EIF Enhanced Integrated Framework
Trade for LDC development

Rethinking LDC trade priorities

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Background

The COVID pandemic dealt a blow to the integration of least developed countries (LDCs) into global markets, as the value of their exports fell more sharply than those of other countries and their share of global trade shrank. Due to the mix and destination of their exports, the 16 graduating LDCs[i] experienced an even steeper decline as global supply chains halted and mineral prices collapsed. A widespread move during the pandemic towards digital trade, e-commerce and teleworking, which cushioned the economic shock in many countries, was slower and more difficult in LDCs with weaker digital infrastructure. As a result, the SDG target 17.11 of expanding LDCs' share of world exports to at least 2 per cent by 2020 was missed.

In this context, it seems natural to question whether the goals set out in the Istanbul Programme of Action (IPoA) (2011-2020) aiming for half of LDCs to meet graduation criteria could be achieved, and whether LDCs current focus in the multilateral trading system requires a fresh perspective. The answer to these depends on the value for LDCs of existing preferential market access schemes and the alternatives looking forward. This short note argues that while such schemes offer value for some members, there are untapped gains for LDCs in areas where their negotiating effort and political goodwill can potentially lead to much higher returns.

The value of existing LDC schemes

A recent report by the World Trade Organization (WTO) Secretariat evaluates the value of existing LDC schemes and puts trade preferences at their heart. The gains obtained by LDCs from existing preferential schemes vary widely, due to differences in the composition and destination of their exports. For example, on graduation from LDC status, Bangladesh's exporters could face an average 7.90 percentage point increase in export tariffs, compared with a 0.02 percentage point increase for those in Angola.[ii]

In the case of Bangladesh, a 7.90 percentage point increase in tariff barriers may seem like a significant loss of benefit for its exporters. However, imperfect competition in many of the markets to which Bangladesh exports means that importers in those markets have historically been the main beneficiaries of Bangladesh's tariff-free access. The best estimates available suggest that exporters capture only around a quarter of the so-called tariff rent.[iii] A back-of-the-envelope calculation then suggests that the increase in trade costs Bangladesh would face upon graduation from the LDC scheme would be equivalent to only 1.98 percentage points.

LDC preferences in services also offer little value. In most cases, preferences notified by WTO members under the LDC Services Waiver simply replicate the existing most-favoured nation (MFN) regime. There are almost no preferences granted under Mode 4, which relates to the movement of natural persons and in which LDCs have a strong comparative advantage.[iv]

There are at least three other important problems with unilateral preference schemes that may explain the limited value for beneficiaries.[v] First, there is uncertainty associated with the benefits. Of course, this uncertainty depends on the details of each scheme. Nevertheless, in all schemes, it is the importer, and not LDC beneficiaries, that decides the extent of tariff preferences and the conditions associated with them. Under even the most generous schemes, which grant duty-free and quota-free access into the importer's market, the value of the preference depends on the existing MFN tariff, the extent to which the importer grants preferences to other countries, and when the LDC will reach graduation thresholds. Uncertainty around the extent of LDCs' preferential margin leads to underinvestment by the private sector in sectors with large tariff preferences, which leaves potential gains untapped.[vi]

One potential way to address uncertainty around future graduation is for LDC members to put forward proposals that would ensure their own smooth transition.[vii] Such proposals generally involve extending LDC benefits for a certain period after graduation. Avoiding the sudden elimination of benefits at the time of graduation is desirable in itself, but it is also crucial that benefits be gradually phased out over a set period. Otherwise, uncertainty is merely postponed to an extended deadline. A gradual reduction in benefits (clearly decided ex ante and neither donor nor beneficiary specific) should enable graduating LDCs to slowly adjust to their new status, while allowing the impact of the partial removal of preferences to be monitored.

A second problem with unilateral tariff preferences relates to an absence of reciprocity. When LDCs are not present at the negotiating table, talks tend to drift away from areas where they have a comparative advantage and an economic or development stake. Reciprocity in negotiations between other WTO members ensures each side's terms of trade are unaffected, while their production and consumption bundles expand. However, if negotiations exclude sectors in which LDCs have an export or growth interest, LDCs' terms of trade deteriorate, leading to a reduction in their production and consumption baskets.[viii] Shifting away from unilateral tariff preferences and towards more active engagement of LDCs could enable LDCs to contribute to the design of a multilateral trading system that better reflects their interests.

A third problem relates to rules of origin (ROO) being too restrictive or lenient, which can limit the benefit LDCs derive from preferential schemes. When ROO are too restrictive, the costs of satisfying their requirements may not be worth small preference margins, and exporters may prefer to export under MFN regimes. This explains the under-utilization of existing preferential schemes by LDCs. For example, Angola, Bhutan, Kiribati, the Lao People's Democratic Republic (Lao PDR), Sao Tomé and Principe, and Tuvalu export more than 90 per cent of their products under MFN regimes despite LDC preferences being available.

To address this, several LDC schemes have introduced very lax ROO, which has often been accompanied by a significant increase in LDC exports. However, this does not imply that LDCs have benefitted. Exporters of intermediate goods to LDCs are often the main beneficiaries of more lenient rules of origin. The LDC exports that are boosted by these more lenient ROO contain a very large share of foreign value added and very little LDC value added.[ix] This suggests that requests for more lenient ROO in LDC preferential regimes, while contributing to larger (gross) exports from LDCs, do not necessarily lead to value creation in LDCs. ROO should not be too lax if they are to benefit LDCs rather than their foreign suppliers.

The above points do not mean that LDC status has no value. They simply show that tariff preferences, on which a large share of negotiating effort is spent, tend to offer small benefits. However, other features of LDC schemes offer significant value and there is an opportunity to build upon these in the multilateral trading system.

Longer transition periods in the implementation of WTO agreements often accompanied by access to technical assistance and capacity-building support are an important feature of LDC status in the WTO. These recognize the difficulties faced by countries at early stages of their development and with limited fiscal space when implementing agreed reforms. Such reforms often bring long-term gains, but imply short-term costs that many LDCs may not be able to afford. The Trade Facilitation Agreement is a good example. It allows LDCs and other developing countries to apply provisions stipulating which reforms they are able to implement immediately (category A), which they will implement only after a transition period (category B), and which they will implement following the receipt of technical assistance and capacity-building support (category C). Ensuring that sufficient technical assistance and capacity-building support accompanies category C commitments is key to helping LDCs grab the gains from participating in the multilateral trading system, and is therefore crucial for the good functioning of the system.

Exemptions are another feature of LDC status in the WTO. While at first sight they may seem to be an interesting alternative instrument to address the development constraints faced by LDCs, they have a very different impact than longer transitions and technical assistance. First, they keep LDCs away from the negotiating table where multilateral rules are defined, and this shifts the multilateral system away from the development interests of LDCs. Second, they prevent LDCs from benefitting from commitment gains offered by trade agreements. Indeed, market access is only one of the gains offered by trade agreements. Trade agreements provide the opportunity to adopt or lock in reforms that are in the interest of member countries' citizens, but which may be difficult to implement domestically because of pressure from politically well-connected groups or what economists call time-inconsistency. A time-inconsistent policy is one that, if implemented, may benefit all ex ante (e.g. free trade) but becomes ex post impossible (once there are strong investments in the import-competing sector). By locking in free trade reforms at an early stage, members of trade agreements can grab the benefits from this otherwise time-inconsistent policy.

Where are the commitment gains from trade agreements more likely to arise? The literature suggests that the gains will be larger in small countries with governments that are relatively weak when facing pressure from lobbying groups, but which place weight on the social welfare of their citizens that is neither too low nor too high.[x] Arguably, this is a characterization of many LDCs.

Thus, exemptions from WTO commitments do not seem to be in the long-term interest of LDCs. Rather, a stronger emphasis should be put on longer transition periods accompanied by technical assistance and capacity-building support for the implementation of such commitments. In the next section we describe other areas where a stronger involvement of LDCs in the multilateral trading system can help address the economic and development challenges they face.

Looking forward – trade priorities for LDCs

Some of the trade priorities identified below explicitly invoke LDC status (e.g. services preferences), but in others (e.g. e-commerce) LDC status is implicit and should involve enhanced technical assistance and capacity-building support, as discussed above.

LDC services preferences

As noted earlier, LDCs have virtually no preferences in their access to high-income countries' services markets. Granting Mode 4 preferences to LDCs could potentially offer very large gains. Economists estimate that gains from the permanent movement of workers across countries could dwarf by several orders of magnitude gains from trade (or capital movement).[xi] Global estimates suggest better allocation of global resources could expand world GDP by 80 to 150 per cent. Temporary movements would of course bring smaller gains, but are probably more politically feasible in receiving countries. They also reduce problems associated with "brain drain" in origin countries. LDC preferences that facilitate the temporary movement of persons offer an opportunity to test at a small scale the impact of reducing restrictions in movement while benefitting LDCs.[xii]

Mode 1 preferences related to the supply of services from one country to another could also offer large gains. Mode 1 represents around 30 per cent of world trade in services, and its growth has accelerated during the COVID pandemic, as services like engineering, advertising, education and accounting could only be delivered digitally when travel became unfeasible or more costly. Mode 1 is also the mode with the second-fewest commitments by high-income countries, after Mode 4.[xiii] One could argue that existing policies are not too restrictive, but this does not mean that they will remain so in the near future. More restrictive Mode 1 policies could hurt the commercial interests of LDCs.

The rapid growth of digital labour markets through platforms such as Fiverr or Upwork offer an important opportunity for talented workers located in remote countries with lower labour costs. Bangladesh, for example, is one of the two top countries in terms of contracted workers via the Upwork platform (with the US the top employer).[xiv] A recent study also shows that the reputation-building mechanisms of these platforms disproportionately benefit workers from developing countries, as potential employers have direct access to satisfaction ratings given by previous employers. These become a more useful indicator of individual workers' productivity than the names of schools or firms where they previously studied or worked.[xv]

A commitment not to impose restrictions on workers and freelancers located in LDCs could be a valuable addition to LDC status. A renewal of the moratorium on customs duties on electronic transmissions would also ensure less uncertainty. Note that because of the nature of electronic transmission, a preferential moratorium for LDCs could be difficult to implement. Support by LDCs for a permanent ban on duties on electronic transmission could also be in the long-run interest of LDCs. This would eliminate potential future taxation of work undertaken remotely through platforms, and also impose constraints on digital duties that more powerful WTO members could consider introducing in the near future.

E-commerce

The COVID pandemic has also boosted e-commerce both within and across borders, as distribution channels move to more direct B2C models. As with digital labour markets, studies have shown that the reduction in information asymmetries regarding the quality of products and sellers offered to consumers around the world by these platforms' reputation-building mechanisms disproportionately benefits small producers in remote and low-income countries.[xvi] Support could be provided to small and medium-sized enterprises in LDCs to more strongly participate in these platforms through, for example, export promotion agencies. To reap the full potential of such support, it would be crucial to have access to enhanced capacity building and investment in internet infrastructure, logistics and transport infrastructure that could help eliminate existing bottlenecks. Services commitments in telecommunications by LDC members should also help procure foreign investment in this sector.

There is, however, one area related to e-commerce and digital trade on which LDCs, and WTO members more generally, should be spending more time: the high degree of market concentration in these electronic markets. Network markets inherently tend to become natural monopolies. However, the proliferation of platforms is clearly not the answer, as it would make electronic transactions more costly. Rather, as with all natural monopolies (e.g. water or electricity distribution), regulation is essential. Due to a total absence of regulation today, platforms such as Amazon charge fees to sellers that can be as high as 45 per cent of a transaction's value. On eBay, sellers are charged around 13 per cent of the value of their sales. On Upwork, workers are charged up to 20 per cent for the first US$500 they bill, falling to 5 per cent for sums exceeding US$10,000. Uber charges its drivers 25 per cent of their sales. These fees clearly cloak monopoly (or rather monopsony) rents. Regulating these charges at the national level is possible, but only for platforms that do not facilitate cross-border transactions, such as Uber. If cross-border transactions are possible (as with Amazon or eBay) national regulations could be circumvented, as the platforms would provide services from countries with less stringent or no regulations. More importantly, many (if not all) LDC markets are served through platforms in third countries.

Clearly, international regulation is needed. The best place to negotiate global regulations is the WTO. Other organizations, such as the Organisation for Economic Co-operation and Development (OECD), are likely to put less weight on the interests of LDCs, due to the composition of their membership. This requires more engagement and participation of LDCs in these negotiations in the WTO, and fewer exceptions being sought. Decisions around the regulation of e-commerce could potentially have greater impact on the market access of LDCs than tariff reductions.

Environmental goods

Improving environmental sustainability and combating global warming are undoubtedly two of the major challenges facing the world, and LDCs are disproportionately impacted by both. It is perhaps surprising then that environmentally clean industries tend to face more trade restrictions than environmentally dirty industries, as illustrated by a recent study of US trade policy.[xvii] This creates a bias that favours trade in dirty goods rather than clean goods. Therefore, reducing or eliminating trade barriers on environmental goods would be not only environmentally friendly, but also economically efficient.

More importantly, the comparative advantage of low-income countries is more likely to lie in environmentally preferable products (EPP)[xviii] than on goods for environmental management (GEM).[xix] However, the existing Asia-Pacific Economic Cooperation (APEC) list, and various WTO lists based on member submissions under the Doha Round, comprise almost exclusively GEM.[xx] This is not surprising, as the comparative advantage of the high-income and few middle-income members that made submissions to these lists lies in GEM.

A stronger involvement of LDCs (and low-income countries more generally) in environmental goods negotiations is needed, so that outcomes reflect not only their comparative advantage, but also the world's environmental interests. Active participation in the Trade and Environmental Sustainability Structured Discussions (TESSD) is an avenue to explore, as members supporting the relaunching of discussions or a plurilateral agreement in environmental goods also seem open to a total redefinition of environmental goods in WTO negotiations. Arguably, this could include sustainable and organic agriculture, forestry and fisheries, where LDCs (and other low-income countries) have a comparative advantage, and where many countries have high tariff (and non-tariff) barriers. But these goods are unlikely to be included if the negotiating strategy of LDCs and low-income countries is to free-ride on concessions granted by members of the plurilateral agreement.

LDCs and low-income countries should also consider participating more actively in future revisions of the Harmonized Commodity Description and Coding System (HS) classification so that environmental goods are more clearly identified and abuse through dual use (more common in GEM) is avoided. The elimination of protection on clean goods could then be undertaken unilaterally and preferentially for LDC exporters by all high- and middle-income members, without needing to wait unnecessarily for a multilateral agreement on environmental goods.

Labour standards

While the introduction of labour clauses in trade agreements are seen sometimes as protectionist tools for high-income countries, recent studies show they tend

to increase (not reduce) exports from low- to high-income countries, particularly when labour clauses contain cooperation provisions rather than sanctions.[xxi] There are two reasons for this. First, better labour conditions increase productivity in exporting countries. Second, demand in importing countries is boosted when consumers know the fundamental rights of workers are respected.

Cooperation on labour laws requires the enhancement of technical assistance and capacity building to allow for the inclusion of labour clauses in LDC preferential schemes. Alternatively, at the time of graduation, LDC members should be offered enhanced technical assistance and capacity building to adopt international conventions on labour rights (and governance/environmental laws) that would allow them to continue to benefit from duty-free and quota-free access. The EU's Generalized System of Preferences Plus (GSP+) is a step in the right direction, but it could offer more generous preferences, and similar schemes should be sought from other members.

Readiness for future pandemics

The best preparedness for a future global pandemic is global cooperation that ensures markets remain open. As current disruptions in global supply chains have shown, reliance on a small number of suppliers for products with few substitutes or, even worse, reliance on suppliers all located in one country (even when that country is the home country), represents the biggest risk. Restrictive trade policies and changes in trade policies amplify this risk. Committing to a global open trade policy that encourages firms to source from multiple providers offers the best preparedness for future pandemics as it becomes easier to substitute. This commitment should include restraint in the imposition of export restrictions during any global pandemic. LDCs, with their small and often undiversified markets, are likely to extract larger benefits than other members from such an approach.

Criteria to determine LDC status

There are at least four problems with the criteria used by the Committee for Development Policy of the UN Economic and Social Council (ECOSOC) to determine LDC status. First, the different subcomponents of the Human Assets (HA) and Economic Vulnerability (EV) indices are arbitrary, which may weaken the overall indices' usefulness. For example, the exposure subcomponent of the EV index weights agriculture, forestry and fisheries, signalling that reliance on these sectors for a larger share of GDP renders countries more exposed to economic vulnerabilities. During the pandemic however, these sectors thrived, and the entertainment and hospitality sector's share of an economy would have been a better measure of exposure. It is surprising that the EV index is not fed by metrics such as the volatility of GDP per capita or the proportion of poor people in a population, but rather by more distant criteria such as population size or agriculture's share of an economy.

Indicators that more accurately point to economic vulnerability should be found. Given the large volumes of data available today, one could employ machine-learning algorithms, such as Lasso, to statistically determine which variables to include.

Second, the EV and HA indices employ an arithmetic mean across the different subcomponents. This is problematic because one subcomponent (e.g. Health within the HA index) could be at a very low level, but be perfectly compensated for by a high level in another subcomponent (e.g. Education within the HA index). These subcomponents are clearly not perfect substitutes for one another and the indices should reflect their potential complementarity. It is difficult to see, for example, how great educational achievements could lead to high levels of human capital without good health outcomes. A geometric mean would better capture these complementarities.

Third, the weights given to different elements of the HA or EV indices are arbitrary and depend on the number of subcriteria introduced in each of these two indices. For example, the HA index places 50 per cent more weight on increases in secondary school enrollment than in mortality rates for children aged under five. Without judging the moral considerations around these weights, there is no objective or scientific basis for what seems a completely arbitrary decision. At a minimum, the HA or EV indices should be constructed with standard errors that reflect the potential inaccuracy this creates. Alternatively, machine-learning algorithms could be used to estimate the weights to give to each component.[xxii]

Finally, criteria are determined in absolute terms (even if evolving with time), which would eventually trigger the graduation of all LDCs. One could argue, both ethically and economically, that criteria should be relative. A certain percentage of the world's poorer and more vulnerable countries should be granted LDC status. If this were set at 20 per cent, there would permanently be around 39 countries benefitting from LDC status. This does not imply that the IPoA goal of helping half the world's LDCs to meet the graduation criteria is wrong. Absolute targets are necessary to help these countries advance faster, both economically and socially. However, if they remain at the bottom of the distribution in terms of poverty and vulnerability, they should also keep their LDC status.

ENDNOTES

i Angola, Bangladesh, Bhutan, Cambodia, Comoros, Djibouti, Kiribati, Lao PDR, Myanmar, Nepal, Sao Tomé and Principe, Senegal, Solomon Islands, Timor-Leste, Tuvalu, and Zambia.

ii WTO (2020). Trade impacts of LDC graduation. WTO Secretariat. (Table 28). https://www.wto.org/english/res_e/booksp_e/trade_impacts_of_ldc_graduation.pdf

iii Cirera, Xavier (2014). Who captures the price rent? The impact of European Union trade preferences on export prices. Review World Economies 150, 507–527. https://doi.org/10.1007/s10290-014-0186-5

iv See WTO (2020), Trade impacts of LDC Graduation. WTO Secretariat. https://www.wto.orgenglish/res_e/booksp_e/trade_impacts_of_ldc_graduation.pdf

v Fernandes, Ana et al. (2021). Are trade preferences a panacea? The export impact of AGOA. Update to World Bank Policy Research Working Paper 8753. https://documents1.worldbank.org/curated/en/685341550595914166/pdf/Are-Trade-Preferences-a-Panacea-The-Export-Impact-of-the-African-Growth.pdf

vi Borchert, Igo et al. (2020). Go ahead and trade: the effect of uncertainty removal in the EU's GSP scheme. EUI RSCAS; 2020/15. https://cadmus.eui.eu/handle/1814/66268

vii See most recently WT/GC/W/829 (https://docs.wto.org/dol2fe/Pages/SSdirectdocaspx?filename=q:/WT/GC/W829.pdf&Open=True)

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ix Rotunno, Lorenzo et al. (2013). The Rise and Fall of (Chinese) African Apparel Exports. Journal of Development Economics 105, 152-163. https://doi.org/10.1016/j.jdeveco.2013.08.001

x Arcand et al. 2015. Weak governments and preferential trade agreements. In Dur and Elsig (eds). Trade Cooperation. Cambridge University Press.

xi Clemens, Michael (2011). Economics and Emigration: trillion dollar bills on the sidewalk. Journal of Economic Perspectives 25(3), 83-106. https://pubs.aeaweb.org/doi/pdf/10.1257/jep.25.3.83

xii LDCs represent only 14 per cent of the world population, but are home to 50 per cent of the world's poorest.

xiii Roy, Martin (2019). Elevating Services: services trade policy, WTO commitments, and their role in economic development and trade integration. Staff Working Paper ERSD-2019-01. WTO Secretariat.

xiv Horton et al. (2018). Digital Labor Market and Global Talent Flows. In High Skilled Migration into the United States and its economic consequences, eds: Hanson, Kerr and Turner. https://www.nber.org/books-and-chapters/high-skilled-migration-united-states-and-its-economic-consequences/digital-labor-markets-and-global-talent-flows

xv Agarawal, Ajay et al. (2016). Does standardized information in online markets disproportionately benefit job applicants from less developed countries? Journal of International Economics 103-12.

xvi Lendle, Andreas et al. (2016). There goes gravity: eBay and the death of distance. Economic Journal 126, 406-441. https://doi.org/10.1111/ecoj.12286

xvii Shapiro, Joseph (2021). The environmental bias of trade policy. Quarterly Journal of Economics 136(2), 831-886. https://doi.org/10.1093/qje/qjaa042

xviii Balineau and de Melo (2011) define EPP as goods less harmful for the environment during production, use or disposal and characterize GEMs as goods with multiple end uses.

xix De Melo, Jaime et al. (2020). Barriers to trade in environmental goods: how important they are and what should developing countries expect from their removal. World Development 130. https://doi.org/10.1016/j.worlddev.2020.104910

xx JOB/TE/3/Rev.1.

xxi Carrère et al. (2022). Labor clauses in trade agreements: hidden protectionism? Review of International Organizations, forthcoming. https://doi.org/10.1007/s11558-021-09423-3

xxii For an example, see Guillaumont, Patrick (2011). EVI and its use: design of an economic vulnerability index and its use for international development policy. https://halshs.archives-ouvertes.fr/halshs-00557091/document

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