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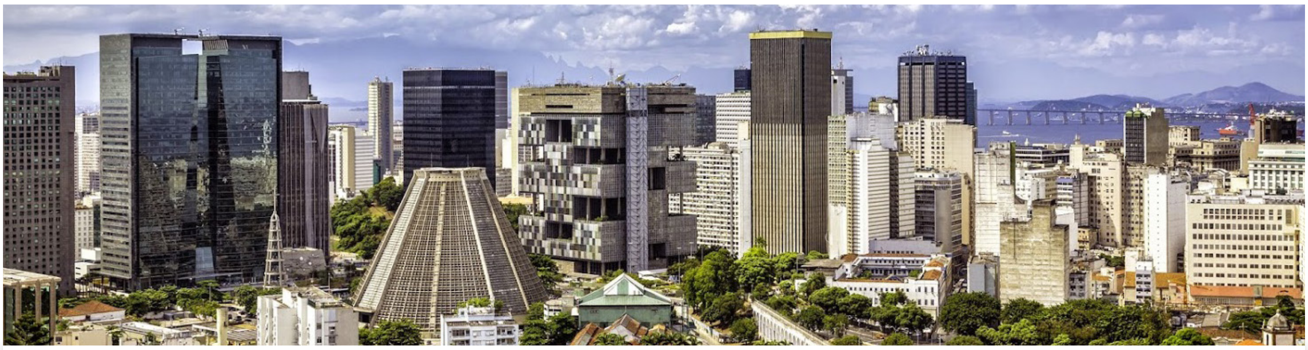

How the Trade Facilitation Agreement can Help Reduce Trade Costs for LDCs

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ABSTRACT

The recently concluded Trade Facilitation Agreement (TFA) provides an ideal opportunity to narrow the scope of aid-for-trade (AfT) activities to heed the call for "Managing for Development Results" (MfDR). The paper reviews the evidence on trade costs by different country groupings, distinguishing between least-developed countries (LDCs) and landlocked LDCS (LLDCs), including new estimates of time in transit for international parcel data that is measured relatively accurately. This review is accompanied by new estimates that provide support for allocating a greater share of AfT funds toward LDCs and particularly toward LLDCs, both groups showing higher trade costs than comparators and less progress in reducing trade costs since 1995. On average, time in customs for imports and exports are also significantly higher for both groups than for their respective comparators. LDCs and LLDCs have systematically lower values for the components in the Organisation for Economic Co-operation and Development's (OECD) new Trade Facilitation Indicators (TFI). New estimates suggest that a successful implementation of the TFA, defined as moving halfway toward the frontier value of the TFI for the respective country grouping could reduce trade costs for imports of LDCs by 2.4 percent and by 4.5 percent for LLDCs. Estimates of time in transit for parcels sent by post are also higher for LDCs than for other developing countries. Even though there is more to trade costs than customs management, monitoring implementation of the TFA would be part of the Istanbul Programme of Action for Least-Developed Countries (IPoA) and a stepping stone toward the concrete trade performance targets that have lacked in AFT activities so far. At the same time, the TFA should take on board the preservation of the environment by monitoring and preventing trade in endangered species.

CONTENTS

LIST OF ABBREVIATIONS

AfT	Aid-for-Trade
CITES	Convention on International Trade in Endangered Species of Wild Fauna and Flora
CRS	Credit Reporting System
DB	Doing Business
DFQF	Duty-free, quota-free
Ferdi	Foundation for International Development Study and Research
GATT	General Agreement on Tariffs and Trade
ICTSD	International Centre for Trade and Sustainable Development
IPoA	Istanbul Programme of Action
LDC	Least-developed country
LLDC	Landlocked least-developed country
LPI	Logistics Performance Indicators
MDGs	Millennium Development Goals
MfDR	Managing for Development results
NTMs	Non-tariff measures
ODA	Official development assistance
OEDC	Organisation for Economic Co-operation and Development
SDGs	Sustainable Development Goals
TFA	Trade Facilitation Agreement
TFI	Trade Facilitation Indicators
UN	United Nations
UPU	Universal Postal Union
WGI	Worldwide governance indicators
WTO	World Trade Organization

LIST OF TABLES AND FIGURES

AID-FOR-TRADE: WHERE DO WE STAND?

The Aid-For-Trade (AfT) Initiative launched in 2005 was part of the Millennium Development Goals (MDGs) — goal 8 "developing a global partnership for development" — with as objectives, a rules-based, open, multilateral trading system; improved market access, including duty-free, quota-free (DFQF) market access for least-developed countries (LDCs); and above all reduce poverty by half in 2015 relative to the 1990 level, a target that has been reached in most countries. Now that the Sustainable Development Goals (SDGs) have been adopted by the United Nations (UN) General Assembly in September 2015, the main trade performance objective with a target is the doubling of the global share of LDC exports by 2020 — which was already part of the Istanbul Programme of Action (IPoA). Now that World Trade Organization (WTO) members have endorsed the TFA agreement signed in Bali in 2013, what is the role of AfT? In Melo and Wagner (2015), we focused on the trade-enhancing and poverty-reducing effects of AfT that were an objective of the MDGs. Here, we focus on the benefits from a successful application of the Trade Facilitation Agreement (TFA): a move toward results-based AfT and an evaluation of the benefits from reduced trade costs with a focus on LDCs and landlocked least-developed countries (LLDCs).

With approximately US$40 billion disbursed a year, AfT represents about 30 percent of official development assistance (ODA) financial flows to developing countries, and what is entered as trade facilitation in the Organisation for Economic Co-operation and Development (OECD) Credit Reporting System (CRS) accounts for only about 1 percent of AfT disbursements. In a recent paper (Melo and Wagner, 2015), we find a lack of correlation between disbursements and the World Bank's Doing Business (DB) data or with the OECD Trade Facilitation Indicators (TFI) of the functioning of customs discussed here. If anything, trade facilitation disbursements have been directed more often than not toward countries that are the closest to the TFA targets as captured by the OECD TFI index that covers all aspects of the functioning of customs. In addition, the geographical pattern of disbursements of trade facilitation assistance does not correlate significantly with any of the usual proxies for trade facilitation — DB time in customs or the Logistics Performance Indicators (LPI).

Together with new estimates, the evidence surveyed here suggests that a shift in trade facilitation disbursements toward LDCs and LLDCs would provide the highest returns for AfT funds. Successful implementation of the TFA would reduce uncertainty related to trade, streamline market access procedures, and provide greater transparency at customs, all factors leading to lower transaction costs. Higher trade volumes would then be an engine of growth and poverty reduction.

Starting from this background, Section 2 summarises evidence on the importance of trade costs, highlighting their importance for LDCs and LLDCs. The objectives and the rationale for the TFA are presented in Section 3. Section 4 reviews the evidence on the effects of trade facilitation on trade costs and gives new estimates for country groups, focusing on LDCs and LLDCs. Section 5 concludes.

REDUCING TRADE COSTS SHOULD BE THE KEY OBJECTIVE FOR AFT

Table 1 gives summary indicators of trade-related performance during the early AfT period across country groupings. The group averages reveal large differences in average indicator values between LLDCs and non-landlocked LDCs as well as other groups. Over the period, the average per capita income of LLDCs was half that of non-LLDCs, itself half that of landlocked non-LDCs, itself half that of other developing countries (col. 1). LLDCs and non-LLDCs had respectable growth rates (col.2); the highest poverty rates (col. 3); and, on average high AfT disbursements (cols. 4 and 5). Governance indicators are lowest for both LDCs groups (col.6). Finally, average trade costs are highest in absolute terms for landlocked countries in their respective groups (col. 7), and the decline in average trade costs appear to be less for landlocked countries (they even increase for the landlocked non-LDC group (col. 8). For example, a rough extrapolation suggests that achieving the IPoA target, which calls for a doubling of the share of LDC exports in global trade by 2020, would require trade costs to fall approximately twice as fast for LDCs as for competitors of LDCs in world markets.

Three components of trade costs have been scrutinised in models estimating the volume of trade: (i) geography (i.e. size, terrain natural infrastructure like water ways, country size, landlocked etc...); (ii) "hard" infrastructure (roads, rail, ports, airports); (iii) "soft" infrastructure — border-related costs, like customs administration and document preparation; border-related policies, like tariffs and non-tariff measures (NTMs) in both domestic and destination markets; and behind-the-border policies, like communications and regulatory policies. Of these, (ii) and

(iii) are up for improvement by directed AfT. While proxies for both the "hard" and "soft" components of trade costs are found to have an impact on the volume of trade, as discussed in Melo and Wagner (2015), there is controversy on their relative importance and on the distribution of AfT between "hard" and "soft" infrastructure (about 10 percent of AfT disbursements go to soft infrastructure). In any case, improving the soft institutional and regulatory infrastructure, including the functioning of customs administrations as targeted under the TFA, will require less funding but is an integral part of trade costs.

OBJECTIVES AND RATIONALE FOR THE TRADE FACILITATION AGREEMENT

Fortuitously for AfT, the signing of the TFA in December 2013 suggests a rather clear road map for where AfT should be focused: identify the measures that will contribute most to reducing red tape and increase predictability in customs clearance (fees, formalities, transit). Requiring publication of procedures to clear goods will strengthen General Agreement on Tariff and Trade (GATT) Article V on Freedom of Transit. The obligation to issue advance rulings in a reasonable time-bound manner will strengthen GATT Article X on Publication and Administration of Trade Regulations (transparency). Pre-shipment inspections to determine tariff classification and customs valuation will be forbidden as will be the introduction of measures making the use of customs brokers mandatory.

Other measures should also improve transparency. For example, requests for revised charges will not be acceptable prior to publication of the new charges. Agencies and authorities in charge of border control will be obliged to cooperate and coordinate activities as has already started with the establishment of "one-stop border posts." Best practices on trade facilitation recommended by the World Customs Organization included in the Revised Kyoto Convention on the Simplification and Harmonization of Customs Procedures adopted in 2006 will require member states to establish and maintain procedures that will help expedite the release and clearance of goods in transit. These best practices are laid down in a detailed article that also obliges member states to allow (to the extent possible) traders to make payments electronically for duties, fees, and other customs charges.

By focusing resources on LDCs, especially LLDCs, AfT should contribute to the post-2015 development agenda in several ways.

TABLE 1:

AfT and Outcomes by country category in developing countries

(Averages per country group over 2005-2011).

Source: Melo and Wagner (table 1) OECD-DAC, WDI, and Povcal.net. Includes LIC, LMIC and UMIC according to the World Bank classification.
Notes:
[a] The head-count ratio (HR) is the proportion of the population living on less than US$2 a day.
[b] The poverty gap (PG) ratio is the percentage of the population under the poverty line
[c] The Worldwide Governance Indicators (WGI) (average score between -2,5 and +2,5)of the six indicators provided for Voice and Accountability, Regulatory Quality, Rule of Law, Political Stability and Absence of Violence, Government Effectiveness, and Control of Corruption
[d] Authors' construction based Arvis et al. (2013). Trade costs relative to the trade costs of the 10 countries with the lowest trade costs (normalised to 100).
[e] Trade costs normalised to 100 on 1995-1996 average.

Country categories (number of countries in parenthesis)	GDP_{pc}	GDP_{pc} growth	HR[a] (PG[b])	AfT_{pc}	AfT / GDP	WGI[c]	Avg Trade Cost[d]	Trade Cost 2010[e]
Column	1	2	3	4	5	6	7	8
Landlocked LDC [LLDC](16)	507	3,9%	72,3 (35.3)	21,5	3,7%	-0,72	319.1	95.4
Non-landlocked LDC [non-LDC] (33)	1192	2,3%	66,5 (31.9)	34,2	3,4%	-0,78	273.9	93.2
Landlocked non-LDC [LL] (14)	2067	4,5%	20,7 (7.7)	19,7	1,2%	-0,65	289.7	109.1
Other Developing [DC] (87)	4833	2,6%	21,4 (8.2)	29,2	0,8%	-0,17	198.9	95.9

TECHNICAL ASSISTANCE

The TFA explicitly recognises that technical assistance will be required for some LDCs that will then link their commitments to the receipt of technical assistance and support for capacity building. To this effect, the TFA has designed three categories of commitments: A) for immediate implementation; B) for a date after a transitional period; and C) after a transitional period during which implementation capacity will have been acquired through technical assistance. A permanent Committee on Trade Facilitation at the WTO is to replace the Negotiating Group on Trade Facilitation that hosted the negotiations leading to the TFA, and a TFA Facility has already been set up at the WTO.

THE TFA IS RULES-BASED

LDCs should be the greatest winners of a rules-based world trading system. Signed by all WTO members, the TFA is rules-based rather than discretionary with specified appeal and review procedures. This gives the TFA a sense of country ownership that was identified as one of the key Paris principles on AfT but which was found to be lacking in the case-study reviews.[1] It is also in the spirit of the outcome of the Busan Partnership for Effective Development Cooperation, which concluded that " (...) country-led and country-level results frameworks and platforms will be adopted as a common tool among all concerned actors to assess performance based on a manageable number of output and outcome indicators drawn from the development priorities of the developing country." (cited in OECD 2013, p.23).

THE TFA OBJECTIVES CAN BE MONITORED RELATIVELY EASILY

Progress on many TFA objectives can be monitored by indicators lending themselves to targets (e.g. whether borders are open at the same times would be one among measures of border agency coordination; acceptance of electronic payments would be a measure of efforts to speed release and clearance of goods, etc... (see the list of indicators in the OECD TFI in Figure 1 below). In turn, evidence is accumulating that these are targets leading to desired results for the AfT Initiative.

DELAYS REDUCE TRADE VOLUMES

Growing evidence from different approaches documents that delays as goods travel from factory to consumer reduce trade volumes. One day less in transit is equivalent to a 0.6 - 2.1 percentage point tariff reduction in tariffs in the destination country, that is a reduction in trade costs.[2]

POTENTIAL BENEFITS FROM IMPLEMENTING THE TRADE FACILITATION AGREEMENT (TFA)

The principal focus of the TFA is to reduce the time it takes to cross borders, that is time spent in customs. Figure 1 shows the density of the distribution of the time in customs for exports and imports in 2015 drawn from the DB database. The top of Figure 1 compares the time-in-customs densities of landlocked vs non-landlocked for all (145) developing countries. The average number of days in import customs for landlocked developing countries is 5.5 and for non-landlocked, it is 3.6 days. Comparing the shapes of the distributions is revealing: more than 50 percent of non-landlocked developing countries spend 2 days or less in customs, while for landlocked countries, the corresponding figure is less than 5 percent, while close to 10 percent spend 10 days or more in customs. A similar — but with less left-skewness — pattern holds for the comparison of LLDCs vs. non-LLDCs. For exports, the comparisons also reveal a similar pattern. Again, the average number of days in import customs for LDCs is higher (4.8) than for non-LDCs (3.7). Benchmarking the average landlocked and non-landlocked time estimates of Figure 2 on Hummels and Schaur mean estimate (a one-day reduction in trading time is equivalent to a 1.3 percent reduction in trade costs), suggests that import-competing activities have a [3.9=(1.9+1.1)*1.3)] percent cost advantage relative to exporting in non-LL countries.

DB data is collected every two years from only a handful of freight forwarders in each country who are asked to report the time and cost for a 20' full container weighing 10 tons to cross the border.[3] Even though they are widely used, DB data may be representative of neither travel time nor of travel cost. Two other estimates, one covering all exports from a single country over a relatively long period, the other covering all parcel shipments from the Universal Postal Union (UPU), provide additional bases of comparison.

Using a dataset covering all exports of Uruguayan firms over the period 2002-11, after controlling for unobserved

1 The five principles are: country ownership, alignment, harmonisation, MfDR, and mutual accountability.

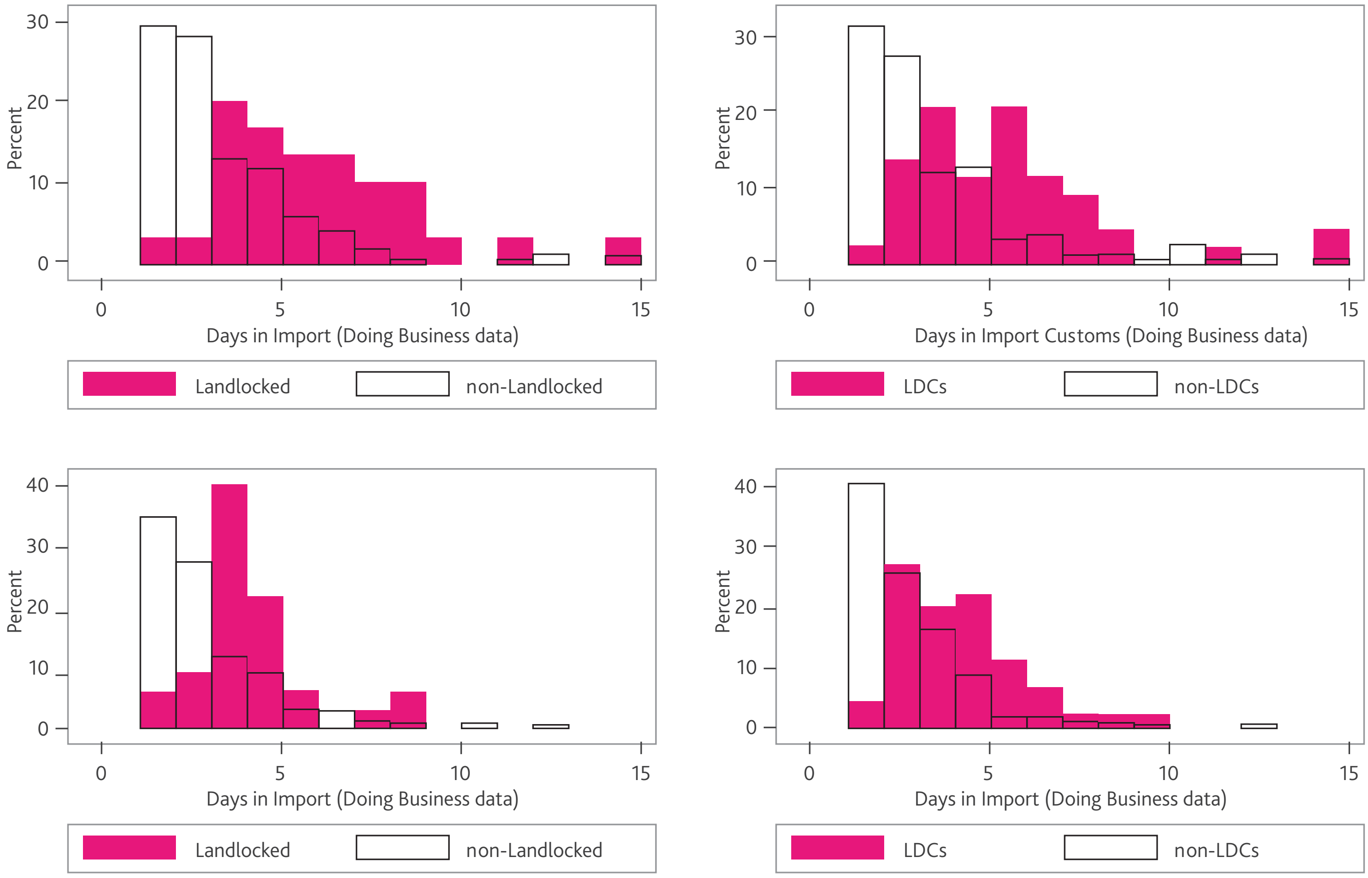
2 Melo and Wagner (2015) summarize the evidence. The contributions in Cadot and Melo (2014) critically evaluate the evidence on the efficacy of the AfT Initiative.

3 Difficulties in assessing the reliability of DB data are discussed in Hallward-Dreier and Pritchett (2015).

FIGURE 1:

Days in customs for imports (left) and exports (right) by category [LL vs. non-LL] (top) and [LDCs] vs. [non-LDCs] (bottom).

Source: Author's calculations from Doing Business (2015)



	Landlocked	non-Landlocked	LDCs	Non-LDCs
Median time in import customs (in days)	5	2	5	2
Median time in export customs (in days)	3	2	3	2

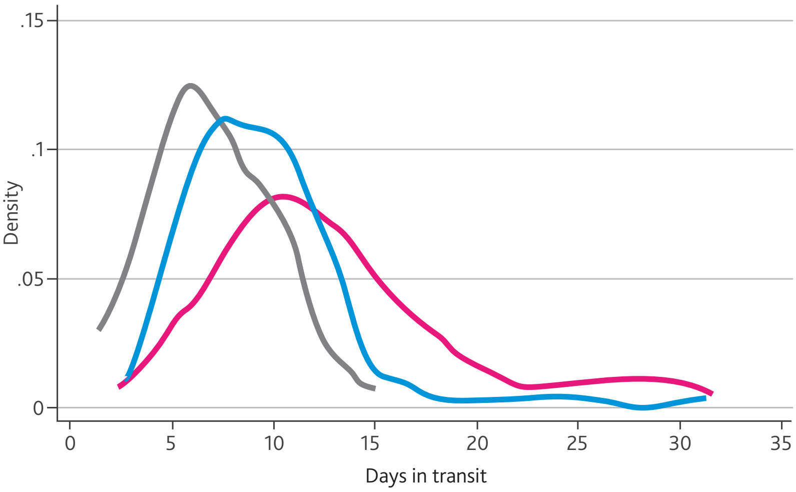


FIGURE 2:

Kernel estimates of time in transit for international parcels

LEGEND:

- Least developed countries (40)
- High income (53)
- Other developing (74)

Source: Authors' calculations from Boffa (2015) heterogeneity both at the firm-year level (e.g. management changes) and at the firm-product-destination level, Volpe Martincus et al (2013) estimate that a 10 percent increase in the median time spent in customs is associated, on average, with a 1.8 percentage point reduction in the growth of firm-level exports.

Figure 2 shows the kernel density estimates of the time in transit (defined as time between sorting facilities in origin and destination countries) for packages weighing up to 30kgs from a large sample of shipments covering many countries.[4] Average days in transit in parenthesis by income group are: high income (7.0); LDCs (13.0); and other developing countries (9.7). Using the conservative mean estimate of Hummels and Schaur (2013) of 1.3 percent equivalent additional costs from an extra day in transit, implies that LDCs face, on average, an extra 4.2 percent trade cost for parcel shipments above those for other developing countries.[5]

Since the signing of the TFA in December 2013, the OECD has produced and released a series of 11 TFI for 187 countries following closely the targets highlighted by the TFA. Currently, this is the most detailed catalogue of the policies and procedures used in border management agencies around the world and arguably the best we have to assess more closely the trade cost handicaps faced across different group of countries. Figure 3 shows the distribution of each one of these measures averaged over countries. Comparing again LDCs with non-LDCs and landlocked with non-landlocked countries, reveals that the values for the LDC group are again systematically lower for each indicator than for the non-LDC group, though not always significantly. For some categories, like advance rulings, the differences between the groups is large, a pattern that is also apparent when the comparison is between landlocked and non-landlocked countries. As expected, on average, border cooperation is greater for landlocked than for non-landlocked countries. The values for the governance and impartiality indicator are also lower for LDCs than non-LDCs and for landlocked than non-landlocked.

Two measurable outcome variables of interest to monitor for AfT activities are time in customs and export volumes and their characteristics. Evidence reviewed in Melo and Wagner (2015) suggests that trade facilitation expands both existing exports (intensive margin effect) and creates new trade flows (extensive margin effect). Reduced time in transit is the second source of reduction in trade costs to be expected from implementing the TFA, since, according to logistics professionals, time savings in customs is the preferred summary indicator of the private sector trade costs associated with clearing goods at the border. These gains should be greatest for countries with the longest times in transit.

BENCHMARKING COSTS FROM TIMES IN TRANSIT

After controlling for structural factors — gross domestic product (GDP) — and for policy variables affecting trade costs (LPIs and WGIs), using the TFI constructed as an average of the 11 indicators displayed in Figure 2, Melo and Wagner (2015, Table 4) estimate the reduction in trade costs from improvements in values of the TFI that might result from implementing the TFA. Measurement is for time in customs for a 20' foot container from the DB data reported in Figure 1. Improvement is measured as the move of the median value of each group to the best performance of its group. For example, if the median value of the TFI for the LDC group were to reach the frontier value for the LDC group, the median number of days in customs for the LDC group would be reduced by 1.8 days equivalent to a percentage reduction in trade costs of 2.4 percent (=1.8*1.3). The corresponding estimates are 3.0 percent for the landlocked developing country group and 4.5 percent for the LLDC group.

CONCLUSIONS AND NEXT STEPS

The unfolding post-2015 agenda is more about broad goals for development that include a numerical target of 7 percent growth for LDCs. This target of higher growth is in contrast with the MDGs where growth was only an indicator. As argued by Prichett (2015), this shift in the agenda toward higher across-the-board aspirations reflects changes in the relationship between donors in rich countries and developing countries. This change of focus is favourable to the growth-oriented TFA objectives reviewed here. Taking implementation of the TFA seriously would lend itself to this measurable target approach.

On average, time in customs for imports and exports are significantly higher for both LDCs and LLDCs, making it difficult for them to meet the IPoA target of doubling the trade share of LDCs in world trade by 2020. New estimates

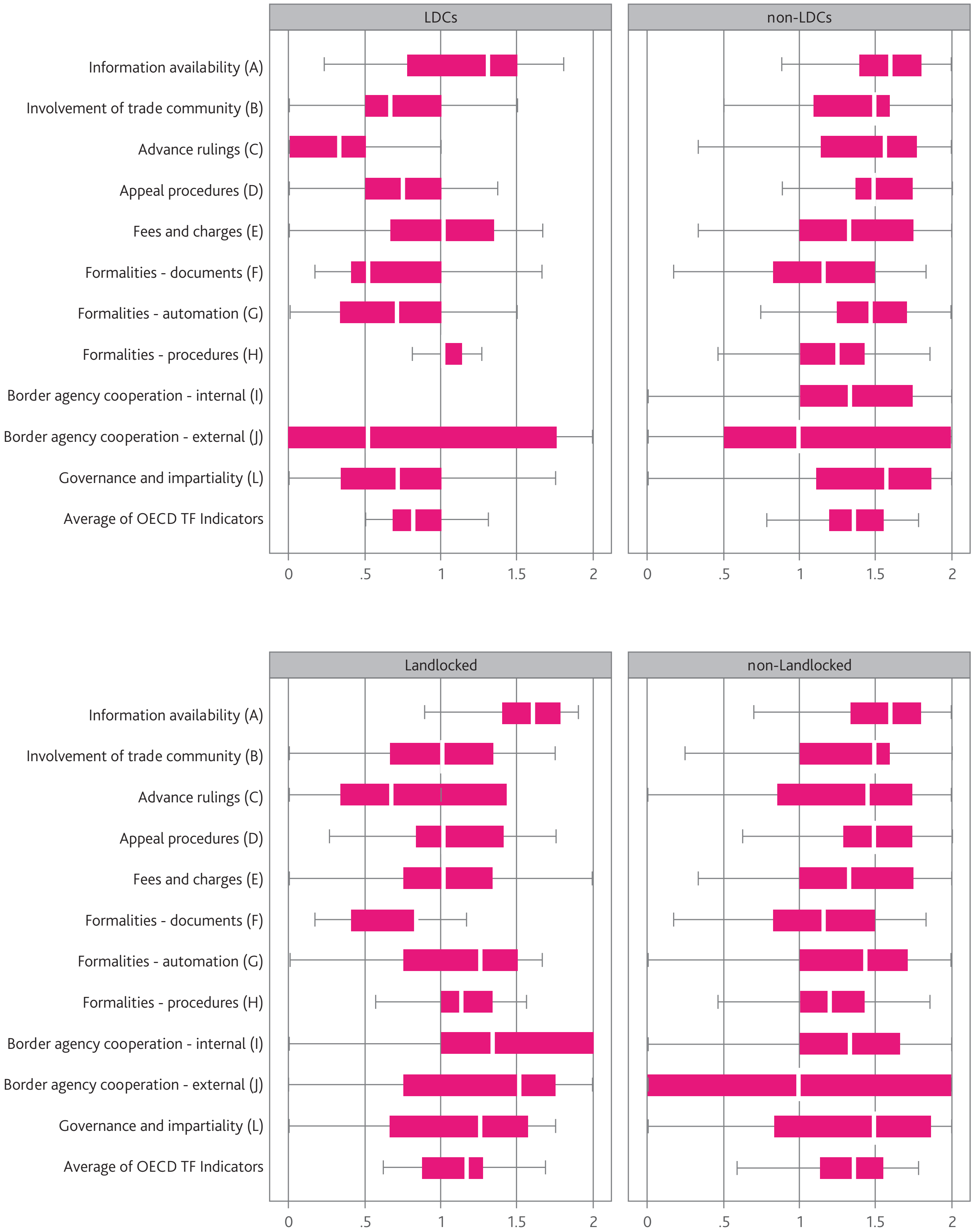
4 The figures are drawn from an estimation of approximately 30 million bilateral parcel shipments averaged over a sample of 167 countries for 2013-14. Except for some European flows, shipments are by air. See Boffa (2015).

5 This is a very rough estimate, since it assumes that the average distance to partners is the same for LDCs and other developing countries. However, since parcels are homogeneous and since freight rates are negotiated multilaterally (rather than bilaterally), it is likely that the difference in average times in transit between the groups mostly capture delays in the receiving countries.

FIGURE 3:

Distribution of the scores of the OECD TFI
(interquartile range across country groupings)

Source: Melo and Wagner (figure 4) from OECD (2015)



reported here suggest that a successful implementation of the TFA proxies as a move of individual group members to the group frontier could reduce trade costs for imports by 2.4 percent for LDCs and by 4.5 percent for LLDCs. While the estimates reported here are only rough orders of magnitude, in the fierce competition characterising our globalised world, these differences in trade cost estimates are not insignificant. Since time in customs can be measured relatively accurately, reducing time in customs for imports and exports by a specified amount at some date would be a verifiable target for the TFA.

Such a target would contribute toward two objectives. First, it would be a step toward meeting the goals of the IPoA. Second, by answering the call for MfDR[6] repeatedly mentioned in the biennial OECD-WTO reviews, this objective would help mobilise support in donor countries, which cuts across the Paris declaration pillars.[7] Even though there is more to trade costs than customs management, monitoring implementation of the TFA would be a stepping stone toward the concrete trade performance targets that have been lacking in AfT activities so far.

Moving ahead, the implementation of the TFA faces two challenges. First, the distribution of AfT funds between "hard" and "soft" infrastructure (about 10 percent of AfT disbursements go to soft infrastructure) will continue to be context-specific. Nonetheless, wherever possible, it should be informed by impact evaluation appraisals. Currently, disbursements for trade facilitation activities (as measured under the CRS) are only 1 percent. While the evidence here clearly supports an increase in this share, it cannot inform on how much.

Second, the SDGs call for taking urgent action on preserving the environment (goal 15). If cooperation measures at customs expedite transit at the cost of verification of trade in the illegal species identified in the 1973 Convention on International Trade in Endangered Species of wildlife Fauna and Flora (CITES), implementation of the TFA might accelerate environmental degradation. Taking this goal on board is essential in implementing the TFA.

6 Since 2012, the World Bank has a third lending instrument called 'Program for Results', the first to link directly disbursements to results. Up to 5 percent of World Bank lending can go through this instrument which is still in its early stages, but has apparently met with success. See Gelb and Hashmi (2014).

7 The five principles are: country ownership, alignment, harmonisation, MfDR, and mutual accountability.

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