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TRADE

PERSPECTIVE PAPER

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

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Post-2015 Consensus

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Introduction

Global flows of goods and services in 2012 were some US\$22 trillion, equivalent to about 60 percent of global GDP. As recently as 1990 the ratio of trade to global GDP was only 40 percent. The unprecedented 20 percentage point increase in just over two decades was driven by policy reforms and changes in technologies.¹ Trade growth has been accompanied by rising real per capita incomes around the globe. East Asian countries have been the stellar performers, most recently and notably China, in sustaining very high rates of real growth over several decades. According to the World Bank's World Development Indicators database, measured in constant 2005 US dollars, average per capita incomes in the East Asia and Pacific region have been growing at 5% or higher for half a century, rising more than 1500% since the early 1960s. But this growth performance has not been emulated in other parts of the world. Real per capita incomes in sub-Saharan Africa, for example, increased only 30% in the last 50 years (ITC, 2014).

The reasons for the differences in growth performance are multi-faceted, and include international and domestic civil conflicts and weak institutions. But economic policies that increased the costs of trade either deliberately or inadvertently are an important factor explaining the observed variation in the ability of countries to exploit trade opportunities.² Trade growth performance is a function of the competitiveness of domestic firms, which in turn is determined in part by the level of trade-related transactions and operating costs associated with moving goods and services across borders, and the access that firms have to intermediate inputs needed for production and distribution. 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 to efforts to lower formal trade and investment barriers (policies that discriminate against foreign products and foreign-owned firms) and more generally reducing trade costs.

The Doha Round and Asia-Pacific Trade Liberalization

Anderson (2014) discusses the costs and benefits of targeting remaining global trade distortions as part of the UN's Post-2015 agenda. He argues that completing the long-standing effort to liberalize global trade under auspices of the WTO Doha Development Round (DDA) will generate a large welfare gain and have a high benefit-cost ratio for the world as a whole and for developing nations. However, the DDA has been deadlocked since

¹ Technological changes include advances in information and communication technology (ICT), which led to a sharp drop in the costs of international telecommunications, and the adoption of containerization and other improvements in logistics, which led to a sharp fall in unit transport costs (Hummels and Schaur, 2013). Average tariffs were in the 20–30 percent range in 1950 (WTO 2007); today the average tariff equivalent of import protection is in 5–10 percent (Kee, Nicita, and Olarreaga 2009).

² There is an extensive literature on the links between outward-oriented development strategies and economic growth performance. Anderson (2014) refers to some of the relevant research, much of which has been discussed at greater length in his earlier papers for the Copenhagen Consensus project. Recent research has documented the importance of trade costs, including the costs of delays and uncertainty created by administrative procedures and red tape, as well as barriers to trade in services, as a driver of competitiveness. See e.g., Arnold et al. (2011), Arvis et al. (2010), Cadot and Malouche (2012), Djankov et al. (2010), Estevadeordal and Taylor (2013), Freund and Rocha (2011) and Hummels and Schur (2013).

2008 and prospects for concluding these talks successfully remain uncertain. The major OECD nations – led by the US – have in recent years shifted towards the pursuit of regional and sectoral trade negotiations outside the WTO – most notably the Trans-Pacific Partnership, an initiative that spans 12 countries, (the US, Canada, Mexico, Japan, Australia, New Zealand, Chile, Peru, Malaysia, Brunei, Singapore and Vietnam) and an effort among 23 WTO Members to conclude a Trade in Services Agreement (TiSA).³ In addition to such regional and multi-country initiatives, the US and the EU are also pursuing bilateral trade and investment agreements, including with each other (the Transatlantic Trade and Investment Partnership—TTIP). A key feature of these efforts involving the US is that they do not include Brazil, China, India, Russia or South Africa (the so-called BRICS), countries that collectively have accounted for much of the global growth and poverty reduction realized in the last 2-3 decades.

The pursuit of regionalism is not limited to the EU and the US. China is active in a number of efforts that aim at liberalizing trade on a regional and preferential basis, including the Regional Comprehensive Partnership,⁴ which does not include the EU or the US. Many developing countries are also engaged in regional trade negotiations and agreements, especially in Africa, where leaders have committed to the creation of a continental Tri-Partite free trade agreement that will bring together the members of the Southern Africa Development Community (SADC); the East African Community (EAC); and the Common Market of Eastern and Southern Africa (COMESA). However, some major emerging economies – e.g., Brazil and India – are less active in pursuing trade integration agreements.

Anderson (2014) discusses extant research on the potential net welfare benefit that could be generated by a DDA agreement – the preferred scenario as this would be a global deal – as well as research assessing three alternative ways of liberalizing trade further in the part of the world that has already done a lot to leverage trade opportunities – the Asia-Pacific region. The three alternatives comprise the TPP, ASEAN+3 (the 10 ASEAN nations plus China, Japan and Korea), and an Asia-Pacific FTA (FTAAP) encompassing all APEC economies (which includes China). He argues that completing the DDA would have the highest benefit/cost (B/C) ratio, and highest aggregate net benefit, for both the world economy (B/C ratio of ~1,300-2,800 and a net present value of US\$772 trillion in 2007 US dollars globally) and for developing countries as a group (B/C ratio of ~2,100-4,700). The Trans-Pacific Partnership (TPP) would yield a B/C ratio of 800-1,700 for the world economy and 1,800-3,300 for developing countries; but if that were to be expanded into a free trade area of the Asia-Pacific (FTAAP) those ratios would rise to ~1,100-2,400 for the world and ~1,600-3,500 for developing countries.

³ The TiSA talks span Australia, Canada, Chile, Chinese Taipei, Colombia, Costa Rica, Hong Kong China, Iceland, Israel, Japan, the Republic of Korea, Mexico, New Zealand, Norway, Panama, Paraguay, Pakistan, Peru, Switzerland, Turkey and the US.

⁴ RCEP involves 16 countries: the 10 members of ASEAN (Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam) and six countries with which ASEAN has a free trade agreement (Australia, China, India, Japan, Korea, and New Zealand).

The Asia-Pacific regional alternatives will generate lower total net benefits than the DDA because by construction they only cover a subset of the world economy. The most ambitious option (the FTAAP) would generate similar net benefit ratios as the DDA, but a lower net present value of benefits (up to \$518 trillion globally). A downside of the Asia-Pacific initiatives is that some of the benefits accruing to East Asian nations will be at the expense of poorer developing countries in other regions.⁵ The Asia-Pacific trade liberalization alternatives that are discussed in Anderson (2014) exclude all of the BRICS except China, which would be a member of both the FTAAP and an ASEAN+3 agreement. Given that it is the other parts of the developing world that are lagging far behind East Asia when it comes to using trade for growth, and that “BRIS” are key countries in their respective regions, it would seem important from a post-2015 global development perspective to include consideration of trade policy reform scenarios that encompass developing countries in the rest of the world. Formal barriers to trade in these countries are often higher than those prevailing in East Asia and the Pacific, as are trade costs more generally (Arvis et al., 2013). As a result trade reforms may have higher net benefit from a development perspective than efforts to further integrate the Asia-Pacific. This point is bolstered by the fact that in the context of APEC there has been a long-standing effort to reduce trade costs – a unique feature of cooperation among the Asia-Pacific economies that does not have a counterpart in other developing country regions (APEC, 2012).

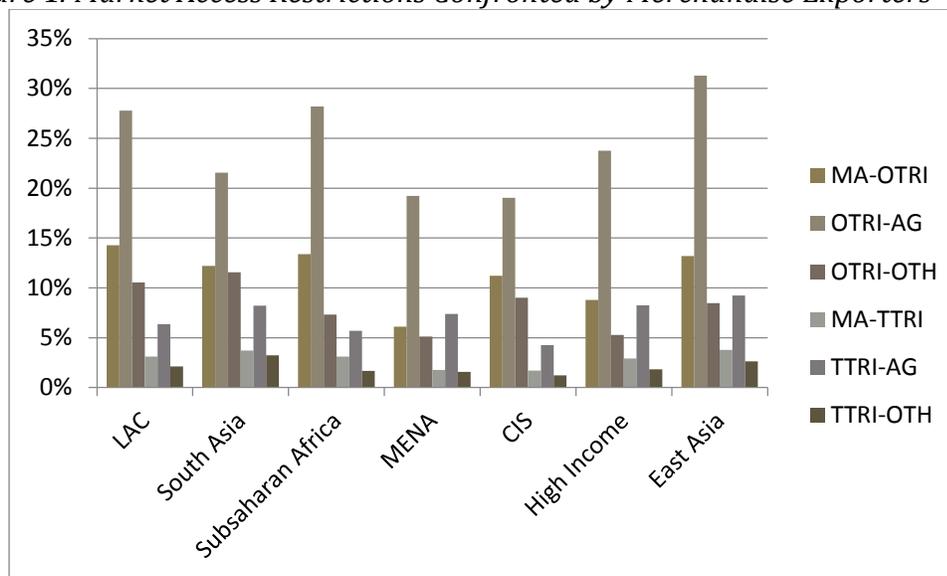
A Broader Perspective

Recent multi-country efforts to characterize current trade policy stances reveal that although East Asian countries confront significant barriers to trade – higher than those for firms located in many other countries – these barriers are imposed by countries in other regions. Figure 1 displays indices of market access trade restrictiveness, defined as the tariff equivalent of trade policies confronted by firms in their export markets, taking into account both applied import tariffs and whatever information is available on NTMs (Kee, Nicita and Olarreaga, 2009). As the coverage and quality of information on nontariff measures (NTMs) varies greatly across countries, a tariff-only trade restrictiveness index is also reported. Both restrictiveness indices are broken down into an agricultural and a non-agricultural component. The data clearly show that agricultural trade restrictions are generally much higher than those against other products and that NTMs represent a substantial share of merchandise trade barriers. In sub-Saharan Africa, for example, tariffs in export markets are low, due in part to preferential access programs, but trade restrictiveness levels are similar to those confronting companies in Latin America or East Asia, and are higher than for firms in developed countries. This points to the importance of reducing NTMs, and improving the understanding and transparency of the various types of NTMs in different markets. These data can also be used to assess the trade policies that countries apply to imports (not reported). The picture that emerges is similar, except that policies in many African and Arab countries are more restrictive on imports than are the

⁵ The rationale offered for focusing on Asia-Pacific is that this is the biggest part of the world economy not yet covered by a comprehensive regional integration agreement. This may be true in a technical sense in that East Asia’s share in the world economy is large and there is no overall pan-Pacific trade arrangement in place, but the same is the case for other parts of the developing world. There is no region-wide trade agreement in Latin America, Africa or South Asia.

policies they confront in their major export markets, reflecting both the composition of exports and preferential access programs for LDCs.

Figure 1. Market Access Restrictions Confronted by Merchandise Exporters

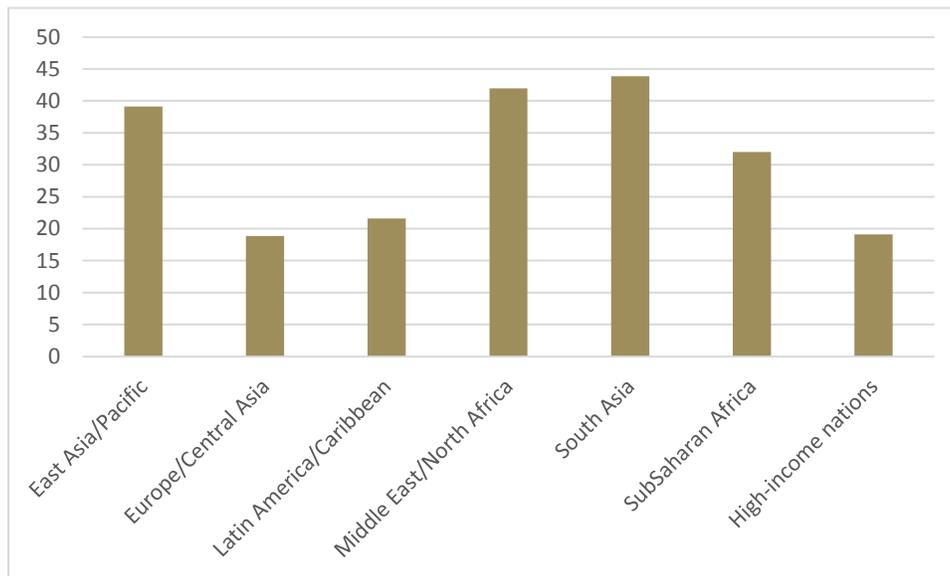


Notes: CIS = Commonwealth of Independent States; LAC = Latin American and the Caribbean; MENA: Middle East and North Africa; MA-OTRI = Market access - overall trade restrictiveness index; TTRI = tariff-only trade restrictiveness index; AG = agriculture; OTH = non-agricultural products.

Source: World Bank, Overall trade restrictiveness indices and import demand elasticities.
<http://econ.worldbank.org/WBSITE/EXTERNAL/EXTDEC/EXTRESEARCH/0,,contentMDK:22574446~pagePK:64214825~piPK:64214943~theSitePK:469382,00.html>

The World Bank has recently compiled a database that assesses the extent to which countries discriminate against foreign services providers (Borchert et al., 2014). Significant barriers to trade in services exist in both high-income and developing countries. However, barriers are on average substantially higher in emerging economies than those in OECD countries (Figure 2). Research using gravity regression models that analyzes the value of international trade in services and uses this to infer the level of barriers to trade in services also concludes that these are much higher than those that affect trade in goods (Francois and Hoekman, 2010). It is unclear how much of the ‘missing’ trade is attributable to policy and how much reflects the fact that natural barriers to trade are higher for services. In practice foreign firms may have to use FDI as a way of contesting markets, implying that barriers to inward FDI must be considered in any assessment of the services trade policy stance of a nation.

Figure 2. Overall Services Trade Restrictiveness Index (STRI)



Source: World Bank. At: <http://iresearch.worldbank.org/service/trade/default.htm#>.

These observations are relevant from the perspective of an assessment of trade barrier reform opportunities as they suggest that it is important to consider reduction of NTMs and STRIs as well as tariffs and trade-distorting agricultural support policies. The focus of attention in the DDA, and therefore the model-based assessments, is overwhelmingly on the latter. The DDA therefore only partially captures the potential net benefits of global trade reforms.⁶ Moreover, for the policy instruments that are covered the DDA is not very ambitious for a large number of developing countries in terms of fostering trade liberalization. Least-developed countries (LDCs) will not reduce their own barriers to trade under a DDA, and all developing countries will limit liberalization of what are deemed to be “sensitive products.” The result of this is that the model simulations on which Anderson (2014) bases his estimates of benefit-cost ratios only reflect limited liberalization. This is important from a post-2015 agenda perspective as there is no reason why the international community should accept what is currently on the table in the DDA as the appropriate focal point for trade reforms.⁷ The potential benefits of global trade

⁶ This point is of course recognized in Anderson (2014), one reflection of which is his argument to discipline the use of export restrictions, which is not an element of the DDA. Anderson argues that the global welfare payoff of a successful effort to incorporate disciplines on export restrictions in the WTO to match those for import restrictions are likely to be significant. Although a benefit-cost ratio cannot be estimated for what such an initiative might bring, clearly the research on this subject is quite compelling in its conclusion that this would be beneficial for the world as a whole.

⁷ Indeed, the DDA is in large part about tariff bindings: upper bounds on import tariffs that governments commit not to exceed. These bindings, which are the currency of WTO negotiations, are often much higher than actually applied tariffs in developing countries. As a result, the DDA – if completed – may do more to reduce the uncertainty of what tariffs may prevail in the future than it will do to lower applied tariffs in many developing countries, which tend to be higher than in OECD countries.

barrier reform opportunities are much greater than what is suggested by the DDA model simulations.

It is also important to recognize that in one area the DDA has delivered a positive outcome that over time will generate large net benefits: the December 2013 Bali Trade Facilitation Agreement (TFA). An implication of this is that the DDA model simulations that underlie the B/C assessment understate what the DDA may deliver by ignoring what will result from implementing the TFA. What the TFA will do to reduce trade costs will depend very much on country circumstances, both the prevailing situation regarding the efficiency of border management and Customs clearance, and the extent to which governments pursue improvements in this area. Econometric analyses of the potential impact of a TFA suggest the potential effects on global trade flows could be significant. Moisé and Sorescu (2013) estimate that full implementation of the TFA may reduce average trade costs in developing nations by some 10 percent.

Reductions of that order of magnitude will generate large welfare gains. World Economic Forum (2013), for example, using a global CGE model that incorporates econometric estimates of the impacts of a number of specific trade facilitation-related variables, concludes that concerted action to raise the average trade facilitation performance of countries to halfway the level of global best practice (defined by Singapore) could increase global GDP by almost 5 percent, six times more than would result from removing all remaining import tariffs.⁸ Of course, achieving trade facilitation improvements will require some investment, in contrast to tariff reductions. Thus, the B/C ratio associated with trade facilitation may be lower than that associated with tariff reforms and subsidy reductions, the main focus of the DDA simulations that are discussed in Anderson (2014). But it is important to note that the overall benefit of trade facilitation can greatly exceed that associated with tariff reductions because what is involved is a reduction in real trade costs – ‘social waste’ – and not a policy instrument that primarily redistributes income across groups within society. Given that the investment and recurring costs of specific trade facilitation initiatives have been argued to be relatively low, the B/C ratio may well be higher than what will be generated by tariff and subsidy reforms.

Nontariff barriers, services trade restrictions and inefficient border management and related real trade costs do not figure much in the DDA simulations that are the basis of the B/C ratios reported in Anderson (2014), nor is it clear to what extent they figure in the Asia-Pacific analyses that are presented. While this neglect is appropriate in the sense that the DDA is unlikely to do much if anything to address the effects of NTMs and services trade barriers, from a post-2015 perspective it is important that attention focus on these areas and that efforts center on going beyond what has been the focus of the DDA. This should encompass not just international trade negotiations but other forms of international cooperation, including aid for trade in support of unilateral reforms that target these areas. It is important not to over-emphasize trade negotiations and trade agreements as the instrument to lower barriers to trade. Post-1980 experience makes clear that in practice

⁸ The focus of the WEF (2013) analysis is on the impact of two trade facilitation measures: border management (customs clearance and other regulatory requirements and processes that pertain to goods entering or leaving a country) and transport and communications infrastructure services. For another recent analysis along these lines see Zaki (2014).

autonomous reforms drive economic development. Trade agreements can help – especially for nations that are land-locked and thus depend on access to neighboring countries with sea ports – but the key is what governments do themselves and what others can/should do to help.

Trade Reform and the Post-2015 Sustainable Development Goals

The case made in Anderson (2014) for further global reforms of trade barriers as an area with a very high benefit-cost ratio is compelling. As noted above, the neglect of trade facilitation implies that net benefits of trade reforms may well be understated based on the scenarios and policies that are considered in the simulation analyses that generated the B/C estimates. Less clear is whether global or regional trade negotiations are a useful focal point for identifying specific targets or indicators for the post-2015 period. Arguably the focus should not be on completion of this or that trade agreement, not least because such trade agreements are in the nature of “black boxes” given the multitude of exceptions and exemptions that are generally part and parcel of such agreements. Trade is not and should not be a goal in itself, so measuring trade outcomes – more trade; more diversification; etc. – arguably is also inappropriate. Instead the focus should be on enhancing opportunities for firms to use trade and enhancing the welfare (real incomes) of consumers in developing countries.

This is only very partially the thrust of what has been proposed by participants in the discussions on the sustainable development goals (SDGs). 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 DDA is a precondition for achieving the post-2015 agenda. It called on bolstering market access for developing countries, including preference programs 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 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:

- 7.1 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 and SIDS with a view to significantly increasing their share in global exports, including doubling the LDC share by 2020.
- 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 quantifiable target is to double the global share of LDC exports by 2020 (although it is not specified what the baseline is and whether this includes 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 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 and/or a low B/C ratio.

Moreover, LDCs already have DFQF access to many high-income markets. There are important exceptions such as Bangladesh exports to the US, and the BRICS can do more, but research has documented that the ‘binding market access constraint’ is often due to NTMs, including restrictive rules of origin. What matters then is helping firms overcome 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 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 an alternative approach should be considered that has a higher likelihood of mobilizing 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 realization 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. A possible candidate is to agree on a trade cost reduction goal – e.g., reduce trade costs for firms operating in low-income countries by 10 percent by 2020.

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 to 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, NTMs 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.

This is not an original idea. APEC member governments have agreed to a common trade facilitation performance target in two consecutive action plans starting in 2001–committing to a total 10% reduction in trade costs over the 10 year period covered – a goal that was achieved (APEC, 2012). How this goal was to be attained was left to each individual government to determine. The APEC Secretariat assisted governments to define key performance indicators that were used as a focal point and a metric to assess progress. These KPIs included indicators compiled by the World Bank on the cost and time associated with clearing goods through customs. Since the APEC initiative was launched other relevant indicators have become available that could be used – e.g., the World Bank Logistics Performance Indicators (World Bank, 2014). In addition use can be made of indirect measures of overall trade costs between country pairs – e.g. Arvis, Duval, Shepherd and Utoktham (2013).

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 (B/C) 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 B/C ratio. This points to a need for careful analysis to assess what would have the greatest effect in lowering trade costs while minimizing required investments. Moreover, a country-by-country approach may lead governments to miss opportunities to cooperate in

areas where joint (concerted) action would enhance net benefits and increase the B/C ratio of interventions. Including a trade cost target as a SDG sub-goal could provide a useful focal point for the deliberation that is needed to identify such opportunities.⁹

Concluding Remarks

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. As argued in Anderson (2014), trade reforms and greater trade integration can also do much to achieve sustainable and human development objectives. Although traditional border barriers such as tariffs and quotas have become less of a constraint as the result of policy reforms around the world during recent decades, trade barriers remain very prevalent. 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. 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 SDGs to revisit business as usual and for governments to adopt a specific target that will provide an operational focal point for action 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 B/C ratio, but it will also ensure greater accountability than has been the case with the pursuit of the MDGs. One possibility in this regard is to adopt a concrete trade cost reduction target along the lines of what has been done in the APEC context: commit to reducing trade costs for firms in low-income countries by 10 percent by 2020.

⁹ Hoekman (2014) discusses mechanisms that can be used to do this. The recently negotiated WTO Agreement on Trade Facilitation offers a multilateral focal point for the pursuit of a trade cost reduction target.

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