TRADE, FINANCE AND DEVELOPMENT

DID YOU KNOW THAT...?

- ✓ The volume of the world trade is increasing, but the world's poorest countries (least developed countries - LDCs) continue to account for a small share of trade, facing major difficulties in accessing world markets and global value chains. Foreign direct investment (FDI) in developing countries is highly concentrated in geographical and sectoral terms, and there is a strong need for investment in sectors which contribute to sustainable development. Inequalities of wealth between countries and within countries have reached alarming and unsustainable levels.
- ✓ A greater volume of trade does not necessarily mean more development, nor an equitable sharing of these benefits among all. In fact, the impacts of trade on development widely vary across countries and within countries depending on several internal factors (such as the composition of economies, economy diversification, type of exported products, institutional capacity, etc.) and external factors (trade agreements and regional integration, barriers to trade, demand and international price of products, among others). Free trade agreements are not necessarily favourable to the poorest countries. And financial flows from developing countries (in illicit financial flows, tax evasion of international companies, fraudulent commercial billing, corruption and financial transfers to tax havens) are greater than the amounts they receive (e.g. in development aid, IDE and shipments).
- ✓ Global policies have been aimed at regulating markets and promoting free trade, which is the role of the World Trade Organisation, although slow negotiations and technical complexity often end up harming the most vulnerable countries. Trade and financial inclusion appear in several goals and targets of the 2030 Agenda for Sustainable Development, which gives greater responsibility to the private sector.
- ✓ The European Union's development policy includes trade and finance as key elements of the development process, but the negotiation of trade agreements with several developing regions has revealed incoherencies and resistance from partner countries. "Aid for trade" seems to be an insufficient tool to address the imbalances in the current system.
- ✓ There are several inconsistencies in the interconnection between trade, finance and development, namely the persistence of rates and non-rates barriers, the fragmentation of the international framework, the inaction towards illicit financial flows, among others. More appropriate and coherent fiscal, budgetary and trade policies at global, regional and local level are needed to avoid marginalisation of the poorest and to enable more inclusive and sustainable development.

Introduction

In recent decades, **world trade flows have undergone major changes**: in the early 1990s, most goods and commodities were traded between countries with advanced economies, but today most trade is between developed and developing countries and the emerging markets/developing economies. The main reason for this change is the relocation of production from industrialised economies to countries where labour costs are lower, particularly for Asian countries. Currently, one of the main trends is the increase of global and regional value chains created by international production networks increasingly based on inter-company trade.

Securing a fairer, more dignified and sustainable world is more than ever a requirement of the international and national community. In this framework, Policy Coherence for Development (PCD) stands as a concept, approach and instrument to ensure that the several sectoral policies do not conflict with efforts to eradicate poverty and promote development at global, European, national and local level.

There are **wide disparities between developing countries.** The share of the world's poorest countries, i.e. Least Developed Countries (LDCs), in global trade is residual, accounting for less than 1% of world exports (0.94% in 2016) and 1.4% of imports, despite representing 12.8% of the world population (WTO, 2017). Regarding the European Union, this is the main market for the export products of the least developed countries, with a market share of 25.1 % of global exports of these countries in 2016, but the share of LDCS in total imports of the EU is low (around 2.16 % of total EU imports in 2016) (EC, 2017a). The trade balance of these countries has been highly deficient, particularly for exporters of agricultural and non-petroleum products, since most of these countries depend on exports of these raw materials and primary products, which have suffered from falling prices on the world markets, while these mainly import processed products with high added value.

The challenges of global development are increasingly interdependent and multidimensional, so the policies and sectors – from trade to migration, from finance to security, to food sovereignty to energy – need to effectively contribute to the achievement of the Sustainable Development Goals. Policy Coherence for Development (CPD) is a concept, approach and instrument to develop this positive connection between policies by identifying and mitigating the negative impacts that several sectoral policies can have on poverty reduction and the promotion development. The European Union (EU) and its Member States have guaranteed PCD as a political commitment and legislative obligation under the Lisbon Treaty, *but are European institutions and countries pursuing sector policies that contribute effectively and sustainably to development?*

4 Myths about Trade, Finance and Development

MYTH 1

Trade generates development

REALITY

There is a proven connection between trade and economic growth, as the economies with the highest export growth are generally those with the highest growth rates of the Gross Domestic Product (GDP). But this does not mean that a liberalised global market is the most efficient way to drive inclusive growth, or that it automatically generates sustainable development.

In fact, trade liberalisation can contribute at the same time to increasing growth and exacerbating inequalities within and between countries, to further discrimination against the poorest, to the loss of important incomes or to an increase in unemployment. This depends on how trade and value chains are organised, how markets are regulated, how income is redistributed, whether countries have the capacity to adapt, or what groups are favoured over others. Richer countries and large multinational corporations often dominate world markets, creating unequal power and information relations.

This also depends on the economic diversification of countries, on transacted products and on integration into the global economy. A country with a poorly diversified economy, dependent on the export of raw materials and low value-added primary products (as are many of the poorest countries), has necessarily a weak position in global markets, being dependent on the fluctuation of international prices of raw materials and failing to generate sustainable development through trade.

MYTH 2

Free trade agreements favour poorer countries

REALITY

Bilateral, regional or multilateral free trade agreements have major impacts on national economies at all levels – from producers to workers, from industry to consumers – and must therefore safeguard social, environmental and human rights issues. This is formally recognised, as more and more agreements include provisions on development and/or environmental standards.

However, in practice, these agreements may not benefit the poorest countries. On one hand, richer countries often keep protectionist measures regarding their exports, including non-rate barriers that result in poor access to products from poorer countries to these markets, while the poorer countries agree to entirely open their markets to products from more developed countries. This makes the competition unequal, since producers in the poorest countries are hampered by the flood of the market with external products and may even prevent the development of the countries' production and industrialisation. In addition, the agreements also represent a loss of customs revenue, which in some developing countries is very important for the mobilisation of financial resources (import taxation accounts for about 11% of public revenue on the African continent on average). The negotiating capacity of countries is often very different, resulting in unbalanced and less favourable agreements for the weakest links.

On the other hand, in a globalised world, agreements between richer countries or regional blocs also influence the poorest countries. The Transatlantic Trade and Investment Partnership (TTIP) negotiated since 2013 between the EU and the US, to take place, will necessarily have an impact on relations with third countries and on the access of the poorest countries to the European and northern markets although the impact in these countries is not being considered.

MYTH 3

The poorest countries receive many funds and financing from more developed countries

REALITY

Development aid and foreign direct investment are, in addition to emigrant remittances, important resources for the development of countries, particularly the most vulnerable, poorest and most needy countries. Regarding development aid, donor generosity and the high amounts invested over decades of development cooperation are often emphasized.

However, the facts have demonstrated that financial flows from higher income countries to lower income countries are, in fact, smaller than the financial flows that come out of the poorest countries to the richest countries. It is estimated that since 1980, developing countries have lost about USD 16.3 billion through illicit financial flows, international corporate tax evasion, fraudulent commercial billing, corruption, and financial transfers to tax havens (Global Financial Integrity *et al*, 2015). In Africa, data show that for every dollar received on the continent in development aid, philanthropic contributions, investment, and other official flows two dollars are from the continent in interest payments on debt, foreign investors profits and illicit flows (UA UNECA, 2015)

Thus, net financial transfers have had a negative balance for developing countries, which has detrimental effects on growth, reinforces global inequalities, and generates enormous social costs for countries, as these resources could be invested in their development. The lack of transparency and regulation in financial systems contributes to exacerbate this problem.

MYTH 4

Financial inclusion requires expensive and difficult-to-access technologies

REALITY

In many developing countries, technological innovations are revolutionising the financial industry and promoting simple and inexpensive access to financial services (savings, payments, remittances, credit, insurance, investments) without the need for high-tech equipment, high level of knowledge or even a bank account. Digital and electronic payments have risen exponentially in many poor countries due to easy access to mobile phones.

For people living in rural or remote areas, where there are no financial institutions, or even the poorest and most marginalised populations in urban areas, who have great difficulties accessing credit, for example, innovations in digital financial services have contributed to financial inclusion. The number of people making payments and several online financial transactions, as well as the number of small and medium-sized businesses with fast access to credit has grown exponentially in many countries. Africa and Asia, the regions of the world experiencing the greatest difficulties of financial inclusion and Internet coverage, are also the regions where mobile phones and digital financial transactions use has grown more, because of its low cost and easy access.

By 2025, the enlargement of digital finance is expected to provide access to financial services to 1.6 billion people, generate 95 million new jobs in several sectors and contribute to tax collection and mobilisation of internal financial resources, which may be affected by key development priorities such as health and education[12].

[12] See Busting the 10 Myths of Financial Inclusion. Development Asia, November 2016, and the World Bank's Global Findex Database 2017.

RECOMMENDATIONS

General and global recommendations

1. To strengthen the **multilateral trading system and the role of the WTO** as a regulator of multilateral trade on a global scale. To continue to reduce **trade barriers**, notably non-rate barriers and trade costs, mainly through the effective implementation of the Trade Facilitation Agreement and the package of support to the poorest countries.
2. To reformulate **global governance** to promote a **financial and trade system that also works for the poorest** through: (i) reforming International Financial Institutions to make them more inclusive, democratic, accountable and transparent, and (ii) strengthening mechanisms for transparency and participation of the poorest countries and civil society actors in trade debates, negotiations and policies.
3. To invest in **evaluations of the potential and actual impacts** of trade agreements and trade barriers in the poorest countries and the most vulnerable populations.
4. To create favourable conditions (at the international and national levels) for the promotion of **financial inclusion** in developing countries and encourage the establishment of political and legal frameworks to facilitate the use of bank accounts and the creation of digital infrastructures.
5. To strengthen the **development of trade agreements and international investment** agreements and to ensure a balance between the rights and obligations of States and investors. For its part, integrating trade issues into sectoral and national development strategies, to promote policy coherence for development and thus contribute to the Sustainable Development Goals.
6. Actively promote all initiatives that contribute to improving the **transparency of national and global financial systems**, particularly in strengthening international cooperation on tax havens, capital flight and tax abuses.
7. Promote **innovative business agendas that serve citizens and the environment** through: promoting social and environmental sustainability along value chains; support for fair, equitable and ethical trade approaches; the facilitation of trade in sustainable goods and services (rather than focus on the mere increase in trade flows); the coherence between trade rules and the objectives of the climate agenda (Paris Agreement) and the development agenda (Agenda 2030).
8. To develop **legally binding international frameworks** in these areas, including: on responsible business practices (in line with the UN Guiding Principles on Business and Human Rights), on investment (with the creation of a Multilateral Investment Tribunal for Dispute Settlement) and on sustainable resource management (with an international convention on sustainable resource management).
9. To support **local economies, local and intraregional trade, diversification and internal economic** transformation of countries, in an inclusive and sustainable development perspective, since only then will it be possible to seize trade opportunities to improve living conditions.

Recommendations for the European Union

10. To strengthen the implementation and monitoring of **sustainable development provisions** in EU trade agreements with partner countries, including labour standards and rights, environmental sustainability and natural resource management, and respect for human rights at all levels.
11. To implement **trade aid better adapted** to the different national contexts of the partner countries, including as targets in this assistance capacity-building for poor producers, cooperatives and small and medium-sized enterprises, facilitate the diversification of national markets, strengthen women's equal rights, deepen regional integration and reduce income inequality. Strengthen the aid focus in the least developed countries (LDCs) and, within these, the most vulnerable populations.
12. To extend **dialogue with the more advanced developing countries**, including through South-South and triangular cooperation, and in areas of mutual interest (e.g. regional integration, regional value chains, trade facilitation and exchange of good practices).
13. To invest in the **full implementation of a policy of coherence for development**, by abolishing any abusive production and trade practices, overfishing and agricultural subsidies that hinder development and threaten food security. Integrating policy coherence for development into the Multi-annual Financial Framework 2021-2017.
14. **To support partner countries in building capacity** in the areas of fiscal administration, financial governance, public financial management and the fight against illicit financial flows; as well as on the participation of the poorest countries in the global reform of international fiscal rules.
15. Strengthen the **application of regulatory frameworks for companies** to integrate social, environmental and human rights standards as well as to ensure that European companies pay taxes in the countries where they extract or create value.
16. Rapidly create a **Financial Transaction Tax** to finance global challenges such as development and climate change.

Trade is not an end in itself. It is a tool to benefit people. The aim of EU trade policy is to make the most of those benefits.

Trade for All Strategy, EU

#ParceirosNoDesenvolvimento

Cofinanciamento