FOREWORD

The World Trade Report 2006 is the fourth in a series launched in 2002. As in previous years, the present Report has taken up a current issue in trade policy. This year we have looked at subsidies. The contribution we hope to make with these Reports is to aid understanding of complex trade policy issues facing governments. This is not intended primarily as a prescriptive Report, but rather as an invitation to deeper reflection, and it is aimed not just at policy-makers but also the public they represent and the individuals and organizations that actively seek to influence government policies. In addition to the core topic, the Report also takes a brief look at recent developments in trade and discusses some salient features of recent trade developments or a particular aspect of trade. This year, the Report looks briefly at trade in textiles and clothing, flows of international receipts and payments of royalties and license fees, trends in the trade of least-developed countries, and the impact of natural disasters and terrorist acts on international trade flows.

Looking first at trade developments in 2005, aggregate real merchandise trade grew by 6.5 per cent, compared with 9 per cent in 2004. The 2005 figure is still above the average growth rate over the last decade, which amounted to slightly less than 6 per cent. A particular feature of the trade scene last year, persisting into the present, is the higher prices of many primary commodities, especially oil. The implications of this tendency are highly varied among countries, both developed and developing, depending on whether they are engaged in commodity production. Taking developing countries as a group, however, higher commodity prices have contributed to the highest share of world trade accounted for by developing countries in more than five decades. The continued strength of China's merchandise exports (in value terms) has been another element in the strong trade performance of developing countries.

The elimination of quota restrictions on textiles and clothing at the beginning of 2005 does not appear to have had a major impact so far on demand or domestic market conditions in the major importing markets – the United States and the EU. What has perceptibly changed, however, is the composition of market shares among exporting countries. China and India, along with a number of other relatively recent market entrants such as Jordan and Peru, have gained market share, while a number of other countries that benefited previously from preferential market access through quotas now account for lower shares. The quotas have only been off for a little more than a year and one should not be too categorical about how the situation will develop. A complicating factor in the analysis is the reintroduction of restrictions on China's exports. Overall, the changed situation raises a number of questions of a developmental nature that merit closer consideration.

The mini-review on changes in international flows of receipts and payments of royalties and licence fees is a proxy – by no means a perfect proxy – of tendencies in respect of high technology investment and production. Some of the results are unsurprising. Developed countries still dominate transactions in both directions, but we do see growth in the share of payments of royalties and licence fees on the part of a number of Asian countries.

The trade of least-developed countries (LDCs) has done better in the aggregate than in recent years, but the increase in the LDC share of global trade is from a very small base and is still well below 1 per cent. Moreover, we are looking at quite mixed results among the LDCs, with some primary commodity exporters doing very well. Only two LDCs account for 35 per cent of the group's total exports and 13 LDCs account for less that one per cent of the total. Progress was made at the Hong Kong Ministerial Meeting in securing duty-free and quota-free access on at least 97 per cent of LDC exports. Moreover, progress is being made in developing the Aid for Trade initiative, whose beneficiaries will include LDCs.

The last of the short thematic essays in Chapter I of the Report, in discussing the effects of disasters and acts of terrorism on trade, tells us that while these events can take a terrible toll in human suffering and inevitably have an impact on trade, the aggregate trade effects often tend to be small. Particular industries are likely to take the brunt of the adverse trade effects, although in the case of enhanced security measures and restrictions reflecting concern about the risks of terrorism, additional transactions costs can have a more broad-based sectoral impact. Governments continue to work on ways of minimizing the latter costs.

Turning to the core theme of the Report, a good deal of material has been put together on subsidies. How do we define them? What can economic theory tell us about them? Why and in what sectors do governments resort to subsidy practices? And what is the role of the WTO Agreement in regulating subsidies in the context of international trade? The Report seeks to answer these questions.

Subsidies defy easy definition. The narrowest definition would not extend beyond budgetary outlays and the broadest might incorporate virtually any government policy resulting in a change in conditions in the market place. The WTO, notably in the Agreement on Subsidies and Countervailing Measures, embraces an approach that seeks to preserve a level playing field between companies, when governments provide financial support. The Report assesses how far this and other definitions used at the national level help to disentangle policy choices facing governments, facilitating a distinction between subsidy practices that distort resource allocation and those that serve a defensible social or economic purpose.

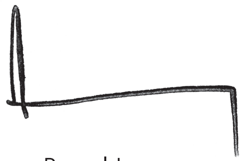
It is clear from the Report that not much can be said *a priori* about the effectiveness of subsidies when pursuing various domestic policy objectives. Much depends on specific circumstances. Economic analysis shows how a subsidy can help when the market allocation of resources is inconsistent with social objectives. An important contribution of economics in this connection is that we can compare the resource costs of pursuing an objective with the benefits that will flow from attaining the objective. Analysis can also reveal whether a subsidy is the best policy among alternatives.

The Report shows that governments have many reasons for subsidizing, including the pursuit of industrial development, supporting the creation of new knowledge through research and development, attaining distributional objectives among members of society, and protecting the environment. Sometimes governments apply subsidies for less defensible reasons, or at least for reasons more likely to disturb economic relations among countries, such as squeezing a strategic advantage out of trading partners. Other stated reasons for subsidizing may have only a tangential or very remote link with economic considerations, such as promoting national security or protecting cultural diversity. Economics is useful here not so much in judging the objective as identifying the most efficient means of attaining it.

A particular contribution of the Report lies in its effort to collect as much information as possible on what governments actually do by way of subsidization. This information on subsidy incidence has been put together from very diverse sources that make comprehensiveness and comparability difficult. Not surprisingly perhaps, sharp differences exist among countries in terms of what they subsidize – some countries favour agriculture, others industry and services. Some countries want to promote new activities, others want to protect existing ones. Some focus on fostering exports. Many countries subsidize infrastructure and social services.

One lesson from the analysis in the Report that I believe deserves particular attention concerns the extraordinary paucity of reliable and systematic information on subsidies. Even in the WTO, many governments are remiss in meeting their notification obligations. It is simply impossible to make good policy or to forge mutually beneficial international cooperation in the absence of information. This is an issue in pressing need of attention by governments.

Finally, the Report's examination of WTO subsidy rules traces the evolution of provisions over time, with continuing additions of detail and precision, against a background informed by the intricacies of legal disputes. The analysis highlights differing views among the WTO membership as to whether the rules are tight enough to prevent unwarranted trade distortions, or accommodating enough to allow governments to pursue particular objectives they regard as important and legitimate, such as promoting development. No easy answer exists to these questions, but one thing is certain – if the rules are not perceived as serving national interests at the same time as promoting international cooperation, adherence will prove no less elusive than the holy grail. Herein lies the challenge for WTO Members, as in so many other areas of international policy cooperation – how to strike accommodations that truly represent shared interests and ensure mutual benefit.



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