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An 'Early Harvest' not so 'early' after all

Least Developed Countries (LDCs) have liberalized trade unilaterally, bilaterally and regionally. Unilateral trade liberalization generally took place as part of the structural adjustment programmes in the 1980s. In the 1990s, regionalism was the main vehicle of trade liberalization, contributing to widespread uniformity in tariff rates in many LDCs. Both measures of trade 'restrictiveness' or 'trade openness' would deem LDCs 'open'. According to the Sachs-Warner index of openness, all LDCs would be considered 'open'. The average index of 'openness' for LDCs as a group is exactly the same as the average for the EU, Japan and the US. According to UNCTAD statistics, the share of exports and imports of goods and services in LDC's GDP is about 62%, yet they account for only 1% of global trade in goods and services.

The recent food, energy and financial global crises had a severe impact on LDCs, pushing an additional 9.5 million people in LDC's into extreme poverty. Climate change is also projected to lead to a risk of hunger for several millions of people by 2020, a significant proportion of whom will be from LDCs. LDCs could not adopt and implement appropriate stimulus measures to combat the crises, primarily due to a lack of adequate fiscal space and access to domestic and external resources. For many countries the crises have jeopardized years of progress in combating poverty and improving the foundations for economic growth. LDC's export revenue fell between 24-32% as a consequence of the crises. Part of this fall is attributable to fluctuating commodity prices, however, non-commodity exports from LDCs have fallen from 8% in 2000 to 4% in 2009.

Growing development needs as well as the global crises require a 'trade' stimulus for the LDCs, particularly in their non-commodity trade. They need a substantial increase in their export revenue to maintain their current level of development and to build resilience against any future crises. As the crises are likely to affect aid flows, the LDCs need trade and investment for poverty alleviation.

To provide such a 'trade' stimulus, the early conclusion of the Doha Round of WTO negotiations would be of interest to all countries. To build trust among LDCs, an 'early harvest' in specific areas (Dar-e-Salaam Declaration of trade ministers from LDCs in 2009) could be agreed at LDC IV. While there are several components to an 'early harvest' proposal of LDCs, demand for duty-free quota-free (DFQF) market access would support the achievement of MDG 8. The accelerated implementation of DFQF would be important in strengthening the Global Partnership for Development between 2010 and 2015. Other critical elements of an 'early harvest' include (i) a waiver to accelerate services exports from LDCs (ii) the easing of the accession requirements for LDCs to join the World Trade Organization (WTO) and (iii) an immediate resolution to the problem of trade-distorting cotton subsidies. This policy brief will focus on two urgent challenges to the development of LDCs, namely DFQF and a solution to the problem of cotton exports.

I. DFQF Scheme

The 2005 Hong Kong Ministerial Declaration committed developed countries to providing DFQF for all LDC products no later than the start of the Doha Round implementation period. LDCs called upon developed countries to grant DFQF to at least 97% of their exports by 2010, and to broaden the coverage to all products at the start of the Doha Round implementation period. Developed countries were also required to inform LDCs of the specific tariff lines that would be eligible, and to establish a product-by-product timeline for granting DFQF to the remaining 3% of lines.

The problem

LDC exports are highly concentrated and restricted to a few tariff lines, hence exclusions from DFQF should not include these products. Some estimates suggest that 25 HS six digit tariff lines cover 85% of LDC exports.

By value about 66% of LDCs global exports comprise fuel. The second most important items are textiles and apparel, roughly 15% of exports, with agriculture and mineral products making up the rest. As most of these products already enter global markets at low duties, only a third of LDC exports would be seriously affected by DFQF schemes. However the products covered by this third are essentially agriculture and textiles and garments on which most countries have significant tariff and non-tariff barriers.

Most countries offer concessions to LDCs, covering a large part of their global exports. For example, when measured in import value terms, the coverage is 96% in Canada, 99% in the EU, 99% in Japan and 71.8% in the United States. However, the proportion of LDC's global exports that actually enter markets duty-free quota-free is as little as 50%. In the EU, where 99% of the products imported from LDCs are eligible for DFQF, the preference utilization rate is estimated at 70–80%. In other markets it is lower. The most important reason for low levels of preference utilization are the 'rules of origin' that apply to products imported under preferential terms from the LDCs.

There is some concern about erosion of preferences should DFQF be extended to all countries. Sub-Saharan beneficiaries of the African Growth and Opportunity Act, most of whom are LDCs, fear that DFQF access to all OECD markets for all LDC products would have a negative impact on their exports. It may lead to an erosion of their preferences in the US markets by giving Asian LDCs, which are more competitive, a leading edge, particularly in products such as textiles and garments.

The possible effects on LDCs of DFQF

Simulations show that if OECD countries extended DFQF with 100% coverage to LDCs, their exports would significantly increase. One source suggests that this would amount to an additional gain of US$2bn for LDCs if OECD countries offered DFQF, and would rise to US$5bn if offered by developing and OECD countries. The national income of LDCs due to DFQF alone could rise by as much as 1%. However, these estimates do not consider the effects of non-tariff barriers such as rules of origin, standards, and trade facilitation. Some studies suggest that rules of origin alone would be equivalent to a tariff of 3-5%.

Only about 50% of LDC global exports benefitted from preferential access in 2008 demonstrating the importance of these non-tariff barriers. The share of preferential access was highest in clothing at 64% and lowest in agriculture at 26%. There was considerable variation in preference utilization between countries due to differences in the applicability of schemes across LDCs. For example, AGOA applies to African LDCs but not the Asian LDCs.

The way forward

While in a static sense the advantages of DFQF in 100% of the tariff lines may be limited due to the small export basket of LDCs, in a dynamic sense the advantages may be substantially increased product diversification and participation in global supply chains. The LDC index of export diversification has remained static during the last decade at 0.7. Developed countries have barriers on agricultural imports from LDCs, while developing countries have greater barriers on non-agricultural products. For both, the proportion of imports originating from LDCs is very small. Thus DFQF imports from LDCs are unlikely to disrupt domestic markets in developed or developing countries, though they may be of great benefit to the LDCs.

On the rules of origin, the Hong Kong Decision (Annex F of the Ministerial Declaration) states, inter alia, that WTO Members agreed to: 'ensure that preferential rules of origin applicable to imports from LDCs are transparent and simple, and contribute to facilitating market access'. Simulations show that about 30% local content requirements in the rules of origin create substantially higher trade than higher percentage requirements. Hence lower requirement of 20-25% local content and substantially more freedom to source raw materials worldwide under the DFQF schemes would be beneficial. The percentage criterion may not technically be the most suitable methodology for some goods such as textiles and clothing. The recent EU GSP proposed rules, allowing the use of imported fabrics to make garments originating in LDCs, could be a valuable example, with some additional flexibility. Administrative costs related to rules of origin are calculated at 3 to 5%. It is necessary to reduce these as well.

For countries whose preference may be eroded by 100% DFQF, measures for enhancing their competitiveness as well as other innovative mechanisms for meeting their trade adjustment challenges should be explored.

II. Cotton

The problem

This is on the Doha agenda due to the efforts of four African LDCs to highlight the devastating consequences of developed country subsidies on the world price of cotton. Heavily subsidized cotton is displacing the LDC exports despite the fact that production costs in LDCs are lower than those in the US. The LDCs claim that these subsidies depress international prices and threaten their sources of livelihood. Cotton, on average, is estimated to sell at about 70 to 75% of an average estimated global production cost. International cotton prices soared to 87% in 2010 due to concerns over supplies not meeting growing demand. However, when the crises hit, production in the 12 main African cotton producers fell by 23.7% between 2008 and 2009. Africa currently produces 12% of the world's cotton but 90% is sold to other countries for processing.

The state of play

Cotton is the main cash crop and the largest source of export receipts for the cotton four countries, accounting for about 80% of government export receipts and about 40% of GDP in Benin; and approximately 75% and 66% of total export revenue in Burkina Faso and Chad respectively. In Mali cotton exports accounts for only 18% of total export revenues but it is the largest foreign exchange earner after gold.

To cushion the effects of fluctuating prices the cotton four countries provide some subsidies to the sector, which they can ill afford to do. For example, Burkina Faso's state-controlled cotton company signed a loan agreement with foreign banks to finance purchases of the cotton fibre in the 2011-12 harvest. Burkina Faso is aiming to increase production to 700,000 metric tons during the harvest, commencing in October 2011, as high international cotton prices encourage wider planting. However, if cotton prices fall, its sovereign debt will be difficult to repay.

The way forward

Given the dominance of cotton in the LDC economies the early harvest package calls for (i) eliminating trade distorting domestic support measures and export subsidies and (ii) granting duty-free and quota-free market access for cotton and cotton by-products originating from LDCs.

Conclusion - 'early harvest' in LDC-IV

Delivering on LDC development requires expeditiously implementing in full the Hong Kong commitment on DFQF. Ten years after the commencement of the Doha Round, LDC-IV could build the political consensus needed for DFQF access in 100% of the tariff lines into the markets of all developed WTO members, and those developing members in a position to do so, for all products originating from LDCs. This would be a clear deliverable of LDC-IV and a confidence building measure for the 'development' content of the Doha Round. 100% DFQF and eliminating cotton subsidies are not new issues. They have been on the agenda for at least eight years and need immediate action for LDC's development. The 'early harvest' is not so early after all.



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