

## Trade justice or free trade?

### Key points

- Trade justice campaigners are today holding a mass lobby of MPs, ahead of the key WTO meeting in Hong Kong in December. The lobby, organised by the Trade Justice Movement, aims to promote “fair trade not free trade”.
- Some of the ideas of the Trade Justice Movement are excellent - such as the removal of trade barriers raised by developed countries against poor countries. However, other ideas advocated by a number of groups within the trade justice lobby are misguided, and some of the claims made about the “damaging effects” of free trade are not based on a balanced assessment or a proper economic analysis.
- There are a range of views within the trade justice movement, which are masked by common support for “fair trade”. MPs and others should support calls for the EU to reduce its trade barriers. But attacks on the WTO and calls for poor countries to raise their trade barriers are mistaken, and are likely to damage rather than help developing countries.

### Free trade: the potential benefits for poor countries

A recent report for Open Europe by Oxford Economic Forecasting suggests that while Britain and Europe would gain from free trade, developing countries could gain even more. The report finds that getting rid of trade barriers would boost Europe’s economy by about 2%. But GDP in African countries would increase by three times as much - just under 6% - lifting millions out of poverty.

There is a large body of economic evidence which suggests that in general, countries which have opened their economies have done better than those which have not, and that developing countries still stand to see large gains from further trade opening.

For example, a study by the World Bank estimated that abolishing all trade barriers could mean annual gains of over \$500 billion dollars for developing countries. A more recent report<sup>1</sup> found that global free trade could reduce the number of people living on less than 2 dollars per day by more than 134 million.

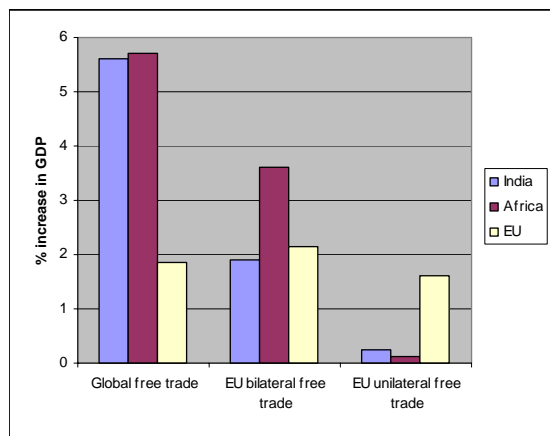
### Should we encourage poor countries to reduce their trade barriers?

The main demand of the mainstream members of the trade justice lobby is that the UK (through the EU) should “stop pushing poor countries to open their economies through world trade talks.”<sup>2</sup> But the evidence suggests that poor countries will benefit most if they open up their own economies too.

There is a spectrum of different approaches which the EU might take. At one extreme the EU might open its own market unilaterally, and not apply any pressure for developing countries to reduce their trade barriers in return. At the other end of the spectrum the EU might demand that poor countries cut their trade barriers if they want access to EU markets.

In general the EU should aim to work bilaterally - not just because this is best for the EU, but also because it will benefit developing countries more too. While the EU getting rid of its trade barriers would do developing countries some good, the effect would be rather limited. However, if the EU works bilaterally with developing countries, so that they also reduce their trade barriers, the gains are likely to be larger. The biggest gains of all are likely to occur through multilateral liberalisation - meaning that poor countries bring down their barriers against each other (which are often the highest trade barriers in the world).

**The gains from free trade:  
Poor countries benefit most if they open up their own economies too**



<sup>1</sup> (Hertel and Winters, 2005)

<sup>2</sup> TJM Briefing note: <http://www.tjm.org.uk/lobby05/questions.shtml>

Working multilaterally or bilaterally with poor countries has the advantage of playing off protectionist interests in different countries against each other. By working in a reciprocal way, exporters in country A who want better access to markets in country B will balance out the effect of producers in country A who seek to raise trade barriers to limit competition and protect their own industries from fair competition.

However, there will be occasions when the EU will not be able to agree fully bilateral deals -for example, the EU should not expect developing countries to match tariff reductions exactly point-for-point, or expect developing countries to open markets overnight. In such situations the EU should adopt a middle way, and should not be afraid to offer some unilateral reductions.

Trade justice groups are right to point out that it is hypocritical of the EU to ask developing countries to open their own markets when the EU maintains protectionist barriers and the CAP. In the WTO talks the EU should be setting an example by leading in opening its markets - rather than being the slowest moving member of the WTO.

### Bad evidence, distorted claims

“Trade justice” is seen differently by different groups within the trade justice coalition. At one end of the spectrum, the charity Christian Aid has been strident in its attacks on free trade. The group is currently running a high profile advertising campaign in newspapers depicting “free trade” as a pair of handcuffs on the developing world. The group previously ran ads featuring a pig in a pinstripe suit crushing a traditionally dressed African with the slogan “Free trade: some people love it”, which claimed that “Our government claims Free Trade is the solution to the world's problems. But that's exactly what you'd expect them to say. Why? Because it allows the world's richest countries and their fat cat companies to profit.”

Apart from the questionable attempt to demonise the people they believe to be their opponents, Christian Aid's campaign is based on a distortion of the facts. A recent report published by the group claimed that an “economic study” had shown that free trade cost sub-saharan Africa \$272 billion.

In fact the study they referred to did not even *purport* to be a comprehensive assessment of the costs and benefits of free trade - it looked only at *one aspect* of the cost of trade liberalisation and not at all at the benefits.

The [report](#) itself admits that “our results will not be comprehensive” and that it only looks at “a component of trade liberalisation impacts for those countries and time periods where scarce access to foreign exchange is a valid assumption” - but Christian Aid chose to present the results as the “cost of free trade.”

In a subsequent [briefing paper](#) Christian Aid went on to argue that developing countries should actually raise trade barriers. They argue that, “developing countries must be allowed to roll back decades of liberalisation: they must be free to raise tariffs if necessary to meet development goals”. **This is disastrously bad advice.**

### **Trade “preferences” don’t work**

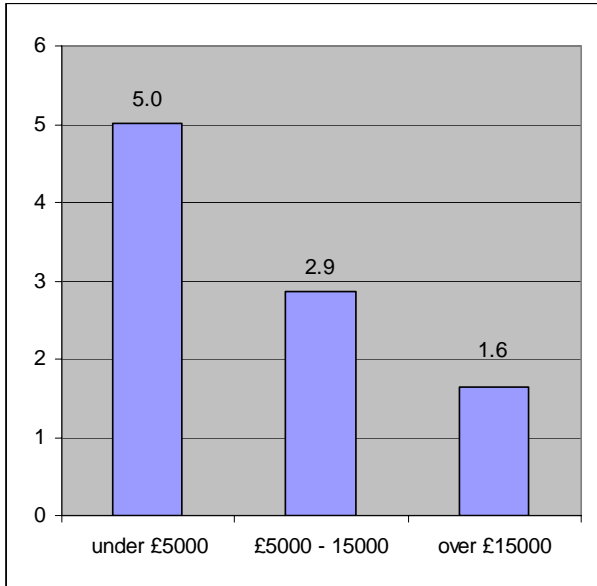
Another idea advocated by some in the trade justice lobby is that developing countries need trade “preferences” - the ability to access developed country markets at a lower tariff rate than rich countries, while simultaneously maintaining their own trade barriers. **But this strategy has already been tried and has failed.**

The goods which are most heavily taxed by the EU - and other developed countries - tend to be the goods which developing countries have a comparative advantage in producing. Agriculture and textiles are the sectors in which protection is highest. This is partly a result of the fact that these sectors have largely been bypassed in previous rounds of world trade negotiations. But this also reflects the power of entrenched lobby groups in rich countries.

In an attempt to offset these unfair policies, the EU already maintains a complex system of trade “preferences” for developing countries. However, the preference system has not been effective. The net effect is that the EU’s applied tariff rate remains higher for exports from poor countries than from rich countries.

Countries with a GDP per capita of under £5,000 a year face an EU tariff of 5% on average. Countries with a GDP per capita of between £5,000 and £15,000 face an average tariff of 2.9%. But countries with a GDP per capita over £15,000 a year face a tariff of just 1.6%.

## Poor countries are hit hardest by EU trade barriers



Worse still, even these overall figures hide some particularly steep tariffs faced by certain poor countries.

### High taxes for the world's poorest

Countries	GDP per capita (£)	EU applied tariff
Malawi	94	11.4 %
Vietnam	240	6.1
Sri Lanka	480	6.9 %
Lesotho, Namibia, Swaziland	980	21.2 %
Columbia	1030	8.2 %
Uruguay	1991	14.3 %
Bolivia, Ecuador	1410	26.1 %
Brazil	1438	8.8 %
Angola, Congo, Mauritius, Seychelles	1950	7.6 %

## Why have preferences failed to offset the EU's anti-poor trade policy?

Firstly, the coverage of the preferential agreements is patchy. 49 small countries on the UN Less Developed Country (LDC) list are granted (supposedly) full tariff-free access. But this list does not cover some of the world's poorest countries, and excludes large poor countries. For example Kenya, India, Pakistan and Nigeria are not included. Furthermore, the list is perversely designed so that if countries make progress, they automatically lose market access.

Secondly, much of the benefit of this system for developing countries is lost because of complex rules of origin. This means that while in theory a country might be allowed to export its products to the EU duty free, this preferential access is only available to goods which contain no parts, materials or ingredients from other countries.

So for example, one study found that while 84 percent of goods from Albania are supposed to be able to enter the EU duty free, in practice only 2 percent do so.<sup>3</sup>

A study by the World Bank in 2005 found that, "the overall value of EU preferences to sub-Saharan African countries under the Cotonou Agreement and under the 'Everything but Arms' initiative and GSP<sup>4</sup> amounted to just 4 per cent of the value of those countries' exports to the EU in 2002". It noted that, "The majority of beneficiaries of U.S., EU, and Japanese preferences have experienced little or no impact."<sup>5</sup>

For small, poor economies this means that many exporters cannot benefit from the preferences, because the import component of their exports is large. This system reduces poor countries' ability to benefit from their comparative advantage in labour intensive assembly industries.

Preferences also have a number of strongly negative side effects. Granting preferences unilaterally makes it less likely that the recipient country will adopt free trade policies itself. Without preferences, exporters in developing countries have an incentive to counteract protectionist domestic producers, because they can hope to gain better access to their target markets if their home country will lower tariffs reciprocally. But if preferences are granted unilaterally, then the export lobby will not have an incentive to argue for free trade.

Preferences are particularly damaging when they are specific to certain industries. For example, the EU's preferential access to bananas and sugar

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<sup>3</sup> Brenton and Machin, CEPS 2002

<sup>4</sup> Generalised System of Preferences

<sup>5</sup> Brenton and Ikezuki, 2005

from Caribbean producers encourages the recipient countries to invest heavily in volatile primary commodity industries, and narrow their production base, leaving them more vulnerable to economic shocks.

The preferences also act as an artificial incentive to invest in industries in which the recipient countries are not internationally competitive. This is now having a very damaging effect as the preferences are eroded away as global tariffs fall as part of the WTO process. For example, the effect for Guiana of the first round of reductions in the EU's sugar preferences is likely to be the equivalent of the UK losing its entire financial services industry overnight.

Academic research suggests that preferences have may actually have had a *net negative* effect for these reasons. Research at the World Bank by Ozden and Reinhart (2004) found that countries which had been removed from the US Generalised System of Preferences had performed better than those which had not - mainly because countries which remained on the scheme had retained higher protection themselves as a result.

## Conclusions

1. Trade justice campaigners are right to call on the EU to reduce its trade barriers against developing countries, which remain high.
2. But the EU should still encourage poor countries to open their markets, as this will bring the biggest gains for developing countries themselves.
3. However, while the EU should aim to work bilaterally, it should also aim to give a lead, and show flexibility.
4. Reducing the EU's trade barriers across the board will do more for poor countries than granting them trade "preferences", which may do more damage than good.

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