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The Rationale Behind Aid for Trade in SVEs

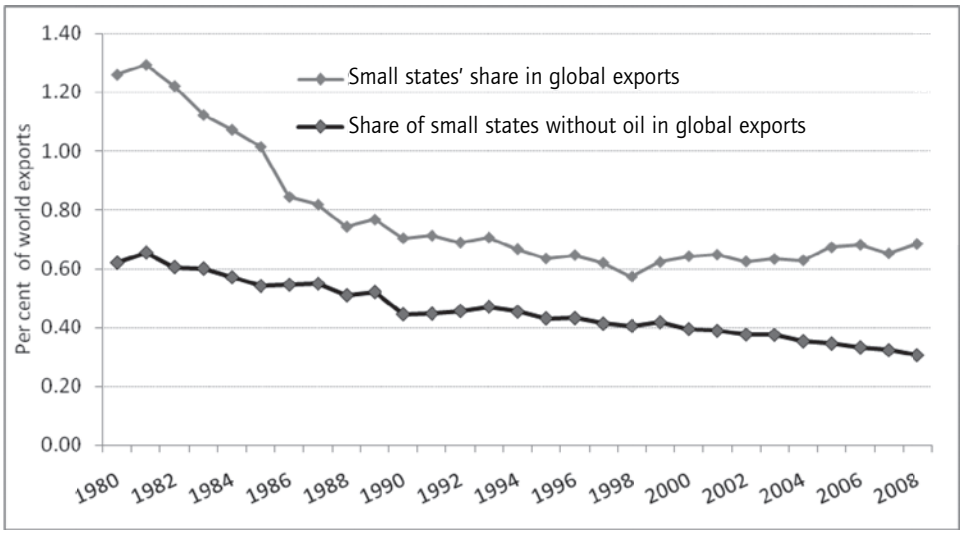
Until the recent economic slowdown, the global process of economic integration among countries intensified, underpinned by an unprecedented rise in the volume of trade and capital flows and a reduction in barriers to worldwide trade and investment activities. This drive to globalisation received substantial impetus from the birth of the WTO, providing specific trade rules and procedures and promising further liberalisation in the world trade regime. Despite these developments, there remain serious concerns that small states have failed to derive significant benefits from the process of trade liberalisation and globalisation.

Section 1 of this paper has highlighted a number of overriding problems constraining the economic development of small states. Most of these problems potentially constrain the countries' international competitiveness, preventing their effective participation in global trade. The trade data seem to confirm this fear, suggesting that over the years small states have become marginalised in world trade. During the period 1948–2008 the combined share in global merchandise exports of the 39 small states covered in this paper fell from 1.05 per cent to 0.62 per cent.[4] When the five oil-exporting small states are excluded, the comparable share fell from 0.52 per cent to 0.18 per cent – i.e. the relative significance of non-oil exporting small states declined by 66 per cent. Even when only trade in services is considered, which is more important than merchandise trade for a number of small states, their declining significance cannot be overlooked. Small states' share in such trade has fallen from 1.45 per cent in 1985 (when the first data on commercial services exports became available) to 0.95 per cent in 2008.

Even the trends for more recent periods indicate sustained declining significance of small states. Between 1995 and 2008, both global merchandise and commercial services exports grew on average by 10 per cent per annum, while merchandise exports from non-oil exporting small states registered a modest annual growth of only 6 per cent. The growth of commercial services exports from small states was also lower at 8 per cent per annum. These figures are significantly lower than the average growth of merchandise and commercial services exports from least developed countries (LDCs), which are estimated to be about 18 and 10 per cent respectively over the same period.

Seventy per cent of the small states in our sample (27 of the 39 countries referred to above) had a lower share of world trade in 2008 than they had in 1995. In the case of services, the corresponding share is 72 per cent (28 countries). On the whole, small states' marginalisation in world trade persists unabated. Figure 2.1 shows that if the oil-exporting countries are excluded, small states' share in global merchandise and commercial services has been subject to secular decline, falling from 0.6 per cent in 1980 to 0.3 per cent in 2008.

Figure 2.1. Share of small states in global export trade



Source: Authors' own estimates using UNCTAD data

Because of their inherent economic characteristics, associated mainly with the small size of their domestic markets, SVEs are highly dependent on international trade for their growth and economic development. Indeed, the trade-orientation of these countries is generally much higher than that of other developing countries. The mean export-GDP ratio in small states is about 55 per cent, compared with less than 30 per cent for the world as a whole. Consequently, marginalisation of these economies in world trade could seriously jeopardise their growth and development. Together with the problem of smallness that results in non-exploitation of increasing returns to scale in production and diversification opportunities into a wide range of activities, these countries also suffer from lack of productive capacity, trade-related infrastructures, and adequate and effective trade policy and regulations. All this has contributed to dwindling comparative advantage as reflected in their declining trade share. Aid for trade has been specifically designed to address many of these issues and is thus very relevant to an international support regime that aims to foster beneficial participation of vulnerable countries in global trade.

Another important aim of AfT is to help developing countries adjust to multilateral trade liberalisation processes. There can be various adjustment requirements, ranging from tackling export shortfalls to capacity development for dealing with new trade measures and provisions, where support would be required. Among these, adjustment support for loss of trade preferences has become one of the most critical issues for many small and vulnerable economies. Calì *et al.* (2006) provide a review and summary of such estimates for a large sample of developing countries, from which it is possible to compute the estimated losses for SVEs.

Many estimates of these costs are available; those by the International Monetary Fund (IMF) and WTO are probably the most consistent across countries and products. Gillson *et al.* (2004) provide more detailed estimates for sugar and bananas. We use various studies to provide the preference erosion figures reported in Table 2.1. The lower bound is obtained by adding two sets of estimates from WTO studies: the estimate made by Low *et al.* (2005) of costs for non-agricultural products due to preference erosion and that made by Low *et al.* (2006) of costs for agricultural products due to preference erosion. The upper bound is computed by including additional estimates that use the highest figures for each country among the available lower bound estimates in Gillson *et al.* (2004), IMF (2003) and Alexandraki and Lankes (2004).

Different assumptions (regarding the liberalisation process and the methods of calculation) produce different losses and gains for individual countries. Our central estimates are mainly based on WTO studies, as they employ the most up-to-date methodology in terms of the assumptions about what an eventual multilateral trade liberalisation may involve. An important part of this methodology is related to the adjustment of preference margins for competition and for utilisation rates (where available). The first type of adjustment accounts for the competition effects resulting from other exporters benefiting from the same preferential scheme or other forms of preferences. The resulting estimates will be lower than those that do not take such effects into account. If there is significant liberalisation, leading to entry into the market by countries that are currently completely excluded, this will underestimate preference erosion. The latter type of adjustment considers the actual rate of utilisation of preferences by exporters from developing countries. This adjustment is computed only for exports of non-agricultural products to the US market.

The estimates provided by the IMF are not directly comparable with the WTO estimates, as they use different methodologies; some caution is therefore required in comparing these. Note also that all estimates are based on partial information and static calculation: hence they are potentially subject to various types of biases. One such bias is due to the fact that the extent of gains or preferential margins that actually accrue to the exporters is unknown. The share is likely to be less than the 100 per cent assumed by the studies, except for sugar, where the quota scheme ensures that countries receive the rents. Other factors are the lack of consideration of elasticities of substitution and of dynamic interaction.

The calculations that rely only on WTO studies give total estimates for SVEs, including textiles and clothing and sugar, of about US$162 million out of a total of US$1,070 million. These are lower bound estimates on current maximum expectations for the Doha Round: taking an upper bound estimate would give a loss of US$654 million for SVEs out of a total loss of US$2,362 million a year for all developing countries in the sample. According to these estimates, the expected costs of preference erosion for SVEs range between 15 per cent (lower bound scenario) and 28 per cent (upper bound scenario) of total costs for developing countries. Considering that the share of population of SVEs in total population in the sample of countries in Table

Table 2.1. Estimated costs by country of agricultural liberalisation and preference erosion (US$ million)

	Preference erosion NAMA – WTO estimate	Preference erosion Agriculture – WTO estimate	Total preference erosion – lower bound	Banana and sugar preference erosion – high liberalisation	Preference erosion (IMF estimates)	Total preference erosion – upper bound
	Low *et al.* (2005)	Low *et al.* (2006)	Low *et al.* (2005); Low *et al.* (2006)	Gillson *et al.* (2004) Alexandraki *et al.* (2004)	IMF (2003)	All sources
SVEs						
Barbados	0.1	1.2	1.3	18.4		18.4
Belize	0.7	9.5	10.2	32.7	18.0	32.7
Botswana	0.8	5.8	6.6			6.6
Dominica		1.0	1.0	14.6	2.0	14.6
Fiji Islands		6.7	6.7	55.5	41.0	55.5
Guyana		6.6	6.6	69.3	41.0	69.3
Jamaica	6.4	8.5	14.9	80.5	46.0	80.5
Mauritius	31.0	23.4	54.4	205.6	201.0	205.6
Papua New Guinea		4.9	4.9			4.9
St Kitts and Nevis		0.5	0.5		3	3.0
St Lucia	0.3	3.1	3.4	30.5	4	30.5
St Vincent and the Grenadines		1.9	1.9	22.0	5	22.0
Swaziland	11.9	5.6	17.5	41.1	21	41.1
Trinidad and Tobago		1.8	1.8	16.7		16.7
Cape Verde			0		0.9	0.9
Comoros			0		0.3	0.3
Equatorial Guinea			0		1.3	1.3
Gambia, The			0		0.3	0.3
Guinea	0.2		0.2		1.6	1.6
Lesotho	30.1		30.1			30.1
Maldives			0		2.8	2.8
São Tomé and Principe			0		1.1	1.1

Table 2.1 (continued)

	Preference erosion NAMA – WTO estimate	Preference erosion Agriculture – WTO estimate	Total preference erosion – lower bound	Banana and sugar preference erosion – high liberalisation	Preference erosion (IMF estimates)	Total preference erosion – upper bound
	Low *et al.* (2005)	Low *et al.* (2006)	Low *et al.* (2005); Low *et al.* (2006)	Gillson *et al.* (2004) Alexandraki *et al.* (2004)	IMF (2003)	All sources
SVEs (continued)						
Seychelles			0		10.0	10.0
Solomon Island	0.1		0.1		2.5	2.5
Vanuatu			0		1.9	1.9
Total SVEs	**81.6**	**80.5**	**162.1**	**586.9**	**404.7**	**654.2**
Others						
Albania	1.2		1.2		10.0	10
Bolivia		0.7	0.7			0.7
Cameroon	1	29.8	30.8			30.8
Cuba			0		0	
Dominican Republic	139.2	21	160.2		100.0	160.2
El Salvador	110.5	2.5	113.0			113.0
Ghana		0.6	0.6			0.6
Guatemala	141.7	1.9	143.6			143.6
Honduras	167		167			167.0
Jordan			0			0
Kenya	14	5.8	19.8	1.3		19.8
Namibia	10.7	6.5	17.2			17.2
Nicaragua	31	1.2	32.2			32.2
Sri Lanka		0.1	0.1			0.1
Zimbabwe	1.9	3	4.9	22.7		22.7
Angola	0.3	0	0.3		21.1	21.1

Table 2.1 (continued)

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Others (continued)						
Bangladesh	61.6	0.1	61.7		222.4	222.4
Benin			0		0.3	0.3
Burkina Faso		1.6	1.6		0.3	1.6
Burundi			0		1	1
Côte d'Ivoire	25.3	22.1	47.4	3.7	69	69
Cambodia	18.8		18.8		53.6	53.6
Central African Republic			0		0.7	0.7
Chad			0		0.1	0.1
Democratic Republic of Congo		0.1	0.1	0.7	0.8	0.8
Egypt		1.4	1.4			1.4
Ethiopia			0		15.4	15.4
Guinea Bissau			0		0.2	0.2
Haiti	21.7		21.7		3.9	21.7
Liberia			0		3.4	3.4
Madagascar	19.1		19.1	5.6	8.6	19.1
Malawi	2	0.8	2.8	13.9	48.6	48.6
Mali			0		0.1	0.1
Mauritania	1.7		1.7		40.4	40.4
Morocco			0		152	152
Mozambique	5.5		5.5		5.7	5.7
Myanmar	8.3		8.3		2.2	8.3
Nepal			0		17.8	17.8

Table 2.1. (continued)

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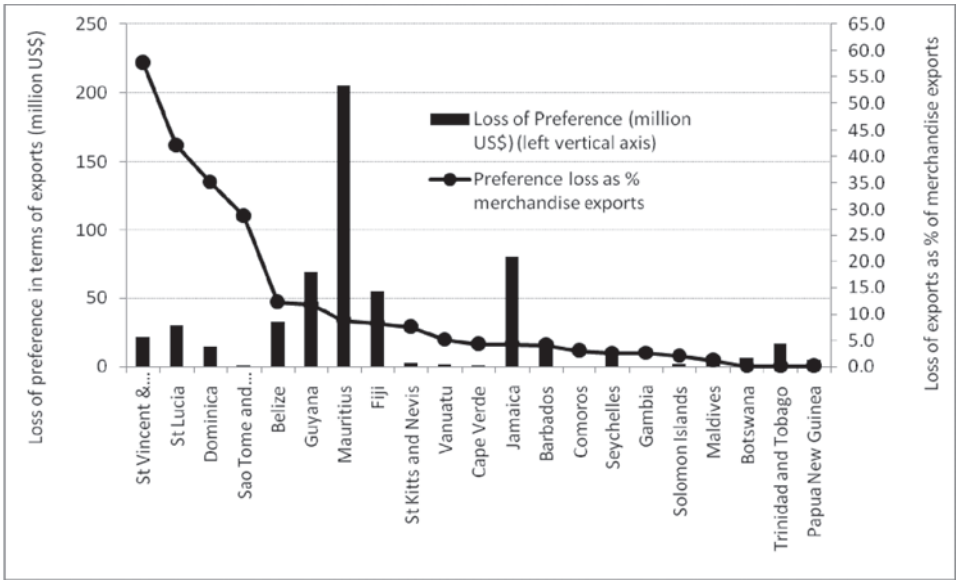
Others (continued)						
Nigeria	1.3	0.1	1.4			1.4
Pakistan		2.7	2.7			2.7
Peru		8.4	8.4			8.4
Senegal	3.6	0.5	4.1		23.6	23.6
Serbia and Montenegro			0		45.0	45.0
Sierra Leone	0.2		0.2		2.5	2.5
Sudan			0		6.9	6.9
Tanzania	1.2	1.4	2.6	5.0	28.9	28.9
Togo	0.2	0.1	0.3		1.3	1.3
Tunisia			0		146.0	146.0
Uganda	0.7	0.5	1.2		9.1	9.1
Venezuela	3.7	0.5	4.2			4.2
Zambia	0		0	5.5		5.5
Non-SVEs	793.4	113.4	906.8	58.4	1040.9	1708.1
SVEs (WTO)	669.4	153.6	823	610.9	492	1319.3
Non-SVEs (WTO)	205.6	40.3	245.9	34.4	953.6	1043
Total preference erosion lower bound		1,069	Cumulative value of countries' estimates from Low *et al.* (2005) and Low *et al.* (2006)			
Total preference erosion upper bound		2,362	Obtained by using the highest estimates for each country among the lower bound estimate, Gillson *et al.* (2004); IMF (2003); Alexandraki and Lankes (2004).			

Source: Adapted from Calì *et al.* (2006)

2.1 is only 2.3 per cent, SVEs are effectively expected to bear a much higher than proportionate share of the costs of preference erosion.

Among the SVEs in our sample, Mauritius, Jamaica, Guyana, Fiji Islands, Belize and St Lucia are likely to suffer most in terms of absolute loss of exports due to preference erosion. When measured as a proportion of the respective countries' total merchandise exports, export losses turn out to be massive for St Vincent and the Grenadines (58 per cent), St Lucia (42 per cent), Dominica (35 per cent) and São Tomé and Principe (29 per cent), as shown in Figure 2.2.

Figure 2.2. Loss of preference of some SVEs



We also estimate the same costs for the group of SVEs as defined in the WTO. This is a larger group and it is expected to face most of the estimated costs of preference erosion: between 77 per cent (lower bound scenario) and 56 per cent (upper bound scenario) of total costs for the countries in the sample. Again, these shares are well above the share of the WTO SVE group in total population (around 14 per cent) This is unsurprising, given that the majority of SVEs are preference receiving countries and that the preferences often allow them to obtain much larger market shares in the preference conceding countries than in a liberalised regime.