CHAPTER 1

WHY TRADE COSTS MATTER FOR INCLUSIVE, SUSTAINABLE GROWTH

Contributed by the World Trade Organization

Abstract: *International trade is not a seamless process. "Frictions" abound that give rise to trade costs. High trade costs effectively nullify comparative advantage by rendering exports uncompetitive. High trade costs deny firms access to technology and intermediate inputs, preventing their entry into, or movement up, global value chains. High trade costs also erode consumer welfare narrowing the range of good and services on offer and pushing up prices. While trade costs do not alone explain the development pathways of economies, they are a major factor explaining why some countries are unable to grow and diversify.*

The range of policies that affect trade costs is broad. Although trade costs are ubiquitous, they are not immutable. Action can, and is, being taken to reduce trade costs. Policy reforms are yielding positive impacts, although these cannot be assumed, with research suggesting that the lowest income countries stand to gain the most from enacting such reforms. Much work remains to be done to reduce trade costs further and integrate countries more completely into the global economy, but there are positive reasons to believe that developing countries and their partners are taking this issue seriously.

INTRODUCTION

Trade costs matter. They exert a strong influence on trade flows; on who trades what and with whom; on where products are made and services traded; and on the goods and services available to consumers and the prices they pay for them. Trade costs interact with economic fundamentals like technology and factor endowments (labour and capital) to produce the pattern of trade and production we observe around the world. As such, they have a great potential to influence the trajectory of a country's economic development. Box 1.1 below provides an overview of why trade costs matter in the opinion of some least developed country (LDC) governments.

BOX 1.1 Why trade costs matter to some least developed countries

"As a landlocked country, Bhutan tends to have higher trade costs in reaching markets beyond borders." **Bhutan**

"Trade costs are very important for the competitiveness of our exports because of our isolation, which together with transport costs and the transit of our goods for export makes us less competitive". **Central African Republic**

"The cost of trade remains decisive in the structure of the prices of imported products and significantly affects the purchasing power of the Congolese population." **Democratic Republic of Congo**

"Despite all the efforts already made, reducing the costs of trade remains a major challenge for Madagascar." **Madagascar**

"High trade costs for accessing imports directly from Sierra Leone are reflected in high prices for the same goods when compared to the prices in the neighbouring countries of Guinea and Liberia. This has to a large extent been responsible for the increase in illegal activities like smuggling across the porous borders, thus leading to loss of customs revenue for the government." **Sierra Leone**

"As a landlocked country, Uganda's trade costs are high, affecting the competitiveness of Uganda's exports." **Uganda**

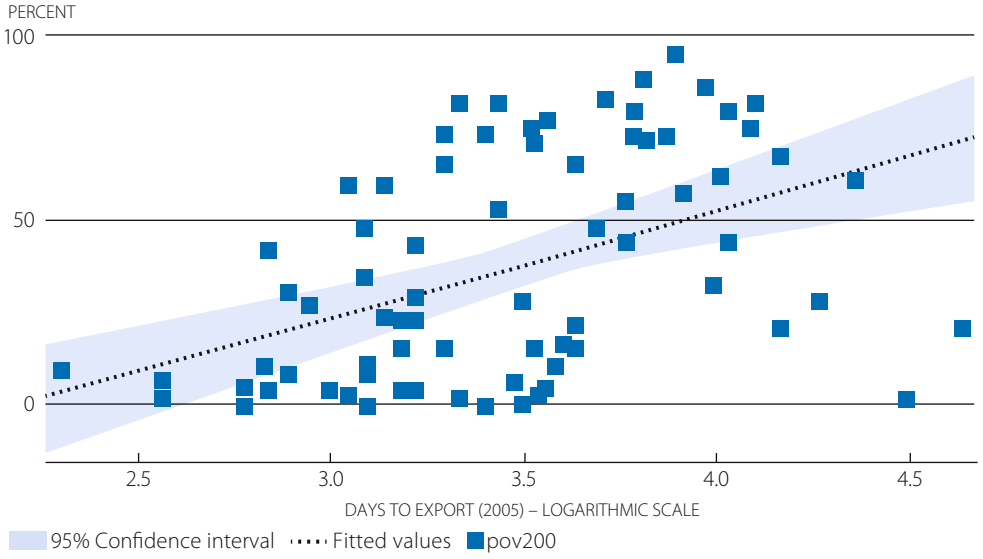
"Our private sector has time and again informed responsible government ministries of the very high cost of doing business. Some even asked government ministries for support by lowering the cost of inputs, especially fuel, electricity, etc. Also, the transportation links do not suit our private sector, adding to the cost of exporting." **Solomon Islands**

Source: OECD/WTOAid for Trade monitoring exercise, 2015.

High trade costs effectively isolate countries from world markets: consumers in these countries cannot take advantage of competitively priced goods from abroad, and their firms cannot access high quality foreign inputs or export to overseas markets. For those living at the base of the pyramid, often in extreme poverty, high prices disproportionately impacts on their consumer welfare. Not surprisingly, lower trade costs are typically associated with net poverty reductions even though the distributional impact of trade costs differs across countries. This positive relationship between trade costs and poverty is illustrated in Figure 1.1. Developing countries with higher trade costs – measured by the number of days required to export in 2005 – tend to have a higher share of the population living on less than USD 2 per day.

High trade costs price some country regions, countries and companies out of export markets, thereby limiting their economic development opportunities. Trade costs may not explain why some countries are low income or least developed, but, in combination with other factors, they do explain why some countries struggle to grow and exploit their comparative advantages (see figure 1.2). Keeping trade costs at reasonable levels and reducing them as far as possible in some key areas is essential to enjoying comparative advantage and the gains from trade.

Figure 1.1 Population living on less than USD 2 per day (2008-12) and number of days needed to export (2005)



Note: The number of days required to export in 2005 is in natural logarithms. High income countries are not included in the figure.

Source: WTO Secretariat calculation. Data: World Bank World Development Indicators.

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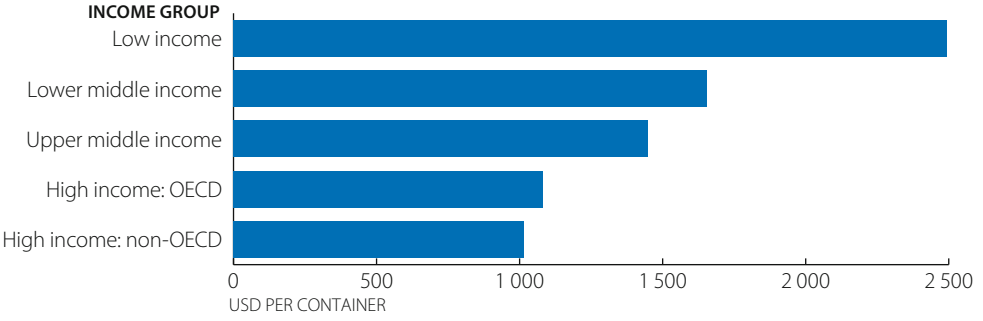
Figure 1.2 Doing Business costs to export, USD per container, 2014



Source: World Development Indicators.

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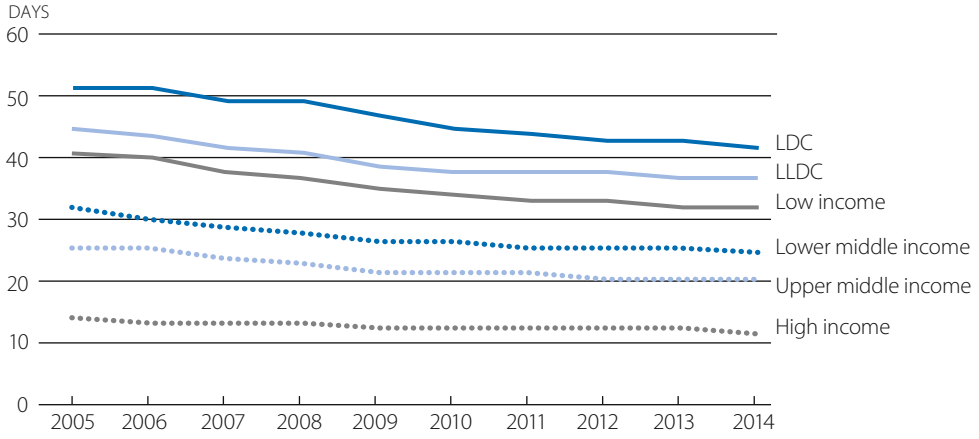
In a static sense, economic welfare can increase from lower trade costs – the real economic cost of doing business is reduced and GDP correspondingly increases as new transactions take place. Dynamic gains are also possible. In particular, access to foreign inputs has been found to be associated with innovation activity: as firms gain access to new goods, they combine them in different ways to make new products. Indigenous technology development or adaptation is at the core of economic development over the medium to long term and harnessing the process is likely an important part of moving up global value chains.

High trade costs are a considerable burden on the poor, undermining economic welfare by pushing up consumer prices and keeping poor producers out of global markets. Figure 1.3 below highlights the average number of days to import. Time is an important parameter for trade costs. Against this background, it is important to note what happens

when trade costs for a particular country stay at an unnecessarily high level while those of its partners fall. The country will be less able to take advantage of specialisation by comparative advantage and thus will feel the gains from trade less fully than its partners. This point stands for countries that remain relatively marginalised from the global trading system as a result of high trade costs, for example, landlocked developing countries and small island developing states.

Figure 1.3 Average number of days required to export by income group



Note: Figures calculated based on simple averages across 44 LDCs, 16 LLDCs, 30 LICs, 48 LMICs, 49 UMICs and 46 HICs.

Source: World Development Indicators.

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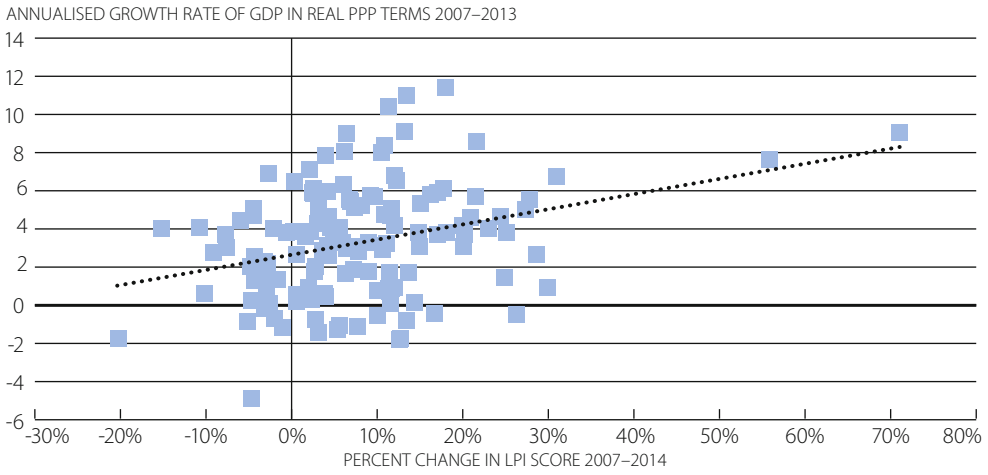
Chapter 2 provides further details on the level of trade costs around the world, but as a general rule, they decrease as per capita income increases: on average richer countries tend to have lower trade costs than poorer countries (Figure 1.1). As a result, some countries are not able to fully reap the economic gains that come from specialisation by comparative advantage, and their pattern of production and trade is distorted due to the presence of high trade costs. Of course, high trade costs may be beneficial for certain people or groups within those countries – this is detailed below. But in an aggregate sense, trade costs prevent the market from allocating resources in the most efficient way possible overall. Consequently, countries that do more to lower trade costs – for instance, by improving logistics and trade facilitation performance – tend to grow more quickly than others. This correlation is highlighted by the large number of countries on the right side of the vertical line in Figure 1.4 below and the higher rates of GDP growth over the period 2006-13 for these countries (i.e. they are making improvements in their logistics performance).

Not only do trade costs matter between countries, they also matter within countries. Firms that face high costs of moving their goods from the factory gate to an international gateway, like a port or airport, effectively have an extra hurdle to clear when they try to enter international markets. Sometimes these barriers keep them out of business altogether, so Policy makers may not even realise the harm that is being done. Regions with high trade costs are often economically deprived and lie at the low end of income distribution (Inter-American Development Bank [IADB], 2013). Of course, many factors are at play in determining the ability of a country to grow and develop, and there are complex interactions among them. But trade costs stand out as one important source of disadvantage for some countries.

A substantial body of research has emerged that highlights the negative impact of trade costs on economic welfare and development, as well as trade connectivity (a range of metrics and indices are in place to track trade costs – see Chapter 2). Respondents to the 2015 joint OECD-WTO Aid for Trade monitoring survey questionnaire (2015 monitoring exercise) agreed strongly as to the impact of trade costs (see Figure 1.5 below). Some 87.0% of the 62 developing and least developed country respondents indicated that trade costs are very important for their export competitiveness. A higher number, 91.9%, believed that trade costs were important or very important for access to imports.

Figure 1.4 Correlation between improvement in logistics performance and GDP growth rate



Source: UNESCAP-World Bank Trade Costs Database; World Development Indicators.

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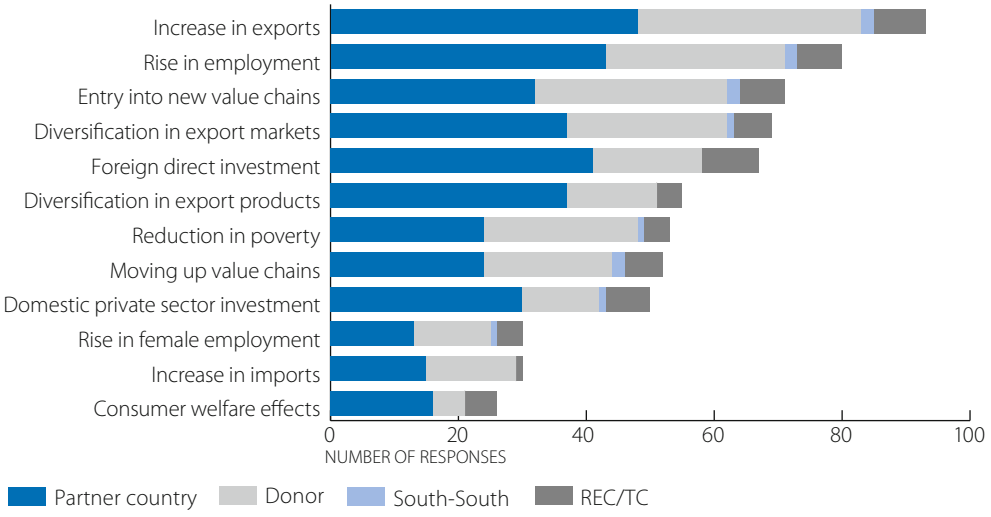
Figure 1.5 What contribution can reducing trade costs make to the target of inclusive, sustainable growth?



Source: OECD/WTOAid for Trade monitoring exercise (2015).

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In the context of the emerging narrative in the post-2015 development agenda, respondents to the 2015 monitoring exercise highlighted issues such as export promotion, job creation, entry into value chains – as well as moving up within them – and export diversification as just some of the ways in which lower trade costs can contribute to the target of sustainable and inclusive growth. The relationships between trade policies, trade facilitation and inclusive growth are explored in UNESCAP (United Nations Economic and Social Commission for Asia and the Pacific), 2013.

WHAT ARE TRADE COSTS?

In the economic literature, trade costs are defined as: "…[a]ll costs incurred in getting a good to a final user other than the cost of producing the good itself: transportation costs (both freight costs and time costs), policy barriers (tariffs and non-tariff barriers), information costs, contract enforcement costs, costs associated with the use of different currencies, legal and regulatory costs and local distribution costs (wholesale and retail)" (Anderson and Van Wincoop, 2004).

Although we live in an increasingly interconnected world, goods and services do not flow seamlessly across borders. A range of factors create friction, which in turn generates costs (Moïsé and Le Bris, 2013). How trade costs and economic fundamentals interact explains, in large part, the range of goods and services exported and the markets served by exporters and importers. The 2015 monitoring exercise asked for respondents' views on a representative cross-section of trade costs:

- For merchandise goods, the questionnaire surveyed views on trade costs: impacts of border procedures (i.e. trade facilitation); tariffs, fees and other charges; non-tariff measures; transport infrastructure; and access to trade finance.
- For services, the following trade costs were considered: network infrastructure (ICT, power, telecoms); transport infrastructure; non-recognition of professional qualifications; restrictions on commercial presence; restrictions on the movement of natural persons; a poor regulatory environment for services; tariffs on product inputs (e.g. on computers for ICT services); and low skill levels in the services sector.

Economists distinguish between fixed and variable trade costs. Fixed costs require investment (e.g. investment needed to meet a product standard in an importing market). Considering just a single period of operation, fixed costs are typically paid once. Variable costs are paid per unit shipped (e.g. transport costs). The international movement of goods is itself costly. Products need to be moved from a factory to a port or airport, processed at the border and loaded onto a cargo ship or airplane. They are then transported an often long distance and unloaded, processed again at the border, transferred onto a truck or train and moved into a local distribution network so that they can finally reach the consumer in the importing country. Externalities such as congestion and pollution arise in this process. Where markets do not operate effectively, pure friction, or economic "waste", can occur.

BOX 1.2 What sets transport costs apart from tariffs?

IADB (2008) identifies at least three factors that set transport costs apart from other trade costs, particularly tariffs:

- Unlike tariffs, transport costs are highly variable over time and the degree of uncertainty is likely to be directly correlated to the quality of the country's infrastructure (quality of the regulation included). A high degree of uncertainty is likely to inhibit trade, particularly trade of new products, irrespective of the level of transport costs.
- Unlike tariffs, transport costs are not a simple, fixed proportion (*ad valorem*) of the price of products. They represent a per unit component that has important implications for the composition of the country's exports. Because of this component, transport costs are never product-neutral, bringing higher penalties for products that are more "transport intensive", not only in the sense of having low price-to-weight ratios, but also because of higher costs related to inventory-holding and depreciation.
- Unlike tariffs, transport costs are not fixed by fiat but respond to variables such as trade flows, the quality of the country's infrastructure and the degree of competition in the transport industry. Bringing transport costs down, therefore, goes well beyond the political economy of protection and requires a more complex set of policy actions than those involved in typical trade liberalisation.

Trade costs in goods markets take many forms. Tariffs are one well-known component, but they only account for a relatively small part of the total level of trade costs in most countries. Non-tariff measures are also important, including product standards, as well as other types of regulation that make it more costly to do business abroad than at home. The business environment and commercial and governance institutions also matter because they affect the cost of doing business for foreign firms. Over the last two decades, trade in services has expanded rapidly to reach more than a fifth of global trade flows. The participation of developing countries in this trade has increased dramatically, rising from 11% of world services exports in 1990 to 20% in 2011. As an input into other economic activities, services are a direct determinant of country's competitiveness. Services such as telecommunications, energy, transport and business services are critical inputs into the production of goods and other services and influence productivity and competitiveness. Opening up to services imports and Foreign Direct Investment (FDI) can be an effective mechanism to increase the availability, affordability and quality of these services, which are crucial for export diversification, economic growth and poverty reduction. In addition, services can offer dynamic new opportunities for exports (World Bank, 2015 monitoring exercise).

Services trade also involves transaction costs. Where pure cross-border trade is possible – for instance, via the internet – issues such as transport costs do not arise. Nonetheless, there may be issues of regulation or infrastructure investment that generate friction. Trade in services is governed entirely by domestic regulation. The regulatory framework governing services trade includes a vast range of domestic laws and regulations in areas that often include land ownership, establishment of foreign companies and migration policies. They exist in sectors as diverse as banking, professional services, transport, education and tourism. Laws and regulations on services sectors are generally dispersed throughout different government agencies and not easily accessible. As a result, the regulatory environment for trade and investment in services is often opaque and unpredictable, which impairs the investment environment and limits the policy making capacity (World Bank, 2015 monitoring exercise).

For instance, online banking is legal in many countries, and in many cases is open to international customers. However, many countries prohibit foreign banks without a local presence from advertising their services domestically, which means that it is relatively difficult for them to do business in a competitive marketplace. Regulatory heterogeneity—the ability to advertise in their home markets but not overseas—is a source of trade costs in the services sector, even in cases where pure cross-border trade is now possible. Of course, there may be strong rationales for regulation in some cases—such as consumer protection—but many countries could still benefit from making their services sector regulations more effective and efficient, which would tend to lower trade costs.

A further source of friction is that such services trade relies on the provision of backbone infrastructure services, such as phone networks or broadband connectivity, without which the service cannot be traded. Another example here would be tourism and transport infrastructure. Sierra Leone cited poor internet connectivity countrywide and poor transport infrastructure, especially in the attractive tourist destinations in the country, as the biggest bottlenecks or sources of trade costs for services. Likewise, Costa Rica highlighted shortcomings in transport infrastructure affecting the tourist sector, which is Costa Rica's largest export service sector. It also stated Costa Rican professionals face trade costs by not being able to exercise in other countries because of restrictions related to recognition of qualifications. (Costa Rica, 2015 monitoring survey)

Integration of goods and services markets has been proceeding apace in most parts of the world in recent decades. Nonetheless, trade costs remain surprisingly high. Anderson and Van Wincoop (2004), for example, review the available literature on goods trade and conclude that a reasonable estimate for the trade costs faced by a representative developed country are around 170% of the producer price of exported goods. The total is made up of international trade costs of around 74% and domestic distribution costs of around 55% (because they are typically referred to in *ad valorem* equivalent terms, trade costs are multiplicative not additive – the 170% figure therefore comes from multiplying 1.55 by 1.74 to get 2.70).

BOX 1.3 Services trade costs – more research required

Better evidence is needed on what the major sources of costs are for services exports in developing countries and the economic benefits of addressing these costs. World Bank studies have noted that since the 1990s services exports of 20 key developing countries have grown by over 15% annually. It is expected that there are considerable economic benefits from the better movement of people across borders. Greater transparency around labour mobility requirements would aid in further movements of natural persons. Related to this, non-recognition of professional qualifications would make it difficult or impossible for professionals to export services from developing countries. There are also a number of other factors which affect developing countries' ability to participate in services trade, including investment in human capital (through health and education services) and institutional impediments (for example, poor regulatory environments for services hamper the development of competitive services sectors in developing countries). In addition, poor and non-competitive infrastructure (e.g. telecommunications) and inadequate financial services inhibit the ability of services providers to efficiently deliver and advertise services. There is also a significant correlation between investment and services trade. Encouraging further FDI is important for increased services exports by developing countries.

Source: Australia, OECD/WTO Aid for Trade monitoring exercise, 2015.

Of course, recent years have seen significant declines in global trade costs (see Chapter 2). Technological innovations, such as the ability to connect buyers in one country with sellers in another through the internet, have made it easier for small firms, and even individuals, to participate in international trade. A case story submitted for the 2015 monitoring exercise provides a snapshot of eBay commercial sellers in Chile, Peru, Ukraine, South Africa, Jordan, India, Indonesia and Thailand. The case story authors argue that there is evidence of a real democratisation of trade due to lower trade costs associated with electronic transactions: 95% of these commercial sellers export to on average more than 30 markets around the world. Moreover, 60-80% of businesses survive their first year, which is about double the rate for the traditional business sector. eBay estimates that barriers related to distance are 83% lower for sales conducted via an electronic marketplace and that the figure is even higher for developing countries, at 94%.

Of course, business models like eBay and other e-commerce platforms cannot function without express delivery services. Those services have taken off in recent years and now reach most parts of the planet. Express delivery is a major international industry and its workers deal with trade costs on an everyday basis. Globally, the industry directly employs over 500 000 workers (GEA, 2015). Reducing trade costs makes it easier for express delivery services to move goods quickly, cost effectively and reliably from one place to another, including small shipments related to electronic transactions.

Policy matters for trade costs in goods markets

Trade costs in goods and services markets can be loosely classified under two headings: locational factors and policy-related factors. Locational factors are exogenous: each country must take them as a given and cannot change them. They include issues such as sharing a common land border, geographical distance and remoteness, being landlocked or a small island state, having a population that speaks one of the main international languages and historical and commercial links with other countries.

Although countries must take geography and history as given, that does not mean that the trade costs related to those factors are completely impervious to government action. Geographical remoteness, for example, tends to increase trade costs substantially and poses particular problems that governments need to work hard to solve.

Policy makers can limit the effect of remoteness by developing the hard and soft infrastructure needed to build an economy that is strongly connected to global trade, transport and production networks. High country connectivity based on appropriate policies can reduce trade costs and limit economic remoteness, even though geographical remoteness in the strict sense cannot be changed.

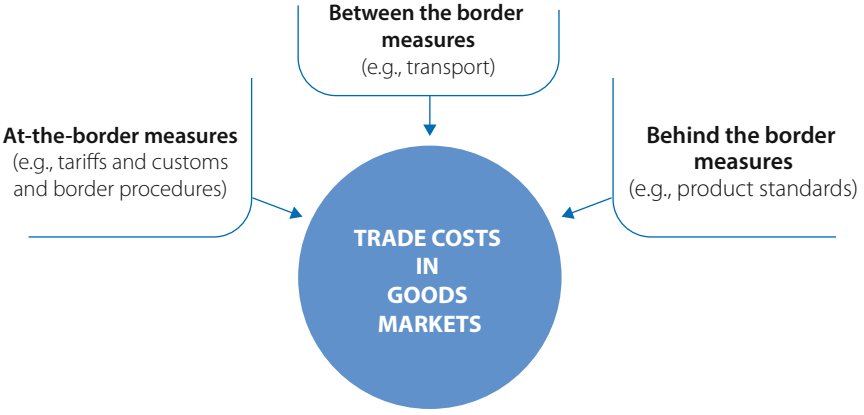
BOX 1.4 The Pacific agreement on closer economic relations (PACER) plus

The Pacific Islands are some of the remotest economies on earth. They are far from major trade routes and even from each other, which makes trade integration difficult. They face particularly high levels of trade costs as small island developing states. The PACER Plus agreement currently under negotiation is designed to support Pacific Island countries' increased participation in international trade. The Agreement will not be a traditional free trade agreement as its primary objective is to promote the economic development of Pacific Island Countries. It contains chapters on issues such as Customs Procedures, Transparency, SPS and TBT measures and co-operation fora chapter on economic and development, including addressing supply-side constraints co-operation. The latter will assist developing country parties to implement the Agreement and maximise the benefits flowing from it. The two developed country markets will be sources of technical assistance and capacity building in various areas, in particular trade facilitation, in line with the new WTO TFA agreement.

Source: Office of Chief Trade Adviser, Joint OECD/WTO Aid for Trade monitoring exercise, 2015.

The case of trade costs that stem from policy-related factors is even starker: action by Policy makers can reduce such costs substantially because they have endogenous causes. Policy measures affecting trade costs come in three types: at the border, between borders and behind the border (Figure 1.6).

Figure 1.6 Types of trade costs in goods markets



Source: Shepherd 2015.

Recognition of the importance of trade costs needs to be distinguished from action by governments to reduce trade costs. For example, while 87% of the 62 developing and least-developed country respondents to the 2015 monitoring exercise recognised the importance of trade costs, only 62% of respondents indicated that trade costs were addressed in their national development strategies, 60% in their national trade strategies and 53% in sector-specific strategies. Interestingly, the percentage is less for infrastructure strategy (35%), although this sector is one that has considerable potential to influence trade costs and performance.

The picture at the regional level is similar: 80% of respondents indicate that the regional development strategy addresses trade costs, 60% in the case of the regional infrastructure and trade strategies and 50% for sector- and corridor-specific strategies. While there is clear recognition of the importance of trade costs, there are difficulties capturing this insight at a policy level, both nationally and regionally. This is especially true on the side of donor partners.

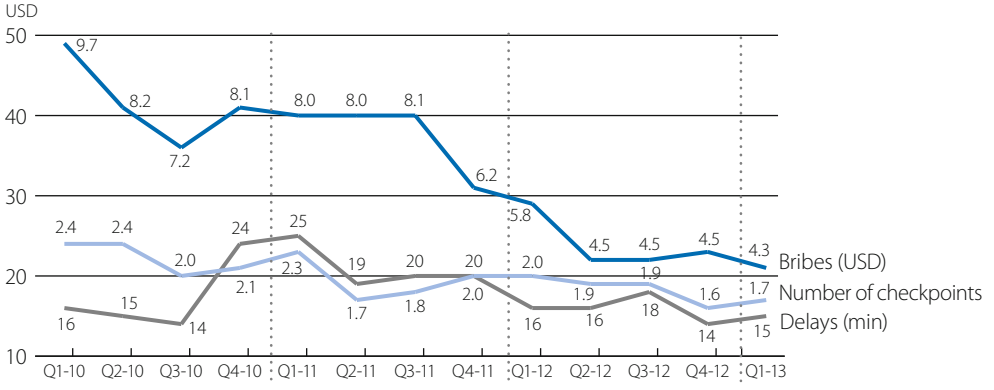
All 37 donor countries and agencies which responded to the 2015 monitoring exercise recognised the importance of trade costs, with 54.1% of them indicating that trade costs are very important to the integration and development of countries and LDCs and 45.9% considering them important. However, only 59.5% of donor countries' aid-for-trade strategies specifically address the issue of trade costs. Of course, trade costs issues are still reflected in aid-for-trade programming, particularly in regional projects and programmes and in country work (73.0% and 64.9% respectively).

One set of border policies that affect trade costs in a very direct way relates to trade facilitation, i.e. customs and other border procedures. When those procedures are slow, expensive or unreliable, costs to business increase – with a resulting impact on trade costs. Trade facilitation reforms can therefore reduce trade costs, and the WTO agreement on Trade Facilitation (TFA) provides one framework for moving forward in this area. The OECD has estimated full implementation of the new WTO agreement could reduce developing countries' trade costs by 14% for low income countries, 15% for lower middle income countries and 13% for upper middle income countries (OECD, 2014).

Trade facilitation in this sense is of particular importance in some contexts. For example, India and Pakistan have only one permitted land border crossing, at Attari-Wagah. In 2012-13, 54% of India's imports from Pakistan and 25% of India's total exports to Pakistan passed through this crossing, even though only a restricted list of products is allowed to be traded. Historically, this border crossing has been well known as a chokepoint for traders. However, recent trade facilitation measures appear to have improved performance somewhat. India has introduced an Integrated Check Post, with a dedicated cargo building, an export warehouse and truck parking facilities. Similar facilities are being developed in Pakistan. Border crossing hours have been increased from eight hours per day to 12, and truck capacity has been increased tenfold. Trade facilitation has brought concrete benefits to the trading community in the form of lower trade costs and higher volumes. (CUTS, 2015 monitoring exercise)

The TFA deals with one set of factors that determine trade costs in goods markets, namely customs and other border procedures. However, many other policies are also at play. As already mentioned, transport plays a key role. On the one hand, goods have to be moved internationally, so policies governing the development and operation of maritime and air gateways have the potential to affect trade costs. Similarly, policies governing air and maritime transport are also relevant. Countries that sign liberal bilateral air services agreements can expect to see their trade costs go down for goods transported by air, such as parts and components that circulate through global value chains (GVCs) or horticultural products and new agricultural productions. Some countries limit competition in some aspects of their maritime services sectors, such as cabotage (movement between domestic ports), with resulting increases in trade costs.

Figure 1.7 Changes in road governance conditions 2010-2013 in West Africa



Source: West Africa Trade Hub

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So far, the analysis has focused on policies at and between borders. But behind-the-border policies are also relevant (e.g. Moïsé and Le Bris, 2013). Wholesale and retail distribution, as well as transport and logistics, determine the ability of producers to get their goods to market in a cost-effective way. Countries with poorly performing distribution and logistics networks tend to suffer from high trade costs and can become insulated from world markets. In some countries in West Africa, for example, completion of national markets – not just the interface between national and international markets – is an issue. Roadblocks are frequent along main trucking routes (Figure 1.7), which lead to significant delays and the prevalence of unofficial "speed money" payments that add to overall transaction costs and uncertainty. A trade costs priority for these countries is reducing or eliminating internal roadblocks, which is not an easy matter in an environment of weak and fragmented governance. It is, however, an area in which local governments and regional institutions are active. Despite the difficulties, progress has been reported between 2010 and 2013 in addressing this issue through the West Africa Trade Hub/UEMOA Improvement in Road Transport Governance Project (IRGT).

Another policy question of relevance for trade costs is product standards. This is a type of behind-the-border measure that is usually not protectionist in intent but can be in practice because of the competitive advantage it creates for national firms. Overseas firms need to certify their products and production processes to meet foreign norms, an often expensive proposition, which adds to the wedge between producer and consumer prices. Box 1.5 highlights some of the concerns raised by respondents as part of the 2015 monitoring exercise.

A case story submitted by the World Bank suggests that in Central America, non-tariff measures are creating obstacles that hinder effective trade integration - with the issue being less about the measures enacted and more about the way they are applied in practice. The Bank study estimates that SPS measures—such as inspection requirements or labeling standards for meats and grains – increase import prices in Central America by approximately 30% on average.

In one country, the entry of foods and drinks into the sanitary registry – a process that verifies that all the products meet the country's SPS standards – requires between 48 hours (for low-risk goods) and 20 days (for goods that require laboratory testing). The exporting company must then spend two to four weeks preparing a product file. They must also pay between 250 and 450 US dollars per item registration. The Bank study suggests that when faced with this type of requirement, some companies – especially if they are small – abandon the effort altogether. The Bank study concludes that while non-tariff measures are effective policy tools to achieve non-trade objectives, such as the protection of human, animal and plant health, the imprudent use of these measures can hurt poor consumers.

BOX 1.5 Examples of trade costs associated with product standards, cited by 2015 monitoring respondents

"Other issues currently exist such as the connection between non-tariff barriers and new trends regarding approval of products by consumers, which are reflected in private standards." **Guatemala**

"Yemen's exports to the Gulf countries face border processing and non-tariff obstacles without appropriate justifications." **Yemen**

"Trade costs depend on markets. In Africa the costs are related to border procedures, while in the EU they are geared towards stringent standards." **Mauritius**

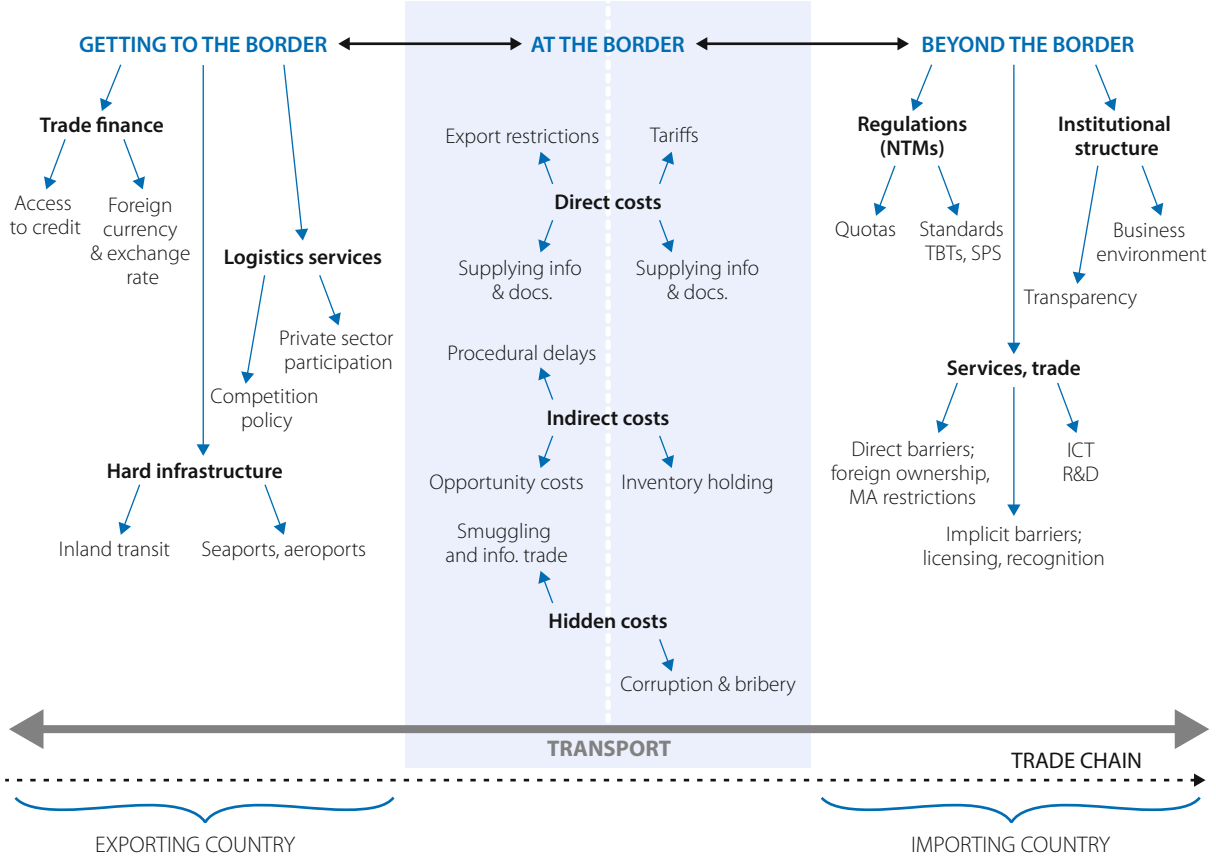
"According to the series of studies by the UNECE (United Nations Economic Commission for Europe) on regulatory and procedural barriers to trade, non-tariff measures, such as standardisation (standards, standardisation policy, use of national, regional and internationally agreed standards), and regulatory issues are a significant source of barriers to trade." **UNECE**

Research undertaken by the Standards and Trade Development Facility concludes that countries can make huge progress in reducing SPS trade transaction costs, while simultaneously strengthening or reinforcing the protection of human, animal and plant health, through proper implementation of the WTO SPS Agreement and implementation of measures in the WTO Trade Facilitation Agreement.

More generally in the area of behind-the-border measures, it is necessary to consider issues such as the business environment and investment climate, which affect the ability of firms to do business internationally. Finance is also crucial: as seen during the Great Trade Collapse, trade finance plays a key role in enabling private sector operators to move goods across borders. Indeed, it is important to remember that it is the private sector that trades. Governments put in place regulations, institutions and structures, but it is people and businesses that buy and sell goods and services. As a result, private sector development is also a key part of the trade costs agenda.

Figure 1.8 summarises the above discussion by means of reference to a broad set of trade cost factors that are of relevance to many countries.

Figure 1.8 Policies affecting trade costs in goods markets at all points in the supply chain

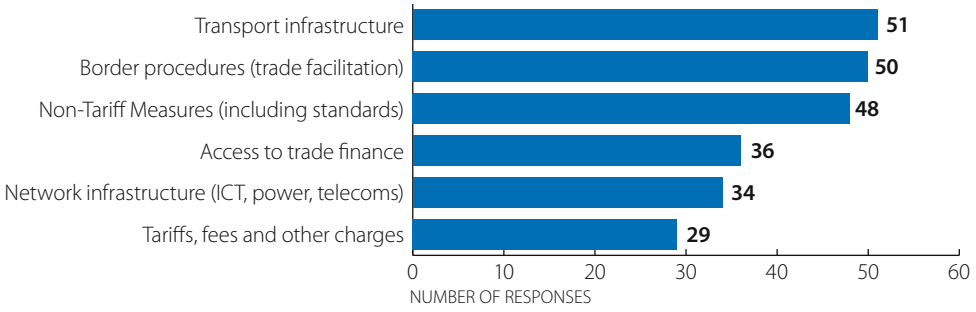


Source: Moïsé and Le Bris (2013).

As this section has made clear, trade costs come in a variety of different forms. However, each country has its own particular circumstances. A particular constraint may be binding in one country in the sense that it represents the main source of trade costs that prevents businesses from engaging with the world economy. The critical policy may be something quite different in another developmental or regional setting.

The OECD-WTO survey provides some information on the types of trade costs that are most important in partner countries (Figure 1.9). The most commonly identified are trade facilitation (in the sense of customs and border procedures), transport infrastructure and non-tariff measures, including product standards. Each of these areas is one in which aid for trade can play an important role. In the case of trade facilitation, aid for trade is built into the architecture of the new WTO Agreement, so there is a strong chance that progress in this area will be possible with a combination of political will in partner countries and mobilisation of resources in donor countries. Transport infrastructure is a key component of traditional aid-for-trade spending, and Figure 1.10 indicates that although progress has been made critical needs obviously remain in partner countries. Finally, non-tariff measures like product standards are frequently the subject of technical assistance programmes run by donor agencies – either governmental or multilateral organisations – and have real potential to reduce the trade cost burden on partner country exporters.

Figure 1.9 Number of partner country survey respondents indicating that a particular source of trade costs is important (goods)



Source: OECD/WTOAid for Trade monitoring exercise (2015).

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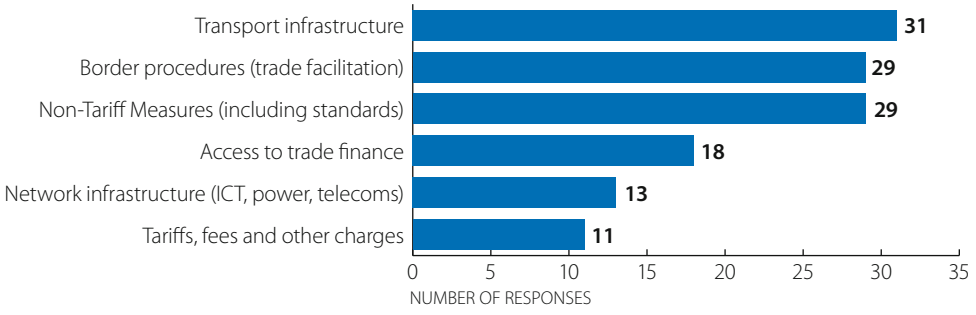
In the context of aid for trade, it is important to ensure that partner country and donor country priorities are aligned. That appears to be the case in the area of trade costs in goods markets (Figure 1.10). The top three priorities are the same: trade facilitation, transport infrastructure and non-tariff measures such as product standards. The evidence in this case suggests that donor countries and partner countries have a sound basis for working together to reduce the most important sources of trade costs in the developing country context.

Figure 1.10 Number of donor country survey respondents indicating that a particular source of trade costs is important (goods)



Source: OECD/WTOAid for Trade monitoring exercise (2015).

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One example reported of a successful aid-for-trade initiative in an area identified as important by partner countries and donors alike is Japan's support for One Stop Border Posts (OSBPs) in East Africa. Japan has worked with local counterparts to develop OSBPs on key routes in the region. As the project enters its advanced phases, the focus is now shifting to capacity building to ensure that customs and border agencies are well versed in the operation of these facilities. It can be expected that this series of interventions will reduce trade costs on key economic corridors in the region, with corresponding economic benefits.

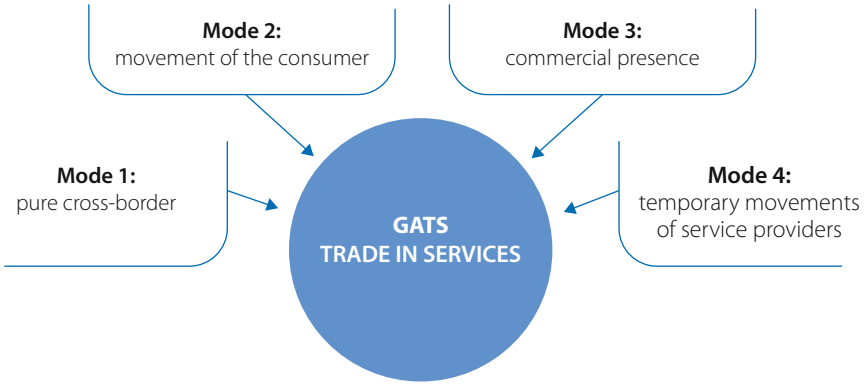
This example is by no means an isolated one. According to the OECD-WTO survey, partner countries, with donor support, have been active in pursuing aid-for-trade activities aimed at reducing trade costs. Over 93% of partner countries have taken action on trade facilitation, and the corresponding figures for infrastructure and non-tariff measures are about 70% and 68%. There is clear evidence of activities aligned with common priorities.

Services policies also affect trade costs

The discussion so far has focused on trade costs in goods markets. But as mentioned at the outset, trade costs in services are also significant. Border measures like tariffs usually do not apply in services markets, but a variety of other issues can contribute to trade costs in the services sector. Recent estimates suggest that despite technological advances like e-commerce, trade costs in services sectors may actually be substantially higher than in goods sectors, perhaps as much as double (Miroudot et al., 2013).

Firstly, there are policies that directly restrict trade in services. The WTO's General Agreement on Trade in Services (GATS) recognises four ways in which services can be traded, known as modes of supply (Figure 1.11). Mode 1 most closely resembles goods trade: it is pure cross border trade, for example, through the internet. Some countries apply direct restrictions on this kind of trade in certain sectors – such as the retail banking example cited earlier. More generally, the ability to engage in pure cross-border services trade depends on the quality and quantity of ICT infrastructure that is available, as well as the way in which access to and use of the infrastructure are regulated. Better connected countries can be expected to have lower trade costs for Mode 1.

Figure 1.11 Trade in services under the GATS



Source: Shepherd 2015.

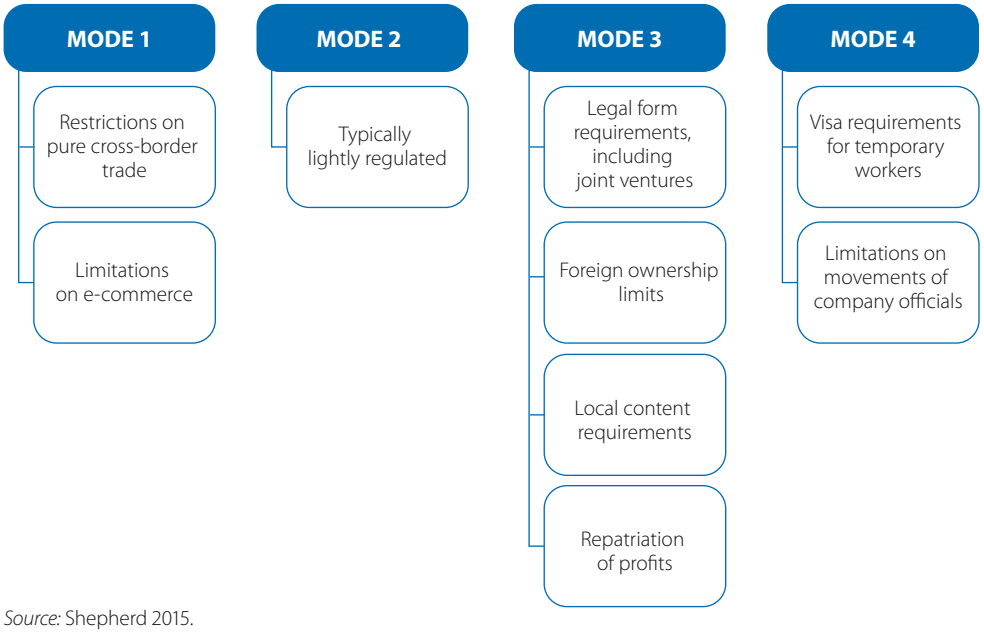
Although Mode 1 services trade is becoming more important, proximity between the producer and the consumer remains necessary in many sectors. For that reason, GATS Mode 3 is often the preferred means of services trade for business. Under Mode 3, services are exported from a country when one of its firms sells services to foreigners through a subsidiary set up in the importing country. Explicit trade policies again affect firms' ability to enter markets through

Mode 3. Some countries apply restrictions on commercial presence in certain sectors, for example, only permitting foreign companies to enter the market through a joint venture with a local company or setting foreign ownership limits. Restrictions on commercial presence, such as a form requirement, limit a company's ability to compete in the marketplace in the most efficient way possible and therefore increase trade costs.

GATS Mode 4 is also a potentially important way for services to be traded internationally. In this case, the service provider (a natural person) moves temporarily to provide the service to the overseas consumer and then returns home. Globally, Mode 4 trade is relatively restricted. One possible reason is that Mode 4 trade intersects with countries' visa regimes, and this trade is seen as having potential implications for local labour markets.

Common to all the GATS modes of supply is the issue of regulation (Figure 1.12). And it is not just border regulations that matter for trade costs. As in the case of goods, behind-the-border regulatory measures also play an important role. Particularly in the case of services, an important factor is regulatory heterogeneity, i.e. differences in sectoral regulations between countries. Services firms develop their business models based on a particular regulatory and institutional environment. Making that business model work in a foreign setting can be challenging because the regulatory and institutional environment may be quite different. Transactions that can be legal in one form in one country may need to take a different form in another. Advertising needs to be adapted to meet not only local standards but also local tastes and interests. More generally, services need to be tailored to meet the environment in which they are being supplied. All of this adds to the cost of doing business abroad as opposed to at home. To a large extent, it is likely factors such as these that make it plausible that despite improvements in ICTs, trade costs in services remain high, potentially even higher than in goods markets, as noted above.

Figure 1.12 Partial typology of policy measures affecting trade costs in services, according to the GATS mode of supply



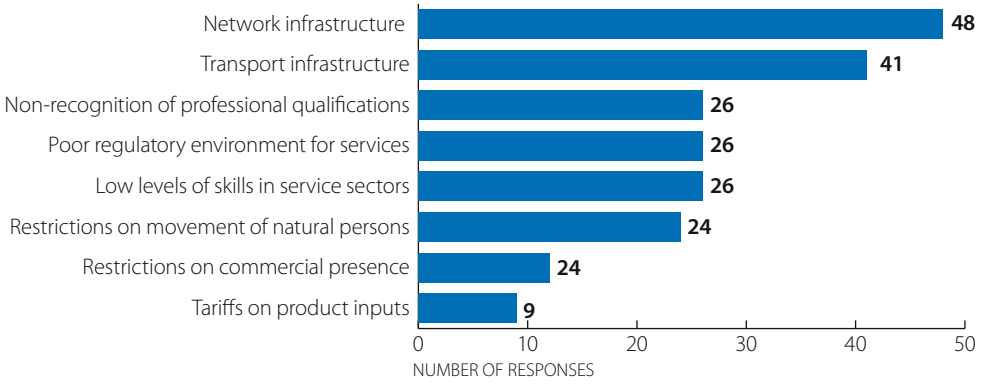
Source: Shepherd 2015.

Respondents to the OECD-WTO monitoring exercise provide an indication of the most important sources of trade costs affecting services' trade (Figure 1.13). The two most commonly cited are network infrastructure, such as information and communication technologies, and transport infrastructure. These issues are important to all service providers because ICTs are typically an important input into the production of modern services. However, network services are of particular importance to services traded by GATS Mode 1 (pure cross-border supply), which includes international e-commerce.

A key issue to emerge from these data is that for partner countries GATS Mode 1 is a key mode of supply. This finding makes sense because GATS Mode 3 (commercial presence) requires substantial investment resources that may not be available in the developing country context, although it is often the preferred means of entry for developed country firms. E-commerce may be particularly attractive to developing country service providers because of its low start-up and operational costs and could represent a significant commercial opportunity in the future.

In addition to issues of infrastructure and connectivity, the Survey data highlight a number of areas in which opening up to services trade could be beneficial in terms of reducing trade costs. Although opening up can provide competitive discipline for local firms and induce quality and process upgrading, it is also important to ensure that there is a sound basis in place for developing the competitiveness of the services sector (locally owned and foreign invested). Aid for Trade has a role in developing this kind of supply side capacity.

Figure 1.13 Importance of trade costs sources (services): partner country view



Source: OECD/WTOAid for Trade monitoring exercise (2015).

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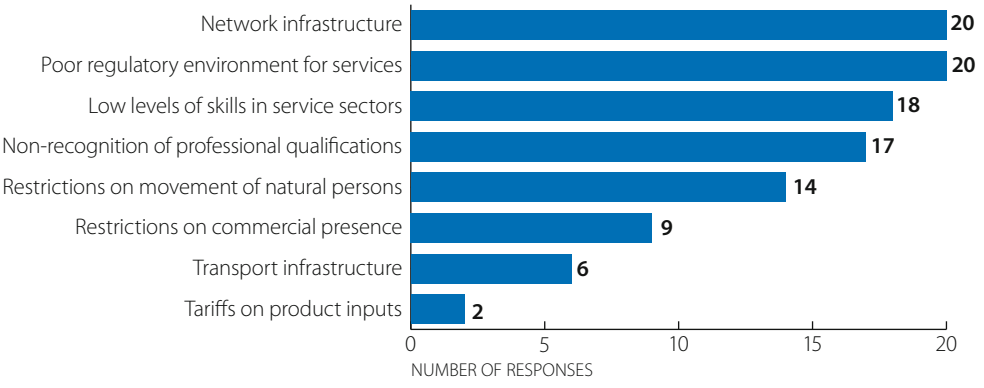
Donor countries (Figure 1.14) also identify network infrastructure as the most significant source of trade costs facing partner countries in services markets. However, there are notable differences in terms of other priorities. For instance, donors highlight poor regulatory environments, low levels of skills and non-recognition of professional qualifications as major issues. To be sure, partner countries also recognise the seriousness of these trade costs factors, but the relative pattern of responses is different in the two cases. There is perhaps evidence that donor countries see trade potentials outside Mode 1 – for instance, in Mode 4 (temporary movement of service providers) – as a subject of future interest for partner countries.

Figure 1.14 Importance of trade costs sources (services): donor view



Source: OECD/WTOAid for Trade monitoring exercise (2015).

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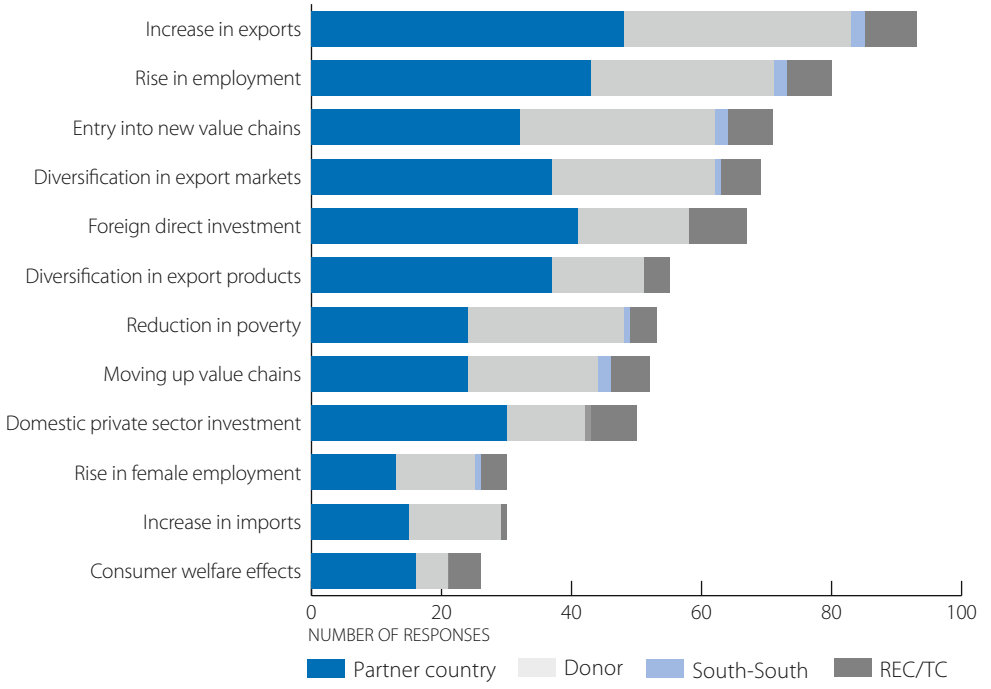
Working together, donors and partner countries have seen concrete results come from aid-for-trade initiatives in their priority areas (Figure 1.15). There have been improvements in trade facilitation, infrastructure and non-tariff measures, in particular.

Figure 1.15 Impacts from actions to reduce trade costs



Source: OECD/WTOAid for Trade monitoring exercise (2015).

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Trade costs in goods and services markets have been presented separately in this chapter, but they can also interact in complex ways. In the context of GVCs, for example, lead firms often need to supply headquarters (business) services to subsidiaries and even arm's-length suppliers that provide inputs into the final production process. Restrictions on trade in services can therefore increase trade costs in goods sectors, as well as in services sectors. Similarly, service providers usually need goods – such as computers and telephones – to provide their services. In this case, trade costs in goods have an indirect impact on trade costs in services. The link in both examples is that services are inputs into goods and goods are inputs into services. In a world of interlinked production processes, trade costs too become interlinked.

LOWER TRADE COSTS MEAN MORE TRADE AND POTENTIALLY HIGHER INCOMES, PARTICULARLY IN DEVELOPING COUNTRIES

One reason trade costs matter in terms of the post-2015 development agenda is that they affect national trade and income performance, including in poor countries. Net effects, as well as distributional issues, are both important from the perspective of sustainable and inclusive growth. This section examines the ways in which trade cost reductions can be associated with changes in trade flows and national incomes.

Countries with lower bilateral trade costs tend to trade more. As a result, measures to reduce trade costs can boost trade all around the world. They can also increase diversification, as new sectors become competitive and start to play a role in world markets. According to the UNECA (United Nations Economic Commission for Africa) response to the 2015 monitoring exercise: "Reductions in trade costs can support economic diversification, this effect depends, however, on the supply-response of the private sector; hence the diversification is ultimately contingent on private sector skills and capabilities, as well as on the broader industrial policy framework."

Box 1.6 Empirical evidence on the relative trade impacts of lower trade costs

Policies designed to reduce trade costs have been extensively modelled using CGE models. The net result is standard across models: lowering trade costs has the potential to support a major boost in trade flows and enhances welfare. Lowering trade costs eliminates economic waste and improves efficiency.

An example of this kind of analysis is WEF (World Economic Forum) and World Bank (2013). This report considers the incidence of supply chain barriers to trade – a broad concept that includes many of the trade cost factors considered in this chapter. The CGE analysis finds there is great trade and economic welfare potential in the area of trade cost reductions (this is in line with previous work such as Decreux and Fontagne [2011] and Zaki [2014]). Even under a modest scenario in which countries improve trade facilitation performance half way to the regional average, global trade would increase by 9.4% and GDP by 2.6%.

Of course, it is not just global effects but also their distribution across countries and regions that matters. As is typically the case in trade policy simulation exercises, the greatest relative gains – i.e. in terms of percentage of baseline performance – accrue to those countries that reform the most. This means the countries with the highest trade costs, namely developing countries, and particularly those in sub-Saharan Africa. As Figure 1.16 shows, the trade and GDP gains from lower trade costs are strongly development friendly in that they are considerably larger in relative terms in the developing world than in the developed world.

Figure 1.16 Trade and GDP gains from reducing supply chain barriers to trade.

Source: WEF and World Bank (2013).

Indeed, the benefits of reducing trade costs on a broad basis are particularly attractive from a systemic point of view because many reforms affect all trading partners simultaneously, not just a selection of partners, as in a regional agreement. For example, upgrading gateway infrastructure like ports makes it easier to export to and import from all countries in the world, not just those countries in the same regional grouping. Similarly, many trade facilitation reforms that have been implemented unilaterally are effectively extended to all partners in much the same way as a cut in most favoured nation tariffs. Of course, some aspects of trade cost reduction – such as improving transit for landlocked countries – do have a regional dimension and benefit particular countries in very specific ways. Nonetheless, the point remains that general reforms to reduce trade costs tend to be beneficial to the multilateral trading system as a whole even when implemented unilaterally.

The fact that trade costs remain relatively high while tariffs are usually at historical lows suggests that the potential trade gains from reducing trade costs more broadly than just through cutting tariffs could have major scope to promote global trade. The empirical evidence bears out this contention. Studies using computable general equilibrium (CGE) models of the world economy typically find that the gains from modest but broad based trade cost reductions – such as through improved trade facilitation – have great potential to boost trade. What is more, the largest welfare gains go to those economies with the highest trade costs. As a result, lowering trade costs has particular potential to boost economic welfare in developing countries where trade costs are usually higher – sometimes much higher (see Chapter 2).

TRADE COST REDUCTIONS HAVE DISTRIBUTIONAL IMPACTS WITHIN COUNTRIES

Lower trade costs typically bring aggregate economic benefits in the form of increased trade and higher levels of national income. Lower trade costs are also typically associated with net poverty reduction in a general sense, even though local outcomes can vary and depend crucially on patterns of consumption and production within a country.

Innovative recent research has analysed this question using household survey data. Porto (2005) considers the case of Moldova, a lower middle income country. He analyses the effects of a range of trade cost reduction measures covering what he terms "informal" export barriers. Examples include transport costs, cumbersome customs procedures, costly regulations and rent-seeking behaviour. The data on these barriers that increase trade costs come from a World Bank survey of exporters and importers. By linking these data to household-level data on income and expenditure, Porto shows that reducing these types of trade costs has an overall positive effect on poverty: the poverty head count ratio falls by 2.8% to 5.0%, depending on the degree of pass-through that is assumed.

The same author (Porto, 2010) uses household data to examine the poverty impacts of trade cost reductions in Argentina. Specifically, he focuses on the case of improvements in export market access, which could accrue from a number of sources, including trade liberalisation abroad. He finds that the overall effect of improved market access abroad is to reduce the local poverty rate, even though it can be associated with domestic price increases.

A number of other studies look at African countries using similar methods. Balat et al. (2009) consider Uganda, for example, and Diop et al. (2005) examine Rwanda. The former author shows that villages with their own markets – which are associated with lower trade costs in the sense of local distribution costs – tend to have inhabitants with higher incomes than those in villages without market infrastructure. The latter paper finds that trade costs focusing on various factors linked to market access are important determinants of poverty rates. Based on their simulation results, a cut in transport costs could translate into a 20% increase in producer prices, which would in turn see poverty incidence reduced by 6%. Importantly, they show that a decrease in rural transport costs disproportionately benefits poor people, suggesting that appropriate trade cost reduction policies can be part of an overall package of reforms to reduce poverty.

Consumption baskets of the poor vary considerably across countries and also within them. Poor urban people do not consume goods in the same relative quantities as poor people in rural areas. Nonetheless, a significant number of poor people consume imported goods of one kind or another. Most typically, consumption of imported goods is relatively more important among urban poor people than among rural poor people. Lower trade costs clearly have implications for poor people who consume imported goods, whether they are food staples or other products. Lower trade costs should translate into lower consumer prices as part of the friction involved in moving goods from one country to another is eliminated. Of course, these gains are not always fully passed on to consumers. Capture can occur if there is a lack of competition at crucial points in the supply chain, for example, in the transport sector or in wholesale or retail distribution. Improving competition all along the value chain is an important complementary policy to any kind of trade cost reform. Indeed, reducing domestic trade costs – not just international trade costs – can have important impacts on consumption and production patterns, and can represent a "win win" scenario in which consumers and producers both benefit.

The same is also true for intermediate goods, i.e. those products used in the production of other goods. For example, poor farmers in many countries depend on imports of fertilisers. Fertilisers in this case are an intermediate good for farmers. Lower trade costs can help farmers and other producers, including manufacturers, access intermediate goods at lower costs. The effect is to lower their own production costs and make them more competitive in the marketplace, including regionally and globally. Lower trade costs can therefore benefit poor people through intermediate goods channels as well, particularly farmers, but also those employed in labour intensive industries such as clothing manufacture. Increased competitiveness can allow businesses to grow and take on more workers, who are typically unskilled and may include economically vulnerable groups such as women.

Poor producers who are involved in producing export goods benefit from lower trade costs because their production becomes more competitive on world markets, so they can expand. The ability of the production channel to translate lower trade costs into improved outcomes for poor people depends on the degree lower costs are passed on.

BOX 1.7 Managing Aid for Trade projects for inclusive growth

Understanding the distributional effects of aid-for-trade projects is a growing area of focus for some donors. For example, the UK Department for International Development requires an assessment of the poverty impacts of all new aid-for-trade investments to be undertaken before approval. Programmes that are not able to present a credible link between growth and poverty reduction will run the risk of falling out of favour with funders (ICAI 2013).

The Aid for Trade at a Glance 2013 report emphasised the importance of effective results based management systems for the delivery of Aid for Trade. Indeed, evidence of recent evaluations of Aid for Trade programmes (e.g. EIF, ITC, STDF) would suggest that projects are getting better at measuring their direct impacts, for example the reduction in trade times. What is still lacking, however, is the understanding of the more fundamental impacts these initiatives may have on issues such the levels of employment, especially at the lowest percentiles, staple food prices and consumer goods. Some analytical frameworks (e.g. Winters) and practical guidance for incorporating inclusive and sustainable growth into aid for trade programming do exist, yet few initiatives have been able to make a compelling case for their positive contribution to the trade-poverty *nexus*.

While measuring or monitoring the inclusive and sustainable growth agenda at intervention level can be challenging, and resource intensive, some positive examples of how this can be done are emerging. For example, UNIDO has had success in using a value chain approach, and Trade Mark East Africa is mainstreaming gender issues into all new programming as part of their upcoming Results Based Project Cycle Management system, allowing for a disaggregated understanding of impacts on men and women.

Source: Saana Institute

Where dysfunction or a lack of competition impedes this and allows part or all of the gains to be captured by intermediaries in the value chain, the positive effects on poor producers are mitigated. As was the case for the consumption channel, the logic of the production channel is such that complementary policies to upgrade value chains and make them more competitive is crucial to ensuring that poor people in fact benefit in a real way from lower trade costs.

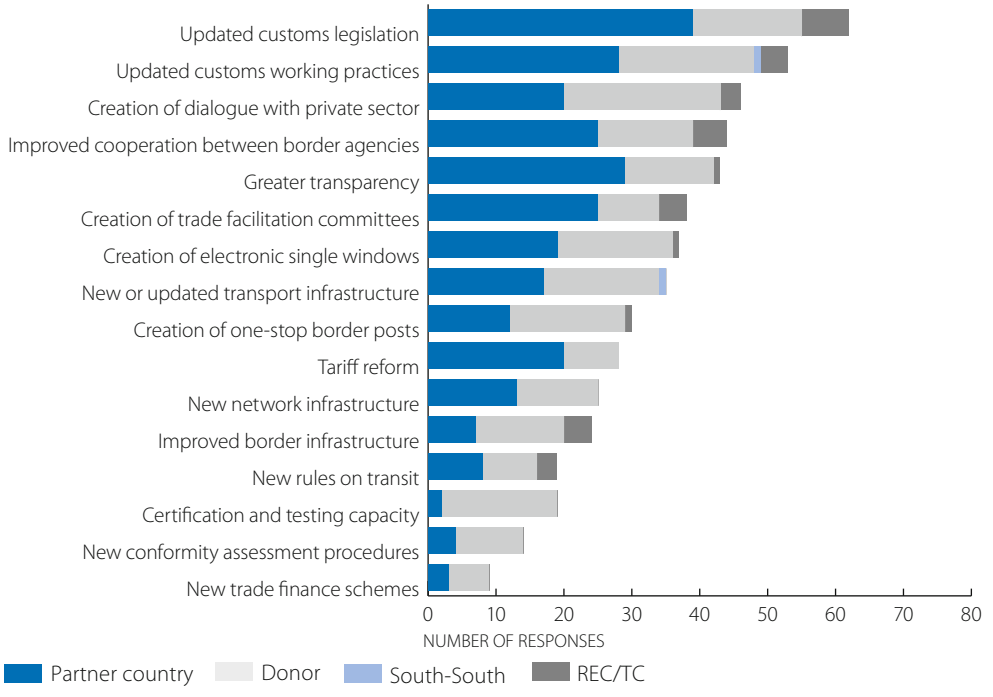
One area of potential concern is of course the impact that falling trade costs can have on domestic producers through increased import competition. A range of policy options exist within WTO legal agreements to deal with such situations, including when import surges are the result of unfair competition. One difficulty is that some developing countries lack a legal basis in their laws or technical competence in their ministries to apply these measures. Equally, they may face commercial pressure from trading partners to desist from such actions. Complementary policies must strike a delicate balance between short-term pressures resulting from import surges and more medium-term objectives, such as creating an appropriate enabling environment and promoting productivity growth.

AID FOR TRADE IS HELPING REDUCE TRADE COSTS

This chapter has so far shown that trade costs matter for the global pattern of trade and production, as well as national incomes and poverty rates and distribution. It has also brought into the foreground the importance of policy as a determinant of trade costs. This is both directly through trade policies and indirectly through other policies that affect the economic implications of trade costs from other sources, such as transport.

If policy matters for trade costs, then it must be true that aid for trade can be part of a successful policy mix to reduce trade costs. This is backed up by the results of the 2015 monitoring exercise. Figure 1.17 below highlights the outputs that have been achieved form aid-for-trade actions to reduce trade costs, as reported by partner developing countries, donors, regional economic communities and South-South partners.

Figure 1.17 Outputs achieved by actions taken to reduce trade costs



Source: OECD/WTOAid for Trade monitoring exercise (2015).

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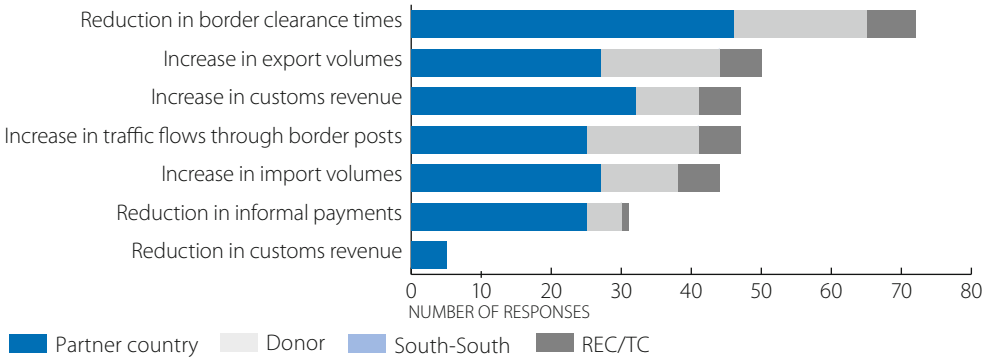
Respondents also believe project outputs translate into economic outcomes. Figure 1.18 gives a sense of the extent to which this has been taking place. Partner countries, donors and regional economic commissions all note similar outcomes, such as reduced border crossing times, increased customs revenue (due to higher volumes) and increased trade, both in exports and imports. There is therefore the positive perception that aid for trade is making a difference in terms of trade costs and the economic outcomes engendered by trade cost reductions.

Figure 1.18 Outcomes achieved by actions to reduce trade costs



Source: OECD/WTO Aid for Trade monitoring exercise (2015).

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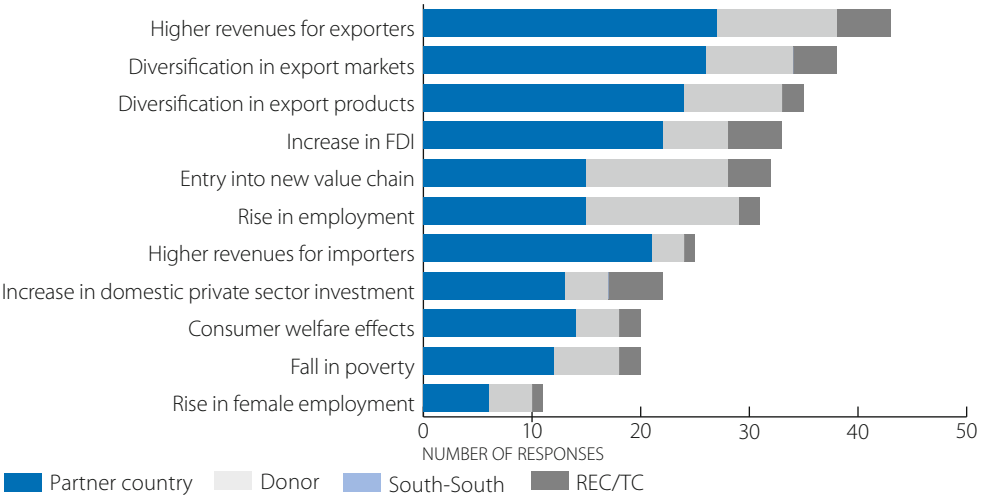
Furthermore, there is also a positive perception that these outputs are translating into positive impacts on the ground. Figure 1.19 highlights that the most positive impacts are expected on export performance.

Figure 1.19 Impacts achieved by actions to reduce trade costs



Source: OECD/WTO Aid for Trade monitoring exercise (2015).

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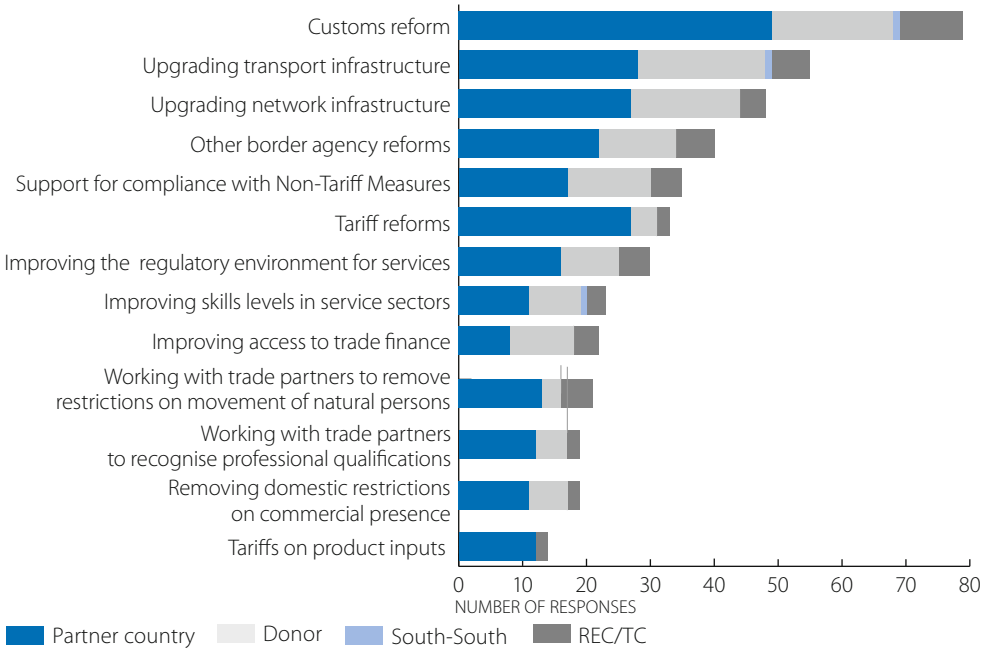
Given the range of actions available to reduce trade costs, it is important to have a clear understanding of what works best in particular contexts. This understanding can be used to help prioritise interventions and provide a joint framework for ongoing collaboration. Based on Figure 1.20, partner countries consider customs reforms, tariff reforms and infrastructure upgrading to have had the most positive results in terms of reducing trade costs for goods and services. Donors identify similar measures but stress the importance of infrastructure relatively more. Regional economic communities consider customs reform to be by far the most effective measure – perhaps influenced by the fact that this survey includes corridor authorities, who are particularly concerned with the question.

Figure 1.20 Types of actions that have achieved the most positive results in reducing trade costs for goods and services



Source: OECD/WTO Aid for Trade monitoring exercise (2015).

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Broadly speaking, aid for trade covers the full set of activities that help developing countries trade more with the rest of the world. Following the categories used in the OECD's Creditor Reporting System, aid for trade includes: technical assistance for trade policy and regulations; trade-related infrastructure; building productive capacity, including trade development; trade related adjustment; and other trade-related needs. All of these categories have something to offer national policy efforts designed at reducing trade costs, so there is much that the donor community and partner countries can do to work together successfully in this area.

As evidenced by donor and partner country responses to the OECD-WTO survey, the three main priorities for aid for trade in the area of reducing trade costs in goods markets are infrastructure, border procedures (trade facilitation) and non-tariff measures such as product standards. Aid for infrastructure can include assistance with the construction or upgrading of important gateway infrastructure, such as ports and airports, or infrastructure that connects those gateways with the rest of the country, like road and rail links. In addition to the costs of developing infrastructure, there is also the cost of maintaining it – and aid resources frequently need to be mobilised for this purpose in contexts where user-pay fee systems are unlikely to be effective, sufficient or equitable. Indeed, developing countries themselves need to mobilise to support key infrastructure development, including in partnership with neighbours, as in the case of the new international Rumichaca Bridge and structural revision of the old bridge. Ecuador and Colombia have collaborated on this project, which is expected to bring trade and tourism benefits to the two countries. Road haulage volumes have increased accordingly and waiting times have been reduced, which is suggestive of benefits to the transport sector that can be passed on to consumers and producers.

In the area of border procedures, the aid community has been active in upgrading relevant infrastructure, such as border posts, and in streamlining procedures themselves, as in the India-Pakistan example discussed above. The WTO TFA gives existing trade facilitation support a legal framework and certainty – as discussed in Chapter 4.

There has also been significant activity in relation to non-tariff measures, particularly product standards. For instance, UNIDO (United Nations Industrial Development Organization) – operating under programmes financed by the EU, the UNDP (United Nations Development Programme) and the Norwegian Agency for Development – has assisted Malawi in developing robust national infrastructure. The Malawi Bureau of Standards was identified as a critical point in the country's quality infrastructure and the areas of testing and certification were also seen as needing to improve relative to the strong demand for them from industry. The response has been an ambitious programme of capacity building so that tests, inspections and certifications issued by Malawian authorities can be recognised internationally, thereby reducing compliance costs for exporters.

As these examples show, targeted interventions can significantly alter the trade costs landscape in developing countries. They, of course, need to be demand driven: the partner country must identify and prioritise needs and international resources can then be mobilised for delivery and upgrading. These three key areas are widely recognised to be the most important ones for aid for trade that aims to reduce trade costs in the developing world, but they are of course not the only ones. Interventions in other areas also matter, depending on particular national contexts. The key is for interventions to be backed up with sufficient resources, as well as the availability of technical know-how, to make a sustained difference in the trade costs environment of a partner country or group of partner countries.

Trade costs often have a regional dimension, so it can be beneficial to work with small groups of countries on regional initiatives. TradeMark East Africa, a multi-donor initiative, has been doing this by promoting standards harmonisation and upgrading capacity in the region. Indeed, the OECD-WTO survey indicates that nearly all partner countries work regionally on reducing trade costs, the most common means being through regional economic communities, free trade agreements and initiatives supported by development partners (like TradeMark East Africa). Trade in partner countries often takes place through key corridors that cross borders and involve multiple modes of transport. A comprehensive aid-for-trade approach is crucial to enhancing corridor performance and reducing trade costs for groups of countries. There is clear evidence that efforts to date are going in the right direction: 76% of partner countries in the OECD-WTO survey indicate that external support is aligned with national and regional needs in reducing trade costs.

CONCLUSIONS

There is clear scope to boost trade and economic welfare by reducing trade costs. Policies to reduce trade costs can be one part of an overall strategy to leverage trade for sustainable and inclusive growth, particularly if designed carefully to ensure that lower trade costs benefit the poorest in the economy. Reducing trade costs needs to be considered as part of the trade and development debate and policies need to be designed carefully and collaboratively.

Key messages from this chapter are as follows:

- The global pattern of trade and specialisation in production is heavily influenced by trade costs. They limit the extent to which countries can profitably engage in specialisation by comparative advantage. High trade costs can price economies out of global trade. Changes in relative trade costs also impact on comparative advantage.
- Although tariffs are at relative lows historically speaking, trade costs remain high and a significant impediment for economic development for many of the poorest economies in the world. Trade costs are influenced by geography and history. But policy matters too: at the border, between borders and behind the border.
- Trade costs in services are important in just the same way that they are in goods markets and may even indeed be quantitatively more important. Moreover, the two interact in complex ways. The emergence of e-commerce, allied with express delivery, is offering new pathways to the global market – one in which distance may be less of a defining characteristic of trade patterns.
- Trade costs are not immutable. Action to reduce trade costs can be, and is being, taken. There are significant global gains to be had in terms of increased trade and GDP from reducing trade costs in a broad-based way. In a distributive sense, the largest relative gains go to the countries that start with the highest levels of trade costs, i.e. developing countries, particularly in sub-Saharan Africa.
- Well-designed aid-for-trade interventions can be effective in reducing trade costs in areas that partner countries and donors agree are priorities, such as infrastructure, trade facilitation and non-tariff measures like product standards. There are positive reasons to believe that developing countries and their partners are taking the area of trade costs seriously and that action in this area builds from solid practical and theoretical foundations.

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