

# **Redesigning the World's Trading System for Sustainable Development**

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## Introduction

In a relatively short period of time, human activity has brought the world to the brink of a major ecological disaster. One manifestation of this is a massive biotic crisis (Elredge 1998; Myers and Knoll 2001; Wilson 1993). The other is the anthropogenic impact on global average temperatures, with effects on rising oceans, disruption of rainfall patterns, and extreme climate variability (Houghton et al 2001; McCarthy et al 2001).

At the same time, social disparities and inequality mark the social and economic landscape of the entire planet, both at the national and international levels (UNFPA 2002; GPM 2004). The powerful forces that have been leading the integration of the world economy have also been at the origin of deep financial and economic crises. To top everything, the world is now witness to more armed conflicts at the regional level than in the past thirty years and world military expenditures have increased dramatically (SIPRI 2004).

Economic performance in the past thirty years has been marked by slower growth rates for the higher and middle income groups of countries, and only modest growth rates for the lower income group of economies. Social disparities continue to exist, and although there is some debate regarding trends today, the magnitude of these disparities is still too big. It appears increasingly unlikely that the Millennium Development Goal of halving the number of hungry people by 2015 will be met.

Even if there is a trend towards the reduction of these social disparities, and that is a very big assumption, the evolution is taking place at a painstakingly slow rate. If we take the environmental Kuznets curve as a heuristic device, we can confidently say that most of the world's developing countries are in the worst possible section of the curve.<sup>1</sup> Whatever the level of per capita income needed to start reducing environmental deterioration, the vast majority of developing countries will remain at the top of the parabola for a very long time given the very slow rates of growth of per capita income or GDP. This is precisely the segment of the curve where environmental degradation is at its highest levels. At current rates of per capita

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<sup>1</sup> The EKC is plagued by serious conceptual drawbacks. One illuminating critique is Tisdell (2000). It does not deal with complex environmental systems, where one parameter worsens while others improve, and it does not consider irreversible damages (such as species' extinctions). In spite of its limitations, it is used by many economists: Cole 1999; Grossman and Krueger 1995.

GDP, even in the best win-win scenarios, the developing world will remain in the worst segment of the curve (as it approaches and the summit from the left and continues towards the right and descending part of the curve) for a very long time, at least sixty years. How will the environment endure this level of punishment?

On the other hand, the ecological footprint imposed by developed countries is still unduly heavy. Although greenhouse gas emissions rates have been going steadily down, the absolute level of emissions continues to increase. Energy efficiency is also improving, with most developed countries having smaller rates of energy consumption per unit of GDP. However, the absolute volume of most natural resources used by developed countries continues to increase. And analyses of material flows reveal the presence of a process of environmental cost-shifting or environmental load displacement.<sup>2</sup>

During the past two decades, the world's multilateral organizations redefined the architecture of the global economy. On one hand, financial and capital account deregulation was promoted (in some cases imposed) in the 1980's. On the other hand, trade liberalization was strengthened as a result of the Uruguay Round, a long process of multilateral negotiations that led to the creation of the World Trade Organization (WTO), successor to the General Agreements on tariffs and Trade (GATT).

One of the dominant leitmotifs of this process was the relentless critique of public sector intervention in anything remotely related to economic affairs. The private sector and the allocation properties of the market system were systematically presented as the best way to handle economic affairs. The drive towards greater deregulation was accompanied by a thrust towards deeper privatization.

This was linked to the expansion of the original mandate of the GATT-WTO system to integrate new areas into the multilateral trading system. These new areas went from investment regulations to intellectual property rights, restricting the capacity of governments to deal with critical issues of development policy and limiting the availability and scope of policy instruments.

Today, the WTO is more than ten years old. It is at the crossroads of a critical situation. On one side, there are countries and a trade-policy community that demand more trade liberalization, at a faster rate and in more branches and sectors of economic activity. On the other side, there is another group of countries and large sectors of civil society demanding a slower pace for future negotiations. They also demand a thorough assessment of what's working and what's wrong with the past record of trade liberalization.

A look at the structure of world trade and the relative shares of different groups of countries provides a sobering backdrop for the assessment of the accomplishments of the WTO. Although exports from developing countries have increased, the structure of world trade remains heavily lopsided. And there remain formidable tariff and non-tariff barriers in developed countries preventing true market access for developing countries' exports. This reveals that the big winners of the globalization *à la GATT-WTO* have not been the world's developing or poorest countries.

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<sup>2</sup> Muradian, R., Martin O'Connor and J. Martinez Alier (2001); Muradian and Martinez Alier (2001a).

In addition, trade liberalization is clearly associated with greater trade deficits in developing countries. Although it led to rapid growth of imports, it failed to keep a higher growth rate for exports. Thus, UNCTAD studies find that average trade deficits for all developing countries during the nineties were higher than those in the seventies by three percentage points of GDP. At the same time, GDP growth rates were lower by two percentage points (UNCTAD 2003). All of this has serious negative implications for developing countries' current accounts and indebtedness.

In addition, there is a disturbing trend towards divergence instead of convergence in several critical domains. For example, in manufacturing industries the tendency is for a higher concentration of total exports in a small number of countries. Lall (2003) points out to this trend and explains it through the greater disparities among countries in their ability to attract, master and improve on new technologies. These are the drivers of dynamic competitiveness. The greater international disparity is not a temporary adjustment to liberalization, and it will not correct itself automatically.

This paper takes a look at the reforms that are needed in the world's trading system in order to guarantee its contribution to the objectives of sustainable development. This overarching goal is based on a combination of healthy environmental stewardship and social responsibility. The first section presents a set of five themes that are required as a backdrop for the general assessment of the trading system. The second section discusses the relation between macroeconomic and trade policies. Changes directed towards recovering a certain degree of autonomy for monetary and fiscal policies are examined. The third section focuses on the Central American countries, their macroeconomic indicators and a brief overview of how their foreign trade patterns affect their natural resource base. The fourth section examines the regulatory regime for agricultural trade and some of the fundamental reforms needed in this area. The fifth section looks at international commodity agreements, non-market access (NAMA), intellectual property and investment rights, and the relation between trade and international environmental agreements (IEA's). The final remarks include references to things that should not be done.

## **Perspectives for Reform**

There are several aspects of the way we think about trade policies and trade flows that need to be carefully revised. They condition the way we are able to analyze what's going on and they are not perhaps the best point of reference. There are also two principles that need closer scrutiny (SDT and PP).

### **The Myth of the Market**

Any reflection on how economic, social and environmental affairs have been managed or mismanaged in the past twenty years cannot fail to observe that this period is dominated by the consolidation of the myth of the market. The notion of the "invisible hand" as a process leading to efficient resource-allocation became the paradigm of all economic policy considerations. It is probably the single most powerful foundation of the "one-size fits-all" approach to economic policy favored by

the IMF and World Bank. And yet, when one asks for the evidence to back up this contention, there is no reply.

A casual observer might note that the economic history of Western Europe and the United States confirms the idea that free unabated markets bring along economic prosperity. But, from the realm of economic history it is impossible to discern where the market stops and other factors, such as state intervention, begin. Subsidies of all types, as well as protectionism and strict regulations on capital and labor mobility are inseparable from the operation of market forces over the past two hundred years (Habbakuk 1962; Landes 1969; David 1975). The idea that the historic record would reveal how the market brought about prosperity and welfare gains is groundless. This, of course, does not mean that markets and prices are unimportant. They are of great relevance, but they are not alone in explaining prosperity in Europe or the United States.

Does theory show the market is the best system for resource allocation? Many economists, those educated under the aegis of neoclassical economic theory, may be tempted to reply that economic theory has demonstrated beyond reasonable doubt that the market allocates resources efficiently. They might say that in a position of general equilibrium, the allocation is Pareto-optimal. The problem is this result depends on the condition of *being in* general equilibrium, and we still lack a satisfactory theory of just how those equilibrium prices are attained in the first place.<sup>3</sup> Thus, there is no rational foundation for the belief that the market is the best system for the allocation of resources.

Perhaps the most important implication of this is that the “invisible hand” is just a metaphor, without robust empirical or theoretical underpinnings. The triumph of the market ideology is in stark contrast with the scientific bankruptcy of general equilibrium theory. From the perspective of applied economics and policymaking, we must abandon this old idea and start thinking in new and more rigorous terms.

Protesters against deeper neoliberal globalization and more trade liberalization are not mystical fanatics shrouded in obscurantism. And trade theory is not a scientific truth that comes out in favor of free trade (as Bhagwati, 2000 pretends). Trade theory is fatally hurt by the flaws of general equilibrium theory. And when we get to the assumptions of the models of international trade theory, their simplicity is misleading. Proofs of the basic theorems depend critically on the technical assumptions, and whenever they need to be relaxed, the conclusions for theory and policy are quite different (Ackerman 2004).

Debunking the mythology of free trade economics is an urgent task if we think sustainability is a priority. Environmental economists and lawyers should examine the implications of these shortcomings of economic theory. The market cannot redress social inequalities, nor can it be the sole mechanism in charge of environmental stewardship. It is vital to understand this if we want to improve our performance in handling economic, social and environmental affairs.

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<sup>3</sup> The best references here are Fisher (1983), Sonnenschein (1973), Debreu (1974) and Mantel (1973). An analytical review of this literature and of its implications can be found in Ackerman and Nadal (2004).

The corollary of this is that the role of the State needs to be reconsidered. Recent financial crises have not been provoked by irresponsible wrongdoings of government, but by speculation and irresponsible exposure of agents from the private sector. Thus, instead of chastising governments for their over-spending, for example, we should look at the way in which private property rights help detonate financial crises of great amplitude. At the macroeconomic level the role of the State is critical in enforcing prudential supervision, implementing adequate risk-management practices and loan and investment policies for the banking and financial sectors.

At the sector level, active State intervention is often important for industrial and agricultural policies. In industry, policies are needed to generate dynamic competitive advantages that are skill and technology driven. These are not automatically transferred to the host country of foreign direct investments. An active role for State agencies is often required to do the job. Developing countries normally do not innovate at the technology frontier; they do need to engage in a protracted effort to absorb new technologies, learn new networking and management techniques before they can generate their own technology-base. These are things that have been done in the developed world for over a century, and the market will not do them automatically for developing countries as they engage in trade liberalization.

Finally, there is a big difference in both objectives and nature between the agents that sign the agreements within the WTO system (i.e., governments) and the agents that actually perform trading operations (i.e., firms and corporations, sometimes very large corporations). Today more than 66% of world trade takes place through transnational corporations, and 40% of this takes place within companies (UNIDO 2003). If in the old days UNCTAD had a clear mandate to monitor markets and patterns of market concentration, but developed countries destroyed this in the 1980's. Today here is a serious disconnect between the overarching WTO objective of reducing or eliminating market distortions and the presence of intense market power in most branches.

Market distortions are not always related to government subsidies but to market concentration. Perhaps the single most important lacuna of all WTO agreements is this lack of reference to market concentration, oligopolies and anti-trust enforcement measures. Where collusion, unfair business practices and market concentration have real impacts on international market prices, WTO has really nothing to offer. Leaving these problems to the obscure workings of international commerce arbitration boards is not the solution because their scope of competence does not include mandatory anti-trust measures applicable to general cases. This is a real problem that has not been addressed by WTO and is screaming for attention.

Vertical and horizontal integration in global commodity markets is a primary cause of market distortion. Possible policy responses include an international review mechanism on mergers and acquisitions (M&A) that involve transboundary transactions. At a minimum, transparency requirements should be imposed on transactions between agents that have more than 20% of a regional or global market. Similarly, M&A's and joint ventures involving cross-licensing and capitalization of patent rights should receive better scrutiny. These operations can

be used to engage in serious business malpractices and unfair competition and can significantly distort market operations.

### **Macroeconomic Policy and Trade**

The last three decades have witnessed the separation of financial flows from international trade. The clearest example of this pertains to short term transactions in the world's currency markets capital flows that are fifty times greater than trade flows. Any assessment of the performance of the world's trading system and its relation to social and environmental sustainability needs to take into account the evolution in the sphere of international monetary and financial relations.

In general, however, trade policy analysts have been focusing too narrowly on their subject, without giving adequate consideration to the fact that trade liberalization is part of a bigger macroeconomic policy package. Thus, they may have inadvertently left outside of their scope of analysis the critical relationship between trade and monetary and fiscal policies. The relation goes beyond the simple references to exchange rate over or undervaluation, and involves the wider issues surrounding finance, capital flows and the policy space in the context of capital account deregulation.

UNCTAD has recently recognized the importance of reinforcing coherence among policies and agents in the interface between the international trading system and the international monetary and financial system (UNCTAD 2004). But reforming the world's trading system must go hand in hand with changes in the role and operations of the IMF. The role, nature and mission of the IMF must be clearly redefined: the world has changed, so the IMF must re-adapt. For one thing, it must stop imposing conditionality and seeking deeper and faster financial liberalization. It must learn from the nature of financial crises today and prevent bailouts that promote moral hazard. The IMF also must transform its decision-making process and prepare to play a responsible lender of last resort role.

One of the most important aspects of the predominant views concerning macroeconomic analysis and policymaking is the separation between macro aggregates and the real sectors of the economy. Thus, we find a group of economists that analyze economic aggregates without any consideration for real sector variables. What happens in agriculture or industry, for example, is of no importance as long as aggregate accounts remain balanced or stable. The same applies to public or fiscal accounts, and to the balance of payments. Aggregate balances are the only thing that matter, with the structure of the individual components being totally irrelevant.

On the other side, we find a community of applied economists that concentrate on the real sectors of the economy, natural resource management and environmental economics. They know that interest and exchange rates matter for the natural resource management and social welfare; they also know that the dynamics of monetary and fiscal policies affect social inequality and the environment. But they are normally not conversant with macroeconomic theory and thus prefer to ignore that aspect of the problem.

Summarizing, the false dichotomy between monetary aggregates and real sector variables needs to be abandoned. A new type of economic analysis, integrating both dimensions, will be more policy-relevant. This implies redefining the contents of macroeconomic policy for developing countries, in both its monetary and fiscal components. And this is the more difficult part of the solution. Unless this is done, there will be few benefits accruing to developing countries from reforms in the trading system. This is of course the most difficult task, but it needs to be addressed immediately. Below we return to this point to examine in greater detail how macroeconomic policies that are relevant for trade flows can be redefined.

### **Special and Differential Treatment**

Special and differential treatment (SDT) is based on the idea that fairness should be an important guiding principle in international economic relations. It is also linked to the recognition of existing international asymmetries as elements of great distortions in the functioning of markets and generators of inefficiencies. In the context of WTO it is linked to the idea that developing countries are not obligated to reciprocate in full trade concessions made by developed countries because they need more time to adjust to the economic forces unleashed by trade liberalization.

SDT is recognized by the original GATT in several of its articles, and these principles were picked up in various rounds of multilateral negotiations and, finally , in several of the WTO agreements. The actual implementation of special and differential treatment relies on various types of mechanisms: limited time derogations; exceptions and preferences in disciplines; lower commitments in tariff reductions; technical assistance commitments; etc.

In practice, however, SDT has really not provided the conditions needed by developing countries to adjust. A few extra years in certain transition periods, or a few tariff points below developed countries' concessions, have not been able to redress asymmetries that took decades or even centuries to crystallize. And invariably, when the few extra years for adjustment go by, developed country trade representatives demand immediate compliance with the commitments that have been established. The lop-sided structure of world trade indicates that SDT has been a failure to establish a leveled playing field.

At the same time, developed countries have failed to honor many of their critical commitments and their non-binding pledges within the WTO system. So, as firm obligations have been enforced on developing countries, the rich developed countries have failed to deliver. The Uruguay Round is a lesson in failed promises that cannot be forgotten when dealing with SDT in future negotiations.

Not only has SDT failed as a policy principle, it has been accompanied by a severe contraction of the policy space of developing countries. As a result of structural adjustment policies, several WTO agreements and some regional and bilateral trade agreements, the array of industrial and agricultural policy instruments has shrunk to the bare minimum. Policy instruments that were used by all developed countries are thus out of reach, as if these countries had kicked the ladder that enabled them to climb to levels of higher living standards. For example, performance requirements are being curtailed by the agreement on Trade-Related

Aspects of Investment Measures (TRIM's), government procurement policies are frowned upon and are now the target for destruction, direct government support mechanisms are also forbidden in many cases because it is assumed they imply unfair competition, etc.

The irony of this is that precisely at a point in time when economic theory recognized asymmetric market configurations as the source of market failure, the world's trading system has essentially turned its back on the notion of special and differential treatment (SDT) as the key guiding principle to eliminate asymmetries.

The first component of a new S&DT framework is recognition that developing countries need more policy space. Under the principles of S&DT the world's trading system must open for developing countries the possibility of using all the industry policy instruments that developed countries used at one point and that late-industrializers also used. These are especially important for accessing dynamic competitive advantages which are skill and technology based. Without these policy instruments, developing countries run the risk of remaining forever in the low-productivity trap of natural resource exporters. They cannot aspire to be able to export goods in the high tech side of the industrial spectrum.

The second component is that financial assistance is essential to get to the level playing field. Today we are far from the required levels of development aid. It is sometimes argued that foreign direct investment (FDI) flows have picked up and that they are preferable to aid. This is misleading because FDI is heavily concentrated in a few developing countries, and because a significant portion of total FDI is made up of mergers and acquisitions (M&A) of already existing companies. It is estimated that up to 30% of total FDI is really M&A and therefore, not an investment in new productive assets. Financial assistance is a different instrument with a rationale of its own, oriented towards long term investments under preferential conditions and should be part and parcel of trade agreements.

There are several successful instances where S&DT has been linked to financial assistance and has played a very important role. Perhaps the most important one is the European Union, where the accession of Spain, Portugal and Greece included a series of financial support mechanisms that allowed these countries to invest in several critical areas. Another example, in the context of an international environmental agreement (IEA) is the Montreal Protocol where developing countries were given not only longer time periods to adjust, but also received technical and financial assistance to facilitate their compliance with the restrictions imposed on ozone-depleting substances.

Although here is much talk about special and differential treatment these days, there is not enough consideration to the principles we have mentioned here. No new round of trade negotiations should take place without having S&DT at its core. The need to make this principle operational is probably one of the most urgent cross-cutting chores of the WTO system today.

## **Process and Production Methods**

The debate about regulating processes and production methods (PPM's) is based on the idea that any effort in this direction will lead to protectionism. Most developing country governments are hostile to the notion of using environment-related PPMs within the WTO system. They argue that this leads to eco-protectionism, not to adequate environmental defense. But the problem is not with PPMs but with unilateral imposition of regulations and standards (Nadal 1994).

The 1998 Appellate Body decision on the US ban on shrimp imports when adequate protection for sea turtles had not been used hints to a trend that is seen with distrust by developing countries: it implies that if developed countries do use PPM-based trade sanctions in an appropriate manner, they will be deemed to be GATT/WTO consistent. This is of course unfortunate because issues that should be the object of negotiations should not be left to the vagaries of dispute settlement and adjudication.

To prevent this WTO members should start a program of consultations with organizations such as UNEP in order to determine if and how PPM-based trade restrictions can be used, and under what types of circumstances they can be invoked. Defining criteria and accompanying disciplines should be the outcome of multilateral negotiations and not unilateral imposition. This is the only manner in which PPMs can be incorporated into the trade and environment agenda without fears that it will lead to unjustified neo-protectionism.

Production processes that are liable to have global or transboundary effects, for example, could be separated from those with purely domestic effects. The first could be candidates for trade regulations and even restrictions under certain circumstances and disciplines. But the most important point here is that all parties should engage in a process of multilateral negotiations that would tackle three important issues: sectors and products, disciplines and financial mechanisms to assist developing countries. Special and differential treatment should be the cornerstone of these negotiations.

The important precedent of the Montreal protocol is of critical relevance here. This international environmental agreement is hailed as a success story and it is based on a multilateral approach to regulations on PPMs. It could be argued that in fact the Montreal Protocol dealt more with products (ozone-depleting substances) rather than processes. But that distinction is a moot point here because that MEA was also dealing with substances used in the production of certain products (refrigerating devices, foams, aerosols, and certain pesticides using methyl bromide). The regulatory regime of the Montreal protocol was based on the phasing out and banning of certain inputs for production processes (refrigerants, foaming agents and active agents in pesticides). This was done through multilateral negotiation and the explicit recognition of asymmetries between members. Thus, developing countries were given longer phasing out periods. In addition, a financial and technical support mechanism was established to deal with this set of asymmetries.

### **Precautionary Principle**

The precautionary principle (PP) is defined in the Rio Declaration as follows: "Where there are threats of serious or irreversible damage, lack of full scientific certainty shall not be used as a reason for postponing cost-effective measures to prevent environmental degradation". The Cartagena protocol has a slightly different formulation.

The PP recognizes the existence of critical ecological thresholds and seeks to prevent breaching those thresholds. The cost of preventive anticipation should not be unduly high and the *onus probandi* rests squarely with those that propose change. The application of the PP requires weighing the risks of inaction with the costs of preventive actions. It is an important and necessary guiding principle in the relations between economic affairs and the environment.

PP is also a response to the commodification of science. Today more basic and applied research is being funded by private companies and this raises serious questions about the objectivity and independence of scientists. But the precautionary principle has generated a major controversy due to fears that it might serve neo-protectionism or that it can stifle technological innovations that could be good for the environment.

Part of the problems arise from the ambiguities that surround the implementation of the principle. Difficulties in determining where uncertainty and risks begin and where reasonable doubt stops make the PP an awkward tool. If improperly managed, it could lead to arbitrary and abusive decisions. For example, there are no easy answers to the question of how to deal with "exaggerated claims of hazard". And although "science by consensus" does not necessarily lead to the best policy advice, it seems that dialogue and ventilation of differing viewpoints is unavoidable in the presence of disputes. The recent decision of the WTO to uphold the request by the European Union to hear the opinion of scientists in its dispute with the United States over genetically modified organisms is a good example of this. That case is a decisive battleground in the war over GMO's, but it still remains to be seen how this dialogue among scientists unfolds.

The problem with this principle is not in its uncertainty, as has been claimed by many of its critics. After all, uncertainty and ambiguity is inscribed all over the WTO system. Consider, for example, the provision in Article 27.3(b) of the TRIP's agreement (of which more below) related to patents on life forms. The article refers to "essentially biological processes", but does this mean processes that occur naturally or carried out by organisms? In reality, that provision, as many others, is rather vague and, as with other items in patent law, it is designed to allow for the greatest amount of patents in the field of genetic engineering. This is a policy choice (not necessarily the best option), but its vagueness is a deliberate component.

The precautionary principle does not hold a monopoly over vagueness. But vagueness and uncertainty is precisely what it is designed to deal with. And in order to use this principle adequately, without transforming it into an instrument of discrimination, it must be accompanied by legitimacy. This is only brought into the system through intensive and protracted multilateral *bona fide* negotiations. If we look at examples where the precautionary principle has been successfully used, this

is the salient feature. The Montreal Protocol mentioned above is, once again, the best example.

## Macroeconomics and Trade

Globalization and the expansion of trade could not have taken place without financial deregulation. Capital flows underpin the expansion of trade and trade liberalization relies heavily on the elimination of cumbersome controls that enforce capital account restrictions. Also, if capital flows are restricted while trade liberalization takes place, there is a higher risk of under or over-pricing as product flows are used to cover capital movements and remittances of profitability.<sup>4</sup>

Deregulating the capital account was supposed to bring about better resource allocation and lower cost of capital. Savings from developed countries would flow to investments in developing countries, spurring growth in productivity and enhancing economic growth. Deregulation in financial and banking systems would also allow for better services through greater competition, lower interest rates and greater rates of investment.<sup>5</sup>

But treating money and financial instruments as products that can be exchanged in a marketplace, just like any other commodity is a fallacy. As Keynes pointed out, money and financial instruments lack intrinsic value; they are extremely sensitive to swings in confidence as to the future evolution of their value. Thus, although financial liberalization did benefit some countries and several sectors (banking and finance, brokerage firms, insurance and real estate), it also increased market volatility, opened new avenues for speculative investments to the private sector and led to lower investment rates. Market volatility and contagion have been accompanied by slow growth and rising unemployment rates in most countries and regions.

In interdependent financial markets, capital flows are conditioned by domestic, as well as external factors. Domestic factors include the real interest rate and expectations about the future evolution of several macroeconomic aggregates, in particular the performance of the current account. External factors include the international rate of interest, the state of other markets, and changes in the regulatory framework in other economies (Shinji and Esaka 2001). Recognizing this single fact is of utmost importance for its theoretical and policy implications.

As capital flows are subjected to minimal controls and restrictions, the relationship between money supply, interest and exchange rates is modified. Thus, financial deregulation restricts the scope of monetary policy. The best known example of this is the impossibility to maintain the triple objective of an independent monetary and fiscal policy, a fixed exchange rate and capital mobility.

<sup>4</sup> In reality, profitability remittances through over and under pricing of inputs and final products among firms of a single corporate group will continue to take place because of differences in tax rates.

<sup>5</sup> Financial liberalization was forced upon the world's economy in order to hedge against risk of fluctuating exchange rates after 1973. It was also driven by the symptoms of a global recession at the end of the seventies and a fall in productivity and profit rates in most developed countries. And by the time macroeconomic policy started to be conditioned by financial and trade liberalization, macroeconomic stability became the number one priority in the 1980's, leaving behind the commitment to full employment of the Bretton Woods era.

Although the open economy model promoted by the IMF is marked by serious contradictions (Nadal 2004) the fund continues to recognize it as the sole reference for macroeconomic policy. The IMF thinks that crises only arise from oversight, errors in policy implementation and a deficient “early warning” system that prevents timely adoption of corrective measures. The IMF is already proposing changes along these lines, but the really touchy decisions concern the type of macroeconomic policy package that it will recommend to the countries that come to the IMF for advice and help. This is an especially delicate question given the immense liquidity that pervades capital markets and the episodes of extreme volatility that mark the dynamics of capital flows. At the very least, the IMF should start by not condemning policies designed to protect countries. The IMF should encourage countries to use Chilean-style holding-period taxes to discourage excessive short-term capital inflows.

The full Mundell-Fleming model is afflicted by serious internal contradictions.<sup>6</sup> Perhaps the most important one is the fact that although a flexible exchange rate is critical for adjusting trade imbalances, capital mobility and anti-inflation policies impose severe rigidities to this adjustment, causing over-valuation of exchange rates and blocking the role of the exchange rate as an adjustment variable.<sup>7</sup> It should be kept in mind that floating exchange rates are not determined by market balances influenced by the fundamental characteristics of an economy.

Also, capital inflows without public intervention expand the domestic money supply as demand for assets denominated in the domestic currency increases. This leads to a surplus in the capital account, an appreciating exchange rate and a drop in the interest rate.<sup>8</sup> This gradually reduces the flow of incoming capital and equilibrium is restored in the balance of payments. But the expansion in the money supply can bring about inflationary pressures and an even greater deterioration of the trade balance. This can be curtailed by sterilizing the effects of the influx of capital through open market operations. However, sterilization interrupts the adjustment process, keeping the interest rate at a higher level than the international rate. This leads to unsustainable configurations of the main macroeconomic variables.

The contradiction is defined in terms of two processes in the model. On one hand, the model requires the interest rate to fall in order to restore equilibrium in the money market in the face of incoming capital flows. On the other, sterilization

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<sup>6</sup> See Fleming (1962) and Mundell (1964). The Mundell-Fleming model does not have strict microeconomic foundations, but its analytical structure depends on the notions that markets always clear, and that trade liberalization is the best way to organize production and consumption. In fact, the close association between the Mundell-Fleming open economy model and general equilibrium theory was acknowledged by its authors (see for example, Mundell 1968), and this close relationship has also been recognized in more recent work (Geanakoplos and Tsomocos 2001). The linchpin of the connection between the Mundell-Fleming and general equilibrium models is the market clearing assumption, which in turn depends on the postulates of perfect competition and flexible prices. The corollary to this reasoning is that if the open economy model is given enough time, it will eventually lead to the desired results. Perfect capital mobility implies that small changes in interest rates lead to very large capital flows.

<sup>7</sup> Strictly speaking, the trade balance will deteriorate when the domestic currency becomes overvalued if the Marshall-Lerner conditions are met, i.e. if the absolute value of the sum of the exchange-rate elasticities of imports and exports is greater than one. Whether these conditions are met is irrelevant if the exchange rate is impeded to act as an adjustment variable.

<sup>8</sup> In the standard Mundell Fleming model when the money supply grows and the level of income remains constant, the interest rate falls, reducing the cost of holding money and this re-establishes equilibrium in the money market.

maintains the money supply constant and a higher interest rate. In practice, the contradiction is resolved through intervention with sterilization, a higher interest rate, a chronic currency overvaluation and a distorted adjustment process.

Capital controls can contribute to smooth cycles in the capital account, reduce overall economic vulnerability (Furman and Stiglitz 1998; Ocampo 2003). In Chile, unremunerated reserve requirements shielded the economy from overabundance of short-term capital at times of surges and helped attain higher growth rates (Ffrench-Davis and Tapia 2004). They also shielded the economy from contagion at a time of great volatility caused by the Mexican financial crisis of 1994-1995. In Colombia, capital controls also allowed for better handling of maturity periods of external debt (Ocampo and Tovar 2003). In both cases, capital controls allowed policy makers to regain some autonomy for a countercyclical monetary policy.

This is also consistent with the historical record of developed countries which shows long periods of capital controls and only gradual liberalization for capital flows (Eichengreen 1996). The experience of the past twenty years demonstrates that premature and abrupt liberalization of the capital account is inappropriate for developing countries. Even when strong regulatory regimes continued to exist, most developing countries have found it difficult to adapt to the volatile environment of international capital flows. A flexible approach in this domain can play a key role in bringing about stability with adequate foreign investment levels. And although this can increase the cost of certain investments in developing countries, that can help increase economic efficiency.<sup>9</sup>

Capital controls are no panacea. Their central mission is to smooth the cycles of the capital account, enhance stability and allow for a greater degree of independence of monetary policy. This objective can also be attained with the use of balance of payments provisions within the WTO framework. Although these measures were reaffirmed in Marrakesh, they have been left in the backwaters of policymaking thanks to opposition from dogmatic quarters in the WTO, the IMF and the U.S. Treasury. These provisions can provide a constructive response to external accounts' crises (Nadal 1996) and should be reconsidered as an important tool in the intersection between trade and financial flows.

All of this needs to be accompanied by active domestic policies for industrial and agricultural development. In this sense, fiscal policy needs to go beyond the shortsighted objectives of providing strong primary surpluses. As public debt maturities improve, and as debt service to GDP ratios improve, fiscal restrictions can be relaxed and greater investment in education, health, science and technology will contribute to enhance competitiveness, improve welfare and consolidate sustainability.

The world's financial crises, especially in the last decade, have resulted mostly from a combination of unsustainable external accounts, capital surges and reversion of

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<sup>9</sup> As is well known, today the amount of these transactions in the world's currency markets is more than fifty times the size of total foreign trade and long-term investments. A small tax of 0.3% on all such transactions could play a constructive role in an international regime of financial regulation. It could very well be the source of much needed aid to the poorest countries in the world and funding for large international environmental rescue projects.

capital flows. The main thrust of our analysis here is that unless reforms of the world's trading system are accompanied by substantive changes in our approach to macroeconomic policies, we will not be able to improve the chances of sustainable development.

## Central America: Trends in Trade, Macroeconomics and Development

In Latin America, the pattern of restrictive macroeconomic policy over the past fifteen years has led to a long period of sluggish economic performance. In the case of Central American countries, this is shown by falling growth rates, low fiscal revenues, unemployment and social inequality. The key issue here is that macroeconomic policies have lost the capacity to act in a countercyclical manner, and these economies have been left to ride the wave of globalization as best they can. None of the Central American countries has anything resembling controls over capital funds like the ones used in Colombia or Chile. The signature of the Central American Free Trade Agreement (CAFTA) will impose severe limitations on the region's degree of autonomy.

**Table I**  
**Growth Rates for Five Countries in Central America**

|                    | 1981-1985 | 1985-1990 | 1990-1995 | 1995-2000 | 2000-2003 |
|--------------------|-----------|-----------|-----------|-----------|-----------|
| <b>Costa Rica</b>  | 0.31      | 3.8       | 4.9       | 4.6       | 3         |
| <b>El Salvador</b> | -2.6      | 1.8       | 5.5       | 3.5       | 1.9       |
| <b>Guatemala</b>   | -1.1      | 2.3       | 4.1       | 4.1       | 2.7       |
| <b>Honduras</b>    | 1.5       | 3.3       | 3.8       | 3.2       | 3.6       |
| <b>Nicaragua</b>   | 0.6       | -3.4      | 1.5       | 5.1       | 2.7       |

Source: CEPAL (2004)

A cursory analysis of growth rates in the Central American region reveals that in the aftermath of the eighties, growth returned timidly to the region. Countries that chose to attract *maquiladora* industries (like El Salvador) show higher growth rates. Others (Nicaragua) got on the bandwagon of the *maquiladora* investment boom later. All of these countries suffered from the syndrome of concentrating exports in the United States market. Thus, when the U.S. economy went into the recession of 2000, exports dropped and growth rates slowed significantly. The presence and consolidation of China in the U.S. market, as well as the attraction that it exerted on many *maquiladora* investments, puts the Central American export sector at great risk.

CAFTA will prevent these countries to impose performance requirements on these industries. As with NAFTA, the Central American agreement will forbid instruments that help build rich forward and backward industrial linkages between the *maquiladora* sector and the rest of the economy, limiting their capacity to act as a

strong engine for growth. It will also impose the same level of protection for direct foreign investments that NAFTA established in its Chapter 11 provisions. This will subordinate environmental policies to the priorities of trade and foreign investment (Suppan 2004).

Fiscal policy in Central America is used to transfer resources from the real sectors of the economy to the sphere of financial services. This is done not by increasing fiscal revenues, but by cutting expenditures. Data on six Central American countries for the primary and economic balances reveals a clear-cut pattern over the past eight years: the primary balance exhibits either a surplus or a small deficit and the economic balance always shows a deficit. On the other hand, public debt service becomes one of the single most important components of public expenditure, with interest payments reaching the equivalent of 12% of total fiscal revenues. The transfer of resources from the real to the financial sector has a cost for sectors that are critical for social and environmental long-term sustainability.

**Table II**  
**Central America: Fiscal Accounts 1995-2003**

|                       | Costa Rica | El Salvador | Guatemala | Honduras | Nicaragua | Panamá |
|-----------------------|------------|-------------|-----------|----------|-----------|--------|
| Primary Balance (a)   | 1.9        | -0.6        | -0.3      | -0.2     | 0.5       | 2.4    |
| Economic Balance (a)  | -2.0       | -2.1        | -1.5      | -0.7     | -2.2      | -0.2   |
| Interest Payments (b) | 18         | 12          | 11        | 7.2      | 13.6      | 11.8   |

(a) Average percentage of GDP 1995-2003

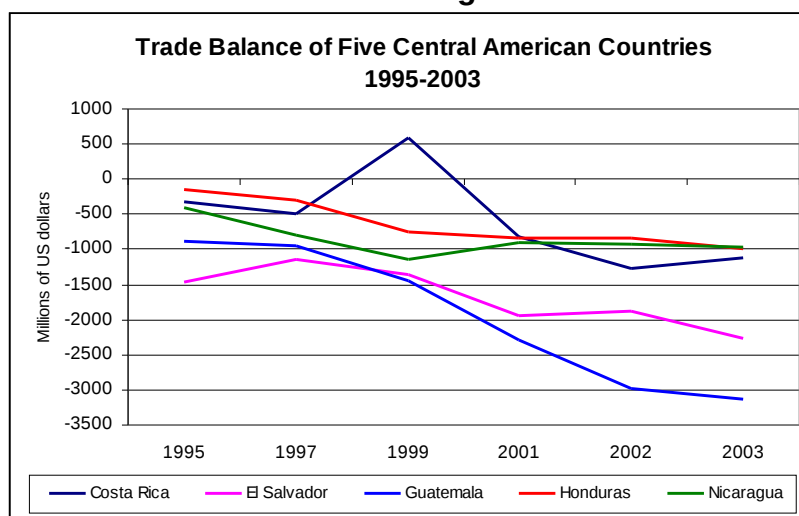
(b) Average percentage of total fiscal revenues 1995-2003

Source: CEPAL (2004)

Already the trade balance shows a disturbing trend of growing deficits. In spite of the presence of a significant *maquiladora* sector, it appears that the region's exporting sector is not performing adequately. It remains to be seen if CAFTA allows the signatory countries to reverse this *negative* trend.

Over the past two decades, the share of primary products in the region's total exports has remained very high. For countries like Honduras, Nicaragua and Guatemala, the share of primary products in total exports is close to 80%, indicating that the natural resource base is, and will remain, under heavy pressure. The most important components included here are cattle, shrimp, fish products, bananas, coffee and other horticultural goods. All of them are "environment-intensive" and they have all suffered from price volatility and a declining long-term trend.

Figure I

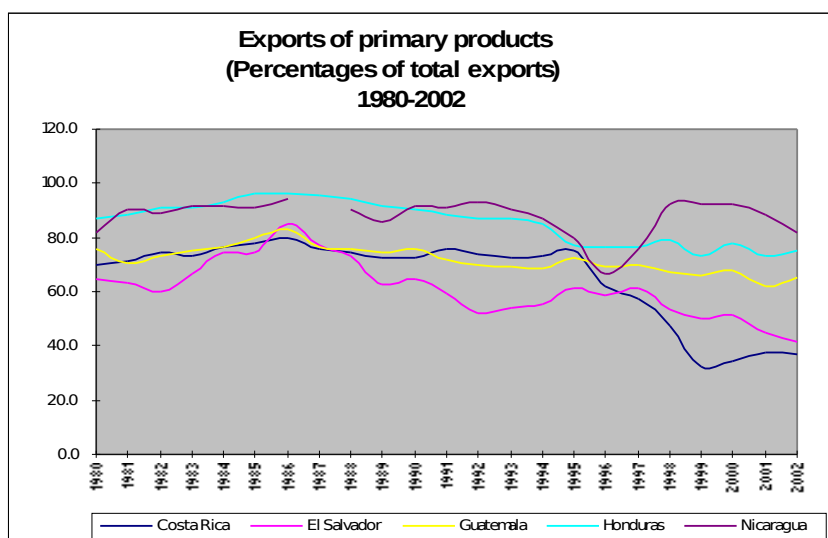


Source: CEPAL (2004)

In the case of Costa Rica and El Salvador, the importance of non-traditional exports increases, but this entails its own problems. *Maquiladora* industries in the apparel and electronic sectors have made an important contribution to exports, but this sector has been seriously affected by the recession in the United States. Also, the competition from China, both as an attractor of new maquiladora investments and as a challenger in the U.S. market, threatens to erode the advantages of the region. Besides, the growing share of Nicaragua and Honduras in the North American market is also a factor that will slow down the contribution of these sectors.

The importance of primary goods in total exports will remain as a dominant trait. CAFTA will not change this structure because of the factors mentioned above, but also because the rationale of that agreement is precisely to take advantage of the static comparative advantages in the region. Exports from this region will remain prone to the long-term trend of declining prices for primary products (Ocampo and Parra 2003). The region runs the risk of remaining in a lock-in trajectory with exports originating in low-productivity sectors close to the natural resource base. In this context of environmental-cost shifting, environment-intensive exports will continue to put heavy pressure on land, water bodies and biodiversity.

Figure II



Source: CEPAL (2004)

## Agriculture

The urgent task of reforming the world's agricultural system lies at the center of the problem area of trade, social responsibility and the environment. What we do today to the agricultural system of the world will determine the history of our future as a species. Yet, the world has been unable to reconcile adequate food production and distribution systems, improving living standards, and environmental sustainability of the agricultural system. Although global agricultural production has continued to outstrip total population, the rate of growth of yields has been slowing down and today it is one third that of twenty years ago (FAO 2003). On the other hand, per capita cultivated surface has begun to contract indicating that we have reached the limits of the agricultural frontier in many key areas of the world. Usage consumption rates of irrigation have spelled overexploitation of many aquifers, and heavy use of chemical inputs also contributes to pollution of underground and surface water bodies. And all of this coincides with a situation in which close to a billion human beings suffers from malnutrition.

The Uruguay Round incorporated agriculture into its negotiations and contributed to trade liberalization in this key sector, but left untouched the capacity of developed countries to channel resources to the agricultural sector. Today, total subsidies for agriculture in the OECD countries are close to 340 billion dollars per year.

The strategic objectives of the URAA were to open up the markets of several highly-populated countries to exports from the United States and Europe, and to maintain a façade of discipline in the relations between these two giant agricultural producers. It envisaged several avenues for the reduction of subsidies for the agricultural sector, but it kept direct payments to farms if the payments are aimed at reducing production and allowed payments that are decoupled from production. It

preserved the capacity of developed countries to maintain highly deleterious export subsidies. The complex array of technicalities is not enough, however, to disguise the fact that the URAA helped sanctify these subsidies. It did not open market access for the products of developing countries while global agricultural commodity prices suffered severe reductions and volatility increased. After ten years of operations, the URAA failed to solve the complex questions of food rights, economic development, social responsibility and environmental stewardship.

Behind this is the fact that the “invisible hand” metaphor does not work in agriculture. Income elasticity of demand for food doesn’t allow for expansion of demand as prices drop. On the supply side, aggregate crop output changes little with price because farmers use all their productive capacity all of the time and cannot influence prices. This is why in the United States acreage has remained more or less constant in spite of price reductions. Summarizing, timely self-correction does not occur. The current policy, based on the false premise that we need to let markets operate freely, is unsustainable (Ray 2004, Ray, Ugarte and Tiller 2003). Thus, agriculture demands supply management policies.

In spite of this, the United States abandoned the policy package that for decades had sought to stabilize prices at levels adequate for consumers and producers, guaranteeing adequate farm incomes. Instead, it opted for trade liberalization and payment schemes that are “decoupled” from technology and output decisions. Policy makers believed that in order to enable exports to drive agricultural growth, “markets should be allowed to work”. But inducing export expansion through price reductions backfired.

Since 1996, world prices for America’s chief farm exports have plunged more than 40 percent, but U.S. crop exports did not increase as a result (Ray 2004). This led to dramatic losses in farm income and increases in government payments to farmers. This spelled trouble for small producers in developing countries as dumping practices destroyed their markets, impoverishing rural communities throughout the world and benefiting vertically integrated agribusinesses. This is why the difference between consumer prices and the price that producers receive is out of any reasonable proportion.

In the future, the system that the URAA helped enshrine must be drastically redesigned. In the first place, developing countries must have the right to use quantitative restrictions (QR’s) to protect themselves from dumping practices and to de-link their key strategic sectors from the paradigm of the URAA. These QR’s are compatible with WTO and are recognized by Article XVIII of the original GATT. Safeguards should also be made available for developing countries to protect their producers from the effects of dumping.

The question of subsidies requires closer scrutiny. Recent studies show that eliminating subsidies will not bring about the rise in agricultural prices that is required to provide farmers with adequate income and agriculture with a healthy foundation for sustainable production. Recent studies show that subsidy elimination would bring about minor changes in several key crops and small acreage adjustments; the price increases would not compensate for the decline in income (Tiller and Schaffer 2004). This indicates that the solution to the global trend of low

prices is not simply the elimination of subsidies. So instead of judging national programs by how much they cost, trade negotiators should discipline the trade-distorting impact of those programs. The world needs adequate crop prices that contribute to a healthy and vigorous worldwide agricultural sector (Ray, Ugarte and Schaffer 2003).

Because global agricultural trade is in disarray, a radically new approach is required. We must replace the old system based on the URAA's naïve illusion that a "free market" would solve all problems, with a sound institutional and legal framework that blends sound supply-management policy measures with adequate support mechanisms in developing countries.

A new institutional arrangement, perhaps a new framework convention, needs to tackle the issues of sustainable agriculture, biodiversity, food security and access to genetic resources, not a piecemeal basis, but in one single undertaking. Only in this manner can the objectives of food security and responsible environmental stewardship be reconciled. The new convention should restate the fundamental right of nations to defend themselves from dumping practices and from the market distortions brought about by the concentration of corporate power. Countries would be allowed to determine the level of support to their domestic producers and be subjected to trade-distorting disciplines explicitly defined in this agreement.

In developed countries the validity of supply-management policies should be recognized once again and support systems should not be considered as *a priori* market distorting. The new framework should incorporate multinational supply management if durable results are desired. These supply-management measures would increase market prices to reasonable levels and, at the same time, reduce volatility as controlling excess capacity in developed countries would become central to agricultural policy.

### **International Commodity Agreements (ICA's)**

International commodity agreements (ICA's) are an important component of the road to greater market transparency and less volatility. In the past, UNCTAD's mandate was to use them to arrest the deterioration of terms of trade and to stabilize markets whenever there were large fluctuations. Several agreements were set up (coffee, cocoa, rubber, sugar, tin and tropical timber) but this role was destroyed in the 1980's in the aftermath of the debt crisis and was never restored.

Over the past century, real prices of primary products have experienced a significant declining trend (Ocampo and Parra 2003). The vulnerability of many countries that rely on one or a few basic products for exports puts undue pressure on people and the environment. ICA's could help change this situation. The need for the reinstallation of ICA's as a relevant policy mechanism stems from the presence of market failures as a result of price volatility and long-term trends of declining prices for many primary commodities.

In addition, ICA's can reduce market distortions due to market concentration and reinstate more transparency in trade through the supervision of operations where

giant corporations control more than 20% of the market. They can stabilize prices at levels that are fair for consumers and producers and dovetail certification and other resource management schemes with commercial trends. Producers that receive a fairer deal through ICA's can be more easily persuaded to improve quality and adopt cleaner process and production methods without exacerbating tensions between trade partners.

ICA's can also blend trade concerns with technical and financial assistance that help improve standards while restoring some sense to the notion of special and differential treatment. The example of the International Tropical Timber Agreement (ITTA), currently being re-negotiated, is encouraging as an example that helps promote fair trade with sustainable use and conservation of tropical forests. New agreements should learn from the experiences of the ITTA, enhancing its virtues and mitigating its errors. The main objective of new multilateral agreements should be a combination of sustainable management of resources, social responsibility and recognition of the legitimate rights and interests of indigenous peoples and other local communities.

A new generation of international commodity agreements could explore ways and means to increase value added of raw commodities, providing developing countries assistance to take advantage of new economic opportunities, from processing to packaging. Adding value to these commodities will create forward and backward industrial linkages that generate more employment opportunities and have healthy multiplier effects in commodity production chains.

Of course, high prices alone will not guarantee sustainable livelihoods for the world's poorest farmers. A range of national and international policies, from credit, land, technology and transportation to tariff protection and access to markets, are essential if agricultural production is to bring a better future for farmers.

## **NAMA**

Market access to non agricultural products (NAMA) deals with the reduction and elimination of tariffs on products not covered in the URAA. In its most extreme form this would establish the mandatory elimination of tariffs on all products. In addition, the NAMA would target so-called non-tariff barriers to trade (NBTs), some of which may be linked to environmental policies and other policies related to community development. The big issue here is that reducing tariffs without additional social safety nets and environmental protection can have negative effects on sustainability.

Two very important sectors from the standpoint of global sustainability would be directly affected by NAMA. The first is fisheries, a sector that is already heavily overexploited. According to FAO 70% of the world's commercial fish stocks are already over-exploited and 34 million people who earn less than one dollar a day depend directly on fishing for their livelihood. The survival of many poor coastal communities depends critically on the conservation of fisheries that may be already threatened with collapse.

Abolishing tariffs in the fisheries sector will unleash a greater degree of fishing effort over already exhausted fisheries. NAMA would induce catches beyond the renewable capacity of resources, thereby impeding sustainable development of fisheries. Further elimination of tariffs on fish products would likely lead to overinvestment in the processing industries and generate additional pressure on fleets and fishermen to increase effort and catch. This will affect marine ecosystems as food chains are further disturbed. Coastal communities and small-scale fisheries will be threatened by resource depletion.

The forestry sector would also be affected by NAMA because the elimination of tariffs on wood products would increase logging in the world's forests. Some of these forests harbor ecosystems that are unique from the standpoint of biodiversity. It is estimated that hundreds of millions of poor people depend heavily on tropical forests for their survival. Their food, fuelwood, and medicines come from these forests; in addition, structural materials for housing and cash crops are essential components of their daily livelihoods. If economic pressure to increase logging is increased, they will also be affected by greater pressure on their resource base.

If NAMA is negotiated carelessly, it could pre-empt efforts to negotiate viable agreements on sustainable stewardship and development in several sectors. It would also impose a single format type of regime for many products that are close to the natural resource base. What the world needs now is a set of new agreements capable of dealing with the complex matrix of problems that are related to resource management, production, and fair trade.

## **Intellectual Property Rights and Trade**

Contrary to the views of trade policy analysts, the objectives of “free trade” clash violently with those of “intellectual property rights”. The first require free competition to attain efficient allocations of resources. The second create monopoly rights that automatically entail loss of welfare. This is especially important in the case of patents, which are statutory monopolies. Nevertheless, these two objectives coexist side by side as if they complemented each other, when in fact they entail a monumental contradiction.

Patents are based on the idea that inventors are rewarded with monopoly rights in return for disclosure of their inventions. In this manner, society can benefit from their inventive activity and they can reap the monopoly rents that accrue to the protected activities. Traditional patent attorneys always agreed that this monopoly protection should only be available where there are clear and demonstrable benefits to society outweighing the adverse effects of monopolies. They also knew that there is an “art of non-disclosure” when filling patent applications and this is why the idea of society recovering the costs of granting monopoly protection is a pious fiction. But economists came along with the simplistic idea that patents are required as incentives for inventive activity and R&D.

First, patent systems are not the powerful incentives for R&D that many believe. Intercapitalist competition is the main force behind the need to innovate (Baumol 2002). This is why market-based capitalism can outperform other economic systems when it comes to technical innovations. Patents, on the other hand, do

serve as important instruments in corporate strategies, rewarding rent-seeking behavior and increasing entry barriers for potential competitors (Baker and Chitani 2002).

Secondly, the vast majority of inventions protected by patents never make it to the production stage. This is because patents serve primarily the purpose of helping segment markets in order to extend monopoly rents. Patents are not an incentive for innovation, they are tools for inter-industry competition. A significant proportion of patents is obtained through incremental innovations or superficial modifications on previously existing products whose protection is about to expire.

Third, strength of IPR's in developing countries is not determinant for R&D investment as studies have found (Kumar 1996). In addition, developing countries are constrained to keep R&D investments at a very low level. Twenty-year patents and wide patentability will not change this state of affairs. In addition, industrial policy instruments that could be used to enhance assimilation of technological capabilities have been forbidden by several components of the WTO system. This makes technological development very difficult and the presence of a patent system will not help. On the contrary, it is an additional barrier to technological acquisition and it may delay innovation and dissemination of information.

Fourth, the TRIPs agreement carries a distorted patent system which blurs the all important separation between invention and discovery. Granting patents on life forms is the foremost example of this distortion. But the process may not stop here and with the convergence of biotechnologies and nanotechnologies it may lead to exclusive monopoly rights of entire environmental dimensions. Already the number of patent applications from the biotechnologies has surpassed the capacity of patent examiners to fulfill their responsibilities. This is dangerous precedent that was to be reviewed according to Article 27.3(b) of TRIPs but that exercise is still to provide a rigorous analysis of the performance of this rule.

Fifth, a system based on wide patentability and long life terms for patents can stifle innovation. The potential cost of patent infringement and the uncertainties that this generates can slow down innovators. In addition, costs of patent litigation can run into the millions of dollars and small and medium firms cannot run the risk of getting caught in this type of problem.

The Uruguay Round managed to incorporate intellectual property rights with trade negotiations. Although there may be some genuine questions in the intersection between these two domains, the agreement on Trade Related aspects of Intellectual Property (TRIP's) is an example of how trade negotiations can be used to impose unfair institutional arrangements on developing countries. In addition, TRIP's involves an extraordinary distortion of the rationality of the patent system, carrying significant risks for social welfare and the environment.

The original array of patent protection treaties only required members to set up a patent system, they did not impose the obligation to grant patents on any specific field. Those legal instruments accepted restrictions in areas such as public health, the environment and on moral grounds. And as far as patent life terms were concerned, they did not impose a uniform standard on member countries. The

technical secretariat of most of those treaties, the World Intellectual property Organization (WIPO), was an organization managed from the perspective of traditional trademark, copyright and patent attorneys.

All of this changed during the Uruguay Round. TRIP's imposed on WTO member countries the obligation to grant and recognize patents in a very wide variety of items. It also imposed the obligation to recognize and grant patents on life forms (Article 27.3b), although this was to be reviewed in 2000. It also imposed long life terms for patents of twenty years and made it very difficult to set up a compulsory licensing scheme. For countries investing very little in R&D, as most developing countries, this is not a good idea.

Already the patent system is plagued with abuses and distortions. For example, a high percentage of patent applications and patents do not involve anything "new", nor do they imply an "inventive step" (two elements required by every patent system). In biotech industries, many patents simply involve minor changes in molecules of existing products whose patents are about to expire. In many cases, these changes do not even have any therapeutic value (violating the "utility" requisite for patents). These are the same abuses that are being projected into developing countries by forcing global standards in IPR's.

It is important to return to a more rational system for the protection of intellectual property. The first step should be to de-link intellectual property rights from the WTO. This is needed in order to redefine a global patent system that is not market-distorting and fulfills its mission to protect inventors' rights. It should not impose wide patentability and long duration for patents and it should abolish patents on life forms, a major element distorting the patent system that has negative effects on human health and access to genetic resources. The notion that this would throw the biotech industry in disarray is preposterous. The real trouble for biotech firms comes from the irresponsible use of molecular biotechnology (that remains a "hit-or-miss technology") and the reprobation of this by the market.

Other areas that need urgent attention include the granting of patents in health and environmental goods. As patents do create barriers to entry, these sectors can be negatively affected by an all too flexible IPR system. The recent battle over supply of medicines to treat HIV/AIDS patients underscores this. But in the future we might see other examples of patents blocking clean technology progress in developing countries. Restoring elements of rationality in the international patent system should be accompanied by restoring the capacity of developing countries to design and implement industrial policies. WTO rules that forbid access to these policy instruments are a mockery of the notion of special and differential treatment.

## **Investment and Trade (TRIMs)**

The best example of how the special and differential (S&DT) clauses in the WTO agreements have been betrayed is the agreement on Trade-Related Aspects of Investment Measures (TRIM's). Through this agreement, developing countries have

been forced to forego the use of important industrial policy instruments. Policies aimed at increasing local content in value added, or limiting imports to a certain proportion of exports, are not allowed under the current version of TRIM's. Even this was not considered sufficient and developed countries engaged in a big display of diplomatic efforts to strengthen these provisions as part of the multilateral investment agreement (MIA).

Thus, instead of protecting developing countries against the effects of market concentration, the TRIM's ended up shielding powerful multinational corporations against public policies in host countries. The policy instruments that are eliminated by TRIM's are important in the context of industrial policy. Some of them are critical in order to obtain technological capabilities and go into higher value added exports. They are essential to building forward and backward inter-industry linkages, and those linkages are the carriers of economy-wide multiplier effects.

The North American Free-Trade Agreement (NAFTA) carries in its Chapter 11 the best example of how trade policy can put commercial concerns above environmental and health objectives. In a perverse twist of priorities, special and differential treatment is accorded to private multinational firms in detriment of public interest in host countries. This restricts policy options and forces countries into remaining in a sub-industrial stage. In the case of Mexico, although this is masked by the presence of *maquiladoras*, the inability to construct backward linkages in industry limits the ability of the exporting sector to pull the rest of the economy in a healthy growth process. In fact, the growth of the *maquiladora* sector simply means greater distortions in the country's industrial system.

The WTO should allow developing countries to impose performance requirements on foreign direct investment. Particularly important are requirements in terms of greater local value added, trade balance restrictions (imports conditioned to export performance), employment generation, regional growth and technological development (transfer of technology). Also, a revision of the TRIM's is required to incorporate the need for greater market transparency through the monitoring of operations of multinational corporations.

## **Final Remarks (What Doesn't Work)**

Reducing trade barriers is not an end in itself. The dynamics of trade negotiations should stop being dominated by this fallacy. The goal is sustainability and development, not free trade *per se*. So, before the world embarks in a new round of multilateral trade negotiations, the WTO should proceed to assess carefully how the existing agreements are being implemented and how they are performing. Implementation problems persist and they need to be solved before jumping to new endeavours. In particular, the WTO should look at the thorny question of who is benefiting and who is losing from the existing institutional and legal framework. Without this, no new issues should be considered.

WTO should be subordinated to the overarching objectives of sustainable development, not to free trade. And in order to do this, it must get away from procedures that diminish its legitimacy. Green rooms, mini-ministerials, the

manipulation of agendas and calendars, chair-driven reverse consensus and negotiations under a “closed-doors-no-minutes” regimes must be abandoned. The WTO secretariat needs to become an objective and impartial agent in the life of this system.

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