic shock is a ... direct cause of conflict' and that 'the sudden shift in the terms of trade in Nigeria in 1992/3 halved Nigeria's income, introduced hyperinflation and led to violence and the overthrow of the government'. DFID also notes that 'countries whose economies are dependent on natural resources such as oil and minerals, face a high risk of conflict' – the so-called 'resource curse' (DFID, 2001).

Various trade policies promoted by the OECD states have severe impacts on people in poor countries. By depriving vulnerable countries of government revenues and by impacting severely on specific groups of people, the basic argument here is that these policies aggravate the risk of conflict and/or undermine post-conflict reconstruction efforts. This chapter now considers four important issues in this regard:

- 1 the tariff and non-tariff barriers, escalating tariffs for processed goods and stringent technical/scientific standards that restrict the access of developing country products to rich developed world markets and inhibit developing country efforts to diversify their economies;
- 2 the use by northern states of domestic and export subsidies that regularly result in the dumping of subsidized produce, often below the costs of production, undermining industries and food security in developing countries;
- 3 the continuing dependence of many developing countries on the export of a small number of commodities, which have suffered falling, volatile prices over the past five decades;
- 4 the aggressive promotion of an increasingly globalized trading system, often for the benefit of northern states, in which developing countries are being required to implement trade liberalization commitments that reduce their policy 'space' to promote policies suited to their national or local circumstances.

Market access restrictions

OECD country trade policy constructs a number of daunting barriers to developing country exporters. Access to developed country markets is often limited by quotas, the exclusion of specific products, tariff barriers and tariff peaks (often for goods that developing countries produce more efficiently than Europe, such as dairy products, vegetables, nuts and fruit), higher duties for processed goods and 'rules of origin' clauses which prevent manufactured goods that require components from outside the region from entering developed country markets.

Tariff escalation is a particularly pernicious measure in which developed countries apply low tariffs to imports of raw commodities but rapidly rising rates to intermediate or final products. For instance, in Japan tariffs on processed food products are seven times higher than on first-stage products, while in Canada

they are 12 times higher. In effect, tariff escalation prevents developing countries from adding value to their exports, inhibits industrialization and locks them into dependence on exporting price-volatile, low value-added commodities (UNDP, 2005, p127). There can be little doubt that such barriers have been a major brake on development in some of the world's poor countries.

Existing schemes trumpeted by OECD countries as improving market access for developing countries tend to be the subject of considerable exaggeration. The EU's Everything But Arms (EBA) initiative, which took effect in March 2001, grants duty-free access into the EU to imports of almost all products from the LDCs. However, domestic and corporate lobbies successfully diluted the initiative by keeping import duties on sugar and rice until 2009 and on bananas until 2006 – among the most important exports of developing countries. While the EBA is a welcome step, it is a much smaller one than generally assumed.

A study commissioned by Oxfam soon after the EBA was agreed, for example, showed that the 'static' gains (i.e. at current levels of exports) of the EBA to poor countries would be just \$7 million. It was likely to result in more 'dynamic' gains (i.e. as countries began to take advantage of more open markets) but the extent of these was hard to predict. The analysis showed that the gains to the LDCs were likely to be so low because only \$95 million worth of exports were actually affected (Stevens and Kennan, 2001).

A subsequent World Bank report suggested that LDC exports affected by the EBA amounted to \$73.6 million in 2000 (equivalent to around 0.5 per cent of total LDC exports to the EU), \$63 million of which were exports in the areas of delayed liberalization – sugar, rice and bananas. It noted that the changes introduced by the EBA initiative are 'relatively minor for currently exported products, primarily because over 99 per cent of EU imports from the LDCs are in products which the EU had already liberalized' (Brenton, 2003). The EU is not, of course, offering duty-free market access to the non-LDC developing countries.

The US African Growth and Opportunity Act (AGOA), passed in 2000, gives preferential access to US markets for several products, such as textiles, and has helped to increase export growth in some countries in Africa. But there are major limitations. The scheme suffers from limited product coverage, uncertain duration and complex eligibility requirements (UNDP, 2005, p128). A recent World Bank study concludes that only a small number of countries receive substantial benefits from AGOA and that LDCs that do not receive preferences for clothing exports have yet to see any impact on their overall exports (since most LDC exports to the US were already duty free). Preferences for clothing products have led to significant transfers to a small group of beneficiaries, but for most countries the overall impact of AGOA preferences is likely to amount to no more than one tenth of 1 per cent of GDP. Seven beneficiaries account for almost all the transfers resulting from AGOA, while the remaining 31 beneficiaries gain little (Brenton and Ikezuki, 2004). US imports under AGOA were valued at just over \$14 billion in 2003, a 55 per cent increase over 2002. Yet these imports are highly concentrated

among major oil suppliers and South Africa: the latter plus Nigeria, Angola and Gabon accounted for 83 per cent of US imports in 2003.¹

Market access alone is no panacea

While market access restrictions are serious for many developing countries, notably non-LDCs, simply ending those restrictions and opening markets is *by itself* no panacea. Even if markets in the North are more open to them, developing countries will still face major constraints in taking advantage – such as supply-side constraints and competing with heavily subsidized northern farms. An UNCTAD agricultural trade experts meeting has described the various internal and external barriers facing developing countries as such:

These countries continued to face domestic capacity limitation in the areas of production, infrastructure and research and development of technologies to improve productivity... Agricultural producers, especially small-scale farmers, had also to cope with the need for investment and limited access to finances to meet incremental working capital needs either because of the non-existence of financial facilities or because of a general credit crunch... Lack of capacity and expertise in the international marketing and transport of their products... A highly oligopolistic market structure in some major commodity markets controlled by large TNCs. Certain product sectors of the world agricultural market, for instance, are highly concentrated and dominated by TNCs, which contribute up to 80 percent of the market share in international agricultural trade... Such a trading environment would place small-scale farmers in developing countries at a permanent competitive disadvantage unless complementary actions were taken to strengthen their position. (UNCTAD, 1999, p5)

However, blunt strategies to increase exports on the part of developing countries do not automatically help the poor or directly benefit wider society. As noted above, a concentration on exports, for example, needs to be well managed and a range of domestic policies need to be in place to ensure that vulnerable groups benefit from overall economic growth; vulnerable groups can become even more adversely affected by a focus on exports, which can lead to instability. In Ghana, for example, expanding cocoa production for export took up increasing amounts of land, pushing women farmers onto marginal lands with steep slopes and poor soil (Curtis, 2001, p66). A World Bank study notes that ‘any favourable effects of improved market access on growth could, in principle, be offset by a direct effect on conflict risk. Indeed, we have found that exports can have a direct, adverse impact on the risk of conflict, namely through the rents on primary commodities’ (World Bank, 2003, p139).

It is clear that other policy changes need to occur alongside greater market access. High quality capacity-building support to developing countries, to enable them to benefit from market access opportunities, can be vital. Donors have recognized the importance of this area in recent years and an extensive set of aid measures has emerged under the Trade-related Technical Assistance and Capacity Building programme which provides over \$2 billion to help developing countries relieve supply-side constraints and build institutional

capacity. However, the programme is severely marred by a multiplicity of technical assistance initiatives, weak coordination and, in many cases, limited ownership on the part of recipient governments, with assistance often narrowly geared to implementing WTO agreements of little benefit to developing countries (UNDP, 2005, p144).

The problem of domestic and export subsidies

Rich countries spend billions of dollars each year in payments to their farmers that subsidize the production and export of agricultural goods. These subsidies depress world prices for key developing world products like sugar and cotton, deny developing world farmers valuable export markets and constitute an unfair playing field that undermines growth in the developing world. Both domestic production subsidies (which undermine the ability of producers in poor countries to compete) and export subsidies (which promote export dumping) can have devastating impacts. UNDP estimates that the real costs for developing countries of rich country agricultural protectionism and subsidies may be as high as \$72 billion a year – equivalent to all official aid flows in 2003 (UNDP, 2005, p130).

Agricultural subsidies that result in export dumping cause farmers in developing countries to suffer low prices, lost market share and unfair competition. In 2003, dumping by US-based food and agribusiness companies meant that wheat was exported at an average price of 28 per cent below the cost of production, soybeans at 10 per cent, corn at 10 per cent, cotton at 47 per cent and rice at 26 per cent. Since the WTO was established, US-based companies, for example, have engaged in steady, high levels of agricultural dumping in their global sales of the five most exported commodities. The WTO rules formally prohibit dumping but the practice is regular, and the rules make it complicated and expensive for poor countries to establish grounds for anti-dumping actions (IATP, 2005, pp127–129).

The EU is the dominant user of export subsidies, accounting for 90 per cent of all subsidies from 1994 to 1997. Brussels sets the European sugar price at three times international prices and subsidizes exports of its sugar onto world markets. Oxfam notes that this blocks developing country exporters from European markets, undercuts developing countries in valuable third markets, such as the Middle East, by subsidizing exports to prices below international costs of production, and depresses world prices by dumping subsidized and surplus production, thereby damaging foreign exchange earnings for low-cost exporters (Oxfam, 2002). The EU spent around \$41 billion in 2003 on agricultural subsidies, much of which involves export subsidies (Oxfam, 2002). One study estimates that EU subsidies and market restrictions on sugar imports cost Mozambique \$38 million and Malawi \$32 million in 2004.² Subsidy levels are also partly hidden: the US, for example, provides 200 times more export support than it declares, equivalent to \$6.6 billion (€5.2 billion) a year (Oxfam, 2005, p3).

The EU and the US claim to have cut their domestic subsidies over the years but in reality there has been little substantial reduction, simply a relabelling of existing support. Since the Uruguay Round of trade negotiations started in 1986, overall agricultural support in developed countries has remained at around \$250 billion annually (Oxfam, 2005). The July 2004 framework agreement that guided the recent WTO negotiations until their collapse actually expanded the ability of developed countries to support their own farmers. Developed countries have managed to change the criteria that would allow them to provide support to their farmers under the 'blue box' system,³ instigated mainly at the behest of the US, which wants to shield its 'countercyclical' payments to farmers (i.e. subsidies paid to producers when commodity prices fall below specific levels).

Oxfam estimated that such box-shifting would allow the US to increase its trade-distorting support by \$7.9 billion a year from current levels, and the EU by \$28.8 billion a year (Oxfam, 2005). Meanwhile, there are no current restrictions on the amount of resources that countries can devote to payments to their farmers through another domestic support mechanism, the 'green box',⁴ so the US and the EU have significantly increased the use of this category of support.

The EU's desire to maintain the status quo can be attributed to fears that changes to the green box could jeopardize the recent reforms of the Common Agriculture Policy, through which the EU has shifted a significant part of its support of agriculture to the green box. For the US, payments under the green box already represent a large proportion of its support to agriculture, so changes in the criteria would lead to important modifications in its system of support.

A US proposal in early October 2005 was widely trumpeted by US officials as involving substantial cuts in domestic support. Yet, closer analysis shows that the proposal would result in negligible cuts to the subsidies paid to farmers while it also called for developing countries to cut agricultural tariffs by more than developed countries. Argentina's ambassador to the WTO suggested that the proposal would mean that US subsidies could actually increase (TWN, 2005).

The WTO's Doha declaration of 2001 agreed to a 'reduction of, with a view to phasing out, all forms of export subsidies'. Until the WTO negotiations collapsed in July 2006, OECD countries had finally agreed to phase out export subsidies by 2013. The US had proposed eliminating them in five years, as had the G20 group of countries. Yet the EU had put forward several conditions for eliminating export subsidies: all countries to agree to 'parallel elimination' not only of export subsidies but also of 'all forms' of export subsidies such as export credits, and progress in this area to be linked to developing countries' movement on liberalization in industrial products and services (South Centre, 2005b).

Commodity dependence and price volatility

Perhaps the most serious trade issue facing many developing countries is the volatility and decline in the prices of the primary commodities on which their economies rely. Ninety-five of the world's 141 developing countries are more than 50 per cent reliant on commodity exports (Benn, 2005). This dependence makes many developing countries highly vulnerable to fluctuations in the price of key commodities – with the impact only increasing for those dependent on fewer and fewer commodities. Poor countries have little influence over the international price of their exports and are less able to manage the impacts of volatile prices.

Between 1997 and 2001 the combined price index for all commodities fell by 53 per cent in real terms. This means that African exporters had to double export volumes to maintain incomes at constant levels (UNDP, 2005, p118). While there has been a recovery in the price of some commodities since then, the current high prices – if history is any teacher – are unlikely to last. The UN estimates that for every \$1 in aid received by sub-Saharan Africa since the early 1970s, \$0.50 has been lost as a result of deteriorating terms of trade (UNCTAD, 2001).

A 2000 World Bank report noted that commodity price crashes can induce the growth collapses that increase the risk of violent conflict. The report also notes that for countries that are heavily dependent on commodity exports, the world price of these commodities significantly affects the duration of the conflict: when prices are high the conflict is less likely to end than when prices are low (World Bank, 2003, pp126, 132, 144).

Of course there is no *automatic* connection between falling commodity prices and the outbreak of violent conflict. However, the steep peaks and slumps in commodity prices that have become a feature of the modern economy can administer severe shocks to a country's political and economic stability. Ethiopia and Burundi rely on coffee for between 60 per cent and 80 per cent of their export earnings: the two-thirds fall in the price of coffee between 1980 and 2000 devastated rural livelihoods, slashed government revenues already strained by debt repayments and radically undermined health and education programmes – all of which can be drivers for conflict. It has been convincingly argued that the sinking price of coffee in the early 1990s in part precipitated the Rwandan genocide of 1994 by halving export revenues, eroding livelihoods and exacerbating ethnic tensions (Halle et al, 2004, p13).

Although the World Bank recognizes the link between dependence on primary commodity exports and conflict, it has played a leading role in encouraging the over production and export of primary commodities as part of advice programmes to increase growth. However, such over production will only depress prices through excess supply, leaving many countries reliant on unfavourable terms of trade (Hanlon, 2003). Thus, this is a fundamental policy area that needs to be addressed by OECD governments if they are serious about addressing the economic causes of conflict and aiding post-conflict reconstruction.

On the issue of managing commodity price shocks, Gilbert identifies five sets of possible policy responses:

- 1 price agreements based on either producer cartels or pacts between consumers and producers;
- 2 stabilization of producer/consumer prices by variable export tariffs or taxes, marketing boards and domestic stockpiles;
- 3 compensatory financing of individual producers by domestic governments or international institutions;
- 4 producer government revenue stabilization funds;
- 5 the use of risk instruments such as forward contracts to stabilize producer revenue. (Gilbert, 1993, p8)

Auty and Le Billon have noted that the first three measures have a long track record, with mixed success, while the latter two have received more attention recently, and their analysis considers the experience of these mechanisms further. What can be said here is that there are no simple solutions to the crisis in global commodity markets, but that a number of policy areas present themselves (see Chapter 6).

First, diversification away from commodity dependence – a cornerstone of development thinking for decades – must remain a vital priority for many developing countries, and for international aid strategies. But developed country trade policies are also critical, since restrictions on market access through tariff escalation and phytosanitary standards, for example, act as a major brake on diversification.

Second, commodity price agreements mainly collapsed in the 1980s, not least due to pressure and opposition from developed countries, but also as a result of disputes over the form such agreements might take. Yet it can be strongly argued that such schemes need urgent reconsideration today, and should not be opposed as unworkable by OECD governments.

Third, existing compensation arrangements need to be greatly improved. The IMF established a Compensatory Finance Facility (CFF) in 1963 with the aim of providing short-term loans to countries experiencing declines in income from commodities and who were unable to borrow on commercial terms. But, as the UNDP has recently argued, it currently provides finance on terms that are unaffordable to most low-income countries in Africa (UNDP, 2005, p142). The EU's Flex scheme, introduced in 2000 to replace Stabex,⁵ initially provided budgetary support to African, Caribbean and Pacific (ACP) countries registering a 10 per cent loss of export earnings and a 10 per cent worsening of the programmed public deficit. Yet these criteria have proved too stringent. As a result only US\$12 million a year on average was disbursed in 2000–2003 to just six of the 51 countries that applied (Auty and Le Billon, p35; UNDP, 2005, p142). Currently, there are too few schemes to adequately deal with commodity price volatility, urgent though this is, while existing schemes have proven largely ineffective.

Fourth, it should be more widely recognized that OECD country trade policies can amplify commodity price volatility. For example, if OECD governments increase their subsidies to domestic producers when the world price of an agricultural commodity is low, then the effect will be to amplify price shocks. The recent increase in US cotton subsidies to farmers had the effect of further reducing the incomes of cotton farmers in the Central African Republic (World Bank, 2003, p133).

Trade liberalization and policy space

Recent years have witnessed a fierce debate about the role of trade liberalization in development. It is important to distinguish between two separate issues: the debate about whether trade liberalization *in the South* is good for development and poverty eradication in the South; and the debate about opening up OECD country markets to southern country exporters (i.e. liberalization *in the North*). The latter issue has received much greater international media attention and is often conflated with the conception of 'fair trade'. Greater access to northern markets is a vital issue for developing countries and this analysis takes it as read that import restrictions have major adverse impacts on many poor countries, as discussed above. Yet the issue of liberalization in the South is also, and perhaps more, important for many developing countries, linked as it is to the critical question of developing greater domestic industrial and agricultural capacity and the longer-term ability to compete in global markets.

Northern governments – and many southern governments – now advocate trade liberalization as the best strategy for growth and development in the South; many, if not most, northern and southern civil society groups are opposed to this as a standard model and advocate greater policy flexibility for developing countries, sometimes involving de facto protectionist strategies. The meeting ground between these two contending views is often in the area of 'special and differential treatment' (SDT), which essentially provides longer time periods for developing countries, and especially the LDCs, to implement multilateral liberalization commitments. Here, the argument is often made that SDT provisions for longer time periods are sufficient. Many NGOs, on the other hand, often contend that long time periods and other SDT provisions do not provide developing countries with sufficient policy flexibility and often question whether the liberalization model is right in the first place.

The evidence that trade liberalization per se is good for development is actually very weak. One analysis by UNCTAD, for example, shows that in a sample of 36 countries classified according to their degree of trade 'restrictiveness' and 'openness' at the end of the 1990s, poverty rose both in those countries that adopted the most open trade regimes and in those that continued with the most closed regimes. 'But in between these extremes there was a tendency for poverty to decline in those countries that had liberalized their trade regimes to a lesser extent, and for poverty to increase in those countries that had liberalized their trade regimes to a greater extent.' The conclusion was that 'from this evidence there is no basis for concluding that trade liberalization,

in the short run, reduces poverty or leads to a more virtuous trade-poverty relationship' (UNCTAD, 2004, p188). Another analysis by UNCTAD of growth rates in developing countries between 1997 and 2001 shows that of 108 countries studied, only 10 out of 35 classified as the 'most open' have high GDP growth and only 7 out of 36 countries classified as 'restrictive' have low GDP growth. There are 37 countries that have either high GDP growth with a 'restrictive' trade regime or low GDP growth with an 'open' trade regime (UNCTAD, 2004, p86).

There is evidence of the adverse impacts of trade liberalization on certain groups of poor people. In particular, cheap agricultural imports – especially but not exclusively of subsidized produce from the North – have at times had a severe impact on farming communities. Imports of cheap subsidized US rice into Haiti, for example, have driven thousands of poor farmers out of business, and forced many people off their land, with many in effect becoming internally displaced (Curtis, 2001, pp153–157). In Zambia, World Bank/IMF-induced policies to reduce tariffs on textiles resulted in cheap imports putting 30,000 people out of work (World Development Movement, 2004). NGOs have reported similar impacts of cheap imports in Sri Lanka, Guyana, Trinidad & Tobago, the Philippines, Mexico, The Gambia and Brazil, among others (Curtis, 2001, pp41–42).

Of course, cheap imports can also benefit certain groups of people and often it is the capacity to manage the shocks that flow from liberalization that will determine whether liberalization has good or bad effects. Poor countries tend to have fewer mechanisms, such as adequate welfare programmes, to cushion the effects on people of such adverse impacts.

The UN's Food and Agricultural Organization (FAO) notes that 'since the 1980s, with trade reforms and unilateral trade liberalization in many developing countries, there have been more frequent import surges by country and by product' (FAO, 2003a). Indeed, the FAO has identified 1217 cases of import surges on just eight commodities in 28 developing countries for the period 1984–2000. An import surge means either that the volume of imported goods rises sharply or that import prices reduce sharply so that they undermine or threaten to undermine domestic production. A surge is defined as a 20 per cent deviation from a five-year average of imports. Since this analysis is highly selective by product and also considers only a small proportion of all developing countries, the real extent of import surges must be much greater (FAO, 2003b). There are few mechanisms that developing countries have in practice to keep such imports out: the process is expensive, onerous or politically difficult. As the FAO has pointed out, currently 'developing countries lack resources to protect producers from artificially low import prices. The potential for raising duties is limited and will decline with lower bound rates' (FAO, 2003b).

The outstanding cases of successful poverty eradication in the post-war world – that is, those in East Asia such as Taiwan and South Korea – all rejected policies to completely open their economies at key stages in their development. These countries often protected their domestic industries, for limited periods and with clear performance requirements, often tended to give preference

to domestic companies on the grounds of promoting long-term industrial development, and actively intervened in the economy through policies of regulation and financing investment. These policies were part of a mix that included those of liberalization now advocated by the WTO, but were far from restricted to them. In a report for the United Nations Research Institute for Social Development (UNRISD), Kwame Jomo, Professor of Economics at the University of Malaya, Kuala Lumpur, notes:

There is now considerable evidence that high growth in East Asia was due to successful and appropriate developmental public policy interventions rather than economic liberalization. Clearly then, South Korea and Taiwan have not only achieved far more in terms of growth, industrialization and structural change than Thailand, Indonesia and Malaysia with significantly lower inequality as well. The better economic performances of the first two were due to more effective government interventions, especially selective industrial policy, while lower inequality was partly due to significant asset (especially land) redistribution before the high growth period, full employment and social development to ensure support for developmental public policies. (Jomo, 2003, p31)

A key point about successful development in East Asia was that these countries were not subjected to ‘big bang’ or shock liberalization. Rather, their industrialization had long preceded that of the 1980s and had advanced on the basis of a wide range of trade and industrial policies designed to encourage the emergence of higher value-added activities and the production of high-tech and capital intensive products. In particular, foreign investment was strategically managed to ensure it supported domestic efforts to continue strengthening and upgrading domestic productive capacities (Kozul-Wright and Rayment, 2004, pp15–16).

Advocates of trade liberalization often argue that it can make available new technologies, undermine elite privilege, and thus contribute to greater political liberalization and overall economic growth. This can be true, but so can the opposite – that imported technology can crowd out investment, while corruption can be induced by new links with foreign corporations. In short, whether trade liberalization benefits people often depends on other factors than trade liberalization, such as governance, income distribution and policies of equity promoted by the government. The same applies much more generally to increasing exports – the wealth generated can either be funnelled to domestic elites or benefit society more widely, again depending on domestic circumstances. Whether trade (not just trade liberalization) benefits the poor again also depends on other domestic factors.

There is a particular fear that the EU’s push in Economic Partnership Agreements (EPAs) with regional groups of ACP states will expose poor countries even more to the dangers inherent with promoting full liberalization. EPAs are based on the concept of reciprocal liberalization, where both the EU and the ACP regions will open their markets to exporters from the other. Developing countries may be even more exposed to the dumping of EU

agricultural surplus goods, such as dairy, cereals and beef, under a reciprocal liberalization agreement (Fraser and Kachingwe, 2003).

The evidence suggests that reciprocal liberalization does not benefit both actors equally – those that primarily benefit will be those able to take advantage of market opportunities. For example, an FAO study of the impact of the WTO's Agreement on Agriculture found that 'while trade liberalization [in developing countries] led to a quick increase in food imports, exports did not rise similarly or proportionately. This has implications for the pace of liberalization for countries where supply constraints and other market entry difficulties do not allow them to take advantage of market opportunities as quickly as other suppliers are able to export to them.'⁶ There are currently major concerns that reciprocal liberalization being pushed by the EU in the area of industrial goods (i.e. non-agricultural market access) could have major adverse impacts on domestic industry in developing countries, even causing 'de-industrialization' in many of them (EPA Watch, 2004).

The importance of greater trade policy flexibility

The WTO's agenda of 'progressive liberalization' seeks to promote a one-size-fits-all model of economic strategy in developing countries, reducing their flexibility to pursue possible policies more suited to local circumstances. UNDP has stated that 'the rapidly increasing multilateral agreements – the new rules – are highly binding on national governments and constrain domestic policy choices, including those critical for human development. They drive a convergence of policies in a world of enormous diversity in conditions – economic, social and ecological' (UNDP, 1999, p35). There are various WTO agreements that constrain the ability of developing countries to promote adequate policy flexibility:

- Developing countries are not allowed to raise their agricultural import tariffs beyond a certain level to protect themselves from cheaper imports. Some types of agricultural subsidies previously used by developing countries – for example, for land improvement – are now banned under WTO rules, although the LDCs are (unlike other developing countries) exempt from being required to reduce their overall level of domestic support (subsidies and tariffs) to agriculture.
- The WTO's Trade-related Investment Measures agreement covers conditions on investment related to trade in goods and bans many laws, policies and administrative regulations that favour domestic over foreign capital inputs. These include: local content policies, where governments require a corporation to use or purchase domestic products; trade balancing measures, where governments impose restrictions on the import of capital goods by corporations to reflect the level of exports; and foreign exchange balancing requirements, where a corporation's permitted imports are tied to the value of the export so that there is a net foreign exchange earning (Curtis, 2001, p52).

- The WTO's Agreement on Subsidies and Countervailing Measures (ASCM) prevents governments from providing subsidies to encourage the use of domestic over imported goods ('import substitution subsidies'). According to a study for UNCTAD, 'the ASCM bans exactly the type of subsidies primarily used by developing countries (while allowing the subsidies for research, regional development or for the adoption of environmental standards which are typically used by developed countries)' (Nefeld, 2001).

Certainly, these kinds of policies have not always been successfully used by developing countries in the past, and many could be criticized as being ineffective development strategies over the long term. Nonetheless, many such policies have been successfully used – and for this reason it must be a source of concern that they are no longer options.

OECD governments have been decidedly hypocritical when it comes to policy flexibility. On the one hand, they have consistently stated that developing countries must themselves decide and follow their own development path. On the other hand, they have a strong presumption in favour of promoting economic models and international rules that entail onerous restrictions on the same countries.

Policy flexibility and the extent of SDT provisions are critical for fragile states at risk of conflict or emerging from conflict. These countries' economies are often even more vulnerable to the kinds of adjustment costs that liberalization can entail. They must be able to benefit fully from the exemptions from liberalization commitments envisaged in current SDT arrangements. But the argument from this analysis is that especially the poorest and most fragile states should have greater flexibility than in current arrangements to promote policies suited to their own national circumstances, and that their policy options should not be limited to liberalization.

In June 2005, the G33 group of developing countries called for 'more meaningful special and differential treatment' in the WTO negotiations, including a framework on 'special products' and a special safeguards mechanism (SSM). They stated that products that meet the criteria of food security, livelihood security and rural development should be designated as special products, which should be exempt from tariff reduction commitments. The SSM would 'provide more operationally effective remedy for developing countries against import surges and price depressions', should be available to all agricultural products, and would be invoked if the volume of imports of the product concerned exceeds the average volume of imports of the preceding three years, or if the price of the imports falls below the monthly average over the previous three years – in which case a duty or quantitative restrictions could be applied for a maximum of a year (South Centre, 2005a, pp309–311).

Even though protection has become heretical in the WTO orthodoxy, its potential importance as a policy instrument is often still recognized. UNCTAD, for example, noted in a report from 2000 with regard to agriculture in the poorest countries that 'small farmers involved have no way of withstanding

large-scale international competition. They need protection if large-scale unemployment and the spread of poverty in these countries are to be limited. They should be allowed flexibility [in the WTO agreements] regarding import restraint and domestic subsidy in order to protect and support household subsistence farming and small-scale farming' (UNCTAD, 2000, p24).

That protectionist policies have been badly used by some developing countries in the past is beyond dispute. However, the reason why protection is off the radar screen of OECD countries has in this author's view little to do with the past effectiveness (or not) of such policies and much more to do with serving the interests of the private companies in OECD countries that stand to benefit most from open markets globally.

Addressing conflict-sensitive trade policy

Some donors and international institutions are beginning to recognize the importance of trade policy for conflict prevention. But this is happening only slowly. Donors are increasingly thinking about conflict prevention but are rarely thinking of trade policy in that context. And trade analysts rarely factor in conflict to their thinking. Within the WTO, for example, there has been little attempt to systematically address the issue of conflict and trade. There are few mentions of conflict in the various WTO rules and, as a further indicator, a search on the WTO website reveals almost no sources of information or analysis on the subject of conflict and trade or on fragile states.

The EU has produced numerous documents detailing its commitment to conflict prevention and the Council has stated that 'all relevant institutions of the Union will mainstream conflict prevention within their areas of competence' (EU, 2001). A Conflict Prevention Unit has been established in the External Relations Directorate of the European Commission (EC), responsible for mainstreaming conflict prevention priorities within Community policy. Within the Council, a Policy Planning and Early Warning Unit has been introduced to provide capacity for analysis and initiatives to support conflict prevention. Common Foreign and Security Policy working groups and committees, such as the Africa Working Group and Political and Security Committee, are increasingly reflecting on strategies to prevent and manage conflicts and feeding these approaches into decision-making (Bayne, 2003).

Since 2001 the EU's conflict prevention unit has developed the EC Checklist for Root Causes of Conflict, which aims to increase awareness and prompt early action in conflict-prone fragile states. The checklist requires staff to determine the extent of a particular state's income dependency, 'capacity to react to natural disasters or international conditions (i.e. massive swings in commodity prices)' and ability to attract investment.⁷ The checklist is reviewed when country and regional strategy papers are drafted and, in theory at least, helps draw attention to the conflict prevention activities that aid should target (EU, 2002).

The Commission noted in 2002 that ‘trade policy can be identified as a priority area for future work. The Commission is well-placed to ensure a proper examination of the relationship between trade integration, political stability and economic progress and make proposals for targeted use of trade policy instruments...’ (EU, 2002).

In April 2005 the European Council adopted a common position on conflict prevention and resolution in Africa. It notes that EU policy will address conflict prevention ‘by seeking to address the more structural root causes while targeting the direct causes – trigger factors – of violent conflict’, and aid reconstruction ‘by supporting the economic, political and social rebuilding of post-conflict states and societies’. The position mentions trade policy, noting that:

The EU shall seek:

- *to support the mainstreaming of conflict prevention perspectives within the framework of Community development and trade policy and its associated country and regional strategies;*
- *to introduce, as appropriate, conflict indicators and peace and conflict impact assessment tools in development and trade cooperation so as to reduce the risk of aid and trade fuelling conflict, and to maximize the positive impact on peace-building...;*
- *to improve development and trade cooperation with regional, sub-regional and local actors to ensure consistency between initiatives and to support African activities.’*

The position also commits the EU to ‘work to ensure that regional trade integration measures, within a policy context comprising safety nets for vulnerable groups, support conflict prevention and resolution’ (EU, 2005).

While the EU has made some progress at the declaratory and practical level of addressing conflict prevention through development policies, many major policy gaps remain. The EU – and indeed rich countries generally – could be doing far more to help countries trade their way out of poverty. It could, for example, do much more to help reduce their dependence on primary commodity exports, to prevent them being adversely affected by inappropriate liberalization and to help ensure that its trade policies support conflict prevention and reconstruction. Some of these have been noted above, particularly policies on market access, trade flexibility and commodity prices, among others. These are clearly major political or ‘high policy’ changes that may involve difficult negotiations. Then there are other more ‘technical’, institutional reforms:⁸

- Make conflict prevention a stated objective of the Common Foreign and Security Policy.
- Strengthen the capacity of the Conflict Prevention Unit to analyse the links between trade policy and conflict, particularly in the case of the Economic Partnership Agreements, and ensure these are more adequately fed into the decision-making system.

- Develop more effective peace and conflict impact assessments.
- Strengthen annual reviews of conflict prevention policies.
- Ensure that the EU advocates conflict-sensitive development policies in multilateral forums.

The World Bank has launched conflict-sensitivity assessments that focus on resource distribution patterns and emphasize inclusiveness of opportunities; its Conflict Analysis Framework aims to ‘enhance conflict sensitivity and conflict prevention potential of World Bank assistance’ (Picciotto et al, 2005, p31). The Bank has a conflict analysis framework and is discussing how to make poverty reduction strategy papers (PRSPs) conflict sensitive. It has also developed a framework for engaging in countries emerging from conflict – the so-called Low Income Countries Under Stress initiative. To become conflict sensitive, the Bank would have to systematically assess the risks of violent conflict likely to be created by, or have an impact on, an operation. Similarly, perhaps IMF programme design and surveillance could incorporate an evaluation of the risks of conflict when discussing trade-offs between policy choices (Lefrancois, 2004). In reality, it would seem that these assessment processes, which are relatively new, need to become much more deeply embedded and mainstreamed within policy formation.

Policy towards fragile states

US economist Dani Rodrik has written that ‘societies that benefit the most from integration with the world economy are those that have the complementary institutions at home that manage and contain the conflicts that economic interdependence triggers’. These include strong institutions in the areas of governance, the judiciary, civil and political liberties, social insurance and education.⁹ This view is important for this study since many developing countries do not, of course, have such strong institutions, including most that are at risk of, or emerging from, conflict. This applies especially to fragile states.

In recent years many donors have begun to reform their aid programmes to focus more explicitly on the particular circumstances of fragile states, a process has been partly driven by the attacks of 11 September 2001 and the US ‘war on terror’ (Christian Aid, 2004). But while various donors have recently produced official strategies towards fragile states, none has explicitly focused on how trade policy specifically can play a role.

The *Fragile States Strategy* of the United States Agency for International Development (USAID) produced in early 2005, notes that ‘there is perhaps no more urgent matter facing USAID than fragile states’ and that a ‘different and more strategic approach’ to fragile states is needed. This should include: analysis and monitoring of the internal dynamics of fragile states; priorities reflecting the realities of fragile states; programmes focused on those priorities and the sources of fragility; and an Agency business model that allows for timely, rapid and effective response. The overall impetus for the new US focus on fragile states is mentioned in the conclusion: ‘Fragile states have long posed

a problem for the United States and are now recognized as a source of our nation's most pressing security threats. Driven by a dramatically changed landscape, responding more effectively to fragile states has moved to the centre of the foreign aid agenda.'

The analysis does not specifically mention trade policy anywhere in its 11 pages. USAID does produce a 'fragility framework' that considers security, political, economic and social policies needing to be in place to address better governance in fragile states – but the analysis there, to this author, looks like it could refer to any developing country rather than the specificities of fragile states. The economic section simply refers to the importance of 'economic and financial institutions and infrastructure that support economic growth (including jobs), adapt to economic change and manage natural resources' and of 'economic institutions, financial services and income-generating opportunities that are widely accessible and reasonably transparent, particularly related to access to and governance of natural resources'.

Later, the analysis mentions 'illustrative' economic policies for vulnerable states – such as 'foster institutional and policy development that promotes economic growth and effective management of natural resources' and 'improve revenue generation/tax systems and expenditure'. It also lists 'illustrative' policies for states in crisis: 'focus on reviving the economy, with particular attention to basic infrastructure, job creation, income generation, early market reform, natural resource management, independent central banks and tax codes'; 'distribute seeds, fertilizers and tools and provide related training, and rehabilitate farm-to-market roads'; and 'advance transparency of resources, particularly in countries rich in natural resources and where profits from these resources are used to fuel conflict'. The latter point is the only mention of a trade-related policy, and is restricted to concerns of 'transparency' (USAID, 2005).

DFID's policy document, *Why We Need to Work More Effectively in Fragile States*, released in January 2005, recognizes that 'fragile states are the hardest countries in the world to help develop' but makes only passing reference to trade, stating that: 'For the international community to provide effective support to fragile states, it needs to combine aid with diplomacy, security guarantees, human rights monitoring, trade policy and technical assistance (such as in tracking down criminal activity)' (DFID, 2005).

In its summary of an international forum on aid effectiveness in fragile states in London in January 2005, the OECD's Development Assistance Committee (DAC) notes that:

There is increasing recognition by donors of the need to apply policy approaches that are tailored to the needs of fragile states... Meeting the special needs of fragile states often requires the use of a range of instruments in addition to aid including diplomacy, security and financial measures such as debt relief. A coherent, whole of government approach is therefore required of international actors, which involves those agencies responsible for security, political and financial affairs, as well as those responsible for development aid and humanitarian assistance.

The DAC's stress on coherence is important, but noticeable is the absence in this report of any mention of trade policy (DAC Chair, 2005).

The EU's *European Security Strategy*, produced in December 2003, calls on the EU to be 'more active in pursuing our strategic objectives' and notes that 'this applies to the full spectrum of instruments for crisis management and conflict prevention at our disposal, including political, diplomatic, military and civilian, trade and development activities. Active policies are needed to counter the new dynamic threats' (EU, 2003). The strategy highlights state failure as one of the five threats facing Europe, but the EU has devoted less attention to addressing this than the other identified threats, such as terrorism and proliferation of weapons of mass destruction.

Although the EU has great potential to address the problems of fragile states, given the wide range of policy instruments available to it, and given the large number of declaratory statements recognizing the importance of conflict prevention, noted in a previous section, at present the EU does not apply these instruments effectively (Saferworld and International Alert, 2005). EU action remains often fragmented and uncoordinated, lacking an overall strategy and direction. Two prominent NGOs working in this area, for example, note that 'the institutional disconnect between the Commission and the Council means that the complementary conflict prevention and development programming is not integrated into the strategic and operational planning of crisis management operations' (Saferworld and International Alert, 2005).

As well as the range of policies identified above, there are further ways in which EU policies could specifically address fragile states. The Council could agree on a common position for fragile states, which would help to ensure a coherent, strategic approach. More development assistance could be targeted to fragile states, which could include trade capacity-building support and otherwise be cohered with other trade policies. The EU's institutional understanding of how trade policy can help fragile states needs to be significantly enhanced, and this analysis must be fed into the decision-making system. The EU also needs to focus on fashioning more proactive development cooperation strategies for fragile states that take more account of the specificities of fragile states and that ensure coherence between the EU's different policy instruments.

Conclusion and recommendations

OECD countries are taking some steps to prevent future conflict. Yet if governments and institutions recognize some of the economic causes of conflict, their policies often betray little of this understanding. The political will to address some critical policy areas is, frankly, lacking. And the importance of trade policy to conflict-prevention and post-conflict reconstruction has yet to be fully taken on board and is a missing piece in the jigsaw.

It is hard to disagree with a report for International Alert arguing that 'international responses to insecurity and violent conflict reflect a prevailing assumption that the problem essentially consists of episodic and contained

events, rather than coherent manifestations of entrenched structural global causes and dynamics' (Alexander and Smith, 2004, p9). It is precisely these entrenched causes, often directly related to OECD country policies, that need to become much more seriously addressed if conflict-sensitive trade policy is to become a reality rather than an aspiration on the part of some sections of the development community.

In summary, OECD states need to:

- take increased steps to abolish market access barriers to poor country exports and abolish export subsidies in the developed world;
- recognize more clearly through better research the links between trade policy and conflict and increase efforts to design conflict-sensitive trade policies;
- increase support for developing country efforts to diversify their economies – specifically, identify and remove the trade-distorting subsidies and protectionist import standards that inhibit economic diversification in the developing world;
- improve trade policy flexibility so that poor countries can take greater advantage of trading opportunities that are currently available under the WTO's SDT provisions.

As regards fragile states in particular:

- While the immediate need is often (good quality) aid and reconstruction, trade policy is also critical even for immediate development needs in the case of countries dependent on commodities, and certainly in the medium term. Research needs to be conducted to assess the importance of trade policy in fragile states and to ensure this is incorporated into the design of overall development cooperation packages. DFID notes, for example, that 'before we decide whether to deploy significant resources, we need to improve early warning of instability and understand more about the political economy of the states concerned' (DFID, 2005). This applies to trade policy as well as to aid.
- OECD countries need to improve and cohere approaches to failed states and engage in better research to design appropriate trade policies and ensure this is incorporated into the design of overall development cooperation packages. As recommended in a paper commissioned by the DAC on aid policy in difficult environments, conflict-sensitivity criteria should be mainstreamed in macroeconomic advice, fiscal policy and public expenditure reforms, PRSPs and public expenditure reviews. It also recommends to 'privilege diplomacy, private investment, trade and security assistance over aid in donor engagement in fragile states but provide sufficient aid to make the other instruments effective' (Picciotto et al, 2005, p10).
- Donors could provide more capacity-building support specifically to fragile states to enable them to jump-start their trading activities. A ring-fenced financial fund could be established for this purpose. More aid

could also help support fragile-state attempts to manage future economic shocks. DFID, again, notes that ‘economic shocks have the potential to turn fragility into a crisis and poverty into destitution. The capacity to manage shocks, whether natural disasters or economic, is crucial for fragile states. Fragile states are seldom able to do this without help from the international community’ (DFID, 2005).

Notes

- 1 See the Africa Growth and Opportunity Act at www.agoa.gov/.
- 2 Cited in O. Brown, 2005, pp6–7.
- 3 These are domestic support programmes that are linked to production-limiting programmes; for example, if the level of payments is based on fixed areas and yields, or per head of livestock.
- 4 These are support payments to farmers that are deemed non-trade distorting and thus exempt from reduction commitments.
- 5 Stabex was a stabilization system under which ACP States were eligible for compensation if their export revenues from trade with the EU dropped compared to a six-year average. Such a drop would trigger an automatic compensation payment to the affected government for use in aiding economic diversification and to benefit producers in the affected sector.
- 6 Cited in Konandreas, 2000.
- 7 See the EC checklist for root causes of conflict at www.europa.eu.int/comm/external_relations/cpcm/cp/list.htm
- 8 See, for example, Bayne, 2003.
- 9 Cited in Trocaire, 2003.

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