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Trade and the SDGs: Making 'Means of Implementation' a Reality

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Background

The 2030 Agenda for Sustainable Development recognises that international trade is an important mechanism through which many of the specific goals and targets that have been agreed can be achieved. Making trade an effective means of implementation will require action on a broad front. This issue of *Commonwealth Trade Hot Topics* demonstrates how a common denominator of such actions is to reduce the costs of trade. This is so as to permit firms in developing countries to source the inputs they need to be competitive and to give households better access to a range of products and services that will improve their welfare, ranging from food security to health. Many of the sustainable development goals involve services – finance, transport, medical, education, etc. Trade can help improve the availability and quality of services. Thus, efforts to reduce trade costs should include services sectors as well as trade in goods.

International trade and implementation of Sustainable Development Goals (SDGs)

The experience of countries that have successfully used trade to achieve and sustain high rates of economic growth over a long period illustrates the high potential pay-offs to pursuit of a trade-oriented development strategy that exploits international trade and investment opportunities. Trade and foreign direct investment (FDI) are mechanisms that allow firms to exploit economies of scale and specialise in the activities in which they have a competitive advantage and can be powerful sources of technology transfer and knowledge spillovers.

In today's highly integrated world economy where value chains span many countries, the level of trade-related transactions and operating costs is a major determinant of the ability of the most efficient firms to expand their market share. High trade costs increase what firms have to pay for critical inputs of goods and services and decrease the returns they obtain from engaging in exports. Indeed, high trade costs may simply bar productive firms from trading at all, thus precluding them from leveraging the opportunities that are offered by world markets (Figure 1).

Trade costs are not just an issue for the exchange of goods. They also affect trade and investment in services. Regulatory barriers to services trade, such as restricting the ability of foreign providers to offer services through nationality requirements or banning inward foreign direct investment in segments of the transport or communications sectors will increase costs for all firms and make them less competitive. Services generally account for a significant share of the total costs of production of a firm. Actions to facilitate trade in services will increase competition on markets and give firms and households access to services at lower prices and increase the variety of services that

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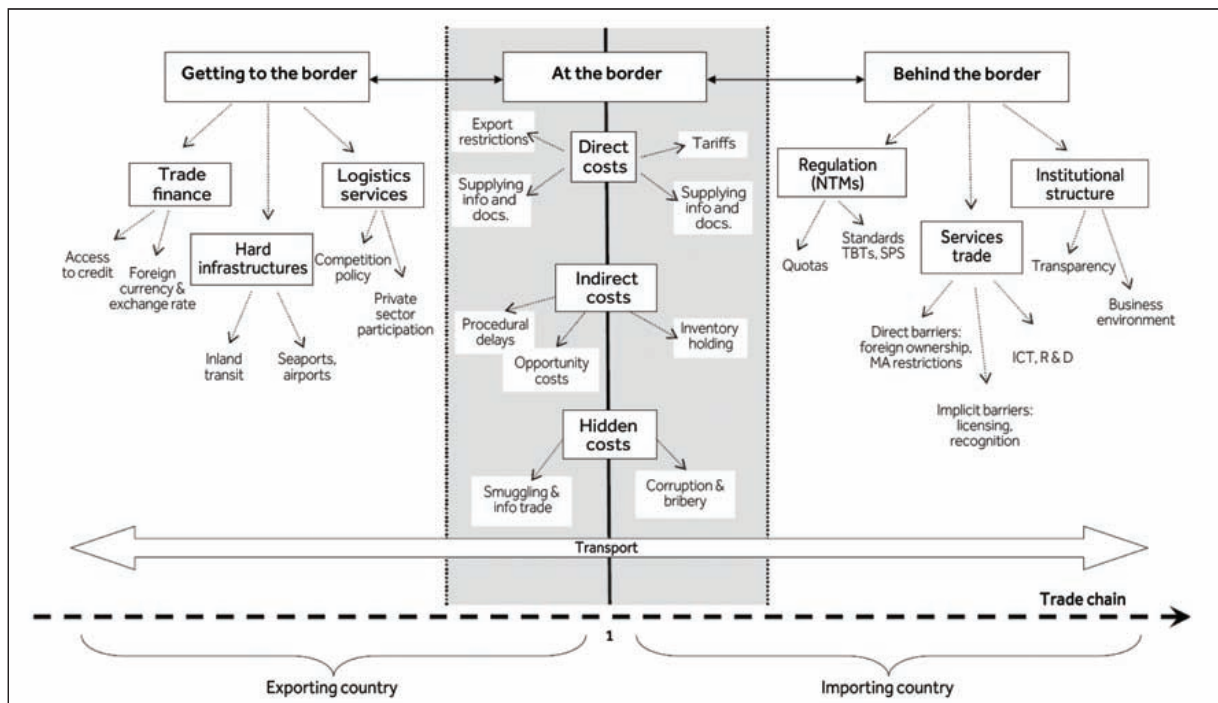
Figure 1: How Trade Costs Matter



Source: Moï se and Le Bris (2015, p. 12)

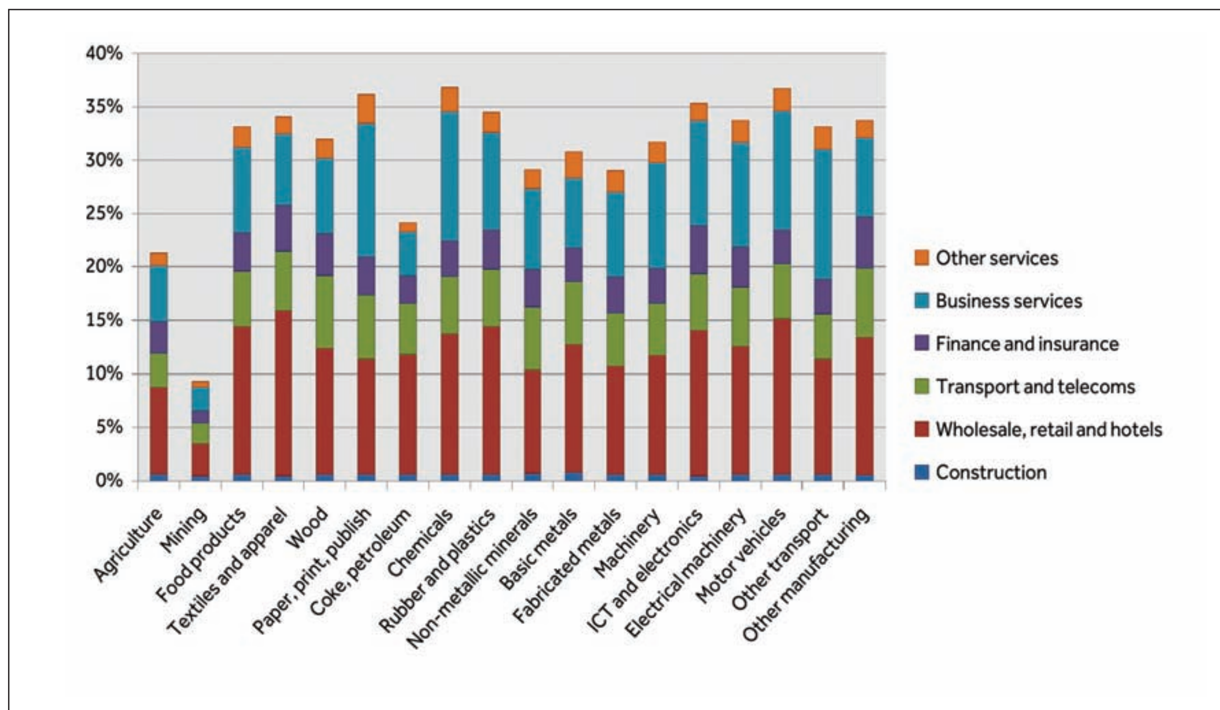
are offered (Francois and Hoekman, 2010). This is not just a domestic policy agenda; equally important is that developing countries can access export markets, including through the temporary cross-border movement of services suppliers – mode 4 in WTO speak. The decision by World Trade Organization members to permit countries to grant preferential access to their services markets to least developed countries (LDCs) – the so-called services waiver – is a good first step forward in this regard.

More generally, attaining sustainable development objectives is to a significant extent a services agenda. Improving health and educational outcomes, reducing regional inequalities through better connectivity by bolstering transport and information and communication technology (ICT) networks and ending poverty all depend on investments in the associated sectors of activity – many of which are services: health, education, transport, telecommunications, etc. Trade and FDI can help improve the supply of, and access to, such services. While there has been much discussion on the need to improve productive capacity in developing countries, this is as important for services as it is for manufacturing. Indeed, the latter depends very importantly on the former (Figure 2).

The 2030 Agenda for Sustainable Development and the associated Sustainable Development Goals (SDGs) (United Nations, 2015b) recognises the potential role of trade as a 'means of implementation' – an instrument that can be used to achieve the SDGs. It is a positive development that trade is more prominent as an instrument to achieve the SDGs than was the case with the Millennium Development Goals. The trade targets that are included in the SDGs and that are somewhat elaborated in the Addis Ababa Action Agenda (UN, 2015a), centre on improving market access for developing countries, concluding the WTO's Doha Development Agenda negotiations and duty-free, quota-free (DFQF) market access for LDCs. These policy areas have long been on the agenda of international trade negotiations. Co-operation in these areas can contribute to sustainable development, but may not do much to address the main constraints that limit the scope for trade to make a positive difference.

A major factor that inhibits more effective use of the global trading system by firms in LDCs is high trade costs. Extensive evidence suggests that trade costs are much higher than prevailing tariff rates of protection. Even if account is taken of non-tariff measures (NTMs), foreign market access barriers in export markets are rarely the binding constraint on trade expansion. The post-1980 experience makes clear that autonomous reforms drive economic development. However, non-tariff barriers and services trade restrictions do not figure prominently in the SDGs and the 2030 agenda.

Figure 2: Services Share of Manufacturing Value Added



Source: OECD-WTO Trade In Value Added Database, June 2015

Trade targets and the 2030 sustainable development agenda

The SDGs reference trade policy and trade-related measures in a number of the specific goals and targets, as follows (UN, 2015b):

- **Goal 2** (*end hunger*) includes a call to correct and prevent trade restrictions and distortions in world agricultural markets, including through the parallel elimination of all forms of agricultural export subsidies and all export measures with equivalent effect.
- **Goal 8** (*decent work and economic growth*) calls on improving Aid for Trade support for developing countries, especially for LDCs, including through the Enhanced Integrated Framework for trade-related technical assistance (EIF).
- **Goal 9** (*industry, innovation and infrastructure*) notes the need for quality, reliable, sustainable and resilient infrastructure, including regional and trans-border infrastructure and increasing the integration of small-scale industrial and other enterprises, in particular in developing countries, into value chains and markets.
- **Goal 10** (*reduce inequality*) stresses the importance of special and differential treatment for developing countries, in accordance with WTO agreements.
- **Goal 14** (*conserve maritime resources*) calls on disciplining (rich countries') fishery subsidies.
- **Goal 17** (*strengthening the means of implementation and the global partnership for sustainable development*) includes language on the importance of:
  - a universal, rules-based, open, non-discriminatory and equitable multilateral trading system under the WTO
  - significantly increasing developing countries' exports, including doubling the share of LDCs by 2020
  - timely implementation of DFQF market access on a lasting basis for all LDCs and ensuring that preferential rules of origin are transparent, simple and contribute to facilitating market access
  - enhancing policy coherence for sustainable development
  - respecting each country's policy space and leadership to establish and implement policies for poverty eradication and sustainable development.

Translating the SDG aspirations into an implementation agenda will require adopting and monitoring specific indicators to help focus attention at the national (developing country

government) and international (partnership) levels on measures to help firms in developing countries utilise trade opportunities. There are many SDGs where trade policy can make a difference. In the case of reducing poverty, attention could focus on reducing anti-poor bias in prevailing trade policies – for example, higher tariffs on products that are important in the consumption basket of poor households. Food security may be enhanced by the removal of not only tariffs and export subsidies, but also trade distorting domestic support for farmers. Access to energy can be enhanced through removing barriers to trade in electricity and energy transport. Growth performance of countries may benefit from diversification and actions to enhance entry and expansion of new firms. In the case of infrastructure, the relevant SDG uses share of rural population with road access as a performance indicator, while from a trade perspective regional/trans-border infrastructure may have a high pay-off, including for the internationalisation of small and medium enterprises (SMEs). However, the UN SDG Indicators website reveals that there is no focus on such indicators. In the case of the trade dimensions of goal 17, performance indicators are limited to the weighted average global tariff, the coverage of DFQF access for LDCs, and development assistance (see http: //unstats.un.org/sdgs/).

Indicators to monitor progress in making trade a means of implementation

Non-tariff measures, behind-the-border regulatory regimes, product standards, connectivity to land, air and maritime transport networks are all policy areas that loom large for developing countries looking to leverage trade to support progress towards the SDGs. They are not the current focus of SDG indicators. While specific policy focus areas will differ across countries and regions, common elements will feature in most countries. One is trade facilitation, logistics performance and international transit regimes. Another is improving access by firms and households to competitively-priced, quality services. As mentioned, services matter not just for trade as an instrument or means of implementation but also for the attainment of specific sustainable development goals.

Focusing on trade costs as an indicator of progress is useful from an economic policy point of view because they highlight that action on a broad front is necessary to reduce distortions in international markets. Trade costs are affected by operating conditions in key backbone services markets, like transport, telecommunications, distribution, finance, and professional services – as well as by product and factor market regulation and their enforcement. From a trade perspective it is not just the effects of prevailing policies across markets and activities in a country that matter. *Differences* across countries in policies applying to a given good or services also give rise to trade costs. It is important to consider both goods and services and the links between them in efforts to identify and reduce sources of trade costs as goods and services cannot be separated in the current era of international production and global value chains (GVCs). More generally, the time it takes to get goods from a producer to a buyer is an important determinant of trade costs (Hummels and Schaur, 2013).

Extensive research has shown that trade costs are substantially higher in poor countries than elsewhere (Arvis et al., 2015). Poor countries also confront higher international trade costs. The result is that firms in these countries – most notably the LDCs – are at a competitive disadvantage. High trade costs are one reason many African countries have a very narrow export base, whether measured in terms of the number of products that account for most revenue earned, the number of export markets or the number of companies that export. Every extra day it takes in Africa to get a consignment to its destination is equivalent to a 1.5 per cent additional tax (Freund and Rocha, 2011). Slow and unpredictable land transport keeps most of Sub-Saharan Africa out of manufacturing value chains (Christ and Ferrantino, 2011).

Higher value added products and intermediate inputs such as machinery parts and components are more sensitive to the quality of logistics services and efficient border clearance than trade in other types of goods (Saslavsky and Shepherd, 2012). Porto et al. (2011) find that greater competition among downstream service providers – such as processors and transport providers – in a sample of African countries would benefit farmers by increasing farm gate prices. Using a large sample of countries and firm-level data, Hoekman and Shepherd (2015a) show that services productivity is a statistically significant determinant of the productivity of manufacturing firms. Many landlocked countries restrict trade in services that are particularly important for value chain participation and investments. Road and air transport policies are significantly more restrictive

in landlocked Sub-Saharan African countries than in comparators, reducing connectivity with the rest of the world by increasing the cost of transport services (Arvis et al., 2010). Borchert et al. (2015) conclude that even moderate liberalisation of air transportation services could lead to a 25 per cent increase in the number of flights.

These considerations suggest using specific trade cost indicators to mobilise actions to help low-income countries benefit more from the trading system. Given the importance of access to services for many of the SDGs and more generally the link between the productivity of the services sectors and economic growth and development (Francois and Hoekman, 2010), such indicators should include measures of trade and investment policy for services. As noted above, many services are inputs into production – a substantial share of production and operating costs of firms, no matter what sector of activity they are engaged in, will comprise services (Figure 2). The cost, quality and variety of available services will therefore be a determinant of the competitiveness and productivity of firms. In turn, lowering services trade and investment barriers is likely to have both direct and indirect positive effects on economy-wide productivity. Barriers to trade and investment in services are often much higher than for goods (Figure 3). High barriers to trade in services and high trade costs for services are also detrimental to growth prospects given that services 'are the future' – technological changes are rapidly increasing the share of products that are digital or that can be digitised.

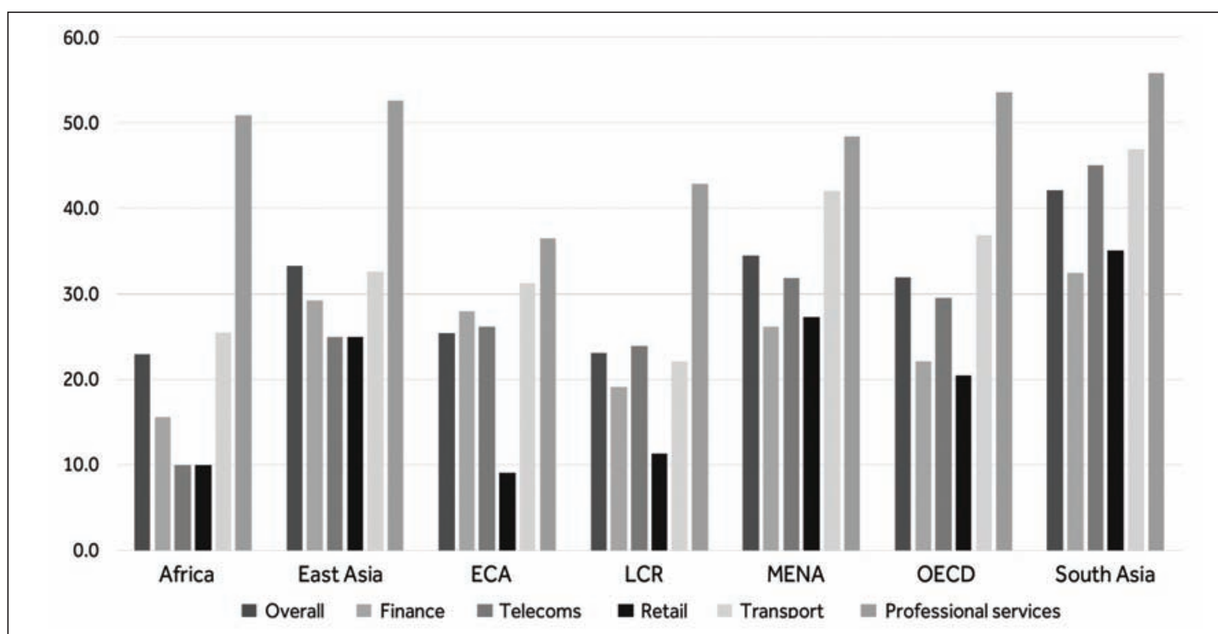
Too little is known about the nature and extent of trade costs in services markets, and how these in turn impact on the competitiveness of firms producing agricultural and manufactured products. This is an area that is of great importance from a development perspective, especially against a backdrop of increasing GVC activity, where services and trade in services is crucial for the integration of firms into – and the operation of – value chains. Although information on services dependence at the firm level and services trade costs is limited, new datasets have been developed recently that characterise the policy stance of governments towards trade and investment in services. Examples include the World Bank's Services Trade Restrictiveness Indicators. These illustrate that barriers to trade in services are significant, but also that in some developing countries formal barriers to trade in services are relatively low (Figure 3). Recent research suggests that the trade cost reduction pay-off to lower barriers to services trade is a function of the quality of the investment climate more generally – liberalisation by itself is not enough (Beverelli, Fiorini and Hoekman, 2015). While data on the role of services in the economy and trade in services have been improving, there is extensive work to be done to improve the coverage and quality of data on services policies, services performance and services trade costs. Leveraging the 2030 sustainable development agenda to mobilise more work in this area would have a high pay-off both in being able to better monitor progress in reducing trade costs and in assessing the services performance dimensions of specific SDGs.

A focus on trade cost indicators for goods *and* services

Focusing on monitoring trade costs trends would help inform the global community as to the most effective measures available to help promote the use of trade as a means to achieve the SDGs. There is a precedent for adopting a trade cost target: Asia–Pacific Economic Cooperation (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 per cent over the 10-year period on a regional basis (APEC Policy Support Unit, 2012). Emulating this initiative and building on and learning from the APEC experience could be one element of monitoring progress in leveraging trade for sustainable development. One possibility would be for countries to establish a target for reducing trade costs over a number of years (Hoekman and Shepherd, 2015b) – for example, to lower costs of trade for goods and services by 1 per cent per annum through to 2030.

An international effort to track the development of trade costs can build on existing datasets. Recent developments in the empirical international trade literature have made it possible to infer trade costs for a wide variety of countries from 1995 onwards, with a data lag of around two years for many countries. The UN Economic and Social Commission for Asia and the Pacific (UNESCAP) and the World Bank have partnered to produce a Trade Costs Database, which contains bilateral trade costs in manufacturing and agriculture for more than 150 countries. The UNESCAP and World Bank effort provides information on the evolution of trade costs through time in different income groups and regions. The methodology used involves a comparison of

Figure 3: Services Trade Restrictiveness Indicators



Source: World Bank STRI database

domestic costs of trade within countries and that applying to international transactions of goods. It captures all sources of trade costs, not just the costs associated with specific policies. While this is a disadvantage from a policy reform perspective in that it does not help governments identify priority areas for action, it is an objective measure of overall trade costs on a country-by-country basis and thus allows for the tracking over time of the impact of efforts to lower trade costs. That said, research is needed to 'unpack' overall trade costs estimates into their determinants, distinguishing between factors that can be affected by policy changes and public investments, factors that require international co-operation (e.g. including those which should be addressed in the context of regional trade agreements), and factors that cannot be changed. Specific initiatives such as the efforts to collect data on services trade policies, transport costs and logistics performance on a country-by-country basis by various international organisations already permit an initial 'unpacking' and mapping of how different policies impact on trade costs.

A focus on reducing trade costs is fully consistent with growth and poverty reduction efforts; lowering trade costs is likely to be a particularly effective mechanism to increase welfare (real incomes). While trade cost reductions are in the self-interest of all countries to pursue, they also benefit trading partners and thus contribute to sustainable development more broadly. The added value of a global initiative on trade cost reduction is not just as an instrument to increase real incomes and attain sustainable development goals, there is also an important public good/collective action dimension. In practice reducing trade costs will require high-level political attention to achieve the needed internal co-ordination within governments, as well as external co-ordination and co-operation across governments to identify and implement cross-border projects and joint ventures that benefit both the countries directly concerned and traders.

A global trade cost reduction initiative can also help to incentivise the relevant international organisations to focus their activities on assisting governments to reduce trade costs. Currently, the international development community is gearing up to assist countries to implement the new WTO Agreement on Trade Facilitation (TFA). But the trade costs agenda goes far beyond what is covered by this agreement (as illustrated by Figure 1). Use of trade cost indicators would help to provide a concrete focal point for both national action and international co-operation, along the lines of what is foreseen in the TFA but with a more holistic frame of reference. In practice it may be that the most important sources of trade costs and supply chain frictions concern areas that are not covered by the TFA, for example, service sector

policies or weaknesses in infrastructure. A trade cost reduction target leaves it to governments, working with stakeholders to determine how best to reduce trade costs, thereby leveraging the implementation of the TFA.

Agreeing on and pursuing trade cost reductions 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, non-tariff 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 all the trade elements of the SDGs.

Using a trade cost reduction target as the focal point for the 2030 sustainable development agenda is of course not a panacea. The specific trade-related action items that are listed in the SDGs are also important. The same is true for regional integration. As recognised in United Nations (2015a), this process can be an important catalyst for expanded participation in regional and global value chains. The improvement of regional transport infrastructure and networks should be supported by the development community.

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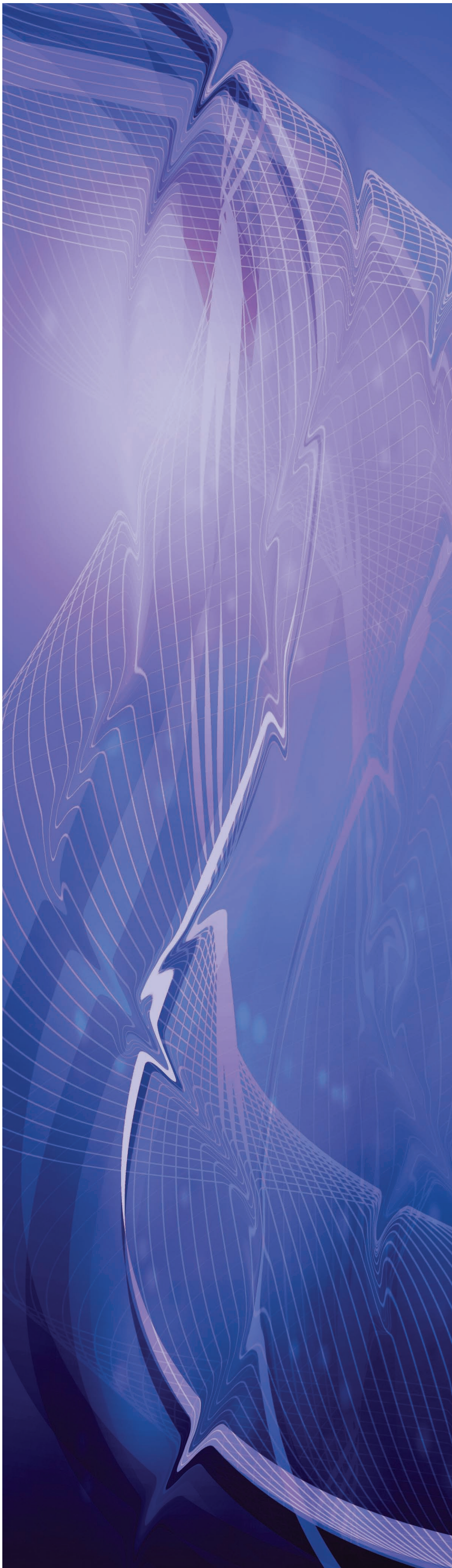

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