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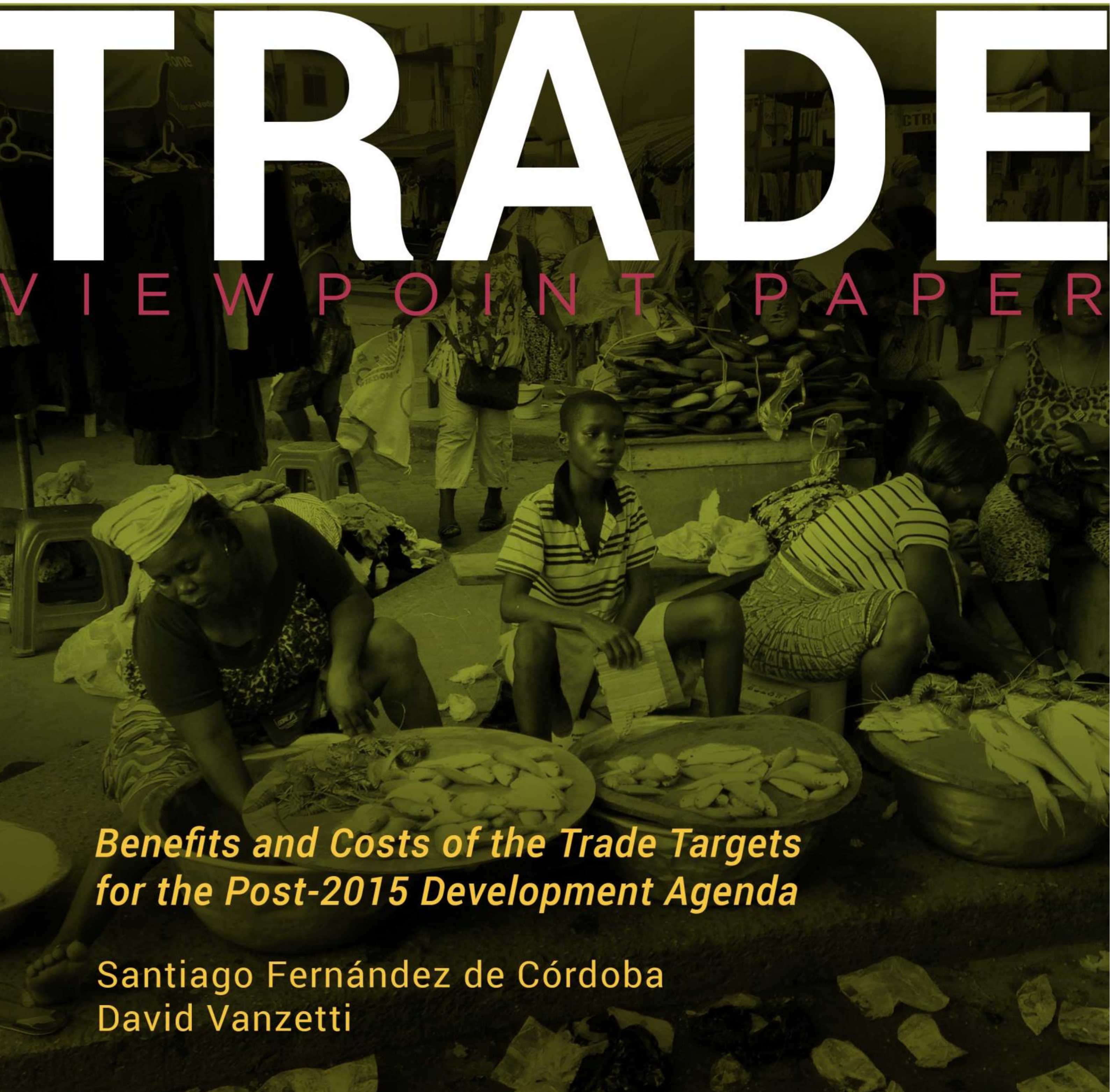

TRADE

VIEWPOINT PAPER

Benefits and Costs of the Trade Targets for the Post-2015 Development Agenda

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Introduction

In response to today's global development challenges, the international community is designing an agenda beyond 2015 with poverty eradication and sustainable development at its core. The United Nations Post-2015 Development Agenda seeks to deepen and extend efforts pursuant to the Millennium Development Goals (MDGs), while the Sustainable Development Goals (SDGs) called for in the Rio+20 Conference, aims to advance principles for sustainable development adopted at the 1992 Rio Earth Summit and promulgated through Agenda 21. Today, these efforts are in the process of converging in one Post-2015 Development Framework centred on poverty eradication at the core, and embracing the three dimensions of sustainable development – that are environmental, economic and social - at the same time.

The Post-2015 SDGs and Trade

In on-going discussions international trade comes up as a key policy area for the design of the post-2015 SDGs. In particular, trade specifically shows as one of the issues linked to "the means of implementation and global partnership for sustainable development"[1] to achieve the SDGs. The so-called "Zero Draft", issued by the Open Working Group Chairs[2], as the basis for the SDGs negotiations, proposes 17 Goals with 212 targets linked to the goals. Out of all the targets, 11 targets have direct reference to issues discussed within the WTO multilateral framework. Most of these trade-related targets are under the proposed goal 17, which aims to "Strengthen the means of implementation and the global partnership for sustainable development." In the latest draft (Zero Draft Rev. 1) there are three points relating specifically to trade. These refer to:

i. a universal, rules-based, open, non-discriminatory and equitable multilateral trading system;
ii. the need to improve market access for exports of developing countries; and
iii. duty-free, quota-free market access for LDCs.

However, there is no reference to concluding the Doha Round as a priority.

The Zero Draft has a significant number of targets that are related to economic issues. There are around 40 such targets, all of which bear direct implications to the effectiveness of trade as a development enabler. These "economic-development" targets include, for instance, the need to reduce global food price instability and the need for inclusive and sustainable business practices particularly.

[1] See the Working Document of the Open Working Group the 11th session. (http://sustainabledevelopment.un.org/)

[2] How are the post-2015 SDGs being presently negotiated? The 2010 MDG Summit requested the United Nations Secretary-General to initiate thinking on the global development agenda beyond 2015. The outcome document of the 2012 Rio+20 Conference on Sustainable Development initiated an inclusive process to develop a set of sustainable development goals. There is broad agreement that the two processes should be closely linked and should ultimately converge in one global development agenda beyond 2015 with sustainable development at its core. The Rio+20 mandated the creation of an Open Working Group of the UN General Assembly is mandated to prepare a proposal on SDGs for consideration by the Assembly at its 68th session (Sept. 2013 – Sept. 2014). The Open Working Group was established on 22nd of January 2013.

Trade and Development[3]

Economic growth is itself a necessary but not sufficient condition to achieve a broader development outcome. International trade tends to have a positive relationship with economic growth, and hence development, although the relationship is not strong and the direction of causality not obvious. Economic growth depends on the use of factors of production, capital, labour, land and natural resources. The major factor is capital. The output obtained by combining these factors depends on productivity, which may improve by 1 to 2 per cent per year. Economic literature has shown the strong link between higher productivity and international trade, which therefore leads to higher economic growth. Hence, a successful post-2015 SDGs should totally leverage international trade to stimulate sustainable development globally.

The link between trade and poverty is less clear. However, in the past couple of decades, poverty reduction coincided with expansion in world trade and global GDP. Since the mid-1980s, world trade grew on average at around 6 per cent per annum and the world GDP at around 3 per cent. The trade-to-GDP ratio of the world increased from an average of 30 in 1986-1990 to 50 in 2008-2012. The change in the trade-to-GDP ratio was particularly high among low-income countries: from 27 to 53 over the same period.

Much progress has been made towards the goal of an open, rules-based, multilateral trading system. Traditional trade market access barriers, such as tariffs, have been reduced considerably during the past decades. High income country applied mfn tariffs on imports from developing countries are now 4.7 per cent for agricultural products and 3.1 per cent for industrial products. However, significant peaks remain, particularly in agriculture, textiles, clothing and footwear, and motor vehicles. The highest EU tariff for example is 605 per cent for some dairy products. The highest Japanese tariff is trade in services. With further multilateral liberalization stalled, many developing countries are 692 per cent. Moreover, developed countries' tariff peaks in sectors of export interest for developing countries constrain the ability for these developing countries to grow and diversify their exports. High tariffs in developing countries continue to inhibit south-south trade. There are also many barriers to negotiating regional trade agreements. Rather than merely reducing tariffs, these require behind-the-border reforms in areas such as investment, competition, government procurement, state-owned enterprises and intellectual property. These areas are a challenge for many developing countries.

The Importance of Non-Tariff Measures in the Post-2015 Sustainable Development Goals

With the reduction in tariffs in recent years the most important debates today surrounding trade market access are in the area of Non-Tariff Measures (NTMs). NTMs are defined as policy measures, other than ordinary customs duries, that can have an economic effect on international trade. NTMs thus include a wide and diverse array of policies that countries apply to imported and exported goods. Some NTMs are manifestly employed as instruments of commercial policy (e.g. subsidies, trade defence measures), whilst others stem from non-trade policy objectives (e.g. food safety and environmental protection). Regardless of the legitimacy and intention, NTMs are thought to have important restrictive and distortionary effects on international trade.

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[3] Under the Millennium Development Goal (MDG) 1 "Eradicate extreme poverty and hunger", the number of people in extreme poverty declined by half (i.e. by 700 million people) in the period between 1990 and 2010, 5 years ahead of the target date. These concurrent changes may suggest that a nexus connecting international trade, economic growth and poverty reduction functioned particularly well in the past three decades.

These measures can have a variety of effects on developing country exports. In the short term, they increase the costs of production, because upgrading is necessary to meet international standards and requirements that are stricter than, or simply different from, domestic ones. In the medium term, however, compliance with stricter foreign standards and regulations can give rise to higher quality production, and thus higher value added. At least initially, though, NTMs can pose problems for developing countries with low productive capacity.

The impacts of technical NTMs are complex: they vary across firms depending on the time frame used, as well as the characteristics of each individual business, such as size, productivity, and ability to access finance to cover production upgrading. At the same time, the political economy of facilitating market access, for example, in cases of divergent standards is fundamentally different from the case of traditional trade barriers, like tariffs. Most product standards are not about protectionism, but rather the protection of legitimate interests such as consumer safety, health, and the environment, although in some cases these measures are disguised ways of protecting ones market.

Furthermore, Global Value Chains (GVCs) have become for both developed and developing countries a key feature of world trade. Production fragmentation has created a new trade paradigm, where intermediate goods and services move from one country to another before becoming part of a final export. The geographical location of production of goods is driven by the availability of skills and materials, and depends in particular on their competitive cost and quality. These chains of related activities result in more "added value" than the value of the constituent parts and processes taken together. Furthermore, key elements like changes in the business and regulatory environment, new technologies, and the systematic liberalization of trade can have a significant impact on this new pattern of trade. With GVCs dominating world trade and components crossing borders many times, addressing NTMs, which cover both goods and services, would have large impacts on business costs reduction and would therefore boost growth. Furthermore, technical NTMs are particularly important for developing country exporters in the context of GVCs. Firms taking part in GVCs typically require parts and components as well as other inputs to be standardized to particular levels of quality and safety. The ability to comply with such measures is thus a necessary condition for joining and moving up in GVCs.

Non-Tariff Measures and Developing Countries

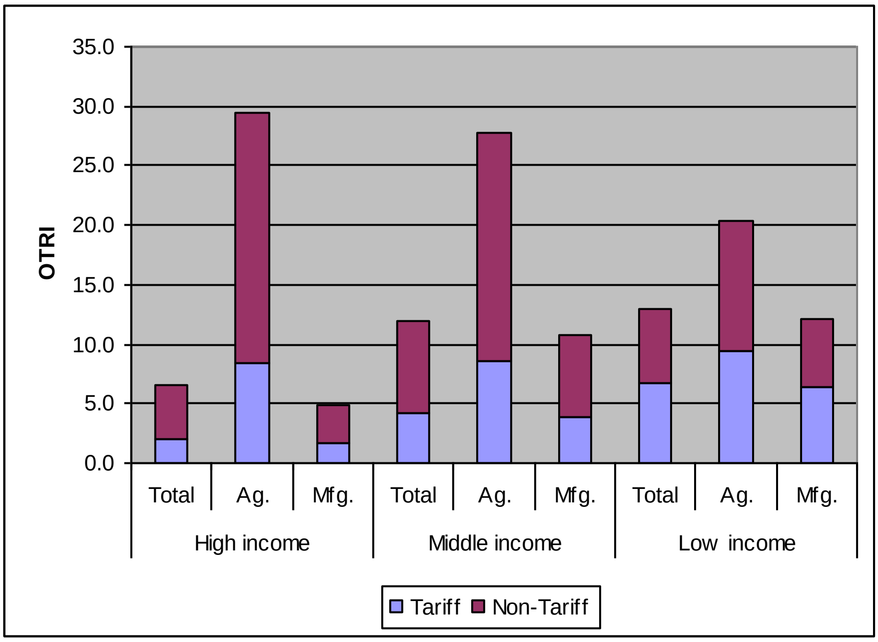
NTMs are of particular relevance to developing countries, especially the implications that NTMs have on their market access as well as for development and consumer protection. One concern is that developing countries often have a more limited capacity for meeting the NTM requirements in their export markets. This is due to a less advanced production process, technology, weaker trade-related infrastructure and inadequate export services. Another concern is that NTMs are frequently applied to product groups of particular export interest to developing countries. Access to information may also be a problem as many developing countries do not always have the resources to assess the nature and implications of the NTMs that their exports face as well as the ones they apply on their imports.

The importance of NTMs can be shown through their actual impact on international trade. UNCTAD analysis shows that NTMs greatly restrict international trade[4]. Their contribution to overall trade restrictiveness is generally much higher than that of tariffs. Large differences in the

[4] *Source*: *"Non-Tariff Measures to Trade: Economic and Policy Issues for Developing Countries",* UNCTAD 2013.

restrictiveness of NTMs are observed between agricultural and manufacturing products, with sanitary and phyto-sanitary (SPS) measures adding substantially to the level of restrictiveness of the agricultural sector. Many of these measures may be legitimate, but many are not. For high- and middle-income countries the effect of trade policies on the agricultural sector is estimated to represent on average almost 30 per cent of the value, with about 20 percentage points due to NTMs.

Figure: Overall level of restrictiveness imposed on imports (OTRI)



Source: "Non-Tariff Measures to Trade: Economic and Policy Issues for Developing Countries", UNCTAD 2013

The Structural Adjustment Process of Trade Liberalization

Trade and its liberalization of goods and services, through bilateral, regional or multilateral negotiations, provide an opportunity for important gains for developing countries in the longer term. The standard argument is that trade liberalization improves efficiency in the allocation of scarce resources in an economy, enhances economic welfare and contributes to economic growth. The global gains from trade can be substantial. Our estimates on global annual welfare gains from multilateral liberalization (WTO Doha Round) are in the order of $100-$200 billion[5]. While these results seem impressive, the percentage changes in aggregate welfare are relatively minor – in many cases, less than 1 per cent. Some policy makers emphasize the importance of governance rather than openness per se. Given the importance of capital to economic growth, domestic and international investors need some assurance that they will receive a competitive return on investment. The role of governance is critical.

Structural adjustment to trade shocks is a common political issue, but there is less academic debate and little empirical data on the process of adjustment to trade liberalization. There are cases where rapid adjustment seems to have created few problems while in other cases there have been major disruptions.[6] As economies open up, imports use existing channels while new exports often come from different sectors that have to gear up production and find new markets.

[5] "*Now What? Searching for a Solution to the WTO Industrial Tariff Negotiations*", S. Fernandez de Cordoba and D. Vanzetti (2006).
[6] Francois, Jensen and Peters (2012) provide a useful review of the discussion. "Trade adjustment costs and assistance: The labour market dynamics", in Jensen, Peters and Salazar-Xirinachs (eds) *Trade and Employment: From Myths to Facts*, ILO, Geneva.

The results from general equilibrium models conceal important sectoral variations: while the exports and production of some sectors are likely to expand considerably, other sectors may suffer large contractions of output and employment as imports increase. This depends of course on how narrowly defined the sectors are specified. Undoubtedly, some individuals bear the brunt of the adjustment with a period of unemployment or reduced wages or returns on capital.

The structural unemployment that occurs as this transition takes place is perhaps the major social cost of adjusting to trade reforms. There are several policies that can be implemented to ease these adjustment costs. One is to phase in tariff reductions. Many regional trade agreements have a ten year phase in period for poorer countries, with some examples of 15 to 20 years. Sectoral changes occur against underlying growth, just as for the economy as a whole. Over the ten year phase in period, an economy growing at seven per cent a year will double in size. Against this expansion, a five or ten per cent contraction is easy to accommodate. The adjustment pressures are quite different because they do not involve the unemployment of labour or the writing off of capital.

Other trade policy approaches include early announcement of the policy change and safeguard measures. Labour market policies include training and unemployment insurance, and measures to help workers relocate. These measures can be specifically targeted to trade affected workers. A wage subsidy to specific workers may be an efficient means of easing the burden of adjustment. Unfortunately, most developing countries do not have well-developed social safety nets, particularly where there is a large informal economy. These nets are important. Without them, workers and the owners of capital are reluctant to take on risky but potentially profitable ventures.

Support Policies, Aid for Trade and Economic Integration

Although the Bali Ministerial Conference of the World Trade Organization (WTO) was successful in reaching an accord, it has been criticized as lacking in the traditional substance of trade liberalization, such as improved market access in agricultural and industrial products, as well as services. The Trade Facilitation Agreement explicitly combines meaningful upgrades in the technology that drives trade relations with provisions that allow developing countries to effectively tailor individual approaches to special and differential treatment, including by designating certain obligations as requiring technical assistance and capacity building prior to implementation. Notwithstanding this partial success, however, the Doha Development Round seems to be paralysed and not encouraging for future efforts at broad-based multilateral liberalization.

Together with these developments, Regional, Preferential Trade Agreements and what is called Mega-Regional Preferential Trade Agreements are becoming increasingly important instruments of trade policy. The links between these agreements and development objectives are ambiguous, and a key policy question is how to make trade agreements work effectively as tools of development, given that any preferential agreement benefits members at the expense of non-members, and members themselves can become worse with the loss of tariff revenue when switching from low-cost to high cost sources of imports.

One way forward is Aid for Trade, including technical assistance and capacity building. Aid for Trade has had some successes since it was launched in 2005, primarily in addressing supply side and institutional constraints, such as infrastructure (e.g. roads and ports). However, the benefits for LDCs in particular seem to be modest, with little improvement in increased exports, export diversification, growth and poverty reduction.[7] Furthermore, cooperation in areas such as product standards is particularly important. The possibility of targeted and predictable Aid for Trade can make it possible for developing countries to take on reform projects that would otherwise be challenging in a context of limited technical and financial capacity.

More to Do

Trade liberalisation is a two-edged sword. Like a new road into a remote village, integration can also bring in competition as well as market access. In spite of possible negative consequences, integrating into larger markets, whether domestically though improved infrastructure, or internationally through reductions in trade costs, is generally regarded as the key to economic growth.

Trade provides competition and also encourages investment and the use of better technology. To assist integration of poor economies into the global market, multilateral agreements are most likely preferable to regional or bilateral approaches. Early announcement and long phase-in periods will assist the adjustment process, and some flexibility seems to be required to negotiate an agreement. Flexibility should not be so great as to limit ambition. With the reduction of tariffs and trade costs associated with transport, non-tariff measures and private standards remain a conspicuous barrier. Transparency is the key to determining whether the non-tariff measures, such as Sanitary and Phyto-Sanitary, are legitimate or not, while developing countries need assistance in meeting regulatory standards.[8]

While trade is most likely a necessary condition for growth, other factors are needed. Investment is the key. Capital needs to be allocated correctly and used productively. Governance is critical. There are many behind-the-border reforms that developing countries could implement to help themselves integrate into the global economy.

While positive, the relationship between growth and the specific SDGs is not strong. While specific SDGs can be targeted with specific policies, growth provides the scope for tackling all or many of the proposed goals without obvious trade-offs. It is not necessary to take resources away from one goal while achieving another. A rising tide lifts all boats.

[7] UNCTAD (2012) "Aid for trade: A failing grade in LDCs?" Policy Brief No 2, April. Geneva. http://unctad.org/en/PublicationsLibrary/uxiiipb2012d2_en.pdf.

[8] UNCTAD has a program to document non-tariff measures. UNCTAD (2012) "Non-Tariff Measures to Trade: Economic and Policy Issues for Developing Countries" http://unctad.org/en/PublicationsLibrary/ditctab20121_en.pdf.

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