

# Assessing the Chinese and Indian LDC Preference Schemes – Initial Observations

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## Abstract

The 2005 Hong Kong WTO Ministerial Declaration stated that developed countries are required to provide duty-free and quota-free (DFQF) market access for at least 97% of products originating from Least Developed Countries (LDCs). It moreover called on developing country members “declaring themselves in a position to do so” to also provide DFQF access to LDCs. Since then, both China and India have implemented preference schemes for LDCs. This paper examines these initiatives and assesses potential benefits and drawbacks for LDCs beneficiaries. It places these preference schemes within broader theories and assumptions on the political and economic dynamics of trade preferences, as well as within the context of China and India’s increased engagement in Africa. I argue that the Chinese and Indian schemes demonstrate that unilateral trade preferences are gaining international acceptance as a standard part of the donor toolkit. This does not, however, address the fundamental problems inherent to these schemes, as potential welfare benefits are mitigated both through limitations in the product coverage and administrative specifications, as well as through the uncertainty of their sustained access. They are also likely to further prevent future multilateral liberalisation due to concerns over erosion of these preferences. Moreover, on their own, these schemes do little on their own to address supply-side constraints in the recipient countries

## Introduction

The 2005 Hong Kong WTO Ministerial Declaration called on developed countries to provide duty-free and quota-free (DFQF) market access for at least 97% of products originating from Least Developed Countries (LDCs) by 2008, or by the conclusion of the Doha Development Round (DDR) at the latest. This was intended to both improve market access for LDCs and combat these countries' concerns over the erosion of their preferences through multilateral liberalisation. In the years preceding this, the European Union, through *Everything but Arms* (EBA), and the United States, through the *African Growth and Opportunities Act* (AGOA), had both launched initiatives to expand DFQF access for LDCs.<sup>1</sup>

The Hong Declaration moreover called on developing country members “declaring themselves in a position to do so” to also provide DFQF access to LDCs, and has led a number of leading developing countries to either expand duty-free initiatives for LDCs or announce completely new schemes. At the 2007 Forum for China-Africa Cooperation, Premier Wen Jiabao announced that China would increase the number of duty-exempted tariff lines for LDCs, under its Special Preferential Tariff (SPT), from 190 to 440, comprising 98% of current LDC import value. In April 2008, the Indian Government announced that it would launch a “Duty Free Preference Scheme for Least Developed Countries”. This scheme would include duty-free access on 86% of all tariff lines. Additional preferential access would be extended on a further 9% of tariff lines, thereby allowing for preferential access on the products comprising 92.5% of global exports of all LDCs. Since the Hong Kong Ministerial, South Korea and Brazil have also announced their intentions to provide LDC duty-free preference schemes.

This paper examines India and China's initiatives and assesses potential benefits and drawbacks for LDCs beneficiaries, by placing these preference schemes within broader theories and assumptions on the political and economic dynamics of protection, liberalisation and in this case, preferential liberalisation. I argue that the Chinese and Indian schemes demonstrate that unilateral trade preference are gaining international acceptance as a standard part of the donor toolkit, in a similar way as development aid and technical assistance programmes have. This does not, however, address the fundamental problem inherent to these schemes. Potential welfare benefits are mitigated

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<sup>1</sup> In the years following the Ministerial, Japan and Canada expanded product coverage for LDCs to include 98% and 100% duty-free access, respectively. Switzerland has announced DFQF coverage for almost all LDC products. Switzerland also included Highly Indebted Poor Countries (HIPC) in the scheme. DFQF access for broken rice and sugar is to be phased in until September 2009.

both through limitations in the schemes themselves, and through the uncertainty of their sustained access. They are also likely to further prevent future multilateral liberalisation due to concerns over erosion of these preferences. Moreover, on their own, these schemes do little on their own to address supply-side constraints in the recipient countries

Section I examines the theoretical foundations of unilateral trade preference schemes, as well as past approaches to examining the political economy behind these policies. This will provide a framework through which to evaluate the Chinese and Indian schemes. The second section surveys at the changing dynamics of South-South trade and the rise of China and India as major actors in global trade. India and China's preference schemes must be viewed as symptomatic of these countries' broader integration into the global economy, and specifically their increased engagement in sub-Saharan Africa. In this sense, the duty-free schemes offer a valuable heuristic for our understanding of these emerging powers' political and economic relations with LDCs, and particularly with those in African countries.

The third section contrasts China and India's LDC preference schemes, and examines initial impacts these schemes are likely to have. I will also look at how these compare to prior developed country preference schemes for LDCs, and to what extent the limitations of these are mirrored in the Chinese and Indian initiatives. China and India's preference schemes thereby offer valuable case studies through which to assess whether prior analyses of unilateral preferences, and the political economy motivating such preference schemes, is applicable if developed countries are the providers and not just recipients of preferences. Do the objections frequently voiced against Northern preference schemes – ranging from their questionable welfare gains and the uncertainty of sustained preferential access, to their potential stumbling effect for multilateral liberalisation — hold in these cases? Is there, in other words, a separate political economy of preferences in South-South trade relations?

I conclude by examining two alternatives to the present model of an ever-growing and ever-more complex global system of disparate LDC preferences: 1) the potential for preference scheme harmonisation, and 2) addressing the imbalances in the global trade system through multilateral liberalisation paired with a scaling up of aid for trade disbursements.

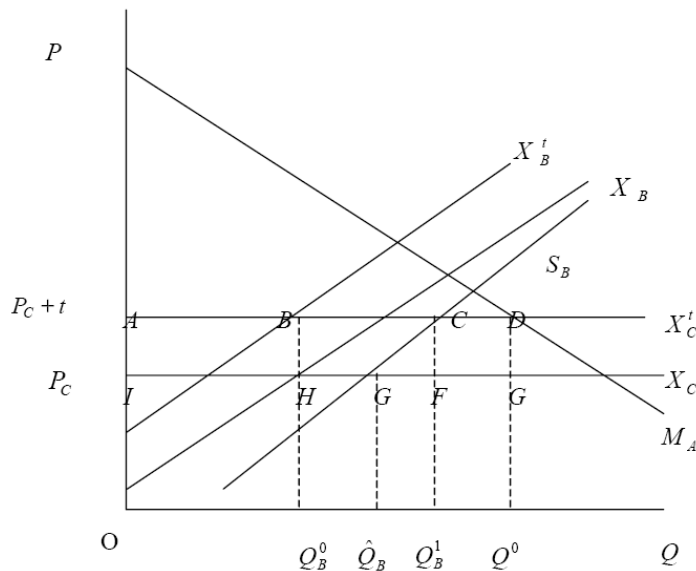
## **I. Trade Preferences**

**a. The rationale**

Trade preference schemes were first promoted as a response to the need of developing countries to foster industrial capacity in non-industrial manufactures in order to reduce their import dependence and to diversify away from more traditional commodities (Hoekman and Ozden 2005). The granting of trade preferences to developing countries was first publicly promoted during the 1960s by development economists such as Raul Prebisch and Hans Singer, among others, as a complement to import substitution industrialisation and within broader efforts towards the New International Economic Order. A temporary improvement in the terms of trade for the preference recipient, relative to non-recipients, would allow developed countries to respond to new export opportunities provided by their preferential margin, and allow for increased exports in higher value-added goods to preference-granting countries. It was to be paired with a programme of import substitution industrialisation and was intended to be gradually phased out as these countries developed new export capacities.

A static partial equilibrium analysis in Bora et al (2002) demonstrates the short-term redistributive effect of trade preferences.<sup>2</sup>

**Figure 1: Partial Equilibrium Analysis of Welfare Effects of Preferential Trade Agreement**



Source: Bora et al (2002:40)

<sup>2</sup> See Mold (2005) for a discussion of Bora et al.'s Partial Equilibrium Analysis.

Gains for the recipient (country B) would be captured in large part by producers in preference-receiving countries, who increase their output volume of exports and increase producer rents (as represented by the area ACGI). These gains would, however, be offset by tariff revenue losses for the preference-granting country, represented by area ACFI, as well as a diversion of trade from the more efficient previous exporters, C, to exporters in the country benefiting from the preferential margin. This entails a net loss for the world, as represented by the area of triangle CFG.

If over time the supply curve of the recipient ( $S_B$ ) does not converge with the export supply curve of the rest of the world ( $X_C$ ), preferences— due to a combination of administrative barriers, supply-side constraints and/or political pressures – would fail to enable the recipients to develop a sustainable and unaided comparative advantage in the respective product. In order for trade preferences to produce long-term welfare gains for the recipient country that extend beyond trade diversion-induced rent transfers, preferences would need to help recipients achieve economies of scale in order to also remain competitive in the absence of these preferences.

#### **b. Limitations of past preference schemes**

As a comprehensive overview by Hoekman and Ozden (2005) has demonstrated, debates over the value of unilateral trade preferences started even before the first GSP schemes were implemented. While the form and substance of trade preferences has undergone changes since this time, the terms of the debate have remained – to a large part – similar. Critiques of trade preference schemes have tended to focus on five main points.

Firstly, it is widely argued that preferences tend to bring few welfare gains as preference margins, especially in primary products that developing countries have traditionally held comparative advantages in, are generally smaller than for manufactures. This has limited the potential benefits of preference utilisation. Because of the low MFN rates facing many products in which LDCs are competitive, on average only 36% of exports actually receive preferential access. This, as Vanzetti and Peters (2009) point out leads also points to an inherent problem in the developed country commitment to liberalise 97% of tariff lines, as the excluded items can cover a large share of trade. Kennan and Stevens (2006) have calculated that the US could comply with this requirement and still exclude from DFQF more than half of its current imports from Bangladesh, Cambodia and Nepal, and two thirds from Haiti.

A second closely related critique of trade preferences is that many of the most important products for LDCs are excluded or offer only a limited preferential margin. The EU's GSP scheme, for example, has excluded most agriculture and fishery products of export interest to the poorest countries while the bulk of raw material exports from the poorest countries entered duty free under MFN conditions (Clark 1991). Because their export profiles are generally focused on primary commodities and industrial raw materials, developing countries face higher protection than other countries, and even with preferences, the margin tends to only be 20-30% less than the MFN rate (IMF and World Bank 2004). Fugazza and Vanzetti (2008) demonstrate that even despite ongoing preference schemes, the trade-weighted average tariff faced by LDCs exporting to developed countries is higher than that faced by other developed countries (see Table 1). The preferences provided through the Lome and Cotonou treaties, have not been able to forestall the declining share of ACP imports in EU, which fell from 7.7% of total EU imports to 2.7% in 2000 (EU Commission in Mold 2005: 20). GSP proponents point to the success of some countries that have been able to benefit from preferences, such as Bangladesh, which was able to shift towards sectors where preferences exist, and built up its garment sector in 20 years from largely negligible to a \$4 billion per year industry. However, this may also be indicative of the fact that trade preferences can engender a deterioration in the terms of trade, as resources are shifted towards sectors where preferences exist (Mold 2005). For the most part, however, the exports of low-income and least developed countries remain confined to a few products, with 10 products accounting for 60% of export value in the case of the EU's ACP preferences (Panagariya 2002).

**Table 1: Trade-weighted average tariffs (including preferences) by development status (percentages)**

Source	Developed	Developing	Least Developed
Developed	2.1	9.2	11.1
Developing	3.9	7.2	14.4
Least Developed	3.1	7.2	8.3
Total	2.9	8.1	13.6

*Source: Fugazza and Vanzetti (2008, from WTTS/TRAINS (2004) database)*

In addition to the limited benefits preferences confer in practice, the administrative hurdles in the form of non-tariff barriers and onerous rules of origin have further limited preference utilisation. Herin (1986, in Hoekman and Ozden 2005) has estimated the costs of documentation and administration of rules origin impose additional costs on exports equivalent to 3% of value. Similarly, Candau et al. (2004) have found that preference utilisation tends to be significantly lower if preferences are small. Therefore low preferential margins are unlikely to induce any significant uptake of preferential access. This is supported by Manchin's finding (2005) that the magnitude of preferences offered has a significant impact on the uptake of preferences. However, once a trader has decided to request preferences, the preferential margin generally does not influence the magnitude of preferential trade volumes in a statistically significant way. This indicates that preferences seem to entail a substantial initial barrier to participation that – once overcome – allows for facilitated utilisation.

A fourth frequent criticism of preferences is the stumbling-block effect they create for multilateral liberalisation. McCulloch et al. (2001:167) argue that the rationale behind trade preferences and special and differential treatment implied that trade liberalisation was bad for developing countries, and thereby left these countries almost wholly outside the liberalisation dynamic of the world system. Ozden and Reinhardt (2005) argue that non-reciprocal trade preferences remove the major incentive that exporting industries have for opposing protectionist measures at home. Therefore trade preferences shift the political balance within a beneficiary country away from export sectors and toward the import-competing sector. Recipients of US GSP, the authors found, tended to have average duties as a percentage of trade 1.66 times higher than non-recipients, even when income is controlled for. Ozden and Reinhardt (2003) similarly found that graduation from the GSP scheme has led to increased unilateral liberalisation.<sup>3</sup> Moreover, a desire to maintain preferences, even if utilisation is low, has made developing countries wary to endorse broader multilateral liberalisation in the DDR, as this would erode their existing preferences (Hoekman and Prowse 2005).

The non-mandatory, unilateral nature of trade preferences has furthermore contributed to preferences frequently failing to achieve their intended effect. A country can lose its GSP privileges if its exports exceed a certain competitive limit, meaning that countries are likely to be excluded at precisely the point that they start benefiting. For

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<sup>3</sup> The significance of this assertion has, however, could be challenged by Rose's finding (2004) which conclude that WTO membership does not improve total volume of trade, whereas GSP doubles trade volume between signing partners.

example, under the US's Caribbean Basin Initiative, the local value content for ethanol was set at 35 %. Once beneficiary countries were able to significantly increase their exports to US, the local value requirement was raised to 70 %, leading to a significant decline in Caribbean ethanol exports to the US (Hoekman and Kostecki 2001). As trade preferences can be inherently unpredictable for recipients, incentives for any significant GSP-related investment is thereby significantly decreased. Preferences have moreover frequently been tied to cooperation in other realms, as the Special 301 provisions in the US's GSP through which the US Trade Representative can revoke preferences if it finds that intellectual property rights aren't adequately protected in a recipient country. These conditionalities on preferences, paired with the fact that they can be revoked by the preference provider with short notice and without any right to appeal, has frequently made these schemes a 'bastion of unregulated protectionism' (Hudec 1987 in Hoekman and Ozden 2005).

### **c. The political economy dimension**

These critiques of preferences all point to their inherently political dimension, as the principle of preferential market access is undermined by provisions limiting the recipient's ability to utilise this access. Examples, such as those listed above, seem to give some reinforcement to the pressure group model of trade policy, according to which well-organised interest groups threatened by increased import penetration, can successfully mobilise to move policy in a direction that favours them. In order to protect import-competing sectors, sensitive products are exempted from preferential access, or this access is constrained through onerous administrative requirements. This is facilitated by the very limited influencing power of the preference recipient within the granting country, especially in opposition to a well-organised domestic lobby.

The trade-offs that motivate the granting of trade preferences and constrain their overall utility was first analytically described in McColloch and Pinera (1977). The authors use the following social welfare function:

$$W = W(I, N, T)$$

W, in this case stands for the social welfare on which policy-makers base their decisions, I is the national income, N stands for various non-economic objectives, and T is the aggregate resource flow to the developing world. The authors argue that, as preferences are provided unilaterally, the new preferential tariff is motivated by "a parameter shift – a change either in the welfare function itself or in the possibilities for tradeoffs among it arguments" (McColloch and Pinera 1977: 959-60). This is premised on the assumption

that the original tariff is based on an initial maximisation of welfare. The preferential tariff in turn either signifies that assumptions on how to maximise welfare have changed, perhaps due to fears of instability caused by poverty in the developing world, or that preferences are seen as a more efficient way to satisfy T. They moreover conclude that preferences are likely to be politically rational for the preference granting country, since the diversion of trade caused by preferences could also end up increasing the welfare of consumers in the donor's country (thereby potentially increasing national income), as well as allowing for a reallocation in resources flows to the developing world from aid to preferences. This reallocation would, however, occur at the expense of non-preference receiving exporters.

McColloch and Pinera's framework provides a helpful, albeit general tool through which to view the political dimension of trade preferences. Within endogenous trade theory there are a number of further hypotheses on the political economy of trade policy that may better elucidate the N variable – non-economic objectives – in McColloch and Pinera's function and may further provide an explanatory framework for the granting of preferences (see Gawande and Krishna 2005 for an overview of these approaches). For one, the foreign policy model of trade policy, which emphasises the bargaining ability and possibilities of countries in both bilateral and multilateral trade negotiations as important determinants of trade policy outcomes, appears to have some explanatory power for the strategic considerations behind preference schemes. This could reasonably also be complemented by geo-strategic considerations, which would contextualise the granting of preferences as part of a broader strategic foreign policy in the context of national security objectives, or to engender support in GATT/WTO negotiations. The social change model of trade policy, which postulates that the political goal of trade policies can be the intention to reduce inequalities and raise living standards of the lowest domestic income group, furthermore provides a helpful analytical device to explain the possibility that trade policies, such as unilateral liberalisation for developing countries, could have altruistic policy-maker motivations that view poverty and inequality as problematic not just domestically, but also globally, and view preferences as a potential remedy for these. This relates closely to past work on the relevance of changing beliefs on trade policy and liberalisation. Krueger (1997) claims that “ideas with regard to trade policy and economic development are among those [factors] that have changed most radically” from the 1950 to the 1990s. This, Krueger argues, would explain the

willingness of so many more countries to liberalise, both unilaterally and through the WTO.

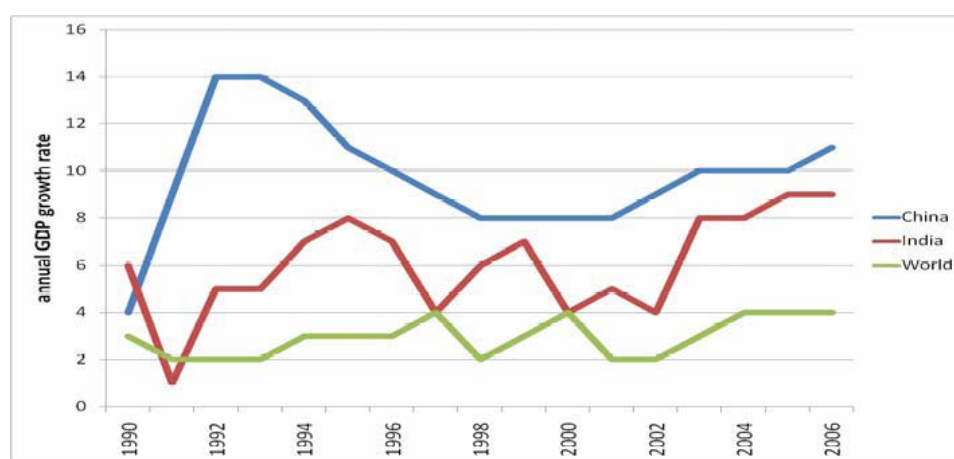
In the specific cases of China and India's trade preference schemes, all of these theories on liberalisation offer a degree of explanatory power, though the true motivations of policy-makers naturally are difficult to decipher and remain largely unknown. Nonetheless, as I argue in the next two sections, both the broader political and economic context of China and India's unilateral granting of duty-free market access for the majority of LDC exports, as well as the details of the schemes themselves, help provide some guidance in evaluating the applicability of these explanations.

## II. The New Giants

### a. China and India's integration into the global economy

Since the beginning of China and India's liberalisation processes in 1978 and 1991, respectively, these two countries have gradually emerged as powers in the global economy. Together they account for 37.5% of the world's population and 7.4% of the value of world output and income at current prices and exchange rates (Armijo 2006). However, the nature of their growth and integration into the economy has been markedly different. In China's case, annual GDP growth rates have remained well above the world average since the 1990s, while India's growth picked up significantly since 2000, and has come close to China's in recent years (see Figure 2).

**Figure 2: Annual GDP growth rate 1999-2006**



Source: WDI (from Kowalski 2008: 1)

China's share of global GDP (at market exchange rates) was equal to India's in 1980 at 1.7%. By 2006, China's share had grown to 5.5 %; India's had stagnated at 1.9%. In PPP terms, China's share is 15%, making it two fifths the size of the G6 (the US, Japan, Germany, Britain, France and Italy). India's share of world production in PPP terms has meanwhile almost doubled since 1980, growing from 3.3 % to 6.4 %. In both countries GDP per capita has also risen significantly faster than the rest of the world's (see table 2).

**Table 2: Share of world production**

	GDP at Market Exchange				GDP in Purchasing Power Parity			
	1980	1990	2000	2006	1980	1990	2000	2006
US	25.2	26.4	30.7	27.4	21.3	21.3	21.5	19.8
Japan	9.6	13.8	14.6	9.0	8.1	8.7	7.2	6.2
Germany	8.3	7.8	6.0	6.0	6.0	5.2	4.7	3.9
Britain	4.9	4.5	4.5	4.9	4.0	3.7	3.5	3.2
France	6.3	5.9	4.2	4.6	4.2	4.0	3.5	4.1
Italy	4.2	5.2	3.5	3.8	4.1	3.8	3.3	2.7
<b>G6</b>	<b>58.5</b>	<b>63.5</b>	<b>63.5</b>	<b>55.7</b>	<b>47.4</b>	<b>46.6</b>	<b>43.7</b>	<b>38.3</b>
China	1.7	1.6	3.8	5.5	3.1	5.6	11.0	15.0
India	1.7	1.5	1.5	1.9	3.3	4.3	5.3	6.4

Source: WDI (from Armijo 2007)

Nonetheless, it is crucial to not gloss over the significant differences in the manner through which these countries have grown, the role trade has played in this growth, as well as the differing nature of their integration into the global economy. While both countries have significantly lowered tariffs, China has done so at a much more rapid rate, especially since its WTO accession (Liang 2007). China's weighted mean tariff for non-agricultural products fell by 86% between 1992 and 2005. The extent of India's liberalisation is apparent by the fact that its customs duties as share of total imports has declined from 60% in 1999 to approximately 10% today, and its weighted mean tariff for non-agricultural products has declined from 49.6% in 1990 to 12.0% in 2005 (Kowalski 2008: 24).<sup>4</sup> Moreover, in its *New Foreign Trade Policy*, the Indian Government expressed its intent to double India's percentage share of world merchandise trade from 0.8% to 1.9% by 2009. China's share of global exports and imports has consistently been more than four times as large as India's, and its share of export value added in GDP (8%) is double India's (4%) for 2005, signifying that trade likely plays a less important role in India's

<sup>4</sup> In the case of agricultural products, the picture is somewhat different. India's weighted mean tariff increased slightly from 50.3 % in 1990 to 52.3 % in 2005. China has decreased its weighted mean agricultural tariff from 19.2 % to 11.8 % from 1992 to 2005.

growth than in China's (Kowalski 2008: 17). China's contribution to the growth of world trade from 1996-2006 amounted to 20 % while India's share was a mere two percent.

In the last decade, both countries have been able to gradually move into higher value-added exports, aided in part by their large domestic markets. China has gradually been diversifying away from low technology manufactures towards the ICT sector, while India has not been able to break into the mid-technology sector, though it is in the process of developing a comparative advantage in computer and communications services, travel, and financial services (Dihel and Kowalski 2008).<sup>5</sup> As Table 3 shows, China has greatly increased its share of exports in iron and steel, office machines, telecommunications equipment, textiles and apparel (Yusuf et al. 2007). Meanwhile some of India's manufacturing sub-sectors have grown significantly, particularly textiles and iron and steel.

**Table 3: Share of Cina and India in World Exports**

World Exports	1980		1990		2004	
	China	India	China	India	China	India
<u>Manufacturing</u>	0.8	0.5	1.9	0.5	8.3	0.9
Iron and Steel	0.3	0.1	1.2	0.2	5.2	1.6
Chemicals	0.8	0.3	1.3	0.4	2.7	0.7
Pharmaceuticals			1.6	1.2	1.3	1.0
Office machines and tel. equipment	0.1	n.a.	1.0	0.8	15.2	0.6
Auto parts	0.0	0.0	0.1	0.1	0.7	0.1
Textiles	4.6	2.4	6.9	2.1	17.2	4.0
Clothing	4.0	1.7	8.9	2.3	24.0	2.9

*Source:* Srinivasan 2006 (cited in Yusuf, Nabshima and Perkins 2007).

China has become fully integrated into regional supply chains and its share of high-technology manufactures among its exports is 30%. India's share has meanwhile stagnated at approximately 5%. Likewise, parts and components make up 31% of China's non-fuel imports, while this value is only 12 % for India (Dimanaran et al 2007: 73). Thus, while India has very gradually moved up the value chain in recent years, much depends on whether it will be able to adapt to product space vacated by China and other South-East Asian countries.

#### **b. China and India's trade with LDCs**

<sup>5</sup> The two countries have very different export profiles, and only have one product in common – refined petroleum – in their list of top 25 exports.

Despite the differences examined above, viewing these countries comparatively, or even in conjunction as “two giants,” still can provide a helpful framework for examining their evolving relations to other countries. This is in part due to the fact that, as Winters and Yusuf argue (2007:4) “the analytical apparatus required is similar”. This is especially true for their relations to sub-Saharan Africa, and the group of Least Developed Countries, who are the beneficiaries of China and India’s preference schemes.<sup>6</sup>

The group of LDCs have grown 7.3% per year on average between 2005 and 2007. The strong growth LDCs have experienced has – on the whole – been driven by record levels of exports and capital inflows (UNCTAD 2008: 10). This growth has, however, varied greatly between countries, with 19 LDCs growing by more than 6% in 2007, while 11 grew by less than 3%, with some LDCs even experiencing negative growth. The improved performance has also largely been attributed to rising commodity prices; 64% of the increases in LDC merchandise exports has been due to oil exports, and 12% from minerals (UNCTAD 2008: 12). While Asian LDCs have been able to gradually diversify away from primary products, African LDCs are becoming increasingly commodity-dependent.

China and India’s role in fuelling the growth of African LDCs has been significant and growing. They now import 9.7% and 1.4% of total LDC exports, while providing 11.2% and 1.7% of LDC imports. As can be seen in Table 4, both countries consume a large and growing share of the world’s primary commodities.

**Table 4: Shares in World Consumption of Primary Commodities**  
*% by volume*

<b>Commodity</b>	<b>China</b>	<b>India</b>	<b>United States</b>
<i>Agriculture 2003</i>			
Rice	29.7	21.4	1.0
Maize	17.0	2.2	32.5
Palm oil	15.8	15.3	0.6
Tea	14.4	17.5	3.8
Sugar	6.6	15.2	12.5
Cotton	31.2	12.8	6.9
Rubber	23.5	8.4	12.9
<i>Metals 2005</i>			
Aluminium	22.5	3.0	19.4
Copper	21.6	2.3	13.8
Iron ore	29.0	4.8	4.7

<sup>6</sup> It is important to differentiate between the 49 countries classified as “least developed” and sub-Saharan Africa. Because the majority of LDCs are in Sub-Saharan Africa, however, a large part of the focus of this paper will be on China and India’s trade with Sub-Saharan Africa.

Zinc	28.6	3.1	9.0
Steel	31.5	3.5	8.5
<i>Energy 2003</i>			
Coal	32.9	7.1	20.6
Oil	7.4	3.4	25.3

Source: *Winters and Yusuf 2007*

It has widely been argued that countries, whose exports match China's imports are likely to receive a boost as it continues to grow rapidly, and the same can – broadly speaking – also be assumed for India (see for example, Stevens and Kennan 2006). LDCs are frequently among the main producers of Indian and Chinese imports, and both countries have greatly increased their trade with the LDCs. Between 2000 and 2006, LDC exports to China have grown five-fold (see table 5). This growth is even larger for African LDCs, whose exports have been increased ten-fold since 1990. Trade with Asian LDCs has also grown significantly, but is dwarfed by exports from African LDCs.

**Table 5: LDC exports to China, at current prices in US \$ (millions)**

	1990	1995	2000	2001	2002	2003	2004	2005	2006
<b>Least developed countries</b>	300	862	4007	2802	3460	6,268	10,409	15,376	20,402
<b>LDCs: Africa and Haiti</b>	167	293	3,036	2,147	2,807	4,444	8,574	12,146	17,600
<b>LDCs: Asia</b>	133	568	958	649	635	1,792	1,774	3,133	2,676

Source: *Comtrade*

India's trade with LDCs, as indicated in Table 6, has quadrupled since 1990 and more than doubled since 2000. However, in India's case the majority of imports, especially in recent years, have come from Asian LDCs, many of which have received preferential access as members of the South Asian Association for Regional Cooperation (SAARC) as well as, since 2006, through the South Asian Free Trade Agreement (SAFTA).

**Table 6: LDC exports to India, at current prices in US \$ (millions)**

	1990	1995	2000	2001	2002	2003	2004	2005	2006
<b>Least developed countries</b>	516	614	993	1,844	1,316	1,427	1,571	2,019	2,372
<b>LDCs: Africa and Haiti</b>	340	272	345	430	510	548	653	853	771

<b>LDCs:</b>									
<b>Asia</b>	167	342	621	1383	800	865	912	1125	1551

Source: *Comtrade*

However, much of China and India's trade with LDCs has been in raw materials, with the processing generally conducted in the importing country. This is further exacerbated through India and China's 2006 structure of tariffs for products from Africa. China levies a 6.5% average duty on raw hides from Africa, but leather and manufactures leather were taxed at 8.8% and 14.6% respectively. Similarly, unroasted coffee had an 8% tariff, while the tariff for roasted coffee was 15%. India and China have both allowed duty-free imports for crude petroleum, but have charged a 15% and 7.4% tariff, respectively, for refined petroleum products. Similar patterns emerge for cotton and apparel, as well as – in China's case – for raw diamonds and cut diamonds. The structuring of China and India's tariffs for African exports and their processed derivatives thereby create the risk of preventing LDCs, particularly in Africa, from diversifying into higher value-added activities.

**Table 7: Tariffs in India and China for Africa's leading exports (in %)**

Products	China	India
Raw hides	6.5	0.1
Leather	8.8	14.7
Manufactures leather	14.6	15
Oil seeds	5	30
Vegetable oils	10	45
Coffee, not roasted	8	100
Coffee, roasted	15	30
Cocoa beans, raw	8	30
Cocoa powder	15	
Petroleum oils, crude	0	
Petroleum products refined	7.4	15
Diamonds sorted	3	
Diamonds cut	8	15
Other precious/semi-precious stones	7.3	15
Jewellery	26.8	15
Cotton	27	10
Cotton yarn	5	15
Cotton fabrics, woven	10	15
Jerseys, etc. of cotton	14	0
Undergarments knitted	14.1	15

Source: UNCTAD TRAINS (in Broadman 2007: 17), darker shades signify a higher processing level.

### **c. A new silk road or a new scramble**

In conjunction with its rapidly increasing trade involvement, China and to a lesser extent India, have become major political players in sub-Saharan Africa. This has been accompanied by an occasionally hyperbolic debate warning about the next scramble for Africa. In its 2006 *White Paper on Africa Policy*, the Chinese Government elucidated its principles for increased engagement with Africa, declaring that it will “respect African countries’ independent choice of the road of development” and provide assistance “with no political strings attached.” In November 2006, Beijing hosted the first Heads of State Summit of the Forum on China-African Cooperation (FOCAC), during which China announced that it would double its development aid by 2009, increase of its provision of technical assistance and non-concessional loans, as well as provide a \$5 billion fund to promote Chinese investment in Africa, and the cancellation of certain debts for LDCs and Highly Indebted Poor Countries. (HIPC). At the FOCAC, China moreover announced its initial list of 190 products that would receive its SPT treatment.

While this increased investment has been widely welcomed, concerns have been raised about China’s policy of non-interference, especially in regard to two of China’s largest trading partners in Africa, Angola and Sudan. In the case of Angola, Taylor (2007:17) has argued that China’s “no strings” engagement “allows the elites in Luanda to continue to be corrupt and ignore governance norms.” When Angola was not granted an IMF loan until it agreed to transparency conditions, China readily agreed to provide a \$2 billion loan. This loan also entailed an agreement that Angola would provide China with a fixed supply of oil, while China agreed to heavily invest in Angola’s infrastructure, though clarifying that up to 70% of this work could be contracted to non-Angolan firms. China has moreover become the largest foreign investor in Sudan, and concerns have been raised over its willingness to supply weapons to a government widely under sanctions and accused of systematic human rights abuses. China has defended its approach by pointing to its respect for sovereignty and has stated – in the words of one Chinese diplomat (cited in Liang 2007: 141) that “[t]here is no need to mix politics into business, which was the mistake we made in the 1960s and 1970s.” To placate Western criticism of its close relationship with Khartoum, China has sent troops to participate in the UN mission in Sudan and has abstained in votes on limited sanctions against the Bashir regime within the UN Security Council.

India's engagement with African LDCs has tended to be on similar terms, albeit at a significantly smaller scale. In 2008 India held its first India-Africa Forum in Delhi. At the Forum, India announced not only its duty-free preference scheme, but also unveiled a "blueprint" for intensifying engagement with Africa. This blueprint would include expenditures in the order of \$500 million on infrastructure projects, as well as increasing the extent of its technical assistance. This, some commentators have argued, was triggered in part by the Indian Government's growing anxiety over China's influence on the continent and a desire to mimic the close ties China has established in recent years. While on the whole India's trade with Africa has been less resource-based, its increased need for energy to drive its growth may change this over time (Goldstein et al. 2006). India's engagement in Africa, Philip Alves of the South African "Institute of International Affairs" argues, represents "a mini-China approach ... . It has all the same elements except on a much smaller scale."<sup>7</sup> India has established a presence in all the same countries as China, including Sudan, and its trade with the continent has increased more than 30-fold between 1990 and 2007.

The heavily commodity-based composition of African exports to China and India has raised concerns that these increased revenues will not lead to broad-based welfare gains. Edwards and Jenkins (2005, cited in Goldstein et al. 2006) have argued that oil and mineral exports have very minimal poverty reduction impact, as the windfalls tend to accrue to a small elite, while at the same time depleting finite resources. Currently China and India therefore only contribute to Africa's export diversification in terms of destination markets, but are not contributing significantly to Africa's production diversification and source diversification (Broadman 2007). In this context, China's and India's increased trade with LDCs, and particularly with many Sub-Saharan African states, needs to be seen as a somewhat mixed blessing that could exacerbate the pre-existing commodity-based export structures, while demonstrating tacit acceptance of widespread corruption and human rights abuses in some of its largest trading partners.

### **III. China and India's LDC preference schemes**

#### **a. Product coverage and inclusion**

As indicated in the previous section, China and India's duty-free schemes for LDCs were announced within the framework of broader cooperation and development packages geared mostly towards the African continent, and in the context of rapidly

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<sup>7</sup> *Financial Times* (8.8.2008) "India follows China's path with Africa overture"

increasing trade with Africa. Both China and India announced their schemes during high-level summits between African heads of state. Moreover, these expanded schemes were announced following the Hong Kong Declaration, while other large developing countries, such as Brazil and Korea were likewise declaring their intent to unilaterally liberalise their markets for LDCs.<sup>8</sup>

However, there are significant differences between the two schemes, including the scope of their coverage, eligibility, and rules of origin, among other areas. China's first announced duty-free access to 190 of its tariff lines beginning in January 2005 through its Special Preferential Tariff, and extended to 42 LDCs, including 31 in Africa and 11 in Asia-Pacific.<sup>9</sup> In November 2007, China's SPT was extended to 440 tariff lines, offering an average preferential margin of 10.4%. Coverage has been extended to all LDCs who have established diplomatic relations with China, including 31 LDCs in Africa, and 11 in Asia-Pacific. Minson (2008) examined the value of preferential access for African countries, and through a simple implicit transfer estimate found that the scheme would lead to a \$10 million in additional revenue per year. The additional duty-free products only represent 1.2% of LDC exports to China, with 90% of exports (especially in oil and minerals) already entering duty-free under the MFN rate. However, the increased preferential margin is of particularly relevance for some LDC exports, such as sesame seeds, cocoa beans, leather, copper and cobalt. Moreover, 49 products not currently exported by African LDCs offer potential for diversification, particularly textiles, yarn and thread. Raw cotton, on the other hand, a significant export for many LDCs, still faces a 40% MFN rate. However, this does offer some potential for expansion into higher value-added manufacturing sectors, especially in garments.

India's LDC preference scheme, launched in April 2008 at the China-India Forum, was preceded by its granting of zero duty access to LDC exports from South Asia, under SAFTA. Among some civil society groups in India there had been building pressure to extend this to other LDCs, as a quid pro quo for LDC support of India's

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<sup>8</sup> Both countries have yet to formally implement their preference schemes. In 2006 Brazil announced that it would offer DFQF access for 32 LDC WTO members beginning in the first half of 2007. Already at the time of this announcement, however, there was some anxiety on the part of Brazilian business associations that were concerned about the effects of full liberalisation, particularly in textiles, electronics, chemicals, and machine equipment, and lobbied for extensive exemptions, as well as a value added rate of 50% (see *Bridges Weekly Trade Digest* (6.12.2006) "Brazil to Grant Duty and Quota Free Market Access To LDC Exports")

<sup>9</sup> Countries not benefiting from China's Special Preferential Tariff include Burkina Faso, the Gambia, Haiti, Kiribati, the Maldives, Sao Tome and Principe, Tuvalu, and the Solomon Islands

efforts to dismantle Western farm subsidies within the G-20 and G-3.<sup>10</sup> The Indian Government in turn commissioned UNCTAD India to produce a report outlining options for an LDC preference scheme. While only the Executive Summary of the report has been made publicly available, it appears that the Government incorporated many of the findings into the structure of its scheme.<sup>11</sup> The scheme is quite comprehensive, offering preferential access on 94% of total tariff lines, comprising 92.5 % of global exports of all LDCs, effective May 1<sup>st</sup> 2008. As of the end of 2008, 12 LDCs had registered for the scheme, though more are expected to follow, and all 50 LDCs are eligible to participate. The most relevant products that would receive preferential access include cotton, cocoa, aluminium ores, copper ores, cashew nuts, cane sugar, ready-made garments, fish fillets, and non-industrial diamonds. For 85% of India's tariff lines, duty free market access would be phased in over five years, with five annual tariff reductions of 20% on current applied rates. On a further 9% (468 products), India will grant an average margin of preference of 48%, granted from the beginning date of the scheme. For 328 items (at the HS-6 level) no tariff preference is available. To what extent this overlaps with the 10 African exports that the UNCTAD study identified as sensitive is unclear. However, as these products account for 40% of the current value of bilateral trade, and seven of these products are liberalised under India's preferential trading agreements with other countries, it stands to reason that at least some of these ended up on the positive list.<sup>12</sup>

#### **b. Rules of Origin and Administrative Barriers**

As discussed earlier, rules of origin play a crucial role in ensuring that trade preference schemes can be utilised by the recipient country. Therefore, the UNCTAD India report called for a general simplification and relaxation of the rules of origin. To what extent this was achieved in the Indian scheme is questionable. It stipulates that i) the local value added content in the beneficiary country is at least 30%, ii) a change of tariff heading at the 4-digit level take place, and iii) that the final process of manufacture

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<sup>10</sup> See, for example, Mehta, P.S. and Kumar, P. "Duty and Quota Free Market Access to LDCs – India and China must act now" *Hindu Business Line* (13.6.2007).

<sup>11</sup> The study recommended that all products which are bilaterally traded are to be included in the positive list. India may also consider granting preferential access to African LDCs on other products which are covered under SAFTA, Indo-Mercosur and the Bangkok Agreement. On this basis, preference would be granted to some 2000 products at the 6-digit level.

<sup>12</sup> . The study moreover identifies 46 sensitive items for Asian LDCs who are receive preferential access through SAFTA – predominantly in the textiles and garment sector - constituting 7% of total imports from these countries. As the details of the study are not being published, it is unclear to what extent concerns raised about competition to domestic producers, or erosion of SAFTA preferences contributed to the products listed on the negative list

is performed in the exporting country. While cumulation across LDC beneficiaries is not allowed, inputs sourced from India would be included in the calculation of value added content. The UNCTAD India report moreover called for a removal of the frequently onerous non-tariff barriers for LDCs as well, but no provisions along these lines were specified in the scheme itself.

The Rules of Origin in the Chinese scheme require 40 % value added or a change of tariff heading. In that sense, despite the higher value added content, the requirements are more permissive than in the Indian scheme. Concerns have also been raised about potential burdens for LDC exporters due to sanitary and phyto-sanitary standards (SPS) and technical barriers to trade (TBT). Minson (2008) has pointed out that according to China's 2006 *Trade Policy Review*, 6.5% of China's tariff lines were subject to discretionary import prohibitions on the grounds of health, environmental safety and national security and this applies to at least two of the 440 tariff lines receiving the Special Preferential Tariff (Minson 2008).

### **c. Comparison to other LDC schemes**

Both the EU's *Everything but Arms* initiative and the US's *African Growth and Opportunities Act* offer significantly wider coverage than the Indian and Chinese schemes. AGOA offers duty-free access for 98% of tariff lines, while a number of sensitive products are subject to quotas.<sup>13</sup> EBA covers 99.7% of tariff lines, equalling 98% of current LDC import value. Exemptions exist for arms and ammunition, while quotas for rice and sugar are being phased out during the latter half of 2009. In this regard, they are more comprehensive than the Indian and Chinese schemes.

However in comparatively assessing potential welfare gains for LDCs, the devil is frequently in the detail. Despite EBA's extensive coverage, Brenton (2003) argues, the changes introduced have frequently led to only minor static gains as the majority of LDC exports already entered duty-free. While this may have changed for LDCs since the end of the Cotonou Agreement, the Economic Partnership Agreements (EPAs) would again make EBA obsolete.<sup>14</sup> AGOA has offered a significant improvement to the US GSP for many of the products covered.

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<sup>13</sup> Steel products, canned peaches and apricots, and dehydrated garlic; sugar, tobacco, peanuts, beef and some dairy products subject to quota access.

<sup>14</sup> However, precisely because LDCs would have to also have to make significant concessions in offering the EU market access, the existence of EBA preferences acts as a disincentive for many LDCs to sign EPAs.

AGOA, unlike EBA and the Chinese and Indian schemes, covers only African countries, including 28 LDCs and 12 non-LDCs. Moreover, it allows for cumulation across its scheme. Allowing for regional cumulation can be decisive in an increasingly fragmented production chains (Collier and Venables 2007). The absence of cumulation with other LDCs in the Chinese and Indian schemes can complicate the ability of these countries to use specialisation in very narrow tasks to break into low-technology manufacturing. While EBA allows for cumulation across the scheme, it only applies to LDCs. This, as Page and Hewitt (2002) have argued, creates the possibility of trade diversion from low-income countries to LDCs, and in Africa there are many cases of neighbouring countries (Malawi and Zambia with Zimbabwe, Uganda and Tanzania with Kenya) where the duty-free exports of the Least Developed are likely to compete directly with their LIC neighbours' exports, which are subject to GSP or MFN rates.<sup>15</sup> While EPAs are arguably attempting to address this, the EU's current system of layered preference systems – GSP, GSP plus and EBA – may entail a negative externality on less preferred developing countries, and may create dynamic losses in foregone diversification opportunities (Borchert 2008).

Rules of origin play a highly significant role in determining whether a country is able to utilise its preferential margin to expand into manufactures. Mattoo and Subraminian (2003) have argued that AGOA's rules of origin restricted the ability of countries to take advantage of these preferences in textiles. However, a 2004 revision in the scheme which allowed for third-country sourcing of inputs has seen a significant supply side response in a number of African countries. In Lesotho, Kenya and Swaziland, apparel accounted for 100 %, 99 % and 99 % of AGOA preferences for these countries, respectively (Brenton and Ozden 2006). EBA's rules of origin require that clothing be produced from yarn, meaning that a double transformation needs to take place. The rationale behind this is that it would allow for substantial value added activities and vertically integrated production, however in practice it has prevented the creation of substantial LDC textile or apparel exports to the EU.

The lack of regional or even LDC cumulation in China and India's schemes, as well as the relatively stringent rules of origin ensure that many of EBA's problems are also relevant in the new schemes. However, this also increases China and India's ability

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<sup>15</sup> Page and Hewitt (2002) also point to the fact that LDCs, by definition, must have a population below 75 million. Therefore, low-income countries that could qualify under the other requirements (per capita income, human resource indicators, and economic vulnerability) are exempted. LDC schemes therefore, by their nature, exclude the majority of the world's poor.

to integrate these countries into its own supply chains. Both countries have made pledges to increase their foreign direct investments in Africa, and this could be decisive in increasing export capacity, particularly if it also benefits non-extractive sectors. Broadman (2007) argues that there are clear complementarities between African countries and China and India in a cotton-textile-garment value chain, with cotton supplied from West Africa to China and India to be turned to fabric, to then be re-exported for apparel production in Sub-Saharan Africa. As demonstrated in table 8, Chinese firms have attempted to control large parts of the production chain in African countries, while Indian firms have made this less of a priority. Rather, they have attempted to facilitate greater integration into domestic and regional markets, frequently also operating through informal expatriate trader networks.

**Table 8: Distribution of Material Input Purchases by Origin Market and Firm Nationality (percentage)**

<b>Origin Market</b>	<b>African</b>	<b>Chinese</b>	<b>Indian</b>	<b>European</b>
Domestic	60	31	27	40
Other Africa	7	4	9	9
Europe	13	1	13	34
North America	3	5	1	6
India	5	2	26	3
Other South Asia	3	1	4	1
China	4	55	7	3
Other East Asia	2	1	3	3
Other	2	0	11	1

*Source: Broadman 2007: 31 (pertains to 2005 median annual purchases)*

Through their preference schemes both countries have seemingly attempted to facilitate this integration process: India has granted duty-free access for raw cotton, as well as some apparel products. The Chinese scheme does not offer preferential access on raw cotton, but China has offered the SPT for a number of yarns, threads, fabrics and apparel products. India has offered preferential margins on cotton, wool and yarns, though non-SAFTA LDCs would continue to pay MFN rates on most textiles.<sup>16</sup>

<sup>16</sup> The Indian scheme was publicly supported by the chairman of the Indian Cotton Textile Export Promotion Council, who saw the preference scheme as a boost for India's textile industry, as it offered opportunities to export yarn or fabric to Africa for conversion into garments. He nonetheless insisted that a 40% value added requirement should have been included for any yarn or fabric to protect from garment imports (see *Business Line* (9.4.2008) "Tariff Preference plan will help Indian Textiles Sector")

As pointed out in Section 1, the potential welfare gains of trade preferences are inherently limited by the uncertainty of sustained access, which constrains potential supply-side responses. While the US Congress has extended AGOA through 2015 (including access to third-country apparel inputs subject to quotas), preferences can nonetheless be revoked. Both AGOA and EBA are autonomously enacted and their potential withdrawal can be used as threats to extract concessions. AGOA privileges are subject to annual reviews, and beneficiaries must be seen to make progress towards establishing a market-based economy and the rule of law, eliminating barriers to US trade and investment, implementing poverty reduction strategies, protecting worker rights and establishing a system to combat corruption. EBA has relatively low conditionalities; nevertheless temporary suspension from the programme is possible. Moreover, its gradual obsolescence as regional EPAs are signed, means that countries will have adjust to these new trading arrangements. Mold (2005) points to the fact that EU standards and import rules are often changed during the course of a few months increasing the uncertainty of access for exporting LDCs.

Similar terms apply for the Chinese and India schemes. The Indian scheme explicitly allows for the removal of products from its positive list if they begin to threaten domestic producers, and while not explicitly stated, the nature of unilateral preferences would permit China to do likewise. Moreover, as quality standards, and especially sanitary and phyto-sanitary standards, in India and China begin to converge with OECD countries this could make it ever more difficult for LDC exporters to increase their market shares. In this regard, preference schemes – like other forms of development assistance – can easily become a reward held out to countries allied with China and India’s geo-strategic or national security interests, while punishing those countries who don’t cooperate with their suspension from the programme.

#### **d. Analysis**

The preceding examination of China and India’s recently unveiled preference schemes for LDCs allows for some preliminary conclusions, both on the political economy of these two countries’ trade relations with LDCs, and on the political economy of unilateral trade preferences more broadly. It appears that these trade preferences are symptomatic of China and India’s broader liberalisation strategies in the context of their integration into the global economy. Moreover, the motivations behind these schemes seem to contribute to broader strategic aims of securing access to African

commodities, and particularly oil, which has become a major driver of China's foreign policy. India likewise lacks significant fossil fuel reserves and its increasing energy-vulnerability must be seen as at least as a partial incentive to its increased engagement in Africa (Armijo 2007). Nonetheless, while potential gains for LDCs benefit broader industrial production strategies in the preference-granting countries, they do seem to offer at least some potential for its beneficiaries to develop nascent industrial capacities in higher value-added products.

This is all the more significant as sustained growth in China and India could create a window of opportunity for African LDCs to expand into higher value-added activities. In a CGE analysis, Freund and Ozden (2006, cited in Dimanaran et al 2007) have attempted to project the results of China's and India's continued and accelerated growth through the year 2020 and found that other countries tend to benefit from cheaper imports from China and India, as well as from these countries' increased aggregate demand. However, this varies from county to country and is highly contingent on whether other countries can move into the product space vacated by China and India. The challenge, Winters and Yusuf (2007) argue, is for low-income countries and LDCs without natural resources and limited human capital, to develop manufacturing capacity in low-wage, labour-intensive industry that can compete with these sectors in China.

However, at this point the ability of LDCs, and particularly of African LDCs to occupy this product space is constrained by a dire need for improvements in these countries' supply-side capacities. Therefore it is crucial, as Hoekman and Prowse (2005) have argued, to not merely concentrate on the depth of liberalisation, but on what measures developing countries should take to improve competitiveness and productivity of national firms. This points to a need for broader behind-the-border trade reforms in order to alleviate poor infrastructure quality, inefficient factor markets, unfavourable regulations, and weak governance. A gravity model analysis in Broadman (2007) found that preferential access and importer restrictiveness is only a significant factor in improving export competitiveness for manufactures, not for general merchandise trade. However, behind the border improvements could lead to much more significant gains. A 10% improvement in export customs procedures would lead to a 15.8% improvement in trade competitiveness (17.1 % for manufactures). Even more significantly, improvements in domestic business procedures would have an almost four-fold rate of return (see Table 9).

**Table 9: Predicted percentage increase in Africa's bilateral exports from improvement in factors (based on augmented gravity model)**

<b>10% improvement in exporter country</b>	<b>All merchandise exports</b>	<b>Manufactured Exports</b>
Export customs procedure	15.8	17.1
Internet access	1.9	2.2
Domestic business procedure	38.4	28.4
Power infrastructure	2.3	15.3

Source: *Broadman (2007: 111)*

A 2008 report by the United States International Trade Commission found that of African export sectors that performed best from 2000 to 2006 all shared three common factors: increased global prices as a result of demand growth, investment in new and expanded production capacity, and the implementation of policies and programmes to promote industrial development. The effect of tariff preferences is viewed as secondary, along with other factors such as increased regional integration, improved product quality, and improved industry organisation. Preference schemes were only seen to play a significant role for the footwear and textiles sectors, due to both AGOA and South Africa's elimination of tariffs for SADC partners. This increasingly points to the fact that the current structure of disparate trade preferences on their own will achieve little in bringing about broad developmental gains for LDCs.

This brings us back to the political role preferences serve for the preference-granting countries and their ability to satisfy the non-economic objectives in McColloch and Pinera's social welfare function. The new schemes provide China and India with an additional carrot in their relations with developing countries, in the form of increased market access. At the same time these preferences create a stick – their removal– and thereby present LDCs with the risk of having any preference-aided export capacities nipped in the bud. Moreover, the lack of strings China attaches to its engagement with certain LDCs can also be seen, as Liang (2007) argued, as an exportation of its own model of an authoritarian developmental state. It is also not unlikely that India expects continued support within multilateral forums, especially the WTO, where it has been one of the major players within developing country coalitions (see Hurrell and Narlikar 2006). While it is possible that these countries broader development packages also have an ideationally altruistic component intended to decrease global inequalities and alleviate poverty in LDCs, the structure of the schemes, both in terms of product exemptions and their rather inflexible rules of origin indicates that they were at least in part shaped by ensuring that import-substituting domestic industries would largely be shielded. Thus, while China and India's trade preference schemes indicate that these have now also

become an integral part of the toolkit for emerging donors, their schemes suffer from many of the same political economy limitations as those of the traditional OECD donors.

#### **IV. Concluding thoughts**

Despite the political economy constraints that limit the effectiveness of preferences, it is nonetheless worth considering two options of how the developmental goals underlying the growing web of disparate preference systems could more efficiently bring about improved export competitiveness in the developing world. A common recommendation in this regard is to increase the integration of preference schemes, while offering full duty-free quota-free access to Western (and potentially BRIC) markets. Collier and Venables 2007 have argued that this would offer LDCs significant improvements, and Mold (2005) argues that various preference systems should be “strengthened and improved, simplified, harmonised, depoliticised and possibly generalised to increase their potential benefits.”<sup>17</sup> Moreover, a recent general equilibrium analysis by Vanzetti and Peters (2009) on welfare gains to LDCs from 100% DFQF access found that this would increase exports from LDCs to developed countries by \$7.5 billion. Adding China, India and Brazil would add a further \$70 million.<sup>18</sup>

A more comprehensive solution that would also bring significant gains for LDCs entails a successful conclusion of the DDR. While this seems unlikely in the present economic and political climate, the role of international institutions in helping policy-makers make welfare-maximising decisions that may be domestically unpopular should not be underestimated. Milner (1999:111) has argued that in past liberalisation efforts, the GATT/WTO “allowed countries to design wide-ranging packages of reciprocal trade concessions that fostered broad liberalisation.” Similarly, in relation to domestic reforms, Haggard and Webb (1994:13) state that in every successful reform effort, politicians delegated decision-making authority to units within the government that were insulated from routine bureaucratic processes, from legislative and interest group pressures, and even from executive pressure. This essentially implies the need for a depoliticisation of the political economy of trade, which may be illusory, particularly during a global economic crisis accompanied by a protectionist resurgence (see Newfarmer and Gamberoni 2009).

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<sup>17</sup> This suggestion was recently reiterated by the Joseph Stiglitz’s UN *Commission for Financial Reforms*.

<sup>18</sup> Vanzetti and Peters assume LDCs could immediately supply all these markets, and that factor out issues such as SPS, TBT and other NTBs.

However, numerous studies have shown that multilateral liberalisation would bring widespread welfare gains, and that erosion would be far less significant than assumed. An OECD study (2004, cited in Heydon and Woolcock forthcoming) found that given a 50% reduction in ad valorem tariffs across all regions, preferential exports would decrease as a consequence of erosion, but new opportunities from MFN tariff reductions offset the negative effect for all but five countries (Colombia, Madagascar, Mozambique, Tanzania and Uganda).

However, in order to provide freer trade and the increases in global welfare entailed therein, these negative effects through global tariff reductions need to be addressed proactively and comprehensively. Hoekman and Prowse (2005) argue that a shift away from preferential “trade as aid” towards “a more efficient and effective instrument to support the poor countries could both improve development outcomes and help strengthen the multilateral system.” Limao and Ollareaga (2004) have, for example, proposed one such mechanism of decoupling preferences from MFN liberalisation in a pareto-improving manner, by moving towards a global system of import subsidies that compensate developed countries for foregone revenues.<sup>19</sup> This would remove the stumbling-block effect preferences and concerns over their erosion create, while allowing for a more efficient and less politicised system of preferential access.

In the short run, however, it may be necessary to address the constraints on preference utilisation, both entailed in the schemes, and on a supply-side level, if the counterfactual continues to be little or no action to improve LDC export competitiveness. Increasing duty-free access would offer welfare gains, particularly in the case of a sustained stalemate in the WTO, or as part of an “early harvest”. More optimistically, it may, as Collier and Venables (2007) have postulated, enable some countries to reach a new stable equilibrium in manufactures by allowing a temporary preferential window for the formation of export clusters and economies of scale. However, considering the political economy constraints on decisive action in improving DFQF schemes, three specific areas offer potential for improved utilisation of schemes and should be studied in greater detail and in a well-resourced manner:

- The role of administrative barriers, including rules of origin, health and environmental standards, sanitary and phyto-sanitary standards, and technical barriers

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<sup>19</sup> This would require a revision of WTO rules, but could be addressed through a similar provision as the Enabling Clause.

of trade, in limiting preference utilisation has been a frequent source of critique. However, we have only limited understanding of the specific relevance on a country-by-country basis of these additional hurdles in preventing LDCs from increasing their export capacity. Firm-level studies, complementing the DTIS process, should be undertaken to see where specific administrative standards restrict export capacity, and to what extent these could be eliminated for LDCs and LICs without significant concerns being raised by import-competing industries in the preference-granting countries. Country-level surveys of these barriers to preference utilisation could allow for recommendations where minor amendments and revisions to the trade regulations of preference granting countries could enable exporters in developing countries to expand their capacity.

- The ability of LDC exporters to utilise several preference schemes simultaneously should be facilitated. LDC products frequently are exported under one preference scheme, and to only one market. The ability to allow for access to other preference systems once a producer has been licensed to export under one scheme should be greatly facilitated, perhaps through the sharing of documentation, or through a centralised authority or even a website that gives simple instructions on how to use the various preference schemes.
- The Washington-based *Center for Global Development* is in the process of launching a high level working group on preferences with representatives from IFIs, think-tanks, the private sector, NGOs, and developing and developed country governments. Its intent is to develop specific recommendations by early 2010 that would lead to identifying limitations of preference schemes, and providing a set of policy recommendations for developed countries, and emerging markets with new LDC trade preferences, to improve and coordinate their trade preference schemes to better serve development objectives. These recommendations will hopefully lead to renewed high-level debates on the prospects for improving trade preferences for developing countries.

However, any substantial progress will require increased willingness among policy-makers, both in developed countries and in emerging powers, such as China and India, to make LDC export competitiveness a worthy aim for its own sake. Therefore, policy-makers must integrate concerns about poverty and inequality in the world's poorest countries into the underlying premises on which their policy-making calculus

rests and decouple these concerns from narrow national economic and geo-strategic interests.

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**Annex 1: LDCs Trade Preferences by the G7, Australia, Brazil, India and China (as of 1.2.2009)**

<b>Provider of Preferences</b>	<b>System of Preferences for LDCs</b>	<b>% of tariff lines exempt</b>	<b>Product Exceptions</b>	<b>Participation</b>	<b>Rules of Origin restrictions</b>	<b>Quota-free?</b>	<b>Conditionalities</b>	<b>Administration</b>	<b>Security of Access</b>
<b>US</b>	<b>AGOA</b> (as enhancement of standard GSP, esp. for textiles and clothing)	98% duty-free, sensitive products subject to quota restrictions (covers 1800 tariff lines more than US GSP)	Steel products, canned peaches and apricots, and dehydrated garlic; sugar, tobacco, peanuts, beef and some dairy, products subject to quota access.	40 countries in SSA (including 28 LDCs)	35% domestic value added (special rules apply for textiles) <sup>i</sup>	Yes, except sensitive products	High Political conditionalities (annual USTR review) <sup>ii</sup>	USTR-approved visa system	Autonomous, but extended in 2008 until 2015
	<b>GSP</b> for least-developed beneficiary developing countries	84% (70% of all LDC import value)	Cotton textiles, wool, some fibres, watches; certain footwear handbags, luggage, other leather items	43 LDCs	35% domestic value added	No	Some political conditionalities (annual USTR review) <sup>iii</sup>	Customs entry form with certification of origin	Autonomous, reauthorized in 2009 through 2015
<b>EU</b>	<b>EBA</b> (Everything but Arms), part of EU GSP	99.7% (98.0% of current LDC import value)	Arms and ammunition; rice and sugar phased in until 1 September and 1 July 2009, respectively	49 LDCs	Depending on product (generally 30-50%, or CTH). Cumulation across LDCs <sup>iv</sup>	Yes, except sensitive products	Low political conditionalities	Customs declaration, certificate of origin	Autonomous (since 2001)
<b>Canada</b>	<b>GPT</b> (General Preferential Tariff)	Duty-free access for all products (over-quota access for sensitive products)	Dairy, poultry and eggs subject to over-quota access	Almost all LDCs	60% value added, cumulation for Canada and GPT countries.	Yes, except sensitive products	Low political conditionalities	Exporter Declaration	Autonomous (entered into force 1 April 2007)
<b>Japan</b>	General System of Preferences	98% (8,859 tariff lines, 99% of import value)	Some agricultural products (especially rice)	Almost all LDCs	CTH, cumulation includes Japan only	Yes	Low political conditionalities	Bill of landing, certification of transit countries, certificate of origin	Autonomous, in force since 2007

<b>Australia</b>	Australian System of Tariff Preference Duta- and quota-free entry	100%	None	Almost all LDCs	50% domestic value added, cumulation for all ASTP countries	Yes	Low political conditionalities	Invoice, Customs form, declaration of origin	Autonomous, in force since (since 1 July 2003)
<b>India</b>	Duty-Free Preference Scheme for Least Developed Countries	85% tariff lines are duty free, 9% receive preferential access (includes 92.5% of import value)	328 Sensitive items	Almost all LDCs (currently 50)	30% domestic value added and CHT, cumulation with India only	Yes	Low political conditionalities	Certificate of origin, bill of landing, invoice customs declaration	Autonomous (enacted in August 2008)
<b>China</b>	Special Preferential Tariff Treatment	440 tariff lines exempt from duty, (98% of import value)	Sensitive products (including cotton)	39 LDCs	40% domestic value added or CHT, no cumulation	Yes	Low political conditionalities	Certificate of origin, bill of landing, invoice and certification of transit countries	Autonomous (enacted in May 2006, expanded in November 2007)
<b>Brazil</b>	Duty-free and quota-free market access (not implemented yet)	To be decided/ unclear at this time	900-1200 sensitive items (most likely in textile, electronics, chemical and machine equipment sectors)	At least 32 LDCs (all WTO members)	40-50% domestic value added (to be decided)	Yes	Low political conditionalities	TBD	Autonomous (announced in 2006)

**Sources:** WTO, UNCTAD, ICTSD, USTR, EU Commission, CUTS, Government of India, Government of China, Stevens and Kennan 2004.

<sup>i</sup> No restrictions for apparel made from US yarns and fabrics, and from SSA yarns and fabrics until 2015 (subject to quota), and apparel made with third-country yarns and fabrics subject to quota until 2012.

<sup>ii</sup> Requires progress toward establishment of market-based economy and the rule of law, elimination of barriers to US trade and investment, implementation of poverty reduction strategies, protection of worker rights and establishment of system to combat corruption, as evaluated annually by President.

<sup>iii</sup> Country must respect IPRs, labour rights and resolve investment disputes.

<sup>iv</sup> More generous regulations apply to some countries that have signed EPA.

<sup>v</sup> Not enacted yet; negotiations with Brazilian industrial sector seem to be ongoing.