Least Developed Country Transition

Edited by Jodie Keane

The Commonwealth

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Commonwealth Secretariat
Marlborough House
Pall Mall
London SW1Y 5HX
United Kingdom

Published by the Commonwealth Secretariat

Typeset by NovaTechset, Chennai, India
Printed by APS Group.

Copies of this publication may be obtained from

Publications Section
Commonwealth Secretariat
Marlborough House
Pall Mall
London SW1Y 5HX
United Kingdom
Tel: +44 (0)20 7747 6534
Email: publications@commonwealth.int
Web: https://books.thecommonwealth.org/

A catalogue record for this publication is available from the British Library.

ISBN (paperback): 978-1-84929-191-0
ISBN (e-book): 987-1-84859-983-3

Foreword by the Commonwealth Secretary-General

Commonwealth countries are dispersed as broadly along the spectrum of economic development as they are geographically. Just over a quarter, 14 in a membership of 53, are classified as least developed countries (LDCs). Some, as a result of social and economic progress, will soon begin the transition from this category. We celebrate with them the development gains achieved, yet recognise that support will be needed through the graduation process.

Not all development partners offer graduation support programmes, even though adverse impacts are likely to be encountered during transition – as a result, for example, of losing trade preference. Substantially increased market costs have to be borne, while infrastructure and economy remain extremely susceptible to environmental shocks and the existential threat of climate change. Regardless of progress against broad economic and social indicators, vulnerabilities tend to persist, threatening to set back achievement of the Sustainable Development Goals.

The guidance offered in this publication draws on research into *'Least Developed Country Transition'* undertaken by the Commonwealth Secretariat in preparation for the 2018 Commonwealth Heads of Government Meeting, funded by the UK government. The research was guided by an inter-agency steering committee with representation from the Organisation for Economic Co-operation and Development, the Enhanced Integrated Framework of the World Trade Organization and the City of London.

Our Commonwealth goal is for the fruits of increased prosperity to be enjoyed by all through social and economic development that is inclusive and sustainable. In solidarity and with goodwill, and by building long-term resilience so that vulnerabilities to untoward episodes can be swiftly overcome whenever and wherever they occur, we collaborate to make irreversible progress towards a common future.

The Rt Hon Patricia Scotland QC
Secretary-General of the Commonwealth

Foreword by United Nations Under-Secretary-General

Eight years ago, United Nations members signed off on the ambitious Istanbul Programme of Action, in response to the urgent need to accelerate the development of the least developed countries (LDCs). The global community set itself the ambitious goal of ensuring that half of LDCs would reach graduation thresholds by 2021.

The LDC grouping of countries was established in 1971. Since then, and as of just this year, only five countries have graduated! In March 2018, the Committee for Development Policy found 12 LDCs had met the criteria for graduation. This is major progress and it is noteworthy that, out of the 12 countries, half are small island nations.

Without a doubt, graduation is a milestone achievement. Yet we must see it as a step and not an end on the longer road towards equitable, inclusive and sustainable development. The Istanbul Programme of Action provisions aim to ensure graduating countries are eased onto a sustainable development path without any disruption to development plans, programmes and projects.

This report is timely. It comes at a time when many LDCs are preparing for graduation. We hope that its analysis and recommendations will help countries map out effective policy and operational responses to ensure smooth and above all sustainable transitions.

Trade and trade preferences are key for most LDCs in their efforts to graduate and, in the longer run, follow a sustainable development path. There must therefore be a focus on the trade-related consequences of graduation.

Many LDCs experience deep structural constraints, including their disproportionately high vulnerability to external shocks and the impacts of climate change. We hope that the example of Mozambique provided in this report will be of use for other LDCs.

Clearly, leadership on graduation has to lie with the graduating country. Yet we must recognise that a smooth and above all sustainable transition hinges on partnership –with development partners, both bilateral and multilateral, the private sector and civil society. The United Nations General Assembly has already called for support to the implementation of such partnership strategies.

Our work also identifies the need to support transition through targeted packages of continued support for the graduated countries, in order not avoid disrupting or, worse, jeopardising development dynamics and progress. Such incentive measures

accompanying graduation should include enhanced access to new sources of financing and targeted support to reap the benefits of trade.

This report presents concrete options for LDCs and their development partners. The global community's 2030 Agenda demands that we accelerate progress towards sustainable graduations, enhance partnerships and work together if indeed we wish the Sustainable Development Goals to become reality for ALL by 2030.

Fekita K. Utoikamanu
High Representative and United Nations Under-Secretary-General,
Least Developed Countries, Landlocked Developing Countries and
Small Island Developing States

Contents

Abbreviations and Acronyms

ACP	African, Caribbean and Pacific
AfT	Aid for Trade
ATM	Automatic Teller Machine
BICA	Business Integrity Country Agenda
BVM	Bolsa de Valores de Moçambique (Mozambique Stock Exchange)
CBSI	Central Bank of Solomon Islands
CCID	Commonwealth Charter for Infrastructure Development
CDP	United Nations Committee for Development Policy
CEO	Chief Executive Officer
CHOGM	Commonwealth Heads of Government Meeting
CLScoreF	Contingent Liability Scoring Framework
CMT	Cut, Make and Trim
CPI	Consumer Price Index
CRA	Competition Regulatory Authority
DeMPA	Debt Management Performance Assessment
DFQF	Duty-Free Quota-Free
DTIS	Diagnostic Trade Integration Study
EBA	Everything But Arms
ECOSOC	United Nations Economic and Social Council
EEZ	Exclusive Economic Zone
EIF	Enhanced Integrated Framework
EPA	Economic Partnership Agreement
EPB	Export Promotion Bureau
EPFI	Equator Principles Financial Institutions
EPI	Export Potential Indicator
EU	European Union
EVI	Economic Vulnerability Index
FDI	Foreign Direct Investment
FFA	Forum Fisheries Agency
FOB	Free On Board
FTA	Free Trade Agreement
GBV	Gender-Based Violence
GDP	Gross Domestic Product
GEM	General Equilibrium Model
GFCF	Gross Fixed Capital Formation
GIH	Global Infrastructure Hub
GNI	Gross National Income
GSP	Generalised System of Preferences

GSP+	Special Incentive Arrangement for Sustainable Development and Good Governance
GTAP	Global Trade Analysis Project
GVC	Global Value Chain
HAI	Human Assets Index
HS	Harmonised System
IEPA	Interim Economic Partnership Agreement
IFC	International Finance Corporation
IMF	International Monetary Fund
ITC	International Trade Centre
IUU	Illegal, Unregulated and Unreported
LC	Local Content
LDC	Least Developed Country
MAM	Mozambique Asset Management
MDPAC	Ministry of Development Planning and Aid Coordination
MFA	Multi-Fibre Arrangement
MFAET	Ministry of Foreign Affairs and External Trade
MFMR	Ministry of Fisheries and Marine Resources
MFN	Most-Favoured Nation
MNC	Multinational Corporation
MSC	Marine Stewardship Council
MSGTA	Melanesian Spearhead Group Trade Agreement
MSMEs	Micro, Small and Medium Enterprises
MTDS	Medium-Term Debt Strategy
NFD	National Fisheries Development
NGO	Non-Governmental Organisation
NYP	National Youth Policy
OBM	Original Brand Manufacturing
ODA	Official Development Assistance
ODI	Overseas Development Institute
ODM	Original Design Manufacturing
OECD	Organisation for Economic Co-operation and Development
OEM	Original Equipment Manufacturing
PACER	Pacific Agreement on Closer Economic Relations
PIC	Pacific Island Country
PICTA	Pacific Island Countries Trade Agreement
PNA	Parties to the Nauru Arrangement
PNG	Papua New Guinea
PPP	Purchasing Power Parity
PRI	Policy Research Institute
R&D	Research and Development
RAMSI	Regional Assistance Mission to Solomon Islands
RMG	Readymade Garments∂
ROO	Rules of Origin
SD	Specific Duty
SDG	Sustainable Development Goal

SIIFF	Solomon Islands Integrated Financial Framework
SITC	Standard International Trade Classification
SPARTECA	South Pacific Regional Trade and Economic Cooperation Agreement
SPS	Sanitary and Phyto-Sanitary Standards
TFA	Trade Facilitation Agreement
TMI	Tri Marine International
TRIPS	Agreement on Trade-Related Aspects of Intellectual Property Rights
ULT	Ultra-Low Temperature
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
US	United States
USA	United States of America
USAID	United States Agency for International Development
VDS	Vessel Day Scheme
WCPO	Western and Central Pacific Ocean
WEF	World Economic Forum
WIDER	World Institute for Development Economics Research
WTO	World Trade Organization

Preface

It has widely been acknowledged that overall achievement of the 2030 Agenda and the Sustainable Development Goals (SDGs) hinges on progress made within the least developed countries (LDCs). As we approach the end of the Istanbul Programme of Action and begin to reach the mid-point of the SDGs, this publication reflects on the transition process within Commonwealth LDCs. Out of 53 Commonwealth member countries, almost one third are LDCs. This situation will change dramatically in forthcoming years, however, as a number prepare to exist the country category in view of their development progress to date (approximately 12 countries by 2024). While for some Commonwealth LDCs this progress is celebrated, for others major concerns remain regarding susceptibility to environmental shocks and the looming climate change crisis.

This publication draws together research findings from a "kickstarter" assignment that formed part of preparatory processes for the Commonwealth Heads of Government Meeting (CHOGM) held in London in 2018. It focuses on two groups of Commonwealth LDCs: first, those LDCs graduating in the coming few years and that exhibit the greatest economic vulnerability to a trade shock induced by graduation and loss of accompanying tariff preferences; and second, those that remain far from graduation but experience severe economic vulnerabilities and susceptibility to extreme environmental shocks.

For both groups of Commonwealth LDCs, the objective of the research (based on case study analyses of Bangladesh, Mozambique and Solomon Islands) was to identify areas where international support measures could be improved so as to more effectively support the transition process, as well as boost export diversification and therefore reduce economic vulnerability. The case study analysis was undertaken by a multidisciplinary team comprising trade and debt expertise, under an inter-agency steering committee including the City of London, the Organisation for Economic Co-operation and Development (OECD) and the Enhanced Integrated Framework (EIF) of the World Trade Organization (WTO).

With regard to the first group of LDCs, the research undertaken during the inception phase of the assignment clearly identified Bangladesh and Solomon Islands as being highly vulnerable to the loss of tariff preferences induced by the graduation process. With regard to this group of LDCs, in order to relay some of the fears related to the graduation process, a guide to trade-related impact assessments using the global value chain (GVC) approach was developed. This was submitted to the United Nations Committee for Development Policy (CDP) and its new online platform (www.gradjet.org), to be embedded within national ministries to guide the transition

from LDC status. It was also applied through fieldwork and case study analysis to Bangladesh and Solomon Islands, the results of which are presented in this volume.

The graduation process and loss of international support measures such as tariff rents may mean 1) a reduction in exports, as a result of the increased cost of trade; 2) margin trimming, where the producer bears the increase in costs; or 3) other competitiveness effects. The international community recognises that LDCs may need particular support as they begin their transition process. According to the procedures set out by the CDP, this may take approximately nine years, starting from the first moment a LDC is formally identified as meeting the graduation criteria.

According to the established procedures, a country can graduate from the LDC category by meeting two of the three criteria at two consecutive Triennial Reviews of the CDP. At the second meeting, the CDP can recommend the country's graduation. Graduation itself normally happens three years later. For example, if a country meets two of the three criteria at both the 2018 and the 2021 meetings of the CDP, it may be recommended for graduation and consequently leave the LDC category in 2024. Alternatively, a country can graduate if its per capita income level is more than twice the income graduation threshold, currently US$1,230, at two consecutive Triennial Reviews. Most of the forthcoming graduates are leaving the category based on progress related to income per capita.

With regard to the second group of LDCs – those far from graduation – we sought to explore ways to deploy targeted economic assessment tools in order to ascertain limitations in public finances and to identify where private finance, for example in infrastructure, could be more effectively leveraged. In this respect, we sought to bring best practice to African Commonwealth LDCs, focusing on Mozambique, through application of the internationally recognised Global Infrastructure Hub framework. Through this approach, we sought to embed effective debt management within the research framework.

In view of the future "Africanisation" of the LDC group – as a number of Asian and Pacific LDCs move out of the category over the coming years – and the specific challenges of commodity-dependent economies, innovative and multidisciplinary approaches are required, to more specifically target structural vulnerabilities, including weak infrastructure. While this publication does not pertain to have all of the answers, it does present a conceptual framework that could assist LDCs and their development partners in the transition process. As the 2030 Agenda and adoption of the SDGs recognise, changes in existing international support measures are required, as well as in our ways of working.

This publication combines the full reports developed as part of the 2018 CHOGM kickstarter assignment and is written for policy-makers, in non-technical language. Graduation from LDC status is imminent for a number of Commonwealth member countries, and greater sensitisation as to the full implications of this movement is required.

This publication is organised as follows. First, we focus on the Commonwealth LDCs most likely to experience a major trade shock as a result of the graduation process:

Bangladesh and Solomon Islands. We find that, in the absence of maintaining the same level of market access, graduation from LDC status will require major trade-related adjustment in Bangladesh and Solomon Islands.

Second, we introduce Mozambique, a commodity-dependent LDC. Without changes in international support mechanisms, including more effective targeting to address economic vulnerabilities, lack of export diversification and susceptibility to environmental shocks, LDCs such as Mozambique will continue to remain far from graduation. This country case study elaborates on some of the specific challenges of commodity exporters and the trade-debt nexus.

The commonalities across both sets of LDC case studies include an emphasis on the critical role investments in infrastructure can make in boosting trade, achieving export diversification and reducing economic vulnerabilities.

We would like to thank all of our research partners and the Commonwealth member countries and civil servants who assisted us in the process of the case study development. Finally, we would like to acknowledge support provided by the UK government, which enabled this research to be undertaken as part of our preparations for the 2018 CHOGM.

Chapter 1

Bangladesh's Apparel Exports to the EU: Adapting to Competitiveness Challenges Facing LDC Graduation*

1.1 Introduction

In 2018, Bangladesh for the first time met the criteria for graduation from the group of least developed countries (LDCs) as assessed at the Triennial Review conducted by the Committee for Development Policy (CDP) of the United Nations Economic and Social Council (ECOSOC). It is expected to fulfil the criteria again in a second consecutive Triennial Review in 2021, paving its way to official graduation from LDC status in 2024. Meeting all three pre-specified graduation thresholds in terms of per capita income, human assets and economic vulnerability certainly constitutes a great achievement, attesting to its journey through a critical development transition.[1]

Indeed, Bangladesh has made great strides in terms of economic development. Since the early 1990s, it has grown at an annual average rate of more than 5 per cent, with a more robust comparable growth rate over the past 10 years, of 6.5 per cent. Its per capita gross national income (GNI) since 1995 has risen more than five-fold, from about US$300 to $1,751. Over the same timeframe, the proportion of population living in poverty has more than halved, from over 50 per cent to 24.3 per cent. Dependence on foreign assistance has declined from 8 per cent of gross domestic product (GDP) in the 1980s to just about 2 per cent. Compared with many other countries at a similar stage of development, Bangladesh has achieved faster progress on various social and human development indicators.[2]

The UN has since 1971 recognised LDCs as highly disadvantaged in their development process. These countries are characterised as being caught in a low-income trap, facing the risk of failing to overcome poverty and deprivation; predominantly dependent on primary commodities for domestic production and exports, with extremely inadequate opportunities for diversification; and critically reliant on foreign aid, owing to limited economic activities accompanied by unfavourable fiscal (internal) and current account (external) balances. To respond to their development challenges, the global community has devised special international support measures.

Bangladesh enjoys certain privileges and special and differential treatments designed for LDCs. These include development partners' various concessions, special attention and commitments to support LDCs with development finance, trade preference and technical assistance. The members of the World Trade Organization (WTO) have also devised more favourable conditions and flexibilities for this group of countries in implementing and enforcing international trade rules and regulations. Bangladesh has been the largest beneficiary of tariff-free access in the EU under the latter's

Everything But Arms (EBA) initiative designed for LDCs. As such, LDC graduation implies that Bangladesh will not be eligible for LDC-specific benefits. Since the EU is the country's largest export destination, the preference erosion in this market will likely have implications.

The impressive socio-economic development of Bangladesh has greatly been facilitated by its export growth. Over the past decades, taking advantage of privileged market access in the EU, apparel exports, locally known as readymade garments (RMG), have exhibited remarkable expansion, generating jobs for 4 million workers, of whom around 60 per cent are women. The industry has become integrated within the clothing global value chain (GVC), with local producers using both domestic and imported raw materials for renowned international brands and other buyers targeting mostly consumers in developed countries. There is huge potential to further enhance RMG exports and for industrial upgradation in the sector, generating higher-value-added products and enabling a move up the value chain. Loss of EU preferences could thus come at a critical juncture of this transformation, potentially weakening Bangladesh's competitiveness.

Against this backdrop, the objective of this case study is to consider the likely impact of loss of EU tariff preferences on Bangladesh's exports, as resulting from LDC graduation. In particular, it aims to identify main competitors, analyse market shares and assess the potential for trade shifts; and to present exporters' and buyers' perceptions on the issues as gathered through a quick and short survey, to ascertain the apparel export sector's competitiveness challenges in light of the graduation prospect. In terms of the approach and methodology, the case study utilises the Commonwealth Secretariat's "A Guide to Graduating from LDC Status" (Keane, 2018) to analyse the graduation implications from a GVC perspective. This includes using quantitative data and analysis as well as qualitative assessments based on exporters' and buyers' perceptions.

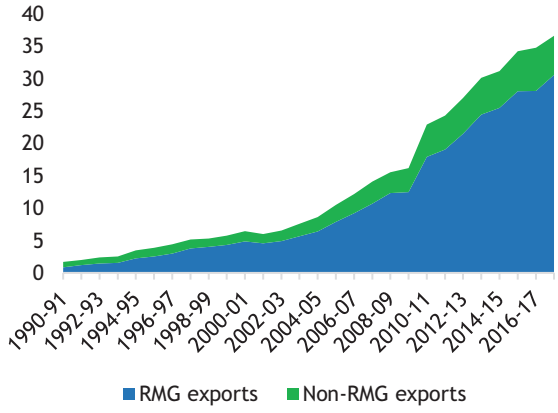
The case study is organised as follows. After this introduction, Section 1.2 provides a brief review of Bangladesh's apparel exports, highlighting the importance of the EU market. Section 1.3 identifies the major competitors in the EU market and analyses the possible impact of graduation on apparel exports. Section 1.4 sheds light on the competitiveness issues from a GVC perspective, while considering perceptions of exporters and buyers. Section 1.5 provides a brief discussion of some broad elements of adaptation strategies in dealing with any adverse consequences. Section 1.6 concludes.

1.2 Bangladesh's apparel exports and the importance of the EU market

1.2.1 Apparel exports from Bangladesh

Among LDCs, Bangladesh is regarded as an export success story. From less than US$2 billion in the early 1990s, its exports rose to $36.7 billion in FY2018. This would imply an average annual export growth rate of close to 12 per cent against 6 per cent for world merchandise exports. In the process of export expansion, RMG emerged

Figure 1.1 Bangladesh's exports (US$ billions)



Source: Authors using data from EPB.

as a flagship export, generating receipts from about $1 billion in 1990 to above $30 billion in 2018 (Figure 1.1). While many countries, particularly in Sub-Saharan Africa, failed to move export production away from primary commodities and other mineral resources to manufacturing, Bangladesh exhibited dramatic shifts, with the share of erstwhile traditional exports (such as raw jute and jute goods, tea, leather and frozen fish) fell from more than three quarters to just about 10 per cent to accommodate the growing relative significance of RMG from virtually nothing to more than 80 per cent (Figure 1.2). In the early 1990s, yearly growth rates were relatively high, given the narrow base of apparel exports. But the 2000s also saw impressive growth rates, even though the sector was by then growing to a considerable size (Figure 1.3). The expansion rate appears to have lost some momentum and become less stable in recent years, particularly since 2014/15. This is largely because of an unprecedented

Figure 1.2 Change in shares of apparel and non-apparel exports in total exports (%)

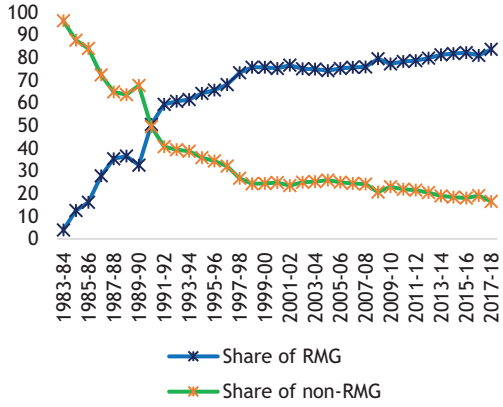
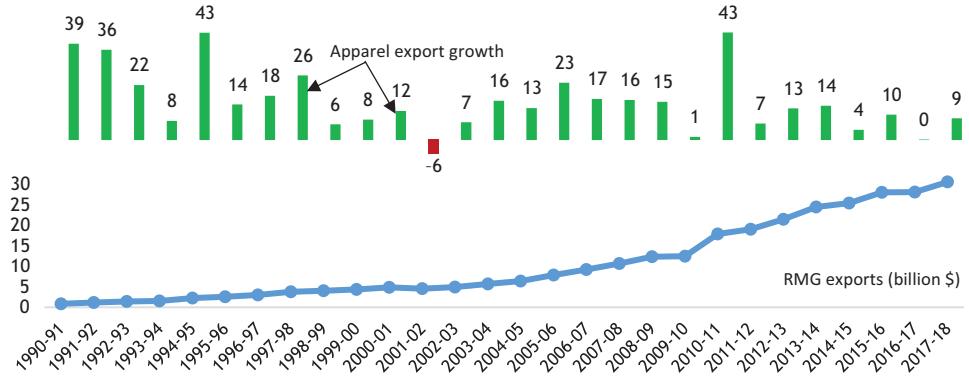


Figure 1.3 RMG exports and growth rates



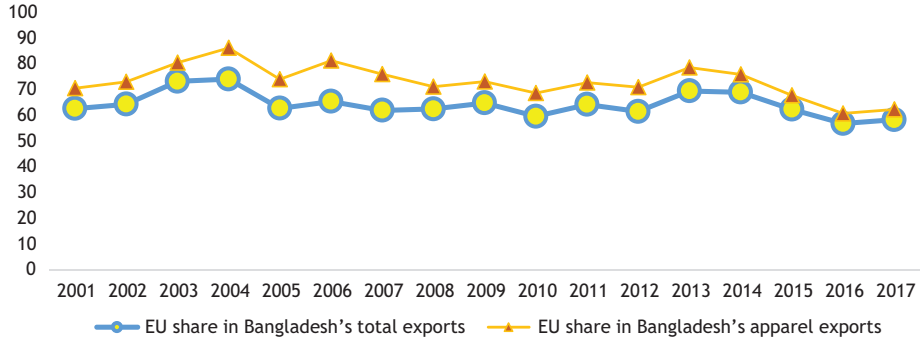
Source: Authors using data from EPB.

slowdown in global trade that has affected the export performance of an overwhelming majority of global economies (Razzaque, 2018b).[3]

1.2.2 Significance of the EU as Bangladesh's export market

The EU has been the largest export market for Bangladesh. In FY2018, more than US$21 billion worth of products was destined to the EU, of which $19.6 billion (i.e. 92 per cent) came from apparels alone. In the same year, the EU accounted for close to 58 per cent of Bangladesh's total exports and 62 per cent of apparel exports (Figure 1.4). Since the early 2000s, the EU's significance in Bangladesh's totally and apparel exports has remained steady. In terms of individual markets, the USA is the biggest single export destination, with a share of 16.3 per cent of Bangladesh's merchandise export earnings, followed closely by Germany (16.1 per cent). Other important markets are the UK (10.9 per cent), Spain (6.7 per cent), France (5.5 per cent), Italy (4.3 per cent), the Netherlands (3.3 per cent), Canada (3.1 per cent), Japan (3.1 per cent) and Poland (2.6 per cent). Information on total and apparel exports to each EU member state and their respective shares in Bangladesh's overall exports earnings is given in Annex Table A1.

Figure 1.4 The EU's share in Bangladesh's total and apparel exports



Source: Authors using data from ITC.

Figure 1.5 Share in Bangladesh's exports by partner countries (%)

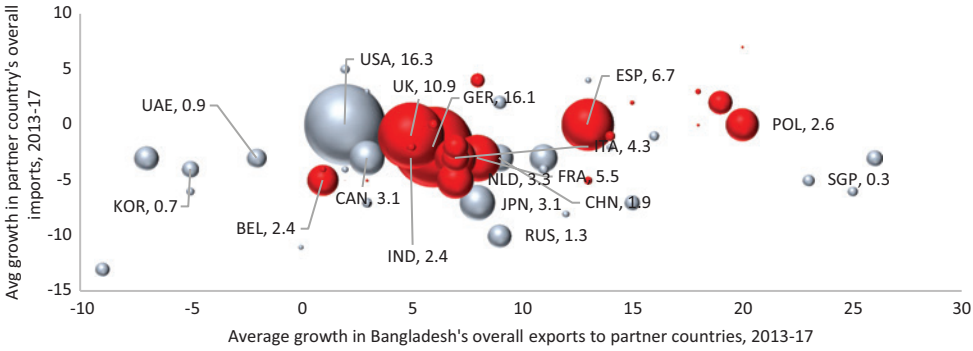
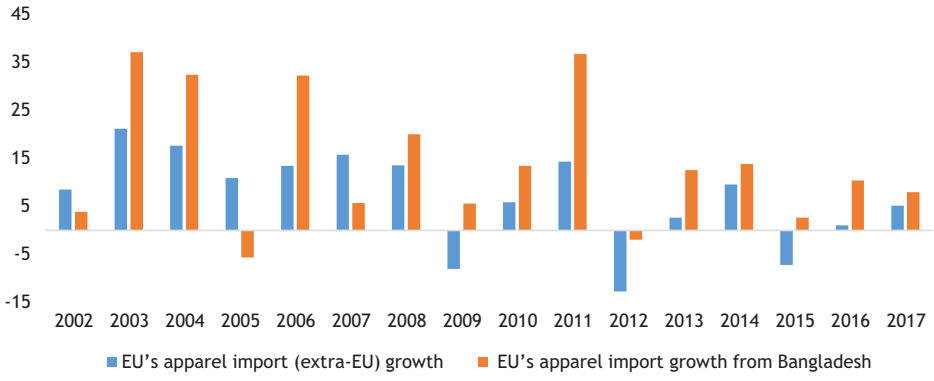


Figure 1.5 shows that, although the overall import growth of most EU member states (measured on the vertical axis) was either close to zero or negative in the five-year period of 2013–2017, their imports from Bangladesh (as shown in Figure 1.5 measured on the horizontal axis) in a large majority of cases grew at a considerable pace. Imports to Spain and Poland, for example, from world markets were virtually stagnant (the average 2013–2017 growth rate being zero), but their comparable import growth from Bangladesh was 13 and 20 per cent, respectively. The top five EU partners of Bangladesh together account for about 45 per cent of total exports and almost half of apparel exports. The notable growth of Bangladesh's exports to the EU and the latter's large shares in Bangladesh's exports make the EU the most critical trading partner of Bangladesh.

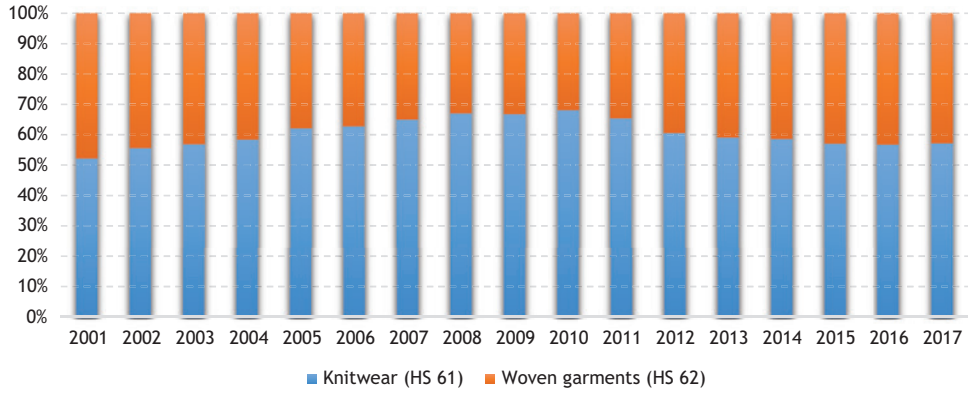
Bangladesh's exports are driven mainly by RMG: over the past decade, its average yearly growth to the EU has been 12 per cent (Figure 1.6). During the same period, EU apparel imports from the world have grown at a rate of 2.4 per cent per year. It is worth pointing out that, immediately after the global financial crisis of 2008, whereas EU imports of apparels from the extra-EU countries declined by more than 8 per cent

Figure 1.6 EU's appareal import growth (%)



Source: Authors using data from ITC.

Figure 1.7 Structure of Bangladesh's apparel exports to the EU



Note: Mirror data are used.
Source: Authors using data from ITC.

in 2009, imports from Bangladesh posted 5 per cent growth. A similar pattern was observed during the relatively recent trade slowdown period of 2015–2016.

Bangladesh's apparel exports to the EU are dominated by knitwear items under the Harmonised System (HS) of product classification category 61, which accounted for a share of about 57 per cent in 2017 (Figure 1.7). The same share actually reached a peak as high as 68 per cent in 2010. Until 2011, EU rules of origin (ROO) required "double transformation" of clothing items as a precondition for tariff-free market access. For woven apparels, this would imply the use of domestically produced fabrics in garment making (i.e. from yarn to fabric and from fabric to garment would fulfil the double transformation criterion). Bangladesh lacks domestic capacity in fabrics, and therefore found it difficult to utilise EU preferences. On the other hand, the knitwear segment has strong domestic backward linkages to spinning factories, thus knitwear products fared better than woven garments. The derogation of EU ROO in 2011 allowed for single transformation for LDC clothing exports. This generated a reinvigorated supply response from the woven garment sector, raising its share in exports.

About 21 per cent of the total knitwear shipment of Bangladesh in FY2018 was destined for Germany, followed by 12.5 per cent to the UK (Figure 1.8). Slightly less than 10 per cent is exported to the USA. Meanwhile, more than a quarter of woven garment exports under HS 62 are USA-bound. Among EU countries, 15.3 per cent of Bangladesh's woven garments are exported to Germany, 11.8 per cent to the UK, 6.8 per cent to Spain, and 5 per cent to France (Figure 1.9).

An analysis of data at a more disaggregated level shows that Bangladesh's single most important (in terms of exports revenues generated) export item at HS 8-digit level is HS 61091000 (T-shirts, singlets and other vests of cotton). Almost three quarters of all export earnings (US$3.8 billion) from this item result from the EU (Figure 1.10). In this particular product, Bangladesh has an EU market share of about 25 per cent. For the largest woven garment – men's or boys' suits, jackets, blazers, trousers, overalls, breeches and shorts of cotton (HS 62034200) – the biggest single market is the USA,

Figure 1.8 Countries' share in Bangladesh's knitwear (HS 61) exports (%)

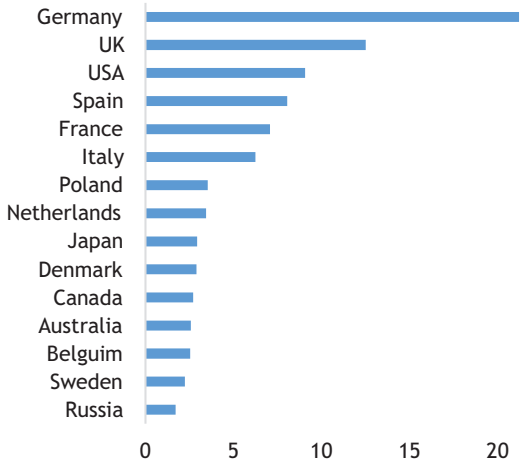
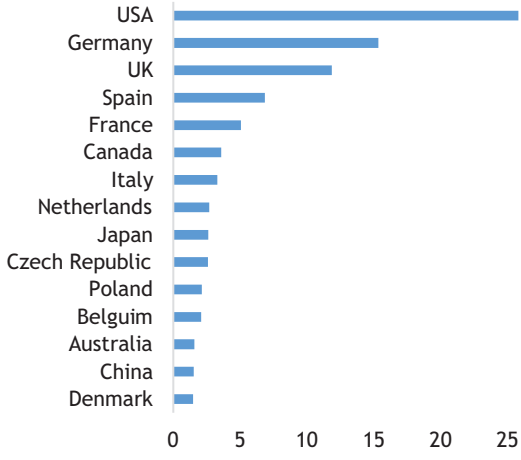


Figure 1.9 Countries' share in Bangladesh's woven garments (HS 62) exports (%)

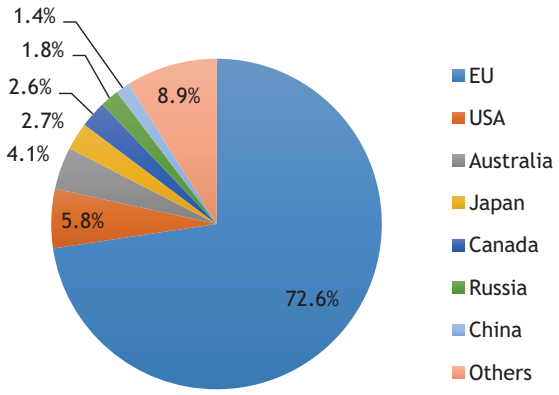


accounting for about 30 per cent of all exports. However, the combined EU member states' share is far greater, at about 50 per cent of Bangladesh's export earnings of this product (Figure 1.11). The other major RMG exports to the EU markets are men's or women's shirts, jerseys, pullovers, shorts made of cotton and fibre, etc. Annex Table A4 provides a list of top 20 Bangladeshi RMG items (at the CN 8-digit level) exported to the EU and their respective market shares.

1.2.3 Further export potential in the EU

Although the EU has been the largest export destination, there is evidence of further export potential for Bangladesh that it could exploit taking advantage of the tariff-free market access. Unutilised export potential by destination market can be determined by making use of a methodology recently developed by the International

Figure 1.10 Partners' share in Bangladesh's exports of HS 61091000



Source: Authors using data from EPB.

Trade Centre (ITC) (Decreux and Spies, 2016). The ITC Export Potential Indicator (EPI) identifies products in which an exporting country has already proved itself to be internationally competitive and in which it is likely to have good prospects of export success. The potential export value in a target market is estimated based on exporters' supply capacity, demand conditions in the market of interest and market access conditions.[4] Potential export values are compared with actual export earnings to reveal untapped opportunities.

Application of the ITC methodology reveals that, in different destination countries, Bangladesh has untapped apparel export potential worth US$17.4 billion, which is more than half of current export earnings from the sector. For the EU, it is estimated that the existing level of exports has an additional $11.3 billion potential, of which more than 90 per cent is in apparels. Figure 1.11 presents export market shares overall across trading partners. Figure 1.12 presents the specific products which account for most exports destined to the EU. Finally, Figure 1.13 summarises potential and actual exports of apparel products, with the numbers in parentheses

Figure 1.11 Bangladesh's export partners share of HS62034200

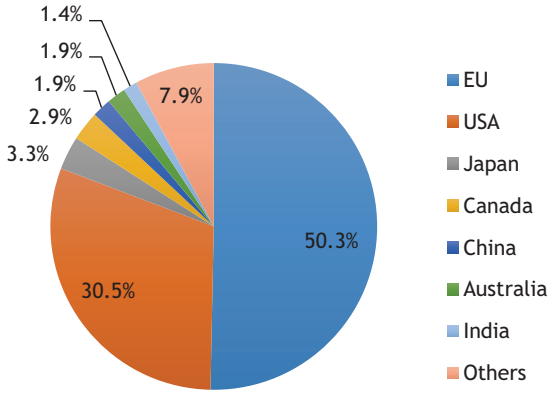
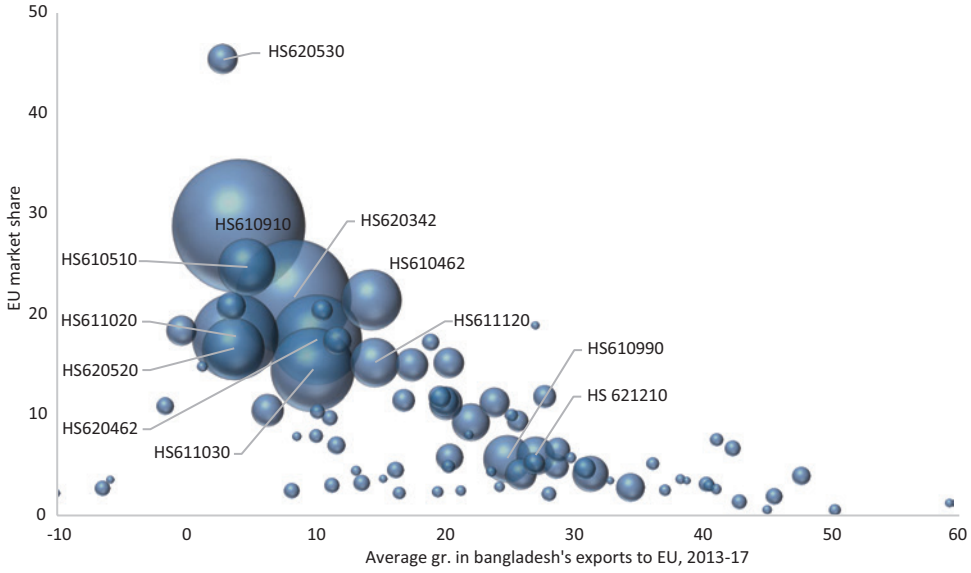


Figure 1.12 EU market shares and Bangladesh's exports growth by products at HS-6 digit level

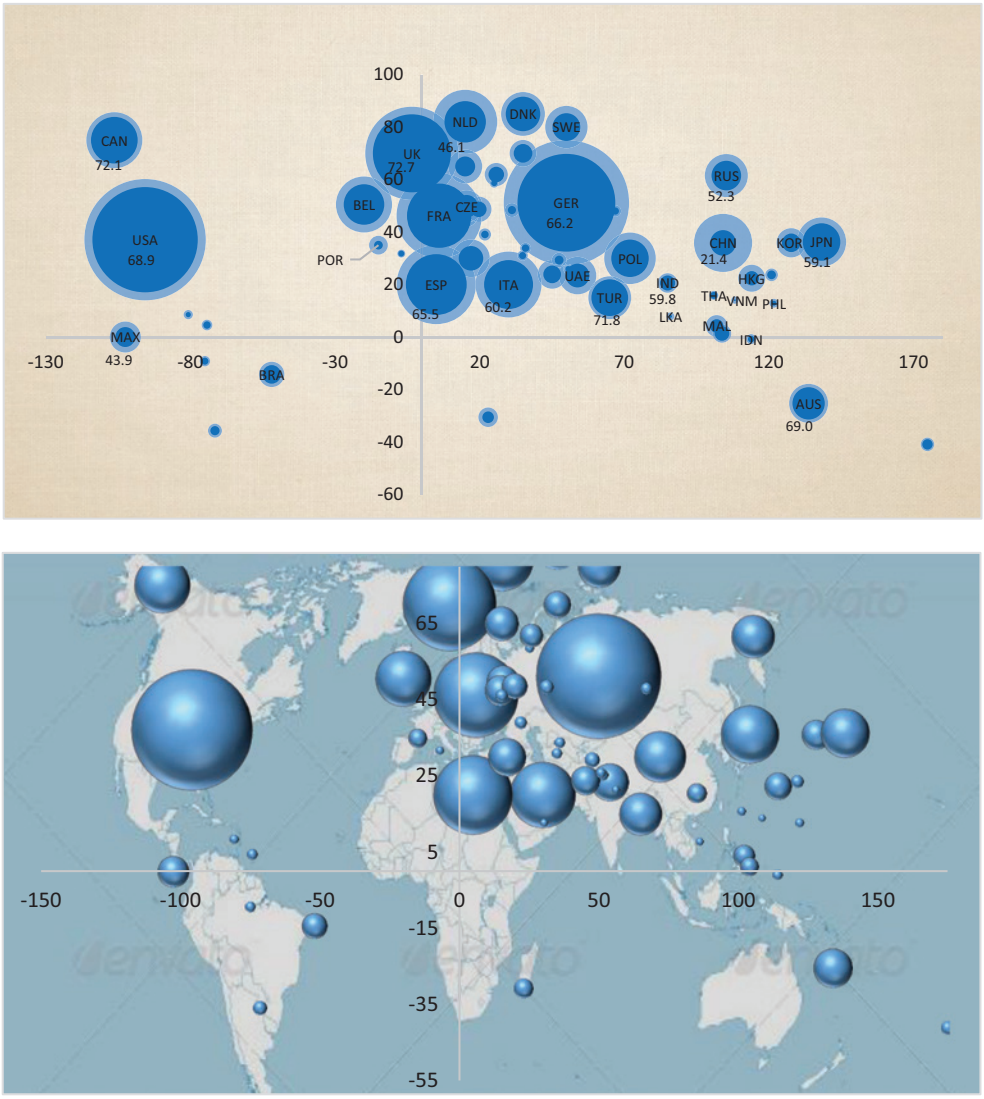


showing the proportion of actual exports as a share of actual plus unexploited export opportunities. The highest absolute difference between potential and actual exports is found for Germany, leaving room for additional export earnings of $2.2 billion. That is, currently about 34 per cent of the potential in the largest EU partner country market of Bangladesh is unexploited. Among other EU partners, only 46 per cent of potential in the Netherlands is utilised. Bangladesh's other major EU markets, France, Italy, Spain and the UK, also show sizeable unexploited market potential.[5] Turning to non-EU countries, the USA offers the biggest unrealised apparel export potential for Bangladesh, estimated at US$1.9 billion – that is, only 69 per cent of all potential is being utilised in the largest exporting destination. It is estimated that Bangladesh is using just 21.4 per cent of potential in China and 60 per cent in India.

1.3 LDC graduations and EU market prospects for ready-made garments

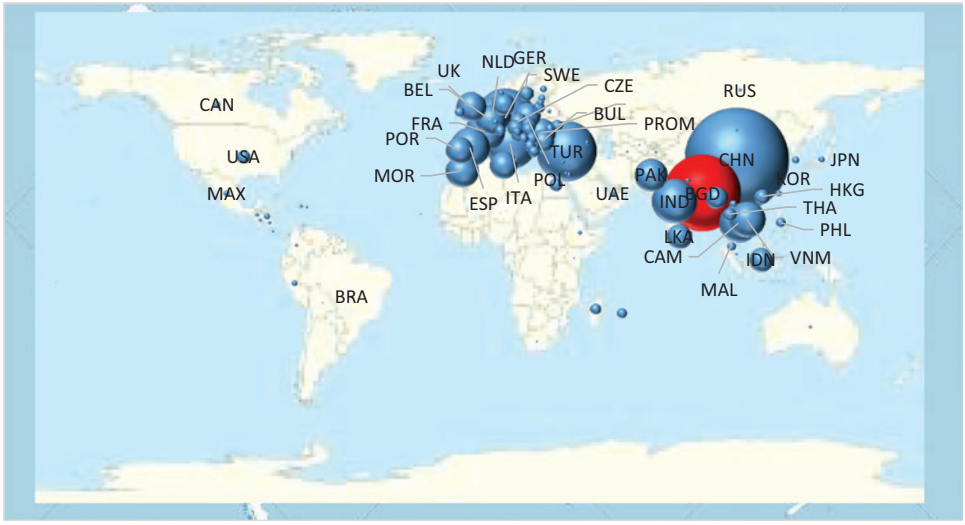
The EU accounts for almost 45 per cent of global apparel markets. In 2017, the combined EU-28 imports stood at US$178.3 billion, of which $116 billion (i.e. 65 per cent) worth of clothing items was sourced from extra-EU suppliers. China, the global export leader, captures about a quarter of the market share (Figure 1.14); it exported $39.3 billion in 2017. Bangladesh is the second largest exporter, with a 12 per cent market share. Turkey and Germany ranked third and fourth largest suppliers in the EU, respectively, each capturing about a 7 per cent market share. Among others, Italy supplied 5.5 per cent, India 4 per cent, Cambodia, France and Spain 3 per cent each, Vietnam and the Netherlands 2.6 per cent each and Pakistan 2.1 per cent.

Figure 1.13 Export potential of Bangladesh's RMG products



An over time comparison of extra-EU competing suppliers' market shares shows a striking development of a diminishing relative significance for China. Between 1990 and 2010, China's market share rose steadily, from less than 7 per cent to just below 31 per cent. However, over the next seven years, it fell by almost 9 percentage points. A close look at Table 1.1 and Figure 1.15 reveals Bangladesh capturing much of China's falling market presence. During 2000–2010, Bangladesh's market share rose from about 3.5 per cent to 6.5 per cent, but then it accelerated further to increase to more than 12 per cent – that is, a 5.5 percentage point rise in seven years. Apart from Bangladesh, Table 1 shows us, Cambodia, Myanmar, Pakistan and Vietnam have also seen their shares rising since 2010. But none of them shows dynamism comparable with that of Bangladesh.

Figure 1.14 Major exporters of RMG in EU markets



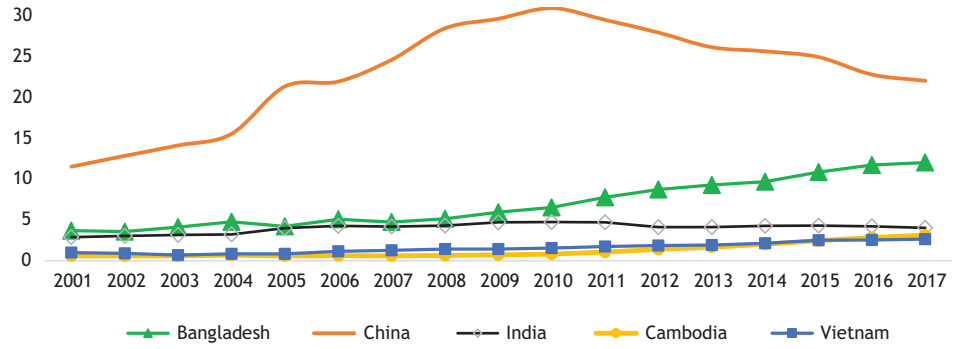
It is necessary to point out that Bangladesh robust export performance was greatly aided by the EU's derogation of ROO requirements for clothing under EBA, as mentioned earlier. The earlier stringent ROO criterion of double transformation for duty-free access proved a binding constraint. Between 2001 and 2010 Bangladesh's market share in woven garments (HS 62) virtually stagnated (Figure 1.16). After single transformation was allowed, the market share of woven products expanded rapidly – from just above 4 per cent in 2010 to more than 10 per cent in 2017. Because of strong domestic backward linkages, ROO did not appear to be a major problem

Table 1.1 Share of extra-EU partners in total apparel imports in the EU (%)

	1990	1995	2000	2005	2010	2015	2017
China	6.84	7.12	11.09	21.32	30.90	24.92	22.02
Bangladesh	0.49	2.08	3.53	4.20	6.54	10.84	12.01
Turkey	7.49	6.82	7.25	9.20	8.24	7.49	7.26
India	2.48	3.43	2.88	3.99	4.74	4.31	4.02
Cambodia	0.00	0.08	0.41	0.59	0.82	2.45	3.13
Vietnam	0.11	0.58	1.08	0.86	1.54	2.50	2.65
Pakistan	0.70	0.91	0.84	0.95	1.12	1.84	2.13
Morocco	1.33	3.39	3.17	2.68	2.15	1.99	2.08
Tunisia	1.95	3.28	3.49	2.76	2.21	1.53	1.45
Sri Lanka	0.47	0.97	1.41	1.21	1.47	1.33	1.24
Indonesia	1.04	2.01	2.67	1.58	1.34	1.08	1.08
Myanmar	0.00	0.03	0.42	0.22	0.12	0.31	0.91
Hong Kong	7.59	6.65	4.96	2.53	0.43	0.54	0.40
Thailand	1.45	1.21	1.48	1.07	0.89	0.44	0.40
Egypt	0.11	0.29	0.37	0.45	0.43	0.35	0.32
USA	0.65	0.93	0.53	0.39	0.38	0.37	0.32

Source: UN Comtrade and ITC.

Figure 1.15 EU apparel market share by selected suppliers (%)



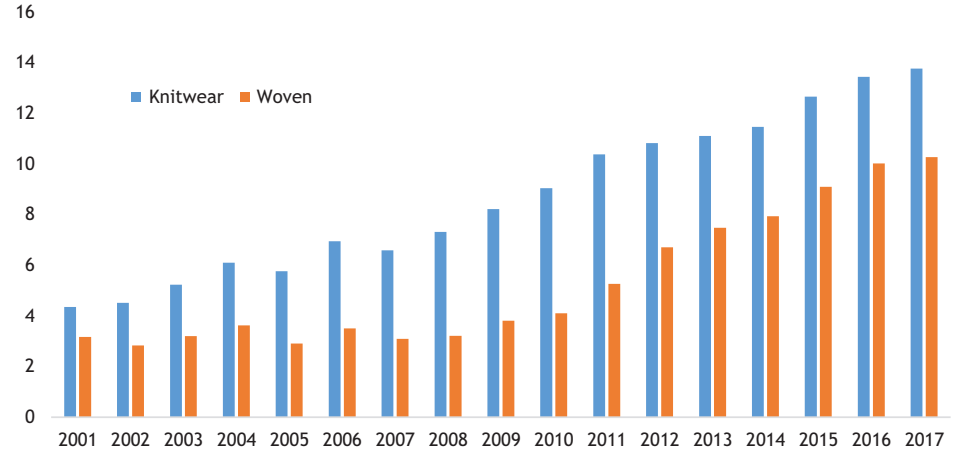
Source: Authors' using data from UN Comtrade and ITC.

in knitwear, and thus Bangladesh has been able to maintain steady growth in market share in this category as well (from 9 per cent in 2010 to 13.7 per cent in 2017).

In the EU, extra-EU suppliers compete among themselves as well as with individual EU member states exporting to other fellow members. While considering only extra-EU imports into the EU, more than one third of total extra-regional imports of RMG are shipped from China (Figure 1.17). Bangladesh is the source of about 18 per cent, whereas Turkey and India, respectively, export 11.2 per cent and 6.2 per cent of total extra-EU imports of RMG to the EU. Annex Table A4 and Annex Figure A1 provide the information on countries' extra-EU market shares.

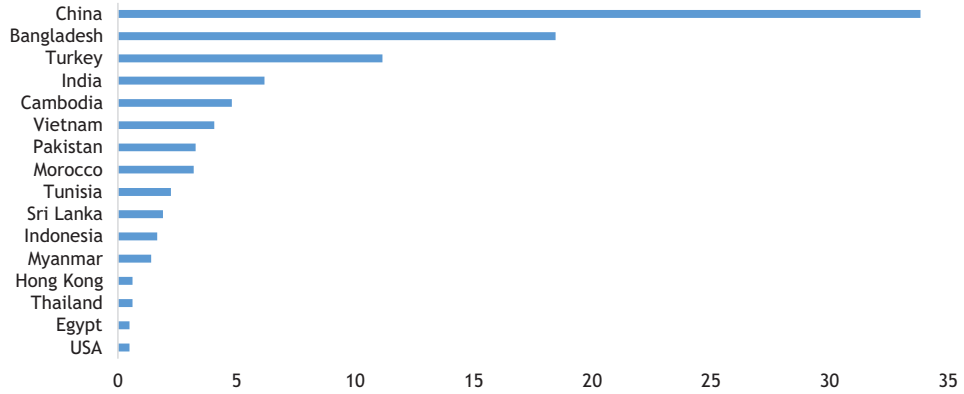
Figure 1.18 provides the market shares of major extra-EU partners for their respective top exporting items at HS 6-digit level. Bangladesh's most important five and twenty products account for, respectively, 22.2 per cent and 18.5 per cent of EU imports

Figure 1.16 Bangladesh's EU market share in knit (HS 61) and woven garments (HS 62) (%)



Source: Authors using data from ITC.

Figure 1.17 Share in extra-EU RMG imports, 2017 (%)



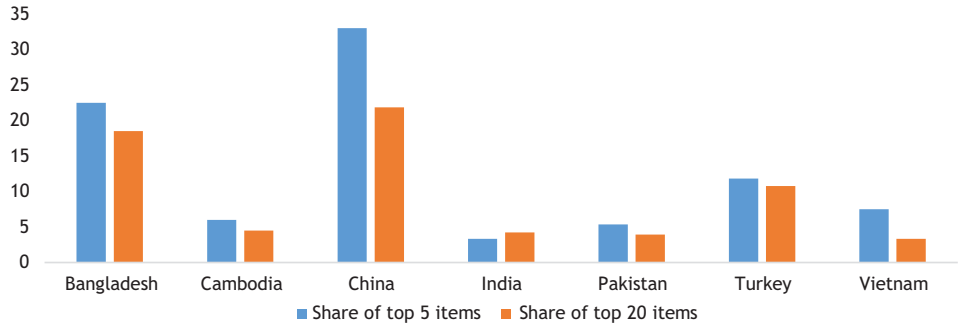
Source: Authors using data from ITC.

in the same products. The relatively high concentration implies that Bangladesh is highly competitive in these items. But it would also suggest scope for diversification to new items within the apparel sector. China's top five items hold about one third of EU imports of those products whereas its top twenty products together represent about a 22 per cent market share. India's share in its top five and twenty products are, respectively, 3.3 per cent and 4.2 per cent, which are lower than its overall apparel market share. This implies that India's reliance on its major items is much less than that of Bangladesh and China. It could also suggest lack of competitiveness in items that are associated with most export revenues.

1.3.1 EU import regimes in apparels

The European community provides trade preferences to support developing countries under its Generalised Scheme of Preferences (GSP). The EU's GSP is based

Figure 1.18 EU market share of competitiors by their respective top five and twenty items (%)



Note: Market shares in the EU market have been calculated for each country for their respective major exporting items at HS 6-digit level.
Source: Authors using data from ITC.

on the WTO's Enabling Clause, which allows developed nations to grant unilateral and non-reciprocal tariff preferences to support the developing countries in their development process. The current GSP regime in the EU offers three different preference arrangements: 1) a general arrangement (Standard GSP); 2) a Special Incentive Arrangement for Sustainable Development and Good Governance (GSP+); and 3) the Everything but Arms (EBA) arrangement for the group of LDCs. Table 1.2 summarises these preference regimes.

Bangladesh, as an LDC, gets duty-free quota-free (DFQF) market access under EBA. When Bangladesh graduates from LDC status, it will lose LDC-specific preferential market access and ROO. Tariff preferences provide significant competitive advantage particularly when Most-Favoured Nation (MFN) tariff rates are high. Although tariffs are generally low in developed countries, including the EU, certain sensitive sectors continue to be protected by high tariffs. Therefore, depending on beneficiary

Table 1.2 EU GSP provisions

	Standard GSP	GSP+	EBA
Indicators	Low- or lower-middle-income countries	Vulnerable (in terms of export diversification, export and import volumes) Standard GSP beneficiaries that have ratified the 27 GSP+– relevant international conventions	LDCs
Number of beneficiaries	18	9	49
Non-sensitive goods	Duty reduction for around 66% of all EU tariff lines.	Duty suspension for around 66% of all EU tariff lines.	Duty suspension for all goods with the exception of arms and ammunition.
Sensitive goods: **– specific duty** **– ad valorem duty**	Duty reduction: – 30% – up to 3.5 percentage points	Duty suspension	Duty suspension
ROO (important provisions only)	Double transformation for textile and clothing items. For all other products a minimum local value added of 50%.	Double transformation for textile and clothing items. For all other products a minimum local value added of 50%.	Single transformation for textile and clothing items. For all other products a minimum local value added of 30%.

Source: Various documents as available on the European Commission website.

countries' export composition, preferential treatment may or may not be a source of competitive advantage. The textile and clothing sector attracts relatively high MFN tariffs and, as such, Bangladesh has benefited substantially from the EBA arrangement for LDCs. An analysis of EU tariff structures (Figure 1.20) shows that about a quarter of EU tariff lines at CN 8-digit level have an MFN duty rate of 0 per cent (i.e. 25 per cent of all products imported by the EU provide duty-free access to suppliers from all countries). Another 4 per cent is subject to specific duties only. In about 25 per cent of tariff lines, MFN duty rates of 5–9.9 per cent are applied while just 4 per cent of products attract more than 15 per cent tariff rates. The MFN tariffs on textile and clothing items are mostly in the range 10–12 per cent, with 88.9 per cent apparel products attracting such tariffs of 12 per cent.

Graduating LDCs can apply for perhaps the second best (after the EBA scheme) preferential regime, GSP+, which grants duty-free access to 66 per cent of EU tariff lines. However, for this scheme, a beneficiary country must 1) have ratified and effectively implemented 27 international conventions on labour rights, human rights, environmental protection and good governance; 2) have a share in GSP-covered imports of less than 6.5 per cent of the GSP-covered imports of all GSP countries; and 3) have at least 75 per cent of its total GSP imports coming from the seven largest sections of GSP-covered imports. Bangladesh fulfils condition 3 and is likely to fulfil condition 1 but is way above the threshold import share under condition 2.[6] Therefore, given the existing GSP rules, Bangladesh may not qualify for GSP+. In this case, the least attractive Standard GSP would be the only option.

It becomes obvious that application of the Standard GSP regime to Bangladesh's current export structure would result in a dramatically changed situation from the present duty-free access for all products, to almost all exports being subject to some tariffs.[7] In fact, about 92 per cent of all Bangladesh's exports will fall under an average tariff of 8–9.9 percent (Figure 1.19). An examination of the tariff schedule reveals that, for 98 per cent of Bangladesh's apparel exports, EU MFN tariff rates are around 12 per cent. Under Standard GSP, these tariffs will be slightly reduced, to 9.6 per cent, whereas, with GSP+, tariff-free access is given for the same products. That is, under GSP+, Bangladesh's apparel exports will enjoy the same tariff preferences as in EBA. However, EBA ROO are more relaxed and less stringent that those in GSP+.[8]

1.3.2 Tariff implications for export earnings

The Commonwealth Secretariat has proposed an analytical framework to study the potential implications of tariffs arising from LDC graduation for a graduating country's exports (Keane, 2018). The prescribed partial equilibrium model comprises two steps: first, it estimates the impact on exports owing to price changes emanating from forgone tariff preferences in the destination market; and second, it estimates the possible increase in demand for goods exported by non-graduates as they become more competitive relative to the graduating country in question.[9]

The advantage of this model is its simplicity: the data requirements are minimum, and the simulation is quite simple. Being a partial equilibrium model means it uses only one sector while disregarding its interactions with others – a feature that

Figure 1.19 MFN tariff structure in the EU and number of product lines

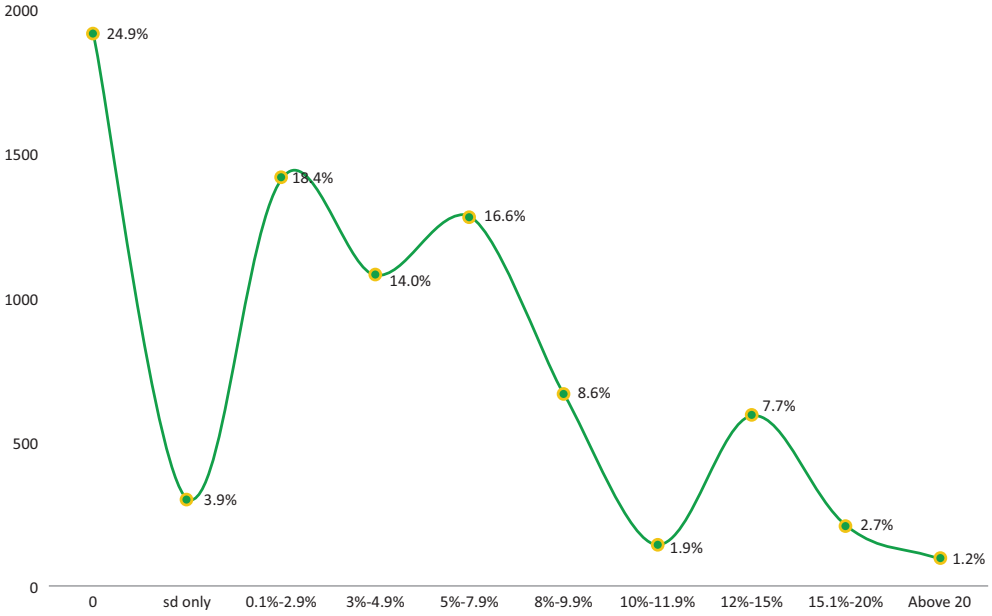
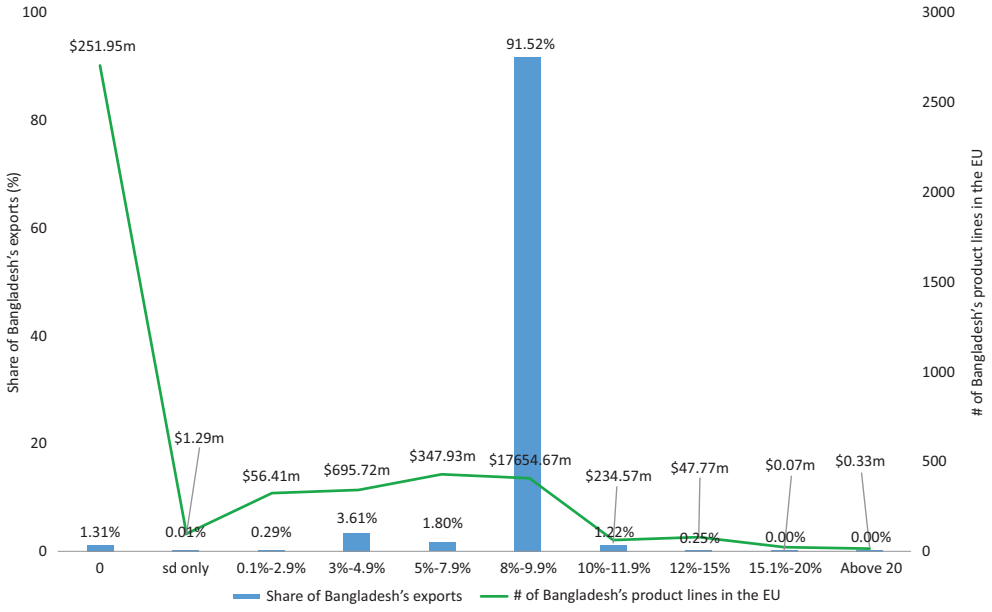


Figure 1.20 EU tariff and Bangladesh's exports under standard GSP



general equilibrium models (GEMs) deal with. However, in contrast with GEMs, the approach employed here can make use of highly disaggregated trade and tariff data.[10] Therefore, the Commonwealth Secretariat framework provides a good basis for undertaking an initial assessment in identifying potential trade-related effects. The potential impact of LDC graduation in this model is transmitted in three ways:

1. Price effects – the price of goods will increase because of graduation, which increases tariffs.
2. This will result in potential substitution between exports from graduates and non-graduates.
3. The results are dependent on market share elasticities and therefore the extent of price sensitivities.

A potential caveat of this approach is that it assumes constant import price elasticities – that is, if the price of a given item declines, each producer adapts in the same way regardless of different adaptation measures within the structure of production. Besides, the potential shifts in exports may depend on producers' supply capacities and competitiveness, which this market-share based approach does not capture.

The trade effect of LDC graduation can be estimated by comparing the unit price received by the preference-recipient country with that of the MFN exporters.

$$P_k^i = P_k^W(1 + m_k^i) \quad \text{or} \quad m_k^i = \frac{P_k^i}{P_k^i} - 1$$

where P_k^i is the unit price of product k received by country i (i.e. preference recipient) and P_k^W is the world unit price of the same product. It is assumed that markets are perfectly competitive and there is no product differentiation. The above equation can be expressed as:

$$P_k^i = P_k^W\left(1 + T_k^{MFN} - T_k^i\right)$$

$$m_k^i = (T_k^{MFN} - T_k^i)$$

where T_k^{MFN} is ad valorem equivalent MFN tariff for product k and T_k^i is exported weighted-preferential tariff faced by country i. The percentage changes in exports as a result of changes in the price of exports is given by:

$$\frac{\Delta X}{X} = \frac{\Delta P}{P} + \varepsilon\frac{\Delta P}{P}\left[\frac{\Delta P}{P} + 1\right]$$

where X is exports and ε is price elasticity of demand for exports. The formula can be utilised to estimate the effect of abolishing tariff preferences resulting from LDC graduation. As a country graduates from the group of LDCs, its tariff preference regime changes, as it will have to pay a higher tariff. The changes in export revenue as a result of graduation can be estimated from the equation below:

$$\frac{\Delta X}{X} = \mu_k^i\frac{\Delta m_k^i}{1 + m_k^i} + \varepsilon\left(\mu_k^i\frac{\Delta m_k^i}{1 + m_k^i}\right)\left(\mu_k^i\frac{\Delta m_k^i}{1 + m_k^i} + 1\right)$$

where, $\mu_k^i = \frac{\Delta m_k^i}{m_k^i}$ indicates the changes in preference margin. The first component in the above equation computes the changes in unit price resulting from changes in tariff preference. The second component calculates the impact on export revenue for the given changes in price.

At the second step, to compute the trade shift effects, it is assumed that the declining exports from the graduate will be proportionally distributed to the other competitors (i.e. non-graduates) based on their market share. The implicit assumption here is that there is no product differentiation among the suppliers, and non-graduates' exports will increase proportionally (i.e. cross price elasticity of demand is 1). Therefore, the market share approach is used to estimate how other countries' exports will be impacted.

1.3.3 Estimation results

The model is estimated using 339 CN 8-digit products exported to the EU in 2015–2017. The analysis uses EU tariff rates at this level of disaggregation for individual products. The impact is estimated based on average exports over the past three years and their share in total EU imports. Export implications are estimated using two post-graduation scenarios: Bangladesh's receiving Standard GSP benefits and being subject to MFN tariffs.

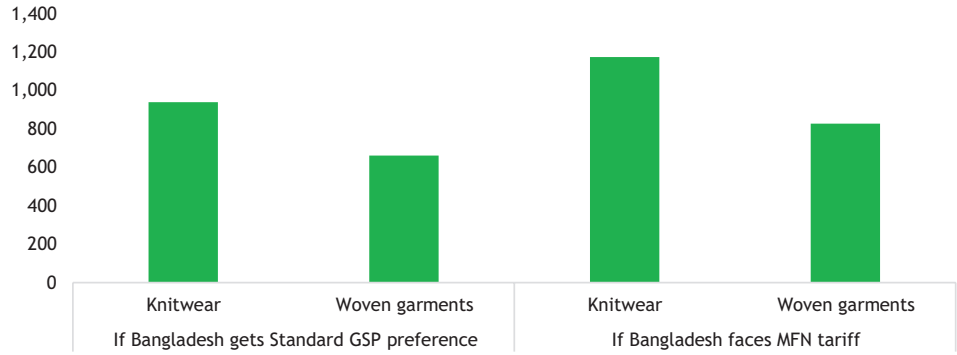
Table 1.3 summarises the results. The estimates are based on alternative values of the price elasticity of demand: between 0.5 and 2. Under the unitary price elasticity of demand, the estimation suggests that replacing duty-free access with the Standard GSP regime would result in a loss of export earnings for Bangladesh of US$1.6 billion – 9.5 per cent of average export revenues from the EU during 2015–2017. The loss would be higher than $2 billion in the unlikely case of facing MFN tariff rates. Forgone export receipts from knitwear would be greater compared with those from its woven counterparts (Figure 1.21). Under Standard GSP, while export loss from woven garments would be lower than $700 million, the comparable figure for knitwear would be close to $1 billion. The most important reason for higher potential losses in knitwear is the higher average tariff rate applied on the former.[11] Besides, as the EU Comext database reflects, Bangladesh exports more knitwear than woven products. With values of the price elasticity of demand higher than 1, the estimated

Table 1.3 Potential loss of apparel export earnings owing to tariff rises

Price elasticity of demand	Potential decline in RMG exports (US$ millions)	
	If Bangladesh gets Standard GSP preference	If Bangladesh faces MFN tariff
0.5	800.8	1,001.0
1	1,601.6	2,002.0
1.5	2,402.4	3,003.0
2	3,203.2	4,004.0

Source: Authors' estimation.

Figure 1.21 Potential loss of knitwear and woven garment export earnings owing to tariff rises (US$ millions)



Source: Authors' estimation.

forgone exports are bigger. If we were to choose, our preferred estimate would have been with the unitary price elasticity of demand. Annex Table A4 provides export implications by individual top 20 export items.[12] It shows that the single most important export items of Bangladesh, CN 61091000 (knitted or crocheted T-shirts), could alone suffer a decline of close to $300 million. The currently large export base and the rise in tariff hike interact to generate this big impact.

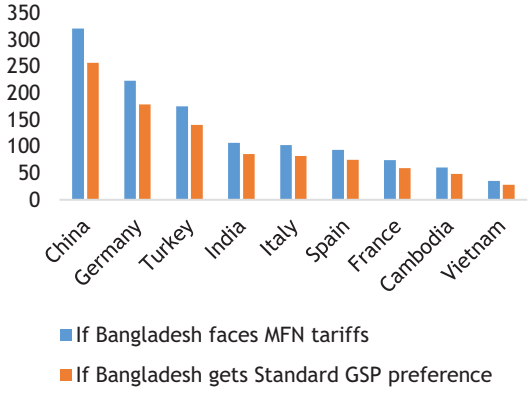
The limitations of the partial equilibrium model have been highlighted, but it is worth pointing out a few other issues too. First and foremost, modelling exercises (including GEMs) cannot capture the implications of the changes in ROO provisions. Graduation out of LDCs will be associated with more stringent requirements (e.g. double transformation in clothing and 50 per cent domestic value addition in other products) for obtaining Standard GSP preferences. Second, it is not clearly known how the rents from tariff preferences are distributed between exporters and importers, which can have implications for price changes. Finally, it is assumed that non-differentiated products can be readily supplied from other countries. In reality, as products are differentiated, individual countries may be able to exert some market power, affecting the model-based estimates.

Notwithstanding the caveats, the estimates presented here are comparable with other assessments utilising different methodological approaches. The United Nations Conference on Trade and Development (UNCTAD) has estimated a 5.5–7.5 per cent fall in Bangladesh's total exports as a result of the loss of preferential access after graduation (UNCTAD, 2016). Rahman and Bari (2019) derive a 7.8 per cent decline in Bangladesh's total exports (equivalent to US$2.7 billion). However, no other studies exist that – like this one – use product-specific disaggregated data to consider implications arising from the EU market.

1.3.4 Potential for trade shifts

The decline in the EU's imports of apparels from Bangladesh will be compensated for by the increases in imports from other countries. This is done using the market share

Figure 1.22 Potential increase in competitors' apparel exports when all competitors are considered (US$ millions)



approach – that is, distributing the graduate's forgone exports among all exporters in the EU based on their current market shares. Potential shifts in exports are analysed under the assumptions of import demand elasticities and cross price elasticities being one.

Being the largest supplier, China gains most: about 16 per cent of Bangladesh's export loss. When the latter obtains Standard GSP, the export gains of China will be about a quarter of a billion dollars, which is quite small in terms of its total exports (Figure 1.22). Germany would be the second largest gainer, then Turkey, India, Italy and Spain. After graduation, if Bangladesh is subject to MFN tariffs, all competitors' gains increase slightly.

If the resultant export gains are limited to extra-EU suppliers only, China's exports rise by more than a half a billion dollars (Figure 1.23). Turkey and India together capture another half a billion dollars, with the former increasing its exports by US$302 million and the latter by $183 million. Cambodia and Pakistan each can obtain an additional $100 million in exports while the comparable rise in Vietnam's

Figure 1.23 Potential increase in competitors' apparel exports if only extra-EU competitors are considered (US$ millions)

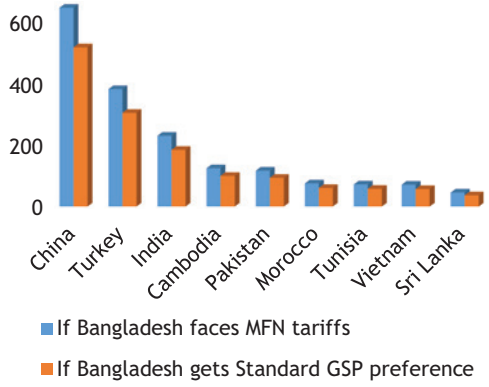


Figure 1.24 Potential rise in extra-EU competitors' knitwear and woven garments exports if Bangladesh pays Standard GSP tariff rates (US$ millions)

Note: The price elasticity of demand and cross elasticity of demand are assumed to be 1.
Source: Authors using data from EU Comext.

exports is estimated at $56 million. Sri Lanka gains $36 million. If export gains are disaggregated by knitwear and woven apparels, China, Turkey, India and Cambodia will benefit highly from increased exporting of knitwear: China's additional earnings from knitwear would be above $300 million under the scenario where Bangladesh would pay Standard GSP rates, and the comparable gains by exporting woven exports would be just above $200 million (Figure 1.24). In the case of woven apparels, Bangladesh's comparators, Pakistan, Morocco, Tunisia and Vietnam, would gain. If Bangladesh is subject to MFN tariffs, each competitor's exports will rise further.

1.4 Assessing competitiveness: A global value chain perspective

1.4.1 Global value chain-led trade

Bangladesh's RMG exports have been facilitated by the so-called GVC-led production and distribution mechanisms. In an overwhelming majority of traded goods, if not all, export market prospects in today's world are critically dependent on a country's positioning in the GVC network in respective consumer products. The value chain captures the entire range of activities (including production and services) needed to bring a product from its conception to end use and beyond. This includes activities such as design, production, marketing, distribution and support to the final consumer.[13] Fundamental changes have taken place in global trade, whereby the traditional concept of an entire production process being undertaken by one firm in one country has been replaced by the GVC-led process characterised by various service providers' presence in different countries catering to the need of final consumers. This GVC mechanism thus involves cross-border fragmentation of production processes, which entails specialisation in a narrower range of tasks by firms organised within global production networks (Razzaque and Keane, 2016).

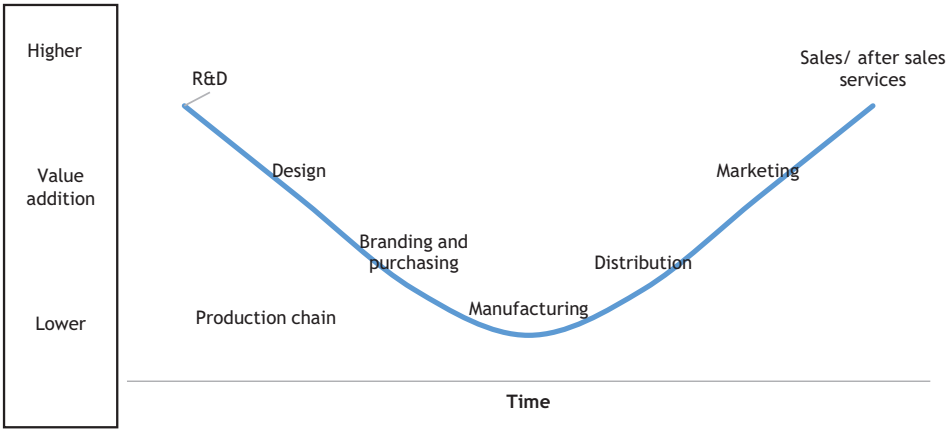
Given the limited productive capacity of many developing countries, integrating with GVCs may provide new trade opportunities for local firms to gain access to

new markets through specialising in a single task. However, the specific location of a country/firm on the GVC map can greatly influence the amount of value added a country is capable of exporting that is embodied in (gross) exports and its capacity to reap a bigger slice of the total value added creation within the entire production process associated with the product (Van Der Marel, 2015). The value added created out of export earnings is important as it comprises workers' wages, entrepreneurs' profits and other costs associated with filling the orders.

It has become a typical feature of GVC-led trade that firms located in developing countries focus mainly on manufacturing activities, whereas research and design (R&D) for product development is provided by global big brands or importers in developed countries, raw materials are sourced from a third-party country and marketing and after sales services are provided by others in countries where consumers are located.[14] One issue is that the manufacturing stage within the smile curve process (Figure 1.25) is known to be generating very small value in proportion to the final retail prices of the products.[15] In general, activities related to R&D, design, brand development and marketing occupy relatively greater shares in overall industry value added. It is, however, true that, at the early stage, it is very difficult to develop specialisation in these activities. With increased integration into GVCs, the likelihood of moving up in certain segments of the value chain increases as exporters grow contacts, acquire relevant technologies and develop human resources to perform high-value added services tasks such as designing, branding and marketing. Participation of foreign direct investment (FDI) firms in export production can greatly facilitate a country's moving up the value chain as these firms enjoy close contacts with brands, buyers and retailers in the importing countries. They often have in-depth R&D capacities and are sometimes either directly or closely associated with global retail businesses.

Although not directly related to firm-level capabilities, the issues of labour and environmental standards, among others, have become critical success factors in GVC

Figure 1.25 The 'smile curve' – stages in a global value chain



Source: Authors elaboration of Mudambi (2008).

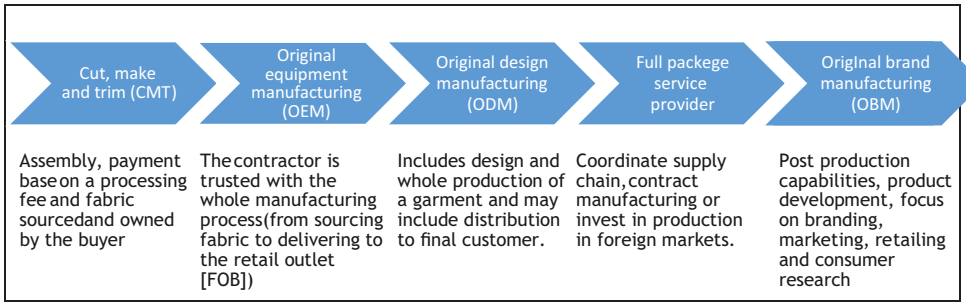
participation (Kaplinsky et al., 2003). International brands and retailers, subject to close scrutiny by consumer groups and non-governmental organisations (NGOs) about their procurement practices, aim to avoid sources that cannot comply with various production, labour and environmental standards.

1.4.2 Bangladesh in apparel value chains and the issue of competitiveness

Bangladesh's apparel production process is related mainly to manufacturing – that is, to processing intermediate inputs to turn into final consumer products. This stage of the global supply chain is the most labour-intensive in nature and, as a labour-abundant country, Bangladesh has a huge natural comparative advantage in it. Among the principal apparel business models (Figure 1.26), Bangladesh is mostly involved in two low-value stages of cut, make and trim (CMT) and original equipment manufacturing (OEM)/free on board (FOB) (Hasan, 2014). Under CMT arrangements, buyers procure the materials from their known sources in any third country and send them to the manufacturer on free-of-cost basis and pay only for cutting and sewing woven or knitted fabric or knit apparel directly from yarn. Under the OEM/FOB system, the manufacturer is responsible for all production activities, including the CMT activities, as well as finishing. Therefore, the manufacturing firm must have capabilities for procuring the necessary raw materials, and undertaking the trimming needed for production (Fernandez-Stark et al., 2011). In this case, the prices quoted by factories include raw materials costs plus CMT charges – that is, the price of fabrics and accessories including cutting and making charges. The apparel export business of Bangladesh generally does not fall under other high-value added models such as original design manufacturing (ODM) and original brand manufacturing (OBM).

Given the value chain segments in which Bangladesh operates, CMT and OEM, it is generally recognised that profit margins cannot be very high.[16] The question is, then, how much more competitive Bangladesh can be if it has to lose tariff preferences in the EU market post-LDC graduation. A comparison of prices obtained by different suppliers to the EU could shed some light on this but drawing any meaningful conclusions would be far from straightforward, for at least two reasons. First, prices

Figure 1.26 Trend towards greater value addition



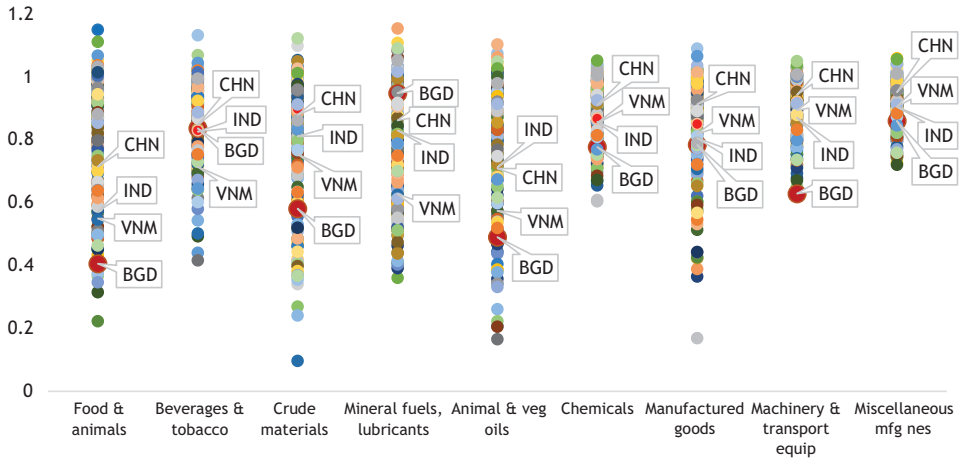
Source: Adapted from ITC (2016), based on Gereffi and Frederick (2010) and Cornelia (2012).

are generally absent in international trade analysis. While economists can use fairly disaggregated trade data (e.g. at HS 8- or 10-digit levels), the computed unit value prices still suffer from aggregation and measurement unit problems.[17] The second difficulty relates to product differentiation. Products supplied by different countries could represent substantial quality differences, and cross-country comparisons, even using highly disaggregated data, cannot fully account for this. Prices on different broad items (such as T-shirts) from various brands and retailers are not available in a systematic manner. Even when available, the retail prices would be very different from those obtained by the firms in developing countries.

While Bangladesh is developing capacities in making relatively high-priced garment products sold by many global brands, until now it has been known mainly as a source for low-cost garment items in bulk.[18] There is also a general perception that not only in garments but also in all major export items, Bangladesh lags behind its main competitors in terms of product quality. An analysis using one of the most comprehensive export quality databases, prepared by the International Monetary Fund (IMF) and UKAid, seems to confirm this view.[19] As Figure 1.27 shows, at the Standard International Trade Classification (SITC) 1-digit level, Bangladesh's export quality is lower than those of China and India in all but one SITC 1-digit level of product classifications.[20] In most categories, Vietnam's unit prices are also higher than those of Bangladesh. In the case of manufactured goods, which include much of the country's apparel exports, Bangladesh is at around the 80th percentile – behind China, Vietnam and India.

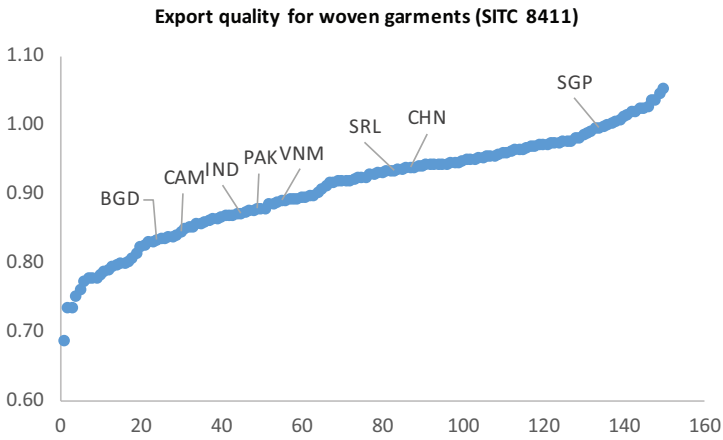
Using the aforementioned database, it is also possible to compare export quality for clothing items. The information obtained for different countries can be used to generate a "quality ladder", measuring the relative quality of a country's exports against all other countries that export clothing (Reis and Farole, 2012). Figure 1.28 shows Bangladesh moving up the quality ladder between 2001 and 2014.[21] However,

Figure 1.27 Quality of export goods by SITC-1 digit sectors



Source: Authors using data from IMF export quality database.

Figure 1.28



other comparators, such as China, India and Vietnam, also moved up, and appear to have made faster progress. When export quality is analysed separately for woven and knitwear items, Bangladesh is outperformed by its principal competitors.

Following Reis and Farole (2012), export quality in the EU can be approximated using unit value prices. Comparisons of trends in unit values over the period 2000–2017 for overall apparel exports, knitwear products and woven garments using export data exclusively for the EU show Bangladesh with generally lower prices compared with other major competitors (Annex Figure A3). For Bangladesh's two single most important export items (CN 62034235 and CN 62034231), its unit value prices in the most recent periods are almost at par with those of China (Annex Figure A3).[22]

1.4.3 Bangladesh's competitive strengths: Buyers' and exporters' perceptions

A large number of international buyers, comprising globally established brands as well as intermediaries, source apparels from Bangladesh.[23] In various global surveys, Bangladesh appears as an important destination for sourcing low-cost garment items.[24] Despite Bangladesh's ability to supply in bulk and its record of consistent export performance, working conditions and workers' safety have been a concern for many buyers.[25] Working conditions are generally recognised as improving in recent times (Moazzem and Sehrin, 2016), enabling a renewed relationship between factories and buyers.

In the interviews, buyers' representatives regarded Bangladesh as competitive and an important source of suppliers. All respondents said supplying in large volumes was one of the country's key strengths. On a scale of 1 (highly dissatisfied) to 5 (highly satisfied), the average score assigned was 4 on volume supplied. The same score was recorded for prices offered by Bangladeshi suppliers. Clearly, competitive pricing and large volume delivery are critical strengths of the industry. On all other indicators,

Box 1.1 Gathering perceptions of buyers and exporters

In an attempt to better appreciate the competitiveness challenges facing Bangladesh, perceptions of buyers and exporters were gathered as part of this study, through a purposively built short survey. Given the scope of this current work, administering a detailed questionnaire-based survey was not possible. Rather, the approach was to conduct some short and focused key informant interviews based on a pre-specified and semi-structured checklist. The checklist was developed following the Commonwealth Secretariat methodological guidelines for assessing firm capabilities suitably adjusted to consider the Bangladesh case. Interviews were conducted face to face, over the phone and by email. Representatives of five buyers/buying houses based in Dhaka and ten garment factory owners were interviewed. The questions in the interview checklists included participants' perceptions on prices and quality of Bangladeshi apparels; future market prospects; buyers' relationships with existing suppliers and their medium-term sourcing strategies; and general competitiveness issues facing Bangladesh, including potential loss of duty-free access.

such as product variety and range, reliability and delivery, the average score was 3. However, one of the biggest buyers of Bangladeshi products participating in the survey provided a maximum score of 5 in each area of supplying in large quantities, reliability and delivery promptness.

When explicitly asked whether demand for Bangladesh's products was price- or quality-driven most buyers' representatives suggested the former. However, there were differing views, indicating improving quality as well as the importance of retaining the niche market, where quality is often dictated by consumers' purchasing power. The buyers' representatives did not agree with the popular notion that the prices of Bangladesh's products were unusually low compared with those of rival suppliers. They were of the view that global export markets were competitive and prices for Bangladesh reflected that reality. Almost all buyers thought that low labour cost would remain an important source of comparative advantage for Bangladesh.

In the discussion on the potential impact of loss of tariff preferences in the EU, the buyers' representatives generally agreed there would be some impact on relative competitiveness, but they could not offer any insights about the impact on export performance. Some respondents were of the view that predicting market outcomes about 10 years in advance would not be practical as export markets are quite dynamic and business models, including countries' moving along the value chain or managing the supply chains, may experience profound changes, determining competitiveness in the medium to long term. In the short to medium term (over two to five years), most buyers do not see any significant changes in sourcing practices involving Bangladesh. One representative, who procures for the US market, expected a 25 per cent growth in his business with Bangladesh over the next five years or so. Another respondent

representing a major brand (and a big buyer) suggested the concerned buyer was satisfied with the products from Bangladesh and could not be sure of alternative sources of supplies.

Exporters' responses were mixed, but more than half of them expressed concerns about the prospect of weakened competitiveness arising from EU preference erosion. Although the sample size was small, it appeared that large firms were relatively less worried about their business prospects. However, according to two fifths of respondents, profitability is already at such a low level that accommodating a margin of lost tariff preference as big as 10–12 per cent would pose an extremely difficult challenge.[26]

Two relatively small firm owners were of the view that many European buyers were procuring from Bangladesh as they did not have to pay tariffs in the EU. They thought that, in the absence of such benefits, those buyers would look for alternative sourcing options. According to them, rather than Bangladeshi suppliers, it is the importers who benefited from tariff preferences. Therefore, LDC graduation could erode Bangladesh's attractiveness as a supplier among buyers.

Along with tariff preferences, the relaxed and more generous EU ROO could also go away with LDC graduation. Under the existing EU ROO regime, non-LDCs are required to fulfil "double transformation" to access GSP preferences. Most respondents reported that such a conditionality to access any future GSP preferences for knitwear garments that might be available should not be a major problem, as Bangladesh currently has domestic capacity to produce yarn. However, for the woven garment sector, using domestically produced fabrics for garment-making in order to access any preferences could be a challenge.

Almost all garment manufacturers interviewed thought that prices obtained by Bangladesh were unusually low as against of those of competitors. Some respondents thought that many firms would undercut prices in order to secure orders, and this tendency has generally lowered prices across the industry. As mentioned above, however, this view was not supported by buyers' perceptions.

Several respondents thought that, despite any preference erosion-induced weakened competitiveness, it might not be easy to replace the supply sources from Bangladesh. According to them, the country has now developed very large capacities, with the associated scale economies benefiting the buyers. When Bangladesh and Cambodia graduate from the LDC category, only African countries will enjoy large tariff advantages. Although several African suppliers, such as Ethiopia, Lesotho and Madagascar, have come up as apparel exporters, they have very small supply-side capacity.

Some respondents pointed out that wages were steadily rising in China, and its industrial upgradation strategy would lead it to transform into a major exporter of technology-intensive goods and services. This would generate more exporting opportunities for Bangladesh and others in labour-intensive manufacturing sectors, including apparels. Wages in Bangladesh are increasing too, but labour cost differences with many other developing countries will be an advantage.

1.5 Adaptation strategies

Even without referring to any specific magnitude of potential loss of export earnings or market share, it can be concluded that LDC graduation will likely dent Bangladesh's competitiveness in the EU. Bangladesh thus has a significant task ahead to prepare for it. Adaptation strategies should include various policy options at the national level and changes/improvements in firm-level business and operational practices. It is not possible to discuss all the associated issues in detail here. However, a few possible broad intervention areas are flagged below.

1.5.1 Exploring most attractive future trade policy regime in the EU

For Bangladesh, the most challenging impact of LDC graduation will be transmitted through the loss of duty-free market access in the EU. However, the graduation process and available EU trade policy regimes mean there exists scope for being strategic and Bangladesh's undertaking proactive initiatives in mitigating any adverse consequences, including weakened competitiveness of apparel exporters.

The political processes within UN systems and development partners generally emphasise smooth graduation and transition processes, although there is not much clarity regarding how other international support measures such as bilateral and multilateral aid and technical assistance can be of help and will actually be made available. However, in the case of preferential market access, it is expected that, once Bangladesh graduates, most likely in 2024, it will remain eligible to access duty-free market access in the EU for another 3 years.[27] Post-graduation, it may be possible to look for an alternative EU trade policy regime that is more generous and attractive to exporters rather than just considering the Standard GSP or MFN options.[28]

Although under the existing rules Bangladesh may not qualify for GSP+, the European Commission's current GSP regime will apply until 2023 and is likely to be replaced by a new regime. Therefore, proactive engagement with the Commission and other stakeholders could be undertaken to influence any future changes in the EU GSP regime that would benefit Bangladesh. Given that several other LDCs are in the process of graduation, coordinated efforts could enhance the chance graduating LDCs having an extended transition period from EBA and/or more liberal GSP+ provisions, including continuation of the EBA ROO for graduating LDCs.

If GSP+ or an equally favourable scheme cannot be secured, striking a free trade agreement (FTA) could be an option, if the EU is interested. Although market size in Bangladesh may appear to be too small for the EU to find it worth considering for a negotiated deal, it is growing rapidly. Given the medium-term growth outlook, Bangladesh's economy is set to grow bigger than US$500 billion by 2025. According to recent PricewaterhouseCoopers projections, Bangladesh would be the 28th largest economy by 2030, in terms of GDP measured in purchasing power parity (PPP) dollars.[29] Another important feature that makes Bangladesh an attractive partner for an FTA is its robust economic growth, accompanied by a highly protected trade policy regime. Indeed, it has been shown that, except for just

one, no country had applied an average tariff rate higher than Bangladesh and yet achieved higher average growth (Razzaque, 2017). A growing market shielded by high tariffs provides preferential partners with a large competitive advantage (over others that do not have such preferential access) and thus should be of interest to many countries.

Undertaking a bilateral trade arrangement with such a major partner as the EU will be a mammoth task for a country like Bangladesh, with very limited trade negotiation capacity and no bilateral FTA with any other country. In the run-up to LDC graduation, serious attention should be given to considering all options for securing a favourable market access in the EU and mobilising capacities for immediate proactive engagement with all relevant stakeholders.

1.5.2 Industrial upgradation for moving up the global value chains

One element of an adaptation strategy should include industrial or economic upgradation to move up the value chain. This may not be feasible at a large scale, but many leading firms will have the necessary capabilities for product and process upgradation. Product upgradation involves the production of complex items, whereas process upgrading requires advancing production methods in combination with using a skilled workforce. Bangladesh has some capacity in the textile industry, improved capacity of which can help upgrade the garment sector into higher segments of the value chain. Currently, a small number of firms are offering product design to their buyers. This capacity can be promoted further.

Review of country experiences by Fernandez-Stark et al. (2011) reveals that, in upgrading into design and branding, a strong commitment to industry growth by both the public and the private sectors is needed to develop the necessary talent and establish a national brand. They also find that successful workforce development for higher stages in the value chain have leveraged knowhow in the developed world by engaging foreign universities in successful apparel countries to help design curricula for local programmes and hiring foreign consultants to develop in-house talent. According to Fernandez-Stark et al., rather than relying solely on learning through experience, fostering collaboration with successful training institutions in the developed world can speed firm-level learning for upgrading. Shortage of specialised professionals and skilled workers in Bangladesh is known to be a severe problem for export-oriented firms, including the apparel sector. Industrial upgradation therefore must consider the need to develop the human resource base.

Industrial upgradation will also imply promoting competitiveness through technological upgradation. Deepening of capital-intensive production processes and automation has already marked garment-making activities in Bangladesh. Nevertheless, there is evidence that, in comparison with such comparators as Cambodia, China, India and Vietnam, the level of capital intensity in Bangladesh's garment industry is very low.[30] As export production technologies seem to converge, there exists considerable scope for improved labour productivity driven by more technology-intensive production processes.[31]

1.5.3 Ensuring compliance as expected from credible suppliers for global consumers

Compliance will remain a major factor in growing export business in the apparel sector. Unfavourable working conditions and labour issues attract widespread global attention and global brands will always avoid the factories that cannot ensure adherence to various acceptable standards. As mentioned above, various initiatives in recent years have been implemented to improve work place safety standards and working environments (Moazzem and Sehrin, 2016). The progress made in these areas should be consolidated and efforts must continue to make further improvements. It is also important to take greater ownership of these issues to maintain good practices in a sustainable manner. During the perception survey, some factory owners mentioned not receiving higher prices or bigger orders despite making progress on compliance issues. However, better workplace standards and practices should be seen as part of a long-term investment and business growth strategy.

1.5.4 Attracting foreign direct investment in the readymade garment sector

FDI can be a big boost to export growth and effective integration into GVCs. It can be instrumental in establishing direct contacts and business relationships with global brands and retailers in producing high-value items. FDI firms are known to secure higher unit value prices for export products. Skill upgradation, productivity improvement, positive spillover effects arising from knowledge and technology transfers and better management practices are some of the direct impacts of FDI participation. The spillover effects can also benefit local firms, facilitating their industrial upgradation and enhanced participation in GVCs. Among others, a weak investment climate and a high cost of doing business discourage FDI inflows into Bangladesh. Since 2000, while the yearly average FDI inflow as a proportion of GDP in China, Cambodia, India and Vietnam has been 2.3 per cent, 7.8 per cent, 1.7 per cent and 5.4 per cent, respectively, the comparable figure for Bangladesh has been less than 1 percent.[32] Attracting foreign investment into Bangladesh's RMG sector should thus constitute a policy priority in preparation for LDC graduation.

1.5.5 Tackling the cost of doing business to boost competitiveness

There are certain areas where Bangladesh can transform its current challenges into opportunities to boost external competitiveness. The issue of excessive cost of doing business in Bangladesh is widely acknowledged. Weak and inadequate infrastructure in conjunction with inefficient inland road transportation and trade logistics contributes to longer lead times and a high cost of doing business, undermining competitiveness.[33] Congestions in the country's main economic corridor, the Dhaka-Chattogram highway; limited containerisation and inefficient handling and management of containers; intricate customs processes; and inadequate port infrastructures all add to trading costs.[34] This reduces trade volumes and domestic value added (which includes wages and profits). Within this reduced value added, for an export-oriented apparel sector there are two-way shipping costs involved: import

of raw materials and then export of final products. The implication is that excessive trading costs make it increasingly difficult for apparel-exporting firms to compete in world markets.[35] Improvements in these areas thus can substantially help recoup a part of the lost trade preferences.

1.6 Conclusion

The impending LDC graduation represents a major development transition for Bangladesh. For a country of more than 160 million people in a land area half the size of the UK, confronting daunting challenges of frequent natural disasters, political unrest and weak governance, making this transition possible will be nothing less than an amazing achievement (Razzaque, 2018a). It represents global recognition of the socio-economic development that Bangladesh has been able to achieve.

However, LDC graduation also gives rise to concerns about potentially sizeable economic costs as a result of loss of access to various support measures associated with LDC status. The available support measures encompass a range of concessions, commitments and provisions made by development partners across the fields of development finance, trade and technical assistance. Of this, the most important consequence will be the loss of trade preferences in the EU.

Taking advantage of duty-free market access and relaxed ROO provisions, Bangladesh's apparel exports to the EU have risen to more than $20 billion. In the global clothing value chain landscape, Bangladeshi firms operate mainly in the low-value added segment of cutting and making of apparels, with the principal source of its competitive advantage being the low wage costs of labourers. The loss of duty-free access could thus adversely impact the country's competitiveness and export prospects. In international trade, higher tariffs imposed against a country's suppliers are generally associated with their lower exports, and tariff preferences tend to enhance export response of the preference-receiving countries. In this context, application of a partial equilibrium model, developed as part of the Commonwealth Secretariat's analytical framework in understanding the potential implications of LDC graduation, shows that loss of tariff preferences in the EU could result in a potential export loss of more than US$2 billion for Bangladesh.

It is worth pointing out that the methodological approach and results reported have certain caveats. Analytical frameworks are simplified representations of the realities, failing to capture many complex interactions involving the demand and supply sides. When the Multi-Fibre Arrangement (MFA) quotas were abolished from global trade in 2005, many analysts predicted huge business losses for Bangladesh, in sharp contrast with an eventual acceleration in its export growth. Considering post-graduation prospects, an argument can be put forward that, even without any preferential treatment, Bangladesh has managed to succeed in the US apparel market. Furthermore, trading is also about building networks and relationships. As such, long-established supply sources in Bangladesh may not be replaced overnight. If EU importers have benefited out of Bangladesh's duty-free access, they may not have alternative and equally lucrative sourcing opportunities elsewhere. Other LDCs and

developing countries enjoying EBA or GSP+ preferences currently do not have such large supply-side capacities as Bangladesh.

Notwithstanding, there is no denying that loss of preferences will trigger serious pressure on Bangladesh's competitiveness. There are certain measures the country can consider to mitigate any potential adverse consequences. These include looking for an extended transition period (from EBA arrangements) for graduating LDCs, possible options and strategies for securing GSP+, widely regarded as the most favourable EU preferential scheme after EBA, a negotiated bilateral trade deal with the EU, etc. On the supply side, industrial upgradation within apparel value chains, including technological upgradation in Bangladesh's garment industry, attracting FDI and ensuring compliance would help. Finally, the cost of doing business is considered excessively high in Bangladesh because of such factors as infrastructural bottlenecks, inefficient customs processes, incompetent port management and trade facilitation measures, dysfunctional inland transportation and weak governance. Any improvements in these areas can contribute to improved competitiveness of exporting firms.

Going ahead, informed policy-making and Bangladesh's preparation for smooth graduation can be aided by several timely and gap-filling analytical studies. These include, among others, analyses of distribution of rents between suppliers and importers from tariff preferences with a view to better appreciating the likely impact on export competitiveness following graduation and the role of preferential treatment in GVC positioning; exporters' pricing strategies with and without preferences (e.g. a comparative analysis of EU and US markets) to gauge competitiveness pressure; the scope of industrial upgradation that is realistically feasible within GVCs for promoting export competitiveness; industrial restructuring that is taking place in China and its likely implications for global apparel market shares by different suppliers; automation and deepening of capital-intensive techniques and implications for development outcomes and industry competitiveness; and implications for different types of possible post-graduation trading arrangements with the EU.

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Notes

* This study was undertaken by the Policy Research Institute (PRI) of Bangladesh with support from the Commonwealth Secretariat, London. It is authored by Mohammad A. Razzaque and Jillur Rahman. Any shortcomings and views expressed are the authors' responsibilities and not necessarily those of PRI and the Commonwealth Secretariat.

1 LDC graduation requires a country to meet development thresholds under at least two of the three pre-defined criteria (of per capita income, human asset and economic vulnerability) in two consecutive Triennial Reviews. Bangladesh achieved graduation qualification by satisfying all the three thresholds. An "income-only" graduation rule is also provided, under which, if the three-year average per capita gross national income (GNI) of an LDC has risen to a level at least double the graduation threshold, the country could be eligible for graduation regardless of its situation under the other two criteria.

2 A summary of Bangladesh's major socio-economic achievements leading to LDC graduation can be found in Razzaque (2018a).

3 World merchandise exports declined by a staggering US$2.5 trillion in 2015 (from the previous year), and then again by more than $500 billion in 2016. As many as 183 countries experienced reduced export earnings in 2015 (compared with the previous year), and for 112 countries export earnings similarly declined in 2016. Given such a gloomy global landscape, Bangladesh did much better by securing modest export growth in both the years.

4 The EPI has three components: exporters' supply capacity of a product, demand conditions and bilateral "easiness" to trade. An exporter's supply capacity is estimated as a dynamic version of market share where expected economic growth is considered to augment the exporter's capacity; and product-specific trade balance measured by the export-import ratio and global margin of preference, which encompasses information on tariff preference. Demand conditions are captured through partners' projected imports, which are determined by projected GDP and population growth; margin of preference in the target market; and distance advantage, which compares suppliers' geographical distances with the target market. The easiness to trade between two countries is computed based on the actual trade relative to hypothetical trade estimated by supply and demand conditions. If easiness to trade between countries is greater than 1, countries find it easier to trade between themselves relative to world markets. The export potential is then multiplication of estimated supply capacity, demand conditions and bilateral easiness to trade. Potential exports are estimated for disaggregated products at HS 6-digit level. The aggregate export potential of a country in a target market is the sum of product-level export potentials.

5 Although Bangladesh is enjoying duty-free access, there could be various reasons for its not being able to exploit the EU market fully. These include underdeveloped trade infrastructure, difficulties

in complying with standards, quality and preferences of consumers and any other barriers in developing relationships with buyers/importers.

6 Bangladesh has not ratified just one of the twenty-seven international conventions. As regards condition 2, Bangladesh's current share in all GSP-covered imports is more than 16 per cent – much higher than the 6.5 per cent threshold. Finally, more than 90 per cent of Bangladesh's exports to the EU are in woven and knit garments, comprising just one section of GSP-covered imports.

7 According to one estimate, 96 per cent of Bangladesh's exports to the EU enjoyed tariff-free access under the EBA scheme in 2016 (European Commission, 2018a). The most likely reason for the remaining 4 per cent exports' not availing of the preference is not fulfilling the ROO provisions.

8 The local value added to qualify for preferential treatment would increase from 30 to 50 per cent for all products. In the apparel sector, currently LDCs can qualify for EBA facilities under single transformation of products (e.g. from fabric to clothing) but under GSP+ treatment products must go through double transformation (i.e. from cotton to fabric to clothing).

9 The second step thus involves the graduate's lost market share being distributed among the non-graduates.

10 Developing an appropriate GEM can be very time-consuming as well. One popular approach is to use the Global Trade Analysis Project (GTAP) computable general equilibrium model. However, in the GTAP model, just one aggregate sector of textile and wearing apparel is used, unlike the trade data at a highly disaggregated level utilised here.

11 This analysis does not consider the fact that LDC graduation could lead to more stringent ROO, with impacts on woven garments, as discussed earlier.

12 This is one key advantage of partial equilibrium models, in which implications by individual products can be evaluated.

13 This definition of a GVC is taken from https://globalvaluechains.org/concept-tools

14 Bangladesh's apparel exports are a prime example of GVC-led trade.

15 The issue of low value addition in proportion to overall GVC-led final product retail prices has also attracted a lot of attention in the context of primary commodities supply chains. It is generally recognised that a large majority of developing countries, including LDCs and Sub-Saharan African countries, have failed to add more value by processing their primary exports and moving up the GVCs within which they specialise. Some commodity exporters are thought have become trapped in captive value chains (Nissanke and Mavrotas, 2010; Keane, 2012). It has been argued that participating in the lower end of GVCs may lead to a "hollowing-out" of the manufacturing sector. This disadvantageous process is also known as "immiserising growth" (Kaplinsky, 2005), a phenomenon recognised within the case study GVC literature of the 1990s but ignored by the current GVC discourse.

16 Data on firm-level costs by various activities and profit margins are not available. Industry sources and key informants suggest it is the high volume of orders that makes it possible for most firms to operate even with a small margin per unit.

17 For instance, the measurement units are often in kg and m^2 equivalents. For garment items, prices in these units generally will not make much sense. Empirical work using these data focuses mainly on determining the changes in variations in these data rather than comparing prices across countries. Another problem with these data are that they can be very noisy over time, given, among others, the possible substantial changes in quality mixes even within a specific category.

18 http://fashion2apparel.blogspot.com/2017/02/top-10-retailers-fashion-brands.html

19 https://www.imf.org/external/np/res/dfidimf/diversification.htm. The estimation methodology (Henn et al., 2013) employed derives quality from unit values of disaggregated products. First, trade prices are modelled as the function of unobservable quality, exporters' level of development and distance between exporters and importers. In the second step, a quality augmented gravity equation is specified. Then, from step one, quality relationship is substituted into the specification in the step two equation, which is then estimated separately for individual products. Finally, the regression coefficients are used to calculate quality estimates.

20 At SITC-4 broad category defined as "mineral fuels, lubricants, and related materials", Bangladesh is shown to have unit values higher than those of China, India and Vietnam. Bangladesh is not a major exporter in the category and thus the higher unit prices reflect a very small quantity of a high-quality product.

21 The IMF/UKAid export quality database provides information until 2014 only.
22 It needs to be pointed out that data used for the EU-specific unit value analysis do not explicitly consider varying qualities. However, following Reis and Farole (2012), measurement of the relative quality has been defined as the unit value of any product relative to the 90th percentile unit value of the same product across countries. The 90th percentile of the unit values has been considered the world standard. Higher values of the index correspond to higher quality levels. The closer a country's position to the origin of the quality ladder, the lower the quality, and vice versa. The total length of the quality ladder shows the potential for further quality improvement of a specific product.
23 Some of the biggest brands that produce in Bangladesh are Benetton, C&A, Carrefour, H&M, JCPenney, Levi's, Gap, Walmart, Target, Tesco and Zara.
24 For example, see the Asia Inspection Global Sourcing Survey 2018, at https://s3.asiainspection.com/images/news/2018Q1/AI_Q1_2018_Barometer_survey_results_Jan2018.pdf accessed on 6 November 2018.
25 Since the collapse of Rana Plaza in 2013, killing more than a thousand workers, two Western buyers' platforms – Accord and Alliance – have been involved in working with the government, industry associations, workers, local and international NGOs and development partners to improve workplace safety in Bangladesh's RMG sector.
26 They elaborated that their current profitability per season was very low. They can stay afloat only because they receive orders for three seasons.
27 This is as per the provision stipulated in Article 17, Paragraph 2 of Regulation (EU) No. 978/2012 of the European Parliament and of the Council dated 25 October 2012.
28 As mentioned earlier, if Bangladesh does not qualify for GSP+, it will be eligible for the Standard GSP scheme, which is much less attractive. The Standard GSP tariff rate on apparels in most cases will be 9.6 per cent (as against zero in all apparels-related tariff lines under EBA and GSP+) in comparison with an MFN rate around 12 per cent. Moreover, eligibility of most developing countries in Standard GSP means there cannot be any gains in competitiveness.
29 In 2030, Bangladesh GDP is projected to reach US$1.34 trillion PPP, while by 2050 it would grow further to $3.06 trillion PPP to become the 23rd largest in the world. Along with the overall economic growth, Bangladesh is experiencing rapid expansion of the middle class, with its rising disposable incomes and high propensity to spend on a new and wide range of products and services. According to one estimate, in 2017 the consumer goods sector had grown 9 per cent to $3.4 billion.
30 Razzaque and Dristy (2018) estimate that, as against of Bangladesh's employing 142 workers in producing garment items worth US$1 million, China and Vietnam each require just 48 workers for the same size of export production. The comparable numbers of workers for India and Cambodia are, respectively, 59 and 75.
31 This could, however, imply that employment opportunities in the sector would diminish. In fact, the impact of automation and more capital-intensive production processes has already been experienced. For instance, as Razzaque and Dristi (2018) point out, between 2010 and 2016, Bangladesh's clothing exports more than doubled, from US$12.5 billion to $28 billion, but jobs in the sector grew only marginally, from 3.6 million to 4 million. Going forward, the garment industry will have to grow at a much faster rate to generate a modest expansion in employment.
32 FDI stock as a percentage of GDP for Bangladesh, at 6 per cent, is far lower than that of its comparators: for instance, the FDI stock for Cambodia increased from about 10 per cent in 1995 to more than 80 per cent in 2016, while Vietnam's share increased from around 28 per cent to more than 55 per cent.
33 The lead time – the number of days from the confirmation of any orders to goods delivered to port and turned over to the freight forwarding company – is also an important determinant of competitiveness in the apparel export sector.
34 World Bank (2016) provides a detailed analysis of these issues.
35 It may be pointed out that, in the World Bank's Ease of Doing Business index, Bangladesh ranks among the worst performing countries (176th out of 190 countries in 2019).

Annex 1.1

Table A1.1 Bangladesh's total and RMG exports to the EU

Economy	Total exports (US$ millions)	RMG exports (US$ millions)	Share of RMG in total exports (%)	Share in total exports (%)	Share in RMG exports (%)
Germany	5,890.72	5,579.51	94.72	16.06	18.22
UK	3,989.12	3,724.26	93.36	10.88	12.16
Spain	2,457.98	2,277.77	92.67	6.7	7.44
France	2,004.97	1,851.93	92.37	5.47	6.05
Italy	1,559.92	1,454.04	93.21	4.25	4.75
Netherlands	1,205.37	935.38	77.6	3.29	3.06
Poland	965.22	864.85	89.6	2.63	2.82
Belgium	877.9	705.57	80.37	2.39	2.30
Denmark	693.29	667.95	96.35	1.89	2.18
Sweden	579.33	533.09	92.02	1.58	1.74
Czech Republic	497.39	492.29	98.98	1.36	1.61
Ireland	175.81	169.88	96.62	0.48	0.55
Portugal	86.63	68.83	79.45	0.24	0.22
Slovakia	84.97	84.15	99.03	0.23	0.27
Slovenia	65.74	57.52	87.49	0.18	0.19
Greece	57.93	50.34	86.9	0.16	0.16
Austria	36.47	27.72	76.02	0.1	0.09
Finland	33.13	29.92	90.32	0.09	0.10
Romania	24.96	19.46	77.94	0.07	0.06
Croatia	16.58	15.28	92.17	0.05	0.05
Hungary	6.44	2.72	42.32	0.018	0.009
Malta	6.2	6.16	99.28	0.017	0.020
Lithuania	6.11	3.78	61.93	0.017	0.012
Cyprus	4.86	1.37	28.19	0.013	0.004
Bulgaria	4.35	3.25	74.67	0.012	0.011
Estonia	1.45	1.26	86.88	0.004	0.004
Latvia	1.38	0.75	54.38	0.004	0.002
Luxembourg	0.29	0.29	100	0.001	0.001
Bangladesh's total exports to EU	**21,334.51**	**19,629.31**	**92.01**	**58.18**	**64.12**
Bangladesh's total exports	**36,668.17**	**30,614.76**	**83.49**	**100**	**100**

Source: Authors' using data from EPB.

Table A1.2 Major export items of Bangladesh to the EU

HS code	Product description	Exports to EU (US$ millions)	Total exports (US$ millions)	Share in exports by product (%)	Share in RMG exports to EU (%)
610910	T-shirts, singlets and other vests of cotton, knitted or crocheted	3,833.4	5235.8	73.2	17.90
620342	Men's or boys' trousers, bib and brace overalls, breeches and shorts, of cotton	2,912	5399.6	53.9	13.60
620462	Women's or girls' trousers, bib and brace overalls, breeches and shorts of cotton	1,777.9	3095.7	57.4	8.30
611020	Jerseys, pullovers, cardigans, waistcoats and similar articles, of cotton, knitted or crocheted	1,618.9	2393.5	67.6	7.56
611030	Jerseys, pullovers, cardigans, waistcoats and similar articles, of man-made fibres, knitted	1,528.1	2096.7	72.9	7.13
620520	Men's or boys' shirts of cotton (excluding knitted or crocheted, nightshirts, singlets	841.5	1851.5	45.5	3.93
610462	Women's or girls' trousers, bib and brace overalls, breeches and shorts of cotton, knitted	793.6	1015.7	78.1	3.71
610510	Men's or boys' shirts of cotton, knitted or crocheted (excluding nightshirts, T-shirts, singlets	708.3	942.9	75.1	3.31
611120	Babies' garments and clothing accessories of cotton, knitted or crocheted (excluding hats)	526.2	767.2	68.6	2.46
610990	T-shirts, singlets and other vests of textile materials, knitted or crocheted (excluding cotton)	493.2	760.6	64.8	2.30
621210	Brassieres of all types of textile materials, whether or not elasticated, incl. knitted or	319.8	473.3	67.6	1.49
620343	Men's or boys' trousers, bib and brace overalls, breeches and shorts of synthetic fibres	309.4	567.3	54.5	1.44
620640	Women's or girls' blouses, shirts and shirt-blouses of man-made fibres (excluding knitted	279.4	395.2	70.7	1.30

(*Continued*)

Table A1.2 Major export items of Bangladesh to the EU (*Continued*)

HS code	Product description	Exports to EU (US$ millions)	Total exports (US$ millions)	Share in exports by product (%)	Share in RMG exports to EU (%)
610711	Men's or boys' underpants and briefs of cotton, knitted or crocheted	238.9	373.5	64	1.12
610442	Women's or girls' dresses of cotton, knitted or crocheted (excluding petticoats)	236.8	314.9	75.2	1.11
620630	Women's or girls' blouses, shirts and shirt-blouses of cotton (excluding knitted or crocheted	225.3	426.3	52.8	1.05
620193	Men's or boys' anoraks, windcheaters, wind jackets and similar articles, of man-made fibres	212	400.6	52.9	0.99
610342	Men's or boys' trousers, bib and brace overalls, breeches and shorts of cotton, knitted	202.7	350.9	57.8	0.95
610610	Women's or girls' blouses, shirts and shirt-blouses of cotton, knitted or crocheted	197.1	279.9	70.4	0.92
620530	Men's or boys' shirts of man-made fibres (excluding knitted or crocheted, nightshirts, singlets	196.6	318.5	61.7	0.92

Source: Authors using data from ITC.

Table A1.3 Selected countries' shares in extra-EU apparel imports (%)

	1990	1995	2000	2005	2010	2015	2017
China	13.26	13.80	19.99	35.61	45.95	37.84	33.84
Bangladesh	0.96	4.03	6.36	7.02	9.72	16.46	18.46
Turkey	14.52	13.22	13.06	15.36	12.25	11.38	11.15
India	4.80	6.65	5.18	6.67	7.05	6.55	6.18
Cambodia	0.00	0.16	0.74	0.98	1.21	3.72	4.81
Vietnam	0.22	1.13	1.95	1.43	2.29	3.80	4.07
Pakistan	1.35	1.76	1.51	1.58	1.67	2.80	3.28
Morocco	2.57	6.56	5.71	4.48	3.20	3.02	3.20
Tunisia	3.79	6.35	6.28	4.62	3.28	2.32	2.24
Sri Lanka	0.90	1.88	2.54	2.03	2.19	2.02	1.90
Indonesia	2.02	3.90	4.81	2.64	1.99	1.64	1.66
Myanmar	0.00	0.06	0.75	0.37	0.18	0.47	1.40
Hong Kong, China	14.72	12.89	8.93	4.23	0.63	0.83	0.62
Thailand	2.81	2.34	2.66	1.78	1.32	0.67	0.61
Egypt, Arab Rep.	0.22	0.57	0.66	0.75	0.63	0.53	0.49
USA	1.26	1.80	0.96	0.65	0.56	0.57	0.49

Source: UN Comtrade and ITC.

Table A1.4 Product-wise loss in Bangladesh's exports to the EU

CN 8-digit code	Product description	Exports to EU (US$ millions)	EU imports from world (US$ millions)	Market share of Bangladesh	MFN tariff	GSP tariff	Potential decline in exports (US$ millions)	
							Under MFN	Under GSP
61091000	T-shirts, singlets and other vests of cotton, knitted or crocheted	3,146.8	1,2831.2	24.5	12	9.6	−370.6	−296.5
62034235	Men's or boys' trousers and breeches of cotton (excl. Denim, cut corduroy, knitted or crocheted, industrial and occupational, bib and brace overalls and underpants)	956.5	4,309.0	22.2	12	9.6	−117.3	−93.8
61103099	Women's or girls' jerseys, pullovers, cardigans, waistcoats and similar articles, of man-made fibres, knitted or crocheted (excl. Lightweight fine knit roll, polo or turtleneck jumpers and pullovers and wadded waistcoats)	978.4	7,662.7	12.8	12	9.6	−114.7	−91.7
62034231	Men's or boys' trousers and breeches of cotton denim (excl. Knitted or crocheted, industrial and occupational, bib and brace overalls and underpants)	861.0	5,942.8	14.5	12	9.6	−102.3	−81.9
62052000	Men's or boys' shirts of cotton (excl. Knitted or crocheted, nightshirts, singlets and other vests)	731.3	4,614.0	15.8	12	9.6	−90.8	−72.7
61102099	Women's or girls' jerseys, pullovers, cardigans, waistcoats and similar articles, of cotton, knitted or crocheted (excl. Lightweight fine knit roll, polo or turtleneck jumpers and pullovers and wadded waistcoats)	711.0	4,769.3	14.9	12	9.6	−85.3	−68.2

61046200	Women's or girls' trousers, bib and brace overalls, breeches and shorts of cotton, knitted or crocheted (excl. Panties and swimwear)	658.2	3,259.4	20.2	12	9.6	−76.1	−60.9
62046231	Women's or girls' cotton denim trousers and breeches (excl. Industrial and occupational, bib and brace overalls and panties)	627.5	4,540.8	13.8	12	9.6	−70.4	−56.3
61051000	Men's or boys' shirts of cotton, knitted or crocheted (excl. Nightshirts, t-shirts, singlets and other vests)	610.2	2,565.7	23.8	12	9.6	−70.3	−56.3
61102091	Men's or boys' jerseys, pullovers, cardigans, waistcoats and similar articles, of cotton, knitted or crocheted (excl. Lightweight fine knit roll, polo or turtleneck jumpers and pullovers and wadded waistcoats)	614.0	3,858.0	15.9	12	9.6	−69.4	−55.5
62046239	Women's or girls' trousers and breeches, of cotton (not of cut corduroy, of denim or knitted or crocheted and excl. Industrial and occupational clothing, bib and brace overalls, briefs and tracksuit bottoms)	577.3	3,416.7	16.9	12	9.6	−67.8	−54.3
62034290	Men's or boys' shorts of cotton (excl. Knitted or crocheted, swimwear and underpants)	436.5	1,520.2	28.7	12	9.6	−51.6	−41.3
61112090	Babies' garments and clothing accessories, of cotton, knitted or crocheted (excl. Gloves, mittens, mitts and hats)	438.9	2,965.2	14.8	12	9.6	−48.7	−39.0
61099020	T-shirts, singlets and other vests of wool or fine animal hair or man-made fibres, knitted or crocheted	368.8	5,777.2	6.4	12	9.6	−40.4	−32.3

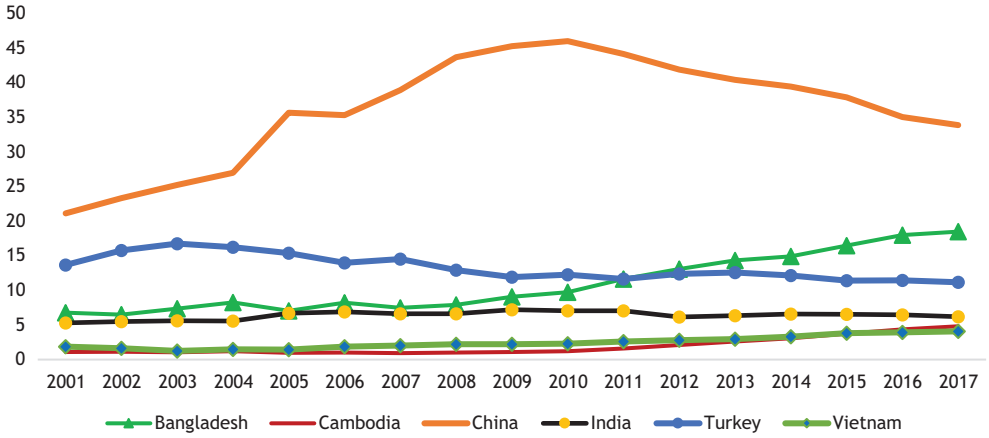
(*Continued*)

Table A1.4 Product-wise loss in Bangladesh's exports to the EU (*Continued*)

CN 8-digit code	Product description	Exports to EU (US$ millions)	EU imports from world (US$ millions)	Market share of Bangladesh	MFN tariff	GSP tariff	Potential decline in exports (US$ millions)	
							Under MFN	Under GSP
61103091	Men's or boys' jerseys, pullovers, cardigans, waistcoats and similar articles, of man-made fibres, knitted or crocheted (excl. Lightweight fine knit roll, polo or turtleneck jumpers and pullovers and wadded waist	286.4	1,729.2	16.6	12	9.6	−32.2	−25.8
61071100	Men's or boys' underpants and briefs of cotton, knitted or crocheted	210.4	1,731.8	12.1	12	9.6	−23.5	−18.8
62063000	Women's or girls' blouses, shirts and shirt-blouses of cotton (excl. Knitted or crocheted and vests)	173.6	2,171.2	8.0	12	9.6	−22.9	−18.3
62053000	Men's or boys' shirts of man-made fibres (excl. Knitted or crocheted, nightshirts, singlets and other vests)	168.1	439.2	38.3	12	9.6	−22.1	−17.7
62064000	Women's or girls' blouses, shirts and shirt-blouses of man-made fibres (excl. Knitted or crocheted and vests)	223.2	4,515.8	4.9	12	9.6	−21.3	−17.0
61034200	Men's or boys' trousers, bib and brace overalls, breeches and shorts of cotton, knitted or crocheted (excl. Swimwear and underpants)	186.6	1,303.1	14.3	12	9.6	−20.6	−16.5
Top 20 products		12,964.4	79,922.6	16.2			−1,518.4	−12,14.8

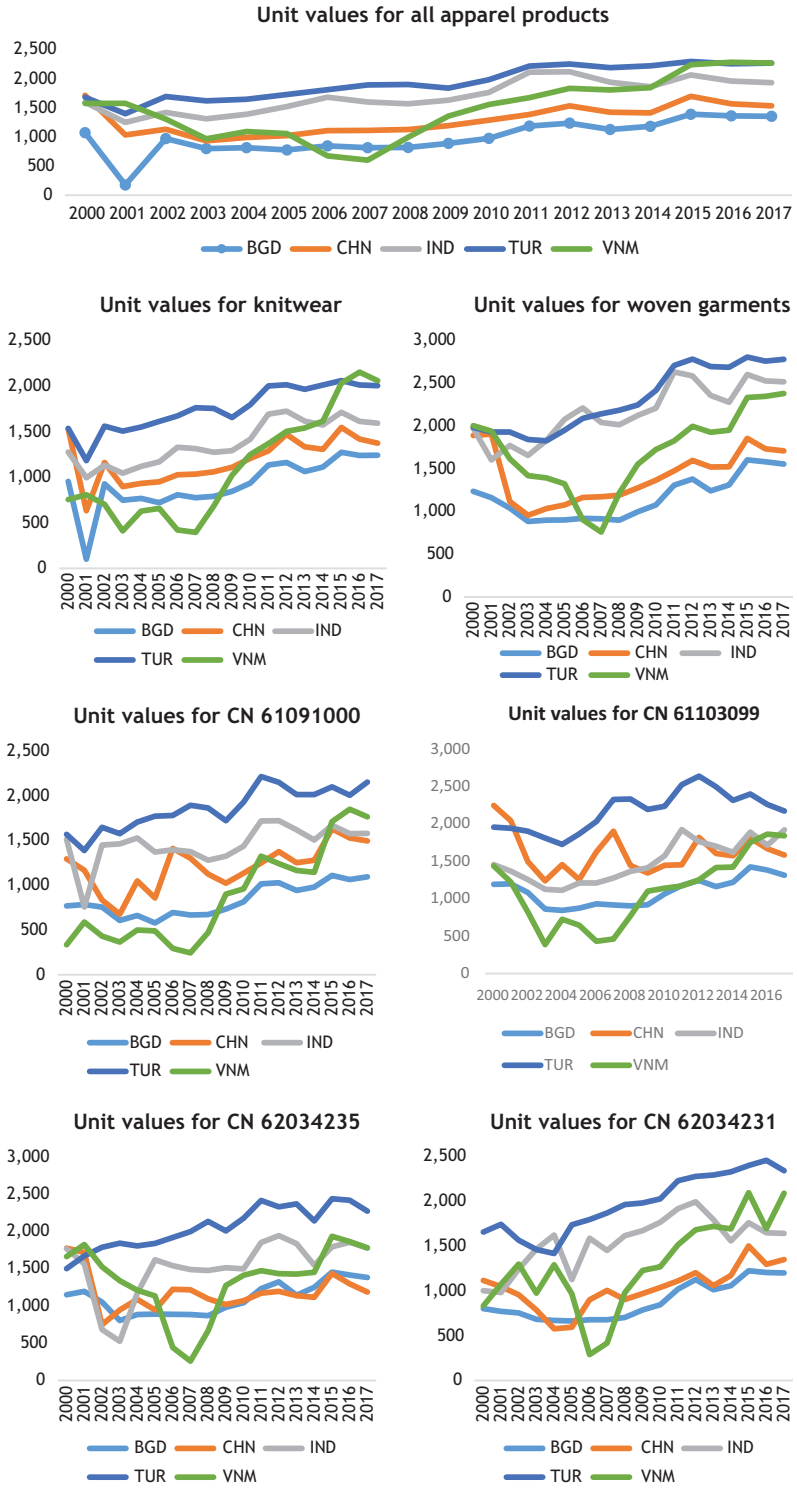
Source: Authors using data from EU Comext.

Figure A1.1 EU apparel market shares (extra-EU) by selected suppliers (%)



Source: Authors using data from ITC.

Figure A1.2 Comparison of unit values for apparel products exported to the EU by different exporters



Source: Authors using data from EU Comext.

Chapter 2

Addressing the Trade-Related Constraints of Non-Graduates: A Focus on Facilitating Infrastructure Investments in Mozambique*

2.1 Introduction

For the best part of the past ten years, Mozambique has seen gross domestic product (GDP) growth exceeding that of the average for its income group. Much of this is attributable to investments in the extractives and oil/gas sectors. Nevertheless, significant levels of poverty, unemployment, regional and gender inequality and vulnerability to climate and environmental shocks remain. The good news is that the solution to many of these issues lies in the hands of the Mozambique government.

Mozambique can mitigate its susceptibility to external (exogenous) shocks by diversifying its export offerings. Agriculture employs the most people of all sectors yet has received much less foreign direct investment (FDI) than sectors whose contribution to GDP is less. If targeted investments were made to improve technology and capacity related to agriculture, linkages could be made to other sectors and within-sector value could be improved, such as through agro-processing. Such a strategy would have an appreciable effect, given that over 70 per cent of the population work in agriculture. It would also help reduce levels of poverty and improve resilience.

Mozambique's vulnerability to climatic and environmental changes could be reduced if it refocused its investment strategies on spending better – and not necessarily more. For example, development with resilience in mind could save on costly periodic maintenance and improve the quality of life of many, especially the most vulnerable. Although vulnerability is found primarily among those living in rural areas, urban areas should not be overlooked. This is because an increasing number of people are moving to the cities to increase their job prospects. Some of them live in informal dwellings that do not have the appropriate land registration and, in many cases, do not adhere to building codes.

In February 2018, in-country research was conducted in Mozambique on the country's framework with regard to infrastructure, – that is, policies, laws and regulations – with a view to developing a toolkit to assess the implications of this for the attractiveness of financing infrastructure investment projects. The framework confirmed that many aspects of Mozambique's infrastructure development processes/procedures have commonalities with those of other countries (Commonwealth and otherwise) and that the Principles of the Charter of the Commonwealth could be used as a basis to determine the extent to which the framework is effective. The mission was funded under the UK government's "kickstarter" programme with a focus on least developed country (LDC) transition.

The research obtained information and data from a number of sources, including:

- Meetings with representatives of a number of institutions (see Annex 2.1);
- World Bank Worldwide Governance Indicators, with 2016 as the most recent year;[1]
- World Bank Doing Business Report 2016;
- International Monetary Fund (IMF) Capital Account Openness 2016;[2]
- World Economic Forum (WEF) Global Competitive Index 2017;
- World Bank Benchmarking Public Procurement 2017;[3]
- Institutional Profiles Database 2016;[4]
- World Bank data;[5]
- Various laws/regulations and policies of Mozambique.

The first step in assessing the implications of the infrastructure framework for attracting financing involve identifying the key components of infrastructure to be assessed and the means of doing this. For this purpose, the Global Infrastructure Hub (GIH) InfraCompass toolkit was employed.[6] InfraCompass takes into account six assessment categories:

1 **Governance** – institutional, governance and legal environment for infrastructure investment;

2 **Regulatory** – openness to investment and the extent to which regulation and competition frameworks support infrastructure delivery;

3 **Permits** – efficiency of the planning and licensing procedures for the issuance of permits and acquisition of land required for infrastructure development;

4 **Plans** – ability of government to plan, coordinate and select infrastructure projects;

5 **Procurement** – extent to which procurement processes and bid management frameworks are standardised, transparent and non-onerous to bidders;

6 **Delivery** – track record of delivery and quality of infrastructure assets.

Modifications were made to InfraCompass to remove evaluation criteria that made reference to Organisation for Economic Co-operation and Development (OECD) data, since these would not be applicable to non-OECD countries such as Mozambique. Meanwhile, two additional categories were included:

7 **Contingent liability and state-owned entity** – effectiveness of risk management framework for contingent liabilities deriving from state-owned entities as well as natural disasters;

8 **Macro-economics and financial market development** – financial stability, depth/efficiency of domestic market, debt sustainability and levels of financial innovation.

Application of the GIH toolkit to Mozambique, a Commonwealth LDC, is detailed later in this case study. The rest of the case study is organised as follows: Sections 2.2 and 2.3 provide an overview of salient factors and key macro-economic and demographic indicators in Mozambique. Section 2.4 looks at the public and private sector and the environment supporting investments. Section 2.5 discusses issues related to debt management and Section 2.6 the effectiveness of local content in Mozambique. Section 2.7 reviews the importance of building for resilience and Section 2.8 the depth of the financial market. Section 2.9 provides an overview of the rule of law and its relevance to infrastructure development. Section 2.10 offers a rationale for the development of a Commonwealth Charter for Infrastructure Development (CCID). Section 2.11 concludes.

2.2 Country overview

Mozambique lies in south-eastern Africa between South Africa and Tanzania, and also borders Malawi, Swaziland, Zambia and Zimbabwe. Approximately 67 per cent of the population (as of 2016) live in rural areas and the population was around 28.8 million as of 2016.[7] The country's endowments include a relatively large agricultural land percentage,[8] natural gas, oil, coal, mineral sands and hydropower.

The UN classifies Mozambique as an LDC because of its severe structural impediments to sustainable development. The country is highly vulnerable to economic and environmental shocks and has low levels of human assets. Mozambique ranks as having low human development (a value of 0.418), with a Human Development Index ranking of 181 of 188 countries (UNDP, 2016). World Bank data suggest the literacy rate is around 50.6 per cent.

Table 2.1 presents the sectors contributing the most to GDP. Agriculture is a large contributor not only to GDP but also in terms of the percentage of the labour force employed, which accounted for 75 per cent as of 2017 (Balchin et al., 2017). Employment in services accounted for 21 per cent, and industry/manufacturing for 4 per cent.

Approximately 60 per cent of exports are attributable to aluminium smelting, natural gas and coal production and heavy sands mining (UNDP, 2016). This suggests Mozambique is not diversified in its export offerings, as there is concentration across just a few sectors.

Table 2.1 GDP contribution of main sectors

Sector	Percentage of GDP
Agriculture including livestock, hunting, forestry and fisheries	25.2%
Industry/manufacturing	21.5%
Services	53.3%

Source: WTO (2017).

2.3 Macro-economics and demographics

Over the period 2010-2014 (and even before), GDP per capita growth was over 7 per cent, the result mainly of export-driven mega-projects,[9] primarily within the extractives industry. Infrastructure (specifically transport) has been built to facilitate access to and from these mega-projects to neighbouring countries. However, there has been less in the way of infrastructure development for rural areas. This means that many in the population derive little benefit from the improved transport infrastructure, which also limits their competitiveness.

The population growth rate has averaged around 2.9 per cent per annum and both per capita GDP and gross national income (GNI) (at current prices) have trended downwards over the past few years. This owes in part to falling commodity prices and the effects of regional drought but also to a falloff in FDI and official development assistance (ODA) following Mozambique's revelations of US$1.4 billion of undisclosed debt and subsequent default on part of its external debt obligation.

Unemployment remains stubbornly around 25 per cent of the total workforce as of the end of 2016, despite the mega-project investments. Further, the informal economy, which is estimated at between 68 and 95 per cent of the total labour force, absorbs many of the new entrants to the labour market on an annual basis (Balchin et al., 2017). Further, vulnerable employment[10] has remained at around 83 per cent.

Headline inflation was around 16 percent by July 2017, down from a high of 26 per cent as of November 2016, and the lending rate was around 27 per cent. These indicators will have had a negative impact on the affordability of domestic credit for both retail and micro, small and medium-sized entities.

Increasing current account deficits coupled with a slowdown in FDI/ODA and relatively low levels of reserves (especially in 2015, when reserves were less than three months of imports) have contributed to the depreciation of the metical. This has in turn contributed to an increase in the debt to GDP ratio.

2.3.1 Reliance on FDI

Analysis of FDI flows over the past few years shows that the ratio of FDI to gross fixed capital formation (GFCF) increased up to 2013 and dropped sharply from 2015, for reasons mentioned earlier. However, looking at the magnitude of the ratio (among other indicators) reveals that FDI was key to financing much of the infrastructure expenditure for 2012 through to 2015. As of 2015, mega-projects accounted for around 70 per cent of FDI inflows (Table 1.3 of WTO, 2017). An overview of selected macroeconomic indicators for Mozambique is provided in Table 2.2.

Table 2.3 provides details of a sample of private sector participation in infrastructure projects for Mozambique.

Table 2.3 provides a summary of a range of diverse infrastructure projects involving private sector participation in Mozambique based on data collected by the World Bank. It shows that public sector expenditure amounted to approximately 27 per cent of the total over the period shown in the table. Although just a sample, the table indicates that private sector participation (comprising mainly foreign investors) in

Table 2.2 Select macro-economic indicators in Mozambique

	2010	2011	2012	2013	2014	2015	2016
GDP at market prices (US$ millions)	10,154.24	13,131.17	14,534.28	16,018.85	16,961.13	14,798.44	11,014.86
Population ('000s)	24,221.41	24,939.01	25,676.61	26,434.37	27,212.38	28,010.69	28,829.48
Per capita GDP at current prices	419.23	526.53	566.05	605.99	623.29	528.31	382.07
GNI per capita (Atlas method) (current US$)	460	480	520	590	620	580	480
Unemployment, total (% of total labour force), ILO	23.5	23.3	22.6	23.3	25.3	25.3	25
Inflation (CPI, % change)	12.70	10.35	2.09	4.21	2.29	2.39	9.97
Official exchange rate (Mt/US$) period average	33.96	29.07	28.37	30.10	31.35	39.98	63.06
Total reserves in months of import	5.21	3.89	2.82	3.20	3.24	2.81	3.13
Broad money to total reserves	1.73	1.91	2.11	2.14	2.62	3.23	2.69
Short-term debt to total reserves (%)	26.64	10.12	11.63	21.44	13.60	29.19	34.76
FDI (% GDP)	12.39	27.90	38.77	41.81	29.47	26.14	28.40
Domestic credit to private sector (% GDP)	24.33	23.29	24.52	28.19	32.00	35.11	34.50
Net ODA (% GNI)	19.80	15.96	14.30	14.49	12.57	12.52	14.23
Net ODA and official assistance (current US$ millions)	1,943.13	2,065.47	2,071.70	2,312.70	2,106.01	1,814.74	1,531.40
Concessional debt (% of total external debt)	72.00	78.89	77.58	68.94	71.32	66.65	69.48
Lending interest rate (%)	19	19.07	15.53	14.88	14.68	16.27	27.04
Vulnerable employment, total (% total employed)	83.80	83.60	83.40	83.10	82.90	82.60	82.5
Poverty headcount ratio at national poverty lines (% of population)					46.1		
GFCF (current US$)/GDP (current US$) (%)	107.13	73.01	40.58	36.68	28.84	38.37	67.72
FDI/GFCF (%)	11.57	38.22	95.54	113.98	102.19	68.13	41.94

Source: Data: https://data.worldbank.org/country/mozambique

Table 2.3 Top private sector participation of infrastructure projects

Project	Sector	Amount (US$ millions)	Year of closure	Private %
Nacala Corridor	Rail/Port	2,730	2017	100%
South Africa Gas Pipeline	Energy/Gas	1,200	2003	50%
Movitel	Telecoms	494	2010	100%
N4 Toll Road Mozambique–South Africa	Roads/Toll	426	1997	100%
Vodacom Mozambique	Telecoms	393	2003	100%
Ressano Garcia Gas-Fired Plant	Electricity	200	2014	100%
Telecomunicaçoes Móveis de Moçambique	Telecoms	160	1997	26%
Companhia dos Caminhos de Ferro da Beira	Transport/ Rail	153	2004	51%
Maputo Port	Ports	150	2003	51%
Kuvaninga Energia Power plant	Electricity	99	2013	100%
Mucuba Solar PV Plant	Electricity	84	2017	52.50%

Source: https://ppi.worldbank.org/

infrastructure projects is very high (from a financial contribution perspective) in comparison with public sector contributions.

Table 2.4 provides details of bilateral and multilateral support for the various projects. Private sector investment far exceeds the amount of support provided by both multilateral and bilateral providers of financing.

2.3.2 Poverty

Results of the fourth national poverty assessment released by the Ministry of Economy and Finance in 2016 indicate that poverty incidence had reduced by 5.6 per cent to 46.1 per cent at the national level.

Table 2.4 Details of multilateral/bilateral support (US$ millions)

Project	Multilateral loans	Multilateral guarantees	Bilateral loan
Nacala Corridor	N/A	N/A	N/A
South Africa Gas Pipeline	230	102	0
Movitel	0	0	0
N4 Toll Road Mozambique–South Africa	0	0	0
Vodacom Mozambique	0	0	0
Ressano Garcia Gas-Fired Plant	0	0	0
Telecomunicaçoes Móveis de Moçambique	0	0	0
Companhia dos Caminhos de Ferro da Beira	110	0	0
Maputo Port	0	7	0
Kuvaninga Energia Power plant	0	0	23
Mucuba Solar PV Plant	63	0	0

Table 2.5 Poverty headcount (P0 measure) using the PLEASe methodology (%)

Area	IAF96	IAF02	IOF08	IOF14
National	69.7	52.8	51.7	46.1
Urban	61.8	48.2	46.8	37.4
Rural	71.8	55.0	53.8	50.1
North	67.3	51.9	45.1	55.1
Centre	74.1	49.2	57.0	46.2
South	65.5	59.9	51.2	32.8
Niassa	71.9	48.3	33.0	60.6
Cabo Delgado	59.1	60.3	39.0	44.8
Nampula	69.4	49.1	51.4	57.1
Zambezia	67.6	49.7	67.2	56.5
Tete	81.9	60.5	41.0	31.8
Manica	62.4	44.7	52.8	41.0
Sofala	87.8	41.3	54.4	44.2
Inhambane	83.0	78.1	54.6	48.6
Gaza	64.8	55.4	61.0	51.2
Maputo Province	65.6	59.0	55.9	18.9
Maputo City	47.1	42.9	29.9	11.6

Source: WIDER (2016).

Table 2.5 indicates that poverty reduction has not been equitable across the country, with urban areas benefiting from a larger reduction (9.4 per cent) than that experienced by rural (only 3.7 per cent). There were also stark differences in poverty reduction between the north, south and central regions, with improvements in the south and centre but deterioration in the north. Notwithstanding the overall improvement in poverty incidence, absolute numbers of people in poverty remain fairly constant, at approximately 11.3 million.

The above results suggest that, while reductions in poverty may have been achieved in various parts of the country, inclusive growth still eludes Mozambique as a whole.

2.3.3 Gender issues

The adult literacy rate for females is around 36 per cent and that for males around 67 per cent.[11] Regional inequality levels in poverty reduction discussed earlier mean women are more vulnerable than men in various parts of Mozambique (as well as in general).[12]

There are no specific gender equality laws in Mozambique or laws that speak to discrimination in the workplace or access to employment. Given the increased vulnerabilities of women and the fact that the majority of investments are in infrastructure (which employs far fewer women), there is a need for policies/initiatives that are geared towards ensuring more inclusive and equal treatment of women.

2.3.4 Youth

Data from the World Bank suggest that around 10 per cent of the youth population[13] are not in education, employment or training. Further, around 42 per cent are unemployed.[14] These youth are at risk of social exclusion if nothing is done to improve their chances of employment. The government's National Youth Policy (NYP) aims to address this issue by facilitating the mainstreaming of youth issues into wider government policies. Full details of the NYP implementation plan have yet to be finalised and released. What is clear is that it is necessary to link youth training to strategic areas of growth to enable Mozambique to capitalise on opportunities to transition into sectors/sub-sectors with greater value added.

2.4 The private and public sectors

The private sector contribution to GDP stands at around 65 per cent, compared with around 84 per cent for developed countries (Santos et al., 2017). Less than 0.1 per cent of business enterprises in Mozambique are medium-sized (employing between 50 and 100 workers). Further, less than 8 per cent of the population are employed in enterprises that are either small or micro-sized. With such low numbers employed in the formal sector, the sustainability of private sector growth could prove a challenge.

At present, there is no national code on corporate governance that is applicable to both public and private sector enterprises.[15] It has long been generally accepted that investors tend to prefer investing in countries with good corporate governance, as information asymmetries are reduced and financial returns are less volatile, which in turn improves access to lower-cost finance.

A proxy for private sector access to credit is given by domestic credit to the private sector (percentage of GDP). Table 2.2 shows that this figure was around 35 per cent at the end of 2016 – appreciably less than for the Southern African region (45.6 per cent)[16] although higher than for LDCs (27.5 per cent). Such a low level is indicative of correspondingly low levels of private sector participation (via domestic credit) in infrastructure projects.

The lending rate was around 27 per cent at the end of 2016, reducing to 19.5 per cent at the end of 2017. Although the latter trend in interest rates is moving in the right direction, the level of the rates may act as a deterrent to borrowing in the local markets and provide a comparative advantage to entities that are able to borrow in foreign currency (from overseas sources). This is particularly relevant for projects that require financing (e.g. costs of imports) in foreign currency and where revenue sources are also in foreign currency. Given local capacity constraints and the structure of micro, small and medium enterprises (MSMEs) (i.e. very few with more than 50 workers), it is more likely that foreign companies will benefit from the current monetary policy framework, resulting in the prevailing interest and foreign exchange rates.

In recognition of the various issues highlighted above, the government has developed the National Financial Inclusion Strategy 2016-2022. This sets three financial inclusion measures for 2022: 1) 60 per cent of the population having access to financial services offered through a formal financial institution; 2) 100 per cent of

districts with at least one access point to formal financial services; and 3) 75 per cent of the population with one financial service access point within 5 km of their place of work or residence. At the time of writing, details were not available as to levels of achievement of these measures.

In April 2013, Mozambique passed Law 10/2013 (the Competition Law) to provide a framework for the management of competition. This law also created the Competition Regulatory Authority (CRA) as the enforcement authority. In 2014, the regulations supporting the law were developed. At present, the CRA is not fully operational, and its Board has not been constituted.

In relation to the public sector, it is understood that the government has taken steps to introduce a state-owned entity law and a decree to enhance the framework to contract public debt and issue guarantees (IMF, 2017). This latter initiative is in response to governance failures in relation to public sector enterprises, related to revelations (in April 2016) of undisclosed borrowings (backed by state guarantees) by Proindicus and Mozambique Asset Management (MAM). The combined borrowings of these entities amounted to a total of US$1.4 billion or around 11 per cent of 2015 GDP. Revelations about undisclosed loans ($0.85 billion) to a third state-owned entity, Ematum, had emerged earlier in 2014. It transpires that all three companies were headed by the same CEO and were incorporated just prior to the borrowings that took place. Following the news of the undisclosed borrowings, donor budget and other support measures reduced significantly; in the case of IMF, funds were suspended.

Given that much of the FDI invested in infrastructure projects in Mozambique is associated with state-owned entities, this failure of appropriate risk management (e.g. risks associated with contingent liabilities) and governance has had a negative impact on investor perceptions of the country's bankability. The ratio of FDI to GDP had more than halved at the end of 2017 to a value of around 12.1 per cent.

2.5 Debt policy

Standard & Poor's has assigned a credit rating of selective default for both Mozambique's long- and short-term debt. Moody's has assigned ratings of Caa3, with a negative outlook for the country's long-term foreign currency debt. These ratings were assigned in the aftermath of the undisclosed loans (and subsequent payment default) and have dropped from levels of B2 (negative) under Moody's and B- under Standard & Poor's in 2015.

The first default took place in May 2016 by MAM when it was unable to make a scheduled US$178 million payment (owing to the Russian bank VTB) and the government failed to step in. A subsequent default by MAM occurred in January 2017 when it failed to make a payment of $59.8 million, again to VTB. A third default then occurred in March 2017, when Proindicus failed to make a payment of $119.2 to Credit Suisse.

At the end of 2016, the sovereign debt to GDP ratio reached 128.3 per cent, of which domestic debt was around 24.6 per cent of GDP, and has been on the rise (IMF, 2017).

This increase in the use of domestic debt is a cause for concern (following reductions in FDI and ODA) as the level of interest rates is significantly higher than what would be obtained via concessionary financing and the maturity is much shorter (with most domestic debt having a maturity less than five years (USAID, 2017)).

The domestic debt market in Mozambique is in its infancy, and all government securities are listed on the Mozambique Stock Exchange (Bolsa de Valores de Moçambique (BVM)). As of September 2017, outstanding government debt securities to GDP were around 4 per cent, with the most liquid component being the Treasury bill, with sizes of US$10–20 million issued the first two Wednesdays of every month (BVM, 2017). The maximum maturity of the bills is one year.

The primary underwriters of government securities (primary dealers) typically hold on to debt securities (i.e. a hold to maturity strategy), which implies there is little to no secondary market trading. Given the relatively short maturity of government securities as compared with the length of infrastructure projects (which can exceed 20 years), the government is exposed to refinancing risk, as it is required to roll over its domestic debt quite frequently.

Discussions with representatives from the Debt Management Unit in Mozambique suggest there is no accounting for sovereign guarantees in this unit's analysis and reporting of debt. Further, the Medium-Term Debt Strategy (MTDS), which is meant to identify the possible risk and cost of debt under various scenarios, also does not incorporate estimates of contingent liability such as those arising from government debt guarantees. Further, there does not appear to be any legal requirement (as might be contained in a public financial management law) of the risk quantification of contingent liabilities and its reporting (by type of contingent liability) to Parliament as part of wider fiscal risk management strategies and reported on in a medium-term budget.

Based on the latest Article IV documents from the IMF (2017), "Mozambique's external debt rating is in 'in distress', and total public debt is on an unsustainable path". All debt burden indicators with the exception of external debt service to exports breach threshold limits (ibid.).

Mozambique needs to produce a debt restructuring plan that is viewed to be credible by its private sector creditors. Unless and until such a plan is produced, confidence in the repayment capacity of the country is unlikely to be restored to pre-default levels.

2.6 Local content

Local content (LC) can be defined as the extent to which a foreign company has used local know-how, resources, etc. to facilitate the production of a particular good or service. Thus, beyond a direct contribution to value added, LC seeks to enhance the sustainability of economic growth by enhancing inclusivity through economic diversification and employment opportunities.

A country could employ numerous types of LC strategies, ranging from simple restrictions on trade imports to those involving the creation of forward and backward

integration within as well as across related sectors. For example, moving from the importation of downstream oil products to the refinement and distribution of oil to locations where it is sold could provide opportunities for forward integration (for existing enterprises) as well as entry into transport logistics (for either existing or new enterprises). Another example of an LC strategy is to mandate that specific types of projects must have a minimum level of local (in practice typically government) ownership. The procurement laws/policies of any country are key to determining the extent to which LC can be effectively achieved.

Although not shown in Tables 2.3 and 2.4 above, the vast majority of private sector investors have been foreign and several can be classed as multinational corporations (MNCs). These types of enterprises generally leverage their existing supply chain in the provision of their services. Given the inherent complexity of some of the types of infrastructure developments on-going and proposed for Mozambique, the MNCs could also provide a valuable source of knowledge transfer required for building productive capacities. However, unless such requirements are embedded in either project contracts or laws/regulations, then such opportunities may be forgone.

2.6.1 The impact of donor policies

Donors sometimes provide funds to aid in capacity-building as well as directly to support trade infrastructure. A review of Aid for Trade (AfT) to Southern African countries by the EU and its member states suggests that trade-related infrastructure make up the largest component, with a much smaller contribution towards building productive capacity. The figure shows that Mozambique was the second largest recipient of aid in the region.

Donor procurement policies can also have an impact on the extent to which LC can be effective. For example, donors often place restrictions on the extent to which state-owned enterprises can participate in bidding. This could have a big impact on Mozambique since the vast majority of its private sector enterprises are small and could have problems competing with international organisations.

Most donors support the idea of national experts and knowledge transfer (and use it in their scoring system for evaluating bids) but measuring the extent of these is not straightforward. For example, in the preparation of a bid, it is likely that many bidders would have included use of a local expert (e.g. a local enterprise) as part of a project team. However, in the absence of rigorous methods of evaluating the quality and extent of knowledge transfer, a foreign entity could "arbitrage" the bidding system by being awarded points for LC while such content is ineffective.

2.6.2 Mozambique procurement laws

In 2016, the government passed new legislation relating to the tender of public works, the supply of goods and the provision of services to the state (Decree 5/2016). The law is applicable to all bodies, entities and institutions of the state of Mozambique. The entity responsible for monitoring application of the regulations is the Public Procurement Oversight Authority.

The regulations require that procurement procedures fulfil a number of criteria, including legality; public interest; transparency; openness; information; equality; competitiveness; impartiality; and good financial management, as well as other public law principles. Further, LC is facilitated by way of either a restriction in favour of the nationality of a bidder or provision of a preferential margin to national bidders.

2.6.3 Local capacity constraints

As discussed earlier, unemployment stands at around 25 per cent in Mozambique, illiteracy levels are relatively high and local private sector enterprises are, in the majority, small and without deep institutional experience of complex infrastructure. These characteristics do not bode well for an effective LC environment at present but implementation of more inclusive development strategies should help reduce these vulnerabilities in the years to come. Such strategies should aim to both increase diversification into high-productivity industries such as those characterised by the mega-projects and increase linkages with other sectors, such as agriculture and fisheries and tourism. Increased capital expenditure in agriculture is vital, as the sector supports the majority of people in the country, and improvements in financing should help improve resilience.

Given time limitations, the research did not obtain details of the extent to which local entities have been beneficiaries of contracts by way of either the new regulations or donor funding, especially where mega-projects are concerned. However, for reasons discussed earlier concerning the size and capacity of the local market, it is not envisaged that the extent of LC has been significant. In 2011, mega-projects accounted for around 36 per cent of all goods imported into Mozambique, and this was projected to be around 16 per cent as of the end of 2017 (IMF, 2017). This improvement, however, owes largely to the reductions in FDI/ODA associated with the mega-projects and hence the need to import.

As it relates to job creation, it is unlikely that things would have radically changed since 2010, when mega-projects accounted for only 5 per cent of total employment despite accounting for over 72 per cent of all capital expenditure over 1992-2010 (OECD, 2013).

LC can also be extended to cover the extent to which the local market participates in the ownership of infrastructure projects. The main means for local participants to achieve this (for large/mega-projects) is by way of the stock exchange, as per Law 15/2011 (often cited as the Mega-Projects Law). Article 33 1(a)(i) states that Mozambican natural persons can participate in the share capital of projects guaranteed by, among other things, "the State or other public entity appointed thereby, in a percentage not less than 5% nor greater than 20% of the referred capital".

In discussions with representatives from the local stock exchange, it appears that the law is not being strictly applied for projects that commenced prior to 2011, in that those entities are not listed on the stock exchange. Even if such listings were prevalent on the exchange, it is unlikely that many local people would have sufficient discretionary income to make investments, given the relatively low GNI per capita and savings rate.

Given all this, it seems that lack of local capacity (i.e. knowhow) coupled with high levels of poverty and unemployment and a relatively low savings rate makes effective implementation of LC difficult for Mozambique in relation to infrastructure projects requiring high skills levels. As a consequence, the framework to enable effective LC should consider, among other things:

- Strategies/plans to include youth in particular (but also others) in strategic growth areas, including those covered by mega-projects, through the provision of vocational training (with qualifications leading to a recognised certification). Such training could be either incorporated into existing vocational offerings or part of new educational establishments. Any new physical establishments should also consider the distance people need to travel to access the facilities; to the extent possible, online courses should also be provided. The government could consider policies to encourage investors to contribute to the development and maintenance of these establishments as part of their corporate social responsibility activities.
- Strategies to increase the savings rate – for example low- or no-tax savings products to encourage people to save. Monetary strategies could also be used, such as a reduction in the central bank's deposit reserve ratio (for deposit-taking institutions), which in turn should lead to reduced interest rates for borrowers.

2.7 Building with resilience in mind

The Mozambican government, in its 2015-2019 Five-Year Plan, wishes to "ensure sustainable and transparent management of environment and natural resources". The country is prone to natural disasters and ranks third in terms of loss of life as a result of such disasters.[17] According to the African Development Bank, around 17 per cent of GDP is lost as a result of early economic loss arising from environmental degradation and poor use of natural resources (Santos et al., 2016). The United Nations further finds that preventative expenditure amounts to just 9 per cent of GDP, yet, over the period 2007–2014, just 1.4 per cent of GDP was spent on the environment.

It is important that the Mozambican authorities do not consider investments in climate resilience as an option in its portfolio of investment possibilities. Such investments should be mandatory and a function of the potential amount of losses (both economic and human) that is or could be suffered over the long term. From an economic perspective, national infrastructure development plans should account for the amounts of expenditure necessary to upgrade existing infrastructure, to make them more resilient, as well as to invest in the development of bespoke resilient artefacts.

Improved infrastructure resilience would help reduce the likelihood of increased risks to those who are most vulnerable, specifically women and girls but also youth and the elderly. From a practical perspective, plans for infrastructure development should factor in likely changes in climate, environmental and other potential disasters and should mainstream gender, youth and other areas that give rise to inequity and non-inclusive growth. Addressing these issues in a more holistic manner would help Mozambique towards achieving Sustainable Development Goals (SDGs) 9 (Build

resilient infrastructure, promote inclusive and sustainable industrialisation and foster innovation) and 11 (Make cities and human settlements inclusive, safe, resilient and sustainable).

It is a common misperception that spending more on infrastructure implies more resilience. As discussed earlier, Mozambique has seen a reduction in its overall poverty rate (following increased FDI) yet major inequalities exist between the north and south of the country. Establishing greater inclusive links with communities would help in understanding the views of the various components of the demographic. Hence, maintenance (or bespoke) expenditure that does not increase resilience could be argued to be an inefficient use of funds.

Given the increased reliance on the extractive industries, the government could also consider the possibility of using environmental taxes as a means of supporting resilience by way of a natural disaster fund. The fund would be used to help in building back better and also act as a first line of defence against exogenous shocks such as those caused by natural and environmental disasters. In essence, the fund is a form of self-insurance.

Infrastructure development is best viewed from a network or systems perspective (see Refocus, 2015). A systems perspective seeks to analyse a proposed infrastructure project in terms of how it will interact with other existing/proposed artefacts incorporating evaluation of social, environmental and other impacts.

The Equator Principles Financial Institutions (EPFI) has emerged as one of the most prominent standards used by financial institutions, worldwide, to ensure that projects they advise on "are developed in a manner that is socially responsible and reflects sound environmental management practices" (see the Equator Principles, in Equator Principles Association, 2013). All the major projects and sectors in Mozambique are examples of areas that would be covered by project financing[18] under the EPFI.

In the provision of project financing, an EPFI will seek independent assurance that a country has conformed to relevant environmental and social laws and regulations. An EPFI will not provide project financing or project-related corporate loans where a client is not able to show it is able to comply with the principles. Further, complying with relevant laws and regulations depends on whether the host country (i.e. where the development is taking place) is classified as designated or non-designated. A designated country is one whose laws meet the requirements of environmental and/or social assessments (Principle 2), management systems and plans (Principle 4), stakeholder engagement (Principle 5) and grievance mechanisms (Principle 6).

For the purpose of the application of the Equator Principles, Mozambique is considered a non-designated country,[19] which implies its laws/regulatory frameworks and institutional capacity are not considered robust enough to provide the level of protection of its people and natural environment that would accrue to that of a designated country. Hence, aligning itself with the Equator Principles would help Mozambique increase the likelihood of prospective investors (seeking financing from an EPFI) obtaining financing for large infrastructure projects.

2.8 Financial market depth

Table 2.6 shows the composition of the financial sector in Mozambique as of 2015.

Despite the number of financial institutions, as of 2015 approximately 60 per cent of the population were not part of either formal or informal financial services (Ministry of Economy and Finance, 2016). As previously discussed, private sector access to credit for Mozambique lags the average for the region.

2.8.1 Eligible collateral

There is no private ownership of land in Mozambique: the state owns all land. Therefore, land cannot be sold, mortgaged or alienated in any way. Restricting ownership of land has provided benefits to communities and vulnerable persons who may not have been in a position to own land but have the ability to reside on land under various conditions as detailed in Land Law 19/1997. This benefit, however, also has the consequence that it limits the variety of what lenders would consider to be eligible collateral as a means of securing debt financing. Many at the lower end of

Table 2.6 Financial sector composition

Credit institutions	Numbers
Banks	18
Micro-banks	11
Credit unions	9
Electronic money institutions	2
Investment corporations	2
Financial corporations	
Venture capital corporations	1
Group purchases management corporation	1
Credit card issuing or management corporations	2
Bureaux de change	15
Savings and loans organisations	12
Microcredit operators	330
Insurance market	
Insurers	18
Micro-insurers	1
Reinsurers	1
Brokers	59
Business agents	10
Social security and pensions funds	
Basic social security	1
Mandatory social security	2
Pension funds	8
Pension funds management companies	6
Capital markets	
Stock exchange	1
Stock exchange operators	9

Source: Ministry of Economy and Finance (2016).

the income scale are not in a position to offer other forms of collateral, and this also restricts their access to credit.

The government's access to credit is usually channelled through bilateral (typically sovereign entities) and multilateral lenders (e.g. IMF, World Bank, African Development Bank) but also increasingly through the domestic debt market. The Bank of Mozambique and the central government both issue debt securities by listing them on the local stock exchange; however, liquidity of such issuances is rather limited as brokers have a buy and hold strategy. Also, volume sizes are relatively low compared with the size of mega-/large projects. Further, the maturities are relatively short, which limits their usefulness as a sustainable means of financing long-term infrastructure.

2.8.2 Financial innovation

In discussions, representatives of two of the largest banks in Mozambique – Standard Bank and Barclays Bank – expressed an appetite for the creation of unitised/mutual funds that could be linked to a portfolio of infrastructure projects. However, they also expressed concern over the lack of clarity regarding regulatory rules for the treatment of such investment fund products. Such funds provide the ability for banks to offer diversified exposure to infrastructure projects, and access could be either by way of the stock exchange or over the counter. An additional advantage of listing such products would lie in allowing international investors (through prime brokers) the opportunity to obtain exposure to infrastructure cash flows remotely. This would not only help improve on the sources of financing for infrastructure projects but also facilitate a secondary market in securities linked to infrastructure.

The subject of the securitisation of infrastructure cash flows was also discussed, in particular the issuance of debt securities whose cash flows are linked to those of the underlying project. In order to enhance the chances of success of the issuance of such securities, a credit rating would very likely need to be obtained from a major credit rating agency. Such ratings could cost a minimum of US$100,000 – but the potential returns of some projects mean this would be worthwhile.

Financial innovation, while at a relatively low level, continues to grow in Mozambique with the increasing use of mobile banking solutions. A significant benefit is that a banked client can transfer money from their account to any mobile phone, allowing the owner of the phone to collect cash at an ATM without having a bank account or credit card. However, less than 5 per cent of mobile phone users make use of mobile money (FinMark, 2016).

2.8.3 Mozambique Stock Exchange

There is a lack of sufficient equity issues, with only five companies currently listed, representing market capitalisation to GDP of 4 per cent (BVM, 2017). This figure is below the average for the region (15 per cent).

Many of the largest companies in Mozambique are either state-owned entities or foreign-owned and already listed abroad. The government has not shown much appetite for listing the largest group of its companies on the exchange.

The government has identified three main groups of companies over which it has some control/ownership. The first group comprises large/mega-project companies related to infrastructure and for which the government has 100 per cent capital ownership. Revenues for some of these entities exceed US$200 million per annum, and their size would make them good candidates for listing. However, the government has preferred to enter into joint ventures with partners willing to buy a minority stake.

The second group comprises those entities that were privatised in the 1990s, which, in many instances, are in need of restructuring, as they are in poor financial condition. These companies are not good candidates for listing unless and until their fortunes have turned around for a period of time.

The third group of companies comprises those where the government has an equity participation. The revenues from these entities are around US$5 million. The government has yet to disclose its plans for privatising this group.

The outstanding government debt securities to GDP ratio amounted to roughly 4.3 per cent as of September 2017, far less than in neighbouring countries. This represents a small portion of the government's borrowing needs and far less than what it has received from FDI/ODA, which has been its primary source of financing. If, however, Mozambique is to build financial resilience, it needs to further develop its government domestic bond market. In fact, the lack of development of this market has a spill-over effect on that of the corporate bond market, which is also in its infancy. This said, 13 companies have listed corporate debt on the BVM, but the banks undertake the bulk of corporate lending.

Lack of sophistication among investors has been cited as a deterrent to investments in the BVM (BVM, 2017). However, poor investor protection and enforcing of contracts is also likely to have a negative impact. Based on the World Bank Doing Business Report 2018, Mozambique ranks 138 and 184 out of 190 with respect to protecting minority interests and enforcing contracts, respectively.

At present, the BVM is regulated by the central bank as governed by the Securities Market Code of 2009. There are, however, various alternatives to stock exchange regulation, as implemented by some other Commonwealth countries: the Securities and Exchange Board – India; the Financial Services Commission – Jamaica; and the UK Financial Conduct Authority. All those bodies are independent organisations whose roles include regulation of the stock exchange.

The Strategic Plan of the BVM points to several areas in the legal/regulatory framework where changes would be required in order to make the exchange more effective (BVM, 2017). Those most pertinent to infrastructure include:

- No clear legal framework for several asset classes, e.g. investment funds.
- No requirement for the financial infrastructure to comply with international standards set by the International Organization of Securities Commissions, such as the Principles for Financial Market Infrastructures – for example central securities depositories and securities settlement systems. Adherence to such standards would help signal to potential international investors that the risks facing an investor (in securities on the exchange) would be managed according to the international norms to which they are accustomed.

2.9 Rule of law

Rule of law can have an impact on the effectiveness of infrastructure development. It captures people's perceptions of the extent to which they comply with and have confidence in the rules of society. Examples include the protection of individual property rights, the enforcement of contracts, the speed of the judicial process, the protection of intellectual property rights and employment or market access for vulnerable persons.

Mozambique has enacted numerous laws in relation to corruption: Public Ethics Law 16/2012, Money Laundering Laws 14/2007 and 14/2013 and Whistle-Blowing Law 15/2012 are examples. Further to this, Decree 5/2016 (public procurement regulations) and Law 10/2013 (competition legislation) are meant to prevent collusion and increase competition, respectively. Despite this, it appears that enforcement of such laws is weak in Mozambique (BICA, 2016).

2.10 Rationale for a Commonwealth Charter for infrastructure development

The specific components of the framework (e.g. legal, regulatory, financial) supporting the delivery of infrastructure vary across Commonwealth member countries. This is not surprising, given that members are at different stages of political, economic and social development. However, there are commonalities (such as the different stages involved in the development) in the process supporting infrastructure development.

The previous sections, focused on case study analysis of Mozambique, have discussed aspects such as governance, rule of law, gender equality and protection of the environment (among others) as having an impact on the perception of either the quality of infrastructure or the extent to which an aspect can influence whether an infrastructure investment is bankable or not. These aspects are also related to Principles of the Charter of the Commonwealth.

SDGs 9 and 11 are "Build resilient infrastructure, promote inclusive and sustainable industrialisation and foster innovation" and "Make cities and human settlements inclusive, safe, resilient and sustainable", respectively.

Without effective infrastructure, it will be difficult for an LDC to transition with momentum and hence to maintain a transition that is not only smooth but also sustainable. The rationale for leveraging the CCID follows from the above arguments: the CCID can be adapted to support investments in infrastructure, as it includes such principles as:

- Support for the rule of law;
- Good governance;
- Sustainable and resilient developments that support economic growth and human well-being;
- Protection of the environment;

- Human rights and gender equality;
- The importance of young people and civil society;
- Recognition of small and vulnerable states.

As noted above, the GIH's InfraCompass toolkit contains the following components:

- **Governance** – institutional, governance and legal environment for infrastructure investment;
- **Regulatory** – openness to investment and the extent to which regulation and competition frameworks support infrastructure delivery;
- **Permits** – efficiency of the planning and licensing procedures for the issuance of permits and acquisition of land required for infrastructure development;
- **Plans** – ability of government to plan, coordinate and select infrastructure projects;
- **Procurement** – extent to which procurement processes and bid management frameworks are standardised, transparent and non-onerous to bidders;
- **Delivery** – track record of delivery and quality of infrastructure assets.

Tables 2.7 and 2.8 provide details of the score for each category/criteria for Mozambique. This assessment excludes the additional criteria (e.g. contingent liabilities) recommended, based on case study analysis of Mozambique.

Other than the providers of ODA, there are two main types of investors in infrastructure: service providers[20] and passive investors.[21] The potential investors

Table 2.7 Governance, regulatory and permits

Category	Criteria	Score
Governance	Control of corruption index score, –2.5–2.5 (best)	–0.87
	Rule of law index score, –2.5–2.5 (best)	–1.02
	Cost of enforcing contracts, as % of claim	119%
	Recovery rate, cents on the dollar	31.50%
	Shareholder governance index, 1–10 (best)	3
	Extent of conflict of interest index, 1–10 (best)	5.3
	Dedicated PPP unit (1 = yes, 0 = no)	1
	Post-completion reviews (1 = yes, 0 = no)	1
Regulatory	Capital Account Openness Index, 0–1 (best)	0
	Regulatory quality index, –2.5–2.5 (best)	–0.7
	Prevalence of foreign ownership, 1–7 (best)	4.5
	Strength of insolvency framework index, 1–16 (best)	10
	Effect of taxation on incentives to invest, 1–7 (best)	3.5
Permits	Dealing with construction permits, no. of days	118
	Number of procedures to start a business	10
	Registering property, no. of days	40
	Quality of land administration index, 1–30 (best)	9.5
	Time required to start a business, no. of days	19
	Cost to start a business, % of GNI per capita	18.10%

Note: The scoring system is detailed on the GIH website at: https://www.gihub.org/

Table 2.8 Plans, procurement and delivery

Category	Criteria	Score
Plans	Preparation of PPPs, 0–100 (best)	50
	National/sub-national infrastructure plan (1 = yes, 0 = no)	0
	Pipeline projects in national/sub-plans (1 = yes, 0 = no)	0
	Guidelines for infrastructure appraisal (1 = yes, 0 = no)	1
Procurement	Procurement of PPPs, 0–100 (best)	73
	Bid evaluation, 0–100 (best)	43
	Publish guidelines for procurement of projects (1 = yes, 0 = no)	1
	Post award management of procurement, 0–100 (best)	64
	Degree of transparency in public procurement score, 0–4 (best)	1
	Calling for tenders, 0–100 (best)	54
	Average procurement duration (in months)	13
Delivery	Infrastructure quality, 1–7 (best)	2.5
	GFCF % of GDP (5–year average)	34%
	Private finance of infrastructure, % of GDP (5–year average)	21%

that the infrastructure assessment toolkit is aimed primarily at are service providers and passive investors (hereafter called investors).

There are potentially numerous criteria that could make a country attractive for investments for any one investor. The criteria detailed above for the toolkit capture those attributes viewed as important based on the results of a principal component regression analysis conducted by the GIH.

There is no generally accepted value (other than for simple yes or no criteria) that any of the above criteria should take to be investable. In fact, an investor may decide either not to invest or to invest based on a single category or otherwise depending on what they deem to be of utmost importance. For the purpose of determining whether a country is attractive, we assume that the average of the permissible range of criteria scores denotes the marginal or minimum level of attraction.[22]

The square root of the sum of the weighted normalised[23] variance of the difference between the actual and marginal scores is calculated for all criteria. A similar calculation is undertaken by assuming that the actual scores correspond to criteria lowest values. The ratio of the former to the latter calculation then determines the extent to which the framework surrounding the delivery of infrastructure is **not attractive**. Hence, the level of attraction is given by 1 minus this ratio.

In the case of Mozambique, the square root of the sum of the weighted variances was 0.85 and the value for the worst case was 1.54. The ratio of 0.85 to 1.54 is approximately 55 per cent, which implies a level of attraction of 1-55 per cent = 45 per cent.

The value of 45 per cent suggests that the policies, regulations/laws, etc. surrounding the development of infrastructure for Mozambique **make it 45 per cent marginally attractive for investment**. This does not necessarily imply that the country is not suitable for investment, as we know that a fair amount of investment has taken place in the country over several years, as evidenced from the roughly average 7 per cent

GDP growth. Such investments have, however, been in select sectors, such as the energy/extractive sectors, and have been aimed at the regional market. These have attracted service providers more than passive investors but have contributed limited value added to LC and have not resulted in appreciable export diversification or equitable reductions in poverty.

Rather than using the "GIH weights", as detailed in Annex 2, suppose one assumes that the weights are equal for all criteria within a category, to see what the difference would be in the attractiveness score. Application of this equal weight strategy results in an attraction score of approximately **49 per cent**. The difference is not particularly significant, suggesting that the equal weights can be used to approximate the "true" score. Note that these equal weights would not be used in general but just in this special case, to facilitate extension of the GIH model.

Extending the analysis to include the additional criteria results in an attractiveness score of **35 per cent**.[24] So the new criteria could be incorporated into the model, they were first mapped to one of the six categories and the weights adjusted to accommodate the increased number of criteria (see Annex 2.3).

Going forwards, precise weights will be calculated for the enhanced model, which incorporates the contingent liability and other criteria. In order to calculate these weights, an analytical method like principal component regression analysis will be explored. However, just like in the GIH approach, data for all criteria will be required across a number of countries (i.e. as many Commonwealth countries as possible where data exist).[25]

In applying the GIH scoring toolkit to Mozambique, no explicit account was made to incorporate the impact of criteria on gender, youth, inequity of poverty, etc. (e.g. the principles of the Charter of the Commonwealth). However, it is to be noted that, whereas some criteria affirm particular principles, several do not, and even compromise them. Therefore, in applying the principles, one would adjust the individual criteria scores (downwards) where these compromises exist.

2.11 Conclusions

Evaluating the quality of Mozambique's infrastructure framework on the basis of the amount of FDI received or the GDP growth rate means using inadequate metrics/indicators of quality, since such growth could occur at the expense of rule of law, gender equality, equity, poverty reduction, etc. A more holistic approach is required that assesses the extent to which such indicators contribute towards improvement in these core principles. This assessment approach is embodied in the CCID.

The GIH InfraCompass toolkit (and its adaptation) provides an analytical basis (via a regression model) on which to use data to determine the nature of the relationship between the infrastructure development process and the quality of infrastructure. As with any regression analysis, the model can be used to determine the sensitivity of its output with respect to changes in the input parameters. As a consequence, questions such as "By how much should financial innovation improve so as to increase the level of attractiveness?" can be answered.

From the data and analysis presented, it is apparent that most investments in infrastructure in Mozambique have been made by way of FDI. These investments have amounted to around 70 per cent of total capital invested in infrastructure projects, with ODA contributing more than 50 per cent of the residual. Reductions in the supply of FDI and ODA could, therefore, have a significant impact on Mozambique's ability to finance its strategic infrastructure priorities. The need to diversify its sources of financing is urgent, and the focus should be on development of the domestic capital market, specifically institutional and regulatory frameworks to support a more effective stock exchange and domestic debt market.

The type of investor that Mozambique has attracted is the service provider as opposed to the passive investor. This type of investor brings capacity (knowhow) and capital that can be employed to extract raw natural resources, which are then exported to generate foreign earnings. These service providers typically receive compensation in the form of payments under a concession agreement that covers the cost of funds and other operating/maintenance costs. The motivation for investment for a service provider is different from that of a passive investor as the latter is more concerned with the efficiency of financial markets and their ability to obtain liquidity when they want to buy or sell securities and to earn a positive rate of return. This suggests the possibility that two different models may be more suitable for assessing the attractiveness of infrastructure.

The extent to which LC can be effective in Mozambique is fairly limited. The limitation derives from shortages in capacity in high-skilled activities related to strategic projects, lack of sufficient infrastructure to support capacity-building at a national level for such projects, lack of availability of discretionary financial resources for making investments at the retail level and lack of sufficient numbers of large local firms that could participate in the supplier value chain for the larger strategic projects.

In order to increase the resilience of Mozambique to exogenous shocks, two main initiatives are required: 1) increase the amount of capital expenditure on productive capacity for the agriculture sector and 2) adopt a systems approach to infrastructure development so as to mainstream climate/environmental impacts and gender/youth and other sources of vulnerability. The result will be an approach that seeks to spend better, not necessarily more, with a view to adopting a more risk-based strategy to addressing developmental needs.

According to the criteria that determine the applicability of the LDC category by the UN system, economic vulnerability is induced through natural shocks, victims of natural disasters and trade shocks, which increase the instability of goods and services. Infrastructure is a critical enabler of export diversification processes, which reduce economic vulnerability. In order to expedite these processes and reduce economic vulnerabilities, leveraging principles from the CCID could support infrastructure development. Economic vulnerability can be alleviated through infrastructure investments better aligned with sustainable development objectives, in line with the CCID.

This case study has assessed the GIH's InfraCompass toolkit (a G20 initiative) and found this to be more suited to types of investors that provide FDI and facilitate service delivery. This is as opposed to the passive investor interested in the financial returns provided by a bankable infrastructure project. In addition, application of the GIH framework is at the country rather than the individual project level. Therefore, greater disaggregation and additional indicators are needed in order to effectively assess whether a country has attractive or "bankable" investment projects, including on an intra-Commonwealth basis.

Commonwealth members tend to invest three times as much with each other compared with other partners in greenfield investments, which includes infrastructure (Commonwealth Trade Review, 2018). However, currently, the extent to which infrastructure investments are aligned with the principles of the CCID are unknown. Applying the principles of the CCID could assist in the creation of a pipeline of bankable intra-Commonwealth infrastructure investments. Such an approach would assess the extent to which LDC frameworks for infrastructure development meet international best practice, benchmark standards and also uphold principles of the CCID.

Such an approach would be aligned with the GIH's InfraCompass, which is a global benchmark for the assessment of infrastructure quality. However, because the GIH framework lacks an effective assessment of economic vulnerabilities that may emerge related to the management of contingent liabilities, and other issues related to debt sustainability, the findings presented in this case study suggest it needs some adaptation within the context of LDCs.

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Notes

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1 http://info.worldbank.org/governance/wgi/#home

2 http://www.imf.org/external/datamapper/datasets/CL/1

3 http://bpp.worldbank.org/

4 http://www.cepii.fr/institutions/en/ipd.asp

5 https://data.worldbank.org/indicator

6 The GIH is an initiative of the G20 whose remit is to "grow the global pipeline of quality, bankable infrastructure projects": https://www.gihub.org/about/about/

7 https://data.worldbank.org/indicator/SP.RUR.TOTL.ZS?view=map

8 This was approximately 63.5 per cent as of 2015: https://data.worldbank.org/indicator/AG.LND.AGRI.ZS

9 Mega-projects refer to large-scale projects as defined within Law 15/2011 with a size greater than US$500 million.

10 The International Labour Organization (ILO) defines vulnerable employment as the sum of own-account workers and contributing family workers.

11 https://data.worldbank.org/

12 Human Development Index 2016: http://hdr.undp.org/en/2016-report

13 A youth is defined as a person between the ages of 15 and 24. Note that the ratio mentioned also accounts for those in the age group 15–29.

14 Based on ILO figures.

15 The Institute of Directors produced a code on corporate governance in 2011 but this is not mandatory.

16 These data, taken from the World Bank database, exclude any high-income countries.

17 https://www.preventionweb.net/english/countries/statistics/index_region.php?rid=1

18 This is a form of financing whereby the cash flows/revenue from a project is the primary source used to pay back financing. The assets of the project are also used as security for financing.
19 See list of designated countries: http://equator-principles.com/designated-countries/. Designated countries have laws/regulations at least as good as those of the International Finance Corporation Performance Standards on Environmental and Social Sustainability and the World Bank Group Environmental, Health and Safety Guidelines.
20 This would include those that provide services under a concession or other arrangement for a fee in return for also financing parts of infrastructure development.
21 This would include those that invest purely to receive an economic return from the revenues generated from the infrastructure but are not part of its operations.
22 This method is applied to all criteria with the exception of yes/no criteria, in which case the average value is 1.
23 Normalised here is achieved by dividing the variance by the square of the absolute largest possible score for some criteria. The result of such a normalisation produces a value between 0 and 1. The weights are those detailed in Annex 2.3.
24 The following sources were used to evaluate the new criteria: the WEF Global Competitive Index, IMF Article IV – 2017, the PPP Law, the World Bank database and in-country meetings. The Contingent Liability Scoring Framework (CLScoreF) is based on work by the Commonwealth Secretariat and is detailed in Annex 2.4.
25 Undertaking this type of analysis is outside of the scope of the kickstarter project.
26 The regression analysis comprised data from 49 countries.
27 Note that scores can take on whole numbers such as 1, 2 or 3 as well as midpoints between 1, 2 and 3.
28 https://www.worldbank.org/en/topic/debt/brief/dempa-2015
29 Bank for International Settlements Principles for the Sound Management of Operational Risk, June 2011.
30 Adapted from Bank for International Settlements Enhancements to the Basel II Framework, July 2009.
31 Bank for International Settlements Principles for the Management of Credit Risk, September 2000.

Annex 2.1 Institutions Interviewed

Ministry of Trade

Bolsa de Valores de Moçambique (Stock Exchange)

PPP Unit (Ministry of Finance)

Debt Management Unit (Ministry of Finance)

Agency for Investment and Export Production

Barclays Bank

Institute for the Promotion of Small and Medium Enterprises

Ministry of Public Housing and Hydro Resources

Directorate of Economy and Planning

Institute for the Management of State Holdings

Standard Bank

National Industry Directorate

Energy & Hydrocarbon

UK High Commissioner

Annex 2.2 GIH InfraCompass weights

Category	Criteria	Weight
Governance	Control of corruption index score, –2.5–2.5 (best)	15.80%
	Rule of law index score, –2.5–2.5 (best)	15.10%
	Cost of enforcing contracts, as % of claim	13.80%
	Recovery rate, cents on the dollar	13.60%
	Shareholder governance index, 1–10 (best)	13%
	Extent of conflict of interest index, 1–10 (best)	12.30%
	Dedicated PPP unit (1 = yes, 0 = no)	10%
	Post-completion reviews (1 = yes, 0 = no)	6.40%
Regulatory	Capital account openness index, 0–1 (best)	18.30%
	Regulatory quality index, –2.5–2.5 (best)	16.60%
	Prevalence of foreign ownership, 1–7 (best)	13%
	Strength of insolvency framework index, 1–16 (best)	11.60%
	Effect of taxation on incentives to invest, 1–7 (best)	11.50%
Permits	Dealing with construction permits, no. of days	20.50%
	Number of procedures to start a business	19.30%
	Registering property, no. of days	18.60%
	Quality of land administration index, 1–30 (best)	17.90%
	Time required to start a business, no. of days	16.80%
	Cost to start a business, % of GNI per capita	6.90%

Note that the sum of the weights under each category should add up to 1. Under the regulatory category, the weights do not add up to 1 since these correspond to criteria that were not included in the analysis. This does not affect the attractiveness score since this is equivalent to saying that the individual score has 0 variance from the average value.

The weights shown in the above table and to follow were derived, by the GIH, on the basis of employing a principal components regression analysis[26] of a much longer list of criteria and reduced to those with larger contributions to the output variables. These output variables are the criteria under the delivery category.

Category	Criteria	Weight
Plans	Preparation of PPPs, 0–100 (best)	45.40%
	National/sub-National infrastructure plan (1 = yes, 0 = no)	31.70%
	Pipeline projects in national/sub-plans (1 = yes, 0 = no)	21.30%
	Guidelines for infrastructure appraisal (1 = yes, 0 = no)	1.60%
Procurement	Procurement of PPPs, 0–100 (best)	18.20%
	Bid evaluation, 0–100 (best)	16.70%
	Publish guidelines for procurement of projects (1 = yes, 0 = no)	15.80%
	Post award management of procurement, 0–100 (best)	13.80%
	Degree of transparency in public procurement score, 0–4 (best)	14%
	Calling for tenders, 0–100 (best)	11.80%
	Average procurement duration (in months)	9.70%
Delivery	Infrastructure quality, 1–7 (best)	33.33%
	GFCF % of GDP (5–year average)	33.33%
	Private finance of infrastructure, % of GDP (5–year average)	33.33%

The weights for each criteria of the delivery category (i.e. the output variables from the principal components regression) are equal since no preference is expressed between them.

Annex 2.3 Equal weights updated model

Category	Criteria	Weight
Governance	Control of corruption index score, –2.5–2.5 (best)	9.09%
	Rule of law index score, –2.5–2.5 (best)	9.09%
	Cost of enforcing contracts, as % of claim	9.09%
	Recovery rate, cents on the dollar	9.09%
	Shareholder governance index, 1–10 (best)	9.09%
	Extent of conflict of interest index, 1–10 (best)	9.09%
	Dedicated PPP unit (1 = yes, 0 = no)	9.09%
	Post-completion reviews (1 = yes, 0 = no)	9.09%
	Management of contingent liabilities/state-owned entities	9.09%
	Domestic market efficiency & depth	9.09%
	Adoption of best practice corporate governance	9.09%
Regulatory	Capital account openness index, 0–1 (best)	7.14%
	Regulatory quality index, –2.5–2.5 (best)	7.14%
	Prevalence of foreign ownership, 1–7 (best)	7.14%

Category	Criteria	Weight
	Strength of insolvency framework index, 1–16 (best)	7.14%
	Effect of taxation on incentives to invest, 1–7 (best)	7.14%
	Framework for incentives	7.14%
	Imposition of fees	7.14%
	Sustainable debt	7.14%
	Financial innovation facilitation	7.14%
	Stable macro-economics	7.14%
	Financial market development	7.14%
Permits	Dealing with construction permits, no. of days	16.7%
	Number of procedures to start a business	16.7%
	Registering property, no. of days	16.7%
	Quality of land administration index, 1–30 (best)	16.7%
	Time required to start a business, no. of days	16.7%
	Cost to start a business, % of GNI per capita	16.7%
Plans	Preparation of PPPs, 0–100 (best)	25.00%
	National/sub-national infrastructure plan (1 = yes, 0 = no)	25.00%
	Pipeline projects in national/sub-plans (1 = yes, 0 = no)	25.00%
	Guidelines for infrastructure appraisal (1 = yes, 0 = no)	25.00%
Procurement	Procurement of PPPs, 0–100 (best)	12.50%
	Bid evaluation, 0–100 (best)	12.50%
	Publish guidelines for procurement of projects (1 = yes, 0 = no)	12.50%
	Post award management of procurement, 0–100 (best)	12.50%
	Degree of transparency in public procurement score, 0–4 (best)	12.50%
	Calling for tenders, 0–100 (best)	12.50%
	Average procurement duration (in months)	12.50%
	Local content – effectiveness	12.50%
Delivery	Infrastructure quality, 1–7 (best)	33.33%
	GFCF % of GDP (5–year average)	33.33%
	Private finance of infrastructure, % of GDP (5–year average)	33.33%

Annex 2.4 Contingent Liability Scoring Framework

The Contingent Liability Scoring Framework (CLScoreF) consists of a numerical evaluation of the quality of a country's contingent liability governance (as embodied in its acts of parliament and practices). It comprises components grouped under a number of categories.

For most components of the scoring framework, a score between 1 and 3[27] will be allocated on the basis of how well the legal framework conforms to that of the evidence factors highlighted in the scoring rationale. A scoring rationale is a table providing details of the evidence required for the allocation of a particular score.

The components, and to an extent the evidence factors, are influenced by the IMF Working Paper on designing legal frameworks for public debt management (Awadzi, 2015) as well as existing and emerging better practice. Awadzi notes that there are other assessment tools that cover aspects of legal frameworks and guarantees, most notably that of the World Bank Debt Management Performance Assessment (DeMPA).[28] The key difference between the DeMPA and the CLScoreF approach is 1) the latter's focus is on contingent liabilities (going beyond guarantees) and 2) the

latter has an emphasis on reducing the propensity for various forms of risk and hence is a more risk-based approach.

Although not scientifically proven, there is much anecdotal evidence and converging consensus to suggest that reductions in the levels of operational and other risks associated with the management of contingent liability reduce the propensity for fiscal surprises. In turn, these reductions imply a lowering of the likelihood of debt unsustainability, which affects other aspects of development. As a consequence, it is expected that there will be a positive and monotonic relation between increases in the value of the CLScoreF and levels of sustainability.

The approach advocated in this annex contributes towards enhanced country sustainability. However, given its risk-based style, it also facilitates its integration into wider enterprise risk-management efforts.

Introduction

The CLScoreF assessment tool has been developed with a specific view to providing a numerical basis for evaluating the quality of the governance surrounding the management of contingent liabilities. The following table provides a description of the components for the CLScoreF tool.

The table shows there are 4 categories comprising 16 groupings and 41 components (i.e. CP-1 through to CP-41). Scores are allocated to each component on the basis of evidence gathered in analysing the component.

The supporting documents (for assessing components) would include primary and secondary legislation, regulations, official policies, budgets, auditor-/accountant-generals reports, consolidated annual statements/reports and other documents evidencing practice.

Where evidence is supported by the constitution or primary legislation, this will attract a higher score than if such evidence is in the form of secondary legislation. As a rule, secondary legislation will attract a higher score than regulations/policies unless the effect of this would be to render the evidence as attracting the lowest score, in which case an average or middle score (whichever is the largest) should be used.

Defining contingent liabilities

Recognition and requirements of contingent liabilities

CP-5 Recognition of implied contingent liabilities

CP-11 Purpose for which contingent liabilities will be issued

CP-18 Justification of the need for the issuance of a contingent liability

Approval process

Authority to create contingent liabilities

CP-1 Legal framework clearly provides the authority for the government to create contingent liabilities

CP-2 Clarity as to which act takes priority or relates to specific forms of contingent liabilities

CP-3 Instruments (e.g. indemnities, guarantees, etc.) that can be used to create a contingent liability

CP-4 Instruments not to be treated as giving rise to contingent liabilities

Eligibility

CP-8 Entities eligible for sovereign guarantees and/or indemnities

CP-9 Entities not eligible for sovereign guarantees and/or indemnities

Institutional clarity

CP-10 Basis for issuance of guarantees when eligibility is wide or narrow

CP-13 Public sector entities, such as local governments, state-owned entities and statutory bodies undertaking guarantees

CP-24 Role of the debt management office

Parliamentary and delegated authority

CP-12 Delegation of authority to create a contingent liability

CP-14 Parliament, cabinet or some other legislative body involvement in approving contingent liabilities

CP-15 Approval by parliament/cabinet (or other legislative body) prior to or after issuance of guarantee

Committees

CP-32 Existence of fiscal risk committee

CP-33 Frequency of meetings

CP-34 Key performance indicators

Performance management

Reporting disclosure

CP-6 Explicitly detailing the exposure of contingent liabilities and performance monitoring requirements

CP-7 Reporting of contingent liabilities in financial statements

CP-22 How fees from guarantees are to be accounted for so they provide a consistent view when accounting for the contingent liability

CP-27 Reporting of total debt to include guaranteed debt

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CP-29 Updating of website

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CP-35 Annual report of auditor-general

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Risk management

Risk assessment

CP-25 Classification of events leading to realisation of contingent liabilities as being low- or high-impact (or equivalent) categories

Risk sharing

CP-19 Percentage share of a contingent liability that a sovereign (or relevant liability provider) will assume

CP-20 Conditions under which contingent liabilities can be terminated when it is deemed no longer a requirement

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Risk management process

CP-16 Details as to the risk management to follow for the management of contingent liabilities

CP-17 Requirement for the payment of contingent liability fees
Contingency reserve
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CP-23 Explicitly limits for contingent liabilities
Fiscal
CP-40 Debt to GDP
CP-41 Weighted average cost of debt

The next section provides high-level details of the structure of the scoring methodology applied to various components, and subsequent sections detail the scoring for each component.

Scoring methodology

Individual component scores

Some components will be assessed as having a score of 1, 2 or 3 of the following form:

Score	Evidence factors
3	Criteria for a score of 3
2	Criteria for a score of 2
1	Criteria for a score of 1

Other components will be assessed as having a score of 1 or 2 of the following form:

Score	Evidence factors
2	Criteria for a score of 2
1	Criteria for a score of 1

For each of the above forms, the highest score is shown in decreasing order. Adjacent to each score are the criteria (or evidence) that should be observed in order for the score to be allocated. In the eventuality that there is no evidence to substantiate a minimum value of 1 (i.e. no data to support a score as high as 1) then a value of 0 is permissible.

In addition to the above, it is proposed that scores be awarded on the basis of 0.5 increments. This approach makes it possible to determine intermediate grades/scores for components and hence adds a finer level of granularity to the analysis. For example, there may be evidence to suggest that a score should be at least 1 but less than 2. Depending on the strength of the evidence (i.e. official documents and practices observed) in support of a score, values may be given as 1 or 1.5 but not including 2. The increment of 0.5 was chosen as it facilitates capturing "average" values, for example 1.5.

From a formal mathematical perspective, the scores are as follows:

Scores
3
[2,3)
[1,2)
[0,1)

Aggregate sovereign score

The aggregate score for a sovereign will be the sum of the individual component scores. This method implies that each category/grouping has equal importance. Based on the distribution of scores, the minimum and maximum scores for a sovereign are 0 and 112, respectively. A score of 112 does not, necessarily, imply that the likelihood of risks occurring is 0 but that it is likely to be very low. Similarly, a score of 0 does not imply that the likelihood of risk occurrences is 1 but that it is more likely than not to occur.

The minimum/maximum scores will be transformed so that the range of the aggregate score is from 0 to 1. This is achieved by multiplying the score by $\frac{1}{112}$.

In addition to the aggregate score, a separate score will be given for each category, also on the basis of a score between 0 and 1. In this way, individual category performance can be analysed separately.

It is important to note that, although it may appear that all factors are prevalent for a score of 3 or 2, this score could be reduced as a result of evidence that actual operational practices differ or are inconsistent with acts/regulations or best/emerging practices. Non-public disclosure will also result in reductions in scores even if operational practice supports a higher score.

Scoring details

This section provides details of the components and scores detailed earlier in this document.

CP-1 Approval entity

Does the public debt management legal framework clearly provide the authority for the government to create contingent liabilities?

Scoring rationale

Score	Evidence factors
3	A single at of parliament identifies an individual (e.g. minister of finance) as being responsible for either committing the sovereign to contingent liabilities or making referrals to an executive/legislative body for issuance of same.
2	The authority is given across multiple acts to an individual (who may or may not be the same as the individual for the score of 3) to issue or make referrals. As an alternative, authority is given to a body (not an individual) for issuance or making referrals.
1	High-level statement in acts of parliament allowing the government to commit the sovereign to contingent liabilities without identifying a specific responsible individual or body.

The above scoring system is geared towards encouraging sovereigns to clearly identify the entity responsible for committing to contingent liabilities. This approach fosters greater accountability and traceability/auditability of the contingent liability

approval process. As a consequence, it serves to reduce the likelihood of operational risks associated with assuming contingent liabilities.

CP-2 Clarity with multiple acts

In the presence of multiple acts of parliament, is it clear as to which act takes priority or relates to specific forms of contingent liabilities?

Scoring rationale

Score	Evidence factors
2	The latest act(s) makes it clear as to which sections of previous acts are still in force (if covering similar forms of contingent liability) as well as the specific form of other contingent liabilities covered by the newer act(s). Further, all relevant acts (subject to prioritisation) are mutually consistent.
1	Any factor highlighted for the higher score is not present.

The above scoring system is geared towards reducing potential inconsistency between laws that are meant to be in force at the same time. As a consequence, it serves to reduce the likelihood of operational and reputational risks.

CP-3 Instruments creating contingent liabilities

Does the framework clarify which instruments (e.g. indemnities, guarantees, etc.) or events can be used to create or lead to a contingent liability?

Scoring rationale

Score	Evidence factors
3	Within the same act identifying the responsible entity for issuing contingent liabilities, the specific instruments (e.g. guarantees, indemnities) or events that can be used to create (or lead to) contingent liabilities are detailed. In addition, contingent liability disclosure via way of annual reports/financial statements or auditor-generals' reports detail contingent liabilities consistent with those identified under the relevant act.
2	As above but where there are multiple acts relating to the authority to create or events leading to contingent liabilities.
1	Where specific instruments (or events) giving rise to contingent liabilities have not been detailed and/or instruments (or events) are detailed but there is evidence that other contingent liabilities are being quantified (e.g. as in the annual report, auditor-general's report, etc.) or existing but not mentioned in enabling acts of parliament.

The above scoring system is geared towards encouraging clear and complete list of contingent liabilities that a sovereign is willing to either commit or is subject to. It serves to reduce uncertainty regarding whether particular forms of assurances (or otherwise) are to be regarded as giving rise to a contingent liability. As a consequence, the system is aimed at reducing operational risk.

CP-4 Instruments not creating contingent liabilities

Does the framework clarify which instruments (or events) are not to be treated as giving rise to contingent liabilities?

Scoring rationale

Score	Evidence factors
3	Within the enabling act a list of the instruments not considered to give rise to contingent liabilities is detailed. Further, disclosure of contingent liabilities does not include instruments that are part of the list within the act.
2	As above but where there are multiple acts relating to the authority to create contingent liabilities.
1	Where specific instruments not giving rise to contingent liabilities have been detailed but these are inconsistent with those being disclosed.

The above scoring system is geared towards encouraging a clear and complete list of instruments that the sovereign is not willing to accept as giving rise to a contingent liability. It serves to reduce uncertainty regarding whether certain instruments will lead to a contingent liability. As a consequence, the system is aimed at reducing operational risk.

CP-5 Enabling act for contingent liabilities

Does the framework recognise implied contingent liabilities?

Scoring rationale

Score	Evidence factors
3	The enabling act explicitly mentions specific forms of implied contingent liabilities, how these may arise and (where possible) how these can be converted into explicit contingent liabilities.
2	As above but where there are multiple acts relating to the authority to create contingent liabilities.
1	Where there is just a high-level mention of implied contingent liabilities.

The above scoring system is geared towards encouraging sovereigns to carefully consider the types of contingent liabilities that may not arise owing to contract but based on moral suasion or repeated practice of previous governments. Empirical evidence suggests the largest fiscal surprises (associated with contingent liabilities) arise from those that are implied, and these generally have higher levels of uncertainty than those associated with explicit exposures. As a consequence, the system strives to reduce levels of risk and uncertainty surrounding potential contingent liability exposures and hence to reduce operational risks.

CP-6 Exposure quantification and reporting

Irrespective of the accounting treatment for contingent liabilities, does the framework explicitly require detailing the exposure of these liabilities and performance monitoring requirements?

Scoring rationale

Score	Evidence factors
3	The enabling act either speaks to how contingent liability exposure will be quantified or makes reference to mandatory guidelines/regulations governing derivation of exposures. Further, the act would make mention of the means by which exposures are reported, the constraints associated with the reporting and the entities to which such reports are required to be made.
2	As above but where there are multiple acts relating to the authority to create contingent liabilities.
1	Where there is just a high-level mention of the quantification of exposure for contingent liabilities.

The above scoring system is geared towards encouraging sovereigns to quantify and report on contingent liability potential exposure. Knowledge of such potential exposures helps manage expectation surrounding the variability of the fiscal budget. This system thus aims to reduce levels of operational risks.

Even if the factors supporting a score of 3 (or 2) are evidenced, the score could be lowered if:

- Analysis of guidelines/regulations/act reveals inadequacies in the methods or practice used to quantify contingent liability exposure. In determining the adequacy of exposure quantification methods, reference will be made to established or emerging better practice as a benchmark.
- It is found that the specified exposure methods (even if they are adequate) are not being actively employed in practice.

If either of the above two cases occurs, then the score should be reduced to 1.

CP-7 Financial statements reporting

Does the framework explicitly require the reporting of contingent liabilities in financial statements?

Scoring rationale

Score	Evidence factors
3	The enabling act explicitly states that details of contingent liability exposures are to be documented in financial statements or annual reports and that these are to be presented to parliament or other legislative body. Further, the act specifies each type of contingent liability that is to be reported on individually as well as in the aggregate. Further, there is no evidence of late reporting of financial statements.
2	As above but where there are multiple acts relating to the authority to create contingent liabilities.
1	Where there is just a high-level mention of the reporting of contingent liabilities.

The above scoring system seeks to encourage sovereigns to provide timely and enhanced disclosure to relevant legislative/executive bodies. This serves to reduce the likelihood of reputational risk owing to potentially conflicting opinions being expressed by other members of the parliamentary framework (not party to a decision to issue a contingent liability) as well as operational risks.

Even if the factors supporting a score of 3 (or 2) are evidenced, the score could be lowered if:

- Analysis of the act reveals there are contingent liabilities not part of the list detailed in the act.
- The financial statements, auditor-general's report or other official documents reveal inconsistencies between the statements and the act.

If the first occurs and there are no inconsistencies between the act and operational practice, then a score of 1.5 should be given; otherwise, the score should be reduced to 1.

CP-8 Explicit entities eligible for guarantees and/or indemnities

Does the framework explicitly state which entities are eligible for sovereign guarantees and/or indemnities?

Scoring rationale

Score	Evidence factors
3	The enabling act explicitly states which entities (i.e. makes reference to persons, corporate entities, etc.) are eligible for sovereign guarantees and/or indemnities. Further, there is no evidence to suggest that entities other than those listed have been the beneficiary of guarantees/indemnities.
2	As above but where there are multiple acts relating to the authority to create contingent liabilities.
1	Where there is a lack of congruence between the type of beneficiaries and those listed in the act(s).

The above scoring system seeks to make it very clear which entities a government can issue guarantees/indemnities to and that there should be congruence between the law and operationalisation of the law. This serves to reduce the likelihood of reputational and operational risks.

CP-9 Explicit entities non-eligible for guarantees and/or indemnities

Does the framework explicitly state which entities are not eligible for sovereign guarantees/indemnities?

Scoring rationale

Score	Evidence factors
3	The enabling act explicitly states which entities are not eligible for sovereign guarantees/indemnities (or expresses conditionalities) even if it is with reference to saying "if not listed as being an eligible entity". Further, there is no evidence of lack of congruence between the law and its operationalisation.

Score	Evidence factors
2	As above but where there are multiple acts relating to the authority to create contingent liabilities.
1	Where there is a lack of congruence between the type of beneficiaries and those listed in the act(s).

The above scoring system seeks to make it very clear which entities a government cannot issue guarantees/indemnities to and that there should be congruence between the law and operationalisation of the law. This serves to reduce the likelihood of reputational and operational risks.

CP-10 Basis for issuance of guarantees

Does the framework provide a clear basis for issuance of guarantees when the eligibility is wide or narrow?

Scoring rationale

Scoring	Evidence factors
3	When the scope of the defining act is wide the framework should provide a basis for allocating guarantees among the eligible entities in a manner that serves to reduce fiscal risks. For example, the risks of guarantees to public sector entities should not be treated the same as loans to individuals or private corporations. When the scope is narrow (e.g. only guarantees for public debt) the framework should provide a basis for how unforeseen circumstances (e.g. acts of god, severe economic contraction) would be handled, e.g. through use of insurance or a contingency fund/reserve.
2	As above but where there are multiple acts relating to the authority to create contingent liabilities.
1	Where, irrespective of the scope, there is only high-level mention of how potential risks will be managed.

The above scoring system seeks to ensure that sovereigns carefully manage the potential risks that could occur as a consequence of adopting a wide or narrow focus towards the management of contingent liabilities. This serves to reduce levels of operational risks.

CP-11 Purpose of contingent liability

Does the framework explicitly state the purpose for which contingent liabilities will be issued?

Scoring rationale

Scoring	Evidence factors
3	The enabling act may explicitly state, for example, that guarantees will only be given for guaranteeing investment projects. Further, there is no evidence of lack of congruence between the act and its operationalisation.
2	As above but where there are multiple acts relating to the authority to create contingent liabilities.
1	Where the operationalisation of the law is incongruent to the letter of the law.

The above scoring system seeks to ensure that sovereigns extend contingent liabilities for the intended reasons as stated in law and that such reasons are clear and known to all. It also serves to reduce the likelihood of operational and reputational risks.

A score of 2 could be given for the case where the law has a general statement along the lines of guarantees being given for "any purpose" but makes reference to specific exclusions.

CP-12 Delegated authority for contingent liabilities

Does the framework provide a clear basis for the delegation of authority to create a contingent liability?

Scoring rationale

Score	Evidence factors
3	Evidence of this is where the enabling act either explicitly states that only a single specified body/person may create contingent liabilities or it identifies those bodies/persons that may act in delegated authority for the primary authority. Further, there is no evidence that such delegated authority results in a different governance framework (with detrimental consequences) than what would transpire with the primary authority.
2	As above but where there are multiple acts relating to the authority to create contingent liabilities.
1	Where only high-level details are provided.

The above scoring system seeks to ensure that only authorised individuals can commit the sovereign to contingent liabilities on a delegated basis. It serves to help in the management of the proliferation of contingent liabilities and auditability of the issuance process. This system serves to reduce operational risks.

CP-13 Oversight of public sector contingent liabilities

Does the framework clearly state whether public sector entities, such as local governments, state-owned entities and statutory bodies can undertake guarantees?

Scoring rationale

Scoring	Evidence factors
3	Evidence of this would include, e.g., explicit mention of which entities are allowed to issue guarantees and other contingent liabilities as well as which ones are not allowed. The framework should state how such liabilities are to be approved (at the public sector entity level) and communicated to the "main authority" for approving such liabilities. Further, there is no evidence that operationalisation of the law is incongruent from the letter of the law.
2	As above but where there are multiple acts relating to the authority to create contingent liabilities.
1	Where only high-level details are provided.

The above scoring system seeks to determine the total sources from which contingent liabilities can originate with a view towards ensuring consistency between law and operations. Hence, it serves to minimise the likelihood of underreporting of contingent liability exposures. This serves to reduce levels of operational risks.

CP-14 Requirement for parliament/cabinet to approve

Does the legal framework explicitly detail whether parliament, cabinet or some other legislative body is required to approve contingent liabilities?

Scoring rationale

Scoring	Evidence factors
3	Evidence would include (in primary act), e.g., clear description of the process for approval including mention of whether approval is prior to issuance or retrospective. Further, the act mentions any constraints on issuance prior to formal approval (assuming prior approval is required) or maximum period of elapsed time after issuance of guarantee (assuming that issuance can take place prior to parliamentary approval).
2	As above but where there are multiple acts relating to the authority to create contingent liabilities.
1	Where there are high-level details stating that parliamentary/cabinet approval is required but no details of the process.

The above scoring system seeks to ensure that knowledge and approval of contingent liabilities do not reside in few hands but that facilities exist for accommodating potentially diverse opinions. Hence, it serves to reduce the likelihood of reputational risk.

A score of 1.5 can be achieved if a process is described but does not contain level of detail for a score of 3.

CP-15 Timing of any parliamentary approval

Is approval by parliament/cabinet (or other legislative body) prior to or after issuance of guarantee?

Scoring rationale

Scoring	Evidence factors
2	Where approval is required by parliament or other legislative body prior to issuance of contingent liability. In the alternative, if prior approval is not required but a parliamentary limit on contingent liabilities is used as a basis for managing liability risks and there is no evidence of breaches of the limits.
1	If there is incongruence between operationalisation of the law and the letter of the law.

The above scoring system seeks to ensure that approval authorities are notified in a timely manner and hence to reduce reputational and operational risks.

CP-16 Risk management process of contingent liabilities

Does the framework provide details as to the risk management process to be followed for the management of contingent liabilities?

Scoring rationale

Scoring	Evidence factors
3	Evidence would include, e.g., details of the risk management process to be followed and/or some reference to other detailed risk documents. The framework should clarify the "main authorities" role in ensuring that the appropriate skills, processes and systems are in place to manage risks. The framework and/or risk documents should, where appropriate, require assessing the impact of changes to market, credit and other relevant factors on contingent liability exposures.
2	As above but where there are multiple acts relating to the authority to create contingent liabilities.
1	Where only high-level details are provided.

The above scoring system seeks to ensure that there is a framework for the risk management of contingent liabilities and that the sovereign has the requisite capacity to measure and manage the risks.

A score of 2.5 (for what would otherwise be a score of 3) could be obtained if minor details, for example lack of specifics on skills, are omitted. Similarly, a score of 1.5 would result for the case where a score of 2 would have been appropriate. Finally, a score of 1.5 (where there is a single act) could be obtained where some level of detail is provided beyond high level but insufficient to result in a score of 2.5.

CP-17 Fees imposed by the ministry of finance

Does the legal framework require the payment of contingent liability fees or authorise the minister of Finance (or other responsible person/body) to charge fees?

Scoring rationale

Scoring	Evidence factors
3	Evidence would include, e.g. (in law), details of the fees and/or any authority to charge fees by the minister or other relevant bodies. Ideally, those determining the fees should not be the same as those issuing or authorising contingent liabilities. Further, there is no evidence that fees are not always being paid/collected by/to the responsible body. In addition, there should be some statement as to how fees are to be used in the risk management of the liabilities and that fees are derived based on the risk posed by the specific contingent liability.
2	Where there is no law but practice is to charge fees.
1	Where there is incongruence between operationalisation of the law and the letter of the law.

The above scoring system seeks to ensure that the sovereign is aware of the expected or likely costs of meeting the costs of contingent liabilities and seek compensation via way of a fee. This serves to reduce levels of liquidity risks.

If evidence exists of fees but those fees are not directly related to the result of a risk analysis, then the score is capped at 2.

CP-18 Need for contingent liability

Does the framework explicitly require justification of the need for the issuance of a contingent liability?

Scoring rationale

Score	Evidence factors
2	Evidence would include, e.g., legal requirement to prove that funding could not be obtained (by beneficiary) without issuance of the contingent liability; there are *a priori* risks where the benefits of the liability outweigh the magnitude and costs of the risks. Additional evidence would include, e.g., guidance/laws on how to conduct cost-benefit analysis.
1	If evidence does not include all the above factors.

The above scoring system seeks to ensure that the sovereign is aware of the rationale for the contingent liability and that there is not an alternative (less risky/cheaper) option. This seeks to reduce levels of operational and liquidity risks.

CP-19 Risk sharing

Does the framework/policy delineate cases for determining the percentage share of a contingent liability that a sovereign (or relevant liability provider) will assume?

Scoring rationale

Scoring	Evidence factors
3	Evidence would include, e.g., explicit percentages against contingency type; percentages based on beneficiary risk rating, etc. In addition, there is no evidence to suggest there is a lack of congruence between the operationalisation and the letter of the law.
2	As above but where percentages are not broken down into the varying types of contingent liabilities.
1	Where there is incongruence between operationalisation of the law and the letter of the law.

The above scoring system seeks to ensure that the sovereign avail itself of risk mitigation strategies via sharing of risks. The intention is that the entity in the best position to manage a particular silo of risk should bear the responsibility for the majority of that risk management.

CP-20 Termination of contingent liabilities

Does the legal framework provide conditions under which contingent liabilities can be terminated when it is deemed to no longer be a requirement?

Scoring rationale

Score	Evidence factors
2	Evidence would include, e.g., explicit inclusion in law allowing the termination of contingent liabilities.
1	Where there is incongruence between operationalisation of the law and the letter of the law.

The above scoring system encourages sovereigns to make use of the option to terminate a contingent liability given that it is no longer needed. This serves to reduce liquidity risks.

A score of 1.5 can be awarded if it can be shown that there is no law but regulation/policy and practice is to include termination options in all contingent liabilities where applicable.

CP-21 Collateral requirements

Does the framework permit for the requirement that beneficiaries post collateral?

Scoring rationale

Score	Evidence factors
3	Evidence would include, e.g., reference to a law detailing eligible collateral, valuation mechanisms, etc.
2	Some evidence exists but only in high-level terms where the types of eligible collateral have not been detailed.
1	Where there is incongruence between operationalisation of the law and the letter of the law.

The above scoring system seeks to ensure that sovereigns identify eligible collateral and that a rational basis exists for its valuation. This seeks to reduce exposures owing to credit and market risks.

Even if the evidence factors exist for a score of 3, there may not be sufficient details regarding how collateral is to be valued. In such cases, a score of 2.5 could be given.

CP-22 Accounting for guarantee fees

Does the framework provide details as to how fees from guarantees are to be accounted for so that they provide a consistent view when accounting for the contingent liability?

Scoring rationale

Score	Evidence factors
2	Evidence would include, e.g. (in the primary act), not accounting for the fee as revenue if not accounting for the liability as an expense. An alternative would be to budget for the full cost of the liability.
1	If budgeting is not as above.

The above scoring system seeks to ensure that sovereigns properly account for expenses given that they may be recognising the benefits of contingent liability premiums. This seeks to reduce operational risks.

CP-23 Limits management

Does the framework explicitly detail limits for contingent liabilities?

Scoring rationale

Score	Evidence factors
3	Evidence would include, e.g., limits for the amount of contingent liabilities that can be assumed in any year; limits could be expressed as percentage of GDP, stock of debt, etc. In addition, evidence would include, e.g., any changes to established limits would require approval from parliament or relevant legislative body. Further evidence would include, e.g., limits cannot be breached without prior approval from parliament or other legislative body.
2	Where not all of the above factors are evident but there are no breaches of identified limits.
1	Where there have been breaches of limits.

The above scoring system seeks to ensure that the sovereign can place a cap on the maximum amount of outstanding and individual exposures in relation to contingent liabilities. In this respect, the system seeks to reduce the propensity for liquidity risks.

CP-24 Role of debt management office

Is the role of the debt management office detailed in the framework?

Scoring rationale

Score	Evidence factors
3	Evidence would include, e.g., details of how the debt management office is involved in the analysis and monitoring of contingent liabilities (i.e. its role, reporting requirements, etc.). Evidence that the creation of the MTDS (by the debt management office) incorporates contingent liabilities (as a requirement in law). In addition to the above, there is no evidence that the letter of the law and its operationalisation are incongruent.
2	As above but where the debt management office does not incorporate contingent liabilities in the MTDS.
1	Where only high-level details are provided or there is a lack of congruence between the letter and operationalisation of the law.

The above scoring system seeks to reward situations where a sovereign has a dedicated debt management office with expertise in the management of contingent liabilities. This serves to enhance the level of analysis (hence reducing operational risks) of such liabilities. Further, since incorporation of the contingent liability into the MTDS is expected to occur, the system also rewards practices that attempt to reduce the likelihood of liquidity risks.

CP-25 Classifying contingent liability events

Does the framework explicitly require classification of events leading to realisation of contingent liabilities as being low or high impact (or equivalent) categories?

Scoring rationale

Score	Evidence factors
3	Evidence would include, e.g., act requiring that outputs of a risk assessment classify liabilities into low- or high-impact events. Further, the result of these assessments is disclosed in publicly available documents. In addition, there is no lack of congruence between the letter and operationalisation of the law.
2	If classification occurs but it is not mandated by law.
1	If there is a lack of congruence between the law and its operationalisation.

The above scoring system seeks to reward situations where a sovereign has quantified the likelihood of a contingent event occurring and its corresponding impact. The benefit of such analysis would be to put the sovereign in a position to be able to quantify its potential costs. This serves to aid the overall risk management process and provides more clarity to the budgeting process and helps reduce operational risks.

Even if the evidence factors exist for a score of 3, the actual risk assessment method may have flaws. The risk assessment methods will be compared against best and emerging better practice. In such cases, depending on the severity of the flaws, the score could be reduced to a value ranging between 2.5 and 0 (i.e. a completely ineffective assessment framework). Similarly, a score that might otherwise result in a value of 2 could be modified to a value between 1.5 and 0.

CP-26 Contingency reserve

Does the framework facilitate the maintenance of a contingency reserve that could be used to meet calls on contingent liabilities in exceptional circumstances?

Scoring rationale

Score	Evidence factors
3	Evidence would include, e.g., laws specifying how such a reserve is to be endowed and utilised and the portion specifically allocated to contingent liabilities. In addition, there is no lack of congruence between the letter and operationalisation of the law.

Scoring rationale

Score	Evidence factors
2	If there is a contingency reserve but no specific laws relating to contingent liabilities but there is evidence that the fund is used to meet contingent liability costs.
1	There is a lack of congruence between the letter and operationalisation of the law.

The above scoring system seeks to reward situations where a sovereign is able to show how utilisation of a contingency reserve serves to manage the risk of contingent liabilities. If properly managed, the contingency reserve can be used to mitigate the severity of fiscal surprises and hence liquidity risks.

CP-27 Reporting total debt

Does the framework explicitly require the reporting of total debt to include guaranteed debt?

Scoring rationale

Score	Evidence factors
3	Evidence would include, e.g., definition (in the act of parliament) of what constitutes total debt or subsets like total public debt as including debt guarantees. In addition, there is no evidence that the letter and operationalisation of the law are not congruent.
2	Where there is no mention in law of what constitutes total debt, etc. but practice is to report total debt as comprising direct obligations plus publicly guaranteed debt.
1	If there is a lack of congruence between the law and its operationalisation.

The above scoring system seeks to reward sovereigns for clarity of disclosure. Such disclosures serve to reduce the likelihood of reputational risk.

CP-28 Recording of contingent liabilities

Does the framework explicitly require a computerised record to be kept of all contingent liabilities?

Scoring rationale

Score	Evidence factors
3	Evidence would include, e.g., a requirement in the public debt management requiring a specified body/entity to record the contingent liability. Further, the act would specify that a computerised system is to be used to log these liabilities. In relation to called contingent liabilities, the system would also record those that have been assumed to be called by the grantor of the contingent liability. In addition, there is no evidence of lack of congruence between the letter and operationalisation of the law.

Score	Evidence factors
2	There is no legal requirement but practice is to record such liabilities on a computerised system.
1	There is a lack of congruence between the letter and operationalisation of the law.

The above scoring system seeks to reward sovereigns for maintenance of electronic records. This serves to reduce operational and reputational risk in the management of contingent liabilities.

A score of 2 would be obtained in the case where all evidence factors for a 3 exist but there is no recording of called most contingent liabilities (e.g. only recording guarantees). A score of 1.5 would be obtained where a similar case exists when there is no legal requirement.

CP-29 Updating of website

Does the framework explicitly provide for the details of contingent liabilities and associated risk assessments to be disclosed via an official government website that is freely accessible to members of the general public and updated on a frequent basis?

Scoring rationale

Score	Evidence factors
3	Evidence would include, e.g., laws specifying that details of contingent liabilities (including risk assessments) must be disclosed on an official government website freely accessible to members of the public and updated on a frequent basis. In addition, there is no lack of congruence between the letter and operationalisation of the law.
2	Where information on contingent liabilities is detailed on an official government website but there are no laws mandating such practice.
1	There is a lack of congruence between the letter and operationalisation of the law.

The above scoring system seeks to reward sovereigns for public disclosure of contingent liabilities. This serves to reduce the likelihood of reputational risk.

A score of 2.5 would be obtained in the case where all evidence factors for a 3 exist (comprising disclosure for most contingent liabilities) but there is either no or just high-level disclosure of others (few in number and not considered potentially materially significant in magnitude). The score is reduced further (to a minimum of 1) if more and/or material liabilities are not disclosed. In the case where the evidence factors exist for a 2, the score could be reduced further on the basis of the extent to which all main contingent liabilities are not disclosed, with the lowest score being 0.

In either the case of a 3 or a 2, irrespective of the completeness of the information, if details on the website are stale in that they do not reflect up-to-date information then scores should be reduced accordingly. As a rule of thumb, data are stale if they are for more than a month from when they are supposed to have been

officially disclosed or produced (whichever is later). Naturally, the frequency of data production will affect whether disclosure (or lack thereof) is to be considered stale. For example, annual reports on contingent liabilities are considered current until the official disclosure/production of the next report. In circumstances where no official date is provided but practice has been to release the data on a periodic basis then that basis should be used as the period. When no regular periodic basis exists, stale is considered in the context of better and emerging practice. Irrespective, no data should be considered current that are more than one year from last disclosure.

CP-30 Ease of access/navigating website

Does the website facilitate accessing/navigating to the relevant areas to view details of contingent liabilities?

Scoring rationale

Score	Evidence factors
3	Evidence would include, e.g., landing page on which navigation to pages on contingent liabilities is clearly identified. In addition, the website is reliable and not down for significant periods of time.
2	Where there is no landing page with reference to contingent liabilities and navigating to a page with such details is not immediately obvious but a page exists.
1	Where there is no page for contingent liabilities but such details are contained in other reports/documents maintained online.

The above system seeks to reward sovereigns for providing ease of access to relevant data of contingent liabilities on an official government website. This serves to reduce the likelihood of reputational risk.

Even if evidence factors exist for a 3/2, the score could be reduced to 0 if the relevant page is ineffective. That is, the page link does not work.

CP-31 Ease of downloading details

Does the website facilitate downloading details of risk analysis relating to contingent liabilities?

Scoring rationale

Score	Evidence factors
3	Evidence would include, e.g., individuals being able to download PDF/Excel/Word or other electronic documents containing risk analysis of contingent liabilities.
2	Where information on contingent liabilities is detailed on an official government website but there is no ability to download details or the details do not contain a risk assessment.
1	There is no reference to contingent liabilities.

The above system seeks to reward sovereigns for providing downloading facilities for risk analysis relating to contingent liabilities. This serves to lower the likelihood of reputational risks.

CP-32 Existence of fiscal risk committee

Is there a fiscal risk committee (analysing the risk of contingent liabilities) comprising individuals from representative ministries whose area of responsibility covers key contingent liability risk silos?

Scoring rationale

Score	Evidence factors
3	Evidence would include, e.g., laws/regulations specifying the composition and responsibility of the committee, term of members, qualifications, frequency of meetings, reporting requirements, etc. Further, there is no evidence of lack of congruence between the letter and operationalisation of the law and the key contingent liability silos are covered.
2	As above, but where there is no law/regulation but a committee exists that fulfils the operational requirement of a fiscal committee.
1	There is a lack of congruence between the committee and the letter of the law.

The above system seeks to mitigate a number of risks, including liquidity, credit, market, operational and reputational risk.

Even if the evidence factors exist for a 3/2, the score could be reduced if it is found that the committee was not effective as a result of any number of factors, including the level of analysis, oversight, coverage, etc.

CP-33 Frequency of meetings

Does the fiscal risk committee meet at least quarterly?

Scoring rationale

Score	Evidence factors
3	Evidence would include, e.g., laws/regulations specifying the frequency of meetings to be at least quarterly. Further, there is no evidence of lack of congruence between the letter and operationalisation of the law.
2	Where there is no law/regulation but a fiscal committee exists that meets at least quarterly.
1	There is a lack of congruence between the committee and the letter of the law.

The above system seeks to ensure that the government has met sufficiently often to provide increased opportunities to better understand the varied nature of risks

affecting the government. As such, the system seeks to reduce levels of all risk types.

CP-34 Key performance indicators

Are key risk indicators disclosed and monitored for the performance of the committee?

Scoring rationale

Score	Evidence factors
3	Evidence would include, e.g., laws/regulations specifying the key risk factors. Further, there is no evidence of lack of congruence between the letter and operationalisation of the law.
2	Where there is no law/regulation but key risk factors are disclosed and applied.
1	There is a lack of congruence between the committee and the letter of the law.

The above system seeks to reduce levels of operational risk in the management of contingent liabilities.

Even if evidence exists for a 3/2, the score could be reduced if there is evidence that key performance indicators are ineffective.

CP-35 Annual report of the auditor-general

Is the report of the auditor-general published annually and does it contain disclosures on contingent liabilities?

Scoring rationale

Score	Evidence factors
3	Evidence would include, e.g., laws/regulations specifying that the auditor-general's report is to be disclosed yearly and that it contains details of contingent liabilities. Further, there is no evidence of lack of congruence between the letter and operationalisation of the law.
2	Where there is no law/regulation but practice is to produce the report annually.
1	There is a lack of congruence between the disclosure practices and the letter of the law.

The above system seeks to reduce levels of operational risk.

Even if evidence factors exist for a 2, the score could be reduced if the report is not produced annually.

CP-36 Unresolved matters in auditor-general's report

Does the report contain matters relating to contingent liabilities that have been unresolved as of the previous report date?

Scoring rationale

Score	Evidence factors
2	Where there are no unresolved matters having a potentially negative fiscal impact.
1	There is a lack of congruence between what is reported in the auditor-general's report and operational practice.

The above system seeks to reduce levels of operational risk.

CP-37 Forward-looking budget projections

Does the budget provide details on forward-looking projections of contingent liabilities covering likelihood of liability events, severity amounts and other risk statistics?

Scoring rationale

Score	Evidence factors
2	Where there are forward-looking projections covering likelihood of severity of contingent liabilities and other statistics.
1	Where only partial details of forward projections, e.g. severity levels without likelihoods of occurrence.

The above system seeks to reduce the likelihood of a combination of risks including operational and liquidity.

CP-38 Details on current contingent liability amounts in budget

Does the budget provide details on the current stock/amount of contingent liabilities?

Scoring rationale

Score	Evidence factors
2	Where the budget provides details of amount of contingent liabilities broken down by type of liability.
1	Where only partial details of contingent liabilities are provided.

The above system seeks to reduce the likelihood of reputational risks.

CP-39 Details of called contingent liabilities in budget

Does the budget provide details of realised contingent liabilities?

Scoring rationale

Score	Evidence factors
2	Where the budget provides details of realised contingent liabilities by type.
1	Where only partial details of contingent liabilities are provided.

The above system seeks to reduce the likelihood of reputational risks.

CP-40 Debt to GDP

Is debt to GDP in the current period less than that in the previous period?

Scoring rationale

Score	Evidence factors
2	Where the change is negative
1	Where there is no change

The above system seeks to assess the impact of debt management policy on GDP. A reduction in the value of the ratio may suggest an improved liquidity position.

A score of 0 is obtained where the change is either positive or no data are provided.

CP-41 Weighted average interest cost

Is the weighted average cost of debt in the current period less than that in the previous period?

Scoring rationale

Score	Evidence factors
2	Where the change is negative
1	Where there is no change

The above system seeks to assess the impact of credit and market risks associated with the total amount of public debt stock.

A score of 0 is obtained where the change is either positive or no data are provided.

Risk definitions

Operational risk:

"Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. This definition includes legal risk, but excludes strategic and reputational risk."[29]

Liquidity risk:

The definition of liquidity risk provided here is non-standard but serves to illustrate the nature of liquidity associated with contingent liabilities:

Liquidity risk is defined as the ability of the government to be able to meet fiscal objectives/obligations in the presence of the realisation of contingent liabilities as and when due.

The term "ability" in the above definition can be linked to the notion of probability that is, the probability of meeting planned expenses, etc., in the light of the occurrence of a contingent liability.

Reputational risk:

Reputation risk can be defined as the risk arising from negative perception on the part of creditors, rating agencies, parliament and others that can adversely affect a sovereign's ability to maintain existing, or establish new, business relationships and continued access to sources of funding.[30]

Market risk:

The following standard definition of market risk is used: market risk is defined as the risk of losses owing to adverse movements in market prices.

Credit risk:

"Credit risk can be defined as the potential that a borrower or counterparty will fail to meet obligations in accordance with agreed terms."[31]

Chapter 3

Adapting to Graduation within Global Value Chains: Potential Increases in Trade Costs Associated with the Tuna Industry in the Solomon Islands*

3.1 Introduction

Solomon Islands has recently been recommended to the United Nations Committee for Development Policy (CDP) for graduation from least developed country (LDC) status. The impacts of graduation are far-reaching, but this case study considers the tuna industry specifically. This is because of the large estimated trade cost increase that may arise through the tariff preference loss induced by graduation.

The quantitative analysis presented in our draft inception report for this assignment, estimated that Solomon Islands might experience a rise in trade costs of around €15 million as a result of the trade shifts that are expected to occur through a loss of tariff preferences. While this analysis is informative, there are limitations to basing policy recommendations on a purely quantitative approach, particularly given the assumptions of perfect substitutability and elasticity, which may not accurately reflect the tuna industry and its organisation within a global value chain (GVC). As such, this contribution to the impact assessment of graduation from LDC status applies a qualitative assessment framework, which draws on GVC analysis.

This case study is organised as follows. Section 3.2 provides an overview of the Solomon Islands economy and LDC graduation; Section 3.3 considers the tuna GVC overall and the position of Solomon Islands within the networks of vertically integrated firms; Section 3.4 provides information on the tuna export industry in Solomon Islands and considers the perspectives of the local private sector and international buyers and competitors; Section 3.5 considers the financial implications of LDC graduation; Section 3.6 offers alternative mechanisms to cope with lost tariff preferences; Section 3.7 reviews additional related issues related to graduation. Finally, Section 3.8 concludes.

3.2 Solomon Islands' economy and LDC graduation

Solomon Islands, as a small island LDC, shares many of the challenges of other small island developing countries in its reliance on a few natural resources (primarily logging) and its exposure to natural disasters and external shocks. In the past 10 years, growth has ranged between 2 and 10 per cent, incidence of poverty has declined and there has been a sizeable increase in per capita income. However, unemployment is prevalent, and the economy is dominated by informal and subsistence activities.

In 2017, real gross domestic product (GDP) growth was approximately 3.5 per cent, driven predominantly by services (2.5 per cent), agriculture and fisheries (0.7 per cent) and industry (0.3 per cent). Despite the slight decline in logging in 2017, growth remained positive and relatively ambitious. Inflation reached 1 per cent in 2017, up from 0.6 per cent in 2016, with the price of oil driving the reduction on the estimated figure. The Balance of Payments was 3.9 per cent of GDP with the trade balance down to US$50 million owing to the decline in log exports. Estimates of GDP growth in 2018 are similar but the anticipated continued decline in logs, coupled with the reduced fishing activities given the decline in the number of days allocated under the Vessel Day Scheme (VDS), may cause growth to slow.

Solomon Islands is in a tight fiscal position as cash reserves have fallen and buffer stocks have been depleted. The current budget has made significant cuts, but there is concern that major financing programmes remain in place, with little to no return for the economy as a whole. The government has initiated a programme of tax reform, which is widely regarded as fundamental to attracting foreign investment and creating a more competitive economy.

There appears to be general recognition that the lack of diversification and unsustainable practices in the extractive industries are hampering long-term growth prospects, but thus far there have been few initiatives to tackle these issues and identify sources of growth with the potential not only to replace the current output from log resources but also to ensure that the gains are dispersed more equally. Access to finance is also a major barrier preventing opportunities for diversification, coupled with inadequate infrastructure to support economic growth.

The context in which Solomon Islands is graduating from LDC status, specifically the indicators it has met, is pivotal to forming a more comprehensive picture of how it may adapt. In 2015, Solomon Islands met two of the three eligibility thresholds for LDC graduation – namely, gross national income (GNI) per capita and the Human Assets Index (HAI). The CDP in its March 2015 report found that Solomon Islands' GNI per capita was US$1,402, above the eligibility threshold of $1,242, and its HAI was 71.7, above the eligibility threshold of 66 (ECOSOC, 2015). The Ministry of Foreign Affairs and External Trade (MFAET) raised a number of important issues in this regard, specifically around the presence of the Regional Assistance Mission to Solomon Islands (RAMSI)[1] following the period of civil 'tensions' from 1999 to 2003, which has likely inflated income statistics; as well as the main industries in the economy, which are predominantly extractive, tending to concentrate substantial income earnings in the hands of a few.

Where there is greatest cause for concern, however, is with regard to economic vulnerability, evidenced by the score achieved in the March 2015 CDP report, which found Solomon Islands' Economic Vulnerability Index (EVI) to be 50.8, well above the graduating threshold of 32. As a small island developing country at the forefront of the fight against climate change, and with limited diversification, the country is highly vulnerable to external shocks and natural disasters. Exports of round logs, for example, which comprise approximately 20 per cent of government revenue, reached peak output in 2016 and are predicted to decline rapidly in the coming years.

According to the Central Bank of Solomon Islands (CBSI), loss of this income stream would be catastrophic for the local economy. Reforestation initiatives are underway but inadequate, at least in the short run.

Furthermore, government coordination remains a challenge. Responsibility for coordinating LDC graduation lies with the Ministry of Development Planning and Aid Coordination (MDPAC), which does not appear to have initiated preparations. The National Development Strategy 2016–2035 is focused predominantly on alignment with the Sustainable Development Goals, failing to mention LDC graduation. MDPAC has recognised the need to address this and is currently developing the Solomon Islands Integrated Financial Framework (SIIFF) to incorporate LDC graduation preparation, in coordination with development partners, to ensure bilateral and regional assistance is aligned with domestic priorities. The SIIFF should include additional support to tackle issues related to economic vulnerability.

Despite the centrality of trade to the LDC graduation process, it appears that consultation with MFAET has been inadequate. In order to avoid an increase in trade costs as a result of lost tariff preferences to the EU and other markets, trade must play a central role, linked to the broader objectives of sustainable growth, economic transformation and diversification.

3.3 Overview of the canned tuna global value chain

This section provides a high-level overview of the canned tuna GVC. It considers the importance of the Pacific in the tuna value chain, the key players, market power structures and the main challenges facing the industry.

3.3.1 Importance of the Pacific in the tuna value chain

Over the past few decades, the canned tuna industry has experienced substantial growth in vessel numbers, catching capacities and total catch, coupled with an increasingly complex structure, resulting from an array of factors including resource sustainability, regulations, increased operating costs, developing consumer demand and changing preferential market access regimes (Hamilton et al., 2011a). The Western and Central Pacific Ocean (WCPO), where Solomon Islands is located, hosts the largest number of industrial-scale tuna purse seine fishing vessels in the world. In 2015, total catch in WCPO was 2.7 million metric tonnes, or 57 per cent of global catch.[2] From 1970 to 2007, the proportion of global catch from WCPO remained fairly constant, between 41 and 52 per cent, but since 2007 catch rates have increased to around 56–58 per cent of total global catch. In 2015, skipjack accounted for the highest volume and value of catch, at 1.82 million metric tonnes and US$2.3 million, or 68 per cent of total catch and 48 per cent of total value of all species caught in WCPO. This is followed by yellowfin (23 per cent volume and 32 per cent value), big eye (5 per cent volume and 13 per cent value) and albacore (4 per cent volume and 8 per cent value). Since 1997, skipjack catch has been the highest in volume; in only two years (2000 and 2003) has the catch value of yellowfin exceeded that of skipjack in WCPO. Skipjack is therefore the most important species for the region, in terms of both volume and value.

Although the EU industrial purse seine fleet is the largest in the world, there are currently no vessels operating in WCPO except in Cook Islands. The main reason for this is that EU vessels did not want to sign an agreement that incorporated the Vessel Day Scheme (VDS). The EU's presence is predominantly in the Western Indian Ocean and Eastern Central Atlantic. However, the importance of WCPO to EU-based canning firms cannot be underestimated. Under the current arrangements, Solomon Island processed frozen tuna "loins" qualify for duty-free quota-free (DFQF) access to the EU market. Tuna loins reflect the international division of labour and the system of tariff protection in canned tuna production in the EU and the USA. To save on labour costs, EU industry imports pre-cooked, frozen loins to be canned using predominantly capital-intensive machinery. These are largely imported from developing country suppliers where labour is relatively less costly and has access to tuna fisheries. This enables EU firms to source raw materials at low cost, despite the generally higher costs of doing business in Europe.

3.3.2 Players in the tuna global value chain

Tuna trading companies

Tuna trading involves the procurement of raw materials from multiple fishing vessels and coordinating the transhipment of catches for sale and delivery to tuna processors. Canning grade tuna trading companies have grown to a position of relative dominance in the supply chain, primarily because of the effectiveness of the services offered to vessel owners and processors. Tuna trading reaps relatively small profits per shipment so trading companies rely on economies of scale to trade high volumes of product. In WCPO, two major trading companies dominate the market: Tri Marine and FCF Fishery Co. Ltd. FCF handles the largest volume of raw material and is the most prominent tuna trader in WCPO, but Tri Marine International (TMI) has a much stronger global presence, especially in the EU market, with a more vertically integrated business model. The two tuna trading firms have a well-established presence in WCPO that is unlikely to be challenged given the significant barriers to entry present (Hamilton et al., 2011b).

It is worth briefly discussing TMI, as the owner of local fishing company, National Fisheries Development (NFD), and the majority shareholder of SolTuna. As mentioned, its core business is tuna trading, although it is also involved in all aspects of the canned tuna supply chain (end-to-end management) – namely, fishing, trading, logistics, processing and marketing. The global and vertically integrated nature of the company enables it to support these operations effectively, ensuring a reliable and economic supply of raw material and tuna products to its major brand clients. TMI has canned tuna brand partners in the USA (Chicken of the Sea and Star Kist) and Europe (Bolton Group) and also supplies a considerable volume of raw material to tuna packers in Thailand and elsewhere. It has a long-standing contract with Bolton Group to supply high-quality yellowfin loins, as well as small volumes of skipjack loins for the Rio Mare and Saupiquet canned tuna brands, which are processed in Bolton Group's Italian factory (i.e. defrosted and packed into cans). The high-quality specifications of the processed tuna are important points to consider in the context

of the increased trade costs through a loss of tariff preferences that would come from LDC graduation for Solomon Islands. However, as the value chain is driven on cost, ultimately if the costs are too high, the tuna will be transhipped to be processed elsewhere.

Tuna processors

The developing world is now the leading location for global canned tuna production – that is, from raw material (whole round fish) to finished product. The leading locations are in Southeast Asia, especially Thailand, the Philippines and Indonesia, and increasingly Vietnam; and in Latin America, especially Ecuador and Mexico. China is also emerging as a major player in this industry, supported in part by a growing and highly subsidised Chinese-owned tuna fleet. The other locations, such as in the Western Indian Ocean and West Africa, are focused almost entirely on the EU market and are propped up by the EU system of tuna preferences. Except for Thailand, all of these locations are in close proximity to major fishing grounds and have access to productive and lower cost labour, and in some cases preferential access to the major consumer markets of *both* the EU and the USA (historically Ecuador). Similar to the tuna fishing industry, the canned tuna processing industry is complex, with global operations influenced by the increasing cost of raw materials and other production inputs, sustainability issues, overcapacity, complex tariff regimes, stricter standards and changing consumer preferences. Thailand is the world's leading producer of canned tuna and the global market price leader for canning grade whole-round frozen tuna. The industry is dominated by five branded processors, which own the leading canned tuna brands in the EU and North America – that is, Thai Union, Dongwon, Princes (owned by Mitsubishi), Bumble Bee (owned by Lion Capital, a private equity group) and the Bolton Group, which owns a minority interest in TMI.

Thailand's tuna processors import almost all of their raw material needs, around 90 per cent of which is sourced from WCPO through trading companies. Given Thailand's processing capacity, global competitiveness, industry know-how and market share, it will continue to dominate the global canned tuna processing industry. The EU also has a canned tuna processing industry but, given the higher price of labour and other inputs, greater attention is paid to the size of the fish, with canneries typically sourcing large whole-round fish to boost labour productivity. Investment in processing facilities in the developing world is a central component of the business model of EU firms, which is closely connected to EU tariff preferences. The survival of EU firms is based to a great extent on protection from relatively low-cost imports via high tariffs and their ability to source raw materials from countries that qualify for preferential access into the EU market (Hamilton et al., 2011a,; Campling, 2016).

Principal canned tuna markets

Canned tuna is a popular low-cost source of protein traded as a global commodity product typified by high volumes and low profit margins. The major markets are the EU and the USA but, with consumption levels stable, there is an increasing focus on consumers in emerging markets such as the Middle East, Latin America, Eastern

Europe and South Africa. It is the supermarkets in the EU and USA that dominate canned tuna retail sales and therefore command the greatest market power in the value chain (Hamilton et al., 2011b).

Supermarkets drive competition to such a degree because of their vast buying power. Often, canned tuna is sold on promotion by the large supermarkets to draw customers into the store, who will then go on to purchase their weekly shops. The oligopolistic nature of the value chain means supermarkets have the greatest market share and sales density, with firms' buyers of canned tuna able to exert significant pressure on the value chain upstream on price and other areas of competition, including product and process standards (Campling, 2017).

Interestingly, in the canned tuna industry, the supermarkets are able not only to squeeze the smaller producers in the value chain but also to disadvantage some of the larger companies that own canned tuna brands, deepening competition among the major suppliers, regardless of their market size. Supermarkets are able to play big brands off of each other, increase their overall sales and use private labels to capture a bigger profit margin. The increasing market share of the largest retailers reflects the market power that a consolidating retail market generates. Big retailers fight for market share by drawing customers in with promotions and lower prices, the costs of which are passed on to suppliers (Havice and Campling, 2017). This translates into lower profit margins further down the chain, such as firms canning for brands or private labels and loining plants.

The increasing influence of private label tuna, as opposed to national brands, is having a further impact on the power structure in the canned tuna GVC. Private label tuna is taking an increasing share of key EU markets and, with no marketing or branding costs, supermarkets are able to offer their own label at a lower price, squeezing branded firms even further. There are important differences between EU markets. Italy remains led by the big brands, which are believed to be in a position to capture high brand rents (Campling, 2013). This is important for Solomon Islands, given that the vast majority of its tuna loins are processed in Italy for the domestic market.

3.3.3 Retaining and expanding market power

There is significant heterogeneity in the branding and manufacturing nodes of the canned tuna supply chain, and each company will have its own logistics and tactics for survival in an attempt to differentiate itself from its competitors. For example, some firms are focussed on trying to secure long-term strategic access to tuna fisheries by making onshore processing investments; others are arms-length from fishing and are focused on branding and marketing; yet others deploy a combination of the two.

There are two main categories of branded firms: branded manufacturers that are often integrated backward into fishing and rely in large part on their own manufacturing for supply and source part of their products from non-branded manufacturers;

and marketing companies that rely on non-branded manufacturers to supply their branded product and focus on marketing and total supply chain management, deriving their profits from brand rent. There are also two main categories of non-branded manufacturers: co-packers, which receive contracts to produce private label and/or branded products according to buyer specifications, and which are sometimes integrated backward into fishing; and contract processors, which generally do not own the fish and are paid a processing fee by tuna trading companies or branded firms, which coordinate procurement, product specifications and sales of finished product. The major issue for the processing node of the supply chain is that it is highly overcapitalised, creating problems for non-branded manufacturers, which rely on high volumes to generate profit in a low-margin industry. Smaller developing countries like Solomon Islands tend to be at the bottom of the hierarchy in the international division of labour in canned tuna production. SolTuna is a contract processor, producing frozen tuna loins, which are an intermediate product procured by canneries in high-cost locations of tuna production. This means that companies like SolTuna are not in a position to capture brand rents – they are price takers.

For Solomon Islands and other Pacific Island Countries (PICs) supplying the tuna market, processing activities that are directly connected to global corporate activity must increasingly fit into the overall business strategies of the large companies driving the industry worldwide. There is a widespread view that canned tuna is too cheap, given the way it is marketed and sold across supermarkets in the EU and US. In order to increase the price, and therefore the profit margins that can be funnelled down the value chain, supplier countries could attempt to restrict supply. PICs, as the owners of the world's largest canning-grade tuna resources, are in a strong position to drive up the price of canned tuna, by putting in place effective limits on fishing activity and controlling supply (Hamilton et al., 2011b).

3.3.4 Issues in the tuna global value chain

Overcapacity in both fishing and processing is a significant issue in the tuna GVC, and any new investments are only likely to exacerbate the issue. The cost of raw materials is increasing, mainly because of tightening of supply, which could lead to the closure of marginal processors. The industry is also facing increased inputs and operating costs, such as in energy, cans, oil and labour, which puts pressure on profitability. As such, firms are increasingly looking for ways to streamline their business models. Furthermore, the sustainability of tuna stocks is of paramount concern not just to tuna processors but across the supply chain. Biological limits have nearly been met in the bigeye and yellowfin species, which has major implications for long-term access to raw materials. Coupled with shifting demand for sustainable seafood in European and US markets, processors are under increasing pressure to source supply sustainably (Adolf et al., 2015; Havice and Campling, 2017). Pertinent to this study, changes in tariff preferences are also likely to have significant effects on developing country processors and suppliers as the rise in free trade agreements (FTAs) and the resultant erosion of tariff preferences reduces the competitiveness of those countries that rely on these to a great extent (Campling, 2016).

3.4 Tuna export industry in Solomon Islands: Incorporating the global value chain perspective

3.4.1 Importance of the tuna industry in Solomon Islands

For Solomon Islands and the Pacific region as a whole, fishing represents the backbone of society and a way of life preserved for generations. Across WCPO, tuna stocks are abundant, and currently supply approximately 50-60 per cent of the world's total tuna stocks. Tuna represents a major source of income for the region and, provided it is managed appropriately, will continue to do so into the future. Despite the strategic importance of tuna for the region, its ability to command a fair price has been a consistent challenge, given the structure of the value chain, as evidenced above. Ensuring the region can command a price that is on a par with the importance of the resource is vital.

Tuna represents an important employment and wage industry, made all the more imperative given the limited economic diversification signalled by the reliance on exports of round unprocessed logs, the and minimal participation of the majority of the population in the formal economy. In a country with significant levels of unemployment and underemployment, the presence of onshore processing and canning plants, which are highly labour-intensive, is crucial.

The fisheries sector accounts for 5.2 per cent[3] of Solomon Islands GDP. The total catch in the national waters of Solomon Islands of all types of vessels – longline, pole and line and purse seine – was 136,365 tonnes in 2015, or US$318 million. Although an increase on 2014 catch and value, this is lower than the 2010 high of 186,510 tonnes ($347 million). In 2015, the national fleet comprised 127 vessels[4] and total catch was 61,670 tonnes. The majority of foreign purse seine vessels fishing in Solomon Islands under access agreements are from Korea, Taiwan, Japan, Vanuatu and FSM. It terms of contribution to GDP, government revenue from foreign vessels access fee payments in 2015 was $41 million, of which the majority ($26.5 million) was through purse seine bilateral and other agreements, such as the VDS. Onshore processing in 2015 was 38,501 tonnes and total employment was 2,356. Employment earnings were estimated at $12 million, with the value of local purchases at $23 million. The multiplier effect of the onshore processing industry in terms of employment and income generation from ancillary goods and services provision is considerable.

Solomon Islands has one processing and canning plant, based in Noro, Western Province, which currently employs over 2,000 workers, 67 per cent of whom are women (IFC, 2016). However, women are highly concentrated at the operational level and significantly under-represented across all levels of management. As the largest employer in Solomon Islands, SolTuna has a strong commitment towards ensuring equal rights and opportunities for women and men in the workplace, with non-discrimination policies and practices in place, as well as targeted initiatives to increase the number of women in typically "male" jobs (forklift driving) and efforts to tackle gender-based violence (GBV) in the community. This is extremely important in a country where gender inequality and GBV are rampant.

Expansions in purse seine fishing activity and processing capacity in the WCPO region are being driven by PICs exercising their legitimate goal of deriving greater economic benefit from their tuna resources. They are doing this by enhancing linkages between fisheries access and onshore investment and development in their local economies (Hamilton et al., 2011b). However, PICs need to strike a balance between achieving domestic development aspirations through using fisheries access to leverage onshore investment in processing facilities, and tuna resource sustainability. Any new plants that are proposed will typically come with requests for additional fishing licences, which, if not managed adequately, will introduce additional fishing effort into the WCPO purse seine fishery and place considerable pressure on already fragile stock levels (Ibid.).

3.4.2 Tariff preferences

As a LDC, Solomon Islands is eligible to receive tariff preferences from all preference-offering countries. The majority of preference schemes are not utilised by Solomon Islands for processed tuna loins or canned tuna, given the minimal duty preference on offer coupled with the cost of transporting the goods to market.

By far the most important preference scheme to Solomon Islands is that offered by the EU market, which for LDCs is known as Everything But Arms (EBA). As well as the EU Generalised System of Preferences (GSP), this study also briefly considers the US and Japanese preference schemes.

European Union

The tariff preferences offered by the EU are based on historical factors such as the colonial domination of key tuna-producing countries by European countries. Once fish stocks in Europe had vastly depleted, French and Spanish boats looked to their colonies for resources and secured duty-free access for inputs for their processing plants (Campling, 2012). For local producers, the ability to access the EU market duty-free is a considerable factor in overcoming the principle challenges they face in exporting, including geographical isolation, cost of transportation, limited infrastructure, high cost of utilities and limited potential for diversification.

The EU employs a tariff escalation policy on tuna products imported into the common market, whereby tariff levels increase with the level of processing. In other words, as extra-EU products come into direct competition with those produced in the EU, the cost of importing those products increases, to reduce the competitive pressure on EU producers. The EU, specifically Italy, represents a significant market for Solomon Islands' exports of processed tuna loins. On average, over the period 2006 to 2015, Italy accounted for 2.4 per cent of total exports from Solomon Islands and 82 per cent of the total value of all exports of processed tuna. The value of tuna exports to Italy was around US$6 million.[5]

EBA, although a non-reciprocal trade arrangement offering almost complete product coverage, has highly restrictive rules of origin (ROO), particularly for processed tuna. Qualifying tuna from Solomon Islands must be caught by an EU- or Solomon

Islands-flagged vessel, which must also be at least 50 per cent owned by a company or nationals from the EU or Solomon Islands. Given that the EU tuna fleet is largely inactive in WCPO and that tuna vessels are very expensive, this is a challenge for a small economy with limited available capital. The EU also demands that imports of fish and fish products comply with strict sanitary and phyto-sanitary standards (SPS) and a regulation on illegal, unregulated and unreported (IUU) fishing.

Although IUU regulations are a burden in terms of compliance, IUU fishing is a major contributor to the depletion of fish stocks globally and undermines conservation and management efforts to improve the long-term sustainability of fish resources. The IUU Regulation establishes a certification scheme to enhance the traceability of fish products through the various stages of the supply chain. Fisheries products from third countries into the EU must be accompanied by a catch certificate issued by the competent authority of the flagged state country of the fishing vessel, which verifies that the fish have been caught in accordance with the applicable national, regional and international laws, regulations and conservation and management measures. If implemented effectively, measures to tackle IUU fishing will be beneficial to the PICs, in terms of enhancing fisheries sustainability. But the additional administrative arrangements required to comply with the regulations lead some to label them a non-tariff barrier, if countries have difficulties meeting the requirements (Hamilton et al., 2011b).

Solomon Islands is already suffering from tariff preference erosion, which is only going to worsen as the EU signs more FTAs with competitor countries. Many major competitors, both in the region and globally, are also able to export tuna products to the EU duty-free – Papua New Guinea (PNG) signed the Interim Economic Partnership Agreement (IEPA) with the EU in 2007 to retain access following expiry of the Cotonou Agreement; Madagascar, Mauritius and Seychelles have been a party to the East and Southern Africa Economic Partnership Agreement since 2009, granting it zero duty on canned tuna and tuna loins; and Ecuador joined the EU's Trade Agreement with Colombia and Peru in 2017 granting it zero duty on tuna products.[6] The EU Single Duty Loins Quota (introduced in 2004) is another source of preference erosion. This allows a predetermined quantity of pre-cooked tuna loins to enter the EU duty-free from third countries on a "first come first served" basis (in 2014 the quota was 22,000 metric tonnes). Typically, this quota is fully utilised by the end of the first quarter. However, in 2014 the quota was exhausted just 10 days after opening – likely taken up mostly by Thai processors, who are otherwise subject to pay 24 per cent duty on loins (Campling and Havice, 2014). The quota has negative trade diversionary consequences for preference-dependent economies *vis-à-vis* cost competitive processors in Southeast Asia.

Japan

Solomon Islands has preferential access to the Japanese market as an LDC. Japan began to grant zero tariffs to LDCs in 2000 and increased the list substantially in 2005. Similarly, Japan differentiates between developing countries and LDCs, offering the latter DFQF on all products. Under the GSP, preferential treatment is provided

for selected agricultural and fishery products in 408 items (Harmonised System (HS) Chapters 1-24) and for selected industrial products in 3,151 items (HS Chapters 25-97). Japan offers DFQF for LDCs for both processed and whole tuna and, under the GSP, offers various reduced tariff rates for processed tuna, ranging from 6.4 to 7.2 per cent, down from 9.6 and 10 per cent, respectively.

Distinct from the EU market, Solomon Islands exports only whole tuna to Japan, used in the sashimi industry, rather than the lower grade skipjack used for canning. In 2016, Solomon Island exports of HS heading 03 to Japan valued just under US$1 million, which represented around 2.5 per cent of all exports of that heading.[7] Upon graduation, Solomon Islands will lose its preferential access to the Japanese market for whole tuna, where it will be required to pay a duty of 3.5 per cent. The margin on offer, however, is insignificant, so LDC graduation is unlikely to present an issue or result in the same competitiveness challenges as in the case of the EU. Moreover, Solomon Islands authorities were unaware as to whether the Japanese DFQF access was utilised, potentially indicating the insignificance of the preference scheme to the tuna industry.

United States of America

Solomon Islands exports processed albacore loins and cans for the US market, but these represent only a fraction of the total production of SolTuna. As an LDC, Solomon Islands is able to export albacore loins and cans, both in oil and not in oil, to the USA duty-free. Following graduation, canned albacore in oil would be subject to a tariff rate of 35 per cent and the equivalent not in oil would be subject to a 6 per cent duty rate. Currently, the US market comprises less than 5 per cent of SolTuna's total exports of both processed loins and canned tuna. The impact of a loss of preferences would be fairly insignificant, and it may be able to offset the loss in other markets into which it is hoping to expand.

Australia and New Zealand

It is worth considering briefly the markets of Australia and New Zealand, which may provide alternative sources of demand for Solomon Islands tuna. Australia is the largest trading partner[8] of Solomon Islands and New Zealand is also a significant trade partner, though not quite so big. While Solomon Islands is able to export to both countries through their LDC preference schemes, it is also a party to the South Pacific Regional Trade and Economic Cooperation Agreement (SPARTECA), which provides non-reciprocal DFQF access to Australia and New Zealand. PACER Plus, a reciprocal FTA, will replace SPARTECA once it enters into force, continuing to offer Solomon Islands duty-free access on all exports – provided ROO are met – into Australia and New Zealand. Should Solomon Islands graduate, this access would not be affected. However, the preference for tuna products under SPARTECA and the successor to the Pacific Agreement on Closer Economic Relations (PACER) (PACER Plus) is commercially insignificant (both countries apply a Most-Favoured Nation (MFN) tariff of 5 per cent), and low-cost high-volume competitors such as Thailand already have duty-free access to Australia and New Zealand for canned tuna under FTAs.

It is evident that the loss of tariff preferences to the EU market will have the greatest impact on Solomon Islands exports of tuna products.

Alternative markets

Campling (2015) also sought to identify potential alternative markets for processed tuna from the PICs, given the mature nature and complex export requirements into the EU and US markets. The study took into account five factors: the dynamics of market demand, existing suppliers, tariffs and duty available to PICs, non-tariff measures and freight costs. The conclusion reached was that, based on these five dynamics, no alternative market to the EU exists for PIC exporters of canned tuna and limited opportunities may exist for pre-cooked loins. Each of the alternative markets studied is supplied by a cheaper competitor in terms of freight costs. The proximity PIC producers have to the raw material is countered by the costs of doing business in the region coupled with lower levels of productivity.

The critical importance of the EU market to PIC producers cannot be underestimated; it appears to be the only sizeable market with high demand and a high price/quality ratio that PIC processors can competitively supply. The trade preferences offered under EBA, IEPA and the GSP+ (the EU's Special Incentive Arrangement for Sustainable Development and Good Governance) continue to be the most commercially viable competitive advantage, particularly when factoring in the relaxed ROO in the IEPA (for more see below). In light of this assessment, it is critical that PIC governments continue to dedicate adequate resources to ensure compliance with the EU's strict regulatory requirements for on-going market access (Campling, 2015).

3.4.3 Tuna production in Solomon Islands

The two major firms in Solomon Islands' tuna fisheries industry are NFD and SolTuna. The ownership structure of both NFD and SolTuna makes for a highly integrated fishing, processing and canning operation in Solomon Islands and is a major strength of the local tuna industry.

NFD's main business is in fishing and it supplies the majority of its catch to SolTuna, with the remainder shipped straight to Thailand for processing, apart from a small amount of ultra-low temperature (ULT) freezing of whole tuna that is sold in the lower-grade Japanese sashimi market. NFD currently owns seven purse seine boats, five smaller and two larger vessels, and fishes in the archipelagic waters and Exclusive Economic Zone (EEZ) of Solomon Islands, as well as outside under the Parties to the Nauru Arrangement (PNA). In longline fishing, NFD has 30 of the 100 licences provided to Solomon Islands under the quota scheme, with the remainder taken up principally by Taiwan. In pole and line fisheries, NFD owns three vessels and is in the process of purchasing a fourth, although at present this is a marginal fishing activity. Of the four fishing mechanisms, purse seine fishing offers NFD the greatest premium, given the Marine Stewardship Council (MSC) Certification.

SolTuna operates the local brand with the processing and canning plant in Noro. At present, 70 per cent of SolTuna's operations are in loins, the majority of which go to the EU, and 30 per cent in cans, which go predominantly to domestic and regional

markets. This structure of production has changed significantly over the past five years: it was previously 85 per cent loining and 15 per cent canning. In the loining business, where SolTuna is a contract processor, with this part of the business is the foundation for the company in terms of scale and overheads. The plant's canning operations are where the greatest profit potential lies, but only because of the foundation provided by the loining base. While international volumes contribute, it is the local and regional markets that bring in the most revenue. SolTuna also supplies albacore to the US market, in the form of cans for the brand Ocean Naturals and cooked loins to the two US-based canneries. Despite the preferential access of Solomon Islands to the US market as an LDC, sales comprise less than 5 per cent of SolTuna's total processing operations.

The EU is the most important market for Solomon Islands and the lead export destination of processed tuna loins, with the tuna canned and sold predominantly in Italy and Spain. Solomon Islands' tuna is considered to be of higher quality, which consumers in Italy and Spain demand to a much greater extent than Northern European consumers. This facet is explored further in the sections below on characteristics and value addition. Despite the integrated nature of the fishing and processing in Solomon Islands, the power structure of the supply chain and the marginal quantities supplied mean local firms in the domestic economy are unable to influence the price at which they can sell their tuna.

Costs

Tuna fishing, processing and canning face considerable costs of production in Solomon Islands. NFD's main operating cost for fishing vessels is fuel, duty on which was raised by more than 100 per cent in early 2018. Energy costs are also considerable, coupled with the labour costs of management, which make up 10 per cent of the total work force. SolTuna identified energy as the major cost in its operations, which is substantially higher than that paid by firms in other countries, primarily Southeast Asian firms. Currently, SolTuna is a standalone operation and does not source power from Solomon Power, the state-owned energy provider, as it cannot meet the company's requirements. SolTuna generates the power it requires to run its operations and provides minimum transmission and distribution far more efficiently than Solomon Power. SolTuna is considering other sources of energy, such as renewables, as a way to reduce input costs, particularly as expansion plans are put in place.

Additional costs highlighted by SolTuna include testing to ensure compliance with EU health and safety regulations. Presently, fish samples are sent to New Zealand for testing, which is very costly and risky, as the samples must be packaged and shipped correctly and quickly. The National Public Health Laboratory in Solomon Islands is receiving support from the Standards and Trade Development Facility of the World Trade Organization (WTO) and the United Nations Food and Agriculture Organization to secure accreditation as a competent authority, which will enable testing to be done onsite. This should reduce the costs involved in exporting processed loins to the EU market. Reducing costs such as these is vital because of the structural costs related to small island economies as locations of manufacturing (Winter and

Martins, 2004; Campling and Havice, 2007), such as ocean-going freight costs – an issue raised in the survey of tuna product buyers (Section 3.4.5).

Employee retention and attendance are further costs facing SolTuna. On average, workers are absent for unexcused and unknown reasons 18 per cent of the time. Absence of a reliable workforce leads SolTuna to employ far more workers than is necessary, increasing costs further. Reducing the level of controllable absenteeism could significantly improve SolTuna's productivity and cut staffing costs. The International Finance Corporation (IFC, 2016) estimates that bringing absenteeism down to 15 per cent each day[9] would mean SolTuna could earn an additional US$1.58 million in annual revenue. Gender-related issues and responsibilities are significant factors in retention issues and absenteeism, and the company has ramped up efforts to improve equality as well as additional strategies to improve healthcare and childcare, tackle GBV and expand career pathways (ibid.).

Investment

The recognition of the tuna industry's importance to the local economy, in terms of employment and growth, is driving the government's commitment to boosting onshore investments, particularly outside the capital, Honiara. The government recognises the success achieved in Noro, which it would like to replicate in other areas. Current operations are below capacity; NFD reports that between 25,000 and 30,000 metric tonnes are landed per year at the processing plant and cannery in Noro, but, according to the Ministry of Fisheries and Marine Resources (MFMR), Solomon Islands has the capacity to supply 100,000–170,000 metric tonnes per year.[10]

Two sites were identified for their potential a number of years ago and investors had expressed interest in developing onshore operations in exchange for access licences and other concessions from the government. However, these investments fell through, as a consequence of the challenges of acquiring the land. The majority of land in Solomon Islands is customarily owned, which often creates insurmountable challenges when identifying property rights. One site in particular, however, is considered worth the time and effort required to secure, provided the land issues can be resolved. Bina Harbour, located in Malaita, has long been recognised as an ideal location to build a canning and processing plant, given the natural harbour and location along the major shipping routes. This would provide much-needed employment in the province and create value addition opportunities through canning to the local market, as well as competition for SolTuna, which would lead to further gains. MFMR hopes to secure the land by 2018, but there was little indication as to how this would be achieved and the different approach that may be adopted.

The challenges of land, infrastructure and the cost of utilities is a serious impediment to investment in Solomon Islands, hampering progress significantly. The Forum Fisheries Agency (FFA) stressed that Solomon Islands could take an additional one or two processing plants but, for any new investment in Noro, space, energy and limited labour supply would be major challenges. SolTuna faces significant challenges finding experienced productive workers, which, coupled with the high turnover and absentee rate, adds further costs to any investment. While SolTuna and

NFD would welcome more competition, they recognise that any onshore investment needs to provide social and economic benefits. SolTuna takes a more cautious view of additional investments, noting that, as the VDS is fully embedded, foreign investors do not need to invest onshore to access fishing licences, as these can be purchased directly from the government. The experience of other countries in the region, such as PNG, where processing plants in Lae are operating well below capacity, provides further reason for caution when considering expansion opportunities in processing and canning operations.

3.4.4 Characteristics of Solomon Islands' tuna and value addition prospects

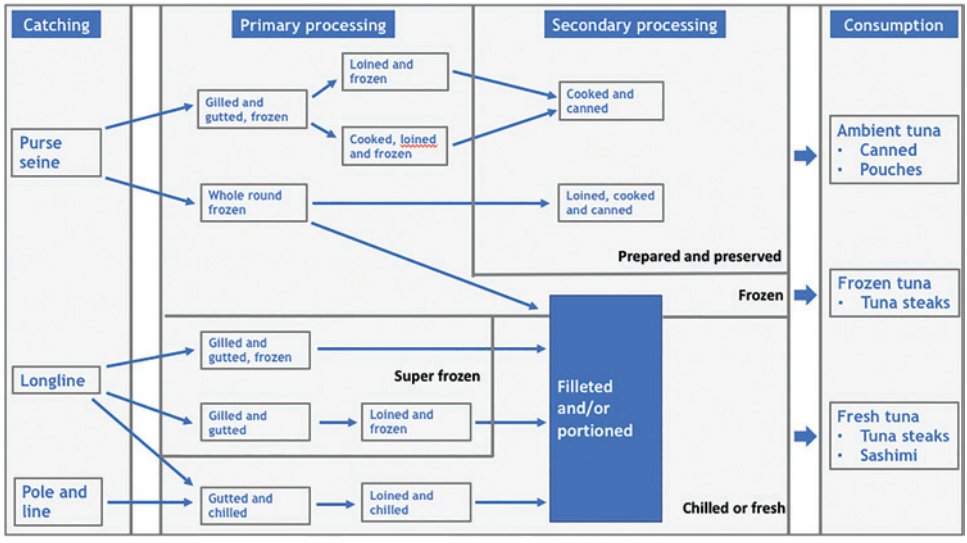
The impact of a change in the price of Solomon Islands' tuna will depend on whether demand for the good is based primarily on its price or on the quality of the product. To determine whether Solomon Islands can continue to supply tuna to the EU following a loss of tariff preferences, it is important to consider the characteristics of the product.

To set the scene, Figure 3.1 details the forms of catching, processing and consumption of tuna. Ambient tuna is the cheapest product, followed by frozen steaks. The highest quality, and therefore more expensive, tuna is that in fresh form, sold as either steaks or sashimi.

The majority of Solomon Islands' tuna exports to the EU are caught by purse seine vessels, and cooked, loined then frozen. Once landed in the EU, they are put into cans and sold in the regional market.

Canned tuna is identified as a commodity product, directly competing with various other sources of canned fish and, in some markets, with canned meat too, and, as such,

Figure 3.1 Overview of Tuna Value Chain in the Solomon Islands



price is typically the most important factor determining demand in end markets. On first glance, canned tuna appears relatively homogeneous, but this simplification neglects the differences in species and the tastes and preferences of consumers in end markets. There is considerable difference across the main canning species (i.e. albacore, skipjack and yellowfin) in terms of quality and therefore price. In order to identify whether value chains are price- or quality-driven, it would be useful to assess each species' value chain in turn and consider what impact changes in price have and where in the production chain the cost changes will be felt. Although this is beyond the scope of this study, it is important to consider the composition of tuna species and the end markets, as these offer valuable insights into the product differentiation that occurs within the EU market.

One of the major branded buyers of SolTuna's product is Rio Mare, which is owned by the Bolton Group and is number one in the Italian market. The Italian and, to a certain extent, Spanish markets demand high-quality yellowfin tuna in olive oil, distinct from the Northern European market, which typically demands lower-quality canned skipjack tuna in brine or vegetable oil. As the majority of Solomon Islands' tuna is sold to Italian canneries and then on the local market, SolTuna product could have certain advantages of quality. However, both local industry experts and international tuna buyers agreed that there would be limited room for manoeuvre on the price, regardless of the higher-quality product on offer, which would not make up for the 24 per cent duty rate that Solomon Islands' tuna would incur upon graduation.

In addition to product characteristics, it is worth noting the potential value addition opportunities highlighted by NFD and SolTuna. NFD has recently started exporting sashimi tuna that has undergone ULT freezing to Japan. Although sashimi tuna is of a much higher quality than the processed loins exported to the EU, it is not considered a "high-grade" product in Japan. NFD is hoping to own its own longline fleet to further tap into this market, and there is reportedly potential to expand this to the Chinese market, although the room for growth in China has frustrated many sashimi grade suppliers (Campling et al., 2017). Despite NFD's intentions, the growth potential in this value addition activity is restricted. The main suppliers of sashimi ULT products to Japan are Korea and China, using their large and subsidised fleets. Furthermore, there are only three or four major buyers of the product in Japan, which makes it a very difficult market to tap into. Coupled with the high energy costs involved in ULT processing facilities and distribution (e.g. ULT containers), it seems unlikely that the sashimi market will ever offer Solomon Islands' tuna a replacement for the EU processed loins market, especially in terms of the employment generated.

SolTuna intends to diversify its product selection beyond processed loins, and 2017 saw the first export of canned tuna to the US and UK markets, the latter branded under the name Reel Fish. SolTuna has reported that these have been well received and, given the price premium that these cans attract, there is potential for further increasing the proportion of canning to loining as consumers pay closer attention to the source of their food to support local sustainable production.

There are additional opportunities in the New Zealand market, where SolTuna is hoping to sell own branded tuna with a focus on the "Solomon Islands tuna story" as a

way to attract the more socially conscious consumer who may be more willing to pay a premium for a product that is sustainably caught and supports responsible fishing and labour practices. SolTuna is hoping to work with Pacific Trade and Invest to support initiatives in New Zealand such as trade fairs and other marketing activities to increase brand exposure. There is also potential to expand SolTuna-branded cans to the UK market.

To adjust to the increase in canning operations, SolTuna has reconfigured its whole processing layout in Noro, to increase throughput. At present, the plant operates at a maximum of 120 tonnes a day and 110 tonnes on average. New equipment should increase the maximum capacity to 150 tonnes a day, with an average of 135 tonnes. The additional capacity would likely shift to the canning side of the plant, to supply the potential new markets in New Zealand and the UK.

An additional value addition opportunity is in fair trade, as well as the MSC certification in the purse seine and eventually in the longline industry. As consumers become more conscious of where products originate and the labour practices around their production, fair trade certification could create additional value addition opportunities for SolTuna and NFD, as well as ensuring local fishers receive a fair wage. FFA is currently considering initiatives with regard to the application of labour terms and conditions to all boats licensed in the Pacific, in addition to the monitoring and tracking devices that are required to obtain licences under the PNA system. This initiative is intended to ensure that labour is not squeezed following any price increases and could provide the market advantage to target more socially conscious consumers.

Growth in the domestic and regional canning markets could further contribute towards offsetting the increased trade costs through loss of tariff preferences. SolTuna has captured almost 100 per cent of the local market and, according to local industry, the domestic market is still growing. Across the region, SolTuna is highly regarded; growth in Vanuatu, for example, could provide opportunities to expand.

Nevertheless, opportunities in the canning sector, although greater than in previous years, require far greater volume requirements, which SolTuna will be unable to meet. Furthermore, the domestic and regional canning markets will be unable to compensate for the loss of the EU market. In spite of these diversification and value addition initiatives, it is unlikely that there will be a massive shift towards canning and away from processing loins. As such, the EU market will remain the most important market for Solomon Islands tuna products. Despite the country offering higher-quality tuna, local industry and FFA made clear that the loss of tariff preferences will lead to a cost increase that would be too large for buyers to be willing to absorb and alternative products and markets that would be unable to make up the revenue shortfall.

3.4.5 Local private sector perspective

The companies involved in tuna fishing and processing in Solomon Islands are acutely aware of the tariff preferences in processed loins on offer through the EU market,

given the centrality of this access to their business models. These are considerably more important than the preferences on offer by other nations, given the size of the EU tuna market. The local industry is sufficiently concerned about the loss of tariff preferences that would arise through LDC graduation if the IEPA is not signed or GSP+ acceded to.

SolTuna made clear that, should preferences to the EU market be lost, although the diversification and energy-saving initiatives underway have the potential to generate sizeable returns, loss of EU market access would close down its operations, as it would be unable to absorb the cost increase given the small and very costly nature of processing operations in Solomon Islands. Most, if not all, of the 2,000 plus workers would lose their jobs and the knock-on effect across the local economy of Noro would lead to the closure of those services reliant on the processing plant, compounding the negative impact by increasing unemployment further. Government revenues would also take a severe negative hit, at a time when they can ill afford to. SolTuna reiterated that the domestic market would be unable to fill the gap and, without the loining, it would be unable to produce sufficient canned product for the local market, known as dark flakes.[11] Solomon Blue, as the dark flakes are known, is a staple diet in the Solomon Islands, and an important source of food security in times of natural disasters, which hit the islands regularly. Without a domestic supply of tuna, local consumers would need to import tuna from across the region, which is likely to be of higher in price. The end result could be an increase in food insecurity.

SolTuna also predicted that TMI would be unable to absorb the cost further up the supply chain, despite its vertically integrated nature, and would pull out of Solomon Islands, given the general expense involved in processing operations and its ability to source the product far more cheaply elsewhere. This is supported by the responses from the buyers' survey detailed in Section 3.4.6. For the fishers, not only would NFD face a significant reduction in demand for its tuna catch but also the additional services provided, such as haulage, transport and stevedoring, would all disappear with the loss of preferences. The highly integrated nature of the supply chain means both companies are highly reliant on each other. The knock-on impacts on employment would be considerable, for those directly related to the industry activities as well as those in service provision in and around the plant.

3.4.6 International buyers' perspective

In an effort to develop an outsiders' view of the commercial prospects of export-oriented tuna processing in the Solomon Islands, we undertook a survey of buyers. This was administered to all of the world's leading canned tuna companies, both branded firms and major non-branded processors. The five responses that we received provide a number of important insights on the types of pressures buyers themselves are under, their perspectives on Solomon Islands as a location of tuna processing, including in relation to competitors, and their views on the commercial viability of Solomon Islands.

The design of the survey drew in part on the Comparator Questionnaire for Multinational Firms in Keane (2018), with several tuna industry-specific questions

incorporated. The survey was administered online and was followed up with telephone interviews and/or email correspondence. The respondents included two of the world's leading canned tuna branded-processors, and three major non-branded processors/traders. All of whom have direct experience with investments in the Pacific Island Countries, including the Solomon Islands, and as such benefit from local-contextual as well as global insights.

It is worth reiterating that SolTuna is the sole tuna processor in the Solomon Islands currently utilising the EBA preference. The firm exports canned tuna, mainly within the sub-region but also, in early 2018, to the UK, under the Reel Fish brand, but this activity is *dependent* on its main business, which is the contract processing for frozen tuna loins for TMI. SolTuna loins are predominantly used for canning in Italy for the Italian market. Tuna loins are an intermediate product procured by canneries, generally in higher-cost locations such as the EU, the USA and Japan, but also by Thailand and American Samoa (Campling et al., 2007; Campling, 2015). In short, loining companies like SolTuna are price-takers.

All buyers agreed that the principal **overall strengths and opportunities** of SolTuna were 1) duty-free access to the EU and 2) Solomon Islands' position in the WCPO purse seine fishing ground and the relative abundance of tuna stocks in the area. In fact, across 11 questions comparing the Solomon Islands with buyers' other suppliers, the sole factor where it was perceived as "better" was "access to tuna fisheries". (In relation to all other factors, Solomon Islands was ranked "worse" or "the same".)[12] Connected, access to a relatively steady supply of yellowfin tuna is an advantage because it is in high demand in the Italian market, which SolTuna supplies, as well as Spain, throughout the year. Loining plants that process only skipjack are at a disadvantage to those that can offer yellowfin loins too, but demand for yellowfin is low compared with skipjack. However, as in all industrial yellowfin tuna fisheries, continuity of supply is an issue, at least compared with skipjack, which tends to be caught all year round.

Other strengths noted by buyers were that SolTuna is recognised as producing a good-quality product. TMI is widely seen in the global tuna industry as a supplier of high-quality product with good control of the supply chain. It has worked closely with SolTuna on this issue, including recruiting and assigning permanent staff and consultants to maximise SolTuna's quality standards and the provision of on-going training programmes for all of its workers on quality, safety and social programmes such as financial literacy. These types of support were noted by buyers as being common interventions among their suppliers in other countries too, especially on techniques and operational processes for the cleaning of fish to improve yield and quality. In the case of SolTuna, because of its long history in Solomon Islands, it has a relatively productive and experienced workforce, including management, although, as discussed above, it does suffer from high rates of absenteeism.

Connected, it was recognised that SolTuna had the advantage of being integrated with the supply chain of Bolton Group-TMI. Unlike most canned tuna firms, Bolton-TMI is unique because it is completely vertically integrated, from fishing vessels to retail brands. This provides access to crucial marketing support from related companies

within the Group. It also means that SolTuna has access to working capital and operational support from TMI. TMI was crucial in getting MSC certification for the Solomon Islands skipjack and yellowfin tuna purse seine and pole and line fisheries. Buyers also noted the very strong local canned tuna brand, which is widely known in the Pacific Islands region, and is currently exported to Australia too.

All buyers agreed that the overall weaknesses and challenges were to do with the Solomon Islands' economy overall. This includes the high costs of doing business owing to remoteness, a lack of economies of scale, weak infrastructure and logistics capabilities and the face that all non-fish inputs into processing are imported. Government bureaucracy was noted as challenging for both current and potential investors. As already noted in Section 3.4.4, government procedures related to EU shipments are seen as slow, which can result in delays and problems with shipments. All of these factors combine to produce a higher cost structure compared with competitors, especially in China and Indonesia.

Buyers also noted the relatively low volume of output compared with competing loin producers as an important issue specific to SolTuna. The expansion of production has been noted as a potential here – that is, to meet buyer demands for volume and consistency of supply and to achieve better economies of scale. However, it was suggested that the costs of expansion for the Noro plant were high. It would require investment in a wide range of physical and social infrastructure, such as the unloading wharf, cold storage, power, water, logistics and, crucially, labour. This degree of investment is necessary because, even if the plant were expanded, it is not automatic that more fish would be landed for processing. This is because wharf space determines the number of vessels that can call to unload fish at one time. Further, given that each purse seine vessel expects to unload at least 250-300 metric tonnes per day, having two boats at the same time would mean that the plant would need to take 500-600 metric tonnes per day, and, if turnaround time were less than this, vessel owners would not want to sell to the plant.

Buyers compared SolTuna with companies based in several other countries, including China, Colombia, Ecuador, PNG, Indonesia, Thailand and Vietnam. For each of the five indicators of supplier performance, SolTuna was ranked less highly than the buyers' comparator suppliers (Table 3.1). By design, tuna loins are a highly standardised product and, as such, new demands tend to be minimal – but if they *are* required it introduces a degree of risk (e.g. the potential for mistakes to be made).

It is worth considering buyers' views on **ocean-going freight** in a little more depth as it is a competitive disadvantage, both identified directly and implied indirectly within the "weak" and "average" relative rankings in Table 3.1 (especially price, response time and punctual delivery). On a per tonne basis, a refrigerated (reefer) container from Solomon Islands to Europe costs around US$260, while from China, Thailand and Vietnam it is $70–80. For East and Southeast Asian producers, sitting on the East-West sea-freight "superhighway" and being in or close to port-based logistics hubs is a direct benefit; for PICs, it is an outcome of being dependent on infrequent, feeder routes. To get a further sense of the very high cost of freight from Solomon Islands and comparable countries (Fiji and PNG), Table 3.2 compares freight rates for

Table 3.1 Tuna buyers' perceptions of SolTuna compared with competitors

Indicator	Very weak	Weak	Average	Strong	Very strong
Regular and reliable product quality		1	3		
Price		1	3		
Response time		1	3		
Punctual delivery		2	2		
Responding to new demands		4			

Note: One of the five respondents did not complete this section of the survey.

a full refrigerated container of frozen loins to two alternative markets – Thailand and American Samoa. The data indicate two trends. First, they reiterate the cheapening effect on freight of the huge volumes associated with the main East-West route, even for intra-regional trade in Southeast Asia. Second, they show the costs of sending loins to and from isolated Pacific Islands, as outward cargo from Fiji, PNG and Solomon Islands is very high (although Fiji benefits from its position as a regional hub), and inward cargo to American Samoa is similarly high for all countries.

The issue here is not just freight prices but also the length of supply lines, which has negative implications for reliability and response times, and the costs of maintaining higher inventory. The long supply chain to Europe is a roughly 60-day transit, plus production and storage time, which means that SolTuna's buyer needs to keep buffer stocks in Europe. Until recent years, TMI addressed the lack of freight to Noro by loading loins on its own carriers to Bangkok, where they were shifted into refrigerated containers and loaded onto a container liner. Since then, TMI has invested in container handling facilities at Noro and used this to attract Maersk line to operate a regular feeder service to and from Noro. This has served to reduce cost, vastly improved shipping efficiencies and allayed EU concerns around preservation of the cold chain. This suggests two things. First, big firms like TMI with its parent Bolton have relative leverage by way of their high volume of freight purchasing, which makes negotiation

Table 3.2 Freight cost Comparison for 40 foot refrigerated containers of frozen loins (US$/container)

	Lae, PNG	Noro, Solomon Islands	Suva, Fiji	Bangkok, Thailand	Jakarta, Indonesia	General Santos, Philippines	Ho Chi Minh City, Vietnam
Bangkok, Thailand	5,200	4,800	4,000	N/A	1,450	2,950	800
Pago Pago, American Samoa	5,000	5,500	3,700	6,000	6,000	6,200	6,250

Source: Campling (2015) citing rates from major shipping lines and freight forwarders – various, April 2015.

possible. Second, SolTuna is vulnerable to shifts in Maersk's business strategy. TMI is reportedly currently investing more to make Noro a container transhipment hub, which would help solidify against the second issue.

All five buyers agreed that **tariff preferences are essential** to tuna processing in small island economies in general and to Solomon Islands in particular. It is worth reporting verbatim buyers' views on this issue:

- "Losing duty free access would likely result in closure of the factory."
- "For a commodity like tuna, duty can be a big cost and [the tariff preference] plays a big role in buyers' decision-making."
- "Solomon Islands needs this [duty-free access to the EU] to compensate for its higher costs of operation. It will never become competitive with its scale of processing volume."
- "Duty is an important consideration in sourcing loins and canned tuna. Buyers are interested in the duty-paid cost of the loins or canned tuna. The duty on loins and canned tuna for the EU is generally 24 per cent. If buyers have to pay 24 per cent on the imports of tuna loins or canned tuna from Solomon Islands, they wouldn't source from Solomon Islands. It's as simple as that."
- "SolTuna is built on the EU export market. It would have to close in the absence of the EU preference. The loss of LDC/EBA would be a disaster for Solomons. The EU market is the lynch pin of tuna processing in Solomons. Yes – there is a local and regional market for canned tuna, but it is also very competitive, and SolTuna couldn't operate viably as a local canner only."
- "Solomons needs the duty-free privileges in order to offset its higher costs of conversion, supplies and logistics."

The view on the issue of a lost preference for export-oriented tuna processing in Solomon Islands is unequivocal. Buyers also noted the parallel impact of preference erosion, specifically in relation to the increasing numbers of FTAs signed by the EU with competing exports of tuna products and the increasing volume of the EU Single Duty Loins Quota noted in Section 3.4.2.

The general consensus on the possibility of other incentives or investments to **offset the cost** advantage to SolTuna should it lose duty-free access to the EU was pessimistic. Any such intervention was seen as unlikely to offer sufficient competitiveness because of the current high operating costs. Two elements were noted:

1. An elimination or substantial reduction in VDS fees if the fish were to be processed for export domestically. "If the government is to shoulder some of the losses by reducing the VDS costs and other benefits, companies might be interest to have a processing plant there." But buyers explicitly disagreed on the potential of this.
2. A direct processing subsidy, such as PNG's recent rebate scheme allocating US$400 for every metric tonne of tuna processed locally caught in PNG waters

(see Havice et al., 2017). This was developed precisely in response to the documented failure of subsidised access to ensure onshore investment at full capacity (i.e., even if a plant was built in return for heavily discounted licences, it would send fish caught by its boats to be processed in other countries).

Both options place very significant demands on the already fiscally squeezed Solomon Islands government and as such would not appear to be viable options. Further, it is worth reiterating that tuna loining and canning is a brutally competitive global industry based on high volumes and small margins. SolTuna rarely records a profit and is vulnerable to rising energy costs. The company would not be able to absorb the cost of duty loss. At the same time, tuna buyers procure from numerous suppliers and SolTuna supplies a relatively small part of global demand: as such, it would not be difficult to substitute its supply of loins with that from competing processors. Given that the big end buyers – brands and supermarkets – are *primarily* price-focused (and *secondarily* concerned about factors such as sustainability), they look for the least expensive products that meet their quality standards.

In relation to the potential of SolTuna to produce a greater volume of canned tuna, it would be necessary for it to command a high price premium, which MSC certification does not often provide, and the issues to do with the reliability of shipments would need careful working out. Given the current situation, buyers of loins hold inventory in cold stores and defrost for packing into cans when required. Should SolTuna switch to canned tuna production, it would need to hold inventory in Europe as a buffer stock (which incurs cost) to avoid the risk of an interruption to supply (which is most costly). As such, without close collaboration with a seller of canned tuna, SolTuna would be likely to face difficulties.[13]

Despite the benefit of the EU preference, EU GSP **ROO** were recognised as a constraint. (Note that the same rules apply to EBA as to GSP+, should Solomon Islands government decide to apply to this scheme.) EU ROO mean that the raw material supply for SolTuna's exports to the EU are limited, except for those fish that are caught in national archipelagic waters and those caught by its own flagged vessels – the NFD fleet. It is also worth noting that some respondents recognised that leading tuna buyers – branded firms and supermarket buyers – capture revenue gains from tariff preferences through rigid bargaining. As one industry representative put it, buyers are "able to shift the advantage to them by creating cut throat competition between and among suppliers".

There was some ambivalence around the potential of "global sourcing" ROO should Solomon Islands choose to sign the Pacific IEPA. Buyers did not agree that it would change raw material supply dynamics in the region. Some thought it would improve supply available to SolTuna; others noted existing constraints such as the need to increase the fish unloading rate. All agreed that signing the IEPA would *not* change their thinking of Solomon Islands' competitiveness as a tuna processor, not unless large-scale investment was forthcoming. But, somewhat contradictorily, three buyers noted that it *might* change their thinking on investing in tuna processing in Solomon Islands.

The view of buyers on the relationship between **the price-driven and quality-driven** aspects of the trade in frozen tuna loins was unanimous. Quality is a given: there is no market for bad loins. There is some differentiation in product type between single-, double- or triple=cleaned loins, depending on buyers' requirements, and the price is higher for greater levels of cleaning. Some brands – and even national markets, such as Italy – are known for high quality, whereas others compete entirely on price (and thus require only single-cleaned loins). In short, all buyers agreed that the supplier that could meet buyer specifications and delivery times at the lowest price would always win the orders.

3.4.7 Impact of lost tariff preferences on the competitiveness of the Solomon Islands tuna industry

Based on the stakeholder interviews in the domestic tuna fishing, processing and canning industry and the perspective sought from international buyers, a loss of tariff preferences to the EU market through LDC graduation, provided that no other arrangement were put in place, such as the IEPA or GSP+, would result in the closure of SolTuna and a significant scale-back of NFD operations. The cost incurred is deemed too great for both local firms and international buyers to absorb, primarily because of the higher costs of production in Solomon Islands compared with for competitors in Southeast Asia and the Indian Ocean.

3.5 Financial support and LDC graduation

Solomon Islands has a significant task ahead of it to prepare for LDC graduation. Securing additional financial support is imperative to mitigate some of the costs involved. It received US$41.9m of Aid for Trade support in 2015, an increase of approximately $39 million on 2002. Almost 50 per cent of this support is channelled into transport and storage. Further improvements to the infrastructure necessary to improve trade facilitation are vital. The recent upgrade and expansion to Honiara Port has likely reduced the wait time for shipping container vessels; however, further investment is needed in storage solutions at the wharf, to store goods waiting to be cleared, and infrastructure related to customs administration, such as implementation of the Single Window. Whether Solomon Islands will be able to tap into traditional aid funding channels following graduation is an important consideration. If the funding available reduces, Solomon Islands will need to identify private sector financing mechanisms to plug the gap.

At the time of writing, Solomon Islands had not yet ratified the Trade Facilitation Agreement (TFA). As an LDC, Solomon Islands is eligible for special and differential treatment to enable it to comply with the provisions of the Agreement, which includes additional time and technical assistance. To ensure Solomon Islands is able to access this support, particularly for transport, storage and related trade infrastructure, the TFA should be ratified imminently.

As a LDC, Solomon Islands has been receiving support under the World Trade Organization's (WTO's) Enhanced Integrated Framework (EIF) facility since 2007. To date, support has focused on the agriculture and tourism sectors, recognised as

potential drivers of economic diversification. Solomon Islands prepared a Diagnostic Trade Integration Study (DTIS) in 2009, which is set to be updated shortly. Support through Tier 1 of EIF will end in September 2018 and the government has since applied for a phase 2. This has been approved but no funds have been dispersed. It is widely recognised that EIF support to Solomon Islands has created real opportunity but progress has been slow, with many activities yet to be implemented. The recent approval of the Tier 2 agriculture project targeting cassava and taro production for export will help local producers tackle the significant SPS issues faced when exporting to the Australian and New Zealand markets, but it may take some time to reap the benefits.

As Solomon Islands prepares for LDC graduation, this will have impacts on its ability to access support, which is technically not available for non-LDC countries. However, given that a number of current EIF beneficiaries will be graduating over the next five years, the EIF has recognised the need to ensure support does not stop abruptly, and that a transition period is agreed. Cabo Verde, Maldives and Samoa are all EIF beneficiaries that have transition periods, agreed through an informal decision or understanding with the EIF during their transition from LDC status. The EIF Board has since reached the decision that all LDCs graduating in the future can continue to access EIF benefits for five years following graduation, which includes access to Tier 2 funding, and it will consider whether after this five-year limit they can continue to benefit from some capacity-building activities (e.g. participating in regional workshops). In addition to the transitional support, graduating counties are entitled to funding for feasibility studies used to seek support directly from development partners.

Samoa in particular undertook significant preparation for LDC graduation, which Solomon Islands could replicate. Although not all of the preparatory work was initiated through the EIF, EIF support was harnessed effectively – such as by aligning the DTIS update with requirements for LDC graduation. As Solomon Islands approaches graduation, it should ensure the continuity of EIF support to undertake the necessary preparations and identify opportunities to promote export diversification.

3.6 Alternative mechanisms to mitigate competitiveness challenges

There are a number of ways Solomon Islands can confront the competitiveness challenges of LDC graduation. The EU offers a transition period of three years for countries graduating from LDC status, during which time they may access the EU market under EBA arrangements. It should be possible for Solomon Islands to request an extension, which requires the government to submit a request to the EU, well in advance of graduation, outlining the need for a transition period to ensure adequate preparations are in place. Furthermore, the government can utilise its network of current and potential trade agreements to mitigate the costs of graduation. It is imperative that the country explore how its trade policy and the resulting trade agreements it chooses to sign – and, importantly, the extent of the development support it receives through these agreements – will reduce the level of vulnerability.

This section reviews the trade agreements in place or under negotiation that Solomon Islands should consider in LDC graduation preparation.

Solomon Islands has signed the Melanesian Spearhead Group Trade Agreement (MSGTA), the Pacific Island Countries Trade Agreement (PICTA), the Pacific Agreement on Closer Economic Relations (PACER) and its successor, PACER Plus. Despite this prevalence of trade agreements, implementation is limited, given the considerable supply-side capacity constraints faced in the economy. There is an increasing emphasis on the need to go beyond traditional trade agreements and ensure the intractable constraints facing the economy are being addressed through sufficient means, including development cooperation and support to address key SPS and technical barrier to trade issues that have so far prevented the economy from utilising the preferential access to its key markets.

3.6.1 Interim Economic Partnership Agreement (IEPA)

Solomon Islands has the option of acceding to the EU-IEPA, for which the government is currently undertaking preparations. The network of interim and comprehensive economic partnership agreements (EPAs) between the EU and African, Caribbean and Pacific (ACP) states enables developing countries in the ACP regions, particularly those that have graduated from LDC status, to retain preferential market access to the EU market on a reciprocal basis. In the Pacific, Fiji and PNA have signed an IEPA with the EU in order to retain access to the latter's market for sugar and tuna, respectively. The IEPA offers Solomon Islands a way to retain preferential access for processed fish and fish products but crucially grants more flexible ROO through global sourcing. Global sourcing relaxes the originating rules, enabling tuna that has been processed onshore in Solomon Islands to qualify for DFQF entry to the EU regardless of the vessels' flag and ownership, subject to that vessel complying with SPS and IUU regulations. This will increase the availability of qualifying raw material, reduce fluctuations and smooth out the supply of tuna to the loining plant, which can then be exported to the EU market. There are wider considerations at play for Solomon Islands in its decision to accede to the IEPA, such as the revenue implications and reduced policy space, but certainly the benefits to the tuna industry are well understood.

The inclusion of the ROO derogation in the IEPA was initially anticipated to have a positive developmental impact on beneficiary countries. Hamilton et al. (2011b) look at this issue for the PNG economy in an attempt to identify what impact, if any, this derogation had on long-term income and employment generation and whether it had led to effective conservation and sustainable management of fishing resources, including compliance with SPS and IUU regulations. The study found that the impact of global sourcing on the development of the PNG economy had been negligible since 2008, mainly because existing canners had not taken advantage of the derogation. Additional investments are planned that will likely take up the derogation, following which the developmental impacts can be assessed. In addition, the derogation could contribute to improved working conditions for employees in the processing and canning industry. Greater investments will lead to increased demand for labour and,

in trying to attract labour, plants may be more likely to offer favourable working conditions as well as additional benefits. The opportunity for wider indirect benefits is also possible, although this will require coordination not just between firms in the industry but also across national and provincial governments (ibid.).

It is worth noting that global sourcing has created a considerable source of tension among the canning EU member states, such as Italy and Spain. The EU industry fears, although these fears have not yet played out, that IEPA signatories could become a platform for Southeast Asian firms wanting to bypass the MFN duty rate of 24 per cent. Should this occur, this would likely erode the commercial logic of the EU's presence in WCPO, with the logic of the preference collapsing with it, given that it no longer supports an EU industry. The end result could be that the tariff is liberalised across the board, eroding completely the preference margin offered to countries trading under the EU's preference schemes (Hamilton et al., 2011a). The mandatory three-year review periods as part of the IEPA may lead to the conclusion that global sourcing rules be removed – an important consideration for Solomon Islands' authorities to factor into their decision-making.

Domestically, both SolTuna and NFD stressed that the IEPA would deliver significant benefits for their production processes through global sourcing, which should help level out supply and increase the amount of tuna available for processing.

3.6.2 Pacific Agreement on Closer Economic Relations Plus (PACER Plus)

In June 2017, Solomon Islands signed the PACER Plus trade agreement between Australia, New Zealand and nine PICs. Compared with the IEPA, PACER Plus is a comprehensive FTA covering services, investment and development cooperation. Solomon Islands is eligible to receive support from Australia and New Zealand both prior to and following ratification through the Readiness Package and the Work Programme. The Readiness Package covers support to update customs procedures (implement HS2017), mitigate revenue loss as a result of liberalisation, update legislation and raise awareness of the agreement. Activities under the Work Programme will target supply-side capacity and export diversification, as well as tackling some of the primary issues that have prevented Solomon Islands from accessing the Australian and New Zealand markets thus far.

Included in both FTAs, however, is a MFN clause that states that, if a party to either agreement enters into an FTA with a third party (that is either a developed or a large developing country), access that is more favourable must also be given to the other party. Under PACER Plus, Solomon Islands has offered greater market access than that offered as part of the IEPA – 85 per cent product coverage compared with 80 per cent under the IEPA. However, PACER Plus offers a longer transition period, up to 25 years following graduation from LDC status, or 2027, whichever is later. If PACER Plus is signed first, the shorter transition period offered to the EU on signing the IEPA will also have to be given to the PACER Plus parties. Likewise, if the IEPA is signed first, the greater product coverage should be given to the EU once PACER Plus is signed. Timing is, therefore, crucial, and the government will need to

decide between offering the EU more product coverage and potentially reducing the transition period on select imports from PACER Plus parties.

Mitigating the challenges associated with small island developing states requires a careful balancing act between trade liberalisation and effective government policy to ensure sufficient economic diversification to reduce associated economic vulnerabilities. Participation in international trade through signing of FTAs has the potential to help stem the cost impacts of LDC graduation, particularly in the EU case as evidenced here, but commitment on the part of the government and development partners is required to support the private sector to access third country markets and enable the economy to cope with the wider ramifications of graduation.

3.6.3 Special Incentive Arrangement for Sustainable Development and Good Governance (GSP+)

Should Solomon Islands wish not to enter into a trade agreement with the EU but to maintain current levels of access to the EU market on graduation, it should prepare for accession to the EU's GSP+. The GSP+ scheme provides an alternative avenue for Solomon Islands to retain duty-free access to the EU market provided that it ratifies a number of international treaties on human rights, and others. It may be possible for the government of Solomon Islands to request legal assistance to transition from EBA to GSP+, to help ratify the outstanding treaties required to qualify for this preference scheme.

Our analysis suggests that Solomon Islands has already ratified a number of the treaties required to join GSP+. However, it still needs to ratify some specific GSP+ treaties, notably[14] the International Covenant on Civil and Political Rights (1966) and the Convention Against Torture and other Cruel, Inhuman or Degrading Treatment or Punishment (1984).

The GSP+ regulations require continuous monitoring of beneficiaries' obligations, to ensure the country is abiding by its commitments to maintain ratification of the international conventions covered by GSP+, and that they are effectively implemented and reporting requirements are complied with. Importantly, beneficiary countries must accept regular monitoring and cooperate with the European Commission to provide all necessary information.

Ratification of the 27 international conventions is the first step and precondition for countries to become eligible for GSP+. Subsequently, the EU is ready to guide the eligible country through the process of GSP+ application. Once a country has submitted an official application, the Commission has six months to take a (positive or negative) decision. There is no option to delay that decision (e.g. if the application is not complete), so it is strongly advised that countries informally discuss their application with the Commission before the official submission.

Based on correspondence with the Commission, it takes around another two to four months for the Council and the Parliament to give their assent to the decision. Once the country has become a GSP+ beneficiary, it is subject to an on-going monitoring process to ensure it maintains its obligations under GSP+ (this is a process that can

be demanding in terms of administrative capacity of a country). The EU makes an effort to fund projects in targeted GSP+ beneficiaries, for example implemented by the International Labour Organization to support effective implementation of the latter's conventions.

It is important to note that the EC's current GSP Regulation[15] will apply until 2023. Thereafter, a new GSP Regulation will apply. In view of the likely graduation trajectory of Solomon Islands, whereby graduation from LDC status will effectively begin in 2021, it is recommended that the process of informally discussing the application for GSP+ with the Commission begin now. Even if a transitional arrangement whereby EBA market access is granted for an extension of three years post-graduation from LDC status, securing GSP+ membership before 2021 would provide an assurance that market access will remain post-graduation, because Solomon Islands has upgraded to a new preferential trade regime with the EU, built on its achievements related to economic, social and environmental progress (as indicated by its ratification of the GSP+ conventions).

3.7 Additional considerations of LDC graduation

3.7.1 Services waiver

The services waiver for LDCs allows WTO members to grant preferential treatment for services and service suppliers from LDCs. In order to take advantage of the waiver, a country must submit a notification that specifies the preferential treatment, the sectors concerned and the timeframe for the preferences. Despite some efforts to encourage LDCs to utilise the waiver, there has been limited take-up across the board.

Solomon Islands has yet to submit any notifications, or consider the potential impacts the waiver may generate for the domestic economy. Loss of access to the waiver as a result of LDC graduation is therefore uncertain, but it removes a potential channel Solomon Islands can explore in expanding its services sector, which is integral to boosting economic diversification. The opportunity costs of the loss of the services waiver and interaction with the maritime sector deserve more careful attention and analysis.

3.7.2 Intellectual property

The Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), which came into effect on 1 January 1995, is to date the most comprehensive multilateral agreement on intellectual property. The areas of intellectual property that it covers include copyright and related rights, trademarks, geographical indications and industrial design, among others. The three main features of the TRIPS are standards of protection to be provided by each member; enforcement of general principles applicable to all intellectual property rights enforcement procedures; and dispute settlement.

WTO members recognise that LDCs need continuing technical and financial cooperation in order to realise the cultural, social, technological and other

development objectives of the intellectual property system. LDCs are provided with maximum flexibility in implementing laws and regulations in the domestic economy, with the objective of enabling them to create a sound and viable technological base.

Solomon Islands is currently drafting an Intellectual Property Strategy, which has yet to be written into legislation. It is also considering becoming a member of the World Intellectual Property Organization in order to receive related technical assistance to improve legislation, but as of yet this has not happened. The impact of LDC graduation has not been fully explored or analysed from an intellectual property perspective by the government, so it is unclear to what extent the loss of support will have. However, there will be much greater pressure on Solomon Islands to comply with the provisions of the agreement and with far less technical and financial support to do so.

3.8 Conclusion

The recommendation of Solomon Islands for graduation from LDC status merits recognition of the progress the country has made in the face of considerable adversity, given the challenges of geography, size and reliance on highly vulnerable primary commodities. As the country is forced to shift away from exports of round logs, it must identify the sectors with the greatest potential to deliver substantial growth, contribute to employment generation and diversify the economy's export base. Tuna offers one such channel through which these goals can be achieved, provided that the government can proactively support the industry and ensure the right conditions are in place to allow it to grow sustainably.

Loss of tariff preferences to the EU market through graduation, without the security of continued access of Solomon Islands' tuna products through FTAs or participation in GSP+, would likely result in the closure of the domestic fishing industry, loss of the largest employer, and removal of a major source of protein nutrition in the country. There could be severe economic ramifications. To avoid this scenario, the government must prepare the country for graduation and ensure that access to the EU market for Solomon Islands' tuna is retained following a likely transition period.

At the current time, the main issue seems to relate to sequencing. While an intention has been signalled to ratify the IEPA, within the interim period and ahead of LDC graduation by 2021 on the current trajectory, it would seem most fortuitous to proceed to secure GSP+ ahead of 2021. Conversations with the European Commission could begin now, to signal the intention to upgrade to GSP+ while preparations for the IEPA continue. Politically, this movement signals progress on social and environmental indicators, along with the economic progress as indicated by graduation from LDC status.

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Notes

* This case study has been prepared by Dr Liam Campling, Queen Mary University of London, and Ms Victoria Allard, Economic Adviser, Department for International Development. The views expressed are those of the authors and not the Commonwealth Secretariat.

1 The mission began in 2003 and formally ended in June 2017. Although there is still an international police presence (Australia and New Zealand) in Solomon Islands, this is significantly smaller than in previous years.

2 https://www.ffa.int/node/2050

3 Data from Ministry of Finance and Treasury, Solomon Islands. Figures for 2017.

4 Domestically flagged and locally based foreign charters.

5 Data from Ministry of Finance and Treasury, Solomon Islands (source: UN Comtrade).

6 Ecuador represented 21 per cent and 28.2 per cent of total extra-EU imports of canned tuna, respectively, between 2013 and 2015.

7 UN Comtrade data, 2016.

8 Australian exports account for the largest share of imports into Solomon Islands; China is the largest recipient of Solomon Islands' exports.

9 Current levels are 20 per cent on Monday and Friday, 17 per cent on Tuesday and 16 per cent on Wednesday and Thursday.

10 Feedback from MFMR, Honiara.

11 Dark flakes are a by-product of loins and command a much lower price than premium product.

12 See Annex 3.3, Buyer Survey, Question 5.

13 It is worth briefly noting Solomon Taiyo's prior experiences in export-oriented production of canned tuna. Sainsbury's, the UK's leading supermarket in the 1980s and 1990s, purchased 70–80 per cent of Solomon Taiyo's canned product at relatively high prices because, at the time, the UK market price for canned tuna was relatively high compared with alternative markets and fish was caught using labour-intensive pole-and-liners (which Sainsbury's retailed at a premium because of the reduced environmental impacts). However, in the late 1990s, Sainsbury's put a price squeeze on first-tier suppliers of several of its own brand products, including canned tuna, as part of a bitter battle for share of the UK grocery market. As one industry insider exclaimed. "Sainsbury's always showed us a good price, but at the end of the day they didn't … US$34 per case became $21!" Price pressures generated through competition in the UK retail market had a devastating impact on Solomon Taiyo, which was already contending with the higher costs associated with production in small remote economies, despite its 24 per cent preference margin offered through EU trade policy. As a result, Solomon Taiyo was forced to "downgrade" into loin production (Havice and Campling, 2013).

14 See http://indicators.ohchr.org/

15 http://eur-lex.europa.eu/legal-content/en/ALL/?uri=CELEX%3A32012R0978

Annex 3.1 Interviewees

SolTuna – Adrian Wickham, Managing Director

NFD – Frank Wickham, Managing Director

British High Commission in Solomon Islands – HE David Ward, High Commissioner

MFAET – George Tuti (Director), Jenny Barile (Deputy Director), Natalia Patternot (Chief Trade Officer), Tracey Choko (Senior Trade Officer), Kevin Meplu (Senior Trade Officer), Nigel Sandy (Senior Trade Officer)

MDPAC – Nicola Kaua, Samuel Wara, Roy Mae, Shadrach Fanega, Darling Ramo

MFMR – Edward Honiwala, (Director Fisheries), Francis Tofuakalo (Deputy Director Offshore), Ronnelle Panda (Deputy Director, Principal Policy Planning Management), Rieka Kwalai

Ministry of Infrastructure Development – Jimmy Nuake (Permanent Secretary, acting)

Central Bank of Solomon Islands – Donald Kiriau (Acting Chief Manager, Economics Research and Statistics Department), Louisa Baragamu (Acting Manager, Economics Research and Statistics Department), Doreen Monogari (Debt Unit Analyst, Currency and Banking Department)

Ministry of Finance and Treasury – Courtney Cleary (Adviser), Margaret Leoa (Senior Policy Analyst) and Kevis Kimasaru (Senior Policy Analyst)

FFA – Leonard Rodwell (Fisheries Development Advisor), Peter Cusack (Regional Coordinator, Pacific Islands Regional Ocean scape programme), Mike Batty

World Bank and Asian Development Bank – Guido Rurangwa (Resident Representative, World Bank), Dalcy Tozaka (Senior Country Coordination Officer, Asian Development Bank)

Ministry of Foreign Affairs and Trade, New Zealand – Don Higgins, High Commissioner to Solomon Islands

EIF, WTO – Jonathan Werner, Country Coordinator for Samoa

TMI – Phil Roberts, Managing Director

Annex 3.2 Interview questions

Questions for NFD, SolTuna and FFA

Firm-level organisation:

1. Which are the main firms involved in the tuna industry in Solomon Islands? Which of these would you say is the most important and why? How much of the domestic and regional (if applicable) market does this firm capture?

2. What processing is carried out in Solomon Islands? What are the products that Solomon Islands firms produce? What are the inputs that go into the products and how much of these are imported?

Costs of production:

3. What are the main costs of production for SolTuna and other firms in Solomon Islands in the fisheries industry?

Markets:

4. Which tuna products are exported from Solomon Islands and where do the exports go?
5. Are these products transformed into other products, e.g. from cooked loins to canned tuna? In which countries are the consumers of the final goods located?
6. Who are the buyers of Solomon Islands tuna products? Are there different buyers for different products? Where and to whom do the buyers sell the products to?
7. Are Solomon Islands firms able to influence the price they can charge for their produce when selling to buyers, or do they take the price offered?

Value addition:

8. Where are Solomon Islands producers located along the tuna GVC? Do you think it is possible for Solomon Islands producers to upgrade along the value chain and move into higher value-added production? What might they do? Why do you see this as being an improvement?
9. If it is possible to upgrade, what do you think might influence that decision?

Trade preferences:

10. Are you aware of any tariff preferences? If so, which are used? Why are some not used, e.g. Japanese preferences? Do these matter for local firms?
11. How important is the EU market for Solomon Islands producers?
12. If it is important, how important is this tariff preference?
13. Are you aware that Solomon Islands might graduate from LDC status and potentially lose its tariff preferences to the EU market?
14. If so, has there been a consideration of the potential impact this might have for the Solomon Islands tuna industry? What are these? Do you think graduation will lead to downgrading risks for Solomon Islands' producers?
15. What course of action should SolTuna and other firms exporting to the EU from Solomon Islands take if they lost preferential access to the EU market?

Product differentiation:

16. Is Solomon Islands tuna different to tuna produced and sold in other parts of the Pacific? In other parts of the world? How, for example, does tuna from Solomon Islands compare with tuna from Ecuador, Seychelles or PNG?

17. Is Solomon Islands tuna able to be distinguished from that produced in other countries?
18. Do the strategies of regional competitors (PNG, Kiribati) have an impact on SolTuna's business model and exporting strategies? Are these countries the direct competitors for Solomon Islands or would it be other processors such as Ecuador, Thailand?

Effects of trade policy changes:

19. If the price of Solomon Islands tuna exported to the EU increased, would SolTuna and other local firms be able to absorb the cost? If so, how; and if not, why not?
20. If not, what would be the impact on the local economy, in terms of employment and government revenue? Would it have an impact on planned or potential investments, both by incumbent and potential firms in Solomon Islands?
21. Do you see a role for the government to mitigate indirect negative socio-economic impact of the loss of tariff preferences?

Additional challenges:

22. What are the additional challenges firms in Solomon Islands face in exporting, specifically to the EU market and also in general (capacity challenges, supply constraints, product testing, etc.)?
23. Would signing the IEPA be a positive step for the Solomon Islands tuna fishing industry? What would be the impact of signing the IEPA on the business models of local firms?

Questions for MFAET

1. Status of EPA and Trade Com support.
2. Aid for Trade package through the EPA – involvement of development partners.
3. Investment promotion in fisheries?
4. Status of PACER Plus – MFN clause contained in both agreements – has Solomon Islands analysed which to sign first?
    a. How could they leverage both agreements; what are the linkages between them?
    b. Look at the text and the market access offers
5. Has the government started preparations for LDC graduation; what is the process and is the government planning on seeking an extension or delaying graduation? Analysis of the impact?
6. What is the current status of the DTIS update and which sectors are highlighted as being of importance to the economy? Is there potential for diversification of exports in the economy and to what extent will the DTIS tackle the constraints faced?
7. Services waiver and the potential for Solomon Islands to take advantage of it.

8. Future trade agreements and the other development partners – Japan, Korea – what is Solomon Islands position on these?

Ministry of Finance and Treasury

1. What are the estimates of lost revenue as a result of LDC graduation from a trade perspective?
2. What is the process of tax reform in Solomon Islands?
3. Export data on fish exports.

Questions for MDPAC

1. What preparations have been done for LDC graduation; awareness of processes.
2. What are the implications on Aid for Trade commitments and receipts for Solomon Islands as a result of LDC graduation?
3. Revenue impacts of LDC graduation, competitiveness challenges, etc.?
4. Is there engagement with EIF to cover transition?
5. What alternative financing mechanisms are available for Solomon Islands once they have graduated?
6. Which ministry deals with the Global Environment Fund?

Questions for MFMR/FFA

1. Number of industrial scale tuna purse seine fishing vessels in WCPO and in Solomon Islands EEZ.
2. Size of the EU fleet and the number of EU vessels operating in WCPO; Solomon Islands EEZ specifically.
3. What is the contribution of the tuna industry to Solomon Islands GDP?
4. Confirm status of the additional investments and what these are contingent on?
5. Will the new processing plants come with requests for additional fishing licences?
6. What is the impact of IUU fishing in the region and is the government taking the necessary steps to ensure it does not get yellow carded again?

Questions for EIF

1. What support did EIF provide to Samoa during its transition phase from LDC status?
2. Would this support be available for Solomon Islands during its transition?
3. Did Samoa prepare another DTIS in preparation for LDC graduation and, if so, what was the focus of the report – diversification? Restructuring based around changing trade tariff preferences?

Annex 3.3 Buyer survey: Tuna-related impacts of Solomon Islands' graduation from LDC status

1. What is your title and principal role?
2. Are you aware of what SolTuna does?
3. What do you see as the strengths and weaknesses of this business?
    a. Strengths
    b. Weaknesses
4. Which countries are your main suppliers of tuna loins?
5. On a scale from 1 (much worse) to 5 (much better), if sourcing tuna loins from Solomon Islands, how does it feature compared to your main supplier?
    a. Volume
    b. Variety
    c. Price
    d. Reliability
    e. Access to tuna fisheries
    f. Productivity of labour
    g. Ease of doing business
    h. Infrastructure
    i. Compliance with import market government standards
    j. Freight costs
    k. Taxation
    l. Other (please specify)
6. *Who is the comparator supplier in Question 5?
7. On a scale from 1 (very weak) to 5 (very strong), how would you rank the supplier named in Question 6 in terms of the following indicators?
    a. Regular and reliable product quality
    b. Price
    c. Response time
    d. Punctual delivery
    e. Responding to new demands
    f. Other (please specify)

8. On a scale from 1 (very weak) to 5 (very strong), how would you rank Solomon Islands in terms of the following indicators?
    a. Regular and reliable product quality
    b. Price
    c. Response time
    d. Punctual delivery
    e. Responding to new demands
    f. Other (please specify)
9. In what aspects does the Solomon Islands need to improve most in the coming five years:
    a. Reliability
    b. Response time
    c. Quality
    d. Changes to orders
    e. Responding to new demands
    f. Other (please specify in following box)

    Please elaborate a little on your answer(s)
10. What is your view on the main challenges Solomon Islands is likely to face in the coming years?
11. Have you provided any assistance to suppliers in Solomon Islands in relation to the following?
    a. Achieving reliable quality, what/how:
    b. Upgrading technology, what/how:
    c. Speeding up response, what/how:
    d. Punctual delivery, what/how:
    e. Training for workers, what/how:
    f. Training for managers, what/how:
    g. Other (please specify):
12. Have you provided any assistance to tuna loin suppliers in relation to the following?
    a. Achieving reliable quality, what/how:
    b. Upgrading technology, what/how:

c. Speeding up response, what/how:

d. Punctual delivery, what/how:

e. Training for workers, what/how:

f. Training for managers, what/how:

g. Other (please specify):

13. Do tariff preferences matter to buyers of tuna loins and canned tuna? (Please explain why)

14. If you are aware of the rules of origin for fish required for Solomon Islands to export to the EU, do you see any commercial disadvantages in these rules?

15. If Solomon Islands signed an IEPA with the EU and gained access to "global sourcing" ROO that allow processors to use fish from any boat (subject to sanitary and IUU regulations), would this:

    a. Change raw material supply dynamics in the region?

    b. Change your thinking of Solomon Islands competitiveness as a tuna processor?

    c. Change your thinking on investing in processing in this country?

    d. Other (please specify)?

16. Who do you think captures the commercial benefit of EU tariff preferences in the tuna industry (please explain your answers, including any evidence that you are aware of)?

17. Can the cost advantage conveyed to the Solomon Islands by duty-free access to the EU market be offset through other incentives or investments? (If so, please briefly elaborate)

18. Can the cost of losing duty-free access to the EU market be absorbed by:

    a. Domestically based processors?

    b. Tuna trading companies?

    c. Companies controlling tuna brands?

    d. Other (please specify in following box)

    e. Please elaborate a little on your answer(s)

19. Could you explain your perspective on the relationship between the price-driven versus the quality-driven aspects of the trade in frozen tuna loins?

20. What is your view on the strategic advantage of access to yellowfin tuna for a tuna loining plant?

21. Could links to resource access mitigate the loss of Solomon Islands' current tariff advantage?

22. Overall, what are your main motivations in terms of sourcing from:
    a. Solomon Islands (if applicable):
    b. The supplier noted in Question 6:
    c. Other suppliers:
23. Do you have any other additional comments in relation to any of the above questions and responses?

The Commonwealth

The achievement of the 2030 Agenda and the Sustainable Development Goals (SDGs) hinges on progress made within the Least Developed Countries (LDCs). As Commonwealth LDCs begin to move out of the category, alternative support measures and new partnerships will be required to assist in a smooth, sustained, transition process.

Least Developed Country Transition focuses on two groups of Commonwealth LDCs: LDCs graduating in the near future and that exhibit the greatest economic vulnerability to a trade shock induced by graduation and loss of accompanying tariff preferences; and those that remain far from graduation but experience severe economic vulnerabilities and susceptibility to extreme environmental shocks. For both groups of Commonwealth LDCs, the objective of the research (based on case study analyses of Bangladesh, Mozambique and Solomon Islands) was to identify areas where international support measures could be improved in order to boost export diversification and therefore reduce economic vulnerability.

ISBN 978-1-84929-191-0

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