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**TRADE AND THE POST-2015
DEVELOPMENT AGENDA**

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Abstract

Trade can and should play an important role in making progress to achieve the Sustainable Development Goals. This includes trade and investment in services, as realizing many of the goals is conditional on improved performance of services sectors in developing countries. The global environment for trade and investment is likely to be more challenging for low-income countries in the coming decade than it was in the 1990s and 2000s, calling for a sustained effort by governments to reduce trade costs, pursuit of policy reforms to support trade in services, and a greater focus of aid for trade on trade cost reduction and services trade facilitation.

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INTRODUCTION

Sustaining real per capita income growth rates that exceed population growth by a substantial margin is a necessary condition for achieving the post-2015 development agenda. Economic policies determining the incentives to invest in tradable activities are a key factor determining an economy's growth potential and performance. Trade and foreign direct investment (FDI) flows are sources of technology and knowledge as well as mechanisms to foster specialization by firms in activities in which they have a comparative advantage. The experience of many countries demonstrates how effective global integration can be as a core element of an economic development strategy. But numerous countries that have pursued trade liberalization have not been able to leverage trade for development. Many complementary factors need to be in place, notably revolving around the quality of macroeconomic policies and the investment climate confronting businesses.

In the coming decade, the challenge of using trade as an instrument for sustainable development may well be greater than it was in the recent past. Since 2010, following the sharp collapse in trade in 2008 and the equally sharp recovery in 2009, global trade has grown in line with global output as opposed to increasing 2 to 3 times faster than output in the 1980s, 1990s, and much of the 2000s. The period from the late 1980s to the 2008 global financial crisis was unique. Unprecedented high growth rates of global trade reflected a mix of technological change and business innovation, policy reforms around the globe, and the reintegration of the People's Republic of China (PRC) into the world economy. Demand by the PRC for natural resources benefited many countries in Africa and Latin America, but at the same time rapid growth in the PRC's manufactured exports was a major source of competitive pressure. Growth in the PRC increased the economic footprint of East Asia, leading to further dominance of the three regional "factories"/major markets in the world economy (North America, Europe, and Asia). Whether the post-2010 trade slowdown constitutes a "new normal" is a hotly debated question (Hoekman 2015). The answer matters for the role that trade can play in the post-2015 development agenda.

This paper discusses how trade can help achieve the post-2015 development agenda. It starts in section 1 with some reflections on recent global trade-growth trends, followed in section 2 with a discussion of why and how trade is important for poverty reduction and the achievement of the 2030 sustainable development goals. Section 3 puts forward a number of suggestions regarding what could be done by governments to leverage trade opportunities for development and how the international community can assist, both through cooperation in the area of trade policy broadly defined and through aid for trade. Section 4 concludes.

1. GROWTH, TRADE, AND TRADE POLICY

Trade has been a driver of growth in most countries that have been able to greatly increase per capita incomes and reduce the incidence of poverty. Countries in East Asia have been the star performers, with an increase in per capita incomes of some 700% since the early 1980s, followed by South Asian countries (220%) (Table 1). Asia includes the PRC and India, the two most populous nations in the world, as well as a number of other countries with both large populations and large numbers of poor households (e.g., Bangladesh, Pakistan, Indonesia, the Philippines, and Viet Nam). High per capita growth in Asia has therefore implied a substantial reduction in the number of households with incomes below the poverty line.

Table 1: Average Annual Growth Rate of per Capita GDP
(constant 2005 \$)
[update to 2014]

	1975– 1985	1985– 1995	1995– 2000	2000– 2005	2005– 2012	%Δ 1982– 2012	\$ 2012
Developing Regions							
East Asia/Pacific	7.0	9.1	6.5	9.4	9.9	698	2,856
Europe/Central Asia	n. a.	–1.5	3.1	6.5	3.4	70	4,727
Latin America	2.7	–0.6	1.9	1.4	2.8	39	5,642
Middle East/North Africa	1.4	–0.3	3.3	2.8	n. a.	44	2,381
Sub-Saharan Africa	–2.0	–1.6	0.8	3.2	2.5	12	989
South Asia	2.5	3.8	4.6	5.8	6.4	223	1,009
LDCs	n. a.	0.4	2.8	4.7	4.2	60	518
Small States	n. a.	1.2	3.2	4.4	1.9	60	4,468
High Income	3.0	2.6	3.3	2.1	0.8	74	31,373
World	1.9	1.5	2.5	2.0	1.3	55	7,732

GDP = gross domestic product, LDC = least developed country, n. a. = not available.

Source: World Bank. World Development Indicators database.

Trade played an important role in driving the growth that was achieved globally in recent decades. Global trade increased 27-fold between 1950 and 2008, the year the global financial crisis erupted, three times more than the growth in global gross domestic product (GDP). The total value of world trade in goods and services was over \$22 trillion in 2014. The trade-to-GDP ratio for the world stood at 60% in 2014, up from some 25% in the 1960s. The rise in incomes that has been observed in many parts of the world illustrates the payoff to trade openness and economic policies that encourage investment in production of tradable goods and services.

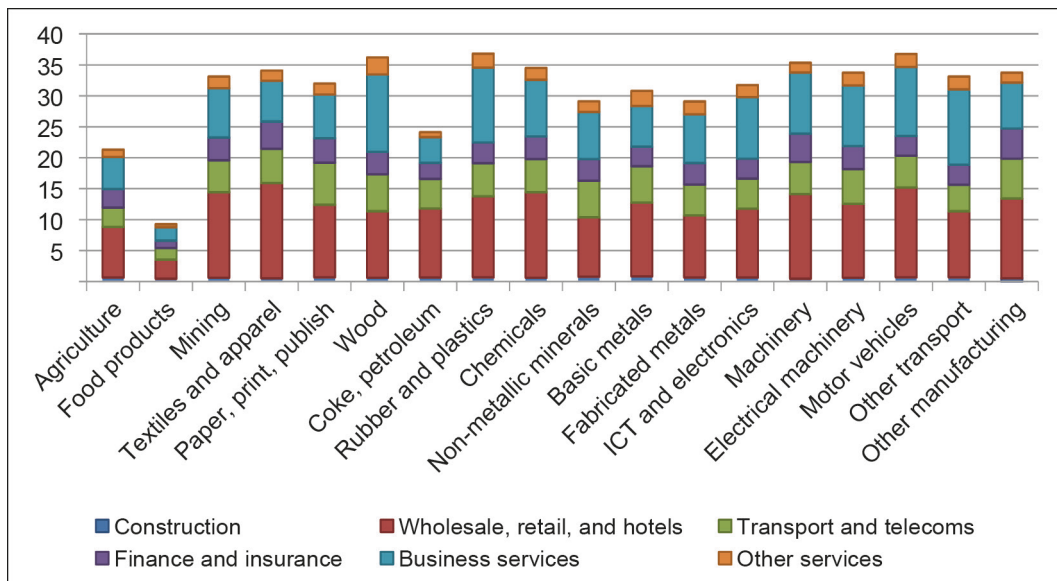
The boom in global trade reflected many factors. Two stand out: innovation and economic policy reform. The technological changes that have underpinned global trade growth are well-known. They include advances in information and communication technology (ICT) that led to a sharp drop in the costs of international telecommunications, as well as new products and services such as video conferencing; containerization and ever larger container cargo ships; wide-body aircraft and express delivery services; and hub-and-spoke networks for multimodal logistics. The result has been to reduce the effect of distance and geography and to permit the organization of production of many products in global value chains (GVCs).¹ Small and medium-sized enterprises (SMEs) today have greater opportunities to sell and source internationally, in part by connecting to the international production network and to buyers and suppliers through internet-based platforms that also provide payment services. Technological change and innovation has led to significant leveling of the international playing field for small companies relative to large multinationals.

¹ The shift to GVC-based production was a major factor leading global trade to grow much faster than aggregate output (GDP). Trade flows are recorded on a gross value basis, including the value of the intermediate inputs that are embodied in a product. Thus, an input that is shipped from country A to B as part of a GVC is measured as an export from A to B; the value of the subsequent export of the processed product from B to C (or back to A) will embody the value of the imported input. From a value-added perspective, this implies there is double counting. GDP, in contrast, is a value-added concept: it is the sum of all value added that is produced in an economy, including only net exports (exports minus imports).

Another key driver of trade growth was the shift to outward-oriented economic growth strategies in many developing countries and former centrally planned economies in Europe and Asia. The world went from a situation with tariffs in the 20%–30% range and frequent use of quantitative restrictions (QRs) and foreign currency and exchange controls to one where exchange rates are much more flexible, capital controls and QRs were largely removed, and the average uniform tariff equivalent for merchandise trade is in the 5%–10% range (Kee et al. 2009).² Effective (applied) tariffs for firms are often zero as a result of preferential trade agreements or duty-free, quota-free (DFQF) programs in the case of the least developed countries (LDCs).

Growth in the incomes of the poor is strongly related to overall growth in the economy—although the precise relationship will vary across countries depending on government policies and social and economic conditions. Given that openness to trade promotes economic growth prospects and the link between growth and poverty reduction, trade policy has an important role to play in efforts to promote economic development. A country’s trade policy is the interface between the world market for goods, services and knowledge, and the national economy. The prices of products that prevail on world markets are critical sources of information for firms to determine whether they can be competitive in a given sector of activity. If costs of production make sales at world market prices unprofitable, then resources should not be allocated to those activities. An open trade and investment regime helps investors to identify activities in which a country has a comparative advantage. This applies to services as much as it does to goods. As services account for a large share of manufacturing value added (Figure 1), the competitiveness of firms depends on their ability to source intermediate inputs and components from the most efficient suppliers and to use the most appropriate available technologies to produce goods and services (Miroudot and Shepherd 2015).

Figure 1: Services Share of Manufacturing Value Added (%)



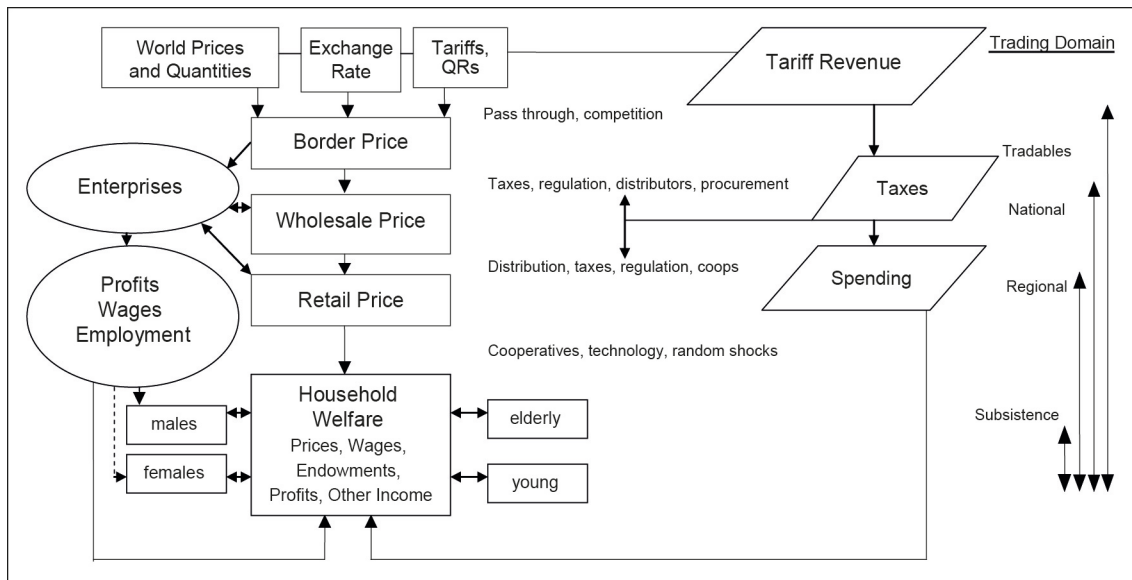
ICT = information and communication technology.

Source: OECD-WTO Trade in Value-Added Database. June 2015.

² Michalopoulos and Ng (2013) calculate for a sample of 50 developing countries that the simple average tariff in the late 2000s was 9.1%.

Trade policy affects the welfare (real income) of households by impacting on the prices of the goods and services they buy and those that they produce—either directly (such as agricultural products) or indirectly, by working in a given sector. Figure 2 provides an overview of the channels through which trade policy impacts on firms and households. Household welfare depends on the retail prices of goods consumed, which are determined by wholesale prices, which in their turn are determined by how the world price is affected by the exchange rate, trade policy instruments such as tariffs, the costs associated with customs controls, and corruption or delays in transporting consignments.

Figure 2: Trade Policy Impacts: Conceptual Framework



QR = quantitative restrictions.

Source: McCulloch, Winters, and Cirera (2002).

For firms, the effects of trade policy depend on the balance between impacts on the costs of inputs and the extent to which the product of the firm benefits from import protection. If tariffs increase the price of key inputs, this will negatively affect a firm, reducing profits and wages and/or employment. If the trade policy increases the price of the enterprise’s output, it may have the opposite effect insofar as sales on the domestic market are concerned. In practice, the net effect is generally an empirical question. Particularly important from a dynamic (growth) perspective is that a liberal trade policy stance may enhance the economic performance of countries by encouraging diversification and expansion along the extensive margin of trade.

From the perspective of the household, what matters are the effects of trade-policy-induced changes in relative prices of goods on wages in affected domestic industries. In addition, trade taxes will generate revenue that can be used to provide transfers to households, e.g., cash transfer programs or the provision of public services such as health and education.³ The net effect of trade policy on households therefore is a function of the impacts on the cost of their consumption bundles, wages, and net transfers received. Given large rates of unemployment and under-employment in many low-income countries, actions to reduce trade protection and facilitate trade can also

³ Nontariff trade policies will not generate revenue but may create rents that are captured by specific groups.

generate new employment opportunities in export-oriented activities and in ancillary services for which demand will rise as export production and incomes rise.

Trade policy will have differential effects on households and enterprises depending on whether firms and workers are engaged in production for export, are focused on the domestic market and produce goods that confront competition from imports, or are engaged in nontradable activities. Trade policy is generally not pro-poor, reflecting the fact that poor households have less political power and thus limited ability, if any, to influence the structure of policies. How trade policy impacts on development outcomes also depends on the pass through of price changes. If retail prices are not affected by trade policy (changes) because of market power in transport or distribution services, or households are poorly connected to markets, prices may not be very responsive to changes in border prices. If, for example, road transport is not a competitive sector, trucking companies may not pass on the reduction in prices that comes with a reduction in import tariffs. Similarly, if firms confront very high costs because of poor infrastructure or corruption and red tape, the supply responses to trade policy may be weak. These considerations illustrate the importance of complementary policies, in particular, a focus on actions to lower trade costs.

Trade is not an elixir for development—it is simply one mechanism for raising incomes over time. Greater openness to trade may not raise average incomes if other policies are not supportive of investment and entrepreneurship. Extensive empirical analysis has found that export surges in developing countries tend to be preceded by a large real depreciation, which leaves the exchange rate significantly undervalued. Ensuring that the real exchange rate does not become overvalued and establishing a macro environment that lowers exchange rate volatility is important (e.g., Schatz and Tarr 2002; Eichengreen 2008; Rodrik 2008; and Freund and Pierola 2012). Countries with weak and unsupportive business environments and high levels of corruption may benefit little from trade liberalization (Freund and Bolaky 2008). A variety of supporting policies and institutions are needed to encourage investment to flow into internationally competitive sectors and the most productive firms, as importantly, to permit resources to be reallocated away from less productive companies.

Equally important is that firms and households have access to a variety of public and private services, most notably connectivity and related infrastructure, health and education, and finance. Many services play an important “intermediation” function, supporting the process of specialization associated with economic development. A variety of financial, logistics, and professional services are critical inputs in coordinating production processes. Services also play a major role in the operation of GVCs, with the productivity of producer services firms impacting on the productivity of firms that use services and in turn on their export performance (e.g., Francois and Hoekman 2010; Miroudot et al. 2010; Hoekman and Shepherd 2015a). Consistent with the findings of Freund and Bolaky (2008) regarding the effects of merchandise trade reforms, Beverelli, Fiorini, and Hoekman (2015) find that the effects of services trade restrictions are mediated by the quality of domestic economic governance. A similar services trade policy reform implemented by two different countries may have very different impacts on the performance of downstream sectors depending on the quality of governance that prevails in each economy, as proxied by indicators such as control of corruption and rule of law.⁴ This is another example illustrating that complementary policies play a critical role in determining the extent to which an economy will benefit from open trade policies.

⁴ The Beverelli et al. (2015) finding is not capturing differences in level of economic development as they control for the level of per capita income.

Global Value Chains and the Post-2008 Trade Growth Slowdown

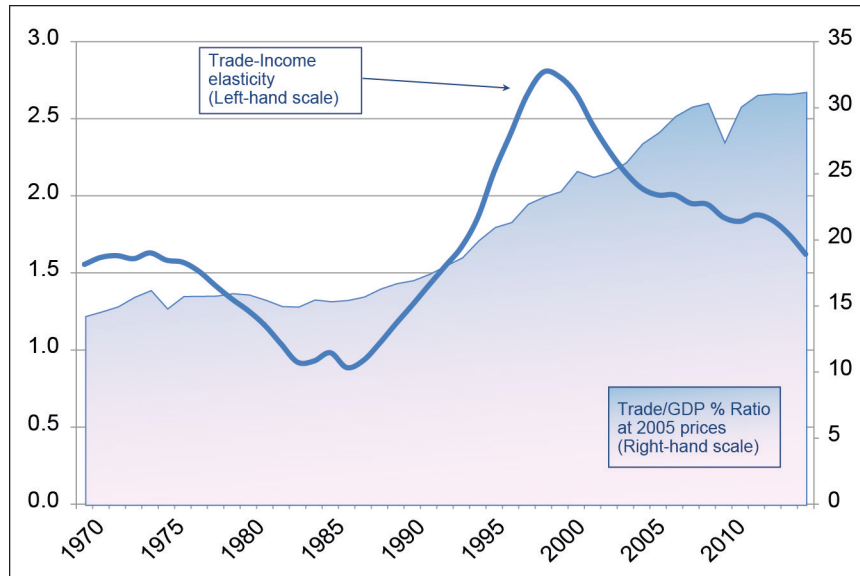
Supply chain–based trade involving manufactured products has been a key feature of East Asia’s growth strategies. This is something that has been much less prevalent in other regions. Indeed, countries in regions with the worst per capita income growth performance are often either not participating in GVCs or are natural resource exporters that provide basic raw materials that are processed in other countries.⁵ Rising real wages and rebalancing of the PRC’s economy toward domestic consumption in conjunction with efforts to lower domestic trade costs may provide greater incentives for investors in the future to (re-)locate GVC activities in regions that to date have been off the GVC map, most notably Africa. Although the ratio of trade to GDP of African economies is often above 60%, exports tend to be dominated by natural resources and agricultural products. To date, most of Africa has not seen the shift toward intra-industry trade, vertical specialization, and participation in international supply chains that has been a driver of trade growth in East Asia, Mexico, Turkey, and Central and Eastern European nations. Moreover, intraregional trade is limited—less than 10% of the total, as measured by official trade statistics (see World Bank 2012), although informal trade within Africa is significant, so the actual figure is likely higher (Pesce, Karingi, and Gebretensaye 2015). However, this mostly comprises low-value items and trade in foodstuffs. While important from a welfare perspective—this type of trade generates revenue for the small traders involved (who are often women)—it does not constitute the type of specialization and GVC trade that has supported high per capita income growth in East Asia.

An important question is whether trade integration continues to offer prospects to drive the type of dynamic effects it had in East Asia. Starting in the early 2000s, the rate of global trade growth slowed relative to income growth (Figure 3). Post-2008, trade growth has been particularly anemic—in line with the very weak GDP growth performance—and trade has not been a driver of growth for either industrialized or emerging economies. Understanding why this is the case and, more specifically, whether it portends a decline in the potential for trade growth is important for countries seeking to use trade for development. The decline in the income elasticity of trade observed in Figure 3 in part reflects the fact that the reintegration of the PRC, and to a lesser extent, the countries of Central and Eastern Europe, is a transitional phenomenon. Once the adjustments associated with what was to a large extent a move from autarky had occurred, trade inevitably grew much more in line with income. A more fundamental reason may be diminishing returns to the use of “GVC-technology.” The more international production is fragmented across countries, the greater the associated gross trade flows relative to total value added. Insofar as at some point in time businesses achieve what they perceive as the optimal use of GVCs, the growth of trade associated with this process will slow and increase more in line with total output (value added) produced. Indeed, insofar as the decline in the output-trade elasticity is due to supply chain managers deciding that it is more profitable to shorten supply chains or to “reshore” production, the result will be a fall in recorded gross trade flows and a smaller difference between the gross value of trade and trade in value added. Supply chain specialists predict that in the coming years there will be a move away from highly fragmented, globe-spanning supply chains toward a greater reliance on regional production networks (Srinivasan et al. 2014, Stank et al. 2014). Greater use

⁵ South Asia is an exception to this pattern, reflecting the large internal market and high barriers to trade that are to a significant extent the result of deliberate economic policies. But even South Asia is much more engaged in GVCs than are most countries in Africa and Latin America.

of technologies such as 3D printing (“additive manufacturing”) and robots/automation of tasks would have similar effects.

Figure 3: Trade-Income Elasticity and Export/GDP Ratio and Trade Growth since 1970



GDP = gross domestic product.

Source: Escaith and Miroudot (2015).

There are a number of reasons to believe that trade has not peaked and can grow faster than income in the coming decades, thus driving the ratio of global trade (exports plus imports) to GDP beyond the current level (around 60%). One reason for optimism is that ongoing and future technological change may on balance drive more trade by enhancing the ability of small firms to engage in international trade. The internet, digitization, more efficient logistics, e-payment systems, translation software, and so on are all potential drivers of the internationalization of SMEs. Another potential driver is rapid growth in trade in services. Services are much more tradable than is generally thought (Gervais and Jensen 2013), but are often subject to restrictive trade policies (see below). Traditional barriers to trade in goods and restrictions on inward FDI continue to be much higher in emerging and developing economies than in Organisation for Economic Co-operation and Development (OECD) nations. There is great potential for further trade growth, especially in developing country regions with high barriers to trade, if these can be lowered. Regional integration is an important mechanism that can be used to do so. Indeed, from the perspective of what trade can do to help achieve sustainable development, regional integration and cooperation is a key priority.

2. TRADE AND SUSTAINABLE DEVELOPMENT

As already mentioned, the most important channel through which trade and investment policy can support development is by increasing economic growth. This is also true for the 2030 Agenda for Sustainable Development and the associated Sustainable Development Goals (SDGs) that were adopted by all United Nations (UN) members

(United Nations, 2015a; b).⁶ Thus, economic growth—itself an SDG (Goal 8: inclusive/sustainable growth and employment) is important for ending poverty (SDG 1). More generally, the additional resources generated through growth are necessary to be able to make the investments required to attain the various goals. This indirect channel linking trade to the SDGs is complemented by other, more direct channels. Thus, trade reform can help reduce poverty if governments focus explicitly on reducing any anti-poor biases that are implied by prevailing trade policies—e.g., abolish higher tariffs on products that are important in the consumption basket of poor households (Nicita, Olarreaga, and Porto 2015). Food security and the prospects of achieving the goal of eliminating hunger may be enhanced by the removal of export restrictions by agricultural exporters (Martin and Anderson 2012). Access to energy may be enhanced by eliminating restrictions on trade in electricity and energy products such as natural gas (Florini and Sovacool 2012). Connecting smallholder farmers to GVCs can have significant positive impacts on health and nutrition (Swinnen 2014) and reducing food losses and wastage (FAO and World Bank 2011). Aid for trade that targets regional infrastructure that spans two or more countries may have a high payoff in improving connectivity for informal day traders as well as firms in the formal sector (Brenton et al. 2014).

Trade policy and trade-related measures are referenced in several SDGs and targets, as follows:

- **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.
- **Goal 9** (*industry, innovation, and infrastructure*) notes the need for quality, reliable, sustainable, and resilient infrastructure, including regional and transborder 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 World Trade Organization (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, nondiscriminatory and equitable multilateral trading system under the WTO, including through the conclusion of negotiations under its Doha Development Agenda (17.10);
 - significantly increasing developing countries' exports, including doubling the share of LDCs by 2020 (17.11);

⁶ The Appendix lists all 17 of the agreed SDGs.

- timely implementation of DFQF market access on a lasting basis for all LDCs, consistent with WTO decisions, and ensuring that preferential rules of origin applicable to imports from LDCs are transparent and simple, and contribute to facilitating market access;
- enhance policy coherence for sustainable development (17.14); and
- respecting each country’s policy space and leadership to establish and implement policies for poverty eradication and sustainable development (17.15).

The focus in the SDGs is on improving market access for developing countries, including through WTO negotiations and DFQF treatment for exporters in LDCs, and ensuring that developing countries have “policy space”—matters that have long been on the international agenda. While development assistance, policy space, and preferential market access can contribute to sustainable development, they may not do much to expand trade. Although there are important exceptions, such as Bangladesh exports to the United States (US), LDCs already have DFQF access to many high-income markets. The US and the large emerging economies, such as the PRC and India, can and should do more to provide LDCs with DFQF access to their markets, but research has documented that the binding market access constraints tend to take the form of nontariff measures (NTMs), including restrictive rules of origin.

The language on trade and trade policy in the various SDGs constitutes “business as usual”—the underlying approach has been pursued in the UN and the General Agreement on Tariffs and Trade (GATT)/WTO context for decades. The only specific target, to double the global share of LDC exports by 2020,⁷ is already included in the Istanbul Programme of Action (United Nations, 2011). There is a mercantilist flavor to how trade is included in the SDGs: the focus is on exports as opposed to trade (imports and exports), and the critical importance of addressing competitiveness weaknesses and improving governance and the business environment confronting firms in developing countries is under-emphasized. What matters is to help firms deal with NTMs in the relevant markets, both at home and abroad.

Many of these NTMs affect services trade and investment. This is important for any consideration of trade and the post-2015 development agenda because the performance of services sectors will influence the extent to which many SDGs will be realized, and trade and investment in the relevant services activities is one way in which that performance can be improved. Each of the 17 broad SDGs (see Appendix) is further articulated into a subset of more specific objectives, reflected in 169 targets.⁸ Many of these targets map directly to (coincide with) the performance of specific services sectors (e.g., health services—SDG 3, education—SDG 4, etc.).

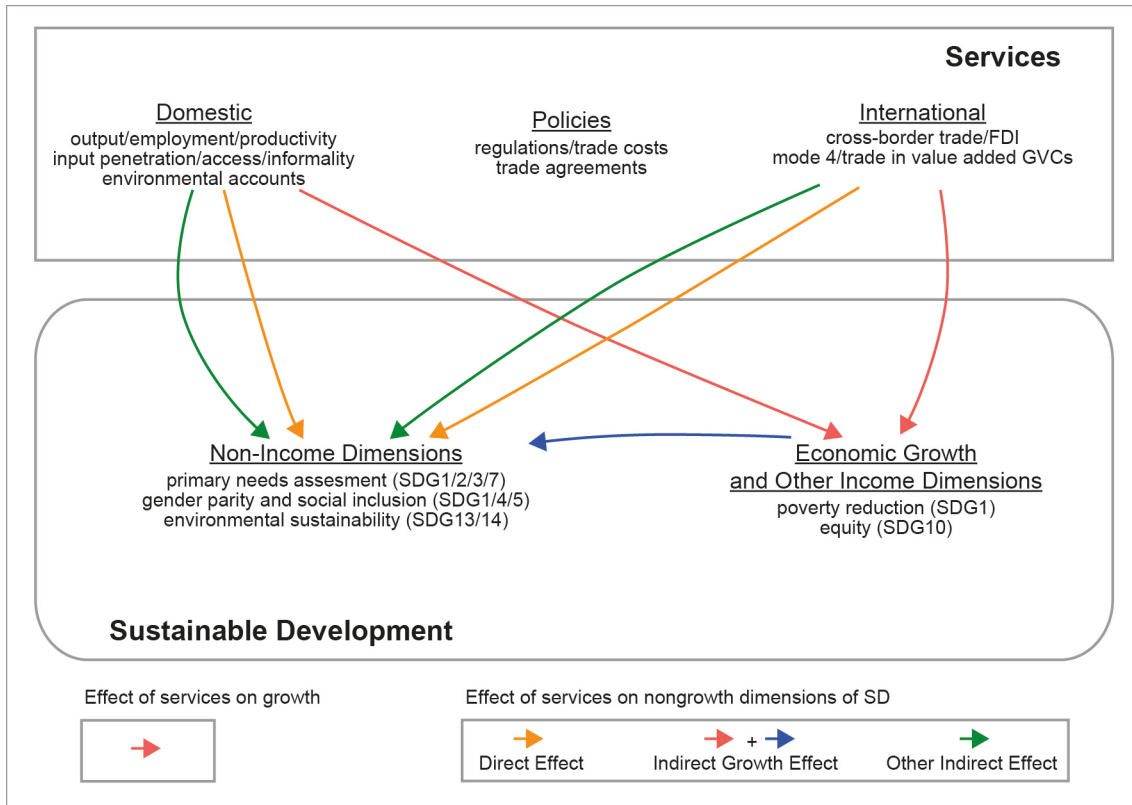
The linkages between services performance and the SDGs are illustrated in Figure 4. The upper box includes both domestically produced services and services provided through trade and investment. The cost and efficiency/productivity of both sources of services provision is impacted by policy. The effect of services performance on sustainable development outcomes is represented in the lower part of Figure 4. This distinguishes between two channels: (i) impacts of better services performance on economic growth—raising incomes increases both the scope to achieve income-related SDGs, such as reducing poverty and, indirectly, helps to realize other SDGs that

⁷ It is not clear what the baseline year is or if the target includes trade in services.

⁸ Sustainable Development Knowledge Platform. Transforming our world: the 2030 Agenda for Sustainable Development. <https://sustainabledevelopment.un.org/post2015/transformingourworld> (accessed 30 January 2017).

require resource investments; and (ii) the direct impact of services performance on specific dimensions of the various SDGs.

Figure 4: Services and Sustainable Development



FDI = foreign direct investment, GVC = global value chain, SDG = sustainable development goal.

Source: Fiorini and Hoekman (2015).

3. LEVERAGING TRADE FOR DEVELOPMENT

To “operationalize” trade as a means of achieving the SDGs, a first requirement is to identify what the binding constraints on trade growth are and then to design an implementation agenda that is focused on attenuating them. Adopting (agreeing on) specific indicators that can act as focal points for action and be used to monitor progress over time in addressing the constraints will help in leveraging trade opportunities. Specific performance indicators are important to focus attention at both the national level (developing country governments) and the international level (development partners) on actions that will help firms in developing countries utilize trade opportunities. Given that the post-2015 development agenda centers to a significant extent on services, such indicators must span services trade performance measures as well as more traditional trade policy foci. To date, the indicators that have been the focus of deliberation are too limited to serve this purpose.⁹

⁹ In the case of the trade dimensions of goal 17, for example, 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/> (accessed 30 January 2017).

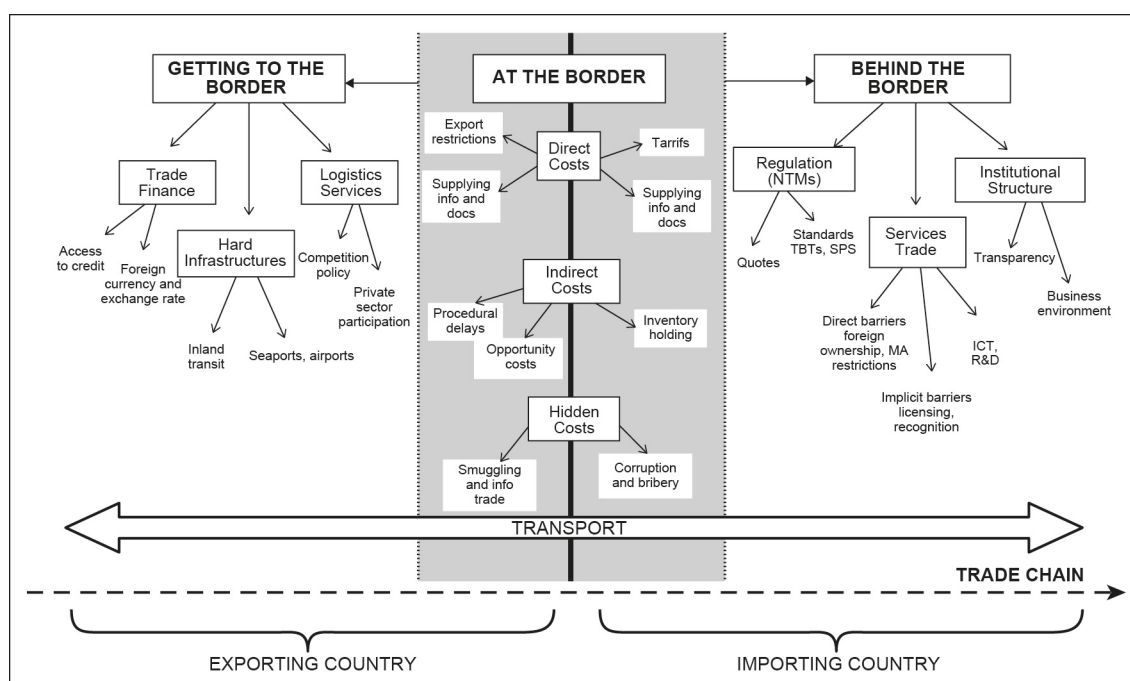
A common factor that inhibits more effective use of the global trading system by firms in developing countries is high trade costs. Extensive research has shown that trade costs are substantially higher in poor countries than elsewhere (e.g., Arvis et al. 2015). The result is that firms in these countries—most 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 (Cadot et al. 2011; 2013). Dennis and Shepherd (2011) find that a 10% improvement in trade facilitation is associated with a 3% increase in the number of products exported. 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; Zaki 2015). Every extra day it takes in Africa to get a consignment to its destination is equivalent to a 1.5% 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).

The available evidence suggests that trade costs are often an order of magnitude higher than prevailing import tariffs. Even if account is taken of NTMs, market access barriers in export markets are rarely the binding constraint on trade expansion. This is illustrated by the diverging trade performance of East Asian countries as compared with other developing country regions—East Asia has historically benefited less from preferential access to markets than other developing regions. The post-1980 experience makes clear that in practice autonomous reforms drive economic development and that key need is to reduce the operating costs that confront firms, including trade costs created by nontariff barriers, services trade restrictions, and inefficient border management. These and related sources of real trade costs should therefore figure prominently in the 2030 agenda for sustainable development.

In today's highly integrated world economy with extensive international production and value chains that span many countries, the level of trade-related transactions and operating costs is a major determinant of the ability of 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.

Trade costs will affect trade and associated investment incentives all along the value chain (Figure 5). They impact on the costs associated with getting products from where they are produced to a country where they have a buyer; they are incurred at the border, reflecting costs of customs clearance and the time and resource costs of dealing with administrative procedures and red tape, and they continue to impact on overall costs, and thus profitability, after products have cleared the border if firms confront inefficient service providers, noncompetitive markets for transport, and so forth.

Figure 5: How Trade Costs Matter



ICT = information and communication technology, MA = market access, NTM = nontariff measure, R&D = research and development, SBS = sanitary and phyto-sanitary measure, TBT = technical barrier to trade.

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

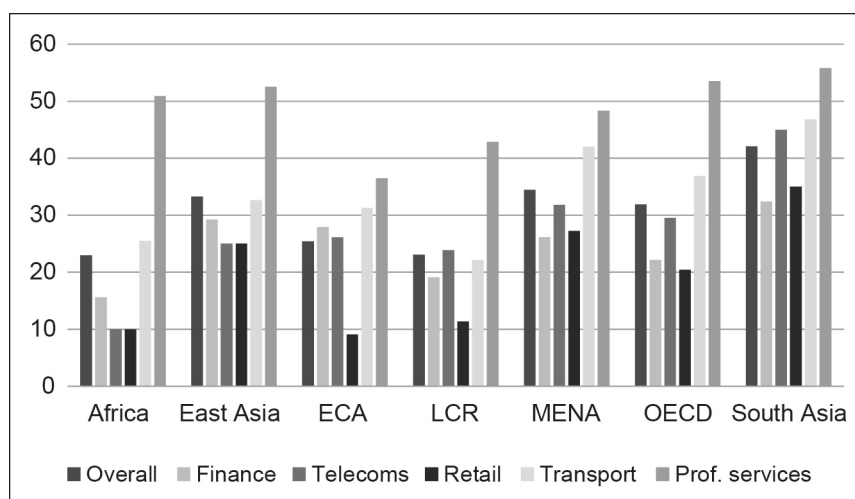
Trade costs also affect trade and investment in services (Miroudot and Shepherd 2015). Regulatory barriers to services trade, such as restricting the ability of foreign providers to offer services through nationality requirements or banning inward foreign direct investment in segments of the transport or communications sectors, will increase costs for all firms and make them less competitive. 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. 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.¹⁰

Barriers to trade and investment in services are often much higher than for goods. Although information on services trade policy is limited, new datasets have been developed recently that characterize the restrictiveness of services trade and investment policies (Borchert, Gootiiz, and Mattoo 2014). The World Bank's Services Trade Restrictiveness Index (STRI) reveal that barriers to trade in services are often

¹⁰ See e.g., Miroudot et al. (2012). 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 liberalization of air transportation services could lead to a 25% increase in the number of flights. 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 are offered (Francois and Hoekman 2010).

much higher than tariffs that apply to imports of goods.¹¹ They also show that in some developing countries formal barriers to trade in services are relatively low (Figure 6). High barriers to trade in services and high trade costs for services are 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 digitized.

Figure 6: Services Trade Restrictiveness Index



ECA = Europe and Central Asia, LCR = Latin American and the Caribbean, MENA = Middle East and North Africa, OECD = Organisation for Economic Co-operation and Development.

Source: World Bank Services Trade Restrictiveness Index database.

Trade Cost Indicators as a Focal Point for using Trade for Development

The foregoing considerations suggest using specific trade cost indicators to mobilize actions to help low-income countries benefit more from the trading system. Focusing on monitoring trade cost 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 (Hoekman and Shepherd 2015c). 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% 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—e.g., to lower costs of trade for goods and services by 1% per year through 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 onward, with a data lag of around 2 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

¹¹ See Services Trade Restrictions Database. <http://iresearch.worldbank.org/servicetrade/aboutData.htm> and OECD. Services Trade Restrictiveness Index. <http://www.oecd.org/tad/services-trade/services-trade-restrictiveness-index.htm> (accessed 30 January 2017).

manufacturing and agriculture for over 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 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 cost estimates into their determinants, distinguishing between factors that can be affected by policy changes and public investments, factors that require international cooperation (e.g., need to be addressed in the context of regional trade agreements), and factors that cannot be changed. Specific initiatives such as the efforts to monitor services trade policies by the OECD, the World Bank, and the WTO, and to collect information on transport costs and logistics performance on a country-by-country basis by the UN Conference on Trade and Development (UNCTAD) and the World Bank (see e.g., World Bank 2014) 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; 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 or collective action dimension. A large and expanding body of research has documented that the potential benefits for the world as a whole of action in this area is substantial (e.g., Decreux and Fontagné 2015).

In practice, reducing trade costs will require high-level political attention to achieve the needed internal coordination within governments, as well as external coordination and cooperation across governments to identify and implement cross-border projects and joint ventures that benefit both the countries directly concerned and traders located anywhere in the world. Explicit trade cost reduction targets will help to incentivize the relevant international organizations to focus their activities on assisting governments to achieve them.

Following the successful negotiation of a WTO Trade Facilitation Agreement (TFA) in 2013, the international development community is focusing on assisting countries to implement the agreement. The trade cost reduction agenda goes far beyond what is covered by the TFA (Hoekman and Shepherd 2015b). Use of trade cost indicators would help to provide a concrete focal point for both national action and international cooperation, 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, e.g., 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 is economically superior to the mercantilist thinking that is embedded in the approach toward trade that is implicit in the SDGs. Reducing trade costs will help importers and exporters, as well as benefit households in developing countries by reducing prices of goods. A major advantage of a trade cost target is that it is left to the governments concerned—both the developing country government and its trading partners—to identify actions that will reduce them. There are many reasons why costs are high, including own trade policies of developing economies, nontariff measures at home and abroad, a lack of trade facilitation, weaknesses in transport and logistics, etc. A trade cost reduction target leaves it to governments to work with stakeholders to identify how best to reduce prevailing excess costs. There is no one size fits all associated with achieving a trade cost reduction target.

Some Implications for Aid for Trade

From a development perspective, it is not just the effects of prevailing policies in a country that matter for the incentives to trade. Differences across countries in policies for a given product also give rise to trade costs. Addressing this source of costs will require more than unilateral action by a developing country government. International cooperation is called for—both aid for trade and trade agreements. In the case of Aid for Trade (AFT), much has been done following the 2005 WTO ministerial conference in Hong Kong, China, the result of recognition by high-income nations that trade negotiations and trade liberalization needed to be complemented with assistance to bolster the supply side in low-income economies. In the case of trade agreements, greater willingness is needed to revisit longstanding shibboleths, most notably the insistence on “special and differential treatment” (SDT) for developing countries.

SDT has been a core element of the approach that developing countries have historically pursued in UNCTAD and the WTO and continues to be prominent in the SDGs (see previous section). A re-thinking of this approach is called for if trade is to be a more effective instrument to help achieve the post-2015 development agenda. SDT has tended to revolve around arguments that developing countries should be able to maintain high(er) trade barriers and provide less than full reciprocity in trade negotiations, as well as efforts to obtain preferential access to major export markets through the generalized system of preferences (GSP) and more recently, DFQF access for LDCs. Much progress has been attained in pursuing this agenda and both have reached if not passed the point of diminishing returns. Most OECD countries now provide DFQF access to most LDCs, but given that average most-favored nation (MFN) tariffs have been declining steadily, the value of DFQF treatment, let alone GSP, is inherently limited and is rapidly converging toward zero.

Efforts to limit the extent of own trade policy concessions in trade agreements are arguably misconceived from a trade and development perspective because they do little to address the key factors that matter for competitiveness and that could therefore help improve trade performance. Policy areas that stand out in this regard include lowering tariffs, the cost and quality of service inputs; reducing the trade-impeding effects of NTMs, and pursuit of trade facilitation. It must be recognized however that dealing with NTMs and opening services markets is more complex than traditional trade liberalization. It is a platitude that tariffs can be reduced at the stroke of a pen by the minister of finance, while regulatory reform cannot. But not enough is being done to deal with the implications of this. This is an area where AFT can do more to help governments to pursue reforms, both on an autonomous basis and via trade agreements.

The launch of the AFT initiative and the creation of the Enhanced Integrated Framework for trade-related technical assistance for the LDCs signified recognition by the WTO membership that technical and financial assistance was needed to help low-income countries improve supply capacity. Many developing countries need to strengthen economic governance and regulatory institutions to ensure that the potential benefits from services liberalization are realized. This calls for greater effort to establish processes that ensure a “whole of government” approach to defining and implementing reforms, supported by “knowledge platforms” (Hoekman and Mattoo 2013) that bring together the associated stakeholders and epistemic communities, or “supply chain councils” (Hoekman 2014) that bring together different groups in society that have a direct stake in the operation of international value chains. The idea is to foster substantive, evidence- and analysis-based discussion of the impacts of prevailing policies with a view to building a common understanding of key factors that impede investment and identifying where there are large potential gains from public action. Such mechanisms could help to

- generate information on the effects of NTMs and prevailing regulatory policies to support a broad-based discussion on potential priorities for action (Cadot and Malouche 2012);
- enhance knowledge of regulatory experiences of other countries and what constitutes good practices, including complementary measures to address market failures and attain distributional objectives; and
- bring together representatives of the business community and international agencies to benchmark performance and assess progress in addressing specific trade constraints and institutional weaknesses that reduce investment in international value-chain activities.

In practice, such mechanisms may best be pursued on a regional basis, linked to regional integration initiatives and regional institutions (such as the regional development banks). First steps could be to undertake a “mapping exercise” to identify existing international networks of regulators (regional or global) and related epistemic communities. AFT that supports this type of international cooperation could help enable progress on services trade liberalization and create more fertile ground for countries to work together to reduce the costs associated with NTMs. Such efforts could also support greater ambition in terms of the design and coverage of trade agreements insofar as it provides greater assurance that the regulatory preconditions for benefiting from commitments to open access to services markets and reduce the negative incidence of NTMs were in place.

4. CONCLUDING REMARKS

The 2030 Agenda for Sustainable Development recognizes 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. A common denominator of such actions should be to reduce the costs of trade 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, implying that efforts to reduce trade costs should

include services sectors and not be limited to trade in goods, which to date has been the main focus of trade reforms and AFT projects and programs.

There is still very great scope to leverage trade for development in many countries, including through expansion of supply chain trade, especially in regions where value-chain-based production is limited—most notably Africa. Technological change, the rebalancing of the PRC's economy toward domestic consumption, and a possible more protectionist policy stance in some emerging and advanced economies all point to a potentially less hospitable global environment than what confronted East Asia in recent decades. Insofar as this is the case, it illustrates the need to focus primarily on national policy reforms and more effective regional integration efforts. The potential for greater use of the “GVC technology” and further specialization and fragmentation of production remains very significant for many developing countries. The same is true for trade in services and prospects for expanding trade in digital products, e-commerce, and so forth.

Much will depend here on the extent to which countries in Africa, Latin America and the Middle East, and Central Asia manage to increase their participation in GVCs. Policies matter importantly—action by governments to reduce trade costs and to refrain from “protectionism”—and on the extent to which international trade in services and digital transactions will expand in coming years. The share of services in total output and employment for the world as a whole has been increasing over time as countries become richer. This is nothing new (Kravis, Heston, and Summers 1983; Riddle 1986), but for any level of economic development the role of services in the economy is today more important than in the past as a result of technological changes in information and communication and other industries. It is therefore important that in thinking about how trade should figure in the post-2015 development agenda, services are front and center in the growth strategies of low-income countries.

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APPENDIX: THE 17 SUSTAINABLE DEVELOPMENT GOALS

- Goal 1** End poverty in all its forms everywhere
 - Goal 2** End hunger, achieve food security and improved nutrition, and promote sustainable agriculture
 - Goal 3** Ensure healthy lives and promote well-being for all at all ages
 - Goal 4** Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all
 - Goal 5** Achieve gender equality and empower all women and girls
 - Goal 6** Ensure availability and sustainable management of water and sanitation for all
 - Goal 7** Ensure access to affordable, reliable, sustainable, and modern energy for all
 - Goal 8** Promote sustained, inclusive and sustainable economic growth, full and productive employment, and decent work for all
 - Goal 9** Build resilient infrastructure, promote inclusive and sustainable industrialization, and foster innovation
 - Goal 10** Reduce inequality within and among countries
 - Goal 11** Make cities and human settlements inclusive, safe, resilient, and sustainable
 - Goal 12** Ensure sustainable consumption and production patterns
 - Goal 13** Take urgent action to combat climate change and its impacts
 - Goal 14** Conserve and sustainably use the oceans, seas, and marine resources for sustainable development
 - Goal 15** Protect, restore, and promote sustainable use of terrestrial ecosystems, sustainably manage forests, combat desertification, halt and reverse land degradation, and halt biodiversity loss
 - Goal 16** Promote peaceful and inclusive societies for sustainable development; provide access to justice for all; and build effective, accountable, and inclusive institutions at all levels
 - Goal 17** Strengthen the means of implementation and revitalize the global partnership for sustainable development
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Source: Sustainable Development Knowledge Platform. <https://sustainabledevelopment.un.org/sdgs> (accessed 30 January 2017).