Global Development Network Series

GLOBAL EXCHANGE AND POVERTY

Trade, Investment and Migration

Robert E.B. Lucas,
Lyn Squire and
T.N. Srinivasan

Global Exchange and Poverty

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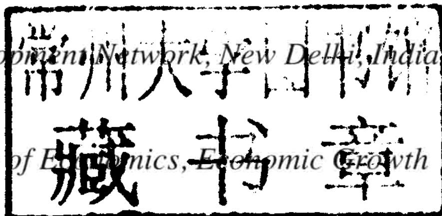

GLOBAL DEVELOPMENT NETWORK

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GLOBAL DEVELOPMENT NETWORK

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Introduction

Robert E.B. Lucas, Lyn Squire, and T.N. Srinivasan

Since humans began to move out of Africa to populate the globe, people living in different parts of the world have shared ideas, faiths, trade, finance and migration (Chanda 2007). But this volume focuses on the more recent wave of globalization which has engulfed the world since the 1980s. Its impact on everyday life is evident in developed and developing countries alike, whether through outsourcing, changing consumption patterns, illegal migration, transnational companies or other avenues. The aggregate statistics are no less compelling. The share of merchandise trade (exports and imports) in world GDP rose from 27.3 per cent in 1981–83 to 47.3 per cent in 2005, with all major regions contributing to the increase. In China the increase was even more extraordinary: from 16.7 per cent to a massive 63.6 per cent (World Bank 1997, 2007, Table 6.1). According to UNCTAD (2006, Table 1.1), inward flows of foreign direct investment (FDI) also show substantial increases, with developing countries increasing their share from 20.3 per cent during 1978–80 to 35.9 per cent during 2003–05. As a result, the total inward stock of FDI as a proportion of GDP in developing economies shot up from 9.8 per cent in 1990 to 27 per cent in 2005. Net migration from low- and middle-income countries rose from 13 million in 1990–95 to 16 million in 2000–2005, with net remittances from workers abroad to low- and middle-income countries rising considerably more rapidly, from $25 billion in 1990 to $155 billion in 2005 (World Bank 2007, Table 6.14). Even so, integration in international labor markets remains far behind the levels achieved in goods and capital markets.

Both the popular media and academic circles regularly debate the impact of globalization. For example, Hertel and Winters (2006) suggest that nearly 126.5 million people will no longer be extremely poor (income below $1 a day) and 193.2 million will no longer be poor (income below $2 a day) in 2015 in the 17 developing countries studied, if there is full trade liberalization and globalization's impact on both investment and productivity are taken into account. If the impacts of productivity are ignored, poverty reduction drops to 66.3 million and 103.9 million, respectively, if $1 a day and $2 a day poverty lines are used. Recent research on FDI indicates a positive impact on growth in

recipient GDP. As one example, Borensztein, De Gregorio and Lee (1998) find that an increase of 0.5 per cent in the FDI-to-GDP ratio increases growth on average by 0.3 percentage points, provided certain thresholds in terms of human capital are met. Even more remarkable, simulations exploring the impact of increased migration suggest that even a small increase in world migration (3 per cent) would increase world output more than a complete liberalization of trade (Walmsley and Winters 2005).

At best, however, such evidence can only be indicative for at least three reasons. First, data are often of poor quality, particularly regarding migration. Second, methodological issues abound. Commonly used techniques such as general equilibrium models and cross-country regressions are fraught with well-known weaknesses, with the equilibrium models invariably requiring strong assumptions about the functioning of various markets, and the cross-country regressions running into difficult issues of endogeneity, causation, omitted variables and so on. And third, it is not clear how much these estimates inform the policy debate in either the developed countries or the developing ones. The lack of country context is crucial here. For example, the design of migration policy in the United Kingdom should be informed by evidence on the impact of UK policies on developing countries and, of course, on the United Kingdom. Similarly, Argentina's negotiating stance at the World Trade Organization should be based on the economic impact of existing and proposed policies. A key argument of this volume is precisely the need for country-specific research on such matters. Before developing this point, however, it is worth briefly reviewing the actual history of policy interaction between the contemporary developed and developing worlds for trade in goods and services, investment and migration.

TRADE IN GOODS AND SERVICES

The longest and most extensive trade discussions, initially regarding trade in goods, have recently expanded to cover trade in services. A multilateral framework for periodic negotiations and implementation of the resulting agreements emerged from the General Agreement on Tariffs and Trade (GATT) in 1947 and its successor, the World Trade Organization (WTO), in 1995. GATT covered trade in goods, while a General Agreement on Trade in Services (GATS) was concluded in 1994. Although global interactions in investment and migration are also of long duration, no formal multilateral framework for negotiations and agreements has evolved.

The book begins with T.N. Srinivasan (Chapter 1) tracing the long history of interactions among peoples of the globe regarding ideas, religion, trade,

finance and migration. He also examines the post-World War II developments leading to the GATT and the failure to establish a formal International Trade Organization. Srinivasan also discusses the often ambivalent role played by the developing countries in the GATT, in the several rounds of multilateral negotiations under its auspices and in the unfinished Doha Development Round, initiated under the auspices of the WTO in 2001.

Chapter 1 shows how the origins of GATT and the WTO can be traced to the bilateral trade agreements negotiated among European countries in the mid-nineteenth century. The concept of 'most-favored nation' (MFN) treatment, that embodies the principle of non-discrimination among trading nations, originated in these early trade agreements. It became the cardinal principle of the GATT and was enshrined in its very first article. The agreement to establish the WTO was part of the many multilateral agreements concluded in the eighth round (Uruguay Round) of multilateral trade negotiations under the auspices of the GATT in 1986. According to Article III GATT (1994, 6):

> The WTO shall provide 'the common institutional framework for the conduct of trade relations among its members in matters related to the agreements and associated legal instruments included in Annexes to this Agreement [that established the WTO]' (Article II), and 'the WTO shall facilitate the implementation, administration and operations, and furthers the objective of this Agreement and of the Multilateral Trade Agreements and shall also provide 'the framework for the implementation, administration and operation of the Plurilateral Agreements.

With the conclusion of GATT, the stage seemed set for significant progress in reducing trade barriers and opening markets. Indeed, up to 1986 the eight successful rounds of multilateral trade negotiations by the GATT contracting parties substantially reduced tariffs and other barriers to trade and accelerated the growth of world trade. Yet many developing countries did not participate in either process. Most developing states chose to remain effectively outside the GATT, either by not becoming contracting parties (Mexico did not join until 1986) or by choosing not to participate actively as contracting parties in multilateral trade negotiations until the Tokyo Round of 1973–79.

In large part because of their desire to pursue the then-dominant faith in import-substituting industrialization as a strategy of development, developing countries not only erected and maintained relatively high barriers to trade, but also failed to participate effectively in the bargaining over reciprocal tariff reductions. As a consequence of this failure, trade barriers in commodities of export interest to these countries were not reduced to the same extent as trade barriers in commodities mostly traded among developed countries. After each round of multilateral trade negotiations, developed countries retained higher

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barriers against imports from developing countries than against imports from other developed countries. Agriculture, a sector of great interest to developing countries, largely remained outside the GATT framework until the Uruguay Round. Trade in textiles and apparel has been exempted from GATT rules since 1961. The Multi-Fiber Arrangement (MFA), that governed trade in textiles and apparel until it was finally phased out on 1 January 2005, was a particularly egregious exception to GATT rules. Apart from being an outright violation of Article I of the GATT, it also permitted the use of bilaterally negotiated trade quotas on an item-by-item basis between each importer and exporter.

Many developing countries resisted the start of the Uruguay Round in 1986 and the inclusion of new items such as services and intellectual property rights in its negotiating agenda. They failed to stop it from convening and the ultimate agreement (signed in Marrakech, Morocco) in 1994 included a General Agreement on Trade in Services (GATS), an agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) and an ultra-legalistic dispute-settlement mechanism. For agreeing to these documents, that arguably were costly from their perspective, the developing countries got a back-loaded phase-out of MFA and an agreement on agriculture which, in fact, did not liberalize trade much. However, developed countries wanted future negotiations to include other issues – such as labor and environmental standards, investment and competition – which the developing countries perceived not to be in their interest. Indeed, the resistance of developing countries in large part prevented the start of another round at the Seattle Ministerial Conference in 1999. However, two years later, at the Doha Ministerial Conference in November 2001, they agreed to launch a new round with a more development-focused agenda. The good intentions implicit in this focus notwithstanding, the negotiation proceeded in fits and starts over the next seven years. Although considerable progress was made in addressing the concerns of developing countries, the gap in negotiating positions of major countries such as China, India and the United States, particularly with respect to liberalization of agricultural trade, could not be bridged. The informal ministerial meeting of the WTO in Geneva on 1–29 July 2008 collapsed with no agreement.

The above summary of the issues between developed and developing countries relating to the global trading system illustrates the limited influence and bargaining power of the developing countries. Their poverty, as well as their deliberate insulation from world markets, resulted in their having only a modest share in world trade. Consequently, they had little bargaining in the GATT over rules of the trading system and reductions in trade barriers. The weakness in bargaining power was compounded by the choice of many developing countries either to opt out of GATT or not to participate effectively in negotiations until the Tokyo Round of 1973–79. By the early 1970s,

developing countries constituted an increasing majority of the membership of GATT. The GATT had incorporated its Part IV on development in 1964 – the same year that the first meeting of the United Nations Conference on Trade and Development (UNCTAD) took place. The solidarity of developing countries in UNCTAD and elsewhere was at its height between 1965 and 1980. However, by demanding and receiving exemptions from GATT regulations, including not having to reciprocate the reductions in tariffs in developed countries, they further weakened their bargaining position. The net result was that after each round, barriers against imports from developing countries continued to be high in developed countries, and sectors of great interest to them, such as agriculture, remained outside GATT until the Uruguay Round. Clearly, the post-1980 trends in integration have improved the bargaining position of the developing countries. As a result, leading developing countries such as Brazil and India appear able to exert more influence, especially since China joined them in the Group of 20 (G-20) formed at the Cancún Ministerial in 2003. This promise for the future is further motivation for the research reported in this volume: developing countries need to be as well armed as possible with empirical evidence on the impact of policies governing trade, migration and FDI in order to strengthen their negotiating positions.

The charter for the stillborn International Trade Organization (ITO) of 1948 contained provisions on the treatment of foreign investment as part of its chapter on economic development. The GATT, concluded in 1947, covered only tariffs and trade. However in 1955, the GATT contracting parties adopted a resolution on international investment for economic development in which they, *inter alia*, urged countries to conclude bilateral agreements to provide protection and security for foreign investment. Prior to the Uruguay Round the most significant development regarding investment was a ruling by a panel in a dispute settlement proceeding between the United States and Canada. The ruling concerned local content and export-performance requirements imposed by Canada on foreign enterprises. The ruling confirmed that existing obligations under GATT were applicable to performance requirements in so far as they were trade distorting. By holding that export-performance requirements were not covered by the GATT, the court underscored the limited scope of GATT discipline with respect to trade-related performance requirements. Although the dispute involved Canada, it was applicable to many such performance requirements imposed by developing countries.[1]

The Uruguay Round negotiation mandate included Trade-Related Investment Measures (TRIMS). These negotiations were marked by strong disagreements between developed countries which wanted to prohibit a wide range of measures such as local content requirements, and developing countries which opposed such blanket prohibitions. As the TRIMS agreement is essentially limited to

an interpretation and clarification of how GATT Article III applies to TRIMS, the eventual compromise did not cover export performance and technology transfer requirements which were discussed during the negotiation.[2] Thus in the GATT/WTO, the only multilateral agreement on investment is a very limited TRIMS.

With the field thus left open for bilateral and regional agreements, it is no surprise that international investment agreements (IIAs), ranging from trade agreements which include investment provisions to bilateral investment treaties (BITs) and double-taxation treaties (DTTs), have expanded enormously. Not only has the number of bilateral and regional agreements with investment provisions continued to rise, but an increasing number of them are South–South agreements between developing countries. According to UNCTAD:

> A growing number of bilateral IIAs – BITs, DTTs, free trade agreements (FTAs) or other forms of IIAs – are concluded between developing economies. As of end 2005, more than 1,100 such South–South IIAs had been concluded … By the end of 2005, the number of 'South–South' BITs had grown to 644 representing 26 per cent of the total number of BITs. In the top 50 economies that are signatories of BITs and DTTs concluded as of end 2005, there are many developing countries. China was second in BTTs with 177 and 13th in DTTs with 95. India was 27th in BTTs with 56 and 18th in DTTs with 83 (UNCTAD 2006, Table A1.10).

Fourteen IIAs other than BITs and DTTs were concluded in 2005, all of them involving a developing country, and almost 70 such agreements were under negotiation as of the end of 2005, all of them involving developing countries (UNCTAD 2006, Tables 1.15 and A1.16, the latest UNCTAD report in 2007 does not include this information).

Despite being the leading intergovernmental organization in the field of migration, the 120-member International Organization on Migration (IOM) has not sponsored multilateral negotiations for setting a global framework for migration. As with investment, migration was covered only to a very limited extent in the GATT/WTO and only in the GATS concluded in 1994. The limited provision relates to the so-called Mode 4 of trade in services covering 'the movement of natural persons', consisting of persons of one member country temporarily entering the territory of another to supply a service (e.g., accountants, doctors, teachers, software engineers). It does not relate to persons seeking citizenship, asylum, permanent employment or residence in a country, thus leaving out a large part of migration (voluntary, involuntary, legal or illegal). Although there is a large potential for beneficial migration under Mode 4 from developing to developed countries, the commitments scheduled in the GATS under Mode 4 were largely limited to two categories:

intra-company transferees regarded as 'essential personnel', such as managers and technical staff linked with a commercial presence in the host country, and business visitors, who are short-term visitors, generally not gainfully employed in the host country.[3]

Although international migration has the potential to affect global development significantly, there have been scant general multilateral discussions of migration and development. This is in large part because some members of the Organization for Economic Cooperation and Development (OECD) oppose such a discussion. The developing countries not only had little input in the unilateral migration policies of industrialized countries, but they also failed to cooperate among themselves in addressing South–South migration and its possible benefits. Discussions of immigration policy are the realm of the interior ministries; the development and trade ministries are rarely consulted. The result is that immigration policies are set with little regard for their implications abroad (with the possible exception of refugee policies). Indeed, relatively few states have ratified some of the key UN and ILO resolutions on migration. The High Level Dialogue on Migration and Development at the UN in 2006 represented a compromise, after proposals to convene an international conference on the issues had failed. Some of the European states have more recently shown a greater concern for the affects their migration policies have on development in the source countries, resulting in the Global Forum on International Migration and Development initiative in Belgium in July 2007. Meanwhile, a substantial range of bilateral agreements on migration has emerged, given the lack of a multilateral framework. However, very few of these bilateral arrangements involve the least-developed countries.

One further finding from this review of the history of trade negotiations warrants mention. Although rich countries have been able to determine the negotiating agenda for the Uruguay Round and the ongoing Doha Round, they have not prevented developing countries, and more broadly in the design of the rules governing the global trading system, did not prevent the significant integration of the developing countries as a group into the world economy since the 1980s. Of course, not all developing countries shared in the growth in trade, FDI and migration. Nevertheless, the developing countries have achieved considerable levels of integration through changes in domestic policies and institutions in the presence of only limited liberalization of trade, investment and migration flows through international agreements (Srinivasan 2004). Further progress, however, may well depend largely, but not wholly, on policies of rich countries in general and, in the particular case of trade, progress in bringing the Doha Round to a successful conclusion. Unfortunately, the prospects for the latter do not seem bright as of 29 July 2008, with the collapse of the informal ministerial meeting of the WTO at Geneva 21–29 July 2008. There was no

date set to resume negotiations. This meeting was to have concluded with an agreement on modalities (numerical targets for commitments of members) for achieving the objectives of the round, the penultimate stage prior to the final agreement concluding the round. With political uncertainty arising from the forthcoming 2008 US presidential elections, parliamentary elections in India in April 2009 and scheduled expiry of the terms of the European Commission in early 2009, it is unlikely that negotiations will be resumed in the near future.

WHY THIS BOOK?

This volume arose out of a research project organized and funded by the Global Development Network, 'Impact of Rich Countries' Policies on Poverty: Perspectives from the Developing World' (hereafter, Impact Project). This book's primary goal is to contribute to an understanding of how policies implemented by rich countries affect development and poverty in developing and transition countries, while recognizing the complexities involved in such an exercise. By focusing on the perspectives from the developing world, efforts to assess the impact of rich countries' policies will be tailored specifically to the context of individual developing countries. The book will also contribute to the contemporary debate on policy coherence and coordination. This debate centers on the possibilities of making the policies of rich countries mutually consistent and coherent in each country as well as coordinated across countries, so that their combined impact is not only more beneficial, but also quantitatively more significant than the existing set of policies.

We believe that the type of specific studies reported in this volume, if replicated for an increasing number of pairs of policies and impacted developing countries, will help OECD countries design coherent approaches to development by embracing their entire arsenal of relevant policies. More broadly, such studies will also improve our understanding of how the benefits of globalization, in the shape of increased flows of trade and labor for development, can be enhanced while reducing any associated costs. The volume analyzes two main components of the many links in the chain connecting rich countries' policies at one end, and development and poverty in developing countries at the other end.

The first component examines the influence of select OECD policies upon trade, migration and foreign direct investment outcomes for developing regions. Examples reported in the volume include: the impact of non-tariff barriers in OECD countries on exports from Argentina; the effect of bilateral investment treaties on flows of foreign direct investment to the Commonwealth of Independent States and Eastern Europe; and the 'tightness' of migration

policies in Germany, Italy and Spain and their consequences for remittances to families in Romania. These studies should help bolster the negotiating position of developing countries by providing them with empirical evidence to make their arguments as effective and compelling as possible.

The second component relates trade, migration and foreign direct investment to measures of development and development-promoting activities, such as income, employment, poverty and skill acquisition, within developing countries. This reflects a determination to move away from the sweeping assessments of global impact described above and toward country- or region-specific investigations which fully allow for local context. Some of the channels explored in this volume include: the impact of foreign direct investment into Argentina on incomes, employment, skill acquisition, innovation and productivity; the degree of skill diffusion generated by migrants returning from Western Europe; and the impact of lower world agricultural prices on poverty in Colombia. Taken together, these two components help analysts understand not only the impact of existing OECD policies on development and the poor, but also the range of possible changes in these policies to make them more beneficial for development.

Although this book focuses on trade, migration and FDI, many other policies, especially external assistance (bilateral and multilateral), pursued by individual states or groups of rich countries, could potentially affect development and poverty. And even an analysis limited to the subset of external opportunities and constraints represented by the rich countries' policies on trade, investment and migration still runs into a number of problems. For example, the levels of trade barriers as specified in the laws of a country and in its trade agreements and their actually applied levels are often very different. Nevertheless, we believe that the studies reported in this volume and summarized in the remainder of this Introduction provide genuinely new insights regarding impacts in well-defined contexts and, moreover, demonstrate the type of research which is likely to be most illuminating and beneficial from the standpoint of developing countries.

TRADE POLICIES, DEVELOPMENT AND POVERTY

The theoretical and empirical literature on evaluating trade policy is vast. Methodologies used vary enormously, from rigorously grounded theoretical models of partial and general equilibrium[4] to cross-country regressions. Two recent surveys, Goldberg and Pavcnik (2007) and Winters, McCulloch and McKay (2004), are particularly interesting and relevant. Taken together, this literature covers most of the issues relating to trade liberalization of all types (unilateral, preferential, regional and multilateral). The three studies on trade

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