Discussion paper

The Role of Trade in Financing for Sustainable Development*

Note by the UNCTAD secretariat

1. This paper maps out possible channels (whether direct or indirect) between international trade – a commercial activity that comprises of cross-border exchange of goods and services – and financing for sustainable development.

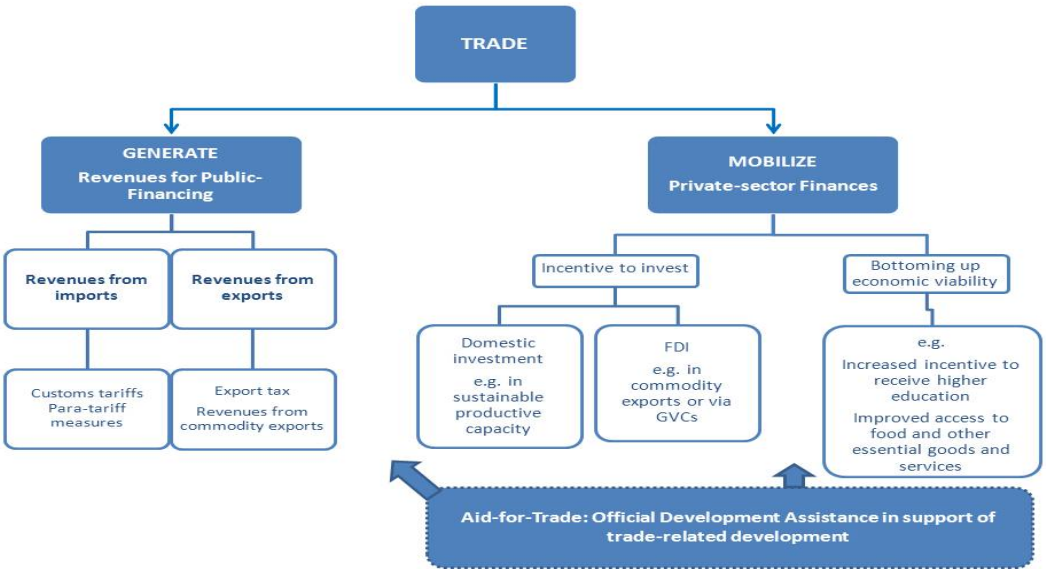
2. International trade can generate or mobilize financial resources that may be used for meeting development objectives. There are two major channels through which international trade can influence financing for sustainable development: (i) public-financing paths; and (ii) private-financing paths.

3. Through public financing paths, a country's participation in international trade ***generates*** the country's public revenue, a major source of financing for sustainable development. The magnitude of the trade-sourced public revenue ranges between less than 5 per cent of total public revenue and over 20 per cent across different developing regions.

4. Through private-financing paths, participation in international trade, or perceived opportunities to benefit from international trade, can ***mobilize*** the private-sector investment in trade-supportive economic activities, which can generate positive externalities to, or indirect financing for, economic and social development of a country.[1]

* This is an unedited document for discussion only.

[1] There could also be the third path - a public-private partnership path which has been dynamically expanding in many developing countries, in the areas of, e.g. trade financing and trade insurance, in addition to state-owned enterprises with private-sector participation.



A. Generating revenues for the public-financing

5. A government can raise revenues from international trade in three major ways: (i) via tax on goods (and services) that are imported to the country; (ii) via tax on goods (and services) that are exported from the country; and/or (iii) directly receiving proceedings from exports.[2]

6. The magnitude of trade-related public revenues (e.g. from import duties, export duties, tax on profits on exports, etc.) varies considerably across low and middle income countries, from average 3 per cent of total public revenue to over 20 per cent (Table 1).[3]

Table 1
Taxes on international trade (as % total public revenue)

	2000	*2011*
High income	1	1
Middle income	7	5
Low & middle income	8	6
East Asia & Pacific	9	8
Europe & Central Asia	6	3
Latin America & Caribbean	7	5
Middle East & North Africa	10	5
South Asia	15	14
Sub-Saharan Africa	N/A	25*

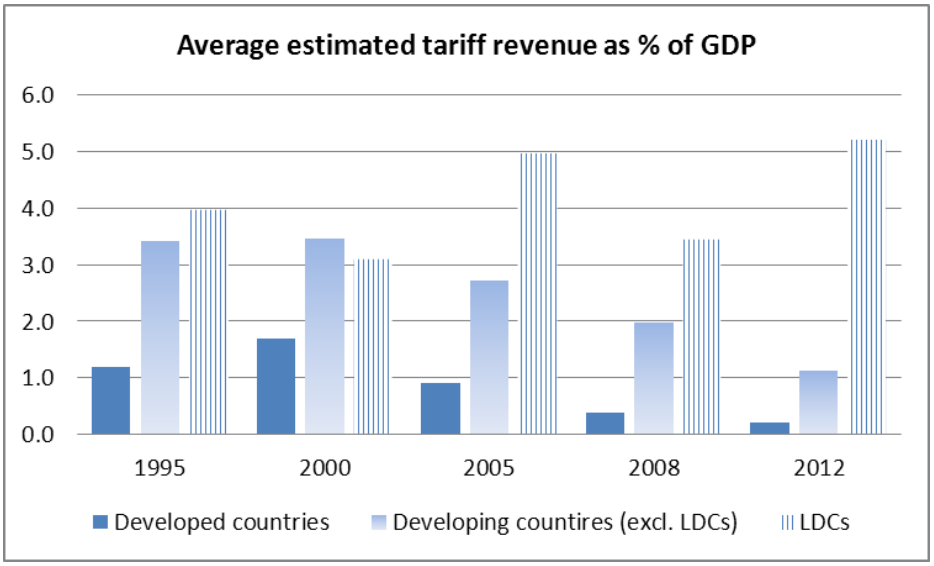
Source: World Bank World Development Indicator 2013 (table 4.14); * Cagé and Gadenne (2014).[4]

[2] Services are put in parentheses as taxes on services involve various regulatory channels, such as licencing fees. Services are also indirectly taxed when they are integrated in a good, e.g. an imported computer program contained in a CD-ROM which is taxable upon import.

[3] Table 4.14, World Development Indicator 2013, World Bank.

A.1 Revenues from imports

7. **Customs tariffs (and other charges)** are levied on the value and/or the quantity of goods imported to a country's customs territory. Other charges, or *para-tariffs* such as customs surcharges, are ad-hoc taxes that are applied for various objectives, e.g. to raise additional fiscal revenues or in protection of a domestic industry.[5]



Source: UNCTAD calculation, based on the WITS/TRAINS database

8. Tariff revenues may represent a significant portion of a country's total public revenues, especially among least-developed countries (LDCs), in large part due to the fact that collecting import duties (i.e. tariffs) requires a relatively simple institution (i.e. through a customs authority at the goods' entry point) as compared to other tax revenues such as value added tax, income tax or corporate tax.

9. An UNCTAD estimate of the magnitude of tariff revenue in relation to the size of a country's GDP suggests that, in a LDC, tariff revenue on average was as large as over 5 per cent of its GDP in 2012, compared to less than 0.5 per cent in the case of a developed country. Estimates made for different years indicate that the relative size of tariff revenues in the economy of developed countries and developing countries (excluding LDCs) were on a clear downward trend, while that in LDCs even increased during 2000s. This is most likely due to a substantial increase in LDCs' participation in international trade (both in imports and exports) in the recent 10–15 years while the tariff rates remained relatively higher than in the former two groups. Total imports made by Sub-Saharan African countries for instance increased by over 70 per cent between 2006 and 2011.

10. The average "tax rate" on imports, i.e. the rate of customs duties has come down considerably as a result of progressive tariff reduction at the unilateral, bilateral/regional and multilateral levels in the past two decades, as being reflected in the downward trend of the level of tariff revenue as a GDP percentage in developed and non-LDC developing countries.

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[4] J. Cage and L. Gadenne (2014), "Tax Revenues, Development, and the Fiscal Cost of Trade Liberalization, 1792-2006", VOX (http://www.voxeu.org/article/fiscal-cost-trade-liberalisation).

[5] UNCTAD Directory of Import Regimes, Part I: Monitoring Import Regimes (1994).

11. Since 2002, the level of tariff rates has declined markedly in the majority of non-LDC developing countries. For instance, between 2002 and 2012, the average applied tariff imposed by developing countries in East Asia has gone down from around 8 per cent to 4 per cent and in Latin America from 6 per cent to 4 per cent. In regions with a large number of LDCs, e.g. sub-Saharan Africa, the average applied tariff fell by a relatively small percentage, from 8 per cent in 2002 to 7 per cent in 2012.[6]

12. Note that, increasingly, tariffs have been eliminated in many countries worldwide. By 2012, almost 40 per cent of international trade were made duty-free under the most-favoured nations (MFN) terms, and an additional 35 per cent was duty-free under bilateral or regional preferential terms. This trend together with the high number of on-going negotiations of bilateral free trade agreements suggests that import duties' revenue-raising power will continue to be eroded in the years to come. Still, remaining trade with positive tariffs can be subject to relatively high tariff rates, e.g. in excess of 10 per cent.[7]

13. Note also that trade-related taxes can be a source of economic distortion. While it can be an effective way to raise public revenue and to protect certain domestic industries, its trade-distorting impact could generate negative impact upon the domestic economy, e.g. loss in efficiency leading to loss in competitiveness in the international market. In the increasingly globalized economy, tariffs on imports may work adversary to the competitiveness of a country's manufactured exports, and to an extent services exports, especially when participation in Global Value Chains is concerned.

A.2 Revenues from exports

14. **Export tax** is a levy on the value or the quality of products exported from the country. Export tax is applied most frequently to unprocessed extractive commodities such as ores and minerals, other base metals and fuels. It is estimated that around 90 per cent of countries in Africa, 76 per cent in Asia and 71 per cent in Americas apply export tax to a varying degree.[8]

15. The magnitude of export tax in terms of tax revenues on country-basis is less clear compared to the import tariffs, as export tax is collected from exporting companies through various channels depending on a country's scheme.

16. Using a cross-country inventory (over 100 countries) of government measures restricting export of products of extractive industries (i.e. industrial raw materials) in 2009 and 2010, OECD shows that export measures including export tax are observed most frequently in exports of waste and scrap metals (42 per cent of all incidence in 2009), followed by ferrous metals (19 per cent), metal ores and minerals (13 per cent) and non-ferrous base metals (9 per cent). Within waste and scrap metals, for instance, OECD estimates that around 19 per cent of waste and scrap of iron and steel is subject to export restriction, of which export tax accounts for around 30 per cent of such incidence.[9]

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[6] UNCTAD (2014), *Key statistics and trends in trade policy*, advanced unedited copy available at: http://unctad.org/en/PublicationsLibrary/ditctab20132_en.pdf.

[7] i.b.i.d.

[8] O. Solleder (2013), "Trade effects of export taxes", Graduate Institute of International and Development Studies Working paper No: 08/2013.

[9] The inventory covers over 10 different types of measures on exports, which include: export tax, export surtax, export quota, export prohibition and export licensing requirement. See: B. Fliess and T. Mard (2012), "Taking stock of measures restricting the export of raw materials", OECD Trade Policy Papers No. 140.

17. Another recent research provides a cross-country dataset with more comprehensive sectoral coverage, for 20 countries comparing two years, 2000 and 2011.[10] According to the estimate based on this Panel Export Taxes (PET) dataset, export tax is most often imposed on products of agricultural commodities in addition to those of extractive industries. The rates of export tax widely vary across products and across countries. On average, the export tax rate on unprocessed commodities is around 20 per cent and those on semi-processed and finished products are around 17 per cent and 13 per cent respectively.

18. An analysis based on the PET database supports the general perception that export taxes are levied most frequently on raw commodities and especially when an export country of the product owns significant market power (i.e. owns a large market share in the international market).

19. The Global Trade Alert indicates that the usage of export tax has been on an upward trend in since the 2008/2009 financial crisis.[11]

20. The application of export tax may have specific purpose apart from, or in addition to, raising government revenues. Certain export taxes may target at, e.g. conservation of natural resources, controlling illegal export activities, or protecting health and/or environment, as well as "sterilization" of windfall profits from commodity exports, primarily from the energy-based products.[12] It may also be used as an industrial policy instrument promoting sectors with higher degrees of processing that may create employment and support structural transformation into more sophisticated activities.

21. **Other revenues from commodity exports**: In addition, governments may raise revenues from commodity exports via various taxation regimes, such as tax on export revenues, tax on profits in general or tax on profits above a certain threshold level. Capturing rents from exports from extractive industries may be done via contractual schemes such as production sharing and/or State equity.[13]

22. Revenues raised through commodity exports may be pooled as a fund such as in the form of Sovereign Wealth Funds (SWF), a state-owned investment fund that direct exporting countries' windfall gains into international bond and stock markets. SWFs mushroomed during the recent commodity boom years. Of an estimated US$ 4.7 trillion held in SWFs by end 2011, over 40% (i.e. US$ 2 trillion) was commodity-derived and owned by developing countries.[14]

23. In certain cases, such as Chile, revenues based on commodity exports are used for a fiscal stabilization purpose, by pooling larger than "normal" tax revenues from commodity exports during a period of commodity boom, and uses those savings to cover falling tax revenues during "bust" periods (i.e. when commodity earnings are low). Such a measure

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[10] O. Solleder (2013), "Panel export taxes dataset: New data on export tax rates", Graduate Institute of International and Development Studies Workign Paper No. 07/2013.

[11] The Global Trade Alert (http://www.globaltradealert.org/).

[12] i.b.i.d.

[13] UNCTAD (2014), "Natural resources sector: Review and identification of opportunities for commodity-based trade and development", Note by the UNCTAD secretariat for the Multi-year Expert Meeting on Commodities and Development, 6th session (TD/B/c.1/MEM.2/26). This document also discusses policy options aiming at making the most of revenues from natural resources for developmental purposes, such as for economic diversification, employment creation and investment for renewable energies.

[14] i.b.i.d., p. 119.

can also insulate the domestic economy from external shocks arising from commodity price volatility.[15]

24. It requires a special attention, however, that several low-income commodity-dependent economies have remained poor, or have not made much progress by way of structural transformation, despite their enormous natural resource endowments.[16] There has been concerns also that the recent dynamic evolution of global value chains in the manufacturing sector may have farther reduced certain commodity-exporting countries' opportunities for structural transformation and economic diversification.[17] The transparency of governance in a broad commodities sector, both on the side of exporting countries as well as multinational corporations, would be essential in this context.[18]

B. Mobilizing the private-sector resources

25. In addition to the above-mentioned direct revenue-generating paths, participation in international trade via export or import, or perceived opportunities in trade, can *mobilize* significant amount of the private sector resources, e.g. in the form of increased (domestic or foreign) investment in productive capacity in trade-related goods and services.

26. Trade already makes up a significant portion of the economy of a developing country, particularly LDCs: the average trade-to-GDP ratio of these countries has risen from 27 (1986–1990) to 60 (2008–2012) out of 100.[19] Their annual growth of GDP was also high particularly during the period 2000–2011, at around 7 per cent per year compared to 3 per cent for developing countries as a whole.[20]

27. Small developing countries and LDCs cannot easily achieve credible development outcomes without trade (both through increasing exports and imports) because of the insignificance of their internal markets and insufficient levels of domestic consumption. These countries have the highest dependence on trade in terms of trade to GDP ratio.

28. At the same time, many of these countries have been experiencing a kind of structural deficit in the current account, i. a net outflow of resources over the medium term despite increases in their exports. The essential cause of this is the lack of structural transformation to achieve economic diversification (see paragraph 24 above). It underlines the need for a holistic approach in order to make the best of trade's development-enabling capacity.

B.1 Bottoming up economic viability

29. There are visible effects of trade on development outcomes, which as a result can improve the effectiveness of publically financed sustainable development policy measures through income channels or non-income channels.

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[15] UNCTAD (2013) *Commodities and Development Report: Perennial problems, new challenges and evolving perspectives*, P.121.

[16] UNCTAD (2014), "Natural resources sector: review and identification of opportunities for commodity-based trade and development", Note by the UNCTAD Secretariat, Multi-year Expert Meeting on Commodities and Development (TD/B/C.1/MEM.2/26).

[17] UNCTAD (2014), "Background note", UNCTAD Global Commodities Forum (7-8 April 2014, Geneva).

[18] i.b.i.d.

[19] World Bank, World Development Indicator.

[20] UNCTAD Globestat.

30. Participation in international trade can substantially increase the household income today, via, e.g. generating jobs for those that had been economically disadvantaged as in the case of increased employment of women in the garment sector in a number of LDCs.

31. A very significant source of export income accrues from remittances – considered as one of the key sectors of services exports – particularly for LDCs. A study of 77 developing countries estimated that a 10 per cent rise in remittances lead to a 3.1 per cent reduction in the percentage of the population living on less than US$ 1.25 a day.[21] Remittances grew by an estimated 6 per cent in 2013 to reach US$ 414 billion, well above the total official development assistance (ODA).[22]

32. Various studies also show that international trade can generate higher incentive for people in much of the developing world to upgrade their skills through education. For example, in India, growth in exports of services enabled by information technology (IT), such as call centres and offshore administrative services has created a new class of jobs which have increased overall returns to schooling, which in turn increased the number of school enrolment of children particularly in English-language schools.[23]

33. Improved access via imports to essential goods and services such as medicines and vaccines, medical equipment, food, energy and environment-related goods generates direct developmental gains for consumers, as well as improves the cost-effectiveness of a given public expenditure on, e.g. healthcare.[24]

34. Also, by transmitting environmental preferences of firms and consumers in world markets, trade can enhance the diffusion of environmental goods, services, technologies, and sustainable and socially equitable methods of production across countries.

B.2 Mobilizing private-sector investment

35. International trade, along other economic activities, catalyses transition dynamics in economic growth by creating a greater incentive to invest in productive capitals and to new technology. Participation in trade can raise the economy's income-generating *opportunities* via inter alia, a "vent-for-surplus", i.e. having access to international markets can enable a developing country to make a better (e.g. more profitable) use of its resources previously unused or underused.

36. Better and a greater variety of input factors (e.g. fuel and raw materials, intermediate goods and machinery equipment) can be imported which lower the production costs and possibly enable new and more sophisticated production which otherwise would not have been feasible in the country. Imports, particularly capital or intermediate goods, can create paths for acquiring new technology and productive/business knowledge from outside. All these increase the prospective return-on-investment in productive capital (physical capital or skills upgrading) and new technology, which in turn boosts more investment for expanding exports.

37. A recent UNCTAD study confirms that, during the 1990–2010 period, there was a significant and positive relationship between the size of foreign direct investment (FDI)

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[21] UNCTAD (2011), *Impact of remittances on poverty in developing countries*, http://unctad.org/en/docs/ditctncd20108_en.pdf.

[22] World Bank (2012). Migration and Development Brief 18. April 23, 2012

[23] E. Oster and B. Millet (2013), "Do IT service centres promote school enrolment? Evidence from India", *Journal of Development Economics*, September 2013.

[24] For example, there is evidence that improving international trade logistics—which reduces trade costs—can help increase vaccination rates in developing countries, because specific handling procedures are required for these products.

outward stocks and the degree of trade openness in terms of the market access conditions (i.e. the level of tariff barriers) of both host countries and parent countries of FDI. This was because a significant portion of FDI was linked to building an "export platform" in the host country, especially when exports from the host country enjoyed good market access conditions (i.e. faced zero or low tariffs) to the parent-country market or to other important third markets. This explains the recent concurrent growth in FDI and trade in intermediate goods among developing countries (e.g. within a network of global value chains) as well as an increase in export of final goods to the world from FDI-receiving developing countries.[25]

C. Official development cooperation in the area of trade

38. **Aid-for-Trade (AfT)** is a component of ODA and contributes principally or significantly to trade development. AfT has supported a large number of developing countries in their effort to make the best use of participating in international trade for boosting their economic development.[26] Since its launch in 2005, the total AfT commitments increased by more than 50 per cent to reach US$ 41.5 billion in 2011 (in 2011 constant price).[27]

39. A sectoral share of ODA earmarked for the economic sector had been declining in the decade prior to 2005. The launching of AfT seems to have halted the downward trend: since 2005 the total ODA in the economic sector remained at around 33 per cent up to 2011, and is estimated to have claimed around 40 per cent in 2012.[28]

40. AfT support trade-related activities in the following broad categories: (i) building productive capacity of the private sector; (ii) economic infrastructure (e.g. transport and storage, communication, and energy generation/supply); (iii) trade policy and regulations (including trade facilitation); and (iv) trade-related adjustment.

41. Various studies have been made so far on the effectiveness and challenges related to the AfT. The AfT can be considered as an additional (albeit limited) source of "private" financing, as many of project under the AfT involve the private sector into its projects either as implementing partners or direct beneficiaries (e.g. small holder farmers, SMEs).

42. The AfT earmarked for building productive capacity of the private sector with a trade development objectives doubled from the average US$ 11.5 billion in 2002-2005 to US$ 18.2 billion in 2011 (this value is estimated to have increased by 92 per cent in 2012 to US$ 21.6 billion in 2012 constant prices).[29] The AfT commitment for trade facilitation, which often involves international logistics companies as an implementation partner, increased from the average US$ 82 million in the base years (2002-2005) to US$ 381 million in 2011.

43. Note that a lion's share of AfT is claimed by a limited number of largely middle-income countries. In 2012, the top 10 recipients (only 2 of which were LDCs) received 50

[25] M. Fugazza and C. Trentini (2014), "Empirical insights on market access and foreign direct investment", Policy Issues in International Trade and Commodity Study Series No. 63, UNCTAD.

[26] OECD/WTO (2013), Aid for Trade at a Glance 2013: Connecting to Value Chains, pp. 57-87.

[27] According to the OECD, the total AfT commitment in 2012 was estimated to be US$ 53.8 billion (in 2012 constant prices), showing around 20 per cent increase from the 2011 level. See OECD (2014), "Aid for Trade in 2012: Increasing Volumes Hardening Terms", presentation at the WTO Committee on Trade and Development Session on Aid for Trade, April 9 2014 (http://www.wto.org/english/news_e/news14_e/OECD.pdf).

[28] i.b.i.d.

[29] i.b.i.d.

per cent of total AfT flows. LDCs as a whole received 24 per cent (or US$ 13.1 billion) of total AfT in 2012, which was down 2 per cent from the 2011 level.

44. Note also that, in recent years, the share of AfT in the form of loans has been increasing. In 2012, 65 per cent of the total AfT was in loans, though the share of loans in the total AfT provided to lower-income countries was lower, at 40 per cent.[30]

45. The above mentioned AfT trend thus presents a mixed result with respect to the paragraph 36 of the Monterrey Consensus on Financing for Development which called for, among others, "(bilateral and multilateral donors to) reinforce the support for trade-related training, capacity and institution building and trade-supporting services".[31]

[30] i.b.i.d.

[31] The paragraphs 26 to 38 of *the Monterrey Consensus of the International Conference on Financing for Development,* (The document reference is given in the footnote 25).