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

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Ensuring that Trade Delivers on the Post-2015 Agenda

This viewpoint paper discusses how trade can be leveraged to achieve the sustainable development goals (SDGs). It does this by reviewing the evidence on the impact of trade on the Millennium Development Goals, focusing in particular on the primary goal of cutting the global poverty rate in half by 2015 (MDG 1). As a critique to the paper by Kym Anderson, I argue that further trade expansion in developing countries would come not from addressing remaining trade barriers – whether multilaterally or, in the absence of progress on the Doha agenda, in the context of the expansion of existing regional blocs – but by ensuring that poor countries are able to tackle their supply-side capacity constraints. In this, the Aid for Trade initiative could play a crucial role.

Progress in Alleviating Global Poverty (MDG 1)

Significant progress has been achieved on MDG 1 (Table 1), even when measured by the stricter metric of US$ 1.25 (instead of US$ 1) per day. In fact, while most of the original MDGs will not be met, the goal of halving global poverty by 2015 was achieved 5 years earlier. China alone accounts for three-quarters of this achievement. Its rapid economic growth has lifted 680 million people out of poverty between 1980 and 2010.[1]

Significant reduction in poverty has also occurred in South Asia, including India, with the region amply meeting the MDG 1 target. Across developing regions, however, the record is very uneven. In sub-Saharan Africa (SSA), notably, it is estimated that the poverty rate by 2015 will be reduced by a mere one-quarter rather than the needed one-half. In absolute terms, the number of poor will have increased from 163.3 million in 1990 (the reference year) to 172.6 million in 2015.

[1] See The Economist, June 1, 2013

Table 1: Population (in million) and share of people living on less than US$ 1.25 (PPP) per day (%)

	1990	2010	2015*
World (Developing countries)	1900 m *43%*	1200 m *20.6%*	970 m *15.5%*
East Asia and Pacific	926 m *56.2%*	251 m *12.5%*	115 m *5.5%*
Europe and Central Asia	8.9 m *1.9%*	3 m *0.7%*	2 m *0.4%*
Latin America & Caribbean	53 m *12.2%*	32 m *5.5%*	30 m *4.9%*
Middle East & North Africa	13 m *5.8%*	8 m *2.4%*	9 m *2.6%*
South Asia	617 m *53.8%*	507 m *31%*	406 m *23.2%*
Sub-Saharan Africa	289 m *56.5%*	414 m *48.5%*	408 m *42.3%*

Notes: PPP = purchasing power parity; m = million. Data for 2015 are forecasts.
Source: World Bank Global Monitoring Report 2013

Trade and MDG 1

How much trade has contributed to the achievement of MDG 1 is difficult to tell in the absence of specific evidence. However, just like "a rising tide lifts all boats,"[2] trade-induced growth has the potential to raise the incomes of all individuals in the economy, making it possible for a large number of them to be pulled out of poverty. Although an early survey of the evidence did not reveal a conclusive link between trade and poverty reduction,[3] recent work[4] on African economies suggests that trade reduces poverty when a set of complementary conditions, including financial depth, good governance and a high level of education, are present. Indeed, a key reason for Africa's failure to reduce poverty is that while much of the continent's recent economic growth was export-led, such growth did not

[2] James R. Hines, Jr., Hilary W. Hoynes and Alan B. Krueger (2001), "Another look at whether a rising tide lifts all boats", NBER Working Paper No. 8412.
[3] Andrew Berg and Anne Krueger (2003), "Trade, growth and poverty: A selective survey", IMF Working Paper WP/03/30.
[4] Maelan Le Goff and Raju J. Singh (2013), "Does trade reduce poverty? A view from Africa", Policy Research Working Paper No. WPS 6327, The World Bank.

create many jobs.[5] Thus, while trade could be a potent force in alleviating poverty, its impact is neither automatic nor generalizable.

Changing Dynamics of World Trade

What role can trade play in achieving the SDG of "end[ing] poverty everywhere" by 2030? In pondering this question, it is important to keep in mind that the dynamics of trade and of the multilateral trading system have changed in fundamental ways. First, trade is increasingly happening within global value chains (GVCs). While in theory this makes it easier for poor countries to integrate into global markets – since they only need to specialize in a chosen task along a product chain instead of producing the entire product – relatively few cases of lower-income countries plugging themselves successfully into GVCs are known.

One reason why GVCs have bypassed the majority of poor countries until now is because of their ostensibly regional character: they are concentrated in North America, Europe and East Asia. As labour costs in these regions escalate and transport costs around the world continue to fall, the geography of production networks might change in the future, with GVCs traveling down south. This represents an opportunity for developing economies, including the numerous least developed countries (LDCs) and low-income economies (LICs) of Africa. Yet, only a handful of these countries will be able to transform themselves into trade hubs in the next 15 years, even if they do all the right things. In this regard, small, landlocked economies might face more formidable challenges than large, coastal economies. Moreover, while the emergence of GVCs might make it easier for LDCs to industrialize, it also makes them more vulnerable to the intrinsically volatile nature of these modern production networks.

Second, the Doha Round, which started in 2001, was named a "development" round precisely because it was linked to the MDGs. The Doha round was expected to contribute to the MDGs by boosting global trade and ensuring that developing countries, and the least developed among them, got a fair share of the projected gains. However, the round was officially declared at an impasse in 2011, and the Bali deal on trade facilitation, which injected fresh hopes for renewed negotiations on the remaining Doha issues, is in limbo following India's insistence that it be linked with progress towards a permanent solution on public food stockholding.

The failure of the Doha round has a silver lining for a number of LDCs and LICs – for the estimated gains from the proverbial successful scenario would have been very small at best. However, as the Doha talks stalled, LDCs were promised an "LDC package", featuring duty-free, quota-free market access, a services waiver, improved rules of origin, and "a step forward on cotton", which, if implemented, would have delivered important welfare gains to them. Yet, except for the services waiver, which is currently under discussion, the LDC

[5] Vinaye Ancharaz (2011), "Trade, Jobs and Growth in Africa: an empirical investigation of the export-led jobless growth hypothesis" (mimeo). Available at http://www.oecd.org/site/tadicite/48735521.pdf

package has suffered the same fate as the Doha round. The SDGs will therefore be launched in a "post-Doha" context, with no pro-poor multilateral trade negotiations in sight.

A Critique of Anderson's Paper

Against the above backdrop, a number of "mega-regional" deals are being pursued. The paper by Kym Anderson (2014) discusses some of these initiatives as "opportunities for trade barrier reform" in the absence of progress at the multilateral level. His main argument is that capitalizing on these "opportunities" would boost world trade, which could contribute to poverty reduction as well as to other SDGs. There are several flaws in this logic, however.

First, three of the four "opportunities" involve possible expansion of regional trade agreements (RTAs), such as ASEAN (Association of Southeast Asian Nations)+3 (that is, ASEAN plus China, Japan and Korea), the Trans-Pacific Partnership (or TPP), involving the United States and a subset of the APEC grouping) and a free trade area across the Asia-Pacific (FTAAP). Anderson notes that the broader Asia-Pacific region accounts for about 60 percent of the global economy and is therefore a good approximation to the world. However, in so far as the main SDG goal of poverty reduction is concerned, it is worth pointing out that this region does not feature the majority of poor countries, which are further away in Sub-Saharan Africa and South Asia. Although these countries could benefit from the net trade creation effects of RTA (regional trade agreement) expansions in the Asia-Pacific – a rather unlikely proposition given the lack of trade across the Indian Ocean – it remains doubtful whether these would be sufficient to lift hundreds of millions of people out of poverty. At best, the poverty reduction would occur in the region itself – notably in China – which is not so much the focus of current global poverty reduction efforts.

Second, at a time when the mega-regionals are far from being concluded, any estimates of their welfare effects will be purely hypothetical. A number of issues remain unsettled in the TPP, and the configuration of all three blocs is yet uncertain. The debate on the TPP suggests that the initiative is led by the U.S. State Department and is aimed at ring-fencing China. An initiative of such scale, which, additionally, lacks the support of the U.S. private sector, is most likely to fail. One thing that is clear, however, is that if the TPP does go ahead, it will redefine the rules of the game in a number of areas – for example, rigorous quality standards, GATS[6]-plus commitments in services, more advanced intellectual property rules, and "new generation", WTO-plus issues such as government procurement, and labor and environment standards. These will not only further marginalize poor outsider-countries; they will also render the results of any modeling effort extremely shaky.

Third, the paper's focus on "trade barrier reform" is rather unsettling. Ever since Yeats, Amjadi, Reincke and Ng's (1996) seminal work on Africa's marginalization in world trade, economists have come to realize that the main barrier to poor countries' exports is not market access per se but the countries' own trade policies and, more importantly, their

[6] General Agreement on Trade in Services – the WTO agreement on services trade.

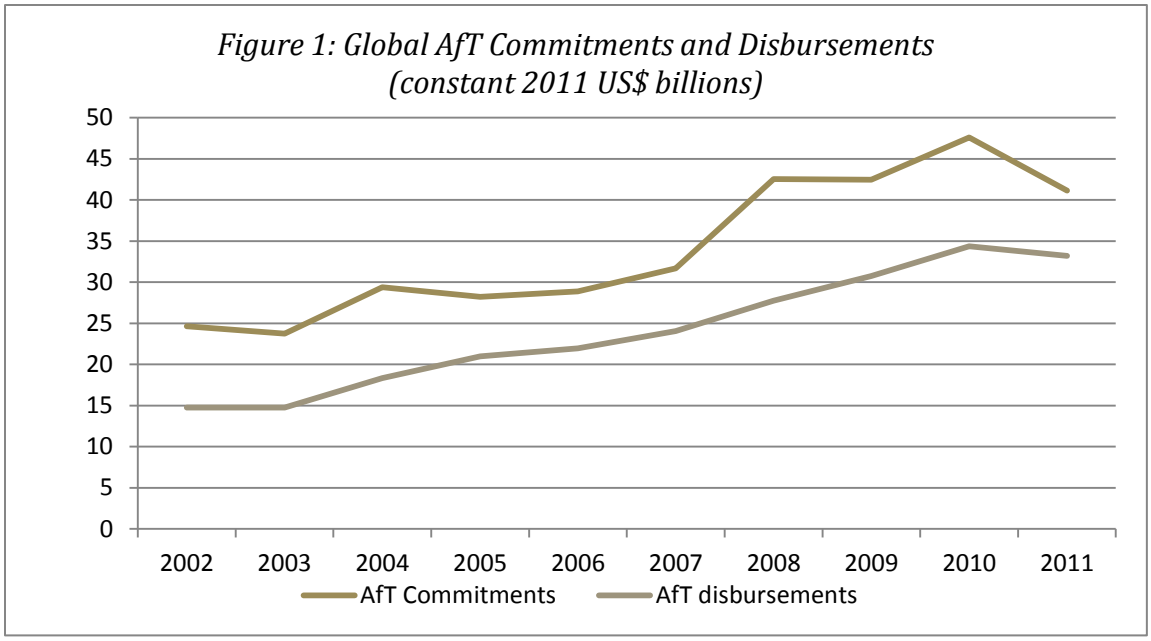
supply-side capacity constraints.[7] Before this time, and especially in the 1990s, it was generally believed that trade liberalization was the only way for a country to increase its exports. This spawned a great deal of research looking at the impact of trade liberalization on trade, growth and poverty. As tariffs continued to fall – both in developed and developing countries – non-tariff measures have emerged as the key constraint to market access. In the meantime, developed-country GSP programs have expanded and improved, and recently, emerging economies like India and China have launched their own preferential trade schemes for LDCs. Yet, supply-side capacity in LDCs and LICs has remained dismally low, plagued by myriad bottlenecks.

Enter Aid for Trade

The Aid for Trade (AfT) initiative was designed in 2005 "to help developing countries, particularly LDCs, build the supply-side capacity and trade-related infrastructure that they need to assist them to implement and benefit from WTO [World Trade Organization] Agreements and more broadly to expand their trade". I argue, in the rest of this paper, that AfT could play a key role in helping the world's poorest economies address their domestic capacity constraints and boost their exports, and I thus call for greater AfT resources to be directed to lower-income economies.

No aid scheme would matter if it did not provide adequate resources in a timely and predictable manner. Indeed, "additionality" is at the very core of the AfT initiative. Since the initiative started by marking off existing Official Development Assistance (ODA) as AfT, with the promise that this endowment would grow over time as donors delivered on their aid pledges, it is crucial to ask if this has been the case so far. Unfortunately, the evidence is not very positive. Between 2005 and 2011, total AfT commitments amounted to US$ 262 billion. Of these, only US$ 193 billion was disbursed, leaving a gap of US$ 69 billion, or 26 percent of committed resources. What is more, the funding gap has grown wider over time since 2005, decreasing only in 2011 when both commitments and disbursements declined significantly (Figure 1). These trends clearly suggest that AfT flows are not predictable; worse, they are volatile and vulnerable to economic shocks.

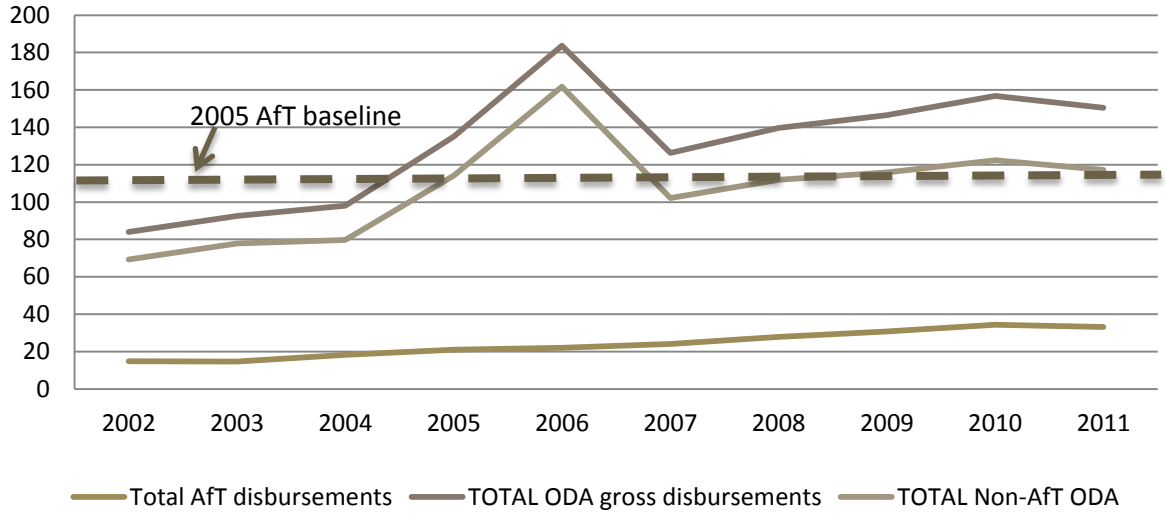
[7] See Alexander Yeats, Azita Amjadi, Ulrich Reincke and Francis Ng (1996), "Did External Barriers Cause the Marginalization of Sub-Saharan Africa in World Trade? World Bank Policy Research Working Paper No. 1586; and Francis Ng and Alexander Yeats (1996), "Open Economies Work Better! Did Africa's Protectionist Policies Cause its Marginalization in World Trade? World Bank Policy Research Working Paper No. 1636.



Source: Author's computation using data from the OECD CRS database

It is difficult to verify additionality of AfT using aggregate aid data. Nevertheless, a sufficient condition for additionality is that both AfT and non-AfT ODA (that is, ODA minus AfT) increase over a given period. On this count, while AfT has increased steadily since 2005, non-AfT ODA flows have fluctuated, with a spike in 2006 and a slight increase in recent years before the drop in 2011. On the whole, however, non-AfT ODA was almost at the same level in 2011 (US$ 117 billion) as in 2005 (US$ 114 billion) (Figure 2). Meanwhile, over this period, the share of AfT in total ODA went up from 15.5 percent to 22 percent. This could be interpreted to mean that some AfT flows were being fed by diverting resources away from ODA in other sectors. If true, this would be a cause for concern for recipient countries.

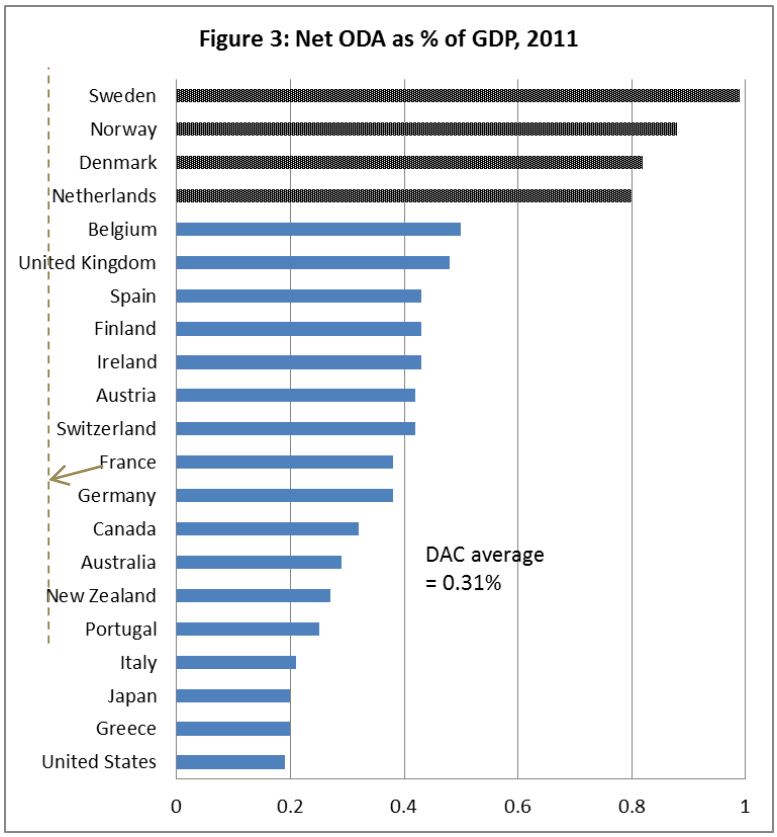
Figure 2: ODA and AfT flows (constant 2011 US$ billions)



Source: Author's computation using data from the OECD CRS database

Another approach to verifying additionality of AfT funds is to ask if donors have delivered on their promise – as reiterated most recently at the G8 summit in Gleneagles in 2005 – to provide 0.7 percent of their GDP as aid by 2015. Critics have argued that this target does not constitute a meaningful metric of the adequacy of aid. Rather, they argue that defining adequacy should be based on the demand-driven aid needs of developing countries, which – understandably – are much bigger than the amount the 0.7 percent target could ever provide. But the fact remains that the donor community has failed to meet this modest target. Net ODA in 2011 was a mere 0.31 percent of the OECD's GDP – although it was close to 0.5 percent in 2010. In that year, the shortfall was estimated at US$ 19 billion, of which, the OECD estimates, only US$ 1 billion could be attributed to the economic crisis. Africa has received less than half of the US$ 25 billion that was promised.

But it would be unfair to blame all Development Assistance Committee (DAC) member-countries for missing the aid targets. Some – Sweden, Norway, Denmark and Netherlands – have actually overshot the 0.7 percent-of-GDP target while others – notably, the UK – are making considerable efforts to achieve the goal by 2015 despite a tightening domestic budget constraint (Figure 3). At the other end, the US – the biggest donor in absolute terms – provided less than 0.2 percent of its GDP as aid in 2011, and lies at the bottom of the league. In view of the lack of progress on the MDGs, if aid is to contribute towards achievement of the SDGs in the next 15 years, development partners must at the very least follow up on their Gleneagles commitments. In particular, the US must step up its aid budget significantly.



Source: Author's computation using data from the OECD CRS database

Have AfT Resources Been Effectively Utilized?

Driven by the search for value for money in the context of tighter budget constraints at home, donor countries have been investing significant amounts of resources in monitoring and evaluating their AfT activities. This fixation with aid evaluation runs the risk of diverting attention, and aid flows, away from pressing issues. Similarly, while developing countries must come to terms with the reality of GVCs, the problems that they – and more particularly, the least developed countries – face in integrating the world trading system are well known, and they have hardly changed despite changes in the way trade is taking place today. If anything, these changes underscore the need to address the traditional impediments to trade. In a world of fragmented production, opportunities may be easily lost to competing countries if the basic building blocks of national competitive advantage cannot be put together.

These building blocks are the familiar supply-side factors that most LDCs continue to grapple with. Trade-related infrastructure and productive capacity-building in sectors of potential export interest to LDCs are as relevant today as they were at the launch of the AfT initiative in 2005. The fact that over 97 percent of AfT resources have been directed to these two areas suggests that the initiative has correctly diagnosed these problems.

To judge the effectiveness of AfT programs at the aggregate level, as is often the case, is both methodologically challenging and plainly wrong. The relationship between AfT and indicators of the variable it is ultimately meant to impact – namely trade – is an inherently noisy one, adulterated by a string of intervening variables that are difficult to measure with accuracy. The lack of a statistically significant effect of aid on trade, then, should not be construed summarily as ineffectiveness of AfT. It may simply reflect the weaknesses of the underlying model – or that aid is too little to make an impact yet. It is therefore important to ensure that flawed evaluation methods do not lead donors to scale back aid from countries or programmes that are deemed to be under-performing.

The effectiveness of AfT can only be reasonably gauged at the project level. And here, some positive experiences are emerging. AfT seems to be most effective when it is additional and predictable; when AfT projects are owned by the host country and trade mainstreamed into the national development strategy; when donor objectives are aligned with the recipient government's priorities; and, critically, when adequate local absorptive capacity exists.[8] In other words, AfT works when the right conditions are present. The onus to build the environment in which aid could impact trade and, ultimately, the SDGs, should be shared by both the donors and the host countries.

[8] See Vinaye Ancharaz, Paolo Ghisu and Christophe Bellmann (2013), "Assessing the effectiveness of Aid for Trade: Lessons from the ground" in M. Razzaque and D. te Velde (eds.), *Aid for Trade Effectiveness: Current Issues and Future Directions*, Commonwealth Secretariat and ODI, London, 2013.

This paper was written by Vinaye Ancharaz, Senior Development Economist at the International Centre for Trade and Sustainable Development. The project brings together more than 50 top economists, NGOs, international agencies and businesses to identify the goals with the greatest benefit-to-cost ratio for the next set of UN development goals.

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