Basic Concepts and Proposals on the use of Policy Spaces in Trade-supported Strategies for Sustainable Development

By Werner Corrales-Leal
International Centre for Trade and Sustainable Development
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ICTSD welcomes feedback and comments on this document. These can be forwarded to Werner Corrales-Leal, wcorrales@ictsd.ch


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<th>Acronym</th>
<th>Description</th>
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<tbody>
<tr>
<td>ACP</td>
<td>African, Caribbean and Pacific group of states</td>
</tr>
<tr>
<td>ASCM</td>
<td>Agreement on Subsidies and Countervailing Measures</td>
</tr>
<tr>
<td>BIT</td>
<td>Bilateral Investment Treaties</td>
</tr>
<tr>
<td>CI</td>
<td>Conditional Incentives</td>
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<tr>
<td>CIPR</td>
<td>Commission on Intellectual Property Rights</td>
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<tr>
<td>CL</td>
<td>Complementarities and Linkages Strategy</td>
</tr>
<tr>
<td>CR</td>
<td>Competition Regulation</td>
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<td>DA</td>
<td>Development assistance</td>
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<td>DSM</td>
<td>Dispute Settlement Mechanisms</td>
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<td>DSU</td>
<td>Dispute Settlement Understanding</td>
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<td>EPA</td>
<td>Economic Partnership Agreement</td>
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<tr>
<td>ES</td>
<td>Environmental Sustainability Strategy</td>
</tr>
<tr>
<td>FDI</td>
<td>Foreign Direct Investment</td>
</tr>
<tr>
<td>FR</td>
<td>Financial Market Regulation or Financial Sector Regulations</td>
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<tr>
<td>FTA</td>
<td>Free Trade Agreement</td>
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<td>GATT</td>
<td>General Agreement on Tariffs and Trade</td>
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<td>GATS</td>
<td>General Agreement on Trade and Services</td>
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<td>GDP</td>
<td>Gross Domestic Product</td>
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<td>IA</td>
<td>International technical Assistance</td>
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<td>IF</td>
<td>Institutional Frameworks</td>
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<td>IMF</td>
<td>International Monetary Fund</td>
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<tr>
<td>IPR</td>
<td>Intellectual Property Rights</td>
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<tr>
<td>LI</td>
<td>Learning and Innovation Strategy</td>
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<td>MEA</td>
<td>Multilateral Environment Agreement</td>
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<td>MP</td>
<td>Market Access Preferences</td>
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<td>Multilateral Trading System</td>
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<td>NNRR</td>
<td>Natural Resources</td>
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<td>PPP</td>
<td>Public Procurement Preferences</td>
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<td>PR</td>
<td>Performance Requirements</td>
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<td>R&amp;D</td>
<td>Research and Development</td>
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<td>SCM</td>
<td>Subsidies and Countervailing Measures</td>
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<tr>
<td>S&amp;DT</td>
<td>Special and Differential Treatment</td>
</tr>
<tr>
<td>SH</td>
<td>Social and Human capital Strategy</td>
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<tr>
<td>SME</td>
<td>Small and Medium Sized Enterprises</td>
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<td>SPS</td>
<td>Sanitary and Phitosanitary</td>
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<td>Small and Remote Economies</td>
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<td>SVE</td>
<td>Small and Vulnerable Economies</td>
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<tr>
<td>TBT</td>
<td>Technical Barriers to Trade</td>
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<td>TRIMS</td>
<td>Trade Related Investment Measures</td>
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<td>TRIPS</td>
<td>Trade–Related aspects of Intellectual Property Rights</td>
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<td>TSDS</td>
<td>Trade Supported Strategies for Sustainable Development</td>
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<td>UNCTAD</td>
<td>United Nations Conference on Trade and Development</td>
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<td>WIPO</td>
<td>World Intellectual Property Organization</td>
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FOREWORD

A fundamental disagreement has been building up since the foundation of the WTO over the role of the multilateral trade system in supporting the development strategies of developing countries. Most developed countries have made it clear that they see trade liberalization as the mission of WTO and believe that each member should therefore undertake to maximize that objective without allowing other concerns to stand in its way. However, many developing countries hold an almost diametrically opposed position. They hold that, although the system's mission is trade liberalization, it should be an instrument of sustainable development, which is a fundamental part of its mandate, and that trade liberalization under the WTO should be carried out under rules that enable most of its members - the developing countries - to obtain development benefits from it.

In developing countries, expectations of sustained growth and equality are much more pressing than in developed countries, because daily life there is marked by distressing experiences of volatile growth, poverty, shortages and extreme inequality. Moreover, although more than twenty years have now elapsed since trade liberalization was universally acclaimed as a model, its benefits have eluded the majority of poor countries.

What does the multilateral trading system have to do with all this? Is WTO a development agency? Are the solutions to those problems not to be sought elsewhere? This is frequently heard when developing countries petition for the flexibility in trade agreements to apply active policies for development.

In fact, the multilateral trading system may be an eminently relevant venue for these concerns. It may have a crucial role to play in making needed development policies feasible for developing countries to implement.

A wide set of social, economic and environmental processes is interlinked with trade. The complex nature of the interactions between them explains why liberalization produces the desired development results in some cases, but not in others. That is why an appropriate strategy for sustainable development requires simultaneous action on trade and on a range of other processes. The trading system should not turn its back on that reality. On the contrary, it should create the appropriate spaces for their developing country members to implement policies that enhance their opportunities for sustainable development when combined with a trade liberalization strategy.

The vocation of the ICTSD since its foundation in 1996 has been establishing bridges between trade and sustainable development. This explains why one of its permanent lines of work has been devoted to strategic thinking on how to reconcile these two extremes. In our view, reconciliation is possible only if the prime purpose of the Multilateral Trading System - to liberalise trade - is maintained, while at the same time the developing countries are assured that the rules of the system will not close the door to their legitimate aspirations to obtain tangible development benefits from their integration into the international trade system. It is not a matter of the multilateral system having to change its mission or transform itself into a development agency. Rather, it must maintain its founding purpose, on the understanding that, for the developing countries, liberalization alone may not be enough.

This paper condensates the basic concepts and proposals of the Trade-supported Strategies for Sustainable Development (TSDS), an alternative approach that has been developed at the ICTSD as part of the Centre's work on strategies that put trade liberalization and other policies to work in favour of sustainable development in developing countries. The TSDS represents an on-progress contribution in the line of the commented reconciliation.

Ricardo Meléndez-Ortiz
Chief Executive, ICTSD
INTRODUCTION

For developing countries increasing trade flows is not sufficient to induce the needed structural changes or to bring about improvements in welfare. The majority of these countries show such features as a serious lack of connection between “modern” export sectors and the rest of the economy, a tendency towards the hypertrophy of an informal tertiary sector and towards social exclusion, leading to undesirable social polarization, and a growing specialization in the export of goods associated with potentially polluting activities. All these features need to be addressed if their deep integration in the global economy is to be an instrument for sustainable development in those countries.

Consequently, if the developing countries face the need to apply active policies to derive development benefits from trade liberalization, then the international trade system should allow policy space for them to be applied.

However, the system must retain two characteristics that are its main values. On the one hand it must maintain its goal of ensuring liberalization and minimizing trade distortions. On the other it has to safeguard one of its main virtues, i.e. that it is a rules-based system.

Therefore, it would appear necessary to reconcile international trade regimes and the legitimate development ambitions of developing countries, in order to resolve the present situation in which the trading system fails to respond as it should to the needs and aspirations of the majority of its members.

To achieve this, the agendas of the Multilateral Trading System would have to change, as would those of the various free trade negotiations under way between developed and developing countries. Many of those agendas disregard the fact that it might be necessary to combine trade liberalization with other strategies for development and thus they lead to agreements that only touch on the latter as an afterthought, despite the formal statements usually to be found in their preambles to the effect that trade should serve sustainable development. What is more, since the aims of those agreements end up being limited to maximizing trade flows, their response to possible conflicts between trade rules and policies for sustainable development is to treat the latter as subsidiary.

This paper presents the basic concepts and proposals of the Trade-supported Strategies for Sustainable Development, an alternative approach that has been developed in the International Centre for Trade and Sustainable Development (ICTSD), which aims at putting trade liberalization and other strategies to work in favour of sustainable development in developing countries.

The Trade-supported Strategies for Sustainable Development (TSDS) derive from the concepts of Policy Spaces, which were originally introduced in the WTO by Venezuela during the preparation of the Seattle Conference in 1999, and referred to the need for flexibilities to implement active policies for development (Venezuela, 1999). In the Policy Space dimension of trade rules, developing countries may need to implement actions to tackle supply-side constraints and improve competitiveness, and to target trade-supported policies in environmental or social goals, both of which may be affected in the process of integration in the global economy. Implementing these types of active policies in developing countries might deserve support from the international trade regimes, implying flexibilities in rules, mainly in disciplines related to “behind the border measures”.

The document draws substantially on several papers prepared by the author as part of his work on the matter as a Senior Fellow of the ICTSD, as well as from previous work done as Venezuelan Ambassador to the WTO, and as Senior Adviser at the United Nations Conference on Trade and Development (UNCTAD).1
1. COMBINING TRADE LIBERALIZATION AND STRATEGIES FOR SUSTAINABLE DEVELOPMENT

In economic terms, the integration of developing countries into the world economy should imply successful participation in trade, accompanied by the creation of more and better jobs in the country, and a sustained increase in productivity. In order to achieve such a process, trade liberalization is not sufficient, and it is necessary to implement active "supply-side" policies, aimed at increasing the intensity of knowledge in production and trade, and in creating a system of complementarities and linkages between production sectors.

But beyond the economic factors, growth derived from trade should be associated with a genuine broadening of opportunities for most citizens, and sustainable use of natural resources and environmental values, which again is not a guaranteed or automatic outcome of trade liberalization alone. In sum, in their incorporation to the globalised economy, developing countries should aim at maximising development benefits, and not just increasing trade.

However, maximizing development benefits implies that liberalization must be used as an instrument to optimize development, and not that trade must be maximized while trying to keep below certain limits the negative impacts that short term liberalization might eventually produce on development goals of countries involved. In fact, two perspectives of the optimization problem may be taken regarding trade and development. The first perspective (the "original optimization problem") consists of trying to maximize the sum of development results, while establishing conditions on trade liberalization that would ensure that trade openness would never fall below a certain lower limit and trade distortions would never go above a predetermined ceiling. The second perspective (the "dual problem") consists of maximizing trade liberalization while trying to keep "development distortions" below a certain upper limit. It is obvious that development outcomes may differ in the results of the two optimization perspectives.

Developing countries find themselves facing the need to chose strategies, some of which should be synergistically combined with trade liberalization to ensure long term sustainability of development gains. Others should be implemented to reduce the deviations from the development path that external shocks and disasters involving natural hazards may cause, and to improve the economies' capacity to recover from these events. Reconciling trade liberalization and the above mentioned development objectives would imply ensuring that the former support the attainment of the latter.

Our proposal aims to help reconcile those ends, for which we consider a group of trade-supported strategies for sustainable development that could perform as bridges between the extremes.

1.1 Sustainable Development Goals and Policy Objectives in Developing Countries’ Integration Into the Global Economy

Box 1.1 contains an illustrative list of the types of social, economic, political and environmental goals developing countries legitimately aspire to reach through integration into the international economy.
The following is a non-exhaustive illustration of development goals that trade-supported strategies for sustainable development should pursue within the economic, social, environmental and political spheres of development, defined from a developing country perspective:

In the economic sphere, the main development goal should be securing stable, long-term economic growth, based on sustained productivity increases. Four conditions are inherent to this goal:

- Securing stable growth from trade, in the short and long term horizons, including increasing resilience to (capacity to recover from) external shocks;
- Diversifying production and trade towards goods and services of ever increasing added value and knowledge intensity, and favouring knowledge spill-overs from export sectors to the whole economy;
- Reducing productivity and income differentials among regions, sectors and social groups; and
- Enhancing income and employment spill-overs from growth; i.e. improving the capacity of the economy to translate trade-led growth into more and better jobs and household income.

In the social sphere, goals may be summarised as expanding people’s freedoms and opportunities and maximising social cohesion. Three objectives may be used to illustrate this goal:

- Substantially contributing to alleviating poverty and reducing inequality and social exclusion, including through creation of stable job sources and promoting networking of SMEs, cooperatives and micro-enterprises;
- Ensuring livelihood sustainability for disadvantaged groups (e.g. rural livelihoods) and access to basic goods and services for all people, particularly nutrition (food security), health and education, and environmental public goods (e.g. clean air and water); and
- Reducing gender disparities in the opportunities created by trade liberalization, market reforms, human capital creation and the enhancement of production capacities.

In the environmental sphere, the main objective could be expressed as using natural resources and the environment in a sustainable manner, preserving their value for the benefit of present and future generations. In practice, some environment-related goals that should be pursued within a trade-supported sustainable development strategy are:

- Guaranteeing that economic advantages based on natural resources can be enjoyed and enhanced in a sustainable manner by means of a rational management of natural-resource-based industries (e.g. physical and economic policies for conservation of natural resource endowments);
- Ensuring that achievements in export growth, productivity and diversification of the economy as well as improvements in consumption, are based on best practices to minimize negative externalities and favour environmental sustainability (i.e. sustainable energy provision to support economic growth; environment-supportive trade policy instruments and technologies, infrastructures and productive processes); and
- Engaging in sustainable trade activities based on bio-diversity (bio-trade), while conserving biodiversity and eco-systems equilibrium by introducing economic incentives and appropriate environmental standards.

In the political sphere, the goals may be articulated as enhancing the legitimacy of trade and trade-related policies, by ensuring their accountability according to development benchmarks and increasing people’s participation in the policy making process. Two lines of action should be put in place responding to these goals:

- Implementing monitoring processes to follow-up the outcomes of trade and trade related policies making use of sustainable development benchmarks; and
- Ensuring the effective participation of stakeholders in the processes of defining trade-supported strategies for sustainable development, and in monitoring the outcomes of their implementation.
1.2 Goals and Strategies of Competitiveness Policies from a Developing Country Perspective of Sustainable Development

The circumstances that developing countries currently experience in their integration into global trade, as well as the opportunities for obtaining sustainable benefits from such integration, can be improved by implementing competitiveness policies. However, for competitiveness policies to play this role, they must actively pursue sustainable development goals, and not just increasing exports.

Clearly not all problems of development can be solved by competitiveness policies, which are mainly economic in nature, but these policies may be instrumental - if so designed - in promoting sustainable development in its three spheres. Conversely, if they are directed exclusively towards maximizing trade or trade-led GDP growth, they might well end up obstructing the diversification and knowledge intensification of the economy at large, deterring relevant improvements in productivity and, most importantly, hindering the possibilities of achieving legitimate social and environmental objectives.

Box 1.2 A definition of Competitiveness Policies for Sustainable Development

A Competitiveness Policy for Sustainable Development can be defined as one conducive to

"Strengthening and enhancing the production structures, trade capacity and policy institutions of a country, with a view to improving its ability for positive integration into the global system securing long term, stable economic growth, based on producing goods and services that meet the test of international competition under fair market conditions, while expanding the real incomes and real freedoms of their citizens and using their natural resources and the environment in a sustainable manner, preserving their values for the benefit of present and future generations" ...

Source: Corrales, Sugathan and Primack (2003).

The most relevant strategies in achieving the economic goals of competitiveness policies

Two fundamental sets of economic goals should be addressed by national competitiveness policies of developing countries. The first consists of fair competition in international markets, i.e. securing conditions for achieving effective market access and fair trade for the country’s exports. The second is to help the country derive sustained economic growth from that competition, while at the same time achieving a capacity to internally amplify the effects of that growth in terms of productivity increases, more and better jobs and income improvements for ever-greater proportions of the population.

The goals related to market access and fair-trade conditions fall within the sphere of “trade policies”. Important aspects in this realm are active export promotion, as well as negotiating tariff reductions and the removal of non-tariff barriers, and ensuring that disciplines on subsidies and related matters are complied with.

Regarding the enhancement of supply-side capabilities and internal amplification of benefits, two strategic considerations must be made.

- The first is that there is a need to develop local capabilities to permanently differentiate and diversify production, and to increasingly enhance productivity and add value to exports. Putting in place a process of this kind in turn requires capacities to innovate and to adapt and create technology, and not just "buying technology".

- The second is that the only way of increasing employment spillovers from trade, in a process in which technology is
intensified and productivity is increasing, is to enhance complementarities and linkages between economic sectors, promoting supply chains, clusters and industrial districts.

Therefore, in developing countries competitiveness policy must be based on combining strategies with the two above-mentioned directions: A strategy for technological learning and innovation; and a strategy for creating complementarities and linkages. 4

Ensuring social effectiveness: strategies and lines of action

Competitiveness policies must be socially effective, i.e., they must effectively contribute to the enhancement of opportunities and freedoms, including the generation of sustained and relevant real income increases for the majority of the population. Obviously a competitiveness policy package cannot on its own secure the full attainment of these objectives, but it may positively contribute towards them through the effects of two strategies which should be implemented by means of four complementary lines of action.

The first line of action corresponds to the strategies for learning and innovation, and for creating complementarities and linkages as already mentioned. It consists of the creation of more and better jobs and wages throughout the whole economy.

The other three lines of action belong to a Strategy for Human Capital and Social Capital formation. One of them relates to education and training; the other two to inducing positive impacts in the urban informal sectors and the rural low-productivity sectors by promoting synergies between them and the economy-wide reforms:

- Contributing to human capital formation at all levels, by means of training processes undertaken by firms and intermediate organizations in the economy; and through the ordinary programmes in the formal education system;
- Fostering/strengthening social capital; i.e. networks of cooperation in which players in the informal sectors may support their economic operation while at the same time helping to maintain the solidarity associations that enhance their social impact on poor communities (e.g. cooperative networks and other forms of social-relational capital); and
- Introducing institutional innovations allowing the informal sectors to benefit directly from facilities in the financial markets.

These connections between economic policies and social goals are very important for the sustainability of development in many developing countries, where social exclusion and political polarization are rooted in the inability of the “modern economy” to provide jobs and sources of income for a substantial part of the population. The “social effectiveness” of a competitiveness policy must pass this test.

Mainstreaming an environmental sustainability strategy in competitiveness policy

There are positive environmental impacts which may indirectly derive from the attainment of specific goals of a competitiveness policy in the economic dimension. 5 However, mainstreaming direct environmental considerations in competitiveness policies is a need for developing countries, based on three considerations.

In the first place, complying with environmental standards is increasingly important to secure access for exports from developing countries to many markets, which forces these countries to satisfy these criteria in order to compete internationally. Secondly, it must be realized that trends shown by the majority of developing countries’ trade, based on an increase in exports of commodities supported in natural resources, lead to increased rates of exhaustion of their natural capital. Additionally, there is also a trend to increase exports based on potentially degrading processes, which entails both a deterioration of their own environment and possible market-access limitations. Finally, biodiversity, if properly managed with a sustainable
perspective, may become a concrete and very important competitive advantage for many developing countries.

In consequence, mainstreaming an Environmental Sustainability Strategy in competitiveness policies would be a necessity for developing countries, and policy instruments should be available to them in order to make its implementation feasible.

Inequality and poverty effects of the combined application of trade liberalization and the trade-supported strategies

Five factors account for the worldwide trend towards income concentration over the past twenty years.

The first is differentiated access by the population to capital (including access to human capital, social capital, land and credit). The second is the marked (and, to a certain extent, unavoidable) bias towards skilled labour, originating in technological change that is sweeping through all of the world’s economies alongside trade liberalization. In third place is the adoption of recessionary macroeconomic policies. Fourth is the growing importance of financial revenue as a source of private individuals’ income. Finally, there are some of the reforms in labour institutions introduced as part of ‘Structural Adjustment Programs’.

No one would argue that all the instruments that a society can use to pursue equality and eradicating poverty are in the realm of trade strategies or policies for competitiveness, nor are these necessarily the most important. But the strategies discussed here, managed together, can help to improve social impacts and to control some adverse trends.

Box 1.3 summarizes the most important contributions that the TSDS can make to improving income distribution and alleviating poverty, and include ideas on macroeconomic policies since the latter have a very great influence on these two expressions of inequality. The ideas set out in the box are based on the relationships that exist between equality and employment, on the influences of trade and macroeconomic policy, and on the relationships discussed in earlier paragraphs on the effects of combining complementarities in production and innovation strategies.

Box 1.3 Illustrations Of The Guidelines That Competitiveness Policies Should Follow To Maximize Their Contributions To Equitable Income Distribution And Poverty Reduction.

General macroeconomic guidelines

Macroeconomic policy must be based on general principles of equilibrium and liberalization (e.g. fiscal and monetary policy and sustainability of debt; appropriate system of competition and incentives; protection of property rights and contracts), but they must also comply with a basic strategic approach requiring these principles to be adapted to local institutions and conditions. In other words, as Cornia (2006) says, a “policy space” must be left to enable the general principles to be translated into specific packages that are sensitive to local conditions.

In addition, this macroeconomic framework must take account of guidelines such as the following:

- minimize the volatility of growth using appropriate mechanisms in the international exchange and finance fields, and stabilization funds where there is high exposure to shocks;
- where adjustment programmes are essential in response to the impact of shocks (both of commercial and financial origin and relating to disasters involving natural hazards), implement the necessary countervailing measures to limit the regressive effect of such adjustments;
• give precedence to public spending aimed at overcoming poverty, giving special priority to improving access to education and health; and the formation of human capital in general; and
• eliminate regional and ethnic bias in public spending.

Guidelines on policies relating to competitiveness and development of production sectors

Regarding policies relating to production, measures that contribute creating employment opportunities increasing capital assets for the poor, such as the following deserve to be highlighted:

• promoting internal complementarities and linkages, and fostering chains of Small and Medium size Enterprises (SME) suppliers;
• providing access to credit for SMEs, micro-enterprises and entrepreneurs in the informal economy.; and
• modulating import tariffs within the internationally consolidated (bound) values to optimise the net labour content of trade balance.

Guidelines relating to human capital and relational social capital strategies

In the macroeconomic guidelines above, priority was established for public spending that maximizes access to education and health, which is a guideline of the human capital and social capital strategy. In addition, the following two cross-cutting guidelines can be applied to sectoral policies in general:

• foster chains of cooperation between micro-businesses and other forms of mutual support that connect the informal sectors and the main body of the “modern” economy; and
• implement performance requirements, whether or not based on incentives, designed to increase firms’ participation in initiatives for training the labour force.

Summarizing: synergies and intertwined effects of the trade-supported strategies

By combining trade liberalization and measures from the four TSDS, policies of developing countries may expect to attain economic, social and environmental benefits from their integration into global trade, as economic, social and environmental processes involved in integration of a country in the global economy are intertwined.

The matrix in Table 1.1 below illustrates how synergies and intertwined effects of the policy actions in the four TSDS may take place. The “X”s at the intersection of each particular row and column mean that the policy measure (in the row) has a favourable impact for achieving the goal (in the column). From the viewpoint of sustainable development goals the table shows how many policy measures belonging to the four basic strategies converge on a single goal.

One illustration of what has been said is the contribution that all the policy measures illustrated, belonging to all the strategies, give to the goal of increasing the effects of employment and knowledge spill overs.

Crossed effects from measures in the four strategies on all kind of goals can also be appreciated in Table 1.1. For instance, the measures under the learning and innovation strategy reinforce environmental sustainability goals, while the measures under the environmental sustainability strategy help to improve productivity or equality.
### Table 1.1 An Illustration Of Synergies On Sustainable Development Goals, Resulting From Combining The Four Trade-supported Strategies

<table>
<thead>
<tr>
<th>POLICY ACTIONS IN THE TRADE-SUPPORTED STRATEGIES</th>
<th>SUSTAINABLE DEVELOPMENT GOALS</th>
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<td>ECONOMIC SPHERE</td>
</tr>
<tr>
<td>Learning and Innovation</td>
<td></td>
</tr>
<tr>
<td>Promote production and exports of higher knowledge content goods &amp; services (LI-1)</td>
<td>x</td>
</tr>
<tr>
<td>Support R&amp;D and innovation for product differentiation and process efficiency (LI-2)</td>
<td>x</td>
</tr>
<tr>
<td>Increase compliance with technical, environmental and health standards in processes and products (LI-3)</td>
<td>x</td>
</tr>
<tr>
<td>Environmental Sustainability</td>
<td></td>
</tr>
<tr>
<td>Support local capabilities in environmental goods, services and technologies (ES-1)</td>
<td>x</td>
</tr>
<tr>
<td>Foster sustainable use of biodiversity-based advantages in trade (ES-2)</td>
<td>x</td>
</tr>
<tr>
<td>Interiorize externalities and incorporate best environmental practice in production (ES-3)</td>
<td>x</td>
</tr>
<tr>
<td>Complementarities and Linkages</td>
<td></td>
</tr>
<tr>
<td>Promote competition; promote transparency in public policies (CL-1)</td>
<td>x</td>
</tr>
<tr>
<td>Enhance &amp; use + externalities in the territory (e.g. through infrastructure &amp; clustering) (CL-2)</td>
<td>x</td>
</tr>
<tr>
<td>Promote and support downstream processing and upstream chains of SME suppliers (CL-3)</td>
<td>x</td>
</tr>
<tr>
<td>Trade policy to improve net labour content in trade balance (e.g. through tariff modulation) (CL-4)</td>
<td>x</td>
</tr>
<tr>
<td>Human &amp; Social Capital</td>
<td></td>
</tr>
<tr>
<td>Human capital formation at all levels within formal education system &amp; productive sector (SH-1)</td>
<td>x</td>
</tr>
<tr>
<td>Cooperation networks to increase scale and connect informal sector units to formal economy (SH-2)</td>
<td>x</td>
</tr>
</tbody>
</table>


### 1.3 Risk management, Vulnerability and Resilience to External Shocks and Disasters: a Major Challenge in Integrating into the Global Economy

Risk management more directly related with competitiveness policies and the trade-supported strategies that we have been discussing (i.e. technological learning and innovation; creation of complementarities and linkages; human capital and social capital formation; and environmental sustainability) must be focused on two kinds of measures. The first is minimizing risks by means of ex-ante measures, i.e. by controlling exposure and introducing prevention practices. The second is strengthening institutional and economic capabilities to recover; i.e. enhancing resilience.

However, since the economic resilience of an economy to disastrous events may be expressed in terms of the ratio of the damage caused by their typical disasters to their Gross Domestic Saving, this draws attention to the close relationship that there can be between a country’s resilience and its net export earnings. Indeed, for any economy, but in particular for small economies subject to frequent disasters, there is a strong feedback between disasters and international competitiveness. Not only is competitiveness adversely affected by external shocks and...
disasters, but a high level of competitiveness could improve the capability to recover from disastrous events.

**Trade-supported strategies, competitiveness and vulnerability to economic shocks**

The structural solution that trade-supported strategies for sustainable development can offer for (trade-related) price shock risks is to diversify production and upgrade technology, in line with the first two strategies mentioned in section 2.2.

Regarding financial shocks, trade-supported strategies would call for renewed attention on agreements on investment and the chapters on investment in the free-trade agreements are negotiated. Not only would the conditions of financial and exchange policy have to adopt precautionary rules (e.g. the Basel rules), which, as we have said, are in force in many developing countries, but also the rules on foreign investment treatment would have to pay close attention to the conditions relating to the recognition of various types of investment as "covered investment". These rules would have to include safeguard clauses that could be activated as required when there were serious indications of risk.

**Disasters related to natural hazards: policy measures to reduce vulnerability and increase resilience in small economies**

Regarding disasters involving natural phenomena, there is clear evidence that developing countries are suffering them more frequently. In the case of small countries, these disasters may have a significant magnitude in relation to the size of the economies, making them increasingly vulnerable. Aside from their exposure to disasters, small developing economies often experience severe economic and social restrictions regarding their integration into the world economy. Added to the circumstances of the disasters, especially the effects of recession associated with disaster events, these economies can fall into vicious circles of stagnation and poverty, characterized by serious limitations for implementing improvements in competitiveness, and be unable to recover.

Actually, the resilience of small developing countries may be choked off to the extent that they become unable to recover without major external intervention, not only in terms of humanitarian aid after the disaster, but also mainly for reconstruction and prevention, and for the generation of greater resilience of their own.

Indeed, the situations experienced by small and vulnerable developing economies may not be resolved without far-reaching action of two types. Firstly, own action through policies to develop production and competitiveness, such as those we mentioned when referring to the trade-supported strategies. Secondly, international cooperation going beyond immediate aid after disasters and taking a form that is not a burden on those economies.

It is not merely that these countries require international aid for immediate humanitarian assistance when the event occurs, or reconstruction loans. In small economies subject to frequent disasters it may be necessary for international cooperation to take numerous measures and in some cases major ones, for various purposes. Those purposes include rapid recovery from losses in international competitiveness; reconstruction of infrastructure in such a way as to prevent similar losses from future events; and especially mainstreaming risk management in all public and private activities involving strategic planning of development, regional planning and planning of future investment in general.

Only if international cooperation takes such steps can it help these small countries to improve their own capability to recover without compromising the investment they need for their future development.
1.4 Making the Negotiating Perspectives Coherent With the Objective of Supporting Sustainable Development Strategies

This section discusses how to make the perspectives of trade negotiations coherent with the objective of supporting sustainable development strategies. The discussion considers how our trade-supported strategies may affect the supply and the demand sides of developing countries’ economies, and how trade rules of different kinds may be used to implement policies in those two sides.

In previous sections it has been stressed that development challenges that developing countries face in their integration in global trade may be addressed by combining trade liberalization, which mainly influences the demand side, and other trade-supported strategies for sustainable development which essentially affect the supply side. Policy instruments and trade rules that may support (or hinder) the implementation of policies to address those challenges can be classified according to three broad dimensions: market access and fair treatment to developing country exports; policy spaces; and resources for development support.

By implementing policies in the supply and demand sides, which involves paying attention to the three mentioned dimensions of trade rules (and not only to market access), it is possible to strengthen the developmental value of trade policy and international trade negotiations. Increasing the attention on supply-side issues in negotiations, and complementing the traditional approach of “offensive” and “defensive” perspectives with one of “capabilities development” constitute concrete and practical recommendations in the line of ensuring the desired coherence.

The potential value of policies in the supply-side and the demand-side of the economy

Looking at the economy from the supply side and the demand side allows us to sketch an economic image of the interaction between policies used to implement trade liberalisation and trade-supported strategies, on the one hand, and the processes they target, on the other.

In the demand side individuals and social groups benefit from consuming goods and services offered in the marketplace.

In terms of immediate (static) social objectives, when considering the implementation of trade-supported strategies for sustainable development in the demand side, it is relevant to consider how international trade and trade-supported policies may become instruments to enhance access to basic goods and services by all social groups (e.g. how these rules may contribute to defending rural livelihoods or to enhancing access to medicines by the poor).

In terms of the potential for growth (dynamic perspective), a key question on the demand side is how to absorb increases in output to create exogenous impulse to overall demand for a country’s goods.

On the one hand we must look at how exports may be sustainably increased by achieving effective improvements in international market access, and by implementing export promotion and facilitation policies. On the other hand, we may consider substituting domestic products for imported goods and services, particularly in order to increase the net labour content of the country’s trade balance.\(^{10}\)

In the supply side we find that almost all dynamic considerations may be realised. Changes in production structures and capabilities may be induced by means of creating conditions for diversification and opportunities for sustained growth in jobs creation and productivity. On this side, we must look at how policies may help amplify capabilities to create goods and services that can be sold competitively in both domestic and international markets, while creating more and better jobs and income sources, and generating conditions for a sustainable use of natural resources and the environment.

Such amplification may be made feasible by sustainably enhancing the quantity and quality of the supply of factors engaged in actual
production, as well as the knowledge bases and the institutions supporting the whole set of production processes, including the suitability of economic, social and environmental policy.

In brief, the greatest potential for sustainable development in economic, social and environmental terms can be addressed by promoting changes of structures, improving capabilities and overcoming constraints in the supply-side, though intervention on the demand side may in some cases be more effective in the short term. However, while the latter may contribute to immediate growth or to solving specific constraints, in general demand-side policies will not trigger structural changes or support sustained growth.

Three dimensions in which trade rules affect developing country capacities to implement trade-supported strategies for sustainable development

The development challenges that developing countries face in their integration into global trade fall into three broad dimensions. The first two refer to policies aimed at achieving effective access to trade opportunities and to improving systemic competitiveness, as well as social and environmental conditions. The third dimension refers to net resource inflows that developing countries may need to relieve major supply-side constraints, undertake institutional reform and implement institutional capacity building. Policy instruments and trade rules may hinder or support the search for solutions to each of these sets of problems.

In the Market Access and Fair-trade dimension, developing countries seek improved, stable and predictable entry to foreign markets through traditional market access mechanisms (e.g. tariff treatment, customs valuation, rules of origin, import licensing procedures, etc.), as well as solutions to the negative impacts that third countries' trade policies may have on limiting their exports (e.g. anti-dumping and countervailing measures; misuse of technical or health standards or export subsidies).

In the Space for Sustainable Development Policies (Policy Space) dimension, developing countries seek the ability to implement actions for productive sector development, competitiveness and vulnerability reduction, including through strategies based on creating technological capacities or fostering complementarities and linkages; and target trade-supported policies for competitiveness in environmental or social/equity goals. Opportunities for implementing these policies might be limited by current WTO (i.e. "behind the border measures") and other international rules.

Clearly, developing countries may deserve support from the international trade regime in the form of Special and Differential Treatment (S&D) instruments providing additional flexibilities, or policy space. However, it must be reiterated that using the 'policy space' approach should not imply a completely open-ended flexibility in S&D, as a balance must be struck between the flexibilities required and the need to maintain the inherent value of a rules-based trading system.

Mechanisms in the third dimension (Resources for Development Support) encompass those ensuring access for developing countries to net resource transfers that may contribute to financing the costs of institutional adjustments and enhancement of capacities, including overcoming the most pressing supply-side constraints and coping with the need to invest in enhancing resilience to disasters in small vulnerable economies.

Financial constraints may prevent developing countries from implementing suitable policies and institutional reforms and would require support from outside the Multilateral Trading System (MTS), e.g. from international financial institutions or donor countries. The ongoing discussion on “Aid for Trade” demonstrates the growing relevance of such constraints. In this context, it is important to emphasize that these additional resources should not be subject to policy conditionalities that would undermine the policy space objectives of developing countries.
Practical ideas on how to better focus the interests of developing countries in trade negotiations

Two practical conclusions may be derived from integrating the considerations we made on the three dimensions of trade rules, and the discussion we had on supply and demand-side policies. As illustrated in Figure 1.1 below, supply-side policies need policy spaces and resources for development support to be implemented, while rules in the market access and fair trade dimension support demand-side policies.

The first idea is that it seems highly relevant for developing countries to give priority to the policy space and resources for development support dimensions in their negotiations, as they may be losing policy space or been limited by financial constraints to implement policies aimed at structural changes, diversification, and higher value addition.

The second idea is that the so called "offensive" and "defensive" approaches to trade negotiations do not capture all the development interests that developing countries should inject in their negotiations on trade and trade-related international rules. These two approaches typically correspond to market access (demand side) interests but they are not able to interpret the interests of creating supply-side capabilities and promoting structural changes in production and trade.
2. IMPLEMENTING ACTIVE SUPPLY-SIDE POLICIES IN THE TRADE-SUPPORTED STRATEGIES

We will now discuss a number of measures that could be considered appropriate for implementing the four trade-supported strategies for sustainable development. In each of those strategies we will begin by discussing arguments on the need for active market intervention, and go on to illustrate the appropriate types of intervention that could be carried out using instruments governed by international trade rules.

There is an extensive literature discussing the pros and cons of active policy interventions for productive sector development and competitiveness. Most of it relates to market failures. We take what we consider the most relevant arguments from these discussions, giving support to policy actions in the four TSDS strategies introduced above. Those strategies aim at inducing deep structural changes arising from technological dynamism that considerations on static efficiency cannot address (Cimoli et al, 2006). Without denying the importance of other factors in implementing the strategies under consideration, the discussion of these issues focuses on externalities; coordination and organization failures; and imperfect information. We will comment where applicable on additional aspects, such as monopolistic competition, transaction costs and economies of scale, among others.

2.1 Active Policies in the Strategies for Learning, Innovation and Creating Linkages

Investment decisions in activities related to new technologies, adaptations and innovations, require information about market opportunities, sources of technologies and other provisions, that imply “search and discovery” costs, or experimenting through formal research and development activities. Such costs are borne by the entrepreneur, but its results can be of enormous societal value, due to information externalities. However, it is the entrepreneur alone who bares the risk of failure, driving his propensity to invest below the socially optimal level. Markets do not give investors the appropriate information signals when there are uncertain learning costs and high levels of pecuniary externalities, which can be associated with many failures (e.g. weak capital markets; restrictive intellectual property rights). The result is a suboptimal level of investment in risky, technologically dynamic sectors.

Additionally, the creation of complementarities and linkages requires the coordination of labour and intermediate inputs markets, logistical and infrastructure support, and final products markets. All these interventions have to be conceived and put into practice, bearing in mind that the potential for action, as well as the necessary know-how to formulate long-term policies and implementation, are distributed among numerous actors, be it the State, private or intermediate organizations. These include: private sector companies and associations; the scientific sector; various State agencies; non-governmental organizations and unions (Messner 1996)\(^1\). Thirdly, innovation systems require both coordination and information to function properly. Multiple coordinated actions that the market cannot supply by itself are required to contribute to the consolidation of innovative clusters and the strengthening of complementarities (Camagni, 2002).

In developing countries, neither coordination nor a sufficient supply of information are attainable without the relevant policy actions aimed at improving complementary supply and demand functions, promoting economies of scale or financing “discovery” costs\(^2\). If the liberalization process is not accompanied with conscious actions to generate linkages and complementarities in the productive sectors, structural changes will be superficial and weak. They might take place in some companies, but they will neither solve the structural heterogeneities of a developing economy nor generate opportunities to pass on...
the benefits of trade to most of the population (Ocampo 2005).

Participation of foreign investment in those linkages creation processes and in technology transfer processes is an important way to help overcome such failures. Collaborative schemes between trans-national and local companies are likely to generate a two-way knowledge flow. However, technology spillovers will have a very low probability of taking place in the absence of active policies that promote national capacity building through the support of local companies and research organizations15.

In all, when the above mentioned coordination failures and information externalities are present, trade liberalization must be combined with active supply-side policies, otherwise it may fail in generating the expected results or tend to produce static benefits based on comparative advantages, but would not generate dynamic benefits associated with technological change (Reinert, 2005; Kumar and Gallagher, 2006).

An additional aspect to consider in relation to the learning and innovation strategies is the protection of Intellectual Property Rights (IPR), which some argue must respect a universal code, and without which there can be no innovation of inward foreign investment. The learning and technology transfer processes to be promoted in an innovation strategy depend on many factors. Of these, intellectual property protection is one, but not the only one, nor is it critical that such protection meets developed countries’ standards in order to promote a knowledge and innovation strategy in most developing countries.

The Trade-Related aspects of Intellectual Property Rights (TRIPS) agreement has protected technology suppliers without a counter-balance to promote competition (Commission on Intellectual Property Rights CIPR, 2002)16. This has increased distortions at the global level that can only be partially counterbalanced by national regulations that move away from a global harmonization of laws and regulations. The key question about IPRs is not whether they promote foreign investment, but whether or not a specific IPR regime helps the country to access the technologies it needs for its development.

Box 2.1 illustrates the use of various economic instruments in implementing the strategies for Learning and Innovation and for Linkages and Complementarities.

The implementation of strategies based on government incentives or direct economic support (for example, contribution to the costs of dedicated infrastructure) should be limited to new investments and subject to careful monitoring. No economic incentive for innovation or linkages creation should simply respond to characteristics of the sector or the kind of investment implied. They should aim to achieve unambiguous strategic objectives, such as generating a specific kind of linkages or training local personnel in particular skills.

Box 2.1 Illustrations On The Use Of Economic Instruments In Implementing The Strategies For Learning And Innovation And For Linkages And Complementarities

In the implementation of actions linked to the two first strategies a great variety of instruments from the five “families” may be useful and there are very many examples of their successful use17:

- Non-reimbursable public financing of R+D activities in specific sectors or in activities that then generate spillovers into many sectors;
- Research conducted in State institutes, the results of which can be passed on free, or at a very reduced cost, to private sectors;
- Intellectual property rules designed to facilitate the adaptation of technologies, for example through the collaboration of academic research centres and SMEs;
- Reforms in institutional frameworks to legitimate decision-making and the follow-up of sub-national policies linked to clusters and industrial districts by networks in which State bodies,
Corrales-Leal — Policy Spaces in Trade-supported Strategies for Sustainable Development

Box 2.1 continued

Within a similar framework of unambiguous technological objectives - and not referred to a sector in general - the use of selective import restrictions could be considered. The approach suggested by UNCTAD (2006b), which consists of modulating the use of tariffs to limit or give differentiated support to imports of certain categories of goods, could be interesting. This type of instrument does not necessarily lead to a rise in the average tariffs in the economy and can be employed, so long as a certain distinction is maintained in tariff negotiations between bound and applied levels, and the negotiations lead to reductions in the averages and not in the applied levels.

Note that this illustrative list does not include import restrictions via tariff increases above the consolidated levels, non-automatic import licences, tax mechanisms that discriminate against imports, or export subsidies. Measures that create opportunities for rent-seeking but fail to generate a countervailing incentive to achieve greater technological capacities or create sustainable competitive advantages are not advisable.

2.2 Policy Intervention in Implementing Strategies for Environmental Sustainability

Most developing countries continue to depend on exports of non-renewable resources or on renewable resource-based production where environmental best practices are not ensured. Additionally, in developing countries most small companies, together with informal sector producers, lack the capability to attain the environmental standards required in international markets and instead use unsustainable production techniques. Developing countries have specialized in exports whose production processes are potentially polluting, while their environmental technical services markets are not well developed.

Active policy interventions by developing countries may be needed to bring those trends under control, both with respect to eliminating negative environmental externalities in production and consumption, and to remunerating (internalizing) environmental services (positive externalities) supplied by some ecological systems. The same can be said with respect to resolving failures that limit investment in technological innovation activities, including those of technical services and environmental technology production (the same failures mentioned in relation to the Learning and Innovation Strategy).

In contrast to what happens with the strategies for innovation and linkage creation, WTO law does not question the freedom of developing countries to implement active policies to control environmental impact in their territories, or the use of economic instruments to facilitate or control the export of environmentally sensitive goods, such as energy. The only legal condition is to refrain from discriminatory treatment.
Box 2.2 illustrates the use of economic instruments in implementing the Strategy for Environmental Sustainability.

Even when considering the relationship between WTO rules and the Multilateral Environmental Agreements (MEAs), it may be noted that of the approximately two hundred MEAs, only some twenty really contain commercial provisions, and until 2005 no disputes had been brought to WTO on commercial provisions in MEAs, so the potential for conflict should not be exaggerated (WTO, Trade and Environment Committee, 2004). However, controversies might arise if a broader view were taken of the Strategy for Environmental Sustainability that the developing countries want, for example by including the generation of national capabilities for the production of environmental goods, services and technologies. If that were done, instruments such as performance requirements, public procurement preferences and others on which there are indeed important disagreements with the developed countries might possibly come into play.

**Box 2.2 Illustrations Of The Use Of Economic Instruments In Implementing The Strategy For Environmental Sustainability**

Some examples to be highlighted in the strategy for environmental sustainability are:

- Simultaneous support for meeting standards, creating local supply and ensuring solvent demand for environmental technical services and technologies by combining four groups of instruments: strengthening standards through their supervision; taxing and fining polluters; providing incentives and credits to pay for demand for services; and reforming institutional frameworks designed to promote the functioning of markets that are incomplete (for example, the market financing R+D activities and the production and provision of services);

- Support for the creation of enterprises and the consolidation of existing firms devoted to the production of environmental technical services and technologies, as well as to the study and sustainable use of biodiversity, by combining subsidies to R+D and adjustments to intellectual property rules so that they strengthen the protection of innovators in regard to local advantages (biodiversity, traditional knowledge) and at the same time facilitate applied research into technological adaptation;

- Support for the two objectives mentioned earlier by guiding the demand of public bodies, State commercial enterprises and private enterprises that use non-renewable natural resources. This guidance may draw on a set of rules conducive to granting preferences when environmental services are contracted from national producers and associations of nationals and internationals, conditional upon given performance indices;

- Support for R&D and sustainability assessment activities on biodiversity and environmental services -based sustainable trade; and

- Subsidies for producers whose operations take place in ecosystems that provide “environmental services”, in order to maintain the integrity of the systems.

Source: Adapted from Corrales (2006b).

Within WTO there is no questioning of the right of developing countries to implement active policies for purposes of controlling environmental damage in their territories, so long as there is no discriminatory treatment, or the use of economic instruments to facilitate or control the export of goods associated with issues of environmental interest, such as energy. However, controversies might arise if a broader view were taken of the Strategy for Environmental Sustainability that the developing countries want, for example by including the formation of national capacities for the production of environmental goods, services and technologies. If that were done, instruments such as performance requirements, public procurement preferences and others on which there are indeed important disagreements with the developed countries might possibly come into play.
2.3 Active Policies and the Objectives of the Strategy for Human and Social Capital

There are two lines of policy action in this strategy: human capital formation and social capital network promotion (relational). The first one is pretty obvious when giving support to all learning and innovation processes and productive transformation. The second one responds to a reality in most developing countries, where social exclusion is partly based on the “modern economy’s” inability to integrate informal producers. (See illustration of the use of economic instruments in Box 2.3).

For the economy as a whole, qualified human resources carry positive externalities, because the social benefit created by innovation and production processes exceed the individual investment training cost and the private benefit to the individual trainee. Private markets do not provide human capital at socially optimum levels; therefore public intervention may be justified not only through public investment in education, but also through performance requirements for private companies, among other means.

Box 2.3 Illustrations On The Use Of Economic Instruments In Implementing The Strategy For Human Capital And Social Capital Formation

<table>
<thead>
<tr>
<th>Cooperation networks and other forms of social capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fostering the formation and consolidation of networks of co-operatives and micro-enterprises of rural producers with very low productivity seeks to connect those producers with demand opportunities they would not otherwise have access to, while also generating scales of activity that facilitate the technical and financial assistance the producers will require to raise their product standards and improve their productivity.</td>
</tr>
<tr>
<td>- To implement this type of action there has to be large-scale public resource investment, and instruments such as the following may be useful:</td>
</tr>
<tr>
<td>- For suppliers of the kind referred to (e.g. cooperatives): i) special tax regimes conditional on specific performances; ii) preferences in public procurement; iii) provision of infrastructure for stockpiling and storage; and iii) subsidized technical assistance and other consulting services for quality improvement and international certification, international marketing.</td>
</tr>
<tr>
<td>- For large companies that could obtain their supplies from the networks, incentives related to the training of suppliers and technical assistance so that the latter can raise standards, conditional on specific performance.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Human capital formation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Instruments that can be used to implement human resources training measures are very varied and are to be found in virtually all the “families”. Some examples are:</td>
</tr>
<tr>
<td>- Publicly funded fellowship programmes for fourth-level training (master’s degrees and doctorates);</td>
</tr>
<tr>
<td>- Subsidies to national enterprises for partial or total funding of personnel training programmes;</td>
</tr>
<tr>
<td>- Provision of infrastructure for schools and health services in clusters and industrial zones; and</td>
</tr>
<tr>
<td>- Performance requirements in international enterprises for the employment of national personnel and their on-the-job training.</td>
</tr>
</tbody>
</table>

Source: Adapted from Corrales (2006b).
Again in this point, we should discuss the distortion effects that come from international regimes on
the protection of IPR, which cannot be neutralized or controlled without State involvement through
active public policies. For instance, IPR policy intervention in the area of health is essential to
guarantee social objectives and human capital accumulation in developing countries.  

An example of actions aimed at promoting co-operation networks and other forms of
relational social capital is encouragement for the development and consolidation of networks
of cooperatives and micro-enterprises of rural producers with very low productivity. This type
of action seeks to connect those producers with demand opportunities they would not otherwise
have access to, while also generating levels of activity that facilitate the technical and
financial assistance the producers will require to raise their product standards and improve their
productivity.

2.4 Links Between Policy Actions and Trade–Related Instruments for the
Implementation of the Trade–Supported Strategies

Policy actions to implement the four trade-supported strategies, as we have seen in
previous sections, may consist of the creation, consolidation or adjustment of institutional
frameworks, or active policy measures. Table 2.1 shows various WTO agreements containing
rules that may affect the implementation of these actions.

Table 2.1 Links Between WTO Rules And Five Families Of Policy Instruments

<table>
<thead>
<tr>
<th>POLICY INSTRUMENTS</th>
<th>TRIMS</th>
<th>SCM</th>
<th>TRIPS</th>
<th>AGR</th>
<th>GATS</th>
<th>GATT 1994</th>
<th>A4T</th>
</tr>
</thead>
<tbody>
<tr>
<td>Institutional reforms and adjustment necessary to</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
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<tr>
<td>successfully implement trade &amp; development strategies</td>
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<tr>
<td>Incentives (and disincentives) to stimulate or condition</td>
<td>X</td>
<td>X</td>
<td></td>
<td></td>
<td>X</td>
<td></td>
<td>X</td>
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<tr>
<td>enterprise performance in the direction of goals</td>
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<tr>
<td>Promotion of foreign direct investment, whether or not</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td></td>
<td></td>
<td>X</td>
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<tr>
<td>focused according to priorities in development strategy</td>
<td></td>
<td></td>
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<tr>
<td>Selective restrictions on imports and/or modulation of</td>
<td>X</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>X</td>
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<tr>
<td>import conditions to priorities in development strategy</td>
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<tr>
<td>Direct use of public budgets to provide (focused) services</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
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<td></td>
<td>X</td>
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<tr>
<td>and infrastructure, or to grant preferences in public</td>
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<tr>
<td>procurement</td>
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</tbody>
</table>

The five categories of instruments shown in the table are: i) Creation, consolidation or adjustment
of institutional frameworks aiming at enabling the operation of economic agents or the implementation
of policies. Relevant examples of these frameworks are those relating to property rights; competition;
macroeconomic equilibrium; and risk management;  
ii) Use of incentives for stimulating or conditioning
firms’ performance in the direction of policy objectives. These instruments may in general be related to rules on subsidies and trade-related investment measures; iii) Promotion of Foreign
Direct Investment (FDI), focused or not in specific
sectors;  
iv) Selective treatment of imports, which may be related to various GATT disciplines (e.g. tariffs, licences or rules of origin); and
v) Direct use of public (budgetary) resources in providing dedicated services or granting preferences. Instruments in this category may be used to focus measures on priority sectors or activities according
to the country’s strategies (e.g. infrastructures, education, health and government procurement preferences).
Finally, Table 2.2 illustrates the types of instruments in the five categories that could be considered useful in implementing actions from the four trade-supported strategies. The "X"s at the intersection of each particular row and column mean that the policy measure in that row may have a favourable impact for achieving the goal in that column.

Table 2.2 Illustrations On The Use Of Economic Instruments In Implementing Policy Actions In The Trade-supported Strategies

<table>
<thead>
<tr>
<th>POLICY ACTIONS IN THE TRADE-SUPPORTED STRATEGIES (1)</th>
<th>Institutional Frameworks</th>
<th>Economic Incentives/Disincentives</th>
<th>FDI Promotion</th>
<th>Selective M Treatment</th>
<th>Public Budget Application</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Property Rights</td>
<td>Organizational and Transparency</td>
<td>Macroeconomic and Others</td>
<td>Competition Reform</td>
<td>Requirements</td>
</tr>
<tr>
<td>Learning and Innovation Strategy (LI)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>LI 1 Promote production and X of higher knowledge content goods and services</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>LI 2 Support R&amp;D and innovation for product differentiation and process efficiency</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>LI 3 Increase compliance to standards in processes and products</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Environmental Sustainability Strategy (ES)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ES 1 Support local capabilities in environmental goods, services and technologies</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>ES 2 Foster sustainable use of biodiversity-based advantages in trade</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>ES 3 Interiorize externalities and incorporate best environmental practices</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Complementarity and Linkages Strategy (CL)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CL 1 Promote downstream processing and upstream chains of SME suppliers</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>CL 2 Generate and use externalities in territory</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>CL 3 Promote Competition. Promote Transparency in Public Policies</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>CL 4 Trade Policy to improve net Labour Content of Trade Balance</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Social and Human Capital Strategy (SH)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SH 1 Human Capital formation at all levels</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>SH 2 Cooperation Networks to increase scales and facilitate connection to Formal Economy</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
</tr>
</tbody>
</table>

(1) Policy actions are categorized into four main strategies: Learning and Innovation (LI), Environmental Sustainability (ES), Complementarity and Linkages (CL), and Social and Human Capital (SH).
3. HOW TO MANAGE POLICY SPACES?

This Chapter tackles the issues of Policy Spaces. Our approach to these issues aims to reduce the potential confrontations between policy instruments and trade rules to a small group of dilemmas. We base this approach on two considerations.

The first consideration is that the potential conflicts on Policy Spaces are actually concentrated in only one of three main domains. In the domain of the existing spaces there are no dilemmas; use should be made of the many spaces in the agreements if they are useful to implement development policies. Secondly - in current and future negotiations - attempts might be made to reduce the existing spaces, but if they exist there is not actually any legal conflict, and it will be for developing countries to stand firm in defending the spaces they need and which might be at risk, and the members of the multilateral system should give full consideration to the legitimate interests of the majority of WTO countries. The third domain covers any spaces that have been lost. In this area, where conflicts may arise, efforts must be focused on revising and even extending the scope of the SDT.

The second consideration is actually how to approach the issue of spaces in the field of S&DT, in which the dilemmas would be concentrated.

3.1 Incentives, Including Subsidies and Performance Requirements

The policies employed by today’s developed countries and by the successful East Asian economies to create national capacities made extensive use of subsidies and other incentives. In some cases access to incentives was made conditional on specific achievements (incentive-based performance requirements), or on compulsory performance requirements. In all cases, success in making use of such instruments was enhanced when institutional frameworks were in place to guarantee the transparency and credibility of policies, and where policy makers enjoyed a minimum level of impermeability to pressures from rent-seeking lobbies and interest groups.

In principle, the WTO Agreement on Subsidies and Countervailing Measures (ASCM) covers only subsidies of a specific nature (that benefit one firm, one group of firms or one region), or in other words, applies only to selectively employed instruments. The ASCM does not cover horizontally applied subsidies. In practice, then, some Policy Space remains for the use of subsidies, for example those for the provision of infrastructure or for supporting enterprises, so long they are based on the size or innovative activity of the firms, but not on sectoral criteria.
Among the subsidies covered by the Agreement are prohibited subsidies (export subsidies and those associated with export performance also prohibited by the Trade-Related Investment Measures (TRIMs) Agreement\textsuperscript{24}); actionable subsidies (that may give rise to proceedings before WTO’s dispute settlement mechanisms);\textsuperscript{25} and the non-actionable subsidies envisaged in article 8 of the ASCM.

The cases of prohibited (export) subsidies ruled on by the DSM concern very large manufacturing industries that require economies of scale and have high start-up costs, for example the ship and aircraft construction industry.\textsuperscript{26}

Wide Policy Space existed in the Subsidies Agreement under the “non-actionable” heading, which included subsidies for research and development (R&D), for regional development and for the introduction of environmental technologies. Among the subsidies included under this heading were the financing of venture capital funds and the free transmission of research results from government research centres to the private sector, as well as support for actual production so long as the product of the R&D measures remained at the “pre-competitive” level.

Non-actionable subsidies ceased to exist when the discussions on article 8 of the ASCM were concluded in 1999, without agreement being reached on amending it or leaving it unchanged. However, a gentleman’s agreement does exist among the members of WTO not to act on these subsidies. That emerged from the Doha ministerial meeting, whose decision on implementation agreed that the Doha Round negotiations would review the status of those subsidies in the light of the proposal submitted by Venezuela and supported by a majority of the developing countries (Bridges, 2001).

“... The Conference ... takes note of the proposal to treat measures implemented by developing countries with a view to achieving legitimate development goals, such as regional growth, technology research and development funding, production diversification and development and implementation of environmentally sound methods of production as non-actionable subsidies, and agrees that this issue be addressed in accordance with paragraph 13 below. During the course of the negotiations, Members are urged to exercise due restraint with respect to challenging such measures.”\textsuperscript{27}

This “statement of fact” has been upheld until now and there is no reason to expect that the situation will change.

The treatment of incentives that may be offered to attract foreign investment remains a grey area. Most direct or indirect incentives are included in the ASCM’s definition of subsidies, but the ideas in that Agreement were developed for subsidies that affect trade in goods and may not easily to apply to investment (Bora et al., 2000).

The WTO TRIMs Agreement bans conditioning foreign investors on performance requirements that discriminate between goods of foreign or domestic origin (for example, local content requirements), or imposing conditions that act as a quantitative restriction (for example, those that condition the imports of a firm on producing a given amount of exports). The prohibition is valid both for “compulsory” requirements and for those associated with an incentive.

All the cases concerning local content requirements adjudicated by WTO’s DSM relate to the automotive industry. Both India and Indonesia pleaded their status as developing countries in defence of their measures, the former on the basis of balance-of-payments arguments and the latter on that of \textit{Lex Specialis} in the ASCM, but their justifications were rejected and the measures had to be withdrawn.\textsuperscript{28}

The TRIMs Agreement does not ban export performance requirements unless they discriminate against foreign producers, nor requirements that reward technology transfer on commercial bases or R&D activities in the country, or that make them compulsory, such as those that promote associations between international and local firms geared to knowledge transfer through “learning by doing”.
Since the TRIMs Agreement entered into force, some developed countries, particularly in Europe, have applied discriminatory measures to input imports that have the same effect as local content requirements. Basically, they apply anti-dumping duties to components imported for assembly in the country. To justify these measures, known as “screwdriver regulations”, it is argued that finished products whose import had previously been restricted through anti-dumping duties were finding their way back into the market through the backdoor: coming into the country as parts that required minimal labour to be transformed back into the products that had originally been penalized.\(^9\)

In general, Bilateral Investment Treaties (BITs) that some developing countries have agreed in recent years with the United States, as well as North-South bilateral and Free-Trade Agreements (FTAs) that have recently been concluded or are nearing conclusion, are far more restrictive than the TRIMs Agreement. In particular, the agreements the United States participates in place a ban on all types of performance requirements, especially for joint ventures and technology transfer.\(^30\) However, it is also true that some of those FTAs have established rules of origin that grant preferences for the importation of parts and components from signatory countries, under cover of the exceptions provided for in article XXIV of the GATT. In other words, these agreements discriminate against imports coming from third countries, which has effects similar to regional content requirements (DiCaprio and Amsden, 2004; Kumar and Gallagher, 2006). It remains to be seen whether what the European Commission will ask the African, Caribbean and Pacific group of states (ACP countries) under the EPAs for concessions similar to those the United States has obtained, or whether the EPAs will stay within the terms of the TRIMs Agreement.

In contrast to the situation with performance requirements, the FTAs between developing countries and the United States do not foresee stricter subsidy regimes than those of WTO’s ASCM. This also appears to be the case in the EPA negotiations to date.

To conclude, a comment is warranted on the potential use of incentives to achieve social and environmental objectives. The freedom to use subsidies to pursue such objective potentially opens up a wide Policy Space for the implementation of environmental, human capital and social capital strategies. The range of possible incentive-based performance requirements that could be applied under this heading is considerable, and needs only to ensure that foreign and domestic investments receive equal treatment to ensure its compliance with existing multilateral rules.

Considering the potential usefulness of instruments based on subsidies and on performance requirements, the notable reduction in Policy Spaces for their use in direct connection with trade in goods (e.g., local procurement or export subsidies) is to be regretted. This is not at all the case, however, in regard to trade in services, the promotion of research and development activities or environmental, social or human capital strategies. Moreover, considering that long-term exports subsidies are not typically an effective capacity-building strategy, we must conclude that the prohibition of such subsidies may not mean the loss of particularly valuable Policy Space.

The bilateral investment treaties and the chapters on investment in some recent FTAs have imposed limitations on the use of performance requirements for the transfer of technology, including joint ventures. This development calls for innovative problem-solving to devise policy instruments that use permitted instruments (e.g. rules of origin or preferences in public sector procurement) to pursue similar objectives.

Finally, it is clear that the Spaces that exist in the area of services should be defended by developing countries in multilateral and other trade negotiations, to prevent the imposition of restrictive disciplines analogous to those of the TRIMs Agreement.
3.2 Focused Promotion of Foreign Direct Investment

In multilateral or bilateral agreements or in the FTAs there is no limit on focused investment promotion on given production sectors or on specific activities consistent with development strategies, such as gearing investment promotion towards economic activities where R+D efforts feature prominently. There are no limits even on the use of investment incentives with the aim of fostering those types of activity, which brings us back to the subject of subsidies and performance requirements. Nevertheless, in the past, the IMF has conditioned on refraining from using incentives for FDI.

3.3 Restrictions on Imports

In the past, both developed and developing countries have used import restrictions to protect national production of finished consumer or capital goods. Typically, this was done by imposing high import tariffs, manipulating taxes and duties on imports or through non-automatic import licences.

Tax manipulation instruments and non-automatic licences, however, may not be efficient. The only legitimate Space in the existing agreements is the difference between bound and applied tariffs (the "water" in import tariffs). Article III.2 of the GATT (National Treatment) prohibits the discriminatory imposition of taxes and article 3.2 of the Import Licence Procedures Agreement establishes the limits that such licensing regimes must observe in their application.

The DSM has considered undue restrictions on imports, based on discriminatory tariffs and non-automatic import licences, mainly in cases related to sensitive textile products and agricultural goods. Very few of them have been taken beyond the consultation stage. The cases of tax manipulation decided by the DSM concern discrimination against imported products through differential taxes applied to them on the basis of "biased" definitions of "similar products". However, in future negotiations, developing countries should bear in mind the usefulness of maintaining a certain degree of distance between applied and bound tariffs and the need for tariff negotiations to lead to reductions in averages rather than in applied levels. In previous sections, we mentioned the possibility of modulating the use of tariffs, as suggested by UNCTAD (2006b), to support non ambiguous technological objectives in certain branches of production. Such a strategy is only viable if these conditions are met.

Finally, it is important to note that in both agricultural and non-agricultural tariff negotiations, more than just supply-side policies are at stake. In many developing countries, revenues from import duties represent a very high proportion of fiscal income, and so negotiations on these issues may jeopardize the funding of public investment programmes and could impact the current account.

3.4 Preferences in Public Sector Procurement

At one time or another, public sector procurement has been used as an instrument of industrial policy nearly everywhere. This is a valuable instrument of productive development policy: purchases of goods and services by central, regional and local governments (including infrastructure construction, and hiring and procurement by State-owned enterprises) typically accounts for between 12% and 16% of developing countries’ GDP.

In practice, the impact of public procurement policies has been largely limited to two areas. First, developing country governments have reserved a share of national procurement markets for small and medium-sized local enterprises: a declared policy objective in almost all countries. Secondly, although hardly any country states this officially, many have reserved a large share of public works contracts for national construction firms. In addition, while the import substitution...
model was in force, many developing countries had State-owned sectors that stuck to a “buy national” doctrine, which had effects similar to local content requirements. They contributed to creating complementarities and supplier chains on the basis of protection rather than competitiveness. Almost always, the gains thus achieved were decimated by privatization and trade liberalisation.

However, public acquisitions have been used in a few developing countries to promote technological development or to introduce environmental standards, as has often been the case in developed countries. Only rarely have the unconditional preferences of import-substitution times been replaced by preferences subject to specific performance requirements, which could be expected to more effectively target capacity-building and linkage promotion goals.

Although, since the WTO’s inception, there have always been pressures to open procurement markets up to international competition, there are currently no disciplines at the multilateral level to limit the granting of preferences in such markets. Moreover, rules on public procurement are an open matter in the negotiations on trade in services. Only a few developing countries are party to the WTO Plurilateral Government Procurement Agreement, some of them because they were pressured into it during their accession to the organization. However, under article XVII of the GATT, State Trading Enterprises have limited scope to grant preferences to local suppliers to procure goods that will be incorporated into export.

In the FTAs negotiated in recent years by some developing countries with the United States, there have been commitments limiting the preferences that each country may grant national suppliers in government procurement. In other words, these FTAs extend national treatment to goods from signatory countries, and introduce transparency disciplines in public procurement. The thresholds that were established for local preference procurement in the FTAs negotiated by the US and several Latin American countries may be considered generous if the intended aim of the preferences continues to be encouraging SMEs, but not if there are more ambitious goals linked to technological development.

We may be sure that such commitments will continue to feature in future FTAs. The negotiations the ACP countries are holding with the European Union (EPAs) also envisage transparency rules and market access for procurement contracts beyond a certain threshold, a minimum requirement that developing countries in general must expect when they negotiate free-trade agreements with Europe. The use of preferences in public service contracting may be an effective instrument for promoting national technological capabilities, especially if combined with some of the aforementioned instruments. For that reason, services negotiations offer an opportunity to consolidate existing Policy Spaces for the use of preferences in public procurement.

As there are no major restrictions arising from international disciplines, priority in this field should be given to the innovative use of the existing Policy Spaces to sustain the implementation of the trade-supported strategies and to the proper interpretation of international agreements.

### 3.5 Intellectual Property Rights

Before the implementation of the TRIPS Agreement, patent systems in nearly all developing countries included instruments that allowed them not to extend protection to all fields of technology, or that granted limited protection to patent holders, making it possible to respond differently to requests for protection from nationals and foreigners. Such instruments allowed, for example, the granting of limited protection to specific inventions as a means of facilitating imitation, adaptation or “reverse engineering” by local researchers and firms. East Asia and the developed countries vastly upgraded the knowledge intensity of their economies under intellectual property rights regimes that were considerably less rigorous than the ones now in force.
TRIPS entered fully into force for all member countries (except, theoretically, the least developed countries) in the year 2000. The agreement requires binding universal minimum standards for granting protection, particularly with regard to copyrights and patents, and makes it compulsory to extend the latter to all fields of technology. These obligations are accompanied by clear and equally binding implementation and supervision mechanisms. In contrast, the TRIPS provisions concerning technology transfer and technical co-operation in favour of the developing countries are vaguely worded and are not binding. Couched in “best endeavour” language, they are virtually impossible to implement.

TRIPS theoretically keeps open some Spaces that developing countries could use to foster endogenous technological capabilities and to implement human capital formation strategies. The first is the possibility of using domestic legislation to combine rigorous rules on patent publication (requiring they should be clear and understandable enough to allow experts to reproduce the stages of invention) with the granting of “narrow patents” (that concede protection to a limited range of variants on the principal invention). Such a combination would tend to favour minor innovations and improvements by local researchers and entrepreneurs, which could be recognised and protected in their turn, thus creating opportunities for adapting major discoveries, inventions and innovations. A second group of Spaces relates to mechanisms for obtaining medicines at reasonable prices. This question was the subject of a fierce debate during the preparation for the Doha Ministerial Meeting, which concluded with a ministerial declaration confirming the right of developing countries (in practice limited to the LDCs) to resort to compulsory licensing mechanisms and to facilitate parallel imports when justified by public health situations and the excessive prices of the medicines.

But, in practice, these Spaces have been reduced outside the purview of WTO by the TRIPS-Plus requirements contained in many recent North-South FTAs. In other cases, they were rendered moot by the restrictive intellectual property laws adopted by many LDCs before the Doha ministerial.

Future negotiations will deal with two issues of particular importance for the developing countries: the proposals for the international harmonization of patent legislation being put forward by Europe and the United States, and supported by the WIPO secretariat; and the appropriate protection of traditional knowledge and of the sustainable exploitation of the specific values of biodiversity.

The narrow spaces that still exist to promote local innovation and adaptation would be seriously reduced if patent legislation were to be harmonised at the global level. If an appropriate solution is not soon found for the protection of traditional knowledge and the developments associated with biodiversity values, developing countries will lose a key potential source of competitive advantage.

### 3.6 The Argument on Policy Credibility at the Multilateral Trade System

Abandoning policy spaces in the multilateral trade system has been advised in the past by mainstream economists as a way of acquiring “policy credibility” in developing countries. According to this argument, investors, both foreign and domestic, would respond positively to signals from developing countries consisting of locking-in their trade and investment reforms through international agreements.

Policy reversals are of course negatively judged by investors. However, the locking-in argument can not be generalised as a basis for abandoning policies that have been applied with evident positive results in creating domestic private sector capacities in successful developing countries, or transparent policies aiming at creating those capacities with no room for reversals of the rights of foreign investors. The lack of validity of the policy credibility argument is particularly
true for multilateral negotiations, where there are not tangible trade-offs for policy spaces lost
(history has proved that market access was not increased as a response for the abandonment of policy spaces in the Uruguay Round).

Nevertheless, three major trading blocs are emerging and consolidating regionally - around the USA, the EU and the Asia-Pacific region. Clustering around these groups meanwhile, are the regional schemes of other developing countries. Within such schemes the opportunities for trade-offs may result much clearer to developing countries, and seeking 'hooks' and 'anchors' with the major blocs to secure market access and insure against adverse trade policy developments may result an intelligent strategy that every country or grouping of countries would have to assess.
4. APPLYING THE TSDS TO DEVELOPMENT SITUATIONS

The ideas on development situations presented in this chapter represent an application of the concepts of the TSDS to defining trade policies and making use of trade rules to support development policies. The Situational Approach may be used in general to define trade policies and to assess the use of trade rules to support development policies, particularly policies in the supply-side of the economy. The initial development of these ideas emanate from a work programme on S&DT undertaken by ICTSD between years 2002 and 2006 under the direction of the author.

4.1 Characterising Development Situations

In a policy analysis and policy definition context, a Development Situation may be characterised by three elements, as shortly described in Box 4.1: its economic and trade circumstances; the particular trade and development policy objectives that may be established in response to those problems and constraints; and the "policy tool box" that countries may implement to meet the challenges they face.

The first two elements (A and B in Box 4.1) would describe circumstances involving development constraints or development policy objectives of the country concerned; and the third (C) would portray the set of policy instruments from which one or more instruments could be used for addressing the former.

A situation is not intended to prescribe the use of any particular policy mechanism or combination of instruments to those developing countries that experience it. The goal is rather to identify a collection of policy tools that such countries may or may not want to use to address the constraints they face and achieve the policy objectives they have given themselves. Within a given Situation, countries must have the flexibility to pick and choose among these instruments as they integrate their overall policy packages, or not to make use of any at all, according to their particular objectives, contexts and preferences.

Box 4.1 Elements in Characterising Development Situations in the Context of the Situational Approach

<table>
<thead>
<tr>
<th>The first two elements: the circumstances and the policy objectives</th>
</tr>
</thead>
<tbody>
<tr>
<td>The first element (A) should describe the context of economic and trade circumstances in which the problems or constraints are present; and the second element (B) should express the particular trade and development policy objectives established as responses to the problems and constrains previously mentioned.</td>
</tr>
</tbody>
</table>

Describing the context (A) may or may not need using quantitative indicators. However, when applicable, there is a need for agreeing on a set of indicators and thresholds that can serve as benchmarks for defining when a development situation would deserve the additional flexibilities (S&DT provisions) involved.

If WTO members accept using the Situational Approach, they would eventually agree that a particular situation or set of situations deserve certain additional flexibilities provided that the chosen indicators fall within pre-established limits for a region, a group of sectors or the whole economy. Therefore, if a Developing Country Member’s indicators fall within these limits, the member will have automatic access to the S&DT provisions associated to the development situation. This logic confers transparency and predictability to the S&DT and ensures developing country members the access to the policy instruments necessary to address the situations they need to tackle.
The third element: the policy tool box

The third element consists of a collection of policy instruments from which a single tool or a combination of instruments could be chosen to integrate the ‘Context specific Policy Package’ that would address the objectives defined in the first and second elements. The use of some of the instruments from the tool box could be currently limited by WTO rules, therefore requiring S&DT in terms of policy flexibilities (e.g. the use of performance requirements prohibited by the TRIMs Agreement).

Solid arguments must accompany the characterisation in order to justify the mutual links between the first two and the third elements; i.e. these arguments are essential to validate the usefulness of particular instruments in addressing specific constraints or policy objectives.


4.2 An Illustrative Set of Development Situations Related to Competitiveness and Vulnerability of Developing Countries

In the competitiveness situations studied by ICTSD, in addition to the potential usefulness of policy measures relating to effective access to markets in other countries, the importance of the supply-side measures belonging to the four trade-supported strategies is highlighted (innovation and technological learning; linkages and complementarities; environmental sustainability; and social and human capital formation). We highlight as well the potential usefulness of regional integration initiatives and effective support from technical assistance to strengthen the capabilities for managing public policies (not only policies on trade but also on the development of production sectors and competitiveness).

In the situations relating to small and vulnerable countries, in addition to the above there is a need for support for the introduction of risk management in all development policies. In the search for additional S&DT benefits it would seem logical to focus attention on these areas, in the dimension of Policy Spaces, mainly through flexibilities in rules, and in obtaining financing to help resolve supply-side constraints and implement programmes of institutional reform and adaptation (i.e. in the dimension Resources for Development Support);

The agreements, decisions and disciplines most often associated with the flexibilities required by the competitiveness situations studied are subsidies (ASCM), investment measures (TRIMS), Rules of Origin and rules related to Standards (Technical Barriers to Trade: TBT and Sanitary and Phitosanitary Standards: SPS); and rules of the services agreement (GATS rules);

There are ample available policy spaces in the services agreement (GATS), which can be used by developing countries to increase their export capacity in a very wide variety of services. Looking at this fact from a complementary perspective, the negotiation of rules in the GATS should guarantee that the necessary spaces are preserved. It would therefore be justified to
consider how these spaces can be preserved through S&DT provisions appropriate to the types of services being negotiated.

Six situations related to vulnerability and competitiveness were assessed in the ICTSD studies in terms of their economic, social and environmental features (see Table 4.1). Policy actions that could be implemented to cope with the development needs, problems and constraints involved in each situation were also studied, demonstrating that a great variety of characteristics frequently present in developing countries tend to cluster and may be addressed with context-specific policy packages. The problems and constraints relating to vulnerability of small developing economies (Small and Vulnerable Economies: SVEs) are particular needs that differ from those related to restrictions on competitiveness, which are experienced by the great majority of developing countries. Therefore, it would seem that the trade-related development problems of the SVEs might be handled in two different groups, one in common with the other developing countries that are experiencing competitiveness situations, and another corresponding to the problems of vulnerability and resilience of the SVEs and their effect on competitiveness, which are exclusive to the SVEs. Addressing many of the problems of SVEs in relation to vulnerability and resilience would need financial support for investments in infrastructure and the introduction of risk management in public policy systems and planning of investment in all sectors. The same can be said for solving problems with capabilities for implementing, coordinating and following up policies in very poor and very small countries. Both types of situations require considerable aid for the formation of institutional capabilities, not limited to countries complying with trade agreements, but also developing capabilities for formulating and monitoring policies for competitiveness, development of production sectors and risk management in all fields. The above would justify a more precise study of the ways of obtaining Aid for Trade resources for those purposes, and the legal means of forging practical links between Aid for Trade measures with S&DT measures.
Table 4.1 Features In Situations Studied On Competitiveness And Vulnerability

<table>
<thead>
<tr>
<th>FEATURES IN THE SITUATIONS STUDIED</th>
<th>COMPETITIVENESS</th>
<th>VULNERABILITY</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>COM 1</td>
<td>COM 2</td>
</tr>
<tr>
<td>High dependence on a few export lines or markets</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>High Volatility of export revenues, Terms of Trade or GDP</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>High vulnerability/low resilience to external shocks and disasters</td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>Abnormally high transportation costs to access international markets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Commercial presence in international mkts.</td>
<td>Not necess. low</td>
<td>x</td>
</tr>
<tr>
<td></td>
<td>Very low; fragile</td>
<td>x</td>
</tr>
<tr>
<td>Export specialization other than agriculture</td>
<td>Mining and/or hydrocarbons</td>
<td>x</td>
</tr>
<tr>
<td></td>
<td>High-tech manufactures</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Other manufactures</td>
<td>x</td>
</tr>
<tr>
<td></td>
<td>Services</td>
<td></td>
</tr>
<tr>
<td>Low technological and innovative capacity</td>
<td>Low capacity to comply intl stds</td>
<td>x</td>
</tr>
<tr>
<td></td>
<td>Low–tech X specialization</td>
<td>x</td>
</tr>
<tr>
<td></td>
<td>Apparent high–tech X spec</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Maquila type low- tech X</td>
<td></td>
</tr>
<tr>
<td></td>
<td>NNRR-based quasi–enclave</td>
<td>x</td>
</tr>
<tr>
<td>High NNRR-based export specialization</td>
<td>Renewable low envl practices</td>
<td>x</td>
</tr>
<tr>
<td></td>
<td>Non renewable</td>
<td>x</td>
</tr>
<tr>
<td>Environmental features</td>
<td>High export specialization in potentially contaminating products</td>
<td>x</td>
</tr>
<tr>
<td></td>
<td>Low capabilities to comply with internatl environmental standards in exports</td>
<td>x</td>
</tr>
<tr>
<td></td>
<td>Low domestic supply capacity in environmental services &amp; technology</td>
<td>x</td>
</tr>
<tr>
<td></td>
<td>Opportunities in sustainable bio-trade not taken advantage of</td>
<td>x</td>
</tr>
<tr>
<td>Social features</td>
<td>Need to increase quality and quantity of human resources</td>
<td>x</td>
</tr>
<tr>
<td></td>
<td>Precarious connection of informal actors to “modern” economy</td>
<td>x</td>
</tr>
<tr>
<td></td>
<td>Per capita Income or GDP</td>
<td>Not necessarily low</td>
</tr>
<tr>
<td></td>
<td>Low</td>
<td>x</td>
</tr>
<tr>
<td></td>
<td>High poverty levels</td>
<td>x</td>
</tr>
</tbody>
</table>

The first situation (COM-1) is characterized around economic problems frequently faced by weak economies in the process of joining the international economy.

In the second and third situations (COM-2 and COM-3) the main problems and objectives are related to complementarities and knowledge-technology strategies although social and environmental features are also mentioned.

COM-2 refers to economies dependent on non-renewable resources and COM-3, to economies that have tried to change their export specializations into manufactures but feature important deficiencies in internal linkages and technological capabilities.

Situation COM-4 is characterised by environmental problems and objectives. Strategies for learning combined with
environmental sustainability strategies play an important role in the benefits associated with this situation. It incorporates many of the environmental problems faced by developing countries in general but also has features related to the paucity of productive linkages. Finally, situations SVE and Small and Remote Economies (SRE) relate to vulnerability and remoteness issues in small economies.

A situation of severe supply-side constraints found in weak developing economies

Many of smaller and poorer countries share conditions of integration into the world economy that can be described as very fragile. They find themselves in an initial bottleneck involving severe constraints on the supply side. They must overcome these constraints to be able to launch any sustainable improvement in productivity, revenue or competitiveness (competitiveness for sustainable development, as defined in section 1).

Countries in this situation show a very high export concentration on a few agricultural products and/or low value added manufactures, very small international market share, low attractiveness to foreign investment except in the exploitation of a few natural-resource based commodities, and serious difficulties in complying with international standards (e.g. SPS). Volatile export prices are also a feature of this situation.

Implications for the terms of trade, negotiation power and spillover effects on employment and income are similar in cases where we find a dual exporting structure, which is a very common pattern; therefore, these combinations can also be grouped in the same situation. In these countries, it is common to find very low productivity sectors coexisting with others having high productivity levels on account of efficient organizations for financing and technological adaptation.

An indicative list of countries experiencing this situation was prepared in the ICTSD study on Situations applying criteria and representative indicators of the circumstances mentioned. Thirty-five developing countries were found to be in the situation, as shown in Box 4.2. All LDCs may be considered as experiencing similar conditions.

Box 4.2 Indicative List Of Developing Countries In Situation COM-1 "Severe Supply-side Exports Constraints In Weak Developing Economies"

| Albania; Antigua & Barbuda; Barbados; Belize; Bolivia; Botswana; Cuba; Dominica; Dominican Republic; Ecuador; El Salvador; Fiji; Gabon; Ghana; Grenada; Guyana; Honduras; Jamaica; Kenya; Kyrgyzstan; Macedonia; Mauritius; Moldova, R. of; Namibia; Nicaragua; Pakistan |

Table 4.2 shows selected policy actions that could be relevant in the situation described above and identifies instruments that could be useful in carrying these out (only instruments subject to international trade disciplines are mentioned). Box 4.3 makes comments and illustrates the possible application of the trade-supported instruments.

As in all cases, in order to apply the incentives, developing countries would need certain flexibility in international regimes. Given that countries in the circumstances mentioned are in general eligible for international cooperation, it is important to state here that active policies are not designed to substitute or exclude any action based in such cooperation.
**Table 4.2 Illustration Of Policy Actions Potentially Useful In The Four Trade-supported Strategies, And Instruments For The Implementation In Situation COM-1**

<table>
<thead>
<tr>
<th>Policy actions</th>
<th>National policy instruments</th>
<th>International instruments</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>CI</td>
<td>S</td>
</tr>
<tr>
<td>LI-1; LI-2; ES-1: Promote and support generation of private supply capabilities</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>of technical services</td>
<td></td>
<td></td>
</tr>
<tr>
<td>LI-1: Negotiate better market access conditions to products with higher degree</td>
<td></td>
<td></td>
</tr>
<tr>
<td>of processing</td>
<td></td>
<td></td>
</tr>
<tr>
<td>LI-3: Increase compliance with technical and health standards by SMEs</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>LI-3: Negotiate with developed countries in WTO conditions on eventual</td>
<td></td>
<td></td>
</tr>
<tr>
<td>obligation to provide for technical assistance when establishing new standards</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(e.g. SPS, among others)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>ES-3: Enforce and monitor implementation of best environmental practices</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>CL-1: Promote suppliers’ chains and downstream processing by SMEs</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>CL-2: Build dedicated infrastructure to support improving export capabilities</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>CL-4: Modulate tariffs to improve labour content in net trade balance (X-M)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>SH-1: Training of personnel at all levels in productive sectors and auxiliary</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>public agencies</td>
<td></td>
<td></td>
</tr>
<tr>
<td>SH2: Promote cooperation networks (e.g. cooperatives) to enhance local devt</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>impact</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Conditional incentives** might be offered to large companies to promote technology transfer to small producers, whether as part of SMEs supplier development programmes, or by granting technical assistance to achieve international health or phytosanitary standards. These incentives (revenue tax, tariff rates, etc.) might be conditional on real improvements in the performance of technical assistance beneficiaries, for example by the achievement of a certain class of independent certification.

It is important to emphasize that if an incentive is conditional on practices such as those foreseen in the TRIMs agreement it falls under performance requirements prohibited by international rules. This does not necessarily mean that such use of a performance requirement should be totally discarded in a situation like the one we are discussing, as we will see later on.

**Direct and indirect subsidies** (the latter through special/preferential lending/credit interest rates) could be offered to small producers to facilitate the acquisition of technical assistance services produced by private suppliers, both in the environmental and in the productivity and quality fields. This acts as a mechanism for promoting the functioning of these services markets, and at the same time helps small producers to improve standards and introduce better environmental practices. Similarly, subsidies might be applied to support infrastructure and supply equipment that the producers cooperation organizations might need to consolidate production.

**Preferences in Public Procurement** could be granted to a certain extent to small producers, subject to having achieved certain environmental certifications or to SMEs taking part in a suppliers’ development program. These preferences might also be used to promote the participation of major companies in technology transfer to SMEs. For example, these companies might become eligible for certain contracts or public procurement if they took part in consortia or other forms of association with SMEs involving a “learning by doing” technology transfer to the latter. Note that this way of using the preferences in public procurement turns them into performance requirements based on incentives.

**Source:** Adapted from Corrales (2007b).
Mineral dependent economies needing to diversify exports and strengthen technological capabilities

Situation COM-2 is commonly characterized by low- and middle-income countries that have historically depended on exports of a few mineral commodities and face problems in trying to diversify their exports and add value through their traditional value chains. In other words, this situation involves the need to overcome bottlenecks in the processes of diversifying and deepening technological change in mineral- and hydrocarbon-dependent countries.

Two more or less generalized characteristics of these economies are that the main export sectors (i.e. hydrocarbons and mining) show a very high apparent productivity in comparison with other productive sectors, which explains a permanent tendency towards the overvaluation of the domestic currency (Dutch disease) and serious difficulties on the part of manufacturing sectors to become internationally competitive; they also generate a very small number of direct and indirect employment opportunities, due to the scarcity of the backward and forward linkages they establish with the rest of the economy.

These economies clearly need to buck the trends described. A solution to these structural problems must be sought by implementing diversification strategies; creating linkages and complementarities between the hydrocarbon and mining sectors and the rest of the economy; and generating competitiveness factors in sectors other than mining by upgrading domestic technological capabilities in general.

Considering these features, the situation should comprise countries whose exports simultaneously exhibit two characteristics: a very high proportion of exports made of hydrocarbons, minerals and their manufactures; and a high index of concentration of exports in a few non-agricultural export lines. In order to provide transparent information on the income levels of the countries in this situation, indicators of the latter variable should be incorporated.

Box 4.4 Indicative Lists Of Developing Countries In Situation COM-2 "Diversifying Exports And Strengthening Technological Capabilities And Linkages In Mineral-dependent Economies"

| High per capita income countries (10 countries): Bahrain; Brunei-Darussalam; Chile; Kuwait; Oman; Qatar; Saudi Arabia; Trinidad& Tobago; United Arab Emirates; Venezuela. |
| Medium and Low per capita income countries (22 countries): Albania; Bolivia; Botswana; Cameroon; Congo, R. of; Colombia; Costa Rica; Dominica; Ecuador; Egypt; Gabon; Ghana; Guyana; Kyrgyzstan; Mauritius; Mongolia; Namibia; Nigeria; Papua-New Guinea; Philippines; Suriname; Swaziland. |

Source: Adapted from Corrales (2007b).

In countries in the situation, we find a range of opportunities to implement policies directed at sustainable development objectives, which are related to intensification of knowledge, environmental sustainability and strengthening of productive networks. Table 4.3 above shows selected Policy Actions that could be relevant in such situations and indicates instruments that could be employed to carry them out. Policy Actions illustrated in the table indicate the range and comprehensiveness of objectives. It also gives a clear picture of the complementarities between measures. Box 4.5 comments on the application of the policy instruments.
Table 4.3 Illustration Of Policy Actions And Trade-governed Instruments Potentially Useful In The Implementation Of Trade-supported Strategies For Development In Situation COM-2

<table>
<thead>
<tr>
<th>Policy Actions</th>
<th>National policy instruments</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>CR</td>
</tr>
<tr>
<td>LI-1, ES-1: Promote and support domestic supply capabilities in services</td>
<td>X</td>
</tr>
<tr>
<td>including by SMEs: engineering &amp; construction mgmnt; mining and mining –</td>
<td></td>
</tr>
<tr>
<td>related (energy-related); and environmental.</td>
<td></td>
</tr>
<tr>
<td>LI-1, ES-1: Promote and support domestic supply capabilities in specialized</td>
<td>X</td>
</tr>
<tr>
<td>capital goods and machinery for the upstream section of the mineral</td>
<td></td>
</tr>
<tr>
<td>(hydrocarbon) exploitation and processing chain</td>
<td></td>
</tr>
<tr>
<td>LI-2: Promote and support national R&amp;D activities for equipment and processes</td>
<td>X</td>
</tr>
<tr>
<td>oriented to specific goals synergetic with LI-1 and ES-1</td>
<td></td>
</tr>
<tr>
<td>ES-3: Enforce environmental standards and monitor best environmental practices</td>
<td>X</td>
</tr>
<tr>
<td>in activities promoted according to LI-1 and ES-1</td>
<td></td>
</tr>
<tr>
<td>ES-3: Enforce environmental standards and monitor implementation of best</td>
<td>X</td>
</tr>
<tr>
<td>environmental practices in activities within the mineral (hydrocarbons) value</td>
<td></td>
</tr>
<tr>
<td>chain.</td>
<td></td>
</tr>
<tr>
<td>CL-3: Promote competition; promote transparency in public policies particularly</td>
<td>X</td>
</tr>
<tr>
<td>in processes involving subsidies and preferences in public procurement</td>
<td></td>
</tr>
<tr>
<td>CL-1; CL-2: Promote and facilitate downstream processing and upstream SME</td>
<td>X</td>
</tr>
<tr>
<td>clusters; support improvement of R&amp;D capabilities in regional universities and</td>
<td></td>
</tr>
<tr>
<td>centres of excellence</td>
<td></td>
</tr>
<tr>
<td>CL-4: Modulate import tariffs to improve labour content of net trade balance</td>
<td></td>
</tr>
<tr>
<td>(X-M), as well as incentivizing domestic production of intermediate goods,</td>
<td></td>
</tr>
<tr>
<td>machinery and components</td>
<td></td>
</tr>
<tr>
<td>SH2: Promote cooperation networks (e.g. cooperatives) to enhance local</td>
<td>X</td>
</tr>
<tr>
<td>development impact of investment projects and clusters</td>
<td></td>
</tr>
<tr>
<td>SH-1: Specialized education and training of personnel at all levels in</td>
<td>X</td>
</tr>
<tr>
<td>productive sectors and formal education system to face demand of other measures</td>
<td></td>
</tr>
<tr>
<td>in the programme</td>
<td></td>
</tr>
</tbody>
</table>

CR: Competition regulation; PR: Performance requirements including for local content in services; CI: Conditional incentives, including incentive-based performance requirements; S: Subsidies; T: Import tariffs; PP: Preferences in public procurement including by State trading enterprises (GATT Article XVII).

Box 4.5 Comments On Possible Uses Of Some National Policy Instruments In Situation COM-2

Promotion of national capacities for the production and supply of specialized services:

Market access by international specialized services suppliers conditional on having a commercial presence in the country and on participating in joint ventures with domestic companies (or with a regional company, or a company belonging to an integration agreement member State or to a free-trade agreement to which the country is a party);

Promotion of national innovation capabilities and R&D:

Creating a fund for financing national technology projects, to which all contractors and suppliers would contribute a given percentage of the value from every contract that increases or maintains the utilization levels at the mines and hydrocarbon fields. Oil and mining companies, operators and entities responsible for projects (who are responsible for the commissioning of works and services in the investment projects) would be compelled to make the relevant deductions and deposit the resources into the fund.

Implementation of an environmentally sustainable strategy:

Requiring mining companies and hydrocarbon producers, field operators and entities responsible for projects, to be accountable for contractors meeting environmental and technical standards; and requiring mining companies and operators to meet environmental and technical standards as a condition of their participation in resource exploitation activities.

Implementation of Policy Actions related to the social capital and human capital formation strategy:

Granting fiscal incentives and procurement preferences in mining and oil companies’ contracts to domestic and foreign contractors, subject to their performance in training and subcontracting supplies and services to cooperatives; and

Subsidizing training activities involving members of cooperatives.

Source: Adapted from Corrales (2007b).
There are almost no limitations originating from multilateral or regional trade rules when using the instruments illustrated below (e.g. performance requirements, or preferential procurement by State enterprises), either because they fall within the trade in services framework, or because the negotiating capacity of producing States has become higher as a result of the current international trends in which international investors show an enormous interests in accessing new reservoirs.

**Deepening “Shallow productive sector development” in manufacture**

A significant number of developing countries export relatively high proportions of goods in relation to their total exports. However, many of these countries have at the same time a permanent trade balance deficit in goods as well as a low contribution from export to domestic value added and to stable and well-paid job creation.

The most common examples are the low-technology “foot-loose industries”, i.e., industrial processes for final assembly of traditional goods for export (e.g. that complete the final phases of clothing finishing with no vertical integration into the textile sector). But examples can also be found in specialist high-technology exports that are not supported by internal chains of component suppliers, either because these chains were never developed or because they were destroyed in the trade liberalization process (e.g. electronics assembly). Free-trade zone subsidy regimes were associated with the origins of these exporting models in many developing countries.

“Shallow integration” was very common in the imports-substitution model. In the current international trade-oriented models, unless backward linkages are built, in addition to negative trade-balance phenomena, there will be a low technological spillover from the export activity to the rest of the economy. Developing countries that successfully undertook these processes to integrate into the international economy did so by building «upstream» supply chains and developing innovation and technological strengthening strategies; or simply diversified into other types of exports. In the current case, the relevant bottleneck is not market access but rather the supply-side limitation that prevents countries from reaping the full benefits of trade liberalization.

Some countries’ relatively easy access to the most dynamic international markets (e.g. Central America and the Caribbean to the US market, ACP countries through preferential tariffs to Europe and LDCs in general to all developed countries) gave special advantages until the late 90s to developing countries from certain regions. However, the relative weight of these factors is now tending to be lower owing to the proliferation of free-trade agreements and China’s accession to the WTO.

**Box 4.6 Indicative List Of Developing Countries In Situation COM-3 “Shallow Manufacture”**

| Albania; Armenia; Belize; Costa Rica; Cuba; Dominica; Dominican Republic; Egypt; El Salvador; Georgia; Grenada; Guatemala; Guyana; Honduras; Jamaica; Jordan; Macedonia; Moldova, R. of; Mongolia; Morocco; Nicaragua; Paraguay; Romania; Sri Lanka; Tunisia; Turkey; Vietnam. |

*Source: Adapted from Corrales (2007b).*

In order to overcome the constraints in this situation, it is necessary to achieve a transition from the current system (i.e. unsophisticated assembly and finishing processes) to a system involving more processing and deeper relations along the value chains. This implies ensuring that the end of the export zones regime does not eliminate export activities, and implementing active policies for diversification, creation of linkages and technology absorption. Accordingly, some of the policy actions in this situation are similar to those in situations COM-1 and COM-2 previously discussed, as shown in Table 4.4.
### Table 4.4 Illustration Of Policy Actions And Trade-governed Instruments Potentially Useful In The Implementation Of Trade-supported Strategies For Development In Situation COM-3

<table>
<thead>
<tr>
<th>Policy Actions</th>
<th>Policy Instruments</th>
<th>National</th>
<th>International</th>
</tr>
</thead>
<tbody>
<tr>
<td>LI-1; LI-2; CL-1: Promote and support capability to supply inputs of intermediate goods and services by domestic firms</td>
<td>CI</td>
<td>S</td>
<td>FR</td>
</tr>
<tr>
<td>LI-2; LI-3: Increase R&amp;D and assistance capability in domestic organizations to facilitate technology adaptation by SMEs</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>CL-1; SH-1: Grant incentives to exporters conditional upon promoting and training SMEs supplier chains</td>
<td>X</td>
<td></td>
<td></td>
</tr>
<tr>
<td>LI-1; CL-1; CL-4: Extension of X processing zones regime and flexibilities in trade rules to enable coordinated transition.</td>
<td>X</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>CL-1; CL-2; CL-4: Implement X subsidies fade out in coordination with measures enhancing suppliers’ capabilities</td>
<td>X</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>CL-2: Dedicated infrastructure to support domestic logistics related to clustering programmes and assistance to SMEs</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>SH-1: Public-sector technical education and training of personnel at all levels in productive sectors in the programme</td>
<td>X</td>
<td></td>
<td></td>
</tr>
<tr>
<td>SH2: Promote cooperation networks of SMEs and other firms to enhance local development impact and increase interactions for R&amp;D and innovation in clusters</td>
<td>X</td>
<td>X</td>
<td></td>
</tr>
</tbody>
</table>

CI: Conditional incentives, including incentive-based performance requirements; S: Subsidies; FR: Financial sector regulations. IA: International technical assistance; DA: Development assistance (net transfers).

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**Circumstances involving a comprehensive range of environmental sustainability issues in competitiveness**

The features of this situation are based on circumstances that many developing countries experience in their relations between trade and environmental sustainability. In fact, the Situation brings together many features on environmental issues present in the majority of those countries. The case has been conceived to show how better solutions can be given to essentially environmental situations when trade liberalization is combined with the four basic strategies: knowledge and innovation; environmental sustainability; linkages and complementarities; and social and human capital.

Three environmental features of integration portray the situation described here: environmental damage in export specialization; inability of local producers to comply with international standards; and the use of opportunities for (potentially) sustainable bio-trade (See Box 4.7).

There is no real need to define the list of countries that could receive additional S&DT benefits in this situation. On the one hand, the situation actually illustrates circumstances that can occur - not necessarily all together - in very diverse countries. On the other hand, there are no significant disagreements at the WTO on allowing flexibilities to all developing countries in the use of active supply-side policy instruments aimed at improving environmental sustainability. Finally, a very large proportion of developing countries tend to fall into this situation. This means that the relevant list for this situation would be the list of all developing countries.

Purely by way of illustration, it is interesting to note that if the Low and Yeats categories for potentially polluting export products are used (Low and Yeats 1990), of the 78 developing countries that have sufficient data, 46 are above the median of all countries in terms of the proportion of their total exports in wood, paper and cellulose, and 16 countries are above the P75 percentile. The equivalent figures in non-ferrous mineral exports are 39 and 18 respectively, and in hydrocarbons and its manufactures, 38 and 11. A list combining countries in the upper quartile of the three statistical distributions mentioned would result in 35 countries. Almost half of all developing country members of WTO show proportions of their exports in these three potentially polluting categories above the P75 percentile.
Box 4.7 Main Environmental Features In Situation COM-4

**Pollution and other environmental damages associated with production processes**

Export baskets in many developing countries have higher proportions than world averages of pollutants from production of goods (e.g. cardboard, paper and cellulose manufactures; non-ferrous minerals; and in general the branches of the Low & Yeats classification). Beyond the export specialization in that type of products, the reality of pollution of the atmosphere and watercourses has severe implications in many countries. These are associated with other production processes and urbanization.

**Opportunities for developing domestic capacities in the production of environmental goods and services**

Against the background described above, there is little national capacity to produce environmental services, or to produce equipment to reduce pollution or restore other environmental damage and in general, to produce technologies in these fields. This contradiction only partially resolved in the cases of large polluting companies, which are generally under more official pressure than small businesses to comply with environmental standards, and have greater financial capacity to respond to it.

Developing countries’ domestic and regional markets for goods, services and environmental technologies are undoubtedly underdeveloped due to shortcomings in sources of funding, for both the demand (potential users of services and technology) and the supply side (research and development, engineering, equipment and services), as well as to inadequate environmental regulations to tackle those market realities. This indicates that environmental sustainability needs are not covered, except marginally by imports made by limited sectors.

**Inability of many SMEs to comply with international environmental standards**

The features of those goods whose consumption or final disposal can cause environmental or health damage are subject to binding standards indispensable for accessing world markets. Developing countries’ small agricultural and food producers and SMEs in general, face serious challenges to comply with these regulations, as in Situation COM-1.

**The (potentially) sustainable use of biodiversity**

Many developing countries have a particularly valuable biodiversity that could be exploited in a sustainable manner to help them integrate into world markets. The characterization here is that the existence of a great potential value is presumed, but there is little factual knowledge about this potential, or about its sustainable use. The enormous expectations, the low level of knowledge and the caution with which ecological risks need to be handled, leads us to argue that institution-building and the strategy on knowledge and innovation have the highest priority in this Situation.

*Source: Adapted from Corrales (2007b).*

There are four main policy objectives implicit in this Situation: i) Limit the net environmental impacts of polluting production activities; ii) Create national capacities for producing and exporting environmental services, environmental control and damage reduction equipment, and the associated technologies; iii) Accumulate knowledge on existing biodiversity and the practices that would allow its sustainable use; and iv) Create opportunities and conditions for the development of activities that allow sustainable biodiversity use.
The first two policy objectives, relating to the limitation of damage and the creation of national capacities in environmental themes, should be addressed with a system of measures aimed at creating domestic markets in environmental goods, services and technologies. It is important to create facilitating frameworks and concrete mechanisms for financing long-term knowledge assets (specific “products” of the private banking system for financing suppliers and purchasers) and to create conditions for reducing financing costs to technology developers and SMEs (they must have access to technical assistance and soft loans for attaining standards).

Specialized human-resources markets serving companies providing environmental services may also be worthy of special attention. It may be essential to provide facilities to finance training and capacity building, as financing can be the main bottleneck for investment in human capital. This can be done by a variety of means, through subsidies to specialized educational centres on the supply side and scholarships for the necessary specializations on the demand side.

Part of the necessary training can be provided through production activities during a technology transfer process, in which specialized international companies participate.

Lastly, entrepreneurial cooperation in value chains and clusters can be a way for firms specializing in producing environmental services and technologies to benefit from positive externalities. They could be created through State policy intervention in those areas, like others illustrated in Table 2.5.

In order to achieve the two objectives related to biodiversity, efforts and policy measures concerning knowledge will be needed. So far, countries can take advantage of it only on a limited scale, because there is a basic need to understand and experiment at controllable scales. In this case, support for research and the creation of institutional frameworks that facilitate harvesting operations under strictly controlled parameters become fundamentally important.

Table 4.5 sets out a group of Policy Actions and a range of trade-related instruments that could be used to implement them. Likewise, Box 4.8 offers some comments on the use of the specific instruments shown in the table, against the background of what we said with respect to the Policy Objectives.

<table>
<thead>
<tr>
<th>Policy actions</th>
<th>National policy instruments</th>
</tr>
</thead>
</table>

IF: Institutional frameworks on biodiversity use and general regulations for the environmental sector; FR: Financial sector regulations; PR: Performance requirements; CI: Conditional incentives; S: Subsidies; PP: Preferences in public procurement
Box 4.8 Comments On Possible Uses Of Some Of The National Policy Instruments In Situation COM-4

There would seem to be a need for reforms in institutional frameworks (IF) to ensure that policies can be set in motion, particularly with regard to:

- The creation of activities to take sustainable advantage of biodiversity at experimentation level and under strict supervision;
- Ease up some existing bottlenecks in domestic goods, services and technology markets and use environmental legislation to get demand moving.

Financial market regulation (FR) should be adjusted to allow private banking to offer loans for intangibles such as environmental services and technologies. Private banks should act as intermediaries, even for allocation of public funds.

Public Procurement Preferences (PPP) and Performance Requirements (PR) could be combined in a way similar to Situation COM 2, to become instruments for creating national capacities.

- Make provision of environmental services (or certain environmental services) to the domestic market by international suppliers conditional on commercial presence (Mode III).
- Make their participation in public procurement conditional on a joint venture with a domestic company.
- Create a fund for the financing the development of domestic technological capabilities, to be endowed by the contribution of a fixed proportion of every service contract or every equipment purchase for environmental protection or remedy. This fund could contribute to the financing of R&D and training.

Conditional subsidies (e.g. reduction and deferred payment of local taxes) that according to the chart could be granted to service providers and equipment manufacturers, in accordance with specific goals or predefined achievements such as the following:

- quality certificates for equipment and services granted by independent centres (e.g. ISO);
- successful training of a given percentage of staff;
- they could also be granted to SMEs, associated with certificates of achievement of standards.

And finally, direct subsidies should be reserved for:

- training scholarships and
- R&D activities related to public policy objectives.

Source: Adapted from Corrales (2007b).

High vulnerability in the integration of small economies into global trade

The focus on the topics of economic vulnerability, remoteness and size of the economy gives rise to two situations: SRE and SVE.

The situation of SVEs combines smallness (ordinarily associated with high volatility and low resilience to external shocks) with high vulnerability to external shocks and/or disasters related to natural phenomena, including or not the circumstance in which high transportation costs (remoteness) are implied; and the situation of SREs represents circumstances combining both smallness and a remote location (remoteness) which implies very high transportation costs.
There is clear evidence that small countries face certain particular obstacles to their benefiting from integration into the global economy, but there is also evidence that the size of the economy, its remoteness and insularity do not by themselves explain the majority of the competitiveness constraints from which countries of both proponent groups suffer, since these characteristics are also found in many other developing countries.\footnote{38}

Box 4.8 shows a list of developing countries and LDCs characterised as SVEs in one of the simulations conducted by ICTSD, illustrating the outcome of a particular combination of these features. This list results from a simulation that limited the market share to 0.12 percent of the world exports and the population to 10 million inhabitants, while considering various vulnerability criteria including natural risk indicators, GDP volatility and exposure to price shocks. \footnote{39}

Box 4.9 Indicative list of LDCs and Developing Countries in Situation SVE, with Global Market Share under 0.12% and Population under 10 million inhabitants

| Albania; Antigua & Barbuda; Armenia; Barbados; Belize; Benin; Bolivia; Botswana; Burundi; Central African Rep; Chad; Costa Rica; Djibouti; Dominica; Dominican Republic; El Salvador; Fiji; Gabon; Gambia; Grenada; Guinea-Bissau; Guyana; Haiti; Honduras; Jamaica; Jordan; Kyrgyzstan; Macau; Macedonia; Maldives; Mauritania; Mauritius; Moldova; Mongolia; Nicaragua; Panama; Papua-New Guinea; Paraguay; Rwanda; Sierra Leone; St Kitts & Nevis; St Lucia; St Vincent & the Grenadines; Solomon Islands; Suriname; Swaziland; Togo; Tonga; and Trinidad & Tobago. |

Source: Adapted from Corrales (2007b).

The conclusion reached from the studies on these situations is that small countries have scale restrictions that can aggravate the constraints that other developing countries experience in trying to diversify or to integrate into their own economies the processing of their commodities. If, in addition, they suffer from external shocks or frequent disasters, they face even more severe constraints to preserve any improvements in competitiveness that they may have achieved and to recover from any damage suffered during disasters. The same can be said for countries with per unit transportation costs that are much higher than those of the rest of the world and that in addition have economic scales that prevent them from making themselves the investments in logistics and infrastructure - they would need to overcome their disadvantages. Worse yet is the situation in countries that simultaneously meet the three conditions - smallness, vulnerability and remoteness.

We reiterate that countries in situations SVE and SRE share many supply-side constraints related to competitiveness with those in situations COM-1 and COM-3. On the other hand, there are policy actions that correspond to vulnerability and remoteness problems, which are specific to small, vulnerable and remote countries.

As a consequence, some of the policy actions and instruments mentioned for situations COM-1 and COM-3 are also shared by the SVE and SRE situations. However, international technical assistance and international development assistance are relatively more important in these policy actions. The expected development of Aid for Trade programmes in WTO would provide additional resources for both purposes.

On the other hand, there are policy actions that correspond to vulnerability and remoteness problems, which are specific to small, vulnerable and remote countries. It can be seen in Table 4.6 that policy measures relative to vulnerability and remoteness, as well as to weakness of State organizations of SVEs and SREs would depend to a large extent on external support. In fact, given the small size of these economies, even those with the highest per capita GDP, they are extremely limited in addressing their needs related to vulnerability and resilience using their own resources.
### POLICY ACTIONS RELATED TO VULNERABILITY AND REMOTENESS OF SMALL COUNTRIES

<table>
<thead>
<tr>
<th>Policy Actions</th>
<th>Trade-governed instruments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Negotiate priority consideration to SVEs vulnerability to disasters in development cooperation schemes, including in the IF and Aid for Trade programmes, for development financing and technical assistance</td>
<td>X X</td>
</tr>
<tr>
<td>Conduct recovery/reconstruction of assets damaged in disasters, incorporating standards and best practices for risk prevention</td>
<td>X X X</td>
</tr>
<tr>
<td>Incorporate best practices for risk management in all areas of planning: international finance; territorial &amp; sectoral development; infrastructure; investment projects programming</td>
<td>X X X</td>
</tr>
<tr>
<td>Establish financial mechanisms to support the recovery of priority areas, activities or services from disastrous events (funds and/or insurance)</td>
<td>X X X</td>
</tr>
<tr>
<td>In international trade and investment agreements limit exposure to risks of external shocks, and ensure prompt access to safeguards to protect international reserves in cases of shocks as well as in disasters</td>
<td>X X</td>
</tr>
<tr>
<td>Negotiate priority consideration to remoteness of small economies in development cooperation schemes, including in the IF and Aid for Trade programmes, for development financing and technical assistance</td>
<td>X X X</td>
</tr>
<tr>
<td>Implement comprehensive institutional reforms in trade-related services such as logistics, and conduct investment in infrastructure and logistics, with the participation of international ODA and private investors</td>
<td>X X X</td>
</tr>
</tbody>
</table>

### POLICY ACTIONS RELATED TO ECONOMIC AND INSTITUTIONAL WEAKNESS OF SMALL COUNTRIES

<table>
<thead>
<tr>
<th>Policy Actions</th>
<th>Trade-governed instruments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Negotiate and implement simplified procedures for implementing trade rules including for notification (e.g. antidumping; safeguards; ASCM; SPS)</td>
<td>X X X</td>
</tr>
<tr>
<td>Increase and deepen international technical assistance for preparation and implementation of trade–supported strategies for development, as well as for implementing logistics and infrastructure plans for trade support</td>
<td>X X</td>
</tr>
<tr>
<td>Negotiate special (simplified and less onerous) conditions for dispute settlements involving SVEs and SREs (e.g. Art 4 of DSU “substantial trade interest”; negotiate rules that incentivizing the use of mediators)</td>
<td>special</td>
</tr>
</tbody>
</table>
ENDNOTES

1  In particular, materials from the following papers have been used in preparing this document: “Developing-country policy issues in reconciling trade liberalization and sustainable development goals” (Corrales, 2007 a); “Developing countries’ competitiveness and vulnerability in a Situational Approach to Special and Differential Treatment” (Corrales, 2007 b); “An approach to Special and Differential Treatment based on Development situations” (ICTSD, 2007); “The EPAs and Sustainable Development: Benchmarks for a pro-development monitoring of the negotiations” (ICTSD and APRODEV, 2005); “Competitiveness Revisited: A Policy Approach for achieving development objectives in the economic, social and environmental spheres” (Corrales, 2003 a); “Spaces for Development Policy, Revisiting Special and Differential Treatment” (Corrales, Sugathan and Primack, 2003); and “Special and Differential Treatment and the Spaces for Policies in WTO: Two Elements of the Development Dimension in the Multilateral Trading System” (Venezuela, 1999).

2  Taking the perspective of nations competing with others or considering that the commercial progress of certain countries is necessarily to the detriment of others is totally wrong and is not essential to an approach to competitiveness policies encompassing sectors and national economies. The best known critique of competitiveness as a capacity or a disposition of a nation to race with others in a “zero-sum” competition emanated from Paul Krugman more than a decade ago (Krugman 1994), but Krugman’s ideas limit the scope of competitiveness policies to the levels of firms, ignoring the fact that merely improving the ability of a country’s firms to compete internationally is not a sufficient condition for making its whole society benefit from the gains of trade-led growth.

3  In many ways, the small group of successful developing countries that have been able to catch up based their economic development on a constant learning process which in turn was supported by an actively pursued course of technology development and innovation at one end, and by a sustained investment in human capital at the other. Stiglitz (1999) notes “[...] the accumulation of capital could explain only a fraction of the increases in per capita income in the countries in East Asia Their miraculous growth is largely attributed to closing the knowledge gap, the gap between the more developed and less developed countries...”

4  There is a detailed discussion of the four Trade-supported Strategies for Sustainable Development (TSDS) in the paper “Developing-Country Policy Issues in Reconciling Trade Liberalization and Sustainable Development Goals” (Corrales, 2007).

5  For instance, diversifying production and trade towards higher value-added products (goods and services, including environment and energy-related services), while at the same time increasing employment spillovers and reducing heterogeneity in productivities, may help to achieve higher rates of growth and better social results with a lower intensity of natural resource exploitation.

6  As can be seen in the other explanations below, some of them are also based on access to various forms of capital.

7  Two examples illustrate exposure to shocks: high dependency on exports of minerals and hydrocarbons, which are subject to volatility and cycles of very widely fluctuating prices; and exposure to risks of frequent disasters involving natural phenomena. The latter have a differential effect on the poor population, as they to be more exposed and recover less easily.

8  There are two types of risks of external shock in relation to movements of capital. The first is related to the entry and exit of foreign capital, and the second to the external debt of public and private agents in the country. In the first case, the flows tend to be pro-cyclical owing to the high perceived risk for developing countries in international markets. The higher exposure to risks related to foreign debt arises from currency volatility and the repayment structures offered by the financial markets; the scope of secondary markets, and the highly unfavourable ratio between the speculative pressure that developing countries face and the size of their domestic financial markets. Our perception of developing country risk mirrors the volatility of international financial cycles, where phases of great “appetite for risk” alternate with “famines” associated with the “flight towards quality assets” (CEPAL, 2002).
The international strategy for disaster reduction (ISDR) has been testing synthetic indicators of economic vulnerability to disasters involving natural phenomena, using the ratios of the cumulative values of the damage to the Gross Capital Formation. Monitoring of the indicator shows that vulnerability is growing for many small developing economies. Indicators on resilience are also being studied by ISDR, based on comparing the saving capacity of a country with the scale of the damage caused by the typical disasters that affect it. The saving capacity can in turn be expressed in terms of the sum of investment expenditure and the trade balance (exports minus imports), highlighting a clear link between trade performance and resilience (Miquilena, 2006).

In fact, the domestic component of the increase in demand (growth in domestic demand), as it is based on real income growth, must be seen as the result of enlarging the output capacity and simultaneously creating an independent increase of the exogenous sources of demand, linked to international trade (either increasing exports and/or substituting imports).

In this context, the term “Supply-side Constraints” include low labour productivity and structural constraints within the institutions to overcoming such restrictions (e.g. poor educational and health service systems); limited mastery of management know-how, lack of appropriate process technology and weakness in national innovation systems; scarcity of input-output linkages between exporting sectors and domestic productive units, mainly SMEs, implying insufficient upstream impacts of job creation and knowledge spillovers; low quality and limited coverage of infrastructure and logistical support resulting in poor connectivity to global markets (poor transportation and access to shipping infrastructure, telecommunications), and inappropriate macroeconomic policy frameworks leading to unstable exchange rates and high inflation.

Discussions about ‘policy space’ in the MTS have ranged from groups demanding open-ended policy spaces for developing countries in any circumstances - at one extreme - to experts in the mainstream trying to discredit any ‘policy space’ proposal, even under transparent rules addressing specific development situations related to competitiveness, equity and social goals, at the other.

Promotion of linkages is an answer to many different market failures, such as entry barriers, technological externalities and pecuniary externalities in the context of information failures. (See Bekerman and Cataife, 2001).

For an interesting discussion about discovery costs and investors’ uncertainties, see Hausman and Rodrik (2002); Rodrik (2005); and Kumar & Gallagher (2006).

Discussions of these arguments in the indicated direction can be found in Mytelka (1991); Pietrobelli (1996); Lall (1994, 2000a, 2002); Archibugi and Pietrobelli (2003).

The CIPR was designated by the British Government - in 2001. In particular, it sought to consider how IPR regimes could be designed to benefit developing countries within the context of international agreements, including the TRIPS agreement; and how the international rulemaking framework could be improved and developed.

References to Asian examples can be found in Amsden (1989, 2001); Jenkins (1991); Ichimura (1998); Mytelka (1998); Lall (2000 a , 2002, 2004); UNCTAD (2003); Corrales et al. (2003); Capellin (2003); Kumar (2003, 2005); and Kumar and Gallagher (2006). Different uses of this type of instrument in Latin America and the Caribbean and proposals for the region can be examined in Fuentes and Vatter (1991); Messner (1996); Teubal (1998); UNCTAD (2003); Rodríguez-Clare (2003, 2005); Mytelka and Farinelli (2003); Peres (2005); and Abreu (2006). Accounts of their application in different parts of the world and with reference to developed countries at the present time are to be found in Metcalfe (1997); Cohen and Lorenzi (2000); Rodrik (2001, 2005); Navarro Arancegui (2001); Mytelka and Smith (2002); Camagni (2002); Moncayo (2005); and UNCTAD (2006b).

The term “environmental technical services” is used here to denote economic activities carried out by companies or individuals in order to sell services such as environmental impact studies, remediation
and damage control, contaminant control, etc. The term environmental service is reserved for the more ecological concept of services supplied by an ecosystem to the rest of the society, where production takes place (e.g. coffee growing) while at the same time preserving biodiversity.

19 For example, not only negative, but also possible positive effects are recognised in the case of subsidies (capturing externalities vs. encouraging over-exploitation that may cause "environmental stress"). During the Uruguay Round negotiation, provisions were introduced into the Agriculture Agreement and into that on Subsidies and Compensatory Measures to ensure that subsidies used for environmental purposes could be excluded from Domestic Supports accounting. Additionally, article XX of the GATT provides room for restricting trade policies for the purposes of resource preservation.

20 The relevant legal principles which to a large degree determine the fact that no disputes have been brought to WTO over conflicts between MEAs and the multilateral trade rules are the principle of Lex Specialis (which states that a more specialized agreement takes precedence over a more general one) and that of Lex Posterior (according to which the agreement signed most recently takes precedence over one signed earlier).

21 In developing countries it is crucial to prevent prices of medicines putting medical treatments beyond the reach of the poorer population. This can be avoided promoting competition between generic medicines suppliers, and/or through compulsory licensing to local producers, or by facilitating parallel imports of medicines.

22 Refers to Aid for Trade proposals, including technical assistance and direct transfers for supporting adjustment and covering costs involved in overcoming supply-side constraints (e.g. supporting infrastructure investment)

23 Compulsory requirements include a commitment by foreign investors to fulfil certain industrial or trade policy mandates (e.g. purchasing local components or generating a given amount of foreign currency) as a condition for operating in the country. Conditional incentives (incentive-associated requirements) typically consist of direct subsidies or tax advantages in exchange for performance by a national or foreign investor that coincides with a national policy objective.

24 Article II of the ASCM.

25 Actionable subsidies are those that may give rise to proceedings before WTO’s dispute settlement mechanisms instigated by Members who consider that by reason of that subsidy their domestic industry has suffered or that concessions granted them have been affected.

26 In the case of the Korean ship-building industry (DS 273) Europe successfully claimed that Korea was subsidizing an industry by tax reductions, direct subsidies and advance payments (DiCaprio and Gallagher, 2006).

27 Paragraph 10.2 of the Doha Ministerial Declaration, contained in document WT/MIN(01)/W/17. A new proposal by Venezuela, together with Cuba (TN/RL/W/41/Rev.1) carried the original proposal further, suggesting the launching of an exploratory process with a view to deciding the types of subsidy that would be included in a revised category of non-actionable subsidies, accessible only to developing countries (Corrales et al., 2003).

28 DiCaprio and Gallagher (op.cit.) refer to the difference between the case of Indonesia, which related to a new policy for the production of a "national automobile", implemented subsequent to the TRIMs Agreement, and that of Brazil where the measures had been in force in all the international assembly plants long before and formed an integral part of the country’s automotive policy. The authors draw attention to the fact that the various requests for consultations made to Brazil in 1996 and 1997 never went beyond that stage, whereas the consultations with Indonesia, initiated in 1996 by Europe, Japan and the United States, resulted in a decision by the panel in 1998.
The “screwdriver regulations” are a formal response to practices aimed at evading an original anti-dumping measure (Safarian, 2002; Kumar, 2005).

In some cases, bilateral investment treaties have introduced provisions that give foreign investors the right to initiate a dispute against the State of the country receiving the investment, or the concept of “measures equivalent to expropriation”, which could include policy measures of the receiving State that create a right to compensation for investors.

The reason that very few cases of import restrictions have gone beyond the consultation stage is connected with the threat of panels. The Chile-Alcohol case (DS 110) was decided against Chile on the finding that it applied higher duties on spirits than on its local Pisco (DiCaprio and Gallagher, op.cit.).

UNCTAD (2006a, 2006b) estimates that by the end of the 1990s that proportion was on average 20% or more for low-income countries and no less than 12% for those of medium income.

Refers to policy instruments that would be implemented at national level. In some cases implementing such instruments would require flexibilities granted by means of Special and Differential Treatment provisions.

Refers to instruments negotiated internationally and administered by third parties, either governments or international organizations.

Only instruments subject to international trade disciplines are mentioned in the table, and we take for granted that investment processes in primary exploitation and/or processing that stimulates demand on specialized services and capital goods are already in place. For those processes to effectively take place, they depend on the relation between world supply and demand of mineral commodities and fossil fuels, as well as on countries’ reserves and institutional conditions (enabling institutional frameworks) prevailing in them. The situation found in world markets in recent years indicates that this dynamism corresponds to a long cycle. This derives in great measure from the enormous growth of demand in Asia.

Again we would point out here that the content of the box is an illustration of opportunities and in no way a list of recommendations, like a “policy package”. Such a package would need to take account of the economic, technological and institutional specificities of each country together with its development objectives.

Mode III of Service Supply.

No significant differences have been found in characteristics strongly related to competitiveness, between SIDS and landlocked countries, on the one hand, and the rest of developing economies on the other, especially those that have been characterized in this paper by the situations COM-1 and COM-3. The problems of trade and competitiveness in which no differences are perceived are, among others, insufficient value added or insufficient processing of exports, insufficient links between export activities and the rest of the economy, volatility in the price of exports, advantages or disadvantages for attracting foreign investment, or difficulties in overcoming problems relating to international technical and health standards.

Twelve countries share the characteristics of those in the list but have populations ranging between 10 and 15 million inhabitants: Angola, Burkina Faso, Cambodia, Cuba, Ecuador, Guatemala, Malawi, Mali, Niger, Senegal, Zambia and Zimbabwe.
BIBLIOGRAPHY


ABOUT ICTSD

Founded in 1996, the International Centre for Trade and Sustainable Development (ICTSD) is an independent non-profit and non-governmental organization based in Geneva. By empowering stakeholders in trade policy through information, networking, dialogue, well-targeted research and capacity building, the centre aims to influence the international trade system such that it advances the goal of sustainable development.