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The Arab Financing for Development Scorecard**International trade as an engine for development****Summary**

The global financing for development framework considers trade as an enabler and catalyst to achieve the 2030 Agenda for Sustainable Development. The framework provides normative policy dispositions and commitments that developing countries can capitalize on to turn trade into a means by which to finance sustainable development.

Traditionally, the multilateral trading system (MTS) has contributed to economic growth but has also recently faced serious challenges. In 2018, the World Trade Organization (WTO) came under threat following the paralysis of its dispute settlement system and the rising tide of trade protectionism and counter retaliatory measures imposed outside the realm of the multilateral trade rule book. The uncertainty and growing trade tensions are creating spillovers, opportunities, ripple effects and externalities which are bound to be case-specific for Arab economies. The crisis facing the MTS and the Doha Development Agenda (DDA) opens the doors to revamp the WTO and make it fit for purpose for sustainable development. In this vein, the Inter-Agency Task Force on Financing for Development (IATF-FfD) recommended that governments use intergovernmental meetings to accelerate the progress of WTO reform.

Moreover, the intransigence over the DDA has created incentives for the proliferation of deep and comprehensive regional trade arrangements. The present document details several considerations that Arab economies may wish to factor in as they forge ahead with the creation of the Arab Custom Union or as the Arab regional integration project takes deeper and closer steps towards the realization of the "ACCESS framework" that has been proposed by the Economic and Social Commission for Western Asia (ESCWA) as the preferred regional and institutional integration framework to deliver Arab regional development and by which to pursue the 2030 Agenda.

The Committee on Financing for Development in the States Members of the Economic and Social Commission for Western Asia is invited to discuss the findings of the present document.

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Introduction

1. The Addis Ababa Action Agenda (Action Agenda) recognizes international trade as an engine for inclusive economic growth that contributes to the promotion of sustainable development. Through the Action Agenda, the international community renewed its commitment to promote a “universal, rules-based, open, transparent, predictable, inclusive, non-discriminatory and equitable multilateral trading system” to provide “meaningful liberalization opportunities” (para. 79), including exports from developing countries, in particular from least developed countries with a view towards “doubling their share of global exports by 2020” while “integrate[ing] sustainable development into trade policy at all levels” (para 82).

2. Equally, the commitment to “analyse and review all aspects of the implementation of special and differential treatment provisions” (para. 84) was reaffirmed, and the commitment to “strengthening regional cooperation and regional trade agreements” as well as to boost “coherency and consistency among bilateral and regional trade and investment agreements and to ensure that they are compatible with WTO rules” (para. 87).

I. TRENDS IN GLOBAL TRADE: TENSIONS, PROTECTIONISM, SPILLOVERS, OPPORTUNITIES, RIPPLE EFFECTS AND EXTERNALITIES

3. Contrary to the commitments made in the Addis Agenda, the multilateral trading system is confronted with critical, if not existential, challenges. The year 2018 saw growing trade tensions, notably between the United States and China, with the potential ramifications extending beyond the realm of their national economies. At the time of drafting this paper, the United States had more than doubled its tariffs on \$300 billion worth of Chinese commodities, while Beijing retaliated with tariff hikes on \$110 billion worth of American goods.¹

4. Projections show that as global trade veers away from these two economies, other countries will profit by capturing some of the exports diverted from the United States and China. According to the United Nations, most of the trade affected by the increased American and Chinese tariffs will divert to third countries.² However, the spillover effects of trade veering away from China and the United States (whether owing to tariffs or the manipulation of monetary policies and actual exchange rates) are bound to be significant and very case-specific for the rest of the world, including for Arab economies. Moreover, the extent by which global value chain patterns will shift across regions will ultimately depend on whether the growing tide of protectionism (tariffs and counter-retaliatory measures) are temporary or stationary and the extent to which competitiveness is maintained within regional and global value chains (GVCs).

5. The WTO continues to caution that world trade will face headwinds in 2019 and 2020 due to the rising trade tensions. According to the WTO Director-General, there has been a sevenfold rise in tariffs imposed across the globe in just one year. The WTO estimates, in a worst-case scenario that a breakdown in international trade cooperation would lead to wider trade conflicts and trigger further tariff escalations, eliminating 17 per cent of global trade and 2 per cent of world gross domestic product (GDP) growth in 2022.³ The very fact that the ongoing trade confrontations are taking place outside the realm of the of the WTO undermines the multilateral trading system (MTS). Indeed, multilateral trade rules are far from perfect and need reform, but the manipulation (namely, the dispute settlement body being brought to paralysis) of the WTO mandate and its rule book holds adverse repercussions for many developing countries.

¹ The tariffs imposed by the United States and China on each other in 2018 covered more than half of their bilateral trade. Their total trade was valued at about \$640 billion in 2017.

² United Nations Conference on Trade and Development (UNCTAD), Key Statistics and Trends in Trade Policy 2018.

³ World Trade Organization (WTO), “Global trade growth loses momentum as trade tensions persist”, Press Release 837 (2 April 2019).

6. In its 2019 report on Financing Sustainable Development, the United Nations Inter-Agency Task Force on Financing for Development (IATF-FfD) found that world merchandise trade had reached \$17.7 trillion in 2017, an increase of 10.4 per cent from 2016 figures. These values were estimated to have reached \$19.6 trillion in 2018. Several factors contributed to this growth namely the rise in commodity prices (fuel and minerals) and South-South trade which remained strong, accounting for 28 per cent of global trade. Developing countries accounted for 45 per cent of world merchandise exports and 42 per cent of imports.

7. Global services trade increased to \$5.4 trillion, a year-on-year increase of 7.8 per cent. The share of the services trade is expected to reach 25 per cent of total trade by 2030, driven mainly by technological change. Currently, developed economies supply two thirds of services traded internationally. The status quo could change as developing countries adopt digital technologies in trade.⁴

8. Despite the promising numbers in world trade, several WTO members adopted restrictive trade measures. Between October 2017 and October 2018, WTO member States implemented 137 new restrictive measures including import taxes, quotas and tariff increases. The trade restrictive measures impacted \$588.3 billion worth of trade. Those measures tend to increase uncertainty and have repercussions on trade activities and global recovery. On the other hand, WTO member States implemented 162 trade-facilitating measures. However, those measures impacted only \$295.6 billion worth of trade. The accumulation of trade restrictive measures continues to place global economic recovery at jeopardy.

9. The tariff trade restrictiveness index which measures the average level of tariff restrictions imposed on imports indicates that import restrictiveness remained relatively high in developing countries (and less so in Western Asia and Northern African regions). In terms of trade defense and remedies (anti-dumping duties/price undertakings, subsidy and countervailing measures and safeguards), they account for 63 per cent of all trade remedy measures that WTO members resorted to in 2017. Cumulatively, there were 1,500 trade defense measures in effect in 2017. Moreover, when comparing the number of disputes – initiations versus terminations - the recorded trade coverage of these trade remedies reveals that trade remedy measure coverage affects \$93.6 billion worth of commodities, whereas the terminations only covers \$18.3 billion.

10. The Action Agenda aims at doubling the share for least developed countries (LDCs) in global export by 2020 from the 2011 level of 1.1 per cent. In 2017, LDCs merchandise exports increased by 13 per cent after three years of decline. According to the IATF-FfD, almost 66 per cent of LDC exports to the world (in terms of tariff lines) were admitted duty-free. Despite this increase, the LDCs' share of global exports is below one per cent and far from the set target. The IATF-FfD therefore concludes that meeting the 2020 LDC target as stipulated by the Action Agenda and Sustainable Development Goal (SDGs) is highly unlikely, especially given that certain preferential rules of origin regimes remain restrictive, reducing the usefulness accrued from preferential market access.

11. The Director-General of the WTO contends that 98 per cent of global trade takes place or is administered under WTO rules, and that international trade continues to be largely free from tariffs, both as a result of zero most favoured nation (MFN) duties and because of duty-free preferential access. The United Nations Conference on Trade and Development (UNCTAD), however, points out that 50 per cent of world trade takes place only between countries that have signed preferential trade arrangements and cautions that tariffs applied to the remainder of international trade remain high. Preferential access therefore continues to play a key role for agricultural market access, but also remains significant for market access of manufacturing products. Moreover, the uncertainty about the multilateral system due to increased trade tensions has created room for the creation of regional, bilateral and interregional free trade agreements. The current number of regional trade agreements in force is 291.

12. On the 22 February 2017, the Trade Facilitation Agreement (TFA) entered into force. The main purpose of this agreement is to lessen the costs and burdens associated with moving goods across borders. The impact

⁴ WTO. "World Trade Report 2018" (2018).

of TFA on trade costs is immense: the partial implementation of this agreement could lead to about 4 per cent reduction in trade costs, while the full implementation of those measures could reduce trade costs by about nine per cent and increase global trade by \$1 trillion per year.⁵ If digital trade facilitation is implemented, it would improve transparency, further reduce costs, facilitate and increase cooperation and coordination between governmental agencies, and pave the way for cross-border paperless trade.

13. The Economic and Social Commission for Western Asia (ESCWA) previously reported that empirical assessments validate the gains from concluding the Doha Development Round. It has been suggested that even by securing a “Doha-light” trade package of reforms, the global economy could reap \$2.2 trillion in additional annual gains.⁶ Moreover, by comparing the expected socioeconomic and environmental benefit of every dollar spent on the sustainable development targets, it was found that promoting international trade and lowering trade barriers could achieve far more per dollar spent than any other priority area of the Action Agenda.⁷ According to estimates by the Copenhagen Consensus, concluding the Doha Development Agenda could provide developing countries with \$2,011 for every dollar spent.

14. The IATF-FfD indicates that 80 per cent of trade requires some sort of short-term credit or guarantee. This would imply that \$14 trillion in trade finance is needed to finance \$18 trillion in annual trade flows. Currently the global trade financing gap stands at \$1.5 trillion.⁸ The two main barriers behind this gap are: the high cost of capital for commercial banks on trade finance in Basel capital requirements and the decrease in correspondent banking due to de-risking. The trade financing gap has a bigger impact on small and medium enterprises (SMEs) when compared to multinationals – over 50 per cent of trade finance requests by SMEs are rejected while only 7 per cent for multinational companies.⁹ In order to lessen the gap, multilateral development banks (MDBs) have substantially increased their activity in trade finance benefiting SMEs. In 2017, the value of trade finance facilitation reached \$28.5 billion.

II. TRADE AS AN ENGINE FOR FINANCING SUSTAINABLE DEVELOPMENT

REGIONAL CONSIDERATIONS FOR THE ARAB REGION

15. To realize a universal, rules-based, open, transparent, inclusive, non-discriminatory and equitable multilateral trading system, the WTO would have to resolve the outstanding accession requests by Arab countries. More than two decades after the creation of the WTO, only 13 Arab countries have been granted WTO membership. Several Arab countries’ accession requests date as far back as 1987. The State of Palestine continues to be barred from receiving permanent observer status, although the Protocol on Economic relations has granted it, de jure, a separate customs territory/envelope in which to exercise economic and trade autonomy.

16. More importantly, the League of Arab States decision to forge ahead with the creation of the Arab Customs Union provides de jure grounds for notifying the WTO of this regional integration arrangement, including all its constituents. The Arab Custom Union (ACU) would provide a new modus operandi and create

⁵ WTO. “Trade Facilitation”, available at: https://www.wto.org/english/tratop_e/tradfa_e/tradfa_e.htm.

⁶ This estimation is based on a package of measures, including the implementation of the agreements on trade facilitation (\$960 billion); international services (\$1,039 billion); digital economy (\$147 billion.); the implementation of the decision on Duty-Free Quota-Free (\$7.1 billion.); elimination of agricultural subsidies (\$5 billion) and food export controls (\$ 45.5 billion.); and the liberalization of environmental goods (\$ 9.5 billion). ICC Research Foundation, “Payoff from the World Trade Agenda 2013”, (April 2013), available at: <https://piie.com/publications/papers/hufbauerschott20130422.pdf>.

⁷ See the Copenhagen Consensus, Post-2017 Consensus: Trade Assessment: available at: <https://www.copenhagenconsensus.com/publication/post-2015-consensus-trade-assessment-anderson>.

⁸ This represents the amount of trade finance that was requested by importers and exporters but rejected – Asian Development Bank. “2017 Trade Finance Gaps, Growth, and Jobs Survey”. (2017).

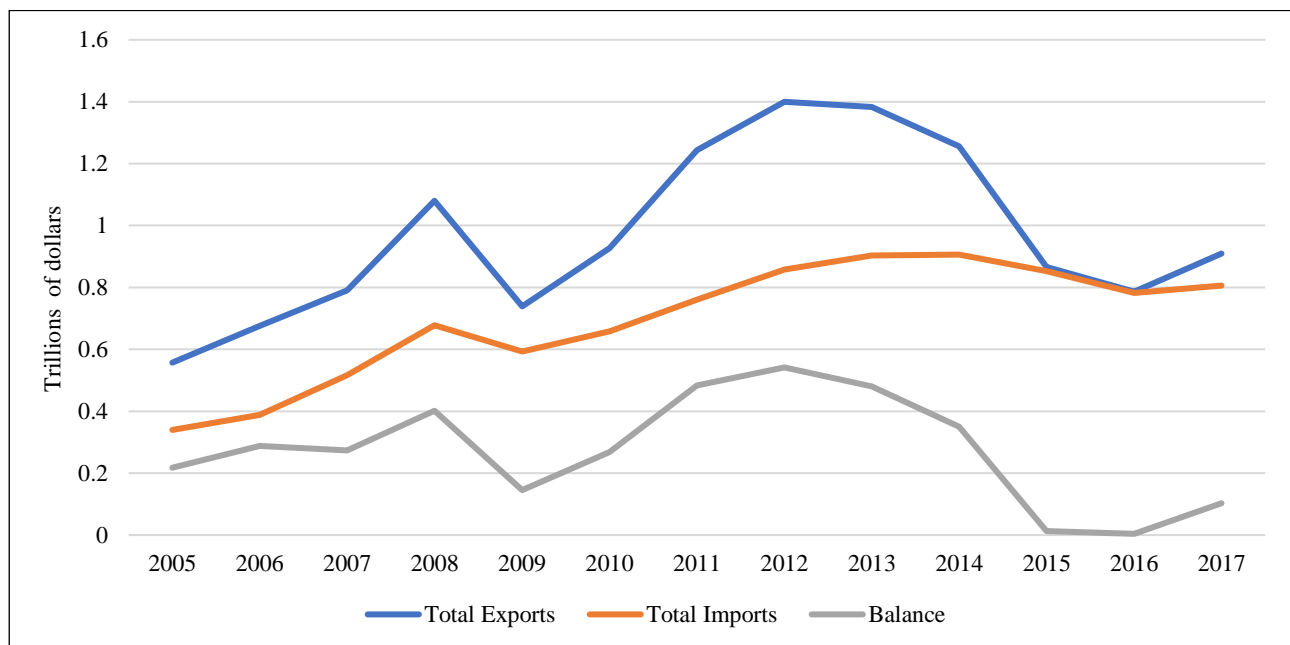
⁹ WTO. “Trade finance and SMEs”.

de facto grounds for Arab non-WTO members to benefit from both MFN treatment and preferential market access granted by third countries within the ambit of regional trade agreements, all of which would require technical adaptations for the proper functioning of the ACU.

17. In 2015, the Arab region exports increased by 12 per cent to reach \$1,123 billion (figure 1). The driver of this increase was higher oil prices which boosted related export revenues in oil-rich countries, while the imports increased to \$1,054 billion, a 6.3 per cent increase year-over-year. As a result, the region witnessed a positive balance. During 2011-2014, the region experienced a decrease in exports driven mainly by lower oil prices. This trend had major repercussions on foreign reserves, fiscal balances and external debt trends.

18. In 2017, the Arab region became a net exporter of goods. A decline in commodity prices caused most Arab economies to experience current account deficits. Total merchandise exports amounted to \$909 billion (\$461 billion or 50.7 per cent of which are attributed to fuel revenues) while the total Arab import bill amounted to \$806 billion for the same year. The net value of the export surplus was \$103 billion in 2017. Between 2010 and 2017, the Arab region witnessed an export surplus of \$2.2 trillion.

Figure 1. Arab merchandise exports and imports, 2005-2017



Source: ESCWA based on UNCTAD data.

19. ESCWA had also reported that the trade-growth and development nexus was stifled given that Arab export competitiveness was adversely affected by heterogeneous regulatory frameworks associated with extra-regional preferential trade agreements between Arab countries and non-Arab countries. These agreements superimpose regulatory requirements and specific rules of origin that do not necessarily take into account sustainable development imperatives. Relying on them to increase exports has undermined the competitiveness of some countries and, in some cases, the cost of complying with those rules has outweighed the gains made by countries from lowering their export tariffs as required by those agreements. In some cases, the cost of compliance with the rules exceeds the benefits offered by regional trade agreements. Consequently, the composition of trade partners significantly impacts the trade-growth nexus.

20. It is interesting to note that intraregional trade is generally subject to lower tariff restrictiveness than otherwise imposed through interregional trade. According to the 2019 UNCTAD key statistics and trends in trade policy bulletin, Western Asia and Northern African economies face, on average, a tariff of 1.9 per cent when exporting intraregionally, as opposed to 0.6 per cent when exporting to developed economies.

More so, these economies enjoy the highest preferential margins intraregionally. In other words, intraregional trade continues to pose an important export channel/destination for the region's economies and holds more favourable prospects for non-oil exports.

21. Several factors explain this situation and why the trade-growth nexus in the region remains subdued: the structural changes between trade and output witnessed in recent years; weak external demand associated in part to the sovereign debt crisis; and poor logistical performance. In addition, the Arab region remains one of the most restrictive regions in services trade, with a relatively high Services Trade Restrictiveness Index. The inefficient supply of services provided mostly by the public sector and the high cost of key backbone services, including transport, telecommunications, storage and distribution, are factors that discourage investment and restrain trade expansion potentials.

22. The Arab region is highly dependent on trade for financing. Merchandise trade as a percentage of GDP is at 68 per cent while the world average stands at 44 per cent. Despite the strategies to decrease oil dependency followed by most Gulf Cooperation Council (GCC) countries, oil trade is still a major source of revenue for these countries. On the other hand, service trade as a percentage of GDP for the Arab region stands at 18 per cent, higher than the world average of 13 per cent.

23. According to the IATF-FfD, taxes on international trade, such as customs duties (taxes on imports) and export taxes (taxes on exports) and domestic value added taxation, are a direct linked to a country's development financing capacity. Income from trade taxes remains an important contributor to public revenue, such as LDCs.¹⁰ In this context, it is worth highlighting the following considerations associated with each of the above-mentioned tax related financing channels:

(a) *Taxes on exports*: Export taxes and licensing fees have resulted in increased financial returns for some Arab countries. However, since Arab commodity exports only represent a small fraction of world exports (excluding oil products), the use of taxes on exports as a financing means can adversely alter the terms of trade and diminish national welfare, as the incidence of the tax falls on the domestic economy (producers) rather than external markets (consumers). This argument has provoked a parallel discussion on the abolishment of consular fees within both multilateral and preferential trade. There is consensus nonetheless to support the use of export taxes on raw materials and primary commodities, preferably when the export country holds a dominant market power. Yet, export taxes may have indirect effects on sustainable development when they are imposed to conserve natural resources and combat trade-based money laundering;

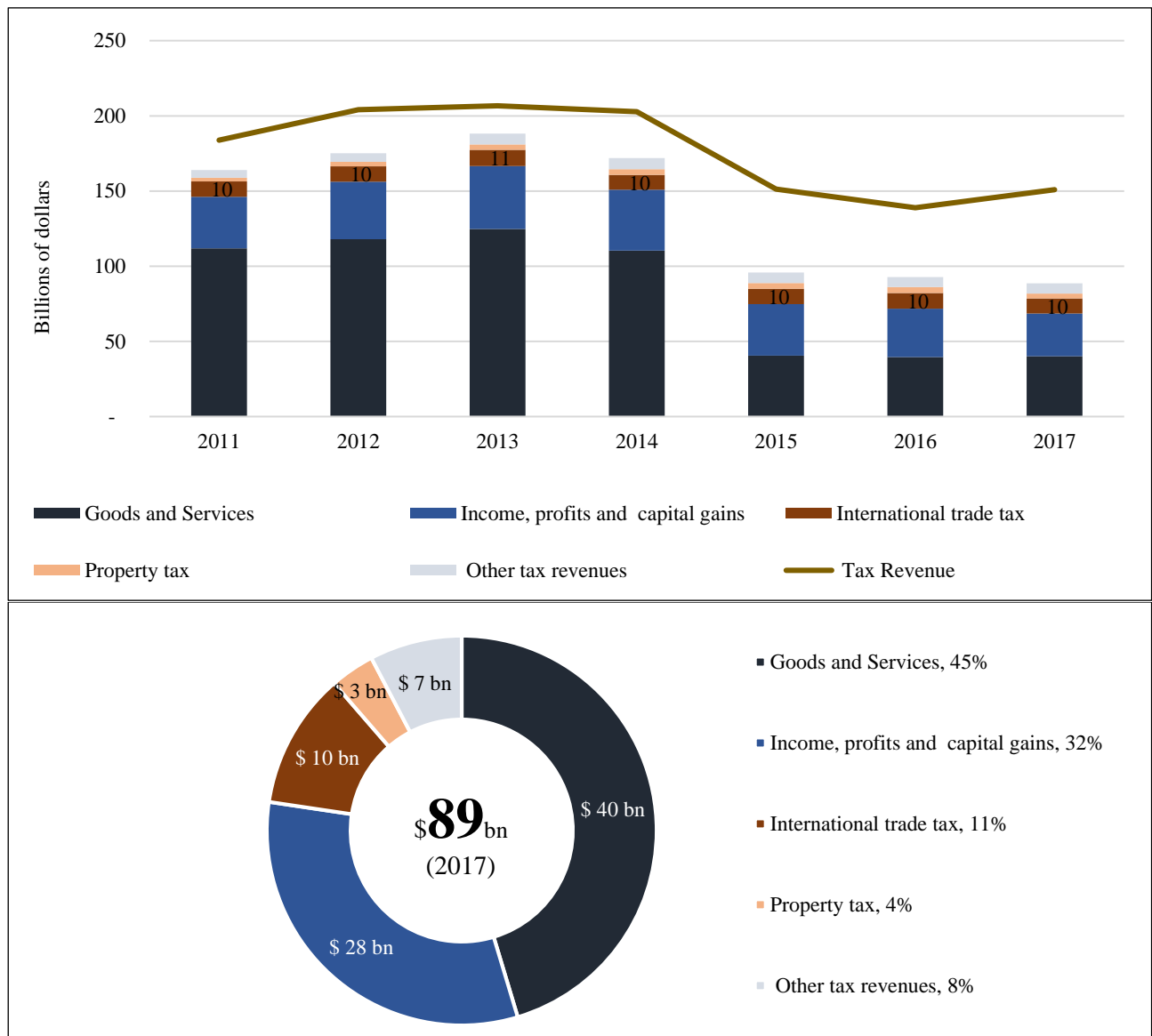
(b) *Taxes on imports*: Custom duties in the Arab region have declined considerably due to unilateral, regional and multilateral trade liberalization measures. For some countries, the loss in revenue was largely compensated by domestic sales and value added taxes. Trade taxes in total tax revenues declined on average from about 26 per cent in the early 1990s to 15 per cent in 2012.¹¹ According to the Arab Monetary Fund, the share of customs revenues represented nearly 3.8 per cent of total public revenue in 2015. However, according to national sources, the share of trade taxes amounted to 6.6 per cent of tax and non-tax public revenues in 2017 (figure 2) or 11 per cent of tax revenues in the same year.¹² Raising trade taxes remains contingent on the interplay between several policy priorities, including renegotiating a trade justice multilateral trade agenda; the extent to which tariff overhangs can be exploited without adversely affecting welfare; the implications on regional integration aspirations and extra-regional preferential trade agreements; the interaction between tariffs and domestic taxes; and the acknowledgment that trade taxes can distort trade and protectionism thus constituting a source of economic distortion;

¹⁰ Taxes on international trade on average account for less than 4 per cent of public revenue globally, but they account for 10 per cent in LDCs.

¹¹ Mario Mansour, "Tax policy in MENA countries: looking back and forward", IMF Working Paper 15/98 (May 2015). Available at: <https://www.imf.org/external/pubs/ft/wp/2015/wp1598.pdf>.

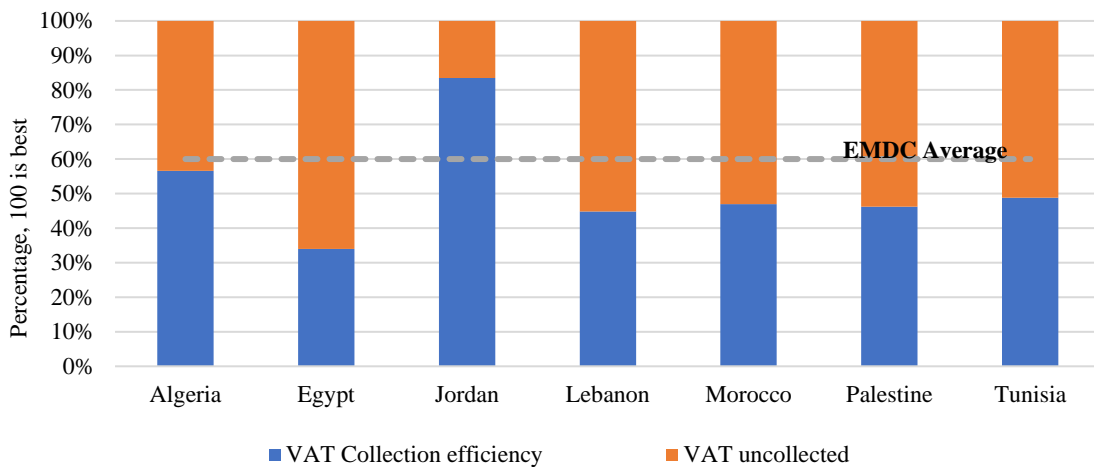
¹² Missing data for Comoros, Djibouti, Iraq, Syrian Arab Republic and Yemen cannot be extrapolated.

Figure 2. Trade taxes, tax dynamics, Arab region 2011-2017



(c) Tax systems in the Arab region have mostly relied on indirect taxes, including the adoption of value added tax (VAT) to raise public revenues. However, by design, indirect taxes tend to be regressive and so the burden of taxes tends to be higher on the middle and lower class than on the rich, since the former constitute the largest sections of consumers in the Arab countries. Exempting basic food items and other products mainly consumed by the poor can reduce the level of regressive VAT. There is evidence that the VAT is not that regressive as a result of differentiated rates and exemptions in some developing countries (Bird and Gendron, 2007). Thus, the case for the VAT is usually based on the efficiency argument that it is a broad-based tax with little intersectoral distortions. (box 1).

**Box 1. VAT collection efficiency for Arab countries
(selected middle income countries), 2017**



Sources: National authorities, IMF; and ESCWA staff calculations.

The VAT rates vary widely among middle income Arab countries. It reaches as high as 20 per cent in Morocco, and 11 per cent in Lebanon and as low as 5 per cent within the GCC customs union. In 2017, most middle income Arab countries, VAT collection efficiency fell below the Emerging Markets and Developing Countries (EMDC) average of 60 per cent. Jordan's tax collection efficiency is said to be at 84 per cent, the only country between the selected ones with a VAT collection efficiency above the EMDC's average. The uncollected VAT revenue reaches as high as \$19.2 billion for Egypt. Caution needs to be taken into consideration when interpreting such figures as low efficiency scores which can be attributed to the effect of multiple VAT exemptions, reduced rates, non-compliance on government revenues (tax avoidance/evasion) and low registration thresholds (particularly in Egypt, Morocco and Tunisia) as they amplify this effect by producing large variations of the effective tax rate.

24. One of the salient objectives of the Arab Development Outlook was that by 2030 the Arab region could be hosting trade preferences from over 110 countries spread across five continents. By 2021, most intraregional imports would be granted duty-free access under ACU. Under those conditions, the narrow window to raise tariffs or impose seasonal or tariff rate quotas and fiscal charges would be further reduced. In this situation, the opportunity to employ trade taxes to finance development would not only be restricted by overhang margins maintained under the WTO, but also by three main binding constraints:

- The decision to establish an Arab Customs Union by 2021 which, if created in coherence with Article XXIV of the General Agreement on Tariffs and Trade (1994), would imply opting for relatively low common external tariffs to accommodate the Customs Union of the Gulf Cooperation Council (on the assumption that no compensatory adjustments or technical adaptation would be required by third countries);
- The need to opt for a low common external tariff for an Arab Customs Union to maximize consumer welfare, given the modest influence that many countries have on their terms of trade owing to structural deficiencies;
- A detailed review of how extra-regional preferential trade agreements operate and how they would be technically adapted following the establishment of deeper forms of Arab integration beyond an Arab Customs Union.

25. Another important point that Arab countries may need to factor into the discussion over the use of trade taxes as an engine for financing development relates to the findings associated with illicit financial flows (IFFs). There have been few studies on the development impact of IFFs on Arab economies. Though there have been many studies on related issues from a security perspective, development has been largely ignored.¹³

26. An ESCWA report on illicit financial flows in the Arab region provides compelling evidence of the structural, socioeconomic, governance and security vulnerabilities that continue to undermine Arab economies due to the pervasiveness of IFFs, which are eroding the region's domestic resource mobilization capacities to the detriment of their potential to finance sustainable development. Substantial leakages in the range of \$60 billion to \$77 billion associated with trade-based illicit flows arising from skewed fiscal, tax and trade policies were identified as the most pervasive forms inciting illicit financial flows. These leakages are a lost opportunity that could have otherwise been harnessed to create the fiscal space necessary to sustainably finance development. Illicit flows are distorting trade and taxation systems in as much as they are creating inequalities impairing governments' expenditure eligibility requirements and perception-based governance and corruption standings.

27. The following top-line messages on international trade emanated from the work of the IATF-FfD in 2019. These messages intersect with Arab trade interests and have several ramifications for the formulation and development of trade policy in the Arab region:

- The crisis of the multilateral trading system opens the door to revamp it and make it fit for purpose for sustainable development. Governments will use appropriate intergovernmental meetings to accelerate progress with WTO reform and complete longstanding work on the development agenda;
- New and existing trade and investment agreements are encouraged to address synergetic linkages between trade, investment and socioeconomic policy (such as finance, taxation, competition, labour, gender, and technology) in order to enhance trade contribution to the SDGs;
- Actions are required to allow micro, small- and medium-sized enterprises (MSMEs) to better tap trade opportunities and integrate into international value chains;
- The increase in multilateral development banks (MDBs) provision of financing and guarantee is timely but would need to be complemented by greater private finance, as well as potentially by national development banks, including by reversing the decline in correspondent banking, which is partly responsible for the trade finance gap.

¹³ Within related literature on capital flight, very few studies exist. However, see Abdullah Almounsor, "Capital flight accounting and welfare implications in the MENA region", 2008.