

# Beyond Brexit: Four Steps To Make Britain A Global Leader On Trade For Development

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## Abstract

This paper looks at how the UK can, after Brexit, develop a world-leading trade for development policy. It uses a systematic assessment of how rich country trade policies affect developing countries to identify the leading approaches used elsewhere. It then identifies and describes four key steps: i) eliminating or lowering tariffs; ii) improving preferential access for

the very poorest countries; iii) cutting red tape at the border; and iv) enhancing the effectiveness of its aid for trade. These steps would enable the UK to improve substantially on the approach taken by the EU and other countries, benefit UK consumers and businesses, and set a new standard in trade policy for development.

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## Executive Summary

In August 2016, the Center for Global Development (CGD) published a paper (Anderson, Juden, and Rogerson 2016) that used a threefold test to identify opportunities for global development presented by Brexit: such opportunities would be good for global development, good for the UK, and enabled by Brexit. Trade falls squarely within this bracket. This report looks at how the UK can develop a world-leading policy of trade for development.

As part of the EU, the UK has had little control over its trading arrangements with developing countries. If, as expected, the UK leaves the EU Customs Union, it will regain control of the tariffs, policies, and rules governing its own trade. Prime Minister Theresa May has set out her “ambition that the UK will be a global leader in free trade” (BBC News 2016), and this note lays out how the country can do so via its policies on trade for development.

Trade policy in the developed world has an important bearing on development and is one of the seven areas assessed as part of CGD’s Commitment to Development Index, or CDI (CGD 2015). The present analysis draws on the Commitment to Development Index assessment of how rich countries’ trade policies affect developing countries, and combines it with the latest thinking from trade policy experts to identify the key elements of the UK’s policy on trade for development after Brexit. It identifies four steps that would establish the UK as the key global leader in trade for development.

First, the UK government should immediately issue a declaration that no Least Developed Country (LDC) will face higher tariffs as a result of Brexit than it currently does. This step would ensure certainty for businesses in developing countries so that they can continue to invest in future production, and it would cost the UK nothing.

Second, the UK government should seek to simplify existing trade arrangements as much as possible. The simplest and most powerful arrangement would be to have truly free trade—low or zero tariffs on almost all imports from all countries, removing altogether the need for complicated “rules of origin” and tangled webs of different tariffs for thousands of different products. New Zealand has demonstrated how very low, broad-based tariffs can be successful.

If the UK does choose a tariff regime, the government could improve upon the current preferential offer from the EU for developing countries in several ways. It could expand coverage to additional poor countries, going beyond the somewhat arbitrary UN criteria for designation among the LDCs and making use of objective criteria to extend tariff elimination to other poor countries. This may need agreement at the World Trade Organisation (WTO) but, as a liberalising measure, would attract support from members. In addition, the UK can make the rules of origin (which require countries to demonstrate the origin of their products) more flexible, for example by allowing countries to “accumulate” inputs from other preference-receiving countries and count those as their own production (an approach known as “extended cumulation”).

Third, the UK government could narrow the gap with world leaders on non-tariff barriers to trade, for example by reducing the time and cost for goods to pass the UK border and by raising the minimum value of imports that triggers the need for tariffs and taxes to be paid.

Fourth, the UK government should invest more in Aid for Trade to support reform in developing countries, and it should pilot the introduction of payment for performance to reduce the possibility that any aid funding may go to waste.

Several of these propositions need further work before a policy could be put in place. Still, the UK won't leave the Customs Union for at least two years, and in that time it can consult on its approach widely with developing countries and work closely with the World Trade Organization (WTO) and its members.

Ultimately, this approach would lead to benefits not only in developing countries but also in the UK, as imports provide additional choice and drive productivity enhancements in the UK market.

This is an area of opportunity for the UK to demonstrate its outward-facing approach and to show that trade openness is a genuine win-win which creates higher levels of prosperity in both countries through choice and value in traded goods as well as improvements in domestic productivity.

# 1. Introduction

As part of the EU Single Market and Customs Union, the UK has had little control over its trading arrangements with developing countries. This note lays out how the UK can become the global leader in trade for development if, as expected, the country leaves the EU Customs Union.

Rich countries' trade policies are an important factor in low-income countries' development (Cline 2003). The UK currently imports some £34 billion each year from developing countries and is an important market for many. For example, the UK receives nearly 10 per cent of Bangladeshi and Kenyan exports (Mendez-Parra, Papadavid, and te Velde 2016).

As part of its Commitment to Development Index (CGD 2015), CGD systematically assesses how countries' trade policies treat developing countries. The only objective, regular assessment of trade policy's effect on development, the Commitment to Development Index scores countries on the following criteria:

- **Market protection:** agricultural subsidies (see box 1 below) and tariffs on imports from developing countries—weight 50 per cent
- **Impediments to imports:** red tape on imports, calculated using the World Bank's ease of doing business index for the documents, days, and costs required to import a container—weight 25 per cent
- **Restrictions on services:** calculated using the Services Trade Restrictiveness Index of the Organisation for Economic Co-operation and Development (OECD)—weight 25 per cent

The UK will gain more control in these areas. Note that the weighting in market protection points to its particular importance. The level of agricultural subsidy is also an important factor for development. Whilst a full assessment of the UK's options on agriculture is beyond the scope of this paper, box 1 notes the potential importance to development.

The ingredients for the best trade policy for development can therefore be thought of in four parts: first is the access the UK provides to poor countries to its markets, including (second) the access it provides for the very poorest countries and (third) the red tape and regulation it applies at the border. Fourth is the use of aid and technical assistance to promote better trade policies in poor countries. The following sections take up each of these issues in turn.

### **Box 1: Agricultural Subsidies**

The Commitment to Development Index incorporates the level of agricultural subsidy in assessing market protection. By subsidising agriculture, countries suppress global prices, artificially improve the competitiveness of their agriculture sector, and disadvantage producers with lower levels of subsidy. A full assessment of the UK's options on agriculture policy is beyond this paper (and the trade elements are covered elsewhere) but here we note some of the importance of agricultural subsidy from a development perspective.

Outside of the EU, the UK would need to develop its own agriculture policy. The EU currently spends almost 40 percent of its budget on agriculture. In the UK, this equates to some £3bn per year<sup>1</sup>. Much of this subsidy is no longer tied to the production of particular crops which has reduced their distortionary impact. Still, this is a significant level of subsidy which is over a third of the £8.5 billion total UK agriculture gross value added and some 12.5 percent of the £23.9 billion total output in 2015.

A World Trade Organisation (WTO) agreement limits agricultural subsidies and has been an important driver of reform. A breakthrough was made in Nairobi in 2015 with an agreement to phase out export subsidies. A new analysis by Glauber (2016) suggests the WTO can simplify its negotiations and take major strides to reduce levels of agricultural subsidy, by harmonizing support levels at 5 percent of the value of agricultural production (in developed countries). The UK should consider how it might achieve this ambition.

The UK has long-argued across Governments of all colours to remove agricultural subsidies and distortions and now has the opportunity to do so and promote an efficient agricultural sector and provide important leadership at the WTO. As the UK is a relatively small producer globally, this may not have a significant impact on global prices (and for that reason would also leave UK food prices largely unchanged). However, the UK's ambitions will have an important impact on the direction of agricultural reform in the EU and WTO and could catalyse major benefits for developing and developed countries alike.

## 2. Providing the Best Possible Access for Developing Countries to the UK Market

Currently, the UK shares the EU's trade policy, including its tariff levels, trade agreements, and preferences for poorer countries. The EU has an array of different kinds of agreements with different countries, including the following:

- **The General System of Preferences (GSP)** offers reduced tariffs for a broad group of developing countries on around two-thirds of products.
- **The GSP+** offers reduced tariffs for 90 per cent of products to a smaller group of around 10 countries, conditional on their meeting criteria on labour rights, the environment, and governance.
- **Duty-free, quota-free access for LDCs** applies to 48 countries and almost all products.<sup>1</sup>

Some other developing countries also get improved access to the EU market through Free Trade Agreements or economic partnership agreements (EPAs). EPAs are trade agreements between the EU and developing countries which remove almost all EU tariffs but are “asymmetric” in removing a lower proportion for developing countries. They are permanent, allow the developing country to use certain “safeguard” tariffs to protect domestic protection, can promote regional trade cooperation and are also seen as a stepping stone to further agreements. Still, EPAs are controversial because they require poor countries to provide market access for European firms in exchange for continued access to the EU market.

In all cases, developing countries need to meet EU product standards and comply with rules of origin to demonstrate that products originate in the territory or territories that enjoy reduced tariffs. The EU has been criticised for slow progress in agreeing to EPA deals, insistence on reciprocal tariff reductions, and until recently, complex rules of origin. Its practices have also complicated regional integration processes in Africa.

Despite all of these preferences, the overall average level of trade protection that the EU applies to developing countries is higher than that applied by several high-income countries outside the EU, and it is particularly high in the important agricultural sector. The International Trade Centre ranks countries by the overall tariff-equivalent value of protection they apply to imports from all developing countries; on this ranking, the EU performs worse than, for example, New Zealand. CGD's Commitment to Development Index ranks New Zealand as the best performer on trade for development because the country has the lowest tariffs and domestic agricultural subsidies. All rich countries, however, have important protectionist weaknesses in their policies—so an independent UK has a real opportunity to become a global leader in free trade for development.

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<sup>1</sup> This scheme is known as “Everything But Arms,” as it applies to all products except armaments (though in practice arms are not a very important export category for Least Developed Countries).

**Table 1: Import tariffs on goods from developing countries**

Import tariffs on goods from developing countries					
Country	Overall Protection (Tariff Equivalent)	Agricultural Tariffs	Agricultural Subsidies (Tariff Equivalent)	Total Agricultural Protection (Tariff Equivalent)	Textile and Clothing Tariffs
New Zealand	2.5%	0.4%	0.9%	1.3%	7.9%
Australia	4.4%	0.4%	9.7%	10.1%	10.1%
United States	4.6%	4.4%	12.9%	17.9%	8.8%
Canada	6.5%	19.0%	8.2%	28.7%	10.4%
EU	9.0%	18.9%	14.8%	36.5%	6.4%
Japan	18.1%	105.6%	-0.5%	104.7%	5.0%
South Korea	26.2%	111.5%	-0.1%	111.3%	9.8%

Source: Roodman, CDI (2013), based on CEPII 2007 data.

## 2.1 Improving Market Access

How can the UK do better on market access?

*First, guarantee no increase in tariffs or reduction in quotas for LDCs.*

Whether the UK will remain part of the EU Customs Union is unclear. Regardless of the outcome, the UK should urgently reassure LDCs (those that currently receive duty-free, quota-free access) that no new tariffs will be applied to goods after the UK leaves the EU. Such a commitment would cost nothing, does not depend on and would not undermine the process of negotiating Brexit, and could be critical for many firms' investment decisions. A similar ambition should be stated for other developing countries, acknowledging that the process may be complicated for non-LDCs.

*Second, institute simple tariffs for all.*

At present, the EU has 12,651 different tariffs (compared with, for example, Norway, which has just over 1,000), which all vary by country group (Lewis 2016). This complexity makes life difficult for everyone. Countries with duty-free access for all products still need to worry about rules of origin, and other countries face wide variation in the levels of tariffs on different products.

A serious approach to free trade implies reducing tariffs consistently for nearly all products and for all countries. Such an approach would reduce prices and increase the range of products available to consumers. The greatest increase in imports to the UK would be in low-value-added products, providing complementary inputs to higher-value-added activity reflecting the UK's comparative advantage. Estimates from the Centre for Economic Performance at the London School of Economics are that unilateral liberalisation would



boost UK gross domestic product (GDP) by 0.3 per cent (Dhingra et al. 2016; see also Table 2). UK government revenues from customs charges are so small (around £2.5 billion<sup>2</sup>) that any reduction in revenue could be compensated by the overall increase in GDP.

**Table 2: The effects of unilateral liberalisation and Brexit on UK living standards**

	<i>Optimistic</i>	<i>Pessimistic</i>
Brexit trade effects	-1.37%	-2.92%
Fiscal benefit	0.09%	0.31%
Unilateral liberalisation	0.30%	0.32%
<b>Total change in income per capita</b>	<b>-0.98%</b>	<b>-2.29%</b>

Source: Dhingra et al, 2016

Notes: This includes simulating the unilateral removal of all tariffs on imports into the UK.

Removing tariffs unilaterally in this way would reduce the UK's ability to negotiate reciprocal tariff reductions in export markets as part of trade deals. Still, the benefits of such agreements are small and uncertain, and putting effort into agreeing on mutual access to services trade may be more fruitful from a UK perspective. It may be that a very small number of tariff lines could be retained near-zero where there was a particularly high negotiating value to doing so.

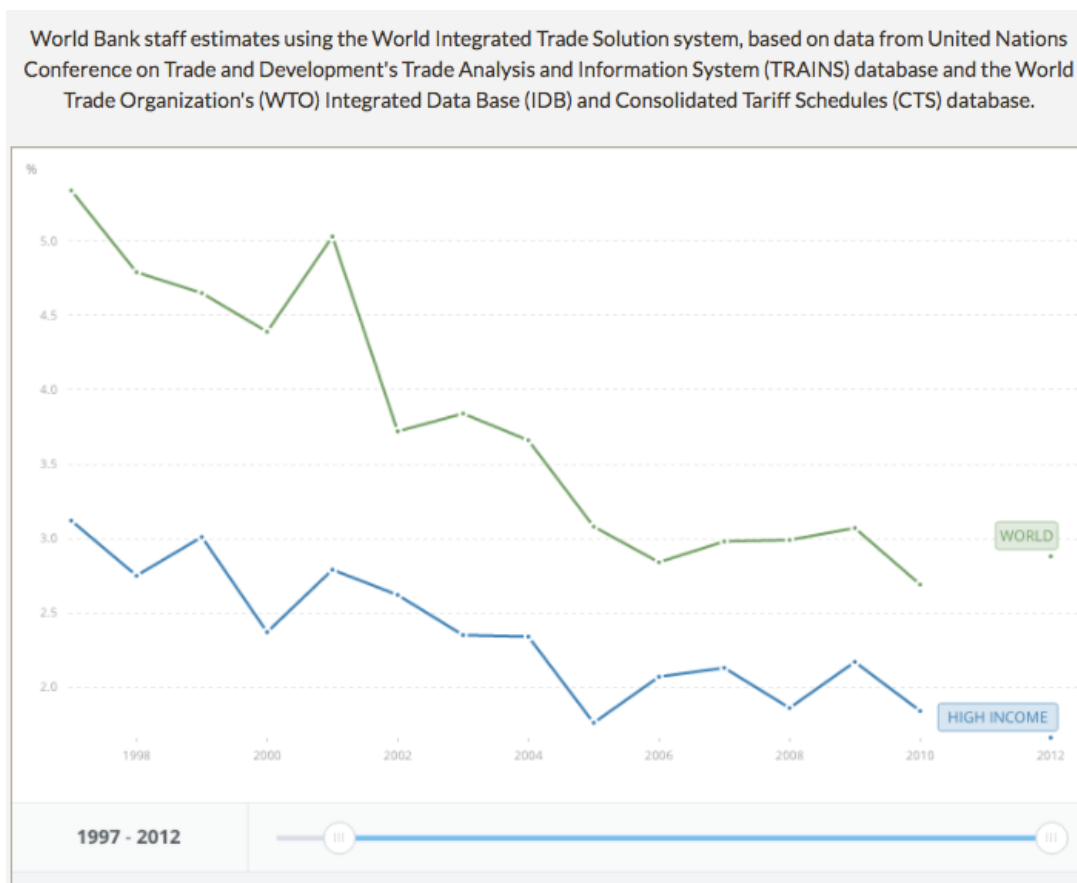
Of course there are always some who lose out from any change to international trade arrangements. But the best approach to dealing with those affected is to provide additional support to individuals to help them retrain and take advantage of some of the many other opportunities in the economy, rather than to protect uncompetitive industries at the cost of everyone else. Public policies to help those “left behind by globalisation” are relatively straightforward but have more to do with adapting to technology change and investing in new skills and mobility than with curbing open trade.

Because tariffs are already relatively low for most products (and falling, on average, for all countries), there is little negotiating capital to be had from maintaining tariffs—most modern trade agreements are in fact focused primarily on standards and other non-tariff barriers to trade. These more controversial, behind-the-border issues are the source of recent political criticisms of the Trans-Pacific Partnership and Transatlantic Trade and Investment Partnership proposals, mainly because they involve concessions of sovereign control. In contrast, reducing tariffs is straightforward and does not require changes to regulatory standards. In any case, haggling with poor countries for reciprocal reductions in tariffs simply reinforces the incorrect idea that reducing protectionist tariff barriers is a cost, when in fact it is a benefit.

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<sup>2</sup> See Financial Secretary to the Treasury (2015), Table C3.

**Figure 1: Tariff rate, applied, weighted mean, all products (per cent)**



The UK already aspires to negotiate free trade agreements with other large economies, some of them still developing (such as India's), that may have important effects on low-income countries through reduction of the value of existing preferences. This effect could be serious in countries for which the UK is a major export destination, but preserving preferences (which were always envisioned as temporary) is a poor rationale for not reducing other tariffs.

Any reduction in export revenues to the LDCs from tariff erosion should be monitored and could be compensated for with new, additional Aid for Trade programmes. Accurately predicting losers ex ante is difficult if not impossible. Estimates could be modelled, but there is no guarantee that producers and consumers would respond in a predictable manner to a range of shifting prices.

Reducing import tariffs to zero (or near-zero on a few items) for all countries would simplify the UK's trade arrangements substantially, enabling importers to provide choice and value to UK consumers and to enhance their productivity. It would also allow future trade negotiations to focus fully on facilitating the type of trade in services that is so important in UK production, and for which tariffs on goods are not relevant and thus a distraction.

*Third, devising better preferences for developing countries.*

Second best to truly achieving free trade by reducing tariffs for all countries is providing tariff-free access for developing countries only. The EU currently offers preferences to LDCs, providing a benefit of €385 million per year (Mendez-Parra, te Velde, and Winters 2016) in tariff payments avoided (and likely more in terms of knock-on benefits of trade).

**Table 3: Summary of key preferential access programmes for Least Developed Countries**

Summary of Key Preferential Access Programmes for LDCs							
Country/ Program	Product Coverage (%)	Excluded Products	Recipients	Average Tariff on Imports from LDCs, 2010 (%)	Agriculture Tariffs Duty Free (%)	Flexibility of rules of origin	Program length
Canada	99	Dairy, eggs, poultry	LDCs	0.3	93	High	10 Years
EU Everything but Arms	99	Arms	LDCs	0.9	97.9	High	Permanent
US (AGOA)	99	Sugar, dairy, confectionery, peanuts, tobacco, meat	African Countries	NA	84.5	High	11 Years
US (GSP for LDCs)	83	Sensitive agricultural products, textiles, apparel, footwear	LDCs	3.2	84.5	Moderate	1-2 Years
Japan	98	Rice, sugar, fish, leather products	LDCs	0.3	-	Low	10 Years
South Korea	90	Mostly agriculture, some manufacturing	LDCs	8.8	-	Low	Uncertain

Source: Elliott (2015), Trade Preferences for the Least Developed Countries: Opportunities Not Panaceas, & Laird (2012), A Review of Trade Preference Schemes for the World's Poorest Countries.

The EU and United States are among the best examples of such schemes. The EU Everything But Arms approach excludes the fewest products (only arms), has relatively flexible rules of origin for supply chain inputs, and is a permanent scheme with no time limit. Canada's preference scheme excludes a few more agricultural items (everything but chickens, eggs, and cheese) but has more flexible rules of origin that allow zero tariffs on products that have substantial imported inputs, so long as those inputs come from other beneficiary developing countries.

The US African Growth and Opportunity Act (AGOA) scheme also offers coverage for 99 per cent of products (with some important exceptions) and a relatively liberal rule of origin for apparel though a 35 per cent value-added requirement (which is nevertheless challenging to reach for the poorest countries in some sectors). AGOA is important due

to the size of the US market. The scheme also offers preferences to a different set of countries—providing opportunities for lower-middle-income countries in Africa, such as Kenya and Ghana, that are not LDCs, but at the expense of access for Asian LDCs. To do this, however, it has a WTO waiver.

The UK could improve upon the EU preference scheme by further relaxing the rules of origin that countries must follow to show that the products were actually produced in their country, and by extending the coverage to more countries. For example, Canada’s preference scheme has more liberal rules of origin than the EU’s, and the US scheme applies to all of sub-Saharan Africa, providing opportunity to the middle-income countries, such as Ghana and Kenya, that are most able to actually take advantage of preferences.

## **2.2 Improving Preferences for the Poorest Countries**

### *Liberalise rules of origin.*

A survey of manufacturing firms in 23 developing countries found that rules of origin were the single most important type of non-tariff barrier for exporters (ITC 2015). These rules require exporters to demonstrate that a product has undergone “substantial transformation” in the country of export. This transformation can be a minimum percentage of final value added produced in the exporting country, or a transformation sufficient to push the good into a different product category—for example, from raw cotton (product code 5201) to a shirt (product code 6105).

There is a balance to be struck between rules that are too relaxed and those that are too tight. When rules are too relaxed, goods may simply be “trans-shipped”—imported and re-exported with no meaningful value added at all in-country, just so that the goods benefit from preferential access. Though the United States has systems in place to prevent pure trans-shipment, Rotunno, Vézina, and Wang (2013) suggest that a surge in African textile exports to the United States may be partly attributable to the trans-shipment of Chinese goods.

When rules are too tight, it is too difficult for firms to take advantage of preferences at all. Increasingly, production of goods is separated across countries in global value chains. Exporters may not be able to source enough of the inputs domestically, particularly in the poorest countries.

Striking this balance is challenging in part because measuring the restrictiveness of rules of origin across preferential agreements is so difficult, particularly where rules vary by individual types of product (as they do with the EU scheme for LDCs). For example, it is difficult to compare the relative restrictiveness of rules based on changes in product classification (Conconi et al. 2016) with those based on the proportion of value added in-country.

Rules of origin should be as flexible as possible and promote development through allowing a low requirement on local content by the exporting country as well as a high level of “cumulation,” whereby exporters can count as “domestic” those inputs sourced from other countries that have the same preferential access. Box 2 sets out developing countries’ proposals for the reform of rules of origin.

## Box 2: The Nairobi Communiqué:

### Proposal for reform to rules of origin by the Group of Least Developed Countries

- 25 per cent value addition with no transportation costs included, or change in tariff classification at heading or subheading level
- Don't combine, but offer alternatives where possible
- Specific processes for processed agriculture, apparel, other manufactured goods
- Provide extended cumulation
- Simplify and streamline documentation requirements

These proposals provide a useful guide. The UK should undertake further research on the optimum model for rules of origin, and consult with LDCs and others on their detailed design (further detail can be found in Elliott 2015 and Estevadeordal and Suominen 2008).

*Determine which countries should receive trade preferences.*

There is a trade-off between providing valuable preferences to a small number of countries and providing less valuable preferences to a larger group of countries. Current EU preferences apply to the UN category of LDCs, which includes a mix of 48 low- and lower-middle-income countries, based on an index of their level of income, human development indicators, and “economic vulnerability.”

In practical terms, any extension of existing UK preferences beyond the current group of LDCs would need to be agreed upon at the WTO. This could be complex especially if a formal waiver is required. Although the United States succeeded at getting a waiver after it extended preferences to all sub-Saharan African countries (through AGOA), expert opinion varies on how difficult it would be for the UK to obtain a similar waiver for extending preferences. In any case, an extension needs to be based on a defensible set of objective criteria.

A first minimal proposal is to extend preferences to all LDCs (who currently receive duty-free access) plus the countries that currently receive duty-free access as part of EPAs. More expansive lists might include all World Bank International Development Association (IDA)-eligible countries (the 78 countries below US\$1,200 in gross national income, or GNI, per capita) or to all low-income and lower-middle-income countries (the 83 countries below US\$4,000 GNI per capita). Traidcraft (2017) have suggested, and are exploring, an objective measure for trade preferences like the UN's Economic Vulnerability Indicators, which measure countries structural vulnerability to exogenous economic and environmental shocks.

What might be the effects of expanding access to a larger group of countries? In 2010, the EU extended duty-free access to Pakistan (one of the largest lower-middle-income countries) as a flood relief measure. Researchers found that this move substantially boosted exports from Pakistan (by more than US\$800 million, or 0.36 per cent of Pakistan's GDP) and had no effect on the exports of other LDCs (Cheong, Kwak, and Yuan 2016). Similar findings have been arrived at using a computable general equilibrium model to explore different scenarios (Bouët et al. 2012).

**Table 4: Possible developing-country groupings for preference schemes**

	Number of Countries	GNI per Capita (Current US\$, Atlas Method)	Total Population (2015, Million)	Total GDP (Current US\$ 2015, Billion)	% World GDP
Least Developed Countries (LDCs) (UN Classification)	48	964	954	911	1.2%
Low-Income (World Bank Classification)	31	620	638	393	0.5%
Lower-Middle-Income (World Bank Classification)	53	2,035	2,927	5,820	7.9%
IDA-eligible (World Bank Classification)	78	1,379	1,641	2,221	3.0%

Notes: Low-income and lower-middle-income are mutually exclusive categories. The other categories (LDCs and IDA-eligible) both overlap with the low- and lower-middle-income categories.

Least Developed Countries (LDCs) are defined by the UN based on an index including income, human development, and economic vulnerability.

Low-income countries are those with a gross national income (GNI) per capita of US\$1,025 or less.

Lower-middle-income countries are those with a GNI per capita of between US\$1,026 and US\$4,035.

IDA-eligible countries are those eligible for grants from the World Bank International Development Association (IDA), which must have a GNI per capita below an established threshold that is updated annually (US\$1,215 in fiscal year 2016).

## 2.3 Decreasing Red Tape

*Increase the de minimis level below which tariffs and value-added taxes are not charged.*

For very small consignments, countries typically set a level below which tariffs and value-added tax (VAT) are not payable. For tariffs, this level is €150 in the EU, which compares unfavourably with the levels in other OECD countries—for example, some US\$800 in both the United States and Australia (Global Express Association 2016). For VAT, the level in the EU is just €22. One study suggests that at this level the cost of collection exceeds the revenue generated, indicating that the level should be much higher for all imports (Hintsä et al. 2014).

Increasing this de minimis level would smooth the flow of trade through ports and be of particular benefit to smaller businesses within the UK (that use small amounts of inputs) or those beyond. However, regardless of what general level is set, the UK could also extend its higher de minimis levels preferentially to groups of developing countries.

There is a strong efficiency argument for the UK to raise its de minimis thresholds for both tariffs and VAT, but the most important argument lies in taking a stand for free trade, thereby making the UK the most attractive trade destination in Europe for dynamic small exporters from emerging economies.

*Relax non-tariff barriers and restrictions on services.*

There are many other important barriers to trade besides tariffs. Indeed, these barriers are widely recognised as being bigger impediments to trade (Dhingra et al. 2016) than tariff levels, which have decreased over the past four decades.

One element of these non-tariff barriers, particularly relevant for goods, is the checks at borders. The Commitment to Development Index ranks rich countries based on the World Bank's ease of doing business indicators, which measure the time and cost it takes to get a container through customs. Denmark ranks best—there is no cash cost for border or documentary compliance, and procedures take less than an hour. The Netherlands ranks best on the OECD's Services Trade Restrictiveness Index, a ranking of the opportunities for provision of services by non-nationals.

Regulations and standards are widely applied by the public or private sector and are often necessary to ensure product quality and safety. However, they can be a particular hurdle for exporters that face different standards in each destination market. After leaving the EU, the UK will have the freedom to set its own quality standards. Exporters in developing countries (as well as British exporters to the EU) will benefit if the new UK standards do not differ substantially from existing EU or international ones. The UK should avoid any schemes that lower standards for developing countries, which would serve only to create a second-class good. More generally, UK regulations such as the Modern Slavery Act will have an important bearing on ethical and sustainable sourcing in developing countries.

## **2.4 Assessing and Mitigating Trade Deal Impacts on Developing Countries**

As the UK embarks on forging new trade relationships with other countries in the developed (e.g., US) and emerging (e.g., India) world, it will need to consider the potentially substantial impact on the developing world.

The UK government already routinely undertakes “impact assessments” of major policies, and given the importance of trade to development, it should assess the impacts of trade deals on its developing-country partners (Crowther, May, and Grady 2016). As the UK lowers tariffs with major trade partners, some impacts will be unavoidable. However, the UK should ensure that it identifies these impacts and considers mitigating their effects through aid or more specific support for trade.

### **3. Aid to Boost Trade in Developing Countries**

While it is right that the UK government should focus first on policy that is entirely within its control (its own tariffs), policy choices within developing countries matter more for their export performance. Here, though, the capacity of the UK to act is more limited. The UK can (and already does) play a role in supporting developing countries through Aid for Trade, and this does not depend on its relationship with the EU.

It currently takes exports from sub-Saharan Africa over 100 hours to comply with outgoing border procedures (World Bank 2016), compared with just 12 hours for OECD countries. It also costs more than three times as much. UK Aid has supported the introduction of automated customs management systems and better port infrastructure in East Africa, making it faster and easier for goods to cross borders. UK-funded advisors are assisting national standards agencies in Africa to help them ensure that their exports meet modern health and safety standards for the UK and EU markets.

Aid has been successfully deployed to enhance trade capacity, for example through initiatives such as TradeMark East Africa, but there are also examples of less successful initiatives. It may come down to a choice between helping the poorest trade partners and helping those with the highest potential. Innovative policy approaches like cash on delivery, targeted at reducing the time or cost for trade, could help ensure results.

The total value of Aid for Trade has been over US\$250 billion since 2006, spent on a mix of improving policy and systems and improving physical infrastructure (OECD and WTO 2015). Quantitative evidence on the overall impact of Aid for Trade is mixed, with some early research finding positive impacts (Cali and te Velde 2011) but more recent evidence offering less positive overall findings (Cirera and Winters 2015). The good performance by TradeMark East Africa alongside the disappointing performance of Trade Market Southern Africa shows that replicating successful projects is not straightforward.

#### **3.1 A Proposal for Cash-on-Delivery Aid for Trade**

The UK can improve upon its existing Aid for Trade offer by making increased use of results-based programmes. “Cash-on-delivery” aid (paying for outcomes, not inputs) is most appropriate where local contextual knowledge matters, where the best combination of inputs is uncertain and local experimentation is needed, and where precise design features and implementation fidelity are most critical (see, for example, the discussion by Savedoff [2016] on energy policy). All of these criteria also apply to Aid for Trade.

A typical Aid for Trade programme might carry out an extended diagnostic project to identify the constraints to change, and then design and contract a project to address these constraints. The payments would typically be made for activities (for example, technical assistance for improving a certain process) that, according to a theory of change, should lead to the desired outcomes. But contracting for activities and inputs doesn’t allow for sufficient experimentation and change.



A better approach is to contract for outcomes (i.e., to offer cash on delivery) and allow those with the required information the flexibility to determine the best way of achieving those outcomes.

Common concerns around cash on delivery focus on exactly what outcomes are contracted for, how they are measured, and whether there is any risk of distortion of priorities according to what is measurable or gaming of indicators. Indicators should be quantifiable, ideally continuous (to allow for variable payment in proportion to the degree of progress), and independently verifiable. Another common concern is how governments might fund any up-front investment costs. Here, then, the proposal is not that cash on delivery should replace all aid, but simply that it replace a portion of aid in a piloted manner. Further, if the outcomes are focused on “soft” rather than “hard” infrastructure, these up-front costs should be limited.

With trade, contracts could be based on the World Bank’s ‘Doing Business’ indicators. We have reasonable econometric evidence (Hoekman and Nicita 2011) that these indicators of the cost of importing and exporting (in both time and money) are associated with greater volumes of imports and exports.

An alternative but similar set of possible indicators that could be used as outcomes for contracted payments are the OECD Trade Facilitation Indicators, which probe border procedures in more detail. Moisé and Sorescu (2013) estimate that streamlining the costs represented by these indicators could reduce trade costs by 15 per cent for low- and lower-middle-income countries.

Rather than trying to tell a specific country how best to reduce that time and cost, we could instead just write a contract to pay a specified amount for each hour the country reduces the time it takes goods to clear the border and exporters and/or importers to comply with documentary requirements.

The potential gains to developing countries are high. The estimated gain to a low-income country from reducing its cost of exporting to that of a middle-income country is 2 per cent higher exports (Hoekman and Nicita 2011). For a typical low-income country, such as Malawi, with total annual exports of around US\$1.5 billion, a 2 per cent increase would be worth US\$30 million a year. The expenses associated with reducing export times would almost certainly cost less than this amount.

In summary, the UK could take the lead in applying a more innovative and potentially much more effective approach to Aid for Trade by using cash on delivery. It could be used as a complement to the other proposals in this note and, as a relatively new approach, could be established relatively promptly as a pilot.

## 4. Conclusions and Further Research

### 4.1 The UK as a Global Leader on Trade for Development

This note has set out the steps necessary for the UK to achieve the world's leading trade-for-development policy. These are summarised in Table 5.

**Table 5: Four steps for the UK to be the global leader in trade for development**

Area	Current Best Approach	How the UK Can Do Better	Issue and Challenges
<b>Best Possible Access for Developing Countries to the UK Market</b>			
1) Eliminating or Substantially Lowering Tariffs	Australia & New Zealand	Reduce all tariffs to zero or a low common rate, particularly for agriculture and textiles  Substantially reduce subsidies to agriculture	Opposition likely from currently protected UK producers, and some loss of tariff income
2) Improving Preferential Access for the Poorest Countries	EU & US	Commit to maintaining preferences currently offered by the EU Extend coverage to wider group of countries Improve rules of origin: - Lower value-added threshold - Generous cumulation	The UK would need to gain approval at the WTO for its preferential regime  Need for modelling and consultation on best approach
3) Cutting Red Tape at the UK border	Denmark & The Netherlands	The UK already does relatively well on customs procedures but could also do the following: - Raise thresholds on customs and tax - Use international product standards	Some minor loss of tax income
<b>Support for Policy Reform in Developing Countries</b>			
4) Enhancing Effectiveness of Aid for Trade	TradeMark East Africa	Context and details of project design are key, as the failure of Trade Market Southern Africa highlights. - Scope and pilot cash on delivery - Assess new UK trade deals for development impact to inform Aid for Trade targeting	Results-based Aid for Trade untested and will need to overcome objections similar to those of other domains

The UK has at least two years before most of these policies would need to take effect, and it should use this time to develop its approach, consulting with developing-country and WTO partners. A number of relevant questions should be researched.

## 4.2 Next Steps and Questions for Research

This work has highlighted several important areas for further research, from practical questions around policy design and impact to fundamental questions about how trade policy impacts the poor. We suggest several areas for further work:

**Cash on delivery and Aid for Trade effectiveness.** This note has illustrated some of the issues in achieving value for money in Aid for Trade, as well as some of the design questions around the level of incentives and potential benefits. The proposal for cash on delivery should be expanded into a full scoping proposal and appraisal of benefits. In addition, a review of the effectiveness of other Aid for Trade interventions should be undertaken, which would identify lessons and provide a benchmark for effectiveness.

**Systematic assessment of richer countries' trade policies.** As outlined in the introduction, only CGD, as part of its Commitment to Development Index, objectively and regularly assesses the impact of rich countries' trade policies on the poor. This work could be expanded to a wider range of higher-income countries. It could also identify, develop, and incorporate new measures of trade impediments, for example the impact of regulations and other non-tariff barriers.

**Measuring rules of origin.** It is challenging to quantify the degree of restrictiveness of rules of origin in preferential trade arrangements, particularly when these rules vary by product type and across different types of transformation required (value added or category change). Developments in this area would be helpful for judging the relative value of the preferential schemes offered by different developed countries. There may also be scope for innovative uses of new technology to better track and trace inputs and goods as they move through globally dispersed value chains.

**Agricultural policy and subsidies.** The UK has announced transitional arrangements for UK farmers, including their continuing to receive current EU levels of subsidy until at least 2019. The EU will also start the process of reforming its agriculture policies in 2017. The UK's and EU's direction on policy matters impacts the world's poor both directly and indirectly through the impact it has on policy direction in developing and emerging economies. *Can agricultural policy be made more friendly to development?*

**Modelling developing and emerging market trade to 2050.** A significant gap in assessing the UK's future trade relations is a model that looks forward at the size of developing- and emerging-country economies and the implications for their trade flows and partners. To understand potential export markets and suppliers, the latest developments in "gravity" modelling should be combined with forward-looking scenarios on economic development to consider where the UK and other developed economies should look for trade enhancement and partnership opportunities.

**Eliminating red tape.** A key constraint to firms from low-income countries exporting to the UK is complying with high EU standards. While the UK should not compromise on safety or on environmental and labour regulations, there may still be scope for sensibly rationalising some existing EU rules.

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