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Options for Trade, Finance and Development: Getting the Institutions Right

Policy Options Paper



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Options for Trade, Finance and Development: Getting the Institutions Right

Jean-Louis Arcand

on behalf of the E15 Expert Group on Trade, Finance and Development

January 2016

Note

The policy options paper is the result of a collective process involving all members of the E15 Expert Group on Trade, Finance and Development. It draws on the active engagement of these eminent experts in discussions over multiple meetings as well as think pieces commissioned by the E15 Initiative and authored by group members. Jean-Louis Arcand was the author of the report. While a serious attempt has been made on the part of the author to take the perspectives of all group members into account, it has not been possible to do justice to the variety of views. The policy recommendations should therefore not be considered to represent full consensus and remain the responsibility of the author. The list of group members and E15 papers are referenced below.

The full volume of policy options papers covering all topics examined by the E15 Initiative, jointly published by ICTSD and the World Economic Forum, is complemented with a monograph that consolidates the options into overarching recommendations for the international trade and investment system for the next decade.

The E15 Initiative is managed by Marie Chamay, E15 Senior Manager at ICTSD, in collaboration with Sean Doherty, Head, International Trade & Investment at the World Economic Forum. The E15 Editor is Fabrice Lehmann.

E15 Initiative

Jointly implemented by the International Centre for Trade and Sustainable Development (ICTSD) and the World Economic Forum, the E15 Initiative was established to convene world-class experts and institutions to generate a credible and comprehensive set of policy options for the evolution of the global trade and investment system to 2025. In collaboration with 16 knowledge partners, the E15 Initiative brought together more than 375 leading international experts in over 80 interactive dialogues grouped into 18 themes between 2012-2015. Over 130 overview papers and think pieces were commissioned and published in the process. In a fast-changing international environment in which the ability of the global trade and investment system to respond to new dynamics and emerging challenges is being tested, the E15 Initiative was designed to stimulate a fresh and strategic look at the opportunities to improve the system's effectiveness and advance sustainable development. The second phase of the E15 Initiative in 2016-17 will see direct engagement with policy-makers and other stakeholders to consider the implementation of E15 policy recommendations.

E15 Initiative Themes

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- Clean Energy Technologies
- Climate Change
- Competition Policy
- Digital Economy
- Extractive Industries*
- Finance and Development
- Fisheries and Oceans
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- Global Trade and Investment Architecture*
- Global Value Chains
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- Innovation
- Investment Policy
- Regional Trade Agreements
- Regulatory Coherence
- Services
- Subsidies

* Policy options to be released in late 2016

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Abstract

The basic tenet of the present policy paper is that economic institutions are the key determinant of economic growth and development, and that policy-makers and developing country governments dealing with trade and finance must concentrate on “getting the institutions right.” In order to be implementable, policy recommendations must correct inefficiencies that the market system will not, implying that correcting market (and institutional) failures constitutes the crux of the policy options. These fall under four headings, informed by the standard list of canonical market failures. First, the widespread existence of externalities and coordination failure imply that: (i) strategic use should be made of official development assistance and blended finance; (ii) domestic resources in developing countries should be better mobilized through stronger domestic tax institutions and a more transparent international tax system; (iii) guidelines should be adopted for broadly-used private standards that affect trade; and (iv) duty-free and quota-free preferences, alongside liberal rules of origin with extended cumulation provisions, should be extended to all least developed countries. Second, standard public goods arguments imply a pressing need for: (i) development-led legal and regulatory reform; (ii) the implementation of a

long overdue trade facilitation framework for services; (iii) the realignment of incentives that determine the sectoral allocation of Aid for Trade funds towards the services sector; (iv) ensuring the availability of correspondent banks in all low-income countries which are otherwise largely cut off from the trading system; and (v) contributing to the construction of a global coordination mechanism for trade and supply chain finance. Third, natural monopoly arguments at the regional level call for: (i) enhanced mechanisms for regional regulatory cooperation in general and financial services in particular; and (ii) enhanced regional aid for trade. Fourth, the existence of asymmetric information problems faced both by developing country governments and international investors suggest a pressing need to: (i) improve technical advice on international economic agreements (including public-private partnerships) available to developing country governments; and (ii) adopt model solvency schemes and debt restructuring approaches. The paper concludes with a recommendation on measuring progress on these policy options through the construction of an aggregate index of “institutional readiness.”

Contents

6	Executive Summary
8	1. Introduction
9	2. Conceptual Framework
10	3. Trade and Finance Policy Options: A Tale of Modern Market Failures
10	3.1 Externalities and Coordination Failure
12	3.2 Public Goods
15	3.3 Natural Monopolies at the Regional Level
16	3.4 Asymmetric Information
19	4. Next Steps and Measuring Progress
19	4.1 Prioritizing the Policy Options
19	4.2 Measuring Progress on the Policy Options
20	References and E15 Papers
21	Annex 1: Summary Table of Main Policy Options
25	Annex 2: Members of the E15 Expert Group

Abbreviations	
AfT	Aid for Trade
AGOA	African Growth and Opportunity Act
ASEAN	Association of Southeast Asian Nations
BEPS	base-erosion and profit-shifting
BIS	Bank for International Settlements
CDS	credit default swap
CIT	corporate income tax
DFQF	duty-free and quota-free
DTIS	Diagnostic Trade Integration Study
EIF	Enhanced Integrated Framework
FSB	Financial Stability Board
G20	Group of Twenty major economies
GATS	General Agreement on Trade in Services
IFC	International Finance Corporation
IMF	International Monetary Fund
ITC	International Trade Centre
KYC	Know Your Customer
LDC	least developed country
MDGs	Millennium Development Goals
MNE	multinational enterprise
MSME	micro, small and medium enterprise
ODA	official development assistance
OECD	Organisation for Economic Co-Operation and Development
PPP	public-private partnership
SDGs	Sustainable Development Goals
SME	small and medium-sized enterprise
SPS	sanitary and phytosanitary
TBT	technical barrier to trade
UN	United Nations
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNIDO	United Nations Industrial Development Organization
US	United States
WTO	World Trade Organization

Executive Summary

The primacy of economic institutions as determinants of economic growth and development is a key empirical regularity that has emerged from the past two decades of research. The mechanisms through which trade and finance affect development do not escape this pattern. Broad agreement was reached among the members of the E15 Expert Group on Trade, Finance and Development, convened by ICTSD and the World Economic Forum in partnership with the Center for International Development at Harvard University, that strengthening the enabling environment through concrete policy proposals in the trade and finance arena is one of the most important ways of advancing the 2030 Agenda for Sustainable Development and the attendant Sustainable Development Goals (SDGs). Members of the Group were also keenly aware of the fact that, to be politically palatable, its proposals would have to pass the “market failure test.” Namely, any meaningful policy proposal would have to be justified on the basis of the underlying problem not being adequately dealt with by the private market system.

The Expert Group has surmounted this challenge and the outcome takes the form of the thirteen recommendations laid out in what follows. The policy options are grouped under headings that correspond to the four canonical forms taken by market failures: externalities, public goods, natural monopolies and asymmetric information.

Policy Options

Externalities and coordination failure

Externalities arise when the private cost or benefit of an activity is not equal to its social cost or benefit. Four recommendations fall under this category.

First, there is a need to focus official development assistance (ODA) in a manner that increases its marginal productivity, often through a focus on building institutions that strengthen the enabling environment, as well as by using it to leverage private sources of capital through blended finance. There is also the potential for improving the productivity of domestic financial resources. In basic economic terms, the social benefit of ODA is significantly higher than its private benefit, and current arrangements fail to “internalize” this potentially valuable positive externality, including ODA’s role in helping to ensure a stable macroeconomic environment. Second, tax policy is a key determinant of the behaviour of firms, be they domestic or

multinational. In order to increase the capacity for domestic resource mobilization of poor countries, major efforts—both at the international and domestic level—need to be made in terms of revamping policies aimed at combatting “base-erosion and profit-shifting” (BEPS). Third, there is a manifest issue of coordination failure involved when it comes to international standards set by dominant private firms, and which cannot be solved in existing fora such as the World Trade Organization (WTO). The adoption of standards is a typical example of a situation where coordination, in order to achieve a socially efficient outcome, is paramount: in the absence of outside involvement, coordination failure is likely. The gains to adopting well-crafted standards can also be characterized as a situation where there are significant positive network externalities to be internalized. Fourth, there has also been a manifest lack of coordination (and political will) in terms of duty-free and quota-free preferences when it comes to the least developed countries (LDCs). The United States, first and foremost, and large emerging powers should therefore accord such access where they have not, and include extended cumulation provisions in their rules of origin to maximize preference utilization by LDCs.

Public goods

At the intra-country level, economic institutions—broadly understood to be legal, enabling and regulatory structures that facilitate wealth-enhancing exchange—are the key public good. Public goods and services possess two characteristics. First, they are non-exclusive: once they are provided, they are available to all irrespective of whether or not they were involved in their financing. Second, they are non-rival: the consumption of the good or service by a given agent does not reduce its consumption by others (if the good, service or institutional structure is rival, then we shift to the slightly different concept of a “common property resource”). As such, they are the best example of goods, services or institutional structures that will be underprovided by the market mechanism and where outside intervention is needed.

The Group formulated five policy options that fall under the public goods heading. All five proposals are typical examples of institutional public goods that would go a long way towards improving the enabling environment in low-income countries, allowing them to harness the development potential of international trade.

First, legal and regulatory reform has to be more development-led: without a well-functioning legal and regulatory framework, economic activity will not develop, but these structures have to be better adapted to developing country circumstances. While this is not a policy recommendation *per se*, it should be kept in mind when designing concrete legal and regulatory policy options. Second, given the pro-poor bias of the services sector, a trade facilitation framework for services is urgently required. Third, and related to the second recommendation, the incentives that determine the sectoral allocation of Aid for Trade funds, which currently tend to ignore the services sector, need to be modified. Fourth, heightened regulatory requirements have led to many low-income countries being functionally cut off from international financial markets by the simple lack of a correspondent (international) bank. Solving this problem in the short run, which is both feasible and relatively low cost, would make a significant contribution to facilitating international trade for firms located in low-income countries. Fifth, the E15 Initiative should contribute to efforts aimed at coordinating trade and supply chain finance.

Natural monopolies at the regional level

Natural monopolies occur when it is socially efficient, from the cost standpoint, to have a single supplier for a given good or service. Of course, the productive efficiency argument immediately begs the question of how to regulate the ensuing monopolistic structure.

For the two policy options that fall under this heading, the Group has used the natural monopoly framework in a slightly less restrictive form. The main point is that there are a number of key institutional failures that are more efficiently dealt with at the regional, rather than national, level because of the importance of underlying economies of scale and scope. The two proposals involve strengthening regional mechanisms dealing with the regulatory aspects of cross-border financial services, foreign direct investment regimes, competition policy and standards, and enhancing, through the appropriate incentives, regional aid for trade initiatives.

Asymmetric information

Asymmetric information arises when, in a bilateral relationship, one party knows something that the other does not. In the market failure framework, this can be interpreted as there being a missing market for the underlying information, which can lead to severe inefficiencies.

The two policy options proposed by the Group under the asymmetric information heading involve: first, strengthening the capacity of developing country government to negotiate and implement public-private partnerships as well as long-term contracts in crucial areas such as extractive industries; and, second, providing low-income countries with access to world class advice as well as in-country capacity building geared towards improving their position when it comes to designing and negotiating sovereign bond issuances and debt restructuring. In both of these fields, low-income countries are currently at a serious informational disadvantage vis-à-vis their international interlocutors.

Next Steps

The policy options put forward by the Expert Group range from ambitious long-term recommendations to options that should technically (if not politically) be easy to implement in the short term. In all cases, work on these options should start immediately. The policy options are broken down into three categories over an indicative time horizon, depending on their ease of implementation (including financing constraints). The paper concludes with a recommendation on measuring progress through the construction of an aggregate index of “institutional readiness.”

1. Introduction

During the past twenty years, our understanding of the determinants of economic growth and development has been profoundly shaped by a vast corpus of cross-country empirical literature. Though it is something of an oversimplification, this literature has given rise to two broadly defined schools of thought concerning the key constraints to economic development and growth, with trade and finance playing a pivotal role.

On the one hand, the “geography” school, often associated with the name of Jeffrey Sachs, holds that a country’s development performance is to a large extent determined by its geographical location.¹ For example, it is argued that a country’s level of GDP per capita is, *ceteris paribus*, an increasing function of its distance to the equator; similarly, landlocked countries are believed to have both a lower level and a lower growth rate of GDP per capita. There are many causal pathways that can explain geographically driven income and growth effects, including the higher burden of disease under subtropical climates, or the infrastructure needed to overcome geographic isolation from world markets for landlocked countries. In a traditional growth accounting framework, both of these examples underscore the fact that geographical fetters to development affect total factor productivity, the overall efficiency with which factors of production such as labour and capital (both human and physical) are transformed into output, the productivity of single factors of production (such as labour), and total factor use.

On the other hand, the “institutional” school of thought, often associated with the work of Daron Acemoglu and his collaborators, has emphasized the importance of a country’s institutional environment, where institutions are understood in their economic (and not political) sense in terms of social structures, such as the rule of law or the protection of property rights, that allow economic activity to develop and flourish.² As with geography, institutional factors can affect the productivity of single factors, total factor productivity and factor use. One of the most important empirical regularities established by the institutional school is that there is a causal relationship linking national economic institutions

(often measured by an index of protection against expropriation risk) to income per capita. Moreover, a second important empirical regularity is that geography affects per capita income *through* its impact on institutions: once economic institutions are appropriately taken into account, geography arguably no longer has an independent impact on income levels.

Where do trade and finance fit into this picture? In order to organize our thoughts, let us divide the impact of trade and finance on economic growth (leaving development *per se* out of the picture for the time being) into two components. First, there are *direct* effects: trade and finance, through well-established mechanisms, may enhance growth performance. Though the causal evidence at the macro level is often weak (the finance and growth or aid effectiveness literatures are cases in point), there is a corpus of microeconomic evidence that points to productivity enhancing causal effects of trade and finance.

Second, there are *indirect* effects, which operate either through geography or through economic institutions. “Geographic” effects of trade and finance include trading arrangements (such as preferences and regional groupings that help achieve economies of scale), which effectively compensate for geographical disadvantages, or financing options, such as development aid or private-public partnerships devoted to infrastructure projects, which overturn geographic constraints, such as being landlocked.

It became apparent, both during two formal meetings and through numerous exchanges, that all members of the Expert Group on Trade, Finance and Development subscribe, in some form or another, to the institutional school of thought, while acknowledging that geographic factors, and the heterogeneity that they generate among countries, need to be taken into account. All of the policy options that emerged from the Group therefore aim at improving economic institutions—both national and supranational—in some shape or form.

¹ See Sachs et al. (1997).

² See Acemoglu et al. (2001).

2. Conceptual Framework

Why are institutions a key determinant of income per capita or growth performance? And how can we cogently structure our understanding of institutions, thereby formulating policy options that have some coherent underlying justification and, more importantly, some chance of implementation?

One of the leading explanations for poverty in the world today is that it is partly a product of departures from Pareto-optimality. When markets, firms and households are subject to market, institutional and informational imperfections, Pareto-inferior equilibria obtain, leading to deviations with respect to the first-best optimum. In layman's terms, this means that we could do more with what we already have, but do not. In contrast to the celebrated Schultzian notion of "poor, but efficient" this manner of seeing the world, which to a large extent stems from the seminal work of economists such as Joseph Stiglitz during the 1970s and 1980s, holds that inefficiencies lie at the heart of underdevelopment. If one takes this view as the point of departure, the big questions for the realm of trade, finance and development are the following: what are the main sources of deviations with respect to the first-best optimum, and what can be done to tackle these deviations in concrete policy terms?

This perspective permeates the policy options formulated by the Expert Group. Indeed, all of the options put forward by the group lie squarely within at least one of the canonical types of market, institutional or informational failure. Economics 101 teaches us that there are four types of market failure:

1. *Externalities*, particularly network externalities, including international standards and other problems of coordination failure;
2. *Public goods and common property resources*, which includes the regulatory and enabling environments, as well as other sundry institutions;
3. *Natural monopolies*, in which problems are more efficiently solved at the regional rather than at the national level;
4. *Asymmetric information*, which can be on the side of the country (lack of capacity) or on the side of the firm (unreliable information available to foreign investors).

An extremely important side benefit of the market failure framework is that *all of the policy options that are proposed in what follows correspond to problems that will not be solved by the market mechanism*. Moreover, *prima facie*, the policy proposals are not based on dubious empirical evidence or abstruse theoretical arguments. Rather, and this is a testimony to the remarkable diligence with which group members approached the task at hand, all policy proposals are based on first-hand observation by group members of facts and constraints encountered on the ground.

The Expert Group policy options are outlined in the following section using the market failure conceptual framework. Four options fall under the externalities and coordination failure heading, five under public goods, two under natural monopolies at the regional level, and two under asymmetric information. The paper then concludes by charting an indicative timeframe for consideration and implementation of the options and a proposal on measuring progress.

3. Trade and Finance Policy Options: A Tale of Modern Market Failures

3.1. Externalities and Coordination Failure

Externalities arise when the private cost or benefit of an activity is not equal to its social cost or benefit. Four recommendations fall under this category. First, there is a need to focus official development assistance (ODA) in a manner that increases its marginal productivity, often through a focus on building institutions that strengthen the enabling environment, as well as by using it to leverage private sources of capital through blended finance. There is also the potential for improving the productivity of domestic financial resources. In basic economic terms, the social benefit of ODA is significantly higher than its private benefit, and current arrangements fail to “internalize” this potentially valuable positive externality, including ODA’s role in helping to ensure a stable macroeconomic environment. Second, tax policy is a key determinant of the behaviour of firms, be they domestic or multinational. In order to increase the capacity for domestic resource mobilization of poor countries, major efforts—both at the international and domestic level—need to be made in terms of revamping policies aimed at combatting “base-erosion and profit-shifting” (BEPS). Third, there is a manifest issue of coordination failure involved when it comes to international standards set by dominant private firms, and which cannot be solved in existing fora such as the World Trade Organization (WTO). The adoption of standards is a typical example of a situation where coordination, in order to achieve a socially efficient outcome, is paramount: in the absence of outside involvement, coordination failure is likely. The gains to adopting well-crafted standards can also be characterized as a situation where there are significant positive network externalities to be internalized. Fourth, there has also been a manifest lack of coordination (and political will) in terms of duty-free and quota-free (DFQF) preferences when it comes to least developed countries (LDCs). The United States, first and foremost, and large emerging powers should therefore grant such access where they have not, and include extended cumulation provisions in their rules of origin to maximize preference utilization by LDCs.

3.1.1. Policy Option 1: The strategic use of official development assistance and blended finance

Analysis of trends in financial flows to LDCs reveals that ODA has played a relatively marginal role, in comparison to domestic public and private finance, in underwriting the Millennium Development Goals (MDGs).³ A review of recent debates and discussions concerning the financing of the Sustainable Development Goals (SDGs) suggests that such trends are not expected to change in any substantive way in the near future. However, ODA enjoys a number of unique developmental advantages over other forms of financial flows with concessionality (if not outright grant) being one of the most important. Thus, strategic use of this scarce resource will be one of the main challenges for LDCs as they position themselves to implement the SDGs in their domestic context. What are the policy options for LDCs in this regard?

It is maintained that the LDCs, alongside their international development partners, need to develop a strategic vision regarding efficient and effective use of ODA in the coming years.⁴ The four key building blocks of this new vision are the following:

- Enhanced flows and better quality of ODA for more targeted and results-oriented projects geared towards promoting specific elements of the enabling environment, such as social and economic infrastructure, as well as productivity-enhancing public institutions and productive sectors;
- Greater use of blended finance to scale up investment by leveraging other sources of finance (including private finance), by enhancing project impact (by keeping broader public welfare concerns well in view) and by ensuring financial returns (for private investors and others) by reducing the average cost of capital, funding viability gaps and providing guarantees against various kinds of risks prevalent in low income economies;

³ In this policy option, the Expert Group is referring explicitly to least developed countries and not to developing countries as a whole.

⁴ The think piece authored by Debapriya Bhattacharya (2015) provides the underpinnings for the first three recommendations.

- Creating a more business-friendly policy environment by strengthening national capacities for accelerated domestic reforms, particularly in the financial sector, public expenditure systems, and in the area of the rule of law, thereby ensuring greater financial mobilization and a more efficient use of these resources.
- Emphasize the role that ODA can play in dampening a country's exposure to shocks, by ensuring that at least part of the allocation of conventional ODA depends on structural economic vulnerability; make sure that conventional ODA is not merged with additional resources geared towards LDC adaptation to climate change, based on physical vulnerability indices.⁵

3.1.2. Policy Option 2: Mobilize domestic resources in developing countries through stronger domestic tax institutions and a more transparent international tax system

Developing countries are chronically short of the funds needed to support their development, as the recent United Nations (UN) Financing for Development conference in Addis Ababa highlighted. Increasing the tax raised in developing countries would help plug this financing gap. Half of Sub-Saharan African countries still mobilize less than 15% of their GDP in tax revenues, below the minimum level of 20% considered by the UN as necessary for development. Several Asian and Latin American countries fare little better.

Corporate tax revenue from multinational enterprises (MNEs) is an important source of government revenue in many developing countries, particularly the poorest. As a share of all revenue, corporate income tax (CIT) is actually more important in low and upper middle-income countries than in advanced countries. In Burundi, for example, one company contributes towards nearly 20% of total tax collection. Developing countries lose precious revenue as the result of cross-border tax planning by MNEs. Tackling “base-erosion and profit-shifting” by MNEs could substantially increase tax collection by developing country governments. A recent International Monetary Fund (IMF) paper estimated that developing countries lose US\$213 billion a year, close to 2% of their GDP, from BEPS.

A particular challenge for developing countries arises from “transfer mispricing.” A major portion of global trade takes place within firms, and tax authorities need to be able to discover the transactions that have taken place, assess whether the correct amount of tax has been paid, and collect any tax due. It can be difficult for a tax administration to know about offshore transactions, so a high level of international cooperation between tax authorities is required.

In recent years, substantial international efforts have been made to address BEPS. In 2014, the G20 leaders recognized that “developing countries should be able to reap the benefits of a more transparent international tax system, and to enhance their revenue capacity.”⁶ The OECD is leading a substantial and unprecedented effort to address major avoidance opportunities that arise under current international tax arrangements. However, developing countries are not central in this process and the OECD has recognized that existing initiatives do not sufficiently include

developing countries or respond to their needs.

Notable progress under the OECD initiative include: (1) a new international “Common Standard” for automatic exchange of information between tax authorities (modelled on the US Foreign Account Tax Compliance Act); and (2) the introduction of country-by-country reporting requirements that will require MNEs to provide specific aggregate information annually to tax authorities in each jurisdiction where they do business, including on the global allocation of income and taxes paid.

For developing countries, more support is needed in two areas. First, to strengthen domestic institutions and legal arrangements in developing countries so that they can implement new international standards and, second, to strengthen the international tax system so it facilitates the work of developing country tax authorities. Concrete steps that could be taken include:

- Increase capacity building efforts on BEPS in developing countries, including by developing toolkits and providing guidance to support the practical implementation of the OECD BEPS measures and other related priority issues (international assistance can be a powerful catalyst for domestic resource mobilization: for example, with modest international support, revenue collection from transfer pricing audits in Kenya has doubled from US\$52 million in 2012 to US\$107 million in 2014);
- Increase the automatic exchange of information between tax authorities, prioritizing the transfer of information to developing country tax authorities;
- Increase the reporting by MNEs to tax authorities, for example by creating a public tracking system that enables ready assessment of progress against international BEPS targets;
- Strengthen the involvement of developing countries in international BEPS initiatives, including those led by the OECD.

Key players for implementation of the above steps include developing country governments, the international business community, the OECD and the IMF, bilateral and multilateral donors, and the UN Tax Committee.

3.1.3. Policy Option 3: Guidelines for broadly-used private standards affecting trade

The road to diversification, value addition, and industrialization in a modern economy involves linking up effectively with global supply chains. In some of these, a single firm that dominates the chain sets the technical standards (the iPhone example springs to mind). In others, important purchasing firms act together and establish industry-wide standards (e.g. EurepGAP or GlobalGAP where the “GAP” stands for Good Agricultural Practices, required by big supermarket chains). While little can be done regarding technical standards required of inputs for a firm's specific product, the second type of industry-wide private standards affects a large number of suppliers. These standards may be conflicting or even contradictory. For many firms, especially small and medium-sized enterprises (SMEs) in developing countries, these standards can be difficult to follow and comply with. Moreover, the justification

⁵ The think piece written by Patrick Guillaumont (2015) delves into the nuts and bolts of these indicators, as well as their application to ODA, in much greater detail.

⁶ OECD. 2014. Secretary General Report to G20 Leaders. Brisbane, Australia

for their existence may not always be sound. For many developing country exporters, private standards are more significant constraints than official sanitary and phytosanitary (SPS) standards and technical barriers to trade (TBT). Fair trade and organic standards, for example, which sometimes provide export opportunities and value added, would be more effective if they were harmonized.

While these difficulties with privately determined standards are akin to those associated with the SPS and TBT Agreements of the WTO, important differences exist. The latter are subject to WTO disciplines and can be challenged, albeit not always effectively. Private standards, on the other hand, even when they affect the whole industry, are self-regulated by the big firms. They are impossible to challenge legally. Assistance to comply with SPS and TBT standards is also a recognized element of Aid for Trade (AfT). However, assistance to understand and comply with private standards does not figure prominently in official aid programmes. This is left to the goodwill of the dominant firms in the supply chain. A related aspect is the nature of contractual agreements between small suppliers and large purchasers.

For private industry-wide standards not to be a constraint but rather a conduit for effective participation in global supply chains, particularly for SMEs, existing limitations can be tackled through:

- Scrutiny and oversight, as well as information dissemination and guidelines concerning private standards, particularly industry-wide ones, that affect large numbers of suppliers; these activities could be undertaken by public bodies (national and international), private sector representatives from developed and developing countries, and civil society; they could be for specific sectors (e.g. food/supermarkets, textiles) and could involve examining whether they are compatible with the requirements of the WTO SPS and TBT Agreements and other international agreements, although it is not clear in the context of voluntary standards whether these constraints could be binding;
- The application of public pressure and the provision of guidelines on harmonizing multiple, rival or conflicting standards employed by large firms or industry-wide standards, including fair trade and organic standards;
- The development of model contracts for selected sectors (e.g. agriculture, mining, forestry, textiles) and the identification of possible “honest brokers” to assist in the formulation of contracts in which developing country firms enter with large established firms;
- The inclusion of compliance with private standards in AfT programmes.

The key players involved include international development organizations (e.g. UNCTAD, UNDP, ITC, UNIDO), the WTO, bilateral and multilateral donors, the World Bank and the IFC, the private sector, civil society and private foundations.

3.1.4. Policy Option 4: Expand duty-free and quota-free market access with simple and liberal rules of origin as well as extended cumulation

The US provides trade preferences for about 98% of products from eligible African exporters and around 90% for Haiti, but only slightly over 80% for Asian LDCs. Moreover, the preferences available to Asian LDCs exclude apparel, footwear, and other labour-intensive products, thereby providing very few benefits in practice.⁷ US policy-makers should consider eliminating (or radically limiting) exclusions from DFQF market access for relatively competitive exporters, such as Bangladesh and Cambodia. Detailed analysis of US trade data suggests that excluding just a few dozen tariff lines (at the 10-digit level) would shield most African Growth and Opportunity Act (AGOA) and Haitian clothing exports, while eliminating barriers to half or more of Bangladesh’s and Cambodia’s exports. Expanding US preferences to Asian LDCs would also open new opportunities for Afghanistan, Nepal, and other very poor countries. However, even when product coverage is universal (or nearly so), LDCs often confront problems in utilizing preferences because of restrictive rules of origin. Allowing LDCs to incorporate inputs from as broad a “cumulation zone” as possible (e.g. all beneficiaries of a country’s preference programmes plus bilateral trade agreements) would help overcome this obstacle. Three concrete steps proposed by the Expert Group are the following:

- The US and large emerging markets should implement DFQF market access for all LDCs;
- All preference givers should also include extended cumulation provisions in their rules of origin to maximize preference utilization;
- The complexity of product-specific rules of origin should be reduced (the EU has over 500 different rules covering eligibility in addition to economy-wide rules) and, for LDCs, there should be no rules of origin for preferential margins below a threshold of 5% for example.

3.2. Public Goods

At the intra-country level, economic institutions—broadly understood to be legal, enabling and regulatory structures that facilitate wealth-enhancing exchange—are the key public good. Public goods and services possess two characteristics. First, they are non-exclusive: once they are provided, they are available to all irrespective of whether or not they were involved in their financing. Second, they are non-rival: the consumption of the good or service by a given agent does not reduce its consumption by others (if the good, service or institutional structure is rival, then we shift to the slightly different concept of a “common property resource”). As such, they are the best example of goods, services or institutional structures that will be underprovided by the market mechanism and where outside intervention is needed.

⁷ The think piece authored by Kimberly Elliott (2015) provides the underlying details.

The group formulated five policy options that fall under the public goods heading. First, legal and regulatory reform has to be more development-led. Without a well-functioning legal and regulatory framework, economic activity will not develop, but these structures have to be better adapted to developing country circumstances. Second, given the pro-poor bias of the services sector, a trade facilitation framework for services is urgently required. Third, and related to the previous point, the incentives that determine the sectoral allocation of Aid for Trade funds, which currently tend to ignore the services sector, need to be modified. Fourth, heightened regulatory requirements have led many low-income countries to become functionally cut off from international financial markets by the simple lack of a correspondent (international) bank. Solving this problem in the short run, which is both feasible and relatively low cost, would make a significant contribution to facilitating international trade for firms located in low-income countries. Fifth, a comprehensive global coordination mechanism for trade and supply chain finance is needed. All five proposals are typical examples of institutional public goods that would go a long way towards improving the enabling environment in low-income countries, allowing them to harness the development potential of international trade.

3.2.1. Policy Option 5: Development-led legal and regulatory reform

Within institutions such as the WTO, current approaches to trade and development have focused primarily on access to developed country markets through trade preference programmes and special and differential treatment for developing economies—both of which are important but not sufficient to achieve economic diversification and poverty reduction. As a critical element, AfT can help countries and their stakeholders advance legal and regulatory reform, but the initiative alone cannot fully build effective national and regional regulatory institutions and legal processes. What is missing is a process (both top-down and bottom-up) for effectively assessing the development benefits of trade policy at the national and regional levels, addressing non-tariff measures from a development perspective, and applying a more widespread, inclusive, and coordinated system for implementing trade frameworks through legal and regulatory reform.

Trade policy often (though not always) establishes a sound framework for legal and regulatory change in areas such as trade facilitation, SPS measures, TBT, and services, all of which have significant implications for economic development and diversification. Yet there is no clear path for implementing these frameworks in practice, and the impacts of reform in these areas remains largely a “public good” which does not always receive sufficient focus. Many countries face challenges as they seek to adopt and implement an expanding range of legal and regulatory disciplines. In many places, the legal and regulatory process itself is weak, with many companies lacking knowledge of

how the system works or a trusted channel for participating in legal and regulatory reform. Addressing these gaps will help implement both WTO frameworks and regional trade agreements in a development-led manner and increase the effectiveness of these trade mechanisms.⁸

In order to shift the focus to development-led legal and regulatory reform, and address existing gaps such as weak regulatory and legal processes and the lack of knowledge by local firms of these processes, the following steps are recommended:

- Create market-driven platforms to identify where development-led regulatory interventions are needed (across both geographical areas and issues);
- Design tools for assessing and developing untapped market potential;
- Share regulatory best practices, including at the regional level;
- Connect the private sector to domestic, regional and international trade institutions.

The actors involved in this long-term process include legal institutions (academic, non-profit, and private sector), regional economic communities, national ministries and institutions (trade, sector-focused, and legal), multilateral development banks, bilateral and multilateral donors, UN economic commissions and agencies, the WTO, as well as the private sector.

3.2.2. Policy Option 6: Trade facilitation framework for services

In support of the United Nation’s adoption of the post-2015 development agenda in September 2015 (the 2030 Agenda for Sustainable Development), and in light of the fundamental contribution which efficiency in the services sector will make to the realization of the SDGs, the Expert Group calls on WTO members to urgently embark on a joint process to establish a Framework for Trade Facilitation in Services.

The impact of the services sector on the process of economic development is relatively neglected, despite the evident and tremendous contribution of the services sector to national and global GDP, employment, and value-added measures of international trade. There was a time when the dominant assumption in the development literature, reflected in policy and practice, was that services were low productivity, low value-added and largely non-tradable. These assumptions are not consistent with the conceptual framework on the modes of delivery established in the WTO’s General Agreement on Trade in Services (GATS). Nor are they borne out by the recent empirical work on the role of services in innovation, multifactor productivity, and trade in value-added. The important WTO work in reaching the Trade Facilitation Agreement has focussed on reducing the costs of trade in goods. Attention now needs to turn

⁸ The detailed arguments underlying the following policy recommendations are spelled out in the think piece written by Katrin Kuhlmann (2015).

towards reducing the costs of trade in services. WTO members need to develop a comprehensive Framework for Trade Facilitation in Services, with attendant measurable indicators as in the Trade Facilitation Agreement.⁹

The steady rise of services in all national economies (often referred to as “servicification”) along with the improved ability to measure the extent of the services sector’s contribution to global trade has highlighted how important international competitiveness in services has become for competitiveness in all sectors.¹⁰ Of the various factors that hamper competitiveness in services, and hence hold back export performance in other sectors, regulatory inefficiencies stand out as a key area within governmental power to redress. This requires greater focus on regulatory benchmarking and regulatory cooperation. While this may constitute wishful thinking in terms of implementation, a greater and more concerted government effort is needed to facilitate trade in services by creating a business environment that fosters innovation, investment and growth, allowing economies to move up the value-added chain. Governments should urgently act to address the costs of doing international business in services in order to harness the potential of services to “leapfrog” obstacles to sustainable development.

WTO members should agree to embark on a joint process to establish a Framework for Trade Facilitation in Services. This Framework should encompass both cooperative and negotiating mechanisms, complemented by capacity building and technical assistance, through which the multilateral trading system can spur concerted action on the need, *inter alia*, for:

- Intensified temporary and short stay visa facilitation;
- Enhanced access to finance for trade in services;
- Common guidelines for governance of electronic trade and cross-border data flows;
- Benchmarking of best practices and development of regulatory principles to address cross-border market failures in services sectors.

The Framework should include mechanisms for public-private dialogue with services stakeholders. It should also allow for and encourage implementation of measures on a regional, plurilateral and multilateral basis. Actors involved include the WTO, bilateral and multilateral donors, and the private sector.

3.2.3. Policy Option 7: Aid for trade funding for services

Considering the contribution of services trade to the GDP of low-income countries, and the fact that barriers to trade in services are concentrated primarily in policy and regulation, there is a need to fund country studies to address policy and regulatory failures and to develop well-tailored policy and regulatory changes to reverse those failures. Aft funds and ODA in general should be applied to this problem. For LDCs, funds from the Enhanced Integrated Framework (EIF) could be effective in addressing policy and regulatory changes required at the country level. With tourism (measured as travel services and passenger transport) accounting for 30% of global trade in services, tourism stands out as a relatively neglected sector in Aft mechanisms.¹¹

Currently, insufficient attention is given to services trade in Aft, especially via multilateral mechanisms, including the EIF. This constitutes a misallocation of funding given the significant development dividends available from services sector growth. World Bank evidence shows that a stronger correlation exists between services growth and GDP than manufacturing growth and GDP, and that services sector growth tends to be pro-poor. The potential for the services sector to contribute to employment growth is even more striking. While aggregate developing country employment data are difficult to obtain, World Bank research shows that the higher the level of employment in the services sector, the higher the female participation rate. A strong correlation also exists between services growth and poverty reduction, chiefly because the services sector generally employs more women; 49 per cent of global female employment is in services. Cutting trade costs for services and increasing Aft in services, including by helping LDCs build supply side competitiveness, should be a high priority.

Boosting growth in the services sector is largely about getting the regulatory setting right, so that public policy objectives can be met without unduly increasing the costs of doing business. Although it is not always fully recognized, there is in general a higher level of government intervention in the services industries than in any other sector. This is partly due to their “invisibility” and to the simultaneity of production and consumption, requiring governments, for public policy reasons, to regulate and set standards for the services suppliers themselves. Regulatory regimes in services are often complex, overlapping and duplicative, and consequently excessively burdensome for business; “one stop” regulatory shops are still no more than an aspiration in many parts of the world. Country studies are required, including mechanisms geared towards helping governments apply the guidance set out in recent World Bank regulatory toolkits designed to boost services competitiveness.

⁹ The Trade Facilitation Agreement has yet to enter into force, as it requires two-thirds majority domestic ratification of the WTO membership.

¹⁰ The policy options paper produced by the E15 Expert Group on Services can be referred to for detailed analysis and recommendations regarding services in international trade.

¹¹ The think piece authored by Frans Lammersen (2015) provides an overview of the salient issues involved in Aid for Trade as well as ways forward.

Concrete steps proposed by the Expert Group include the following:

- WTO members should emphasize the need to utilize AfT funds towards country-specific studies in order to identify and address policy and regulatory failures;
- Dedicated sessions in WTO fora should focus on this topic;
- EIF diagnostic studies for LDC members should concentrate on services policy and regulatory studies.

Parties involved include the WTO, OECD, UNCTAD, ITC, the World Bank, bilateral and multilateral donors, as well as the private sector.

3.2.4. Policy Option 8: Ensure correspondent-banking availability

Banks have sharply cut down on their correspondent-banking networks as the costs of regulatory checks such as Know Your Customer (KYC) activities have far outpaced the growth of business potential. Further issues, centred on Anti-Money Laundering, actions have reinforced this trend. Though hard data concerning this issue is scarce, it is believed in the banking community that the sharpest cuts were made in low-income countries, to the point that some of these countries are on the verge of being excluded from international financial networks. The consequence of this financial exclusion is particularly serious when it comes to the exchange of goods and services since, without the ability to exchange information or funds, local companies struggle to enter into the contractual obligations that underpin international trade. The economic development of many low-income countries is therefore severely compromised.

The Group's proposal is that each country should house at least one local bank with a fully-fledged correspondent-banking arrangement with international financial institutions. The key steps involved in bringing this proposal to fruition are:

- Sponsoring/mentoring by the Bank for International Settlements (BIS), the Financial Stability Board (FSB) or the Wolfsberg Group¹² of the process leading to the improvement of the local correspondent bank(s)'s governance structure;
- Have the KYC process validated by the sponsor so that it will be deemed to be sufficient for international regulatory purposes;
- Secure an international ruling to ensure that developed country banks are compelled to maintain a minimum service correspondent-banking network for each enabled country and chosen bank(s).

The Chairman of the FSB and the Chief Financial Officer of the World Bank Group have recently endorsed a similar proposal.

3.2.5. Policy Option 9: Contribution to Coordinating Efforts for Trade and Supply Chain Finance

It is recommended that a working group be established (within the E15 initiative or another international coalition of experts and institutions) to propose ideas and commission studies that could contribute to improved global coordination efforts in the area of trade and supply chain finance, with the objective of:¹³

- Ensuring appropriate management and dissemination of data, analysis and knowledge;
- Assuring effective advocacy with core stakeholders including regulatory authorities;
- Enabling the development and implementation of effective policy at the national, regional and supranational levels to encourage and facilitate the effective participation of developing countries in global supply chains (there is no policy on trade finance at supranational level, although there may be some intergovernmental arrangements).

3.3. Natural Monopolies at the Regional Level

Natural monopolies occur when it is socially efficient, from the cost standpoint, to have a single supplier for a given good or service. Of course, the productive efficiency argument immediately begs the question of how to regulate the ensuing monopolistic structure. For the two policy options that follow, the natural monopoly framework is used in a slightly less restrictive form. The main point is that there are a number of key institutional failures that are more efficiently dealt with at the regional, rather than national, level because of the importance of underlying economies of scale and scope. The proposals involve strengthening regional mechanisms dealing with the regulatory aspects of cross-border financial services, and enhancing, through appropriate incentives, regional aid for trade initiatives.

3.3.1. Policy Option 10: Mechanisms for regional regulatory cooperation in financial services

The integration of financial services has received insufficient attention in regional integration efforts. Slow progress in the area of financial integration has made it difficult for banks and other financial entities to operate regionally and support their customers so that they can enjoy the benefits of diversified, more efficient and cheaper financial services. It is important to ensure that the full extent of benefits arising from the economies of scale accrue to those in need of finance, such as micro, small and medium enterprises (MSMEs). Access to finance has been highlighted as the single most important constraint for MSMEs to face the competition of an integrated regional market and connect with the global economy. Key issues to be addressed

¹² The Wolfsberg Group is an association of thirteen global banks which aims to develop frameworks and guidance for the management of financial crime risks, particularly with respect to Know Your Customer, Anti-Money Laundering and Counter Terrorist Financing policies

¹³ Alexander Malaket (2015) has provided a think piece that delves into these issues in greater detail.

include the heterogeneity of regulatory frameworks and restrictive market access, significant checks on the mobility of talent, and constraints on cross-border data flow and offshoring regulatory structures. Three concrete steps to be implemented in various regional fora, with regional development banks as key players in the process, include:

- The creation of regional mechanisms such as regional credit bureaus and rating agencies;
- The facilitation of free data flow and offshoring;
- The standardization of documents and documentation requirements.

3.3.2. Policy Option 11: Enhance regional aid for trade

Given the many small markets in developing countries, it is clear that sustained economic growth needs to rely in part on creating larger, more viable markets through the rule-based sharing of resources and production assets. Deepening economic integration via regional cooperation has thus emerged as a key priority in the reform strategies of most developing economies. Regional aid for trade is contributing to this process with commitments that almost tripled from US\$1.2 billion during the 2002–05 baseline to US\$3.1 billion in 2013, although its share is still only 5.5% of total aid for trade.

Regional aid for trade is hampered by many practical complications (including the “tradition” that Diagnostic Trade Integration Studies (DTISs) have always been carried out at the national level), from technical standards to financing issues, while negotiations can be bogged down by poor intergovernmental communications and sometimes a lack of trust among negotiating parties. In fact, regional aid for trade is still insufficiently understood and appreciated in national line ministries and among stakeholders. Moreover, implementing regional strategies is complicated by: membership of overlapping regional organizations; non-implementation of regional agreements; poor articulation within national strategies; and, national and regional capacity constraints. This creates significant problems in terms of ownership, mainstreaming, and aligning national strategies around regional aid for trade priorities. For regional aid for trade programmes to be effective, gaps can be tackled through:

- Involving an “honest broker” (such as regional development banks), or multi-donor programmes (such as Trademark East Africa), or regional initiatives (such as USAID African Trade Hubs), which all offer institutional mechanisms to coordinate regional and sub-regional programmes;
- Having the EIF request that agencies carrying out DTISs move to a regional focus;
- Creating financial incentives such as providing a higher concessionality level for financing regional programmes rather than purely national programmes;
- Building institutional and human capacities to respond

to a wide variety of technical assistance needs covering a range of disciplines, including trade policy, customs, transport, and enterprise development.

The key players involved include regional economic communities, regional development banks, the OECD, UN economic commissions and agencies, the WTO, bilateral and multilateral donors, and the private sector.

3.4. Asymmetric Information

Asymmetric information arises when, in a bilateral relationship, one party knows something that the other does not. In the market failure framework, this can be interpreted as there being a missing market for the underlying information, which can lead to severe inefficiencies. The two policy options proposed by the Group under the asymmetric information heading involve: first, strengthening the capacity of developing country governments to negotiate and implement public-private partnerships (PPPs); and, second, providing low-income countries with access to world class advice as well as in-country capacity building geared towards improving their position when it comes to designing and negotiating sovereign bond issuances and restructuring. In both of these fields, low-income countries are currently at a serious informational disadvantage vis-à-vis their international interlocutors.¹⁴

3.4.1. Policy Option 12: Improve technical advice on international economic agreements, including public-private partnerships and sovereign debt contracts

Population growth together with anticipated robust economic growth in low-income countries is increasing demand for electric power, roads, ports, and other physical infrastructure. Financing this infrastructure will require enormous amounts of capital in the coming decades, and only part of this can come from domestic savings or aid. A large volume of foreign savings is potentially available in the pension funds and other financial entities of rich countries. In an effort to tap this source of capital, developing country governments are increasingly turning to PPPs in a bid to attract foreign investment and address this gap. PPPs are now used in more than 134 developing countries, contributing on average towards 15–20% of total infrastructure investment, often involving foreign investors.

The PPP trend looks set to continue, driven in part by the international aid community. As the aid budgets of OECD countries have come under pressure, international donors are turning to the private sector as a strategic partner. PPPs figure prominently in the recently agreed Sustainable Development Goals. World Bank Group support for PPPs, for instance, has increased threefold over the past decade to US\$2.9 billion and now represents 7% of the Group’s lending, investment and guarantees.

Developing country governments face two types of problems in realizing the benefits that can accrue from

¹⁴ The two policy recommendations in this section are presented and substantiated in much greater detail in the think piece authored by Emily Jones (2015).

PPPs. First, despite the potential for high social rates of return, relatively small amounts of private foreign capital are flowing into infrastructure in developing countries. The obstacles are manifold and include: investments that are large and lumpy; construction risks that are unusually high; returns that are reliant on regulatory agencies and the creditworthiness of national governments; returns to capital that are often back-loaded for projects that already have long gestation periods; and, individual infrastructure projects that require complex legal arrangements often involving multiple parties and government agencies.

Second, even when foreign investment does arrive, many PPPs fail in practice to deliver high public benefits. High-quality PPPs are complex to design, negotiate and manage. Developing country governments face very substantial resource and informational challenges. Project developers have greater access to cost and technology information, and information asymmetries put developing country governments at a disadvantage. Many developing countries have insufficient institutional capacity to conduct solid prefeasibility studies or to structure PPP contracts effectively. Moreover, the public sector liabilities triggered by PPPs can be very sizeable (an aspect of PPPs that is often underappreciated yet is very important in the context of rising developing country external debt profiles). Even for World Bank supported PPPs, which are accompanied by substantial institutional backing and expertise, only 62% of projects between 2002 and 2012 rated as satisfactory or better. There is much to learn from these and other successful experiences with PPPs.

Many governments are addressing these concerns and have recently adopted new legislation that provides a general regulatory framework for private investment in infrastructure. Multilateral agencies have made available guarantees to make risks more acceptable. However, beyond this, very little support is available to developing country governments to ensure that PPPs are effectively designed, negotiated, implemented, and evaluated. Relatively few developing countries have developed a framework for competitive bidding for specific projects that would provide for efficient, low-cost investment. This is true not only for infrastructure but also for sectors such as extractive industries.

The Expert Group therefore proposes to strengthen the institutional capacity of developing country governments to design, negotiate, implement and evaluate PPP projects in all sectors, with a particular focus on infrastructure, through the following steps:

- Expand, including through financial support, the access of developing country governments to world-class, independent, impartial and preferably low-cost legal advisory resources to support the design and negotiation of large specific PPP contracts and other complex commercial transactions, building on initiatives such as the African Legal Support Facility housed at the African Development Bank;

- Develop an internationally recognized model PPP framework to guide PPP projects, with a high level of participation by developing country governments; the United Nations Commission on International Trade Law (UNCITRAL) has model frameworks which are being updated: this initiative could be built upon, and the participation of developing country governments greatly strengthened;
- Provide technical resources to support the development of a clear general legal framework; prepare bankable projects that would allow for competitive bidding in a transparent manner; set up rules governing transparency so there can be accountability to oversight organs of government and the general public concerning the use and terms of public resources in PPPs.

Actors involved include developing country governments, UN economic commissions and agencies, multilateral and regional development banks, bilateral donor agencies, and major private sector infrastructure investors.

3.4.2. Policy Option 13: Adopt model solvency schemes and restructuring approaches

A striking new trend in international finance is that the governments of many low-income countries are issuing sovereign bonds to finance public debt, often for the first time. Since 2006, 15 countries in sub-Saharan Africa (nearly all low- and low and middle-income countries) have made their debut international bond issues, raising US\$17 billion. Developing country governments are entering uncharted territory as they turn towards international financial markets, which offer credit on harder terms than “traditional” donors and which present new political and economic risks and opportunities. While such bonds can provide funding for large projects, create domestic financing space for the private sector, and can be less costly than local issuance, they also come with refinancing risk, re-pricing risk, and exposure to exchange rate fluctuations. In some countries there has been a deterioration in sovereign balance sheets amid expansionary fiscal stances that have led, in some cases, to the rebuilding of debt stocks. Given that several African borrowers have already undergone restructuring, there are mounting concerns about debt sustainability.

As global yields normalize, there is the very real risk of sovereign debt difficulties in developing countries. Yet there is a dearth of suitable mechanisms for dealing with defaults and restructurings in an orderly, timely and fair manner. In practice, restructurings have been conducted under various frameworks without a consistent approach that normalizes local laws and provides clarity for investors. Issuing governments have found themselves vulnerable to competing interests that carry inherent conflicts of interest. Dependence on the market has led to restructuring outcomes that are counterproductive for the policy initiatives of the sovereign issuer.

As was seen with Argentina, and as developing countries including Zambia have experienced, holdout investors bring further uncertainty to final outcomes, prolonging the restructuring process and further aggravating issuer going-concern risks. Negotiations therefore often commence with competing interests that are not aligned within the framework of long-term sustainability. Derivatives markets, such as that for credit default swaps (CDS), are, for some issuers, distorting the alignment of interest further. The precise legal provisions in bond contracts can make a very substantial difference for developing country governments, and the contracts that underpin many issuances are weak.

To tackle these gaps, certain concrete steps can be taken to harmonize the restructuring process, such as adopting English Law or the UNCITRAL Model Law on Cross-Border Insolvency, which would provide a binding mechanism, eliminating holdouts and bringing international recognition to local courts, thereby eliminating judicial/sovereign risks, and in turn providing a framework for efficient negotiations. In 2014, a group representing the world's largest banks, investors and debt issuers (the International Capital Markets Association) created a new framework for bonds that they hoped would address problems faced during the Argentine debt crisis and Greece's 2012 debt restructuring when holdout investors resisted deals and demanded full payment.

Although many governments quickly adopted the new language, this model legal language has yet to be widely used by developing country governments. In sub-Saharan Africa for instance, with the exception of partial inclusion of these terms in recent issues by Ghana and Ethiopia, no external bonds include the full spirit or letter of the model language. This leaves governments vulnerable to blocking minorities of creditors in the event of an attempted restructuring. Possible reasons that explain why developing country governments may have failed to incorporate this new language include a lack of awareness or fears that investors will be put off buying debt that limits their bargaining power in the event of a default, leading to their reluctance to change their bonds and adopt the new framework.

Developing country governments should be supported to strengthen the legal underpinnings of the bonds they issue. The steps proposed by the Expert Group include:

- Expanding, including through financial support, the access of developing country governments to world-class, independent, and preferably low-cost expert legal advisory services to support the design and negotiation of sovereign bond issuances and sovereign bond restructuring;

- Strengthening the in-house legal resources of central banks and finance ministries in developing countries, as well as local lawyers, through training so as to ensure high quality expertise and advice is available to developing country issuers.

Key players include bilateral development agencies, private philanthropy, UNICTRAL, sovereign and other issuers, local courts, and international courts.

4. Next Steps and Measuring Progress

4.1. Prioritizing the Policy Options

The policy options put forward by the Expert Group range from ambitious recommendations, in that they will most probably only be feasible in the long term, to options that should technically (if not politically) be easy to implement in the short term. In all cases, however, work on these options should, if possible, start immediately. The policy options can arguably be broken down into three categories over an indicative time horizon, depending on their ease of implementation (including financing constraints).

4.1.1. Short-term Options

Three policy options deserve immediate attention in that they can deliver benefits rapidly. First, ensuring correspondent-banking availability depends on mobilizing the international banking community. Similarly, the two capacity-building recommendations (improving technical advice on international economic agreements, including PPPs and sovereign debt contracts, and adopting model solvency schemes and restructuring approaches) are relatively short-term ventures, although they do involve coordinating a broad range of players at the international and domestic levels.

4.1.2. Medium-term options

The two services-centred policy options (implementing a trade facilitation framework for services and encouraging AfT funding for services) should be actively pushed in international fora for medium-term implementation. In addition, expanding DFQF and simple and liberal rules of origin (with extended cumulation) to all LDCs depends on nudging the major preference givers. At the regional level, where there may in some instances be a greater convergence of interests, enhancing regional aid for trade and improving mechanisms for regional regulatory cooperation in financial services have a good chance of being adopted—perhaps by having successful regional groupings, such as ASEAN, mentor less successful ones. Providing guidelines for broadly used private standards affecting trade could be taken up by international organizations such as the International Organization for Standardization.

4.1.3. Long-term options

Recommendations that involve the revamping of part of the international trade and finance architecture are long-term in nature and require the buy-in of a plethora of players. This is the case for the proposals on making strategic use of ODA and blended finance, and constructing a global coordination mechanism for trade and supply chain finance.

Of course, given their ambition, the payoffs from these proposals, particularly in terms of achieving the SDGs, could be enormous. Finally, two recommendations formulated by the group (fostering development-led legal and regulatory reform, and mobilizing domestic resources in developing countries through stronger domestic tax institutions and a more transparent international tax system) are also long-term and (largely) need to be implemented at the national level. National economic institutions are notoriously difficult to modify, given the power of existing vested interests. Perhaps a limited number of “test case countries” could be identified in which the political will for such reforms is likely to exist.

4.2. Measuring Progress on the Policy Options

A central element of the empirical literature on the impact of institutions on income per capita and growth is the use of protection against expropriation risk as the main indicator for economic institutions. The work of the Expert Group on Trade, Finance and Development suggests that alternative indicators of what the Group would prefer to term the “enabling environment” could be constructed—above and beyond what is already used by various institutions such as the World Bank. Based on the weaknesses in country-specific trade and finance characteristics identified by group members through their proposed policy options, the constituent elements (some of which, such as visa policy, depend on the response of developed countries) of this new index could be the following:

- A Herfindahl index of concentration in the banking sector;
- The existence of a functioning antitrust authority;
- An indicator of fluidity of visa policy, including the ease of obtaining a short-term visa;
- The number of correspondent foreign banks;
- The existence of a national or regional credit bureau and/or a rating agency;
- The legal system under which sovereign bond issuance takes place.

This list of indicators could be complemented with data from the World Bank’s *Doing Business* survey, and standard composite indicator methods could then be applied to arrive at an aggregate index of “institutional readiness.” While the proposed index may be relatively weak on the “trade” side, it is focused on the finance and development nexus. This is work in progress and it is proposed that a working group be set up (by ICTSD and/or the Forum or another interested institution) to operationalize the construction of this index.

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The papers commissioned for the E15 Expert Group on Trade, Finance and Development can be accessed at <http://e15initiative.org/publications/>.

Annex 1: Summary Table of Main Policy Options

Policy Option	Timescale	Concrete Steps	Key Players
Market Failure: Externalities and Coordination Failure			
1. Make strategic use of overseas development assistance and blended finance.	Long Term	<ul style="list-style-type: none"> – Enhanced flows and better quality of official development assistance (ODA) for more targeted and results-oriented development geared towards promoting specific elements of the enabling environment, such as social and economic infrastructure, as well as productivity-enhancing public institutions; – Greater use of blended finance to scale up investment by leveraging other sources of finance (including private finance), by enhancing project impact (by keeping broader public welfare concerns well in view) and by ensuring financial returns (for private investors and others) by reducing the average cost of capital, funding viability gaps and providing guarantees against various kinds of risks prevalent in low income economies; – Creating a more business-friendly policy environment by strengthening national capacities for accelerated domestic reforms, particularly in the financial sector, public expenditure systems, and in the area of the rule of law, thereby ensuring greater financial mobilization and a more efficient use of these resources; – Emphasize the role that ODA can play in dampening a country's exposure to shocks, by ensuring that at least part of the allocation of conventional ODA depends on structural economic vulnerability indices. 	Developing country governments, and bilateral and multilateral donors.
2. Mobilize domestic resources in developing countries through stronger domestic tax institutions and a more transparent international tax system.	Long Term	<ul style="list-style-type: none"> – Increase capacity building efforts on base-erosion and profit-shifting (BEPS) in developing countries, including by developing toolkits and providing guidance to support the practical implementation of the OECD BEPS measures and other related priority issues (international assistance can be a powerful catalyst for domestic resource mobilization); – Increase the automatic exchange of information between tax authorities, prioritizing the transfer of information to developing country tax authorities; – Increase the reporting by Multinational Enterprises (MNEs) to tax authorities, for example by creating a public tracking system that enables ready assessment of progress against international BEPS targets; – Strengthening the involvement of developing countries in international BEPS initiatives, including those led by the OECD. 	Developing country governments, the international business community, the OECD and the IMF, bilateral and multilateral donors, and the UN Tax Committee.

Policy Option	Timescale	Concrete Steps	Key Players
3. Provide guidelines for broadly used private standards affecting trade.	Medium Term	<ul style="list-style-type: none"> – Scrutiny and oversight as well as information dissemination concerning private standards, particularly industry-wide ones, that affect large numbers of suppliers; these activities should be undertaken by public bodies (national and international), private sector representatives from developed and developing countries, and civil society; guidelines could be formulated for specific sectors (e.g. food, textiles) and could involve examining whether they are compatible with the WTO Sanitary and Phytosanitary (SPS) and Technical Barriers to Trade (TBT) Agreements and other international agreements; – Apply public pressure and providing guidelines on harmonizing multiple, rival or conflicting standards employed by large firms or industry-wide standards, including fair trade and organic standards; – Develop model contracts for selected sectors (e.g. agriculture, mining, forestry, textiles) and identifying possible “honest brokers” to assist in the formulation of contracts in which developing country firms enter with large established firms; – Include compliance with private standards in Aid for Trade (AfT) programmes. 	International development organizations (e.g. UNCTAD, UNDP, ITC, UNIDO), the WTO, bilateral and multilateral donors, the World Bank and the IFC, the private sector, civil society, and private foundations.
4. Expand DFQF access to LDCs with liberal rules of origin and extended cumulation.	Medium Term	<ul style="list-style-type: none"> – Urge the US and large emerging markets to implement duty-free and quota-free (DFQF) market access for all LDCs; – Urge the EU to simplify product eligibility requirements; – Urge all preference givers to also include extended cumulation provisions in their rules of origin to maximize preference utilization. 	The United States, European Union and large emerging markets.
Market Failure: Public Goods			
5. Foster development-led legal and regulatory reform.	Long Term	<ul style="list-style-type: none"> – Create market-driven, neutral platforms to identify where development-led regulatory interventions are needed (across both geographical areas and issues); – Design tools for assessing and developing untapped market potential; – Share regulatory best practices, including at the regional level; – Connect the private sector to trade institutions. 	Legal institutions, regional economic communities, national ministries, multilateral development banks, bilateral and multilateral donors, UN economic commissions and agencies, WTO, and the private sector.
6. Implement a trade facilitation framework for services.	Medium Term	<ul style="list-style-type: none"> – Intensify temporary and short stay visa facilitation; – Enhance access to finance for trade in services; – Develop common guidelines for governance of electronic trade and cross-border data flows; – Benchmark best practices and developing regulatory principles to address cross-border market failures in services sectors. 	The WTO, bilateral and multilateral donors, and the private sector.

Policy Option	Timescale	Concrete Steps	Key Players
7. Encourage Aid for Trade funding for services.	Medium Term	<ul style="list-style-type: none"> – WTO members should emphasize the need to utilize Aft funds towards country-specific studies in order to identify and address policy and regulatory failures; – Organize dedicated sessions in WTO fora that focus on this topic; – Encourage Enhanced Integrated Framework (EIF) diagnostic studies for LDC members to concentrate on services policy and regulatory studies. 	The WTO, OECD, UNCTAD, ITC, the World Bank, bilateral and multilateral donors, and the private sector.
8. Ensure correspondent-banking availability.	Short Term	<ul style="list-style-type: none"> – Sponsoring/mentoring by the Bank for International Settlements (BIS), the Financial Stability Board (FSB) or the Wolfsberg Group of the process leading to the improvement of the local correspondent bank(s)'s governance structure; – Have the Know Your Customer (KYC) process validated by the sponsor so that it will be deemed to be sufficient for international regulatory purposes; – Secure an international ruling to ensure that developed countries banks are compelled to maintain a minimum service correspondent-banking network for each enabled country and chosen bank(s). 	The BIS, FSB, Wolfsberg Group, the World Bank, bilateral and multilateral donors, and the banking sector.
9. Coordinate efforts for trade and supply chain finance.	Long Term	<ul style="list-style-type: none"> – Ensure appropriate management and dissemination of data, analysis and knowledge; – Assure effective advocacy with core stakeholders including regulatory authorities; – Enable the development and implementation of effective policy at the national, regional and supranational levels. 	Working group composed of international experts hosted by an interested institution.
Market Failure: Natural Monopolies at the Regional Level			
10. Improve mechanisms for regional regulatory cooperation in financial services.	Medium Term	<ul style="list-style-type: none"> – Creation of regional mechanisms such as regional credit bureaus and rating agencies; – Facilitation of free data flow and offshoring; – Standardization of documents and documentation requirements. 	Regional development banks, parties to regional economic communities and trade agreements, the banking sector.
11. Enhance regional aid for trade.	Medium Term	<ul style="list-style-type: none"> – Involve an “honest broker” (such as regional development banks), or multi-donor programmes (such as Trademark East Africa), or regional initiatives (such as USAID African Trade Hubs), which all offer institutional mechanisms to coordinate regional and sub-regional programmes; – Have the EIF request that agencies carrying out Diagnostic Trade Integration Studies move to a regional focus; – Create financial incentives, such as providing a higher concessionality level for financing regional programmes rather than purely national programmes; – Build institutional and human capacities to respond to a wide variety of technical assistance needs covering a range of disciplines, including trade policy, customs, transport, and enterprise development. 	Regional economic communities, regional development banks, the OECD, UN economic commissions and agencies, the WTO, bilateral and multilateral donors, and the private sector.

Policy Option	Timescale	Concrete Steps	Key Players
Market Failure: Asymmetric Information			
12. Improve technical advice on public-private partnerships.	Short Term	<ul style="list-style-type: none"> – Expand the access of developing country governments to world-class, independent, and preferably low-cost legal advisory resources to support the design and negotiation of large specific PPP contracts and other complex commercial transactions, building on initiatives such as the African Legal Support Facility housed at the African Development Bank; – Develop an internationally recognized model private-public partnership (PPP) framework to guide PPP projects, with a high level of participation by developing country governments; the United Nations Commission on International Trade Law (UNCITRAL) has model frameworks which are being updated: this initiative could be built upon and the participation of developing country governments greatly strengthened; – Provide technical resources to support the development of a clear general legal framework; prepare bankable projects that would allow for competitive bidding in a transparent manner; set up rules governing transparency so there can be some accountability to oversight organs of government and the general public concerning the use and terms of public resources in public-private partnerships. 	Developing country governments, UN economic commissions and agencies, multilateral and regional development banks, bilateral donor agencies, and major private sector infrastructure investors.
13. Adopt model solvency schemes and restructuring approaches.	Short Term	<ul style="list-style-type: none"> – Expand the access of developing country governments to world-class, independent, and preferably low-cost expert legal advisory services to support the design and negotiation of sovereign bond issuances and sovereign bond restructuring; – Strengthen the in-house legal resources of central banks and finance ministries in developing countries, as well as local lawyers, through training so as to ensure high quality expertise and advice is available to developing country issuers. 	Bilateral development agencies, private philanthropy, UNICTRAL, sovereign and other issuers, local courts, and international courts.

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