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

Ensuring that developing and least developed countries have an opportunity to turn trade into a means of finance and spur growth remains key to the implementation of the Addis Ababa Action Agenda. Failure to do so not only undermines the global financing for development framework and the trade-led components of the 2030 Agenda for Sustainable Development, but also questions the viability of the contemporary trade equality agenda geared towards levelling the playing field among unequal players, which in itself is a source of trade injustice.

The present document shows that the Arab region is not entirely free to take advantage of the normative trade tools and policies enshrined in the Action Agenda. To do so, trade policy recalibrations are needed at the regional and multilateral trade fronts, including by combating new forms of trade and investment protectionism, and through the review of the many extra-regional trade agreements that the Arab region maintains, so as to prioritize its own regional trade integration project since Arab trade integration offers a greater source of per capita growth for the region. Arab countries should also pursue a multilateral trade reform agenda, rather than settle for trade equality norms. The region's terms of trade are arguably vulnerable, a situation that has considerably undermined the trade-growth nexus and the potential for intraregional trade to develop as a major source for financing regional sustainable development strategies alongside the 2030 Agenda.

Representatives of member States of the Economic and Social Commission for Western Asia (ESCWA) are invited to discuss the findings of the present document, bearing in mind that its main aim is to advance the Arab Financing for Development Scorecard.

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Introduction

1. The Third International Conference on Financing for Development resulted in a new global framework to finance the 2030 Agenda for Sustainable Development. The Addis Ababa Action Agenda was designed to mobilize all sources of finance (public, private, domestic, international, bilateral, multilateral, traditional and innovate)¹ to create a fiscal space for Governments to manage a sustainable path to development. It serves as a means of implementation of the 2030 Agenda, including its 17 Sustainable Development Goals (SDGs) and associated 169 targets and 230 measures of achievement. International trade constitutes the fourth pillar of the new global framework by which to finance sustainable development.
2. The present document is intended to serve as input to, and should be read in conjunction with, the Arab Financing for Development Scorecard. The document maps the international trading landscape and corresponding commitments arising from the Action Agenda, and considers whether trade (preferential or non-preferential) has served as an engine for growth and development, as suggested by the Action Agenda.
3. The document analyses a critique of the global financing for development framework, namely the challenges that arise from superimposing sustainable development considerations into the rule-book of the World Trade Organization (WTO), which claims that utilitarianism does not sit well with sustainable development or with trade justice principles. The document recognizes that regional contexts provide the ultimate verdict on the viability of the new global financing for development framework. As such, the document examines the trade-led components of the Action Agenda against the Arab region's realities, to provide an assessment of the net financial flows associated with its trade profile, terms of trade and trade-growth linkages.

I. TRADE WITHIN THE NEW GLOBAL FINANCING FOR DEVELOPMENT FRAMEWORK

4. The Action Agenda is the fourth attempt (following four United Nations development decades and the Millennium Development Goals) to advance the trade-growth and development nexus. Sixty-five trade mandates were showcased through the Action Agenda to advance the nexus,² and accrue gains from meaningful trade opportunities. However, the implementation of the Action Agenda faces the same difficulties as its predecessors (the 2008 Doha Declaration on Financing for Development and the 2002 Monterey Consensus), owing to the following five systemic and governance challenges:

(a) Normative aims are unsupported by affirmative action: Normative trade and development objectives are seldom supported by mechanisms to ensure that they are applied in practice. Grandiose trade objectives and goals promoted in New York remain in stark contrast to the Geneva mindset that dictates WTO rule-making. The World Trade Organization is an independent entity whose norm-setting prerogatives are not dictated by the United Nations. As such, the enforcement of normative principles requires an inter-agency convergence agenda in the field of international trade;

(b) The indiscriminate use of the term 'trade' and its influence on growth and development: The Action Agenda overlooks how the different strands of trade influence growth. It considers multilateral trade, plurilateral trade, preferential trade, trade-openness, trade liberalization, intra-industry trade and supply-chain trade as synonymous, although they influence the trade-growth nexus differently as each operates through distinct rules and forms of governance. Nonetheless, trade in the abstract was sought as an engine for

¹ The new global financing for development framework under the Addis Ababa Action Agenda includes the following seven priority action areas: domestic public resources; domestic and international private business and finance; international development cooperation; international trade as an engine for development; debt and debt sustainability; addressing systemic issues; and science, technology, innovation and capacity-building.

² The mandates include: eliminating trade restrictions; expanding trade finance; prohibiting certain forms of subsidies; promoting a non-discriminatory and equitable multilateral trading system; and strengthening the consistency and compatibility of regional trade agreements with the WTO.

development irrespective of the outcomes rendered by each strand, both in country-specific and cross-country situations. This issue raises the traditional questions of whether multilateral or regional trade are considered a driver of growth and development;

(c) Hinging financing for development outcomes on the World Trade Organization: Another challenge facing the implementation of the trade-led commitments of the Action Agenda is reflected in three distinct, yet contradictory, commitments. The international community resolved to increase world trade in a manner consistent with the SDGs. A stronger commitment then ensued to integrate sustainable development into trade policy at all levels, followed by a third commitment that deferred the entire matter to the World Trade Organization to consider how trade contributes to sustainable development;

(d) Trade equality or trade justice in realizing the financing for development outcomes: The utilitarian bias embedded throughout the WTO rule-book poses another challenge to the implementation of the Action Agenda: the multilateral trading system was designed to promote 'trade equality' but not necessarily 'trade justice'. Trade equality is sought through embedded liberalism to safeguard cardinal principles such as the most favoured nation and national treatment. They level the playing field among unequal players, which remains a source of bias in itself. Trade justice, however, is pursued as exceptions to those general principles, sometimes on the basis of non-binding provisions, including many special and differential treatment provisions granted to developing and least developed countries. Bringing justice considerations into the trade-growth and development equation is a fundamental game changer, as the multilateral trading system has traditionally been developed and judged on utilitarian/mercantile conceptions. However, utilitarian notions do not sit well with justice principles, which rely on concepts such as non-discrimination, distributional equality and reciprocity. Utilitarian principles that aim to maximize aggregate benefits or overall welfare do not necessarily capture the injustices arising from levelling the playing field among unequal players;

(e) Preserving a rule-based multilateral trading system rather than promoting sustainable development: Sustainable development is not prominent in the WTO rule book. At most, it is dealt with obliquely and does not seem to pose a binding legal rule. It is captured as a broad principle in the Marrakech Agreement. WTO agreements do not provide legal grounds to invoke sustainable development considerations. Incorporating sustainable development considerations into the multilateral trade rule-book might prove controversial (box 1). By the World Trade Organization's own logic, inconsistencies may arise from maintaining multilateral non-discriminatory trade openness while safeguarding or promoting sustainable development considerations.

Box 1. Climate change and trade: a conundrum

The Paris Climate Change Agreement recognizes the positive co-benefits arising from trade in mitigating and adapting to climate change, but does not specify the kind of action that can be taken without impinging on multilateral trade rules. Trade actions taken to combat climate change could place sustainable development goals in conflict with WTO rules. The legality of imposing border carbon adjustments or taxing imports on their embodied carbon, for example, might be contestable under the WTO. Similarly, WTO agreements on anti-dumping, subsidies and countervailing measures, and trade-related intellectual property rights could limit the subsidization and exportation of environmental goods, and the development of nascent environmentally friendly industries and technologies.

The Paris Agreement acknowledges that nationally determined commitments can involve transferred mitigation outcomes (e.g. carbon market platforms), allowing for arrangements outside the multilateral process. The Paris Agreement provides possibilities for the creation of carbon market clubs, where countries exchange exclusive rights to trade emissions by generating tradable offset credits to meet their nationally determined commitments. Conflicts may arise, however, when procedures for emission trading or carbon pricing coalitions discriminate against WTO members. Disputes over such actions could produce significant litigation through the WTO dispute settlement mechanism.

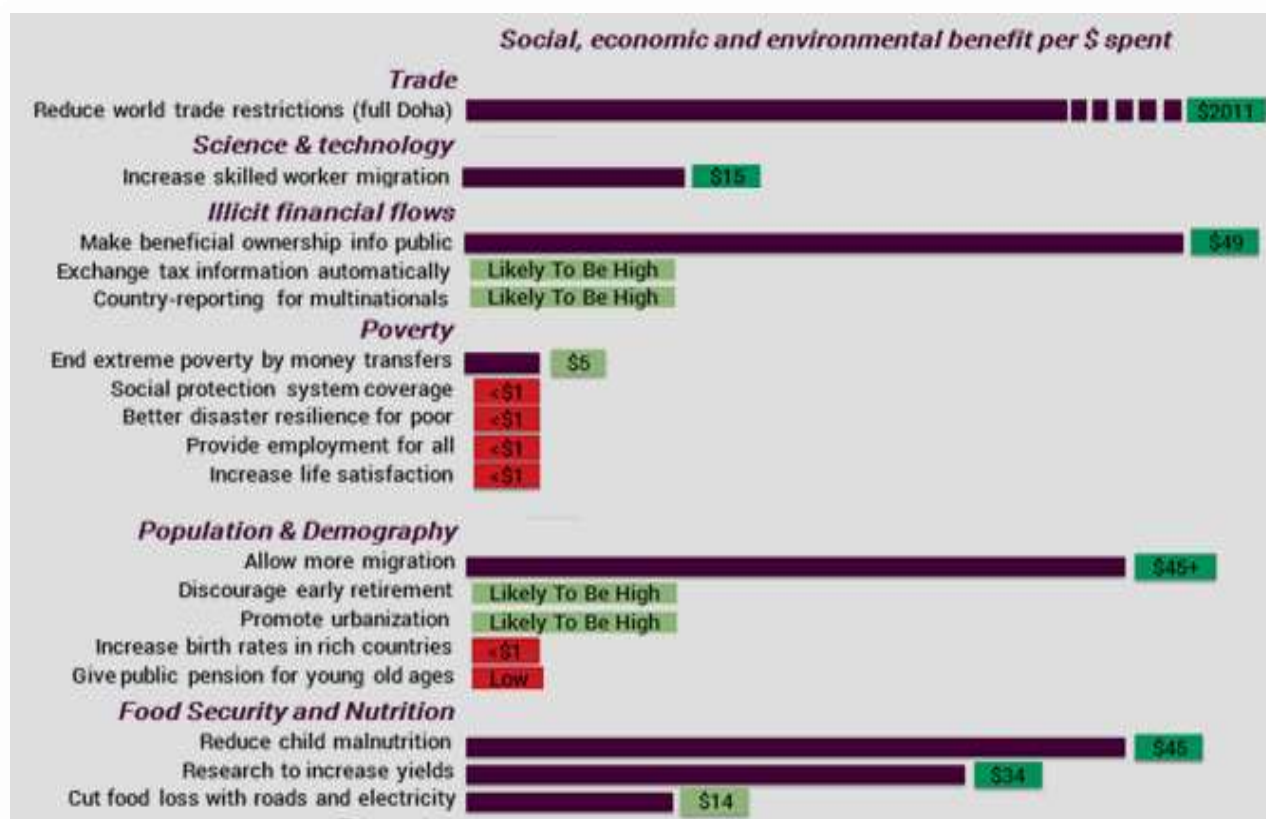
Source: Compiled by ESCWA.

II. SUSTAINABLE FINANCING GAINS FROM INTERNATIONAL TRADE

5. Promoting a transparent, predictable, inclusive, non-discriminatory and equitable multilateral trading system is considered key to financing the SDGs. As such, the Action Agenda calls for redoubling efforts to conclude the Doha Development Agenda. However, this normative objective has eluded the international community since 2001. To attain this objective, a different approach is needed to recalibrate the sustainable development and trade justice dimensions of the Doha Development Agenda, so that developing countries can secure a share in the growth of world trade commensurate to their sustainable development needs. This remains the principal goal of the Doha Development Agenda.

6. Empirical assessments have striven to validate the gains from concluding the Doha Development Agenda. It has been suggested that even if a ‘Doha-light’ trade package of reforms was secured, the global economy could reap \$2.2 trillion in additional annual gains.³ 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.⁴ According to estimates by the Copenhagen Consensus, concluding the Doha Development Agenda could provide developing countries with \$2,011 for every dollar spent (figure 1).

Figure 1. Financial returns on SDG financing



Source: The Copenhagen Consensus.

³ This estimation is based on a package of measures, including the implementation of the agreements on trade facilitation (\$960 billion); international services (\$1039 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). See <https://piie.com/publications/papers/hufbauerschott20130422.pdf>.

⁴ The Copenhagen Consensus.

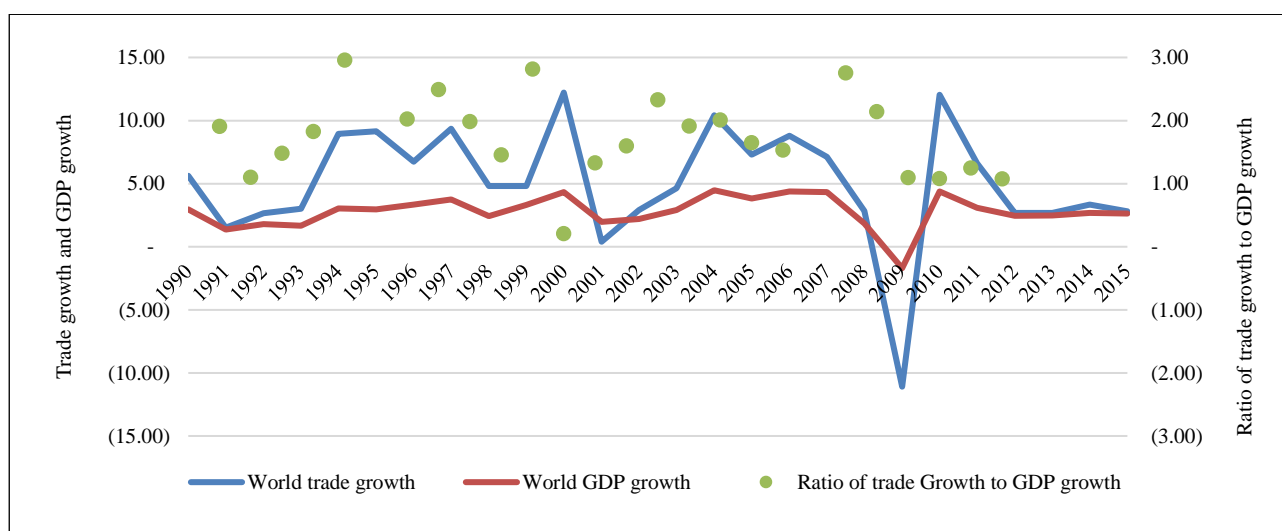
III. TRADE-GROWTH AND SUSTAINABLE DEVELOPMENT NEXUS

A. GLOBAL TRENDS

7. The factors that have prompted the expansion of world trade and output since 1986 are subject to many interpretations, but the fact that they coincided with a reduction in trade barriers is indisputable. By some accounts, 25 per cent of world trade growth was due to tariff reductions.⁵ Trade liberalization is estimated to have generated three times the gains arising from a reduction in transportation costs.⁶ Non-tariff measures also emerged as binding constraints on the trade-growth and development nexus; nonetheless, tariff cuts made it possible for intermediate goods to move across borders at each stage of production within global value chains, generating exponential trade activity in the pre-2007 period and explaining 50 per cent of the increase in global output.⁷

8. However, the pace of growth in world trade slowed following the global economic crisis. In 2016, global trade expanded by a meagre 1.2 per cent, the third-lowest growth rate in the past 30 years.⁸ The bi-directional correlation between trade and output growth lost steam as the elasticity between trade and output growth became less responsive (figure 2). The income elasticity of world trade became more elusive as global trade grew in terms of volume, while its value fell due to competitive devaluations, faltering primary commodity prices, and the cost inefficiencies arising from global value chains.

Figure 2. Trade-growth elasticities



Source: Compiled by ESCWA based on World Integrated Trade Solutions, World Bank, World Development Indicators, United Nations Statistics Division, and the International Monetary Fund.

9. The accumulation of post-crisis trade and investment protectionist measures distorted the trade-growth relationship. In addition, trade defence measures spiked, with more than 200 of 300 new investigations launched by developed countries at the World Trade Organization. Cumulatively, nearly 1,500 trade restrictive measures have been adopted, with more than 1,000 imposed by developed economies. Only 25 per cent of those restrictive measures, in place since the 2007 financial crisis, have been removed.⁹ A key problem in

⁵ https://www.wto.org/english/res_e/booksp_e/world_trade_report13_e.pdf.

⁶ <http://www.sciencedirect.com/science/article/pii/S00221996000060X>.

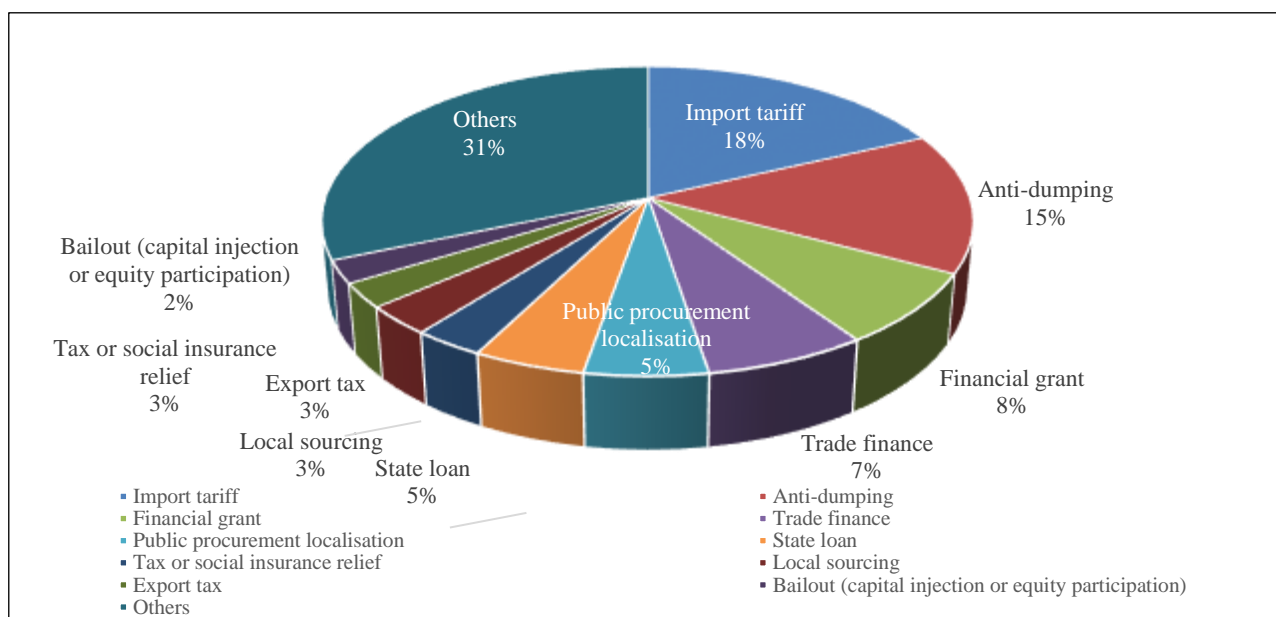
⁷ https://www.wto.org/english/res_e/publications_e/wtr14_e.htm, p. 95.

⁸ <https://www.un.org/development/desa/publications/world-economic-situation-and-prospects-wesp-2017.html>.

⁹ <http://www.ipsnews.net/2016/06/a-healthy-trading-system-requires-progress-and-engagement-at-all-levels/>.

estimating the impact of trade on growth is that protectionism is highly correlated with other growth-reducing policies. Such restrictions and trade policy practices blur the trade-growth causality (figure 3).

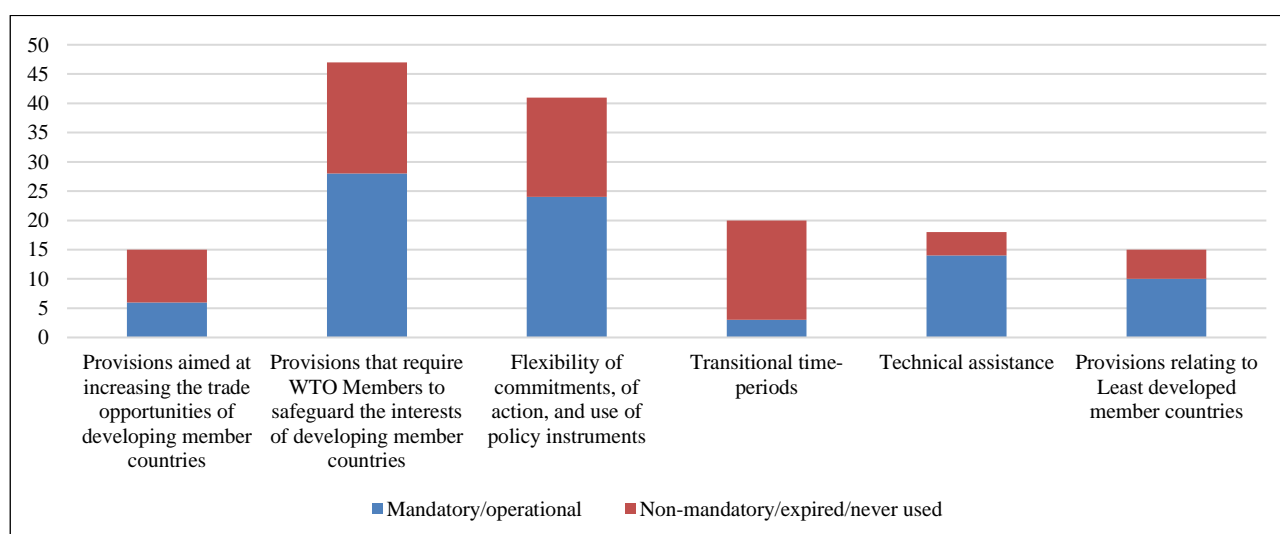
Figure 3. Top 10 global trade distortions, 2009-2017



Source: ESCWA based on Global Trade Alert.

10. The trade-growth nexus is further undermined by the WTO special and differential treatment (SDT) system and provisions in WTO agreements (figure 4). Around 45 per cent of those provisions have expired or never been used since the creation of the World Trade Organization, or are non-mandatory and hold no legal recourse. Mandatory provisions aimed at creating market access opportunities for developing countries account for no more than 4 per cent of the entire SDT system. Nearly 85 per cent of the transitional periods have elapsed, and 41 per cent of the provisions allowing flexibility in implementing commitments and the use of policy instruments have either expired, never been invoked, or do not create any direct market access as they involve setting national inquiry points and the translation of documents.

Figure 4. Operability of SDT provisions in favour of developing countries



Source: ESCWA based on WTO.

B. REGIONAL TRENDS

11. The importance of an inclusive multilateral trading system is emphasized in the Action Agenda. Yet, two decades after the creation of the World Trade Organization, only 13 Arab countries have been granted WTO membership. Several Arab countries' accession requests date as far back as 1987. Palestine continues to be barred from receiving permanent observer status, although the Protocol on Economic relations has granted the Palestinians a separate customs territory/envelope in which to exercise economic and trade autonomy.

12. By 2015, the Arab region had become a net importer of goods and services. A decline in commodity prices caused most Arab economies to experience current account deficits. Total merchandise exports amounted to \$777.1 billion (\$385 billion or 49.5 per cent of which were attributed to oil revenues), while the total Arab import bill amounted to \$844.1 billion for the same year. The net value of the export deficit was \$66.2 billion in 2015. Between 2011 and 2015, the Arab region witnessed an opportunity cost of \$209.6 billion due to worsening terms of trade, which in turn explains the decline in foreign reserves and the rise in external debt trends.

13. Several factors explain this situation and why the trade-growth nexus in the region remains subdued: structural changes between trade and output witnessed in recent years; weak external demand associated in part to the sovereign debt crisis; falling primary commodity prices; 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.

14. The trade-growth and development nexus was also stifled when Arab export competitiveness was adversely affected by heterogeneous regulatory frameworks associated with extra-regional preferential trade agreements. Reliance on extra-regional trade agreements to boost exports has impeded export competitiveness, given that they superimpose regulatory requirements and rules of origin that do not necessarily take into account sustainable development imperatives. In some cases, the cost of compliance with those rules exceeds the benefits offered by regional trade agreements. Consequently, the composition of trade partners significantly impacts the trade-growth nexus.

IV. TRADE AS A MEANS OF FINANCING ARAB DEVELOPMENT

15. A country can use trade policy to raise direct financial resources from two major channels: public-financing, and private-financing paths. The present report is concerned with the first channel. Through public financing paths, a country's participation in international trade generates public revenues in the following three ways:

(a) Direct revenues accruing from export proceeds: In 2015, the gross value of Arab exports amounted to four times the combined amount of foreign direct investment inflows, remittances and official development assistance received by the region in the same year. These resources are however dependent on securing meaningful market access opportunities, both multilaterally and regionally. Estimates suggest that, on average, a 10 per cent increase in intraregional Arab trade would result in a GDP growth of 0.08 percentage points (box 2);

Box 2. Growth from Arab regional trade integration

Deepening Arab regional integration is a source of growth for the Arab region. Estimates show that between 1960 and 2011, trade and tariff cuts had a positive influence on the region's GDP growth performance, and that the overall effect of trade in goods on GDP was higher than that of trade in services. This however is attributed to the relatively high restrictiveness facing intraregional trade in services, as revealed by the World Bank Services Trade Restrictions Database. For the trade-growth nexus to realize its full potential in positively influencing growth, regulatory and structural reforms that reduce trade barriers and encourage service liberalization remain a key policy choice.

An assessment was undertaken to determine the effects of intraregional as opposed to extraregional preferential trade, and their respective effects on output growth performance in the Arab region. It was found that between 1995 and 2010, intraregional preferential trade had a larger impact on per capita growth in the Arab region: a 10 per cent increase in current levels of intraregional trade would cause GDP to grow by 0.08 percentage points on average. However, when the same assessment was undertaken for a different data panel (1995-2015), the trade-growth relationship was unclear due to the 2011 political turmoil in the region.

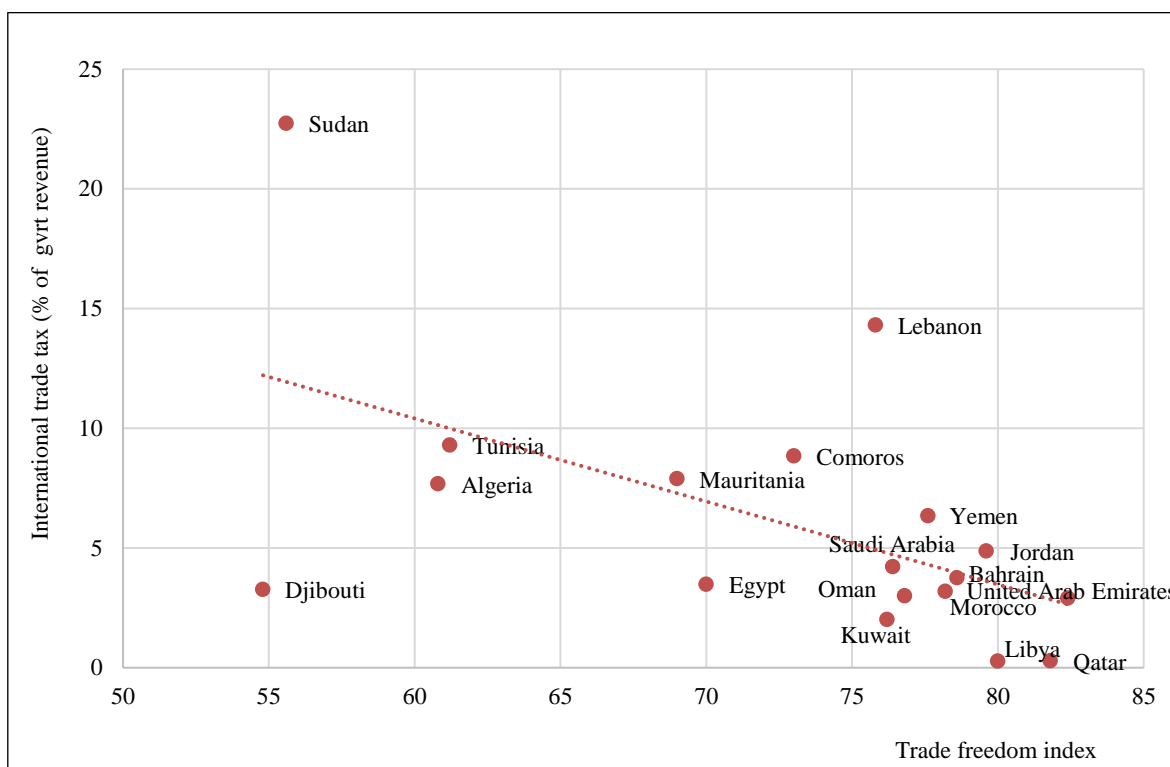
The results continue to validate some earlier assessments, which revealed that intra-Arab regional trade liberalization was a source of higher per capital growth than extraregional and Arab-European Union trade by almost 9 per cent. Moreover, when the intensity of the conflict in the region was factored into the equation, the latter strongly correlated with a reduction of intraregional trade.

Source: Compiled by ESCWA.

(b) 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 market (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;

(c) Taxes on imports: Custom duties in the Arab region have declined considerably due to unilateral, regional and multilateral trade liberalization measures (figure 5). For some countries, the loss in revenue was largely compensated by domestic sales and value added taxes. According to the Arab Monetary Fund, the share of customs revenues represented nearly 3.8 per cent of total public revenue in 2015. Today, trade taxes average about 1 per cent of GDP in both resource and non-resource countries, and rarely exceed 2 per cent of GDP. Trade taxes in total tax revenues declined on average from about 26 per cent in the early 1990s to 15 per cent in 2012.¹⁰ Raising trade taxes remains contingent on the interplay between several intertwined 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 extraregional 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 <https://www.imf.org/external/pubs/ft/wp/2015/wp1598.pdf>.

Figure 5. International trade tax versus trade freedom, 2015

Source: ESCWA, based on data from the Arab Monetary Fund and the Heritage Foundation.

16. One of the main conclusions of the Arab Development Outlook: Vision 2030¹¹ was that by 2030, the Arab region would hold trade preferences from at least 110 countries across five continents through binding regional trade agreements. Most, if not all, of the region's imports by 2021 would be granted duty free access, or at least receive some form of border and beyond border trade preferences. Under those conditions, the narrow window to raise tariffs or impose seasonal or tariff rate quotas and fiscal charges would be further eroded.

17. In that case, the opportunity to employ trade taxes to finance development would not only be restricted by overhang margins maintained under the World Trade Organization, but also by three main binding constraints. The first is associated with a 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 second consideration is associated with 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. The third consideration involves a detailed review of how extraregional 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.

¹¹ <https://www.unescwa.org/publications/arab-development-outlook-vision-2030>.