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# Pressing Ahead with Trade Openness

External competitiveness and access to international markets are paramount for poor countries to realize the development promise of international trade. Pressing ahead with trade openness is a powerful means for countries to help mitigate the impact of the financial crisis and enhance prospects for economic recovery.

The recent food, fuel, and financial crises have put great strain on the global trading system, slowing—and at times reversing—progress in trade integration. In early 2008 sharp increases in world food and fuel prices triggered disorderly and sometimes harmful trade policy responses, including the imposition of export taxes, quotas, or outright bans by some large food-exporting countries. In late 2008 the financial crisis compounded the food crisis and led to a trade credit crunch and sharp increases in trade credit spreads. International trade slowed sharply in the last months of the year and is projected to contract in 2009—for the first time since 1982.

Risks of protectionism and other trade-distorting policies have heightened as economic activity collapses and unemployment soars in many countries. Although trade actions have remained relatively circumscribed so far, several countries have raised border barriers or subsidized automotive, steel, or other export-oriented industries. A resurgence of "buy national" and other inward-looking policies risks retarding market corrections, distorting trade, and triggering retaliation. Maintaining and enhancing trade openness is key not only to preserving the mutual benefits of trade but to supporting the eventual economic recovery.

Even with bleak trade prospects, developing countries can improve their competitiveness and diversify their exports through trade facilitation measures and other behind-the-border reforms. The accelerating pace of globalization and erosion of preferences for poor countries associated with the expanding web of preferential trade agreements make improving domestic competitiveness through behind-the-border reforms imperative. In particular, efforts in the area of trade facilitation could do a lot—and perhaps even more than further reductions in tariff rates—to increase trade flows. The ease of moving goods internationally—including through improved border processing systems, logistics services, and trade infrastructure more generally—has become a key determinant of export competitiveness and diversification.

The crisis also increases the urgency of bolstering multilateral cooperation in the trade area. A Doha Round agreement would help keep markets open at a time of financial stress, ease protectionist pressures,

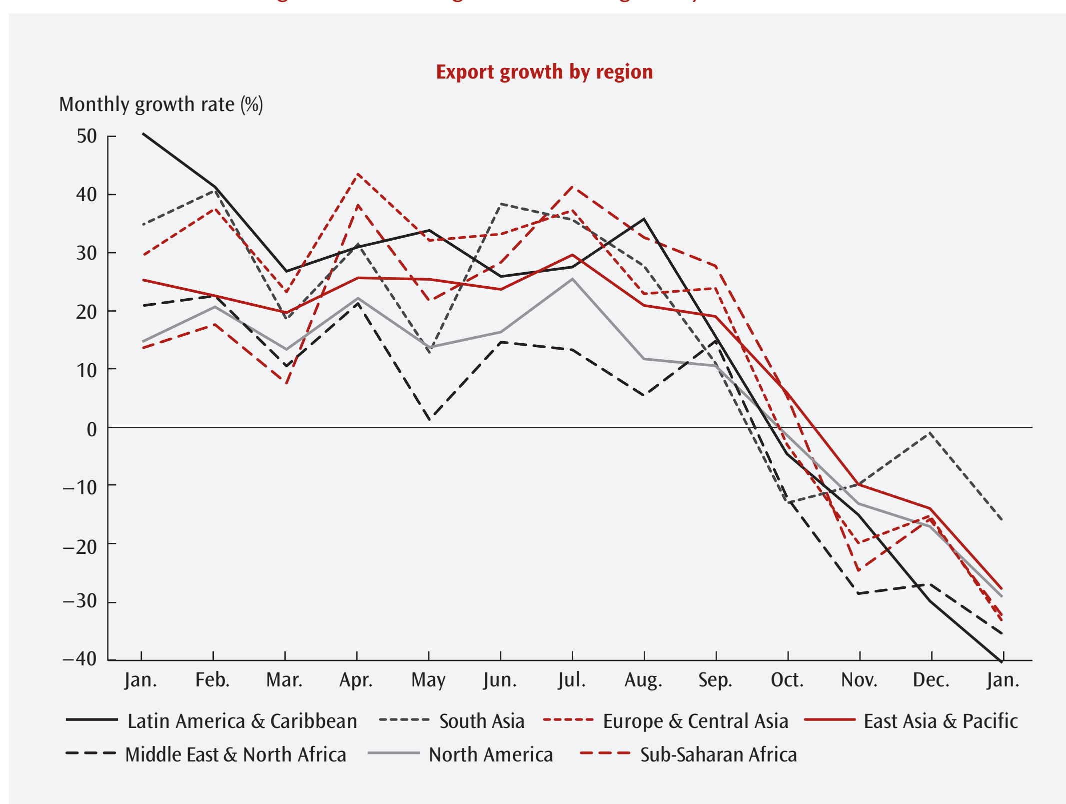
and strengthen the rules-based multilateral trading system. It would also provide a much-needed boost in confidence to the global economy. Moreover, fulfillment of aid-for-trade commitments by high-income countries and international institutions is important to support both the multilateral trade liberalization agenda and domestic trade facilitation efforts. Given that many poor countries continue to face considerable infrastructure and other supply-side constraints to participating in global markets, donors should deliver on their aid-for-trade commitments in support of domestic reforms that address these constraints.

In its first part, this chapter reviews the recent sources of strain in the global trading system—the food, fuel, and financial crises—and discusses their impact on trade finance and policy, including the risk of trade protectionism. In the second part, it discusses possible avenues for transforming the current crisis into opportunities for reform, including completing the Doha Round of multilateral trade negotiations, pursuing domestic reforms aimed at enhancing trade openness and external competitiveness, and mobilizing more effective aid for trade in support of those reforms.

## Strains in the Global Trading System

The multilateral trading system came under heightened strains in 2008 amid major international crises that eventually led to a global economic recession and a sharp drop in international trade.

**FIGURE 5.1 Robust trade growth turned negative in most regions by late 2008**




*Source:* Staff calculations, based on data collected from national sources.

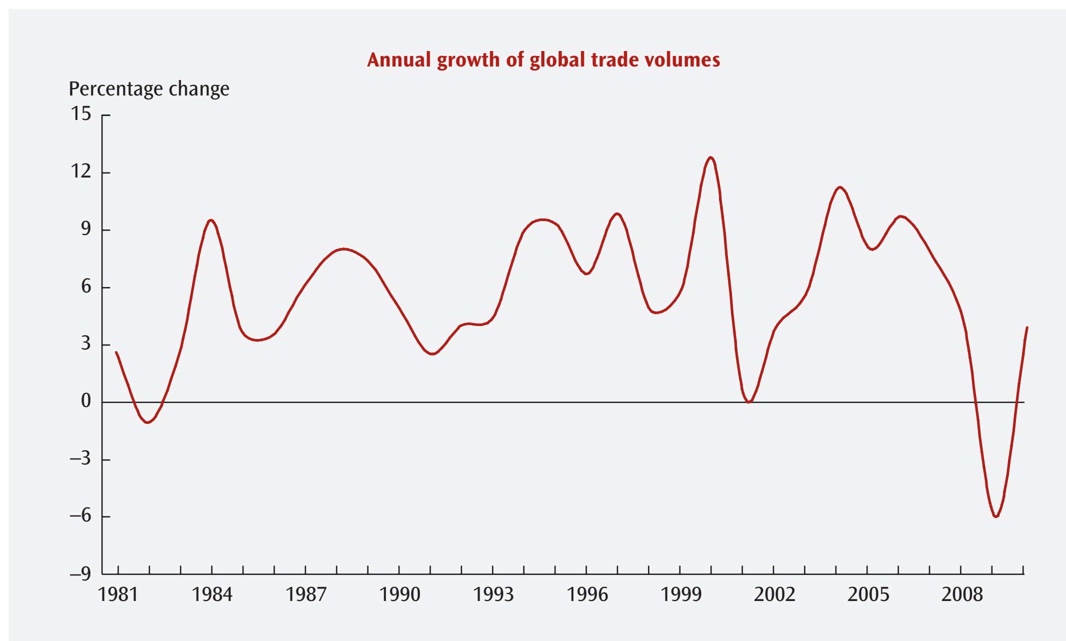
## Recent Developments in International Trade

The global recession has put great pressure on trade. In the fall of 2008 global demand suffered a sharp decline, most of the global economy went into recession leading to falling demand for both domestically produced goods and imports, and by early 2009 robust trade growth had turned negative in most countries.[1] International trade is forecast to decline in 2009, for the first time in 27 years (figures 5.1 and 5.2). Declining demand has been compounded by a contraction in the available finance for trade flows. Monitoring from the World Trade Organization (WTO) and the World Bank indicates that the contribution of protectionist and discriminatory policies to the decline in trade has remained limited to date. However, looking forward, there is a danger of a retreat from the relatively open border policies of the past decade.

The second half of 2008 saw a sharp slowdown in merchandise trade. For the year as a whole, growth in the volume of world trade moderated to 3.4 percent in 2008, from an average of 7.9 percent during 2003–07. According to the World Bank's *Global Economic Prospects* (April 2009), the world trade volume in goods and services is projected to decline by 6.1 percent in 2009, with a significantly sharper contraction in trade volumes of manufactured goods. While tourism is down in many regions, total trade in services appeared to be more resilient than in manufactures. These projections corroborate the WTO forecast of a 9 percent fall in world merchandise trade in 2009, with developed-economy exports falling by some 10 percent on average, and developing-country exports shrinking by 2–3 percent. With the global economy remaining weak throughout the year, a gradual pickup in trade volumes is not expected until 2010.

A number of leading indicators confirm this bleak trade outlook. In late 2008, a large oversupply of ships was reported in many ports, together with falling prices for shipping services. The Baltic Exchange Dry

**FIGURE 5.2 World trade will contract in 2009**

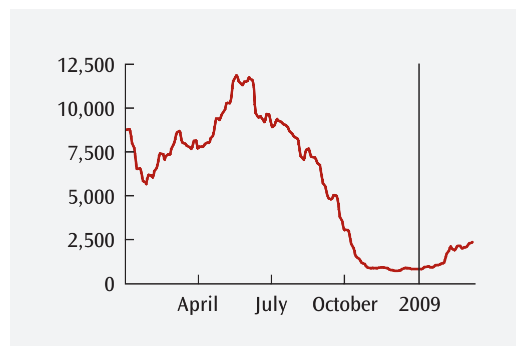



*Source:* World Bank 2009.

Index, a benchmark for global freight costs along key routes, fell by more than 90 percent between May and November 2008, and has yet to recover (figure 5.3).[2] Air cargo traffic, another possible early indicator of trade developments, has also registered its worst decline since the burst of the technology bubble in 2001. According to the International Air Transport Association, the volume of cargo traffic dropped by 13.5 percent in November 2008 (compared with November 2007). December was worse; cargo freight declined by 23 percent.

Falling commodity prices and exchange rate movements have compounded the sizable decline in world trade. In the second half of 2008 commodity prices decreased sharply, and the U.S. dollar appreciated against the currencies of major traders. The 27 percent decline in the International Monetary Fund (IMF) commodity price index between November 2007 and November 2008 is estimated to have contributed to an 11 percent drop in trade. The slowdown has been widespread, across regions and between developed and developing countries, as well as across exports and imports, implying that reduced demand is playing a major role. For instance, U.S. import data by sector indicate that, although the decline in commodity prices is evident, U.S. imports fell across nearly all industries. Declining demand and investment was especially evident among imports of transportation and machinery, electrical equipment, and stone and glass, all of which fell by double digits. Small countries in Africa, Eastern Europe, and Central Asia have experienced the largest percentage declines in exports to the U.S. market.

**FIGURE 5.3 Baltic Exchange Dry Index**




*Source:* Baltic Exchange Information Services Ltd. and Bloomberg L.P.

Depending on the degree of trade and financial openness and the state of readiness to cope with shocks, the impact of the financial crisis has differed by country. Most at risk have been developing countries with large foreign banking and trade exposure combined with weak foreign exchange positions, rigid exchange rate systems, and fragile budgets. In the short run, emerging countries are particularly vulnerable. As a group, they have accounted for the bulk of global growth in 2007–08 and are therefore particularly exposed. Low-income countries appear less vulnerable in the short run because of their lower financial and trade integration. However, they are also often the least equipped to deal with crises. While net commodity importers will see some relief from the rapidly declining price of food and fuel, net exporters face the triple financial, fuel, and food crisis.[3]

## Food and Fuel Crisis

International trade was significantly disturbed in 2007 and early 2008 by large terms-of-trade shocks as a result of surging prices of minerals and various food products. Oil prices doubled between January 2007 and August 2008. Grain prices also more than doubled between January 2006 and September 2008, including dramatic surges in staples such as wheat, rice, and soybean oil. A large number of developing countries that are net importers of food and fuel were severely affected by the increase in the prices of these commodities. Import bills increased and balance of payments deteriorated. In all countries, consumers, especially vulnerable consumers, were negatively affected by the rise in food prices. Both food and fuel prices have in recent months retreated from their mid-2008 peaks. However, food prices have remained and are projected to remain well above their 1990s levels for the next several years.[4]

The 2008 global food price crisis had deep historical roots in the distortions of the world trading system (box 5.1). While several factors beyond trade combined to produce an upward global food price spiral (including high energy and fertilizer prices, depreciation of the U.S. dollar, biofuel production, changes in food buffer stocks, droughts, and increased world demand), the origins of the current spike in global food prices can be traced to decades of trade-distorting policies that have encouraged inefficient agricultural production in rich countries and discouraged efficient production in developing countries.[5] High-income countries have historically protected their domestic producers and subsidized inefficient production—most recently biofuels—dumping surpluses onto global markets. In turn, developing countries have often used trade and other domestic policies to simultaneously tax and protect their agricultural sector, with the net effect in many countries of taxing farmers. Overall, the world has suffered from overproduction in high-income countries and underproduction in poor countries.

**BOX 5.1 Trade policies: A taproot of the global food price crisis**

The global food price crisis had deep roots in the distortions of the world trading system. Historically, agricultural trade-distorting policies have taken the form of specific and ad valorem tariffs that are sometimes linked to quantities of imports (such as tariff rate quotas); quantitative restrictions or prohibitions on imports and exports; and domestic producer supports and export subsidies for farm products. Countries have also availed themselves of additional restrictions in the form of safeguard protection in case of import surges. The trading system in agriculture is further distorted and segmented by the existence of trade agreements whereby preferential tariff rates, market access conditions, or both, are offered on a reciprocal or nonreciprocal basis to a subset of partner countries. Overall, the trading system in agriculture is nontransparent, discriminatory, and highly distorted.

More recently, biofuel policies in high-income countries, which consist of import duties, subsidies, tax credits, and legislative mandates, have had the effect of further distorting global agricultural trade and contributing to the global food price crisis. Biofuel production in the United States from food crops such as maize and soybean oil and in the European Union from rapeseed and sunflower seed oils have fueled the rise in food prices by increasing the demand for these food crops and shifting land out of other crops. In the last three years, 5 million hectares of cropland that could have been used for wheat have gone to rapeseed and sunflowers for biofuels in major wheat producers, including Canada, the European Union, and the Russian Federation. Increased demand for biofuels is estimated to have accounted for 70 percent of the increase in corn prices and 40 percent of the increase in soybean prices. Although oil prices may have been somewhat higher in the absence of biofuels, these subsidies do not promote economic efficiency as an offset to their inflation impact.

The combined impact of these trade-distorting agricultural policies has been to displace and reduce the efficiency of agricultural production globally. While such policies are introduced for a wide range of domestic motives (economic, social, environmental, security), they are welfare-reducing—both in the country applying them and in the rest of the world—relative to direct, first-best policy instruments for achieving those domestic objectives. In distorting the incentives producers and consumers would otherwise face, they are also welfare-redistributing and inherently discriminatory. By promoting less efficient production in developed countries at the expense of investment in generally more efficient production in developing countries, world food prices have been kept artificially low, and domestic food prices in protected markets have been kept artificially high. Policies in developing countries have, until recently, generally taxed agriculture to channel resources into manufacturing, with the result that investment in increasing supply has not been adequate to provide for rapid responses to global price spikes. Furthermore, because agricultural production has taken place in relatively inefficient, thin, and insulated markets, global trade in food products is less resilient to exogenous shocks and less able to handle volatility in trade and output.

*Source:* Chauffour 2008.

While agricultural trade restrictions and direct subsidies in high-income countries have tended to decrease over time, they remain a major source of support for producers in these countries. In 2007 support to farmers in advanced countries from agricultural policies amounted to $258 billion, equivalent to 23 percent of the farmers' gross receipts, down from 26 percent in 2006 and 28 percent in 2005.[6] With prices for major agricultural commodities rising steeply on international markets, the gap between supported domestic prices and world prices has narrowed considerably, contributing to the lowest level of producer support since the estimates began in the mid-1980s. Yet, developed countries did not take advantage of this window of opportunity to structurally reform their agricultural policies. Some progress has been made in moving away from the most production- and trade-distorting policy measures, although they continue to dominate producer support in most developed countries.

The rapid rise in food and fuel prices led to diverse reactions in affected countries. Along with protests and riots, higher prices put macroeconomic stability in jeopardy. The impact of the food crisis across a significant share of the population in many developing countries generated social demands for broad-based action. Governments were pressured to reduce food prices through administrative measures, including lower import tariffs or taxes, subsidies, and price controls.[7] In some countries, the policy response reflected the lack of more targeted mechanisms such as conditional cash transfers or food-for-work programs, which require substantial preparation time and implementation capacity. Many poor countries have narrow tax bases and rely on tariffs and other trade taxes for a large part of government revenue. In such countries, it is important to ensure that the revenue losses from tariff or tax reductions can be accommodated without destabilizing the macroeconomic situation. Tariff reductions can also have adverse effects on poor farmers who previously had a protected market, particularly if the tariff reductions are unanticipated. Such farmers may need targeted assistance as tariffs are reduced. In contrast, direct price controls or untargeted subsidies typically tend to be disincentives for producers, do not concentrate help on the poorest, and drain scarce fiscal resources.

In addition, some large food-exporting countries imposed export taxes, quotas, or outright bans.[8] While it can be difficult for countries with abundant supplies to allow international prices to filter through to consumers, especially when a large majority of the poor are urban, and there is temptation to keep food prices down by reducing exports, such measures reduce production incentives and can have unintended economic and social consequences. In particular, export restrictions tend to distort prices and the allocation of resources (impeding investment and the supply-side response) and prevent local farmers from receiving the higher world market price for their production (slowing the reduction of poverty in rural areas where most poor people live in most of the countries involved).[9] Export restrictions also displace local production to crops that are not subject to export restrictions (aggravating the very food security and price concern that justifies the measure in the first place); cut local production from global buyers and distribution chains (jeopardizing future reentry in once-secure markets); create space for illegal trade (fueling corruption and related forms of governance malpractices); exacerbate the rise and fluctuations of global food prices (creating a vicious incentive for trading partners to follow suit, curb exports, and hoard); and more generally hurt trading partners and the multilateral trading system (weakening the security of poor and vulnerable countries).[10]

Looking forward, trade policies that would help address the food crisis more fundamentally would involve correcting historical distortions in agricultural trade. Priority areas for action include disciplining export controls; reversing biofuel

subsidies; lowering production subsidies; facilitating agriculture trade; investing in trade-related infrastructure; completing the Doha Round; and, in the longer run, further liberalizing agricultural trade on a multilateral basis. While all of these steps would lead to more efficient agricultural markets, the complex web of policy distortions in agriculture has many cross-cutting effects, and it is difficult, especially in the short term, to predict precisely the impact that unwinding these policies would have on food prices. In particular, net food-importing countries might be adversely affected because global agricultural trade liberalization could cause world prices of agricultural commodities—at least those that are highly protected—to rise (while domestic prices in the liberalizing countries fall). Yet, the current conditions of relatively high food prices provide an opportunity for implementing long-standing agricultural trade reform. Instruments such as the IMF's Trade Integration Mechanism exist to help mitigate the possible adverse effects of liberalization on net food importers.

## Financial Crisis

In September 2008, with the impact of the food crisis still unfolding, the multilateral trading system had to cope with another major crisis—this time financial. The financial crisis, which originated in the developed world, fast spilled over to emerging markets and developing countries. The initial shock was a squeeze of liquidity, including for trade finance. The credit crunch in developed-country markets caused havoc in many low-income and emerging countries, as foreign banks abruptly reduced or stopped lending and stepped back from even the most basic banking services, including trade credits and guarantees. Net flows of private capital to emerging markets are projected to decline sharply in 2009. Although they are less financially integrated, low-income countries are also being hurt: trade finance, which is usually considered the lifeline of trade for poor nations that lack other resources to finance their imports and exports, has been disrupted. While the crisis began and spread in the financial sphere, the real economy has not remained immune. With collapsing demand and economic activity, protectionist pressures have intensified.

*Trade finance.* As the financial crisis unfolded, the availability of trade finance tightened and its cost rose because of growing liquidity pressure in mature markets and a perception of heightened country and counterparty risks. The contraction in trade finance was also fueled by the loss of critical market participants, such as Lehman Brothers, a drying up of the secondary market for short-term exposure (as banks and other financial institutions deleveraged), and the volatility of commodity prices.[11] The implementation of the Basel II Accord on banking laws and regulations, with its increased risk sensitivity of capital requirements, in an environment of global recession is also generally considered to have put additional pressure on banks to hold back on trade finance. Regardless of the impact of Basel II, as companies continue to be downgraded, higher risk premiums increase capital requirements, further reducing access to trade credit, especially for small and medium enterprises and banks in emerging markets.[12]

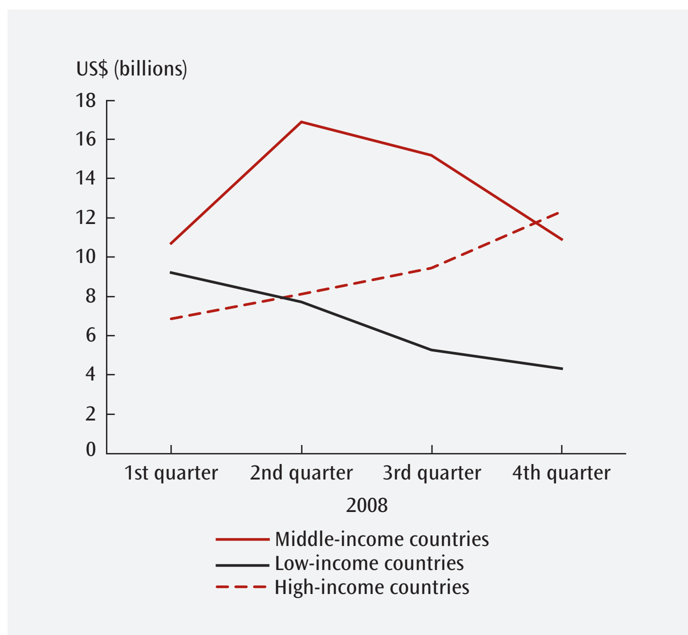
With up to 20 percent of the $15.8 trillion world merchandise trade in 2008 involving secured documentary transactions, such as letters of credit (LCs), trade finance is critical to sustaining the multilateral trading system.[13] As the financial crisis spread, the demand for LCs, insurance, and guarantees increased, because exporters wanted to be certain importers would pay on schedule. This led to delays in international trade, with goods reportedly being docked for weeks before shipment, as terms of financing were finalized. Trade finance has tended to be highly vulnerable in times of crisis. For instance, trade finance to developing countries collapsed during the 1997–98 East Asian financial crisis. Bank-financed trade credits declined by about 50 percent and 80 percent in the Republic of

Korea and Indonesia, respectively, in 1997–98. During the 2001–02 crisis episodes in Argentina and Brazil, trade credits declined by as much as 30–50 percent.[14]

With no comprehensive and reliable data on trade finance available, an overall assessment of trade finance developments in 2008 remains difficult. Selected information indicates that—along with global demand—trade finance flows declined in the last quarter of 2008. According to Dealogic, "structured" medium- and long-term trade finance instruments (such as syndicated loans) contracted by about 40 percent in the last quarter of 2008 compared with 2007.[15] While structured trade finance represents only a fraction of medium- and long-term global trade finance, it appears to be indicative of a broader trend. On short-term trade finance, data from the Society for Worldwide Interbank Financial Telecommunication indicate that the number of trade finance messages declined by 4.8 percent in December 2008, compared with the same period in 2007. This covers collection and cash letters as well as documentary credits and guarantees. According to a survey of 40 banks in developed and emerging markets undertaken by the IMF in collaboration with the Bankers' Association for Finance and Trade (BAFT) in December 2008, banks in developed countries reported roughly the same number of transactions of documentary credits, guarantees, and LCs in October and November 2008 compared with the same period in 2007.[16] In contrast, emerging market banks reported a 6 percent fall in such transactions. These developments are consistent with the data released by the Berne Union of export credit and investment insurance agencies, which indicate that, in the last quarter of 2008, new insurance commitments increased strongly for high-income countries and decreased for developing countries (figure 5.4).[17]

At the same time, the price of trade finance and the need for securing transactions through guarantees and insurance has increased markedly. Tight credit conditions have allowed lenders to drive up interest rates for their loans in many countries, especially in emerging markets (figure 5.5). When banks are under pressure, the capital needed for trade finance may be allocated elsewhere on balance sheets. With no secondary market to offload loans, balance sheets have been constrained. In addition, global currency volatility and more rigorous counterparty risk assessment contributed to higher cost of trade finance for importers, exporters, and financial intermediaries. By the end of 2008, trade finance deals were offered at 300–400 basis points over interbank refinance rates—two to three times more than the rate a year earlier. The cost of LCs was reported to have doubled or tripled for buyers in emerging countries, including Argentina, Bangladesh, China, Pakistan, and Turkey. This assessment was confirmed in the IMF/BAFT survey, which found widespread increases in pricing of all trade finance instruments relative to

**FIGURE 5.4** New insurance commitments (medium- and long-term) reported by Berne Union members on selected countries




*Source:* Berne Union.

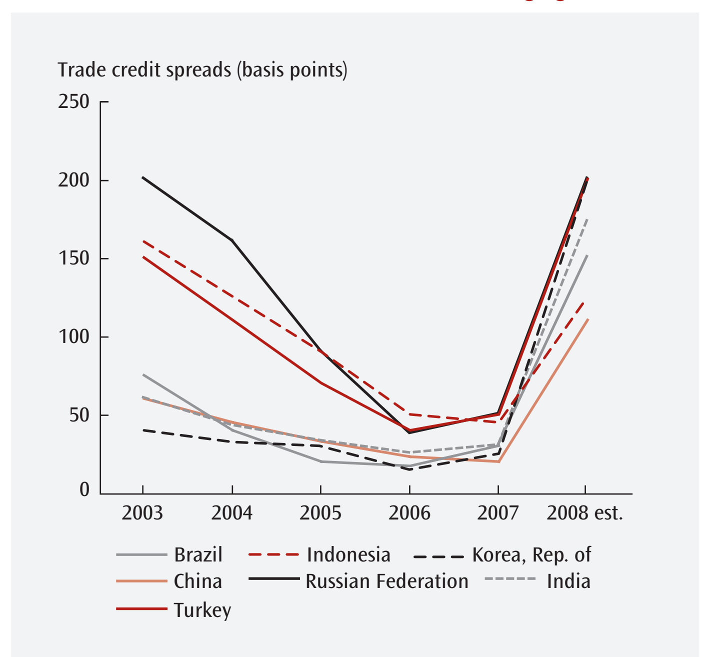
banks' costs of funds. More than 70 percent of respondents indicated that the price of various types of LCs increased because of an increase in their own institution's cost of funds (80 percent of respondents), an increase in capital requirements (60 percent of respondents), or both.

As part of the financial sector bailouts, given the rapidly deteriorating trade finance landscape, a number of national authorities started to intervene to provide blanket liquidity to banks and targeted trade credit lines and guarantees for exporters that have been cut from trade finance. For instance, in October 2008, Brazil's Central Bank was one of the first to issue loans in an attempt to provide relief to exporters. However, the financial interventions did not always lead to the desired results, because banks were concerned about increased counterparty risk and remained cautious, with many preferring to use the injected liquidity to purchase government paper. Moreover, as developed countries bailed out their banks, there has been political pressure to finance domestic transactions rather than provide trade finance that goes to developing countries.

Coordinating national interventions would send a powerful signal to market participants that would help restore confidence and eventually lower the overall cost of public intervention. When central banks lack the foreign exchange reserves to provide trade credit lines, other central bankers could offer currency swaps to help keep normal trade flows. The intervention of the U.S. Federal Reserve in support of Brazil and Mexico through currency swaps in late 2008 was a case in point. Export credit agencies from developed countries could be mobilized further to provide short-term insurance, and lending when possible, for bilateral trade credits. Promoting the use of local currencies in intraregional trade to reduce the dependence on the U.S. dollar and the euro as currencies of payment is another option to consider for reducing pressure on foreign exchange. When these steps are not possible, hard-pressed countries could consider depositing a collateral fund offshore to encourage acceptance of LCs by local importers, as the Indonesian Central Bank did during the 1997–98 Asian crisis.

In parallel, there is scope for financial institutions and enterprises to promote other sources of short-term financing. Factoring is a type of supplier financing that could be particularly suited to a heightened risk environment. Because factoring involves the outright purchase of invoices at a discount rather than the collateralization of a loan, the creditworthiness of the seller becomes less important in the decision process than the value of the seller's underlying assets. Hence, factoring could become an instrument of choice when firms in developing countries have difficulty accessing trade financing. While still a relatively small source of credit in emerging markets, the crisis could be an opportunity to expand factoring in both low-income and emerging countries.

**FIGURE 5.5 Cost of trade finance in selected emerging markets**




*Source:* Data collected by staff from private bankers.

For sectors and products highly integrated in a global supply chain, supply-chain finance solutions should remain a relatively stable source of working capital and thus financing. Corporations already use credit across multiple transaction types as part of daily operations. Since these credits are not intermediated through banks and their underlying risks are borne among party constituents (absent factoring and insurance), they should be more resilient to the credit crunch, at least to its initial direct effect. They will, however, remain vulnerable to the global economic and financial prospects.

Development institutions have taken actions to help ease access to trade finance. For example, in response to the financial crisis, the International Finance Corporation (IFC) has, among other actions, doubled its Global Trade Finance Program to $3 billion to facilitate trade by providing guarantees that cover the payment risk in trade transactions with local banks in emerging markets. To deal with the liquidity constraint, the IFC has also introduced a Global Trade Liquidity Pool, which, in collaboration with official and private partners, is expected to provide up to $50 billion of trade liquidity support over the next three years. Regional development banks such as the African Development Bank (AfDB), the Asian Development Bank (ADB), the European Bank for Reconstruction and Development (EBRD), and the Inter-American Development Bank (IDB) have also launched or expanded their trade finance programs to extend guarantee facilities to international banks confirming local banks' LCs, with a focus on small transactions in low-income countries that have little access to international markets and no or low international ratings.[18]

The international community has recognized the importance of dealing with trade finance concerns in a coordinated fashion. At the Group of Twenty (G-20) meeting in London, in April 2009, leaders reached agreement to ensure $250 billion of support for trade finance.[19] They also asked their regulators to make use of available flexibility in capital requirements for trade finance under Basel II.

***Protectionism temptation.*** If history is a guide, the economic stress and uncertainty that engulfed the international scene in 2008 could be a precursor to rising protectionist tendencies. Raising barriers at the frontier, starting with barriers to trade in goods or services, is often a tempting political option under such circumstances. Restricting capital movements, including for the more secure operations to finance imports and exports, is another inward-looking temptation. As governments consider their policy options, they should be mindful of the domestic and international consequences of such actions. In particular, developed countries can lead by example in avoiding protectionist responses. Less distorting policies to respond to the economic crisis would include the use of fiscal policy to stimulate domestic demand across the board. While trade and industrial policy may boost domestic consumption and production in certain sectors, on balance they tend to impose a net cost on the economy, have adverse domestic consequences on resource allocation and economic efficiency, and discriminate against foreign producers. They are likely to be met with retaliation from other countries, limiting their effectiveness and undermining the international trading system. Trade policy is not the appropriate instrument for pursuing equity objectives or for attaining goals such as employment protection; indeed, the distributional consequences of protectionism may be harmful to many poor households. Finally, once in place, tariffs and subsidies are difficult to remove, potentially creating a host of future difficulties.

Multilateral cooperation is therefore essential to ensure that disruptions to trade in goods and services and trade finance triggered by the global financial crisis remain circumscribed. Unlike in 1929, international trade is nowadays governed by rules and disciplines aimed at preventing the world economy from falling into another trade-induced Great Depression.[20] As noted by its director-

general, Pascal Lamy, the WTO "provides the real economy, the everyday economy, with a collective insurance policy against the disorder caused by unilateral actions, whether open or disguised; a guarantee of security for transactions in times of crisis, henceforth an element of resilience that is vital to the running of a globalised world. In short, a global insurance policy for a global real economy."[21] Yet for the system to hold at times of crisis, all countries need to obey these multilateral rules and disciplines.

At the Summit on Financial Markets and the World Economy, Washington, DC, November 2008, the leaders of the G-20 underscored the critical importance of rejecting protectionism and not turning inward in times of financial uncertainty.[22] They committed to refrain, during the next 12 months, from raising new barriers to investment or to trade in goods and services, imposing new export restrictions, or implementing WTO-inconsistent measures to stimulate exports. However, many countries could increase their applied levels of tariffs and trade-distorting subsidies without breaching their bound rates or other relevant WTO disciplines.[23] According to the WTO monitoring of trade developments, there has been a marked increase in protectionist pressures globally since September 2008, including by a number of G-20 countries. Although there is no general trend, a pattern is beginning to emerge of increases in import licensing, import tariffs and surcharges, and trade remedies to support industries facing difficulties early on in the crisis. Examples of countries that have introduced trade restricting or distorting measures (see table 5.1) include Argentina (more stringent licensing requirements), Ecuador (higher rates on some 630 tariff lines), India (higher tariffs on some steel products), Indonesia (limitations on entry points for certain imports), Ukraine (possibility of an import surcharge), and the European Union (increased export subsidies for selected dairy products).[24]

While resisting outright protectionism, governments, mainly in developed countries, have launched extensive domestic stimulus packages targeted at troubled export industries or competing import industries (such as airline, construction, steel, semiconductors,

**TABLE 5.1 Trade distorting actions taken in selected countries**

| Country | Trade policies | Sector-specific support |
|---|---|---|
| Argentina | ✔ | |
| Australia | | ✔ |
| Austria | | ✔ |
| Azerbaijan | ✔ | |
| Brazil | ✔ | ✔ |
| Canada | ✔ | ✔ |
| China | ✔ | ✔ |
| Ecuador | ✔ | |
| Egypt, Arab Rep. of | ✔ | |
| European Union | ✔ | |
| France | | ✔ |
| Germany | | ✔ |
| India | ✔ | |
| Indonesia | ✔ | |
| Japan | | ✔ |
| Kazakhstan | ✔ | |
| Libya | ✔ | |
| Malaysia | ✔ | ✔ |
| Mexico | ✔ | |
| Morocco | | ✔ |
| Paraguay | ✔ | |
| Philippines | ✔ | |
| Portugal | | ✔ |
| Romania | | ✔ |
| Russian Federation | ✔ | ✔ |
| Spain | | ✔ |
| Turkey | ✔ | |
| Ukraine | ✔ | |
| United States | ✔ | ✔ |
| Uzbekistan | ✔ | |
| Vietnam | ✔ | |

*Source:* WTO. Report to the Trade Policy Review Body, March 26, 2009.
*Note:* Trade policy actions include WTO-consistent antidumping and countervailing duties, but do not include increases in overall domestic support to agriculture or financial sector measures.

and automobile). While not barriers to trade in the traditional sense, these programs aimed at protecting businesses and jobs from the effects of the global slowdown could nevertheless restrict or distort trade, especially when they include "buy domestic" provisions.[25] In particular, industrial subsidies in one country (to the car industry, for example) provide an incentive for other countries to respond with their own subsidies or protection against imports from subsidized producers.[26] They are contagious and could result in a subsidy war that compounds the damage caused and leaves everyone worse off. In addition, they pull resources away from more productive uses. As noted by the WTO, when analyzing these support measures from a trade perspective, it must be recognized that at least some of the measures, which in most cases constitute some form of state aid or subsidy, may eventually have negative spillover effects on other markets or distort competition.

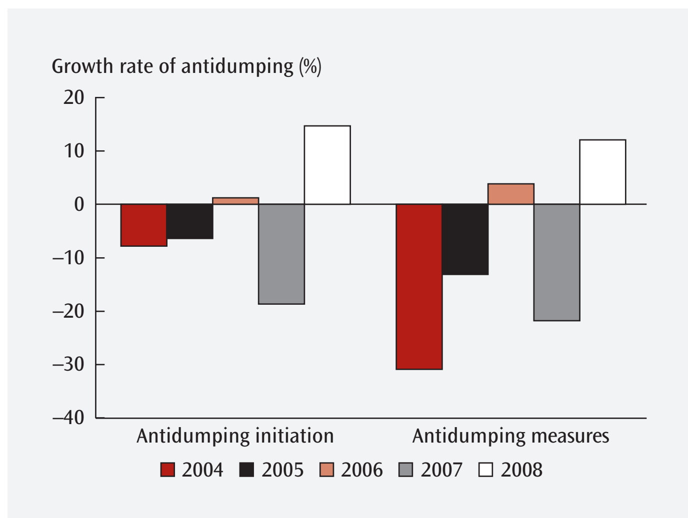
At the G-20 meeting in London, world leaders reaffirmed—and extended to the end of 2010—the commitment made in Washington, DC, to refrain from raising new barriers to investment or to trade, imposing new export restrictions, or implementing WTO-inconsistent measures to stimulate exports. In addition, they agreed to rectify promptly any such measures taken since their meeting in Washington, DC.

The number of antidumping actions rose significantly in 2008 (figure 5.6). Initiations of new antidumping investigations and application of new antidumping measures increased by 31 percent and 19 percent, respectively. With 73 percent of all new investigations, developing countries dominated the use of antidumping in 2008. Brazil, India, and Turkey were the top three initiators with some 100 cases combined. Exporters in developing countries were the most frequent target. Regarding the application of new antidumping measures, India, the United States, and the European Union applied the most measures, some 64 combined, most frequently targeted at China's products.

To strengthen confidence in global cooperation and institutions, it remains important that countries refrain from unilaterally restricting trade in areas where multilateral rules and disciplines do not exist or are not fully developed. For instance, the introduction of export restrictions on agricultural products by many large net food exporters contributed to the severity of the recent food price crisis. Countries should instead strive to keep their markets open and use the crisis as an opportunity to invest in trade-related infrastructure and to implement measures to facilitate trade. In particular, efforts in the area of trade facilitation could do a lot to increase global trade flows and partially counterbalance the effects of the global recession on trade.

In the same vein that multilateral cooperation leads to a global trade outcome superior to beggar-thy-neighbor policies, multilateral cooperation could help make trade finance more affordable and resilient in times of crisis. The Doha Round of negotiations under the General Agreement on Trade in Services could be used to increase the WTO's contribution to making the provision of trade financing more secure and more readily available, particularly in developing countries. Meanwhile, the WTO could continue

**FIGURE 5.6 Growth of antidumping cases**




*Source:* WTO, Antidumping Database; Brown forthcoming.

to use its convening power to raise awareness and find ways to alleviate the situation if it were to deteriorate further.

## Transforming Crises into Opportunities for Reform

As an old Chinese proverb says, a crisis is an opportunity riding the dangerous wind.[27] In the trade arena, the current crisis could provide an opportunity to complete the Doha Round of multilateral trade negotiations, accelerate national trade liberalization and trade facilitation reforms, and fulfill aid-for-trade commitments and improve their efficiency.

### Doha Round

Central to the task of promoting inclusive globalization and making the multilateral trading system more resilient in times of crisis are bringing down barriers to the trade of goods and services that poor people produce and increasing the reliability and predictability of the system's rules and disciplines. A successful Doha Round would help to ensure open markets at a time of financial stress, ease protectionist pressures, and strengthen the rules-based multilateral trading system. It could also provide a much-needed boost in confidence to a global economy experiencing a sharp slowdown, financial uncertainty, and high food prices. The need for a successful outcome has become more urgent, because the circumstances and some of the challenges facing the world economy in 2009, such as disciplining export restrictions or support to industries, are different from those in 2001 when the round was launched.[28]

Seven years into the Doha Round, trade negotiators have remained unable to reach agreement on modalities to further open markets for goods and services and strengthen the rules of the multilateral trading system. Yet trade negotiators have never been so close to an agreement. In the thorny agriculture negotiations, gaps have been narrowed significantly on a number of critical issues, including key parameters for cutting tariffs and trade-distorting subsidies. The IMF and the World Bank have called on all parties to revive the significant package that was on the table in Geneva in July 2008 and work swiftly toward closure. After years of valuable technical work, there is a Doha deal to be seized. According to the World Bank, a deal based on the broad parameters discussed in Geneva would compare favorably with the Uruguay Round on market access and would surpass it in breadth of coverage and tangible benefits for developing countries.[29]

Despite progress leading up to it, the ministerial meeting held in Geneva in July 2008 failed to achieve a breakthrough. Though compromise appeared within reach, the tentative agreement on nonagricultural market access (NAMA) and agriculture reached an impasse in country positions on several issues, including the provisions governing the new agricultural special safeguard mechanism for developing countries.[30] Other areas of disagreement that were not addressed or resolved included domestic subsidies for cotton, tariff-cutting sectoral initiatives in NAMA, and protections for food products with geographical names.

While an opportunity has been missed, the very substantial progress achieved at and since the meeting should not be overlooked or wasted. The compromise package on the tariff and subsidy reduction parameters in agriculture and NAMA circulated during the meeting attracted broad support. Progress was made in the dispute over fisheries subsidies. The long-standing issue of the European Union's banana regime and the margin of preference for ACP (African, Caribbean, and Pacific) producers had also nearly been resolved. The "signaling conference" on services held in the context of the mini-ministerial to set out the possible scope and ambition of a services agreement was a success. Countries showed willingness to lock in actual market access and make new or improved commitments in a wide range of services sectors.

Given the amount of progress made during the July meeting and the G-20 pledge to conclude the round before year-end,[31] efforts to reconvene a ministerial meeting led to revised draft texts for both agriculture and NAMA in December 2008. However, consultation with key players revealed that substantial differences remained, particularly on whether to hold additional specific negotiations for particular sectors, the special safeguard mechanism, and cotton. Under the circumstances, Director-General Lamy decided against calling a ministerial meeting. At their London meeting, G-20 leaders reiterated their commitment to urgently reach an ambitious and balanced conclusion to the Doha Round.[32]

The extent of progress toward the final agreement differs across negotiating groups. In agriculture, developed countries under the agreement would, among other things, cut highest bound tariffs by 70 percent over five years, with an average cut of not less than 54 percent; lower subsidy limits by 70 percent (United States) to 80 percent (European Union); and eliminate all export subsidies by 2013. Developing countries' bound tariffs would be cut by somewhat less than two-thirds of the cuts required of developed countries, and these countries would be able to designate certain "special" products for differential treatment, exempting them fully or partially from tariff cuts. In NAMA, developed countries' average bound and applied tariffs would be cut by roughly a third over four or five years, with the highest cuts in peak tariffs, while developing countries would be subject to little or no cut in applied tariffs. "Rules" negotiations on revisions to the antidumping and subsidies and countervailing measures agreements have also produced a draft text, with the U.S. practice of "zeroing" remaining the primary source of disagreement.[33] Notwithstanding the signaling conference, the services negotiations remained at an early stage. Negotiations in the area of trade facilitation continued to proceed satisfactorily.

Much is at stake in the Doha negotiations. The December 2008 package would boost economic growth and expand opportunity by cutting subsidies drastically, lowering tariffs significantly, and opening up services markets. It would be a mistake for the world economy and harmful for developing countries not to revive it.[34] Existing gaps can be bridged. For instance, there are certainly ways to solve the special safeguard mechanism problem and to establish a user-friendly safety net against import surges of agricultural products to protect fragile farming systems while, at the same time, agreeing on disciplines so that it is not abused and does not hamper normal trade flows.[35] The major players have all indicated their resolve not to lose momentum. Agriculture and NAMA negotiations resumed in early 2009 and discussion is focused on areas of divergence while preserving agreed topics as tabled in the draft texts. Negotiations in other areas, such as services and rules, will continue in parallel.

## Preferential Trade Agreements

With slow Doha Round negotiations toward a new multilateral agreement, the surge in preferential trade agreements (PTAs) is fast reshaping the architecture of the world trading system and the trading environment of developing countries.[36] Such proliferation of regional and bilateral trade agreements could pose serious challenges to the promotion of a more open, transparent, and rules-based multilateral trading system. While preferential agreements may in some instances promote development, they necessarily discriminate against nonmembers and can therefore lead to trade diversion in a way that hurts both member countries and excluded countries. The multitude of PTAs is also becoming cumbersome to manage for many developing countries. As agreements proliferate, countries become members of several different agreements. The average African country belongs to four different agreements; the average Latin American country to seven. This proliferation creates what has been referred to as a "spaghetti bowl" of overlapping arrangements, with

often different tariff schedules, different exclusions of particular sectors or products, different periods of implementation, different rules of origin, and different customs procedures, among other differences. Notable PTAs that came into force in 2008 and early 2009 include bilateral agreements between the European Union and Bosnia and Herzegovina, the CARIFORUM states, Montenegro, and Côte d'Ivoire; between the United States and Peru and Oman; between Japan and Indonesia and the Philippines; and a number of agreements between developing countries, such as between Panama and Chile, Pakistan and Malaysia, and Turkey and Albania.

In 2008 the European Union negotiated a number of economic partnership agreements (EPAs) with ACP countries to replace the system of trade preferences under the Cotonou trade regime. Several interim agreements were initialed with individual countries rather than with full ACP regions. In Central Africa an interim agreement has been concluded with Cameroon (other countries in the region opted out). In Southern Africa, a regional agreement was agreed with Botswana, Lesotho, Mozambique, Namibia, and Swaziland. In West Africa, the European Union reached individual agreements with Côte d'Ivoire and Ghana. In East Africa, a regional agreement was agreed with the East African Community (Burundi, Kenya, Rwanda, Tanzania, and Uganda). In Eastern and Southern Africa, a regional agreement was agreed with Comoros, Madagascar, Mauritius, Seychelles, Zambia, and Zimbabwe (but with individual market access schedules). In the Pacific region, a regional agreement was reached with Papua New Guinea and Fiji (with individual market access schedules). The European Union's aim remains to conclude full regional EPAs. Negotiations over these full EPAs are ongoing with all African and Pacific regions and cover a wider range of topics, including any issues set out in the interim agreements that partners want to reexamine.

## Developments in National Trade Policies

Governments use numerous instruments to regulate trade, including import tariffs, special duties, quotas, technical product regulations, antidumping duties, and discretionary licensing. The commonly used indicators of trade policy, such as average tariffs and frequency measures, capture only partially the impact of trade policies on trade flows. It is often preferable to use summary measures that take into account the effect of all policies affecting trade.

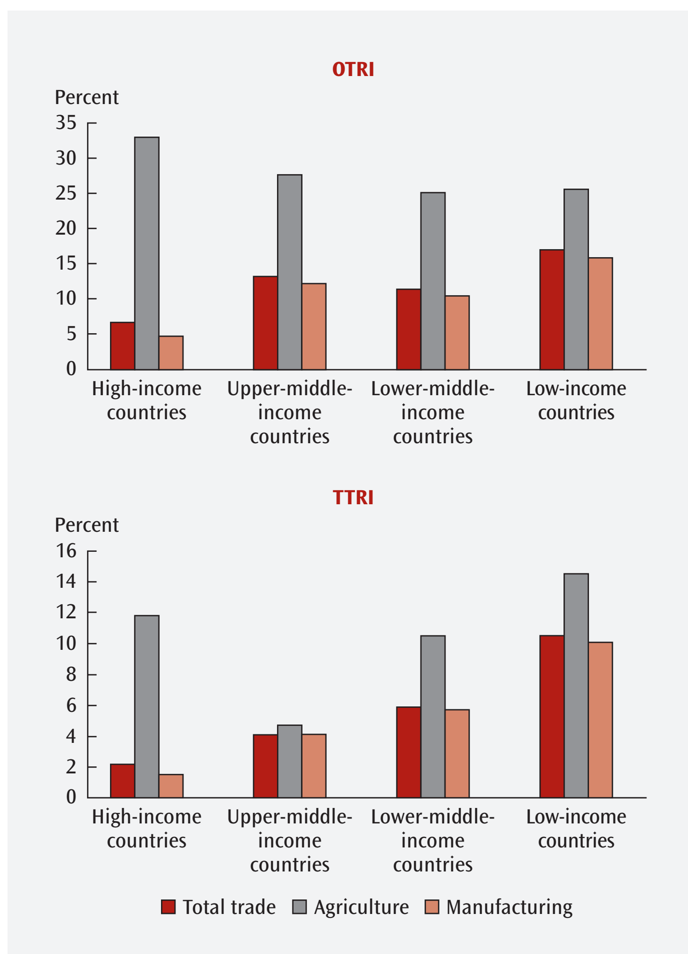
*Measures of trade restrictiveness.* As in previous reports, this section briefly presents two measures of the restrictiveness of trade policies affecting merchandise trade: the Overall Trade Restrictiveness Index (OTRI), and the Tariff Trade Restrictiveness Index (TTRI). Both provide a measure of the uniform tariff equivalent of observed policies on a country's imports: they represent the "tariff" that would be needed to generate the observed level of trade for a country. The level of restrictiveness confronting exporters is captured by two similarly constructed indicators: the Market Access OTRI (MA-OTRI), and the Market Access TTRI (MA-TTRI).

The OTRI captures ad valorem tariffs, specific duties, and nontariff measures (NTMs), such as price control measures, quantitative restrictions, monopolistic measures, and technical regulations.[37] The TTRI is narrower in scope; it takes into account only tariffs (both ad valorem and specific).[38] Because many NTMs are not protectionist in intent (or effect), the OTRI reflects net (overall) restrictiveness; it is not necessarily a measure of the level of protection that a government seeks for domestic industry. Some NTMs include border restrictions, such as quotas or bans, and are motivated by protectionist objectives. Others, such as standards for mercury content or fecal matter, are aimed at safeguarding human, animal, or plant health. Since distinguishing between objectives is not possible, protection is better measured by the TTRI; because of

its limited coverage of trade policy instruments, however, it is best seen as providing a lower-bound estimate of the extent of protection prevailing in a market.

Measured by the OTRI and TTRI, trade policies are generally more restrictive in developing countries than in high-income economies (figure 5.7). This reflects both lower tariffs and the higher percentage of manufactures in the trade of high-income nations (manufactures generally face much lower trade restrictions than agricultural products, which are relatively more important in the export basket of developing countries). Trade restrictions on agriculture are, on average, highest in high-income countries.[39] With the exception of upper-middle-income countries, agricultural TTRIs and OTRIs substantially exceed those for manufactures. Nontariff measures are an important component of overall trade restrictiveness, especially for agricultural products, resulting in OTRI levels that exceed the TTRI by a significant margin. For high-income countries, the OTRI is about three times higher than the TTRI, while in lower-middle-income and low-income countries, the ratio is two or less.

**FIGURE 5.7 OTRI and TTRI by income group, 2007**



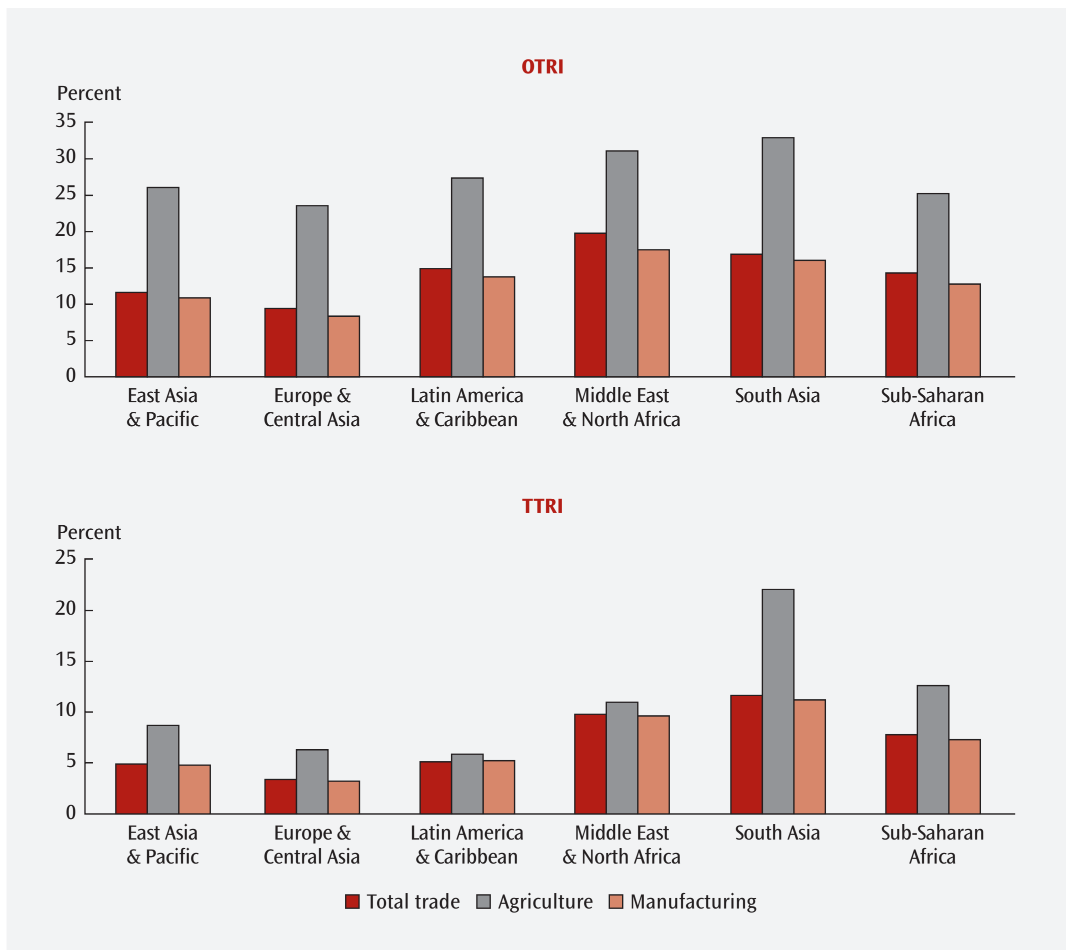

*Source:* World Bank and UNCTAD staff estimates.

The level of trade restrictiveness on average is higher for countries in South Asia and the Middle East and North Africa, and lower for countries in East Asia and Pacific and Europe and Central Asia. Sub-Saharan Africa and Latin America and the Caribbean have overall restrictiveness levels in between these two extremes (figure 5.8). The United States, European Union, Japan, and China account for about 60 percent of world trade. All have policies that are more restrictive of trade in agricultural products than manufactures, with Japan and the European Union imposing significantly higher restrictions (figure 5.9).

For all income groups and all regions, the overall OTRI has fallen since 2002 (figure 5.10). The greatest overall liberalization has been implemented by low-income countries, especially in manufacturing goods. Middle-income developing countries significantly reduced the restrictiveness of agricultural trade. In particular, there has been a significant reduction in China's OTRI, which fell by almost 8 percentage points between 2002 and 2007. This was in part explained by a dramatic reduction of 32 percentage points in China's agricultural OTRI, which led to a sharp reduction in the agricultural trade restrictiveness in East Asia and Pacific. In terms of the overall OTRI, South Asia improved the most followed by the Middle East and North Africa and Latin America and the Caribbean.

***Changes in market access.*** The effect of trade policies on exporters' access to markets is different across trading partners and geographic

**FIGURE 5.8 OTRI and TTRI by region, 2007**

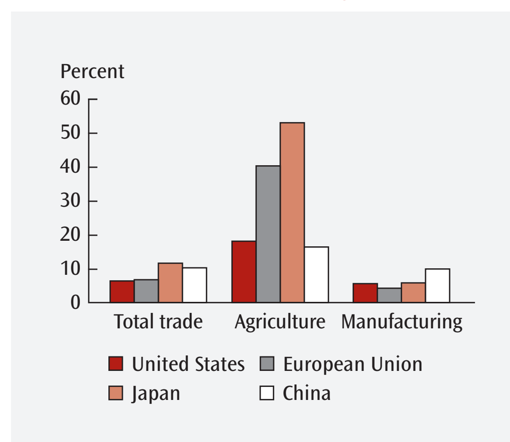



*Source:* World Bank and UNCTAD staff estimates.

regions, in part because of the discriminatory use of trade policies (trade preferences) and in part because of the composition of trade. Figures 5.11 and 5.12 report the MA-OTRI and change in MA-OTRI faced by exporters in each geographic region and country income group. The MA-OTRI measures the overall restrictiveness (including nontariff measures) faced by exports.

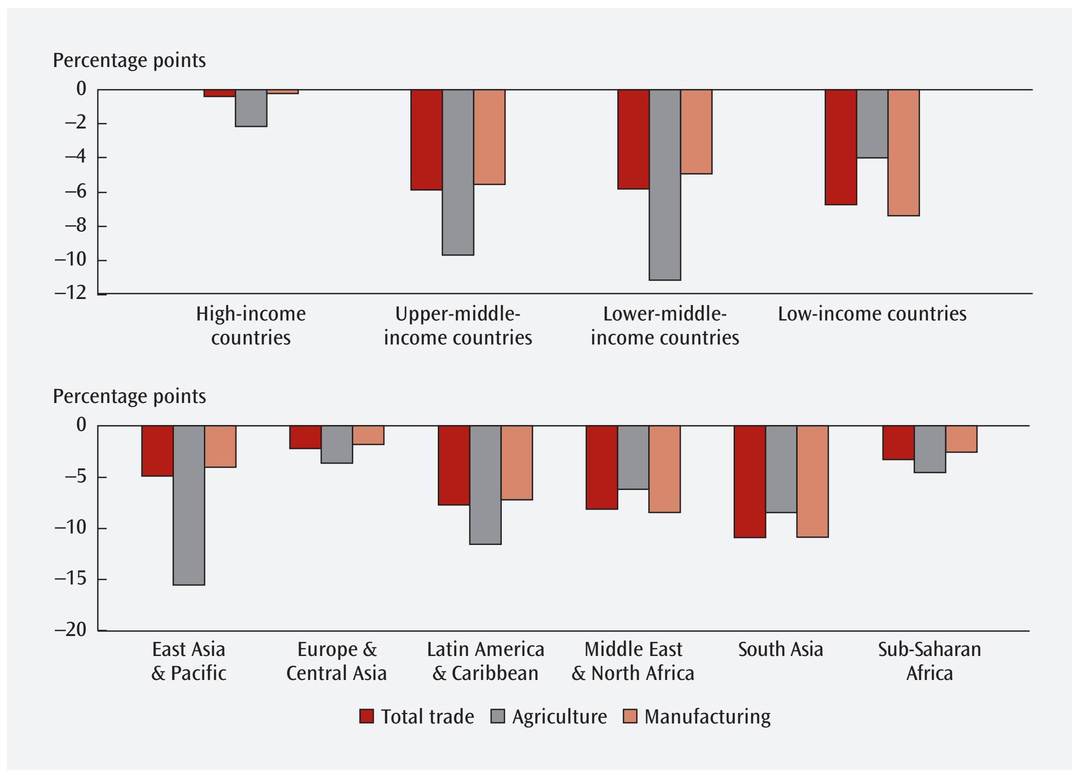
Sub-Saharan Africa countries benefit from relatively liberal market access as a result of preferential access to the major economies and a larger share of exports of commodities for which tariffs are low. Conversely, Sub-Saharan Africa's market access to other low-income countries is restricted

**FIGURE 5.9 OTRI of the four largest traders, 2007**



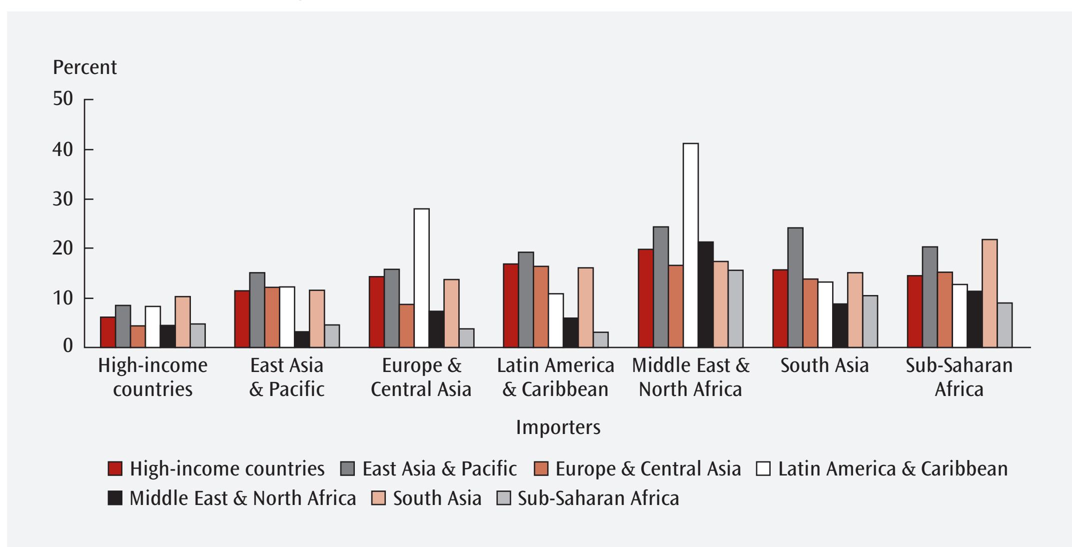

*Source:* World Bank and UNCTAD staff estimates.

**FIGURE 5.10 Change of OTRI by income group and region, 2002–07**



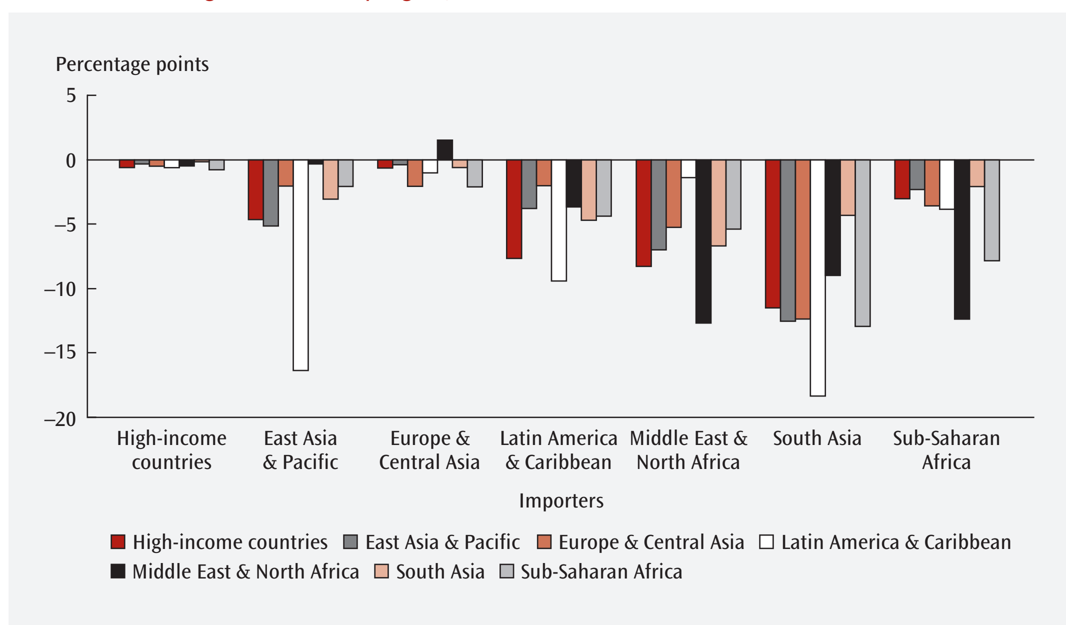

*Source:* World Bank and UNCTAD staff estimates.
*Note:* Most changes in OTRI in this figure reflect tariff changes.

**FIGURE 5.11 MA-OTRI by region, 2007**




*Source:* World Bank and UNCTAD staff estimates.
*Note:* The horizontal axis represents the importing area and the vertical bars show exporters into that area.

**FIGURE 5.12 Change in MA-OTRI by region, 2002–07**



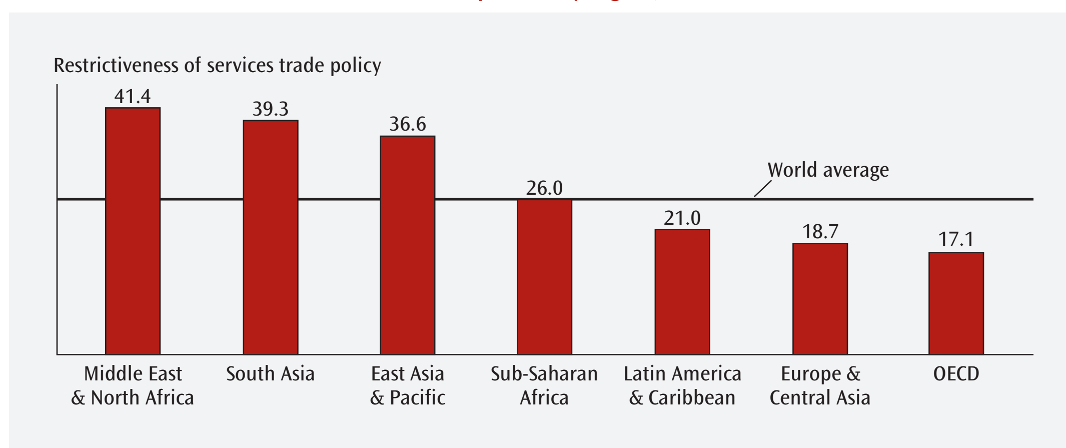

*Source:* World Bank and UNCTAD staff estimates.
*Note:* Most market access changes in the figure reflect tariff changes. The horizontal axis represents the importing area and the vertical bars show exporters into that area.

by relatively high tariffs. Among other regions, Europe and Central Asian market access to high-income countries is facilitated by preferences in the European Union, while the low MA-OTRI confronting Middle East and North African countries is largely attributable to the composition of exports—oil products are generally subject to low import tariffs. Latin America and the Caribbean faces relatively high market access barriers in Europe and Central Asia and the Middle East and North Africa. Interestingly, despite the multiplication of regional trade agreements, restrictions on intraregional market access remain high in many regions.

In terms of changes, market access has improved in recent years, with Latin America and the Caribbean benefiting the most in South Asia, East Asia, and within Latin America; and Sub-Saharan Africa gaining significantly in South Asia but also within Africa. High-income countries increased their market access in most regions. This is largely attributable to export composition, because high-income countries' exports mainly consist of manufactures, for which restrictiveness has declined relatively more. Exports of lower-income countries are more oriented toward agriculture, which faces more restrictive barriers and for which liberalization has been more mute.

***Policies in services markets.*** Permitting foreign firms to compete in services markets is another powerful potential channel for technology diffusion as well as a mechanism to reduce costs and raise the quality of services. As reported in *Global Monitoring Report 2008*, an ongoing research project by the World Bank is seeking to compile data on the extent to which policies discriminate against foreign services providers. To date, surveys have been conducted in 56 developing countries and comparable information obtained for 24 developed countries, covering five key sectors: financial services (banking and insurance), telecommunications, retail distribution, transportation, and professional services.[40] In

**FIGURE 5.13 Restrictiveness of services trade policies by region, 2008**




*Source:* Gootiiz and Mattoo 2009.
*Note:* The regional index is an average of individual countries' services trade restrictiveness index. This index incorporates indexes of financial services, retailing, maritime shipping, maritime auxiliary services, air passenger services, accounting, auditing, and legal services in domestic and foreign law.

each sector, the survey covered the most relevant modes of supplying that service: cross-border trade (mode 1 in WTO parlance) in financial, transportation, and professional services; commercial presence or foreign direct investment (mode 3) in each services sector; and the presence of service-supplying individuals (mode 4) in professional services.

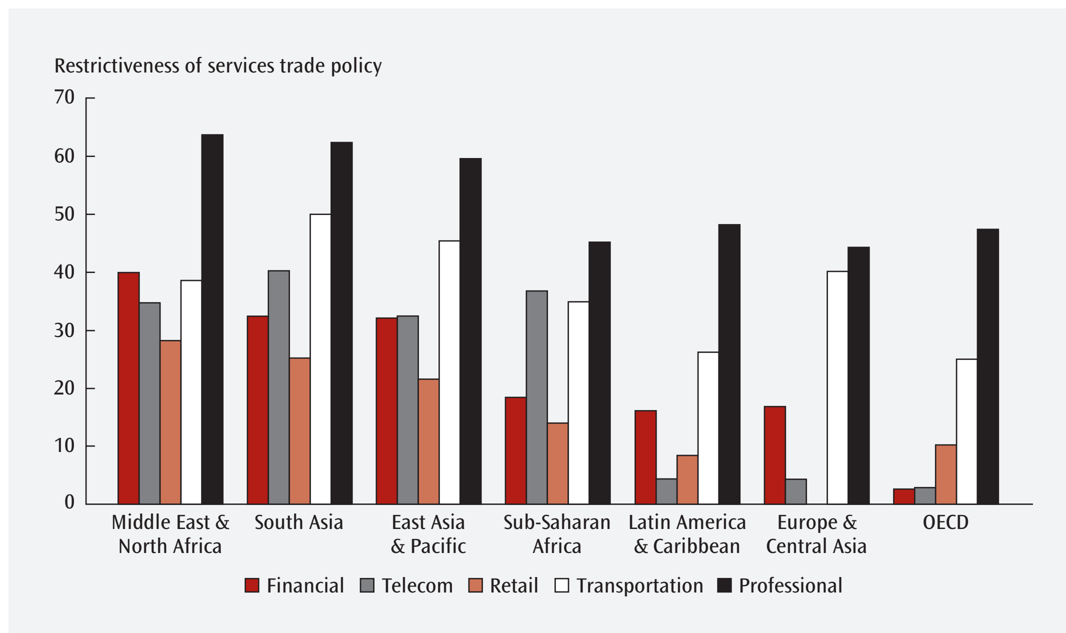
The restrictiveness of services policies varies substantially across world regions (figure 5.13). Interestingly, some of the most restrictive policies today are visible in the fast-growing economies of Asia as well as in the Middle East. In contrast, policies are relatively liberal in Latin America, Sub-Saharan Africa, Eastern Europe, and the developed countries. Some of the poorest countries, like Cambodia, Ghana, Mongolia, Nigeria, and Senegal, are remarkably open, with World Bank–IMF reform programs and accession to the WTO probably playing a significant role. Despite significant liberalization in recent years, telecommunications, finance, and retail services are still relatively restricted in Asia; many Sub-Saharan African countries have opened up telecommunications, especially the mobile segment, to competition, but the sector is still relatively restricted in the region; and transport and professional services are restricted all over the world, including in Latin America, Eastern Europe, and the developed countries (figure 5.14).

## Behind-the-Border Agenda: Impact of Trade Policy vs. Other Trade Costs

The fast pace of globalization and the erosion of preferences for poor countries associated with expanding preferential trade agreements make improving domestic competitiveness through behind-the-border reforms imperative. In particular, efforts in the area of trade facilitation can do a lot to increase trade flows.[41] The ease of moving goods internationally has become a key determinant of export competitiveness and diversification.

There is much that developing countries can do in the area of trade facilitation to expand trade by reducing the transaction costs for their firms and farmers. High trade transaction costs and lack of capacity to rapidly move goods and services across borders prevent many developing countries from taking advantage of *existing* trade opportunities. In particular, outdated and inefficient border processing systems, problems

**FIGURE 5.14 Restrictiveness of services trade policies by region and sector, 2008**




*Source:* Gootiiz and Mattoo 2009; restrictiveness index of cross-border air passenger policy came from the WTO QUASAR database (2007).
*Note:* Financial services = retail banking and life and automobile insurance; telecom services = fixed and mobile phones; retail services = retailing (commercial presence); transportation services = maritime shipping, maritime auxiliary services, and air passenger services; professional services = accounting, auditing, and legal services in domestic and foreign law.

associated with inefficient logistics services, and gaps in the trade infrastructure all result in higher transaction costs, delays, and unreliable supply chains. The high returns to action in this area are increasingly recognized, as reflected in increased levels of investment in trade-facilitation-related reforms by governments and the development community. The World Bank Group, in partnership with donors, is increasing its efforts to provide additional services and resources to help developing countries with trade facilitation activities, including provision of support for regional, multicountry projects.[42]

The available data on the level of trade restrictiveness implied by border policies indicate that nontariff measures are increasing in relative importance as a barrier to trade but that tariffs remain a significant factor, especially in developing countries. The tariffs and NTMs included in the indicators discussed above are only a subset of the policies that may affect trade. Internal trade and transaction costs may be of equal if not greater importance as constraints to trade. Many of these trade costs reflect the domestic economic environment and the overall private investment climate: the legal and regulatory framework, the efficiency of infrastructure services and related regulation, customs clearance procedures, and administrative red tape, among other things.

A substantial amount of information on the extent of product market regulation is available for developed countries, but comparable data do not exist for developing country regulatory regimes. However, data are available for a large number of developing countries on the performance of logistics services and on the internal costs associated with shipping goods from the factory gate to the port, and from ports to retail outlets. The first is mainly captured by the Logistics Performance Index (LPI); the second is largely covered by the Doing Business database.[43] All of these indicators capture dimensions

of prevailing domestic regulatory regimes that affect trade. While they overlap to some extent, they also inform about possible specific bottlenecks. The Doing Business "cost of trading" measures the fees associated with completing the procedures to export or import a 20-foot container, measured in U.S. dollars. These include costs for documents, administrative fees for customs clearance and technical control, terminal handling charges, and inland transport.[44] The LPI is based on a worldwide survey of global freight forwarders and express carriers and measures the logistics friendliness of countries on seven key dimensions (efficiency and effectiveness of the clearance process by customs and other border control agencies; quality of transport and information technology infrastructure for logistics; ease and affordability of arranging shipments; competence in the local logistics industry; ability to track and trace shipments; domestic logistics costs; and timeliness of shipments in reaching destination). Feedback from the survey is supplemented with data on the performance of key components of the logistics chain. Table 5.2 reports the average of these indexes by country income groups. Low-income countries generally have weaker trade facilitation performance than higher-income economies.

Hoekman and Nicita (2008) assess the effects of border barriers and trade costs indicators on merchandise trade flows using a gravity model framework where bilateral trade flows are a function of the economic size and distance between two countries. In addition to standard economic variables, they use both the TTRI and the NTM components of the OTRI (defined as the difference between the OTRI and the TTRI), as well as the Doing Business and LPI indicators as explanatory variables.[45] The results are typical of those of other gravity equation models.[46] Distance is an important determinant of bilateral trade, as are a common border and common language. Landlocked countries tend to trade less, especially in terms of exports, while larger and more populous countries tend to trade more.

Trade policies (tariffs and NTMs) are statistically significant determinants of trade volumes. On average, a reduction in the TTRI of 10 percent would increase trade volumes by a little more than 2 percent, while NTMs add another 1.8 percent.[47] Other trade costs are important. Coefficient estimates for the LPI suggest that a one point reduction in the LPI score would increase trade volumes by about 50 percent. Similar results are found for internal trade costs as captured by the Doing Business indicators. The elasticity of imports to the cost of importing is about 0.48, and that of exports to the cost of exporting is about 0.47. That is, a 10 percent reduction in the cost associated with importing (exporting) would increase imports (exports) by about 4.8 percent (4.7 percent). When including both the LPI and the Doing Business indicators in the estimation, all coefficients remain significant except for the LPI for the importers.

To assess the relative impacts of internal trade costs and the trade-impeding effect of border trade policies, table 5.3 reports the predicted effect on trade if low-income countries were to converge to a set of policies that would generate the observed average levels of the LPI and Doing Business indicators in middle-income countries. These results are compared with the average effect of a reduction in the TTRI and OTRI to 5

**TABLE 5.2 Measures of domestic trade costs**
*averages by country group*

| Indicator | High-income countries | Middle-income countries | Low-income countries |
|---|---|---|---|
| LPI (score)[a] | 3.9 | 3.0 | 2.8 |
| Doing Business, import (US$)[b] | 813.6 | 1,024.2 | 1,212.0 |
| Doing Business, export (US$)[b] | 774.4 | 867.2 | 949.3 |

*Source:* Hoekman and Nicita 2008.
a. On a 5-point scale (5 highest performance).
b. Fees associated with completing the procedures to export or import a 20-foot container (not including tariffs and trade taxes).

and 10 percent, respectively.[48] The predicted increases in trade volumes of low-income countries in this convergence experiment are substantial. The largest increases in trade are associated with actions to improve the logistics-trade facilitation scores (as measured by the LPI). Improving performance on the Doing Business measure of internal trade costs has an impact similar to what could be obtained by further traditional trade policy reform—reducing the TTRI or bringing down the restrictiveness of NTMs.

These results suggest that administrative and regulatory policies are at least as important as trade policies in impeding trade. This finding supports the recent focus of many developing countries on taking action to facilitate trade. The analysis also makes clear that large benefits are still to be gained from traditional trade liberalization, the focus of the ongoing Doha Round of WTO negotiations. As noted above, progress in the Doha Round has unfortunately been slow. Bringing the negotiations to a successful conclusion is important because it would imply improvements in market access to all export markets. Trade facilitation does not require multilateral (or bilateral) negotiations—the costs that are incurred by traders in developing countries can be reduced through unilateral actions. As Ikenson argues, there is great scope to enhance growth opportunities "while Doha sleeps."[49] The recent financial crisis makes this policy prescription even more important. Trade facilitation and supporting measures to enhance competitiveness are areas in which aid for trade can have an important impact.

The trade facilitation agenda facing developing countries is broad and can be defined as covering the infrastructure, institutions, regulations, policies, procedures, and services that allow firms to conduct international trade transactions—involving trade in either goods or services—on time and at low cost. Specifically, this agenda includes (1) modernizing and improving border management institutions, processes, and related supporting hardware (such as information technology), including customs, standards compliance, and transport security; (2) streamlining trade regulations and procedures, such as licensing, trade finance rules, documentary requirements, and work permits; (3) increasing the efficiency and capacity of trade gateways, such as ports and airports; (4) creating an enabling environment for the efficient provision of services such as logistics, transport security, trade finance, testing and certification, remittances, freight-forwarding, and customs brokering; (5) improving trade corridors, including multimodal freight transport and gateway infrastructure; and (6) establishing regional trade facilitation systems, such as transit regimes for landlocked countries, regional sanitary and phytosanitary management, and regional customs harmonization and standardization.

**TABLE 5.3 Effects of convergence by low-income countries to middle-income average**
*percent*

| Indicator/policy area | Increase in imports | Increase in exports |
|---|---|---|
| LPI score | 15.2 | 14.6 |
| Doing Business, cost of trading | 7.4 | 4.1 |
| TTRI for low-income countries reduced to 5 percent | 5.7 | n.a. |
| OTRI for low-income countries reduced to 10 percent | 8.4 | n.a. |

*Source:* Hoekman and Nicita 2008.
n.a. Not applicable.

To help developing countries improve their competitiveness by reducing the costs of engaging in international trade, the World Bank, together with other development agencies, has scaled up its trade facilitation programs and launched a Trade Facilitation Facility. This facility, launched in April 2009, will enable the World Bank Group to respond to increased demands from developing countries to overcome trade bottlenecks imposed by weaknesses in trade logistics, customs, testing and certification, trade

finance, and other aspects of trade facilitation regimes. An integral part of scaling up World Bank and IFC services in the trade facilitation area, the facility creates a one-stop shop by bringing together the different parts of the institution that provide trade facilitation-related assistance and establishing a dedicated facility that will allow the institution to deliver a coherent and expanded package of services, and respond more effectively to the increasing demand for support in this area.

## Aid for Trade

In supporting the multilateral trade liberalization agenda as well as domestic trade facilitation efforts, aid for trade can produce positive cross-border externalities that benefit all trading partners. Although trade is an important engine of growth, many poor countries face considerable infrastructure and other supply-side constraints to participating in global markets. Trade reform is also a "global public good" in that all countries generally benefit from one country's policy and institutional reforms (such as lowering of tariffs and other trade barriers) and investments in trade infrastructure (such as customs reforms and ports). Those benefits are increased when reforms are undertaken by a number of countries concurrently. Because the benefits of reform are not fully captured by the reforming country itself, there is potentially "underinvestment" in reforms. Aid for trade can thus be an important complement to trade reform and global market opening.

To set in motion a process to help provide more and better aid for trade, trade ministers at the 2005 Hong Kong, China Ministerial called on bilateral and multilateral donors to increase the resources for aid for trade, endorsed the enhancement of the Integrated Framework for least developed countries, and established a Task Force on Aid for Trade. The Aid for Trade Task Force recommended, among other things, improvements in global monitoring efforts to ensure that pledges on aid for trade were fulfilled.[50] As part of this effort, three regional reviews took place in 2007 to take stock of progress in the delivery of aid for trade, and a first WTO Global Aid for Trade review was held in Geneva in November 2007 to exchange ideas about best practices and to facilitate collective action to maximize the benefits of aid for trade. In 2008 the WTO announced an aid-for-trade roadmap aimed at monitoring overall aid-for-trade aggregates with a view to evaluating the initiative and mobilizing support for the trade agenda through national conferences.[51] A second global review will take place in early July 2009.

Common themes that emerged from the first global review included the importance of leadership in developing countries to integrate trade into national plans; priority setting in deciding on the projects that deliver the biggest return on investment; thinking regionally, because many capacity and connectivity problems, especially for small or landlocked countries, are regional in scope; ensuring increased and predicable financing, by following through on donor pledges made at the Monterrey, Gleneagles, and Hong Kong, China meetings; and mobilizing the private sector because it is businesses, not governments, that trade.

Leaving aside the methodological limitations in defining and tracking aid for trade discussed in last year's report, aid-for-trade flows increased by some $2 billion in real terms during 2007, or 21 percent relative to the baseline for 2002–05 established by the Aid for Trade Task Force (table 5.4). Total aid for trade in 2007 on the basis of the OECD Creditor Reporting System definition represented roughly 30 percent of total sector allocable official development assistance (ODA), below the 35 percent registered in 2002. A noticeable development in 2007 was the contrast between the performance of multilateral and regional donors, such as the World Bank and the regional development banks, and that of bilateral donors, including the European

**TABLE 5.4 Aid-for-trade commitments: annual averages 2002–05 and totals for 2006 and 2007**
*US$ (millions), 2006 constant prices*

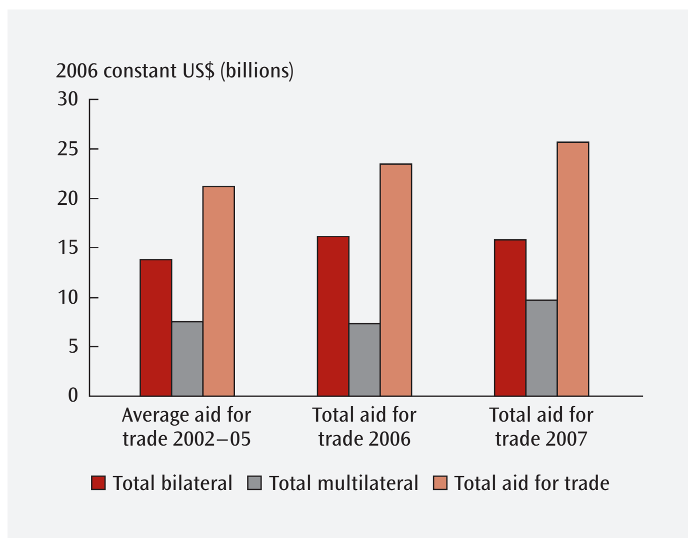
| | Average aid for trade 2002–05 | Infrastructure | | Capacity building | | Trade policy and regulations | | Total aid for trade | | Change 2006 to 2007 | As a share of total aid for trade in 2007 | As a share of donor sector allocable ODA, 2007 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | 2006 | 2007 | 2006 | 2007 | 2006 | 2007 | 2006 | 2007 | percent | percent | percent |
| *Top 10 bilateral donors* | | | | | | | | | | | | |
| Denmark | 387 | 95 | 167 | 142 | 145 | 0 | 1 | 237 | 314 | 32 | 1.2 | 25 |
| France | 681 | 517 | 507 | 310 | 738 | 1 | 4 | 828 | 1,249 | 51 | 4.9 | 21 |
| Germany | 1,160 | 797 | 501 | 1,062 | 968 | 18 | 38 | 1,877 | 1,508 | –20 | 5.9 | 24 |
| Japan | 4,439 | 3,417 | 2,968 | 1,105 | 1,392 | 50 | 46 | 4,573 | 4,406 | –4 | 17.3 | 65 |
| Netherlands | 529 | 134 | 86 | 664 | 508 | 63 | 44 | 861 | 638 | –26 | 2.5 | 10 |
| Norway | 252 | 104 | 142 | 199 | 189 | 21 | 21 | 324 | 352 | 9 | 1.4 | 20 |
| Spain | 372 | 592 | 297 | 111 | 279 | 1 | 7 | 704 | 583 | –17 | 2.3 | 32 |
| Sweden | 216 | 87 | 70 | 213 | 236 | 26 | 34 | 326 | 340 | 4 | 1.3 | 23 |
| United Kingdom | 757 | 108 | 110 | 445 | 374 | 81 | 26 | 634 | 510 | –20 | 2.0 | 10 |
| United States | 3,594 | 2,307 | 2,482 | 1,897 | 1,967 | 316 | 183 | 4,520 | 4,632 | 2 | 18.2 | 35 |
| Total bilateral | 13,810 | 8,649 | 7,749 | 6,937 | 7,716 | 1,046 | 703 | 16,217 | 15,899 | –2 | 62.0 | 27 |
| *Main multilateral donors* | | | | | | | | | | | | |
| AfDB | 565 | 282 | 831 | 243 | 231 | .. | .. | 526 | 1,062 | 102 | 4.2 | 92 |
| ADB[a] | 717 | 166 | 340 | 216 | 257 | .. | 5 | 382 | 603 | 58 | 2.4 | 45 |
| European Commission | 2,479 | 1,647 | 1,352 | 1,161 | 1,133 | 411 | 261 | 3,220 | 2,746 | –15 | 10.8 | 29 |
| World Bank (IDA) | 3,166 | 1,724 | 3,233 | 1,120 | 1,431 | .. | .. | 2,844 | 4,663 | 64 | 18.3 | 44 |
| Total multilateral | 7,321 | 3,874 | 5,918 | 2,933 | 3,414 | 414 | 269 | 7,221 | 9,600 | 33 | 38.0 | 37 |
| Total aid for trade | 21,097 | 12,523 | 13,666 | 9,870 | 11,130 | 1,460 | 971 | 23,439 | 25,499 | 9 | 100 | 30 |

*Source:* OECD Creditor Reporting System (as of January 2009).
*Note:* .. = Negligible.
a. Data provided here are only indicative of ADB's expanding trend and position relative to other institutions. They do not necessarily reflect ADB's actual involvement in aid for trade, which is likely to be higher due to some limitation of current classification systems.

Union. While the main multilateral donors continued to scale up their aid-for-trade programs, several bilateral donors recorded a significant decline in their aid-for-trade commitments. Total commitments from bilateral donors decreased by 2 percent in 2007 while commitments from multilateral donors increased by more than 30 percent (figure 5.15).

The United States and Japan continued to dominate global aid-for-trade delivery, with $4.6 billion and $4.4 billion in 2007,

**FIGURE 5.15 Aid-for-trade commitments: annual averages for 2002–05, and totals for 2006 and 2007**




*Source:* OECD Creditor Reporting System (as of January 2009).

respectively. Other important bilateral donors include France, Germany, the Netherlands, Spain, and the United Kingdom. The World Bank, through the International Development Association (IDA), was the largest provider of concessional aid for trade in 2007, closely followed by the United States; both provided about 18 percent of total aid for trade in 2007. IDA aid for trade has been driven by an increase in aid for infrastructure projects. The ADB and the AfDB are also important providers of aid for trade in their respective regions and among the top 10 donors globally. In 2007, the AfDB allocated more than 90 percent of its total sector allocable ODA to aid for trade. The 10 largest bilateral donors and multilateral agencies funded more than 90 percent of global aid-for-trade activities in 2007. In general, a greater portion of multilateral than of bilateral commitments goes to low-income countries.

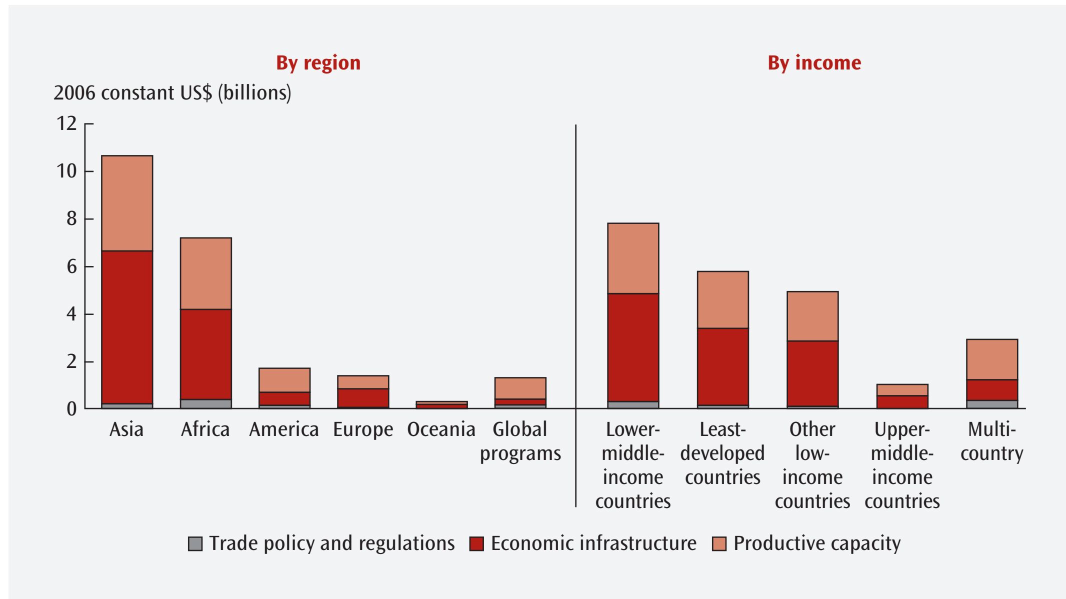
In terms of composition, aid to support the development of economic infrastructure and productive capacity building dominated overall volumes of aid for trade, at 54 percent and 43 percent, respectively, in 2007. Aid for trade policy and regulations, usually delivered through technical assistance, accounted for the smallest share. However, limitations in the data collection might underestimate this portion of aid for trade.

Iraq, India, Vietnam, Afghanistan, and Ethiopia were the top five recipients of aid for trade in 2007, accounting for almost 30 percent of the total. Asian countries received almost 50 percent of all aid for trade—$10 billion on average during 2002–07 (figure 5.16).[52] Africa followed with 32 percent ($7.14 billion). Ethiopia, with 3.17 percent of total aid for trade in 2007, was the only country from Sub-Saharan Africa among the top five recipients. The predominance of Asia largely reflects the volume of aid received for economic infrastructure—almost 60 percent of total aid for trade in the region. Even when excluding large recipient countries in Asia, Africa lags behind: the average Asian country received one-and-a-half times more than the average African country. Low-income countries received only about half of the total aid-for-trade commitments in 2002–07, slightly more than half of which went to least-developed countries.

Progress has been made in trade-related technical assistance for the least-developed countries with the establishment of the Enhanced Integrated Framework (EIF) in 2007, a new executive secretariat, and a trust fund to support its operations. The new EIF governance structure will emphasize country ownership by reinforcing and enlarging the involvement of the EIF national bodies at the country level, linking the WTO-based EIF secretariat to in-country processes, and encouraging recipient countries to lead projects.[53] In September 2007 a pledging conference was held for the EIF Trust Fund in Stockholm; 22 donors pledged $170 million over a five-year period. Since then, a further $3 million has been pledged. With the selections of the trust fund manager and head of the secretariat, the EIF is likely to be fully operational in early 2009.

To complement the EIF, the World Bank launched in November 2007 the Multi-Donor Trust Fund for Trade and

**FIGURE 5.16 Commitments of aid for trade by region, income group, and category, average 2002–07**




*Source:* OECD Creditor Reporting System and OECD/WTO Trade Capacity Building database.
*Note:* Asia includes East and South.

Development to provide additional resources in support of the Bank's trade strategy at the country, regional, and global levels.[54] In its first year of operation, the trust fund has supported work in many low-income countries and regional projects, and enhanced the World Bank's capacity to respond to client demand for trade-related technical assistance and capacity building; develop analytical tools to assist countries to define trade policy strategies; expand research and datasets on trade topics of importance to developing countries; and diffuse knowledge on international trade to developing countries. Some examples of work include a comprehensive program on trade in services in the Africa region; mainstreaming trade and competitiveness in Côte d'Ivoire, Madagascar, and Tanzania; technical assistance for trade policy reform and export promotion in North Africa; a regional study on services trade in South Asia; an assessment of trade facilitation and logistics in Mongolia; and new research on agriculture and poverty with a focus on gender.

## Notes

1. Exports and imports of 45 countries that have reported trade data for January 2009 are uniformly weak, with an average drop of over 30 percent compared to January 2008. Based on a handful of countries that have reported February 2009 data, including China, trade continues to be very weak, and downside risks are large.

2. The Baltic Dry Index indirectly measures global supply and demand for the commodities shipped aboard dry bulk carriers, such as building materials, coal, metallic ores, and grains. The index is sometimes perceived as a leading economic indicator of global trade because dry bulk primarily consists of materials that function as raw material inputs to the production of intermediate or finished goods, such as concrete, electricity, steel, and food.

3. See chapter 1 for a more detailed account of the macroeconomic impact of the global economic crisis on developing countries.

4. World Bank 2009.

5. Chauffour 2008.

6. OECD 2008.

7. Additional information on food and fuel price impacts on individual countries is available in IMF 2008.

8. The world's major developing-country exporters of wheat (Argentina, Ukraine, Russian Federation, and Kazakhstan) and rice (Vietnam, India, and China) introduced various types of temporary export restrictions in an attempt to decouple domestic markets from global markets and rein in domestic food prices.

9. In the case of large exporters, this impact may be less significant as agriculture export is often carried out by large commercial farms that have few links to the rural poor.

10. Export restrictions had a particularly strong impact on the rice market, for which global trade is less than 10 percent of total production. After China, the Arab Republic of Egypt, India, Pakistan, and Vietnam (among others) restricted exports, small countries that relied on imports were unable to ensure adequate supplies. Subsequent bilateral agreements between important trading partners, such as Bangladesh and India, were insufficient to alleviate this problem.

11. The secondary market plays a key role in helping banks undertake transactions that are larger than their current credit and cross-border limits.

12. Whether the contraction of trade finance in late 2008 contributed to the decline in world trade or was a consequence of this decline remains an open question. However, the latter force appears to have been dominant: overall demand for trade finance has decreased with lower trade volumes and higher prices.

13. According to Global Business Intelligence, a consulting firm specializing in international supply chain matters, accounts receivable and payable (that is, open accounts) represent 78 percent of international trade, LCs 15 percent, and finance for export collection (another paper-based transaction similar to LCs but without credit) 7 percent.

14. IMF 2003.

15. In total only 116 trade finance loans (excluding aircraft and shipping) were signed in the last quarter, the lowest quarterly count since 2004.

16. IMF 2009.

17. Evidence of liquidity pressure on trade finance has also been reported by the banks participating in the IFC's Global Trade Finance Program. Major international banks participating in the program have been unwilling to assume a portion of the risk in a particular transaction, leaving the underlying risk to the IFC alone.

18. See chapter 6 for more details on actions taken by the international financial institutions.

19. Leaders agreed to "ensure availability of at least $250 billion" over the next two years to support trade finance through our export credit and investment agencies and through the MDBs.

20. The 1930 U.S. Smoot-Hawley Act that raised tariffs is widely blamed for intensifying the Great Depression.

21. Pascal Lamy, "WTO Is Global Insurance Policy for a Global Economy," speech before the Finance Commission of the French National Assembly, Paris, October 1, 2008.

22. Statement from the G-20 Summit on Financial Markets and the World Economy, Washington. DC., November 15, 2008.

23. It is estimated that if WTO members were to increase their applied tariffs up to their bound rates, the average global rate of duty would double and the value of global trade would be cut by about 7.7 percent; see Bouet and Laborde 2008.

24. Newfarmer and Gamberoni 2009; WTO 2009.

25. For instance, a "Buy American" provision made it into the final $787-billion fiscal stimulus bill passed by the United States in February 2009. It requires the purchase of U.S.-made iron, steel, and manufactured goods for projects of construction, alteration, maintenance, or repair of a public building or public work financed by the bill. However, it also requires that the measure be applied in a manner consistent with U.S. obligations under international trade agreements.

26. Major U.S. and European carmakers received various forms of financial support in late 2008 and early 2009.

27. In the same vein, when meeting with the Swiss president on January 27, 2009, Chinese Premier Wen Jiabao underscored that the word "crisis" in Chinese is made of two characters meaning danger and opportunity.

28. Mattoo and Subramanian 2008.

29. Martin and Mattoo 2008.

30. The special safeguard mechanism allows developing countries to raise tariffs temporarily to deal with import surges and price falls. The blockage in the July 2008 negotiations was about import surges in the particular instance where the mechanism raises tariff above commitments made in the Uruguay Round. A number of countries opposed breaching the pre-Doha Round commitments, while others insisted on being able to do this.

31. Statement from the G-20 Summit on Financial Markets and the World Economy, Washington DC, November 15, 2008.

32. Statement from tthe G-20 Summit, London, April 2, 2009.

33. In calculating the dumping margin of a product (that is, the average of the differences between the export prices and the home market prices), the practice of zeroing puts a value of zero on instances when the export price is higher than the home market price.

34. According to Bouet and Laborde (2008), there would be a potential loss of $1.064 trillion in world trade if world leaders were to fail to conclude the Doha Round and if countries were to subsequently revert to the trade policies in place at the end of the Uruguay Round.

35. Statement of World Bank Group President Robert B. Zoellick on Doha WTO Negotiations, August 18, 2008 at http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,contentMDK:21874660~pagePK:34370~piPK:34424~theSitePK:4607,00.html.

36. As of December 31, 2008, some 421 regional trade agreements had been notified to the World Trade Organization.

37. For more detail, see World Bank–IMF 2008.

38. The OTRI and TTRI are calculated as a weighted sum of ad valorem tariffs and ad valorem equivalent of specific duties, and nontariff measures (for the OTRI), where the weights are import volumes and import demand elasticities (Kee, Nicita and Olarreaga 2008). The OTRIs by country and the data used to calculate the OTRI are posted on the DECRG Trade Research Website under "data and statistics"; see http://go.worldbank.org/C5VQJIV3H0.

39. One characteristic of the OTRI to keep in mind is that it is calculated using weights that reflect actual imports. This may distort the picture about the geographic pattern of protection. An appropriate measure of the OTRI and TTRI is the one that breaks it down by product category, not by source.

40. Gootiz and Mattoo 2009.

41. Djankov, Freund, and Pham, 2006; Ikenson 2008.

42. World Bank 2008b.

43. World Bank 2007; World Bank 2008a.

44. The cost measure does not include tariffs or trade taxes or "unofficial" costs such as briberies. The indicator is part of the Doing Business trading-across-borders index, which compiles the number of documents, the cost, and the time necessary for procedural requirements for exporting and importing a standardized cargo of goods by ocean transport. Local freight forwarders, shipping lines, customs brokers and port officials provide information on required documents and cost as well as the time to complete each procedure. Inland transport costs are based on distance to the shipping port. The methodology, surveys, and data are available at http://www.doingbusiness.org.

45. Hoekman and Nicita 2008. Standard variables include GDP and population of the country pairs, distance between them, controls for adjacency, common language, and access to the sea. Because the OTRI is calculated at the bilateral level, it captures the effect of preferential trade agreements. In the analysis only two components of the LPI are used: indicators of the efficiency of customs and a measure of access to (choice of) and affordability of international shippers. The dataset used spans 104 importers and 115 exporters.

46. For example, Limão and Venables 2001; Wilson, Mann, and Otsuki 2003; Anderson and Marcouiller 2002; Anderson and van Wincoop 2003; Francois and Manchin 2007.

47. The effect of NTMs is captured at the margin, that is, given the effect of the existing tariff structure.

48. The 5 and 10 percent thresholds correspond to the levels that would bring the TTRI and OTRI of low-income countries to that of middle-income countries.

49. Ikenson 2008.

50. Monitoring takes place at three levels: (1) global monitoring, carried out by the OECD; (2) donor monitoring, in the form of self-evaluations; and (3) in-country monitoring, also in the form of self-assessments.

51. For an update of the ongoing work, see WTO, 2008 Aid-for-Trade Roadmap, Annotated Update, July 23, 2008 at http://www.wto.org/english/tratop_e/devel_e/a4t_e/a4t_roadmap_feb08_e.doc

52. In the OECD Credit Reporting System database, Asia includes Middle East Asia, South and Central Asia, and Far East Asia.

53. The Enhanced Integrated Framework (EIF) is a multi-agency (IMF, ITC, UNCTAD, UNDP, the World Bank, and the WTO), multidonor program to assist least-developed countries in addressing national competitiveness priorities through trade diagnostic. The enhancement of the EIF was recommended by the WTO Task Force to improve governance as well as communication and coordination between the various partners.

54. The current donors to the MDTF are Norway, Sweden, and the United Kingdom for a total contribution of approximately $30 million over three years (2007–10).