

Highlights



Inability to reach consensus on a number of key issues and with revealed differences of interests between advanced and developing countries (including LDCs) in the course of the Doha Round have resulted in a perceptible shift towards mega-RTAs. Geopolitical interests and growing demands of global value chains and production networks have led countries to go for deepening integration through mega-RTAs



Challenges originating from mega-RTAs: trade diversion; preference erosion; implications for countries that are left out; adverse consequences for WTO as the global institution guiding multilateral trade



Structural and economic transformation and deeper South-South cooperation to foster competitiveness could help LDCs to offset the negative implications of mega-RTAs



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The Emerging New Trade Alliance Scenario *Why the LDCs Should be Concerned?*

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Background

Multilateral trading system plays a critically important role in defining whether Least Developed Countries (LDCs) are being able to take advantage of trade, and make it work for their development. Advancing the cause of their trade-related interests has assumed heightened relevance under the prevailing global trading scenario. There is, thus, a strong case to identify appropriate modalities to secure the interests of the LDCs in the World Trade Organization (WTO), the key driving force steering the multilateral trading system.

The recent emergence of mega-RTAs could significantly undermine LDCs' export to the larger economies (Palit, 2015). The traditional Quad members, namely European Union (EU), the United States (US), Canada, and Japan, along with several other advanced economies and large developing countries, are the key players in the evolving mega regional trade agreements (mega-RTAs). These countries have traditionally provided preferential market access to the LDCs through the *Generalized System of Preferences* (GSP) schemes as well as unilateral and preferential tariff preferences. Elimination of import tariffs on a wide range of items among the participating countries in the mega-RTAs may result in LDCs facing comparatively higher tariffs on their exports while similar export items from the RTA participants are likely to enjoy reduced or duty-free and quota-free (DF-QF) market access. Since the LDCs lack diversification in their exports, the adverse implications of preference erosion are likely to be highly significant both in terms of exports as also the overall economy. It may be noted that a number of participating countries in mega-RTAs are also major export destinations for many LDCs. For example, the US and EU are major destinations for ready-made garment (RMG) exports from Bangladesh and Cambodia. The emerging situation is all the more challenging also because LDCs, by and large, have tended to remain outside the ambit of mega regional negotiations till now.

Trade diversion as a result of mega-RTAs has emerged as a major concern for the LDCs. According to Elliott (2016), new preferential market access tends to lead to some degree of trade diversion for the non-participating countries. For example, in case of the Trans-Pacific Partnership (TPP) agreement, the preferential access for Vietnam poses risks for major RMG-driven LDC exporters such as Bangladesh and Cambodia, in the form of high tariffs on textiles and apparels export items.

Factors concerning the emergence of mega-RTAs

Proliferation of mega-RTAs has also largely been driven by both economic interests and geo-political strategies pursued by partner economies. Recent rise of mega-RTAs may be attributed to achieve a number specific objectives: (i) failure of developed countries to secure favourable trade deal in the multilateral trading system under the ambit of the WTO; (ii) focus on securing a regional deal that guarantees enhanced market access and conducive environment that would serve the interests of developed countries; (iii) responding to the ever

increasing influence of China in global trade and particularly in Asia; (iv) growing interest to safeguard economic interest of the involved country by not being left out.

At present negotiations on three sets of mega-RTAs have seen notable progress – the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) among Australia, Canada, Japan, Mexico, and seven other Pacific Rim countries¹; the Transatlantic Trade and Investment Partnership (TTIP) agreement between the US and the EU; and China's pursuit of the Regional Comprehensive Economic Partnership (RCEP) negotiations. Whilst these mega-RTAs may be justified on several grounds, these have come under close scrutiny because of their possible adverse implications for the rule-based multilateral trading system as envisaged under the WTO. Their possible impact on interests of the LDCs is also another line of query.

In light of the above, several factors can help explain the recent emergence of mega-RTAs.

First, one may observe that rationale of **mega-RTAs originated from economic realities**. Mega-RTAs expanded the scope of discussion beyond the traditional negotiations regarding tariff barriers. For example, TTIP has prioritised removal of non-tariff barriers, harmonisation of regulations and standards governing trade in services, investment and public procurement. Tariffs, for trade between the EU and the USA, are no longer considered as major barriers.

Second, the objective of **stimulating economic growth through speedy recovery from global financial and economic crises** is a key driver for emergence of the mega-RTAs. It is felt that the negotiated mega-RTAs could present an opportunity for stimulating industrial growth in advanced economies facing significant constraints including the ability to underwrite the large financial resources needed to boost production. For example, in case of TTIP, one expectation was that in addition to low tariffs and significant foreign direct investment (FDI), removing trade barriers at the border and eliminating regulatory impediments would help generate additional revenues for small, medium-sized and large importing and exporting enterprises.

Third, **growing prominence of global value chains** over recent decades is one of the key drivers leading to the emergence of mega-trading blocs. A large part of the manufacturing products currently passes through various stages of production in different locations, i.e. these are assembled with inputs from many countries. It needs to be noted here that, major impediments facing the expanding global value chains are not related to tariff measures, rather these are caused by behind the border obstacles. Increasing power of multinational firms in global supply chains also contributed to this renewed attention. The firms lobby for new types of trade agreements that would benefit their production processes across countries with comparatively reduced costs of production.

Fourth, the countries involved in **mega-RTAs also seek to deepen market access gains** by going beyond WTO's multilateral tariff agreements with help of targeted policies and regulations that influence cross-border movement of services, capital, and labour

(Palit, 2015). In other words, the WTO's rigid institutional framework and rules, which have by and large remained unchanged since 1995, are considered as inadequate in terms of serving the evolving interests of some of the major actors within the trading system.

Fifth, **the difficulties in reaching a consensus during the Doha Round** have without doubt caused a shift towards mega-RTAs. Advanced and developing countries (including LDCs) were not able to come to an agreement on issues of market access for agricultural and manufacturing goods and services also a number of other issues. Rising importance of emerging economies as global powers is now a reality on the ground. The recent dramatic shifts in the balance of power in international trade negotiations, with more prominent role being played by emerging economies such as Brazil, China, India and South Africa, is an important part of contemporary reality. The multilateral trading system is having to come to terms with this new reality.

Finally, **geopolitical interest** has often led countries to go for economic cooperation including through signing of PTAs, and negotiating for mega-RTAs. One cannot ignore that, there is a political dimension which has contributed to the push towards the mega-RTAs. The rise of China in world trade has been particularly disconcerting to the US and other Western countries. China's ascendance was perceived by some of the developed countries to have undermined their geopolitical and national security interests (Bown, 2017). Not surprisingly, most of these regional trade agreements involve countries in the Asia-Pacific region which could emerge as the most important region from the perspective of shaping the world trade order of the future.

As the major economic powers pursue trade liberalisation agendas outside the multilateral system of the WTO, the LDCs continue to remain out of the mega-RTA processes. LDCs have neither the economic clout nor the negotiating prowess to pursue and take part in discussions that aim at deepening trade liberalisation. Some of the trade related issues discussed in mega-RTAs include stringent rules of origin requirements and other non-trade barriers such as SPS and TBT, government procurement, e-commerce, labour and environmental standards as well as intellectual property rights standards. Without the S&D treatment provided under the various WTO Agreements, it is difficult for the LDCs to safeguard their offensive and defensive interests. Mega-RTAs do not encourage such derogation for countries in special needs. Any weakening of the WTO as an institution would, thus, be a setback for the LDCs.

Potential challenges for the LDCs

The LDCs constitute the weakest economies in the world, by definition. Whilst their degree of openness to the global economy has been on the rise, strengthened global integration of their economies continue to remain an endemic challenge. Accounting for 13 per cent of world's population in 2015, the 47 LDCs account for only one per cent of world's GDP (UNOHRLLS, n.d.).² The weak economic growth since 2011 is seen to be a serious obstacle to generating and mobilising domestic resources for structural transformation and investment in the development of productive capacities in the LDCs (UNCTAD, 2014). Indeed, the LDCs are the most vulnerable in this context because of their structural

¹CPTPP has replaced the earlier proposed Trans-Pacific Partnership (TPP) agreement once the USA withdrew from the initiative in January 2017.

²Equatorial Guinea has graduated from the LDCs on 4 June 2017. The number of LDCs now stands at 47 as of now. For near-term comparison purposes, Equatorial Guinea has been included in the LDC group for purposes of analysis in this report.

bottlenecks, limited productive capacities, technological backwardness, and unskilled human capital, not to mention their limited bargaining/negotiating capacities.

Initially, the WTO encouraged the growth of RTAs as a step forward towards a global free-trade regime. More than six hundred RTAs of various types have been notified in the WTO till now. The question has been raised as to whether RTAs are building blocs or stumbling blocs as far as the multilateral trading system was concerned. The emergence of mega-RTAs has in recent times led to a resurgence of this debate. This is because of the risks posed by the mega-RTAs: trade diversion; preference erosion; implications for those who are left out, the possible impacts for the WTO as the global institution guiding multilateral trade. All these have important relevance for the economic interests of the LDCs. Indeed, WTO member countries that are not part of such RTAs will lose out in these markets. Herein lies the worries on the part of the LDCs.

The participating countries in the mega-RTAs will receive new preferential access at the expense of LDCs paying high tariffs. For the LDC exports with high tariff peaks such as agricultural products and textiles and clothing, preferential tariff liberalisation in the member countries, particularly in the emerging developing economies, has the potential to divert trade from the LDCs. This is more so in case of common exports. For example, Vietnam could gain significant access to Japanese markets at the expense of Bangladesh and Cambodia for textiles and apparels. In addition, the restrictive rules of origin could disrupt the supply chains and reduce the trade of intermediate goods of the member countries with the raw material suppliers from the LDCs (Elliott, 2016). Another example – Vietnam will have to develop an upstream textile industry to generate its own inputs (fabrics) for the textile and apparels exports in order to be eligible for tariff reduction, by meeting the yarn-forward rule of the CPTPP. This implies that Vietnam will have to reduce its imports of cheaper inputs from the LDCs. Furthermore, the price of domestic goods of the member countries could rise due to reduced competition from cheaper LDC exports. Producers (importing inputs) and consumers would suffer as a consequence. There was a possibility that less efficient RTA member countries would displace relatively more cost-effective LDC exporters by way of trade diversion.

As is known, preference erosion is defined as the decrease in the margin between a preferential tariff rate and the MFN tariff rates originating from multilateral tariff liberalization (Rahman and Shadat, 2006). The ongoing mega-RTAs could result in preference erosion for the LDCs as deductions in MFN tariffs by the member countries (more particularly the developed countries) would lead to a reduction in the preferential margins that are offered to the LDCs under the various GSP schemes operated by the developed and developing member countries belonging to the RTAs. This will likely reduce the export gains currently enjoyed by the LDCs as a result of preferential treatment offered by the developed countries.

Moreover, the preferential tariff regime put in place by the developed countries are often lower than the MFN rates and cover a limited range of goods (Bhattacharya and Khan, 2014). The resultant lower benefits, together with the DF-QF benefits to be enjoyed by the emerging developing economies in the markets of developed countries, has the potential to make LDC exports less competitive in the global market. The involvement of major advanced economies such as the United States, Canada, EU, and Japan, along with other emerging developing countries such as India, Vietnam, Indonesia

and others, in the mega-RTA, are thus likely to significantly reduce the benefits accruing from trade preferences for LDCs. As a consequence, GDP growth along with other socio-economic indicators such as poverty reduction, industrialisation, and employment generation, concerning LDCs, could be adversely affected.

Strategies for the LDCs

In the context of the recent proliferation of the mega-RTAs and the risks originating from those, the LDCs ought to take appropriate steps to ensure that they are not adversely affected. LDCs should pursue a number of parallel strategies in view of this: (a) building their own supply-side capacities and raising their competitive strength; (b) consider options to join the RTAs; (c) work towards making WTO an effective multilateral system that is capable of addressing the concerns and advancing the interests of the LDCs.

Clearly, the WTO has failed to deliver on its promise to maintain an equitable, non-discriminatory, inclusive and open multilateral world trade regime. The failure of the WTO is reflected in the emergence of the mega-RTAs reflecting an unequal balance of power in world trade order without any discernible sensitivity to special needs of the poorer countries. Preferential tariff treatment is not an effective support measure for LDCs considering their limited supply side capacities. Supply-side constraints not only reduce the exporting capacity of the LDCs but also impede their capacity to expand domestic production base. The problem relating to productive capacities is further magnified because of weak economic and political institutions in the LDCs.

The WTO should do more to improve the supply-side capacity of the LDCs, state of trade facilitation, and provide meaningful DF-QF market access for the LDCs, to help their development process (Bhattacharya and Khan, 2014). As preference is not extended to all the tariff lines of export interest to the LDCs, the DF-QF product coverage should include all exports originating in the LDCs in light of the Hong Kong Ministerial Conference of the WTO.

Lack of export diversification remains an important obstacle for LDCs, particularly in view of coping with the adverse impact of the mega-RTAs. The LDCs need to develop their own productive capacities to remain competitive in the rapidly evolving global market. To achieve this, the LDCs should negotiate more aggressively with the WTO, as a group.

Apart from the manufacturing sector, the service sector has been experiencing fast growth in the LDCs in recent times. Indeed, services has emerged as a significant aspect of the development process in the LDCs. The WTO should enact measures that would support the growth of services trade in the LDCs in light of the services waiver decision of the WTO. WTO should also provide technical assistance to enhance LDCs services export capacity. Offering member countries must take adequate initiatives to improve their offer including 'quota for LDCs' in sectors of their export interest.

Capacity-building support is a must if LDCs are to take advantage of global market opportunities. The Aid for Trade (Aft) initiatives was launched at the 2005 Hong Kong Ministerial Conference to help build the trade capacity and infrastructure of the LDCs. However, the Aft to LDCs accounts for only 3 per cent of total Aft disbursement. WTO has not been able to address the issue adequately (Ancharaz et

al., 2014). The dearth of AfT funding clearly implies that the needs of the LDCs have not been met. Therefore, the case for AfT to help build and enhance export competitiveness of LDCs should receive due attention in the WTO.

The LDCs should aim to enhance South-South Cooperation (SSC) as a way to strategise against the growing mega-RTAs. The high economic growth of India and China over the last decade has presented the LDCs with opportunities in the areas of trade, FDI, and technology. Reduction of high tariffs on imports by emerging developing economies should facilitate exports from the LDCs and provide enhanced market access in those countries.

Transfer of technology could be incentivised by promoting local Research and Development (R&D) capacities and setting reasonable IPR regimes for LDCs at different stages of economic development. The path to cooperation could be improved by developing common regulatory practices at the regional level, supported by regional and bilateral TAs and regional production and value chains networks. Indeed, LDCs should negotiate comprehensive economic partnership agreements (CEPAs) instead of just FTAs with southern countries in order to reap the benefits of closer economic cooperation.

One obvious option available to the LDCs is for them to join the mega-RTAs. The LDCs could lobby for getting market access to

mega-RTAs enjoyed by member countries. LDCs can of course think of entering into bilateral negotiations with developed countries such as the US, EU, Canada, and Japan, to avail of greater market access. However, their bargaining power will be weak in such deals. There is a danger that the negotiations with larger developed countries will be unbalanced (World Economic Forum, 2014). In all likelihood they will be compelled to comply with stringent compliance and IPR regimes if they go into membership/partnership with RTAs.

The recent emergence of mega-RTAs will have far-reaching implications for both the participating and non-participating countries. Steps must be taken to address LDC concerns as regards trade diversion and preference erosion originating from the exclusionary policies from the member countries involved in such mega-RTAs. Cooperation of the LDCs with southern emerging countries, particularly under the rubric of SSC, could be an important way to address the negative implications of mega-RTAs. No smooth transition policy currently exists in the WTO in the context of LDC graduation. A number of LDCs will lose preferential market access following their graduation. WTO must devise a plan to help graduating LDCs (15 of them in 2018) by putting in place appropriate international support mechanism to service the new needs of graduated LDCs.

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