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POLICY BRIEF

Lowering Trade Costs: A Key Goal in the Post-2015 Sustainable Development Agenda[1]

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Highlights

The experience of countries in East Asia and an increasing number of developing nations in other regions illustrates the important contribution that lowering trade barriers can make to economic growth and poverty reduction. Firms in low-income countries tend to confront the highest trade costs. There is a rapidly expanding empirical literature that documents the negative effects of high trade costs on the competitiveness of firms in developing economies and on aggregate productivity.

In the post-2015 era greater efforts are needed to help low-income countries benefit more from the trading system; trade barrier reform therefore remains a priority. Given that trade costs are generated by – and can be reduced through – a variety of policies, there is a strong case for the post-2015 Sustainable Development Goals (SDGs) to revisit business as usual and for governments to adopt a specific target that will provide an operational focal point for both national action and international cooperation to reduce such costs. Not only will this ensure that the focus of the post-2015 agenda will be on an area where there is a high benefit-cost ratio, but it will also ensure greater accountability than has been the case with the pursuit of the Millennium Development Goals (MDGs).

1. This policy brief draws in part on Hoekman, B., "The G20 and the global trading system: leveraging the Asia-pacific experience", EUI RSCAS Policy Paper 2014/09.
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Introduction

As stressed in an open letter to the UN Secretary-General signed by 18 leading economic development experts (The International Growth Centre, 14 November 2014), economic growth is critical for sustainable development. Real average per capita incomes in the East Asia and Pacific region have been growing at 5% or higher each year for half a century. But this growth performance has not been emulated in other parts of the world. Per capita incomes in sub-Saharan Africa, for example, increased only 30% since the mid-1960s. The reasons for the differences in growth performance are multi-facetted, but economic policies that increased the costs – reduced the incentives – to engage in international trade are one important factor explaining the observed variation in economic growth. Aggregate growth is a function of the productivity performance of domestic firms, which in turn depends on the ability of efficient companies to grow and realize economies of scale. The openness of markets to foreign competition is a key factor in this regard, especially for small countries. The level of trade-related transactions and operating costs associated with moving goods and services across borders and the access firms have to intermediate inputs needed for production and distribution has been shown to be a driver of economic performance (see for example Djankov et al 2010[3] and Freund and Rocha 2011[4]). The experience of East Asian countries as well as other economies that have successfully used trade to sustain high rates of economic growth over a long period illustrates the high payoffs lowering trade and investment barriers and more generally in reducing trade costs.

For the past decade, the economic development community – governments, international organisations, development agencies – have pursued the Millennium Development Goals (MDGs), a set of specific objectives and goals to be achieved by 2015 that range from halving extreme poverty rates to halting the spread of HIV/AIDS and providing universal primary education. As 2015 began to approach, efforts were launched to consider how to build on the progress that has been made to achieve the MDGs and to agree on priorities areas for action to guide a post-2015 development agenda. The focus of post-2015 deliberations has been to agree on a set of Sustainable Development Goals (SDGs).

Trade was a means of implementation for the MDGs. This is appropriate as trade per se should not be a goal—it is an instrument that can be used to enhance the welfare (real incomes) of households in developing countries. What matters then is to identify actions that can help firms use the trading systems. The actions that were targeted in the MDGs revolved around improving market access for developing countries. Trade was included as one element of a "partnership for development" (MDG Goal 8), with the partnership referring to trade agreements, including the conclusion of the WTO's Doha Development Agenda (DDA) negotiations and the implementation of programmes to grant Least Developed Countries (LDCs) duty-free and quota-free access to high income countries. A weakness of the approach taken towards trade in the MDGs was the absence of quantifiable indicators to incentivise governments and development agencies to deal with the constraints impeding the use of trade to attain the MDGs.

Particularly important in this regard was that the focus of the "partnership" was primarily on just one factor that underpins the high trade costs that inhibit greater use of the trading system by firms in LDCs. In practice market access constraints in export markets are not the binding constraint on trade expansion. This is illustrated by the diverging trade performance of East Asian countries as compared to other developing country regions – East Asia has historically benefitted less from preferential access to markets than other developing regions. The post-1980 experience makes clear that in practice autonomous reforms drive economic development. Trade agreements can help – especially for nations that are land-locked and thus depend on access to neighbouring countries with sea ports – but the key need is to identify

3. Djankov, S., C. Freund and C. Pham, 2010. "Trading on Time," The Review of Economics and Statistics, 92(1): 166-73.
4. Freund, C. and N. Rocha, 2011. "What constrains Africa's exports?," World Bank Economic Review, 25(3): 361-86.

the primary sources of trade costs and to determine what governments should do themselves to reduce trade costs and where others can/should help.

These observations suggest a focus on trade policy reform and trade cost reduction more broadly. Formal barriers to trade in the "lagging" countries are often higher than those prevailing in East Asia and the Pacific; the same is true of trade costs more generally. Nontariff barriers, services trade restrictions and inefficient border management and related sources of real trade costs do not figure much in the discussions on the post-2015 SDGs. Given the extant research on the links between trade expansion and growth, the key role that trade costs play as an impediment to trade and investment in/operation of international supply chains, and the importance of services in overall trade costs (transport and logistics services, related infrastructure), policy attention should focus on ensuring that trade does more to support the achievement of overall growth objectives.

The premise of this policy brief is that a global commitment to significant reductions in trade costs should be part of the post-2015 sustainable development goals. In contrast to, for example, the 2 percentage point increase in economic growth over 5 years that has been adopted as the primary focal point of the G20, which is endogenous and not under the direct control of governments, a trade cost reduction goal can be mapped to specific policies and instruments that governments do control, and has the additional advantage that pursuit of the objective must involve the business community in each country.

Trade targets and the post-2015 sustainable development goals

The High-Level Panel on the Post-2015 Agenda (2013) noted the importance of ensuring that the global trading system is "open and fair", that the WTO is the most effective tool to increase the development impact of trade, and that a successful conclusion of the Doha Development Agenda is a precondition for achieving the post-2015 agenda. It called on bolstering market access for developing countries, including preference programmes and duty-free, quota-free (DFQF) market access for LDCs, measures to simplify and reduce the negative impacts of rules of origin and reducing the trade-distorting agricultural subsidies. This is all encapsulated in the suggested goal for trade: "Support an open, fair and development-friendly trading system, substantially reducing trade-distorting measures, including agricultural subsidies, while improving market access of developing country products."

The Open Working Group (2014) that was formed to discuss possible Sustainable Development Goals (SDGs) in greater detail includes trade objectives in three of the proposed 17 goals, as follows:

- **Proposed goal 8** - Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all.

  8.a) improve Aid for Trade support for developing countries, notably through the Enhanced Integrated Framework for LDCs.

- **Proposed goal 9** - Promote sustainable infrastructure and industrialization and foster innovation.

  9.2) improve regional and trans-border infrastructure to promote regional connectivity and integration and to facilitate trade.

- **Proposed goal 17** - Strengthen the means of implementation and the global partnership for sustainable development.

  Trade

  17.1) promote a universal, rules-based, open, non-discriminatory and equitable multilateral trading system.

  17.2) improve market access for exports of developing countries, in particular Least Developed Countries, African countries, LLDCs[5] and SIDS [6] with a view to significantly increasing their share in global exports, including doubling the LDC share by 2020.

5. Landlocked Developing Countries
6. Small Islands Developing States

17.3) realize timely implementation of duty-free, quota-free market access on a lasting basis for all least developed countries consistent with WTO decisions and the Istanbul Programme of Action.

This list is essentially 'more of the same' in the sense that there is nothing new relative to what has been the focus in the MDG context, and nothing new relative to the approach that has historically been taken in the UN and the GATT/WTO to address economic development concerns and objectives. The only concrete numerical target is to double the global share of Least Developed Countries (LDC) exports by 2020 (although it is not specified what the baseline is and whether this includes trade in services). In any event, this target is already included in the Istanbul Programme of Action (United Nations, 2011), and thus does not add or change anything.

These goals have conceptual and operational weaknesses. One problem is the mercantilist focus on exports as opposed to trade (both exports and imports). The emphasis on duty-free and quota-free (DFQF) market access and (implicitly) export promotion ('double exports') disregards that in practice lack of competitiveness and limited diversification of low-income economies is a result of domestic policies, including import policies. As firms will generally benefit from access to imported inputs that they use to produce exports – or to sell products that compete with imports – the mercantilist bias may misdirect policy attention towards interventions that will have only a low aggregate benefit.

Moreover, LDCs already have DFQF access to many high-income markets. There are important exceptions such as Bangladesh exports to the US, and the large emerging economies can do more, but research has documented that the 'binding market access constraints' are often nontariff measures (NTMs), including restrictive rules of origin. What matters then is helping firms overcome applicable NTMs in the relevant markets, both at home and abroad, and more generally to lower their trade costs.

Finally, trade outcomes are endogenous – they are determined by demand factors, investment decisions by companies located in a large number of countries, the economic cycle, and so forth. Rather than targeting a certain export volume outcome ('double LDC exports') the focus should be on policies or other actions that can be undertaken by governments and for which they can and should be held accountable.

These considerations suggest alternative approaches that have a higher likelihood of mobilising policy reform efforts that will help low-income countries benefit more from the trading system. One option would be to seek agreement on a measurable trade-related indicator that is highly correlated with the realisation of the various trade objectives listed in the SDG working group draft paper and that would provide a concrete focal point for both national action and international cooperation. One candidate is to agree on a trade cost reduction goal – e.g., reduce trade costs for firms operating in low-income countries by X percent by 2020.

There is a precedent for adopting a trade cost target: APEC member governments agreed to a common trade facilitation performance target in two consecutive action plans starting in 2001– setting a goal of reducing trade costs by 10% over the 10 year period on a regional basis (APEC Policy Support Unit, 2012, APEC's Achievements in Trade Facilitation 2007-2010 - Final Assessment of TFAP-II, Singapore: APEC Secretariat). The global community could emulate this initiative, building on and learning from the APEC experience. One possibility would be for every country to commit to reduce trade costs by at least 5 percent in 5 years, and to use international data on trade costs reported by companies to the World Bank on a country-by-country basis as a baseline (World Bank, 2014, Connecting to Compete, 2014, Washington DC: World Bank).

Trade cost reductions would be in the self-interest of each country, but also benefit trading partners and thus be a contribution to the global public good. It is also fully consistent with the growth objective, as lowering trade costs is likely to be a particularly effective mechanism to increase welfare (real incomes) (see, e.g., World Economic Forum, Bain & Co. and World Bank, 2013. Enabling Trade: Valuing Growth Opportunities).

A global commitment to a specific, numerical trade cost reduction target would also send an important signal to international business community that leaders will pursue trade facilitation initiative, including the implementation of the new WTO Agreement on Trade Facilitation (TFA) (see Hoekman, B., "The Bali Trade Facilitation Agreement and rulemaking in the WTO: milestone, mistake or mirage?", EUI RSCAS Working Paper, 2014/102). A trade cost reduction target would provide a concrete focal point for both national action and international cooperation along the lines of what is foreseen in the TFA, but not be limited to the issues that the TFA covers. Indeed, in practice it may be that the most important sources of trade costs and supply chain frictions are related to service sector policies or weaknesses in infrastructure, areas that are not covered by the TFA. A trade cost reduction target leaves it to governments, working with stakeholders (businesses, regulators, consumer organisations), to determine how best to reduce trade costs. It is fully consistent with the call by the B20 Trade Taskforce (2014) to create national supply chain development strategies, as these will have to center on the identification of specific supply chain frictions and actions to address these trade costs.

The added value of a global initiative on trade cost reduction is not just an instrument to increase real incomes, but there is an important public good/collective action dimension. Realising the objective will require high-level political attention to achieve the needed internal coordination within governments and external coordination across governments to pursue cross-border projects and cooperation. A global trade cost reduction initiative will also incentivise the relevant international organisations to focus their activities on assisting governments to reduce trade costs.

Agreeing on and pursuing such a target would be economically superior to the mercantilist approach that is implicit in current SDG proposals. Reducing trade costs is neutral in the sense of benefiting exporters and importers: lower trade costs will benefit households in developing countries by reducing prices of goods. Some of those goods will be inputs used by firms that export – or that might start doing so if their costs fall enough. A major advantage of a trade cost target is that it is left to the governments concerned – both the developing country government and its trading partners – to identify actions that will reduce them. There are many reasons why costs are high, including own trade policies of developing economies, nontariff measures at home and abroad, a lack of trade facilitation, weaknesses in transport and logistics, etc. A trade cost reduction target leaves it to governments to work with stakeholders to identify how best to reduce prevailing excess costs. There is no one size fits all associated with achieving a trade cost reduction target. A trade cost reduction target is consistent with – and arguably superior to – all the objectives embodied in the proposed SDG trade-related goals.

Using a trade cost reduction target as the focal point for trade reforms post-2015 is not a panacea. It has some potential downsides from an efficiency perspective that will need to be addressed. Thus, the lack of guidance given to governments on what actions will lower trade costs the most could result in actions being pursued that do not have the highest benefit-cost ratio.

Recommendations

- Include a measurable trade cost reduction target as a sub-goal of the post-2015 Sustainable Development Goals.
- Involve the business comunity in each country in identifying interventions that will have the greatest impact in reducing trade costs.
- Conduct careful analysis to assess what would have the greatest effect in lowering trade costs while minimising required investments.
- Prompt cooperation among governments in areas where joint (concerted) action can enhance net benefits of interventions.

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