The Role of Trade in Financing for Sustainable Development

Note by the UNCTAD secretariat

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

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

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

4. Through private-financing paths, participation in international trade, or perceived opportunities to benefit from international trade, can ***mobilize*** the private-sector investment

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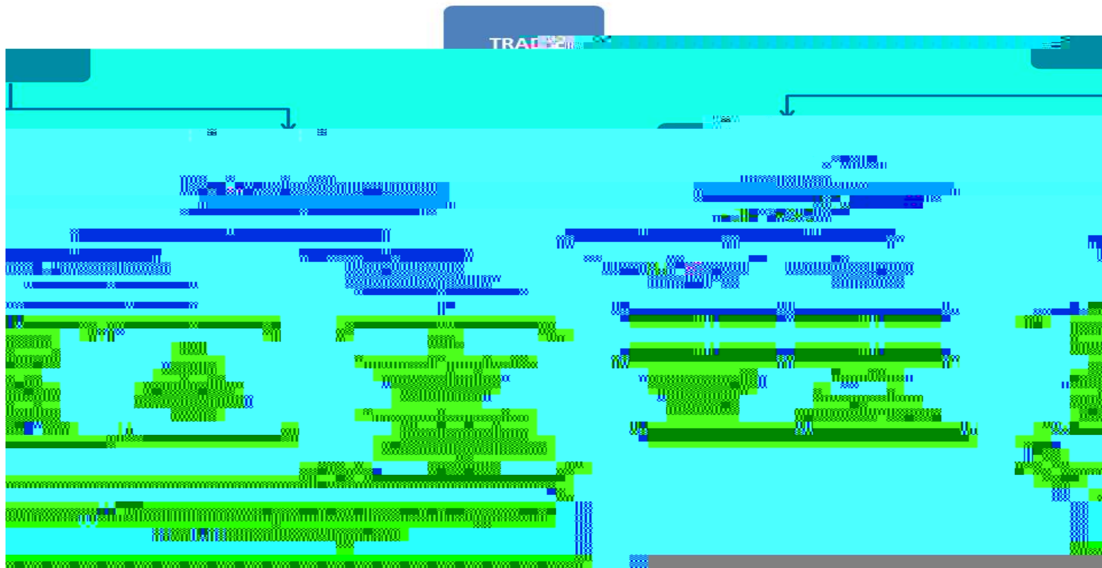

A. Generating revenues for the public-financing

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

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

Table 1

A.1 Revenues from imports

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

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

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

19. The Global Trade Alert indicates that the usage of export tax has Ti(e)n onans
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can also insulate the domestic economy from external shocks arising from commodity price volatility.[15]

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

B. Mobilizing the private-sector resources

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

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

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

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

B.1 Bottoming up economic viability

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

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

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

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

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

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

32. Various studies also show that international trade can generate higher incentive for people in much of the developing world to upgrade their skills through education. For

outward stocks and the degree of trade openness in terms of the market access conditions (i.e. the level of tariff barriers) of both host countries and parent countries of FDI. This was because a significant portion of FDI was linked to building an "export platform" in the host country, especially when exports from the host country enjoyed good market access conditions (i.e. faced zero or low tariffs) to the parent-country market or to other important third markets. This explains the recent concurrent growth in FDI and trade in intermediate

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

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