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Promoting South-South Trade: Recent Developments and Options

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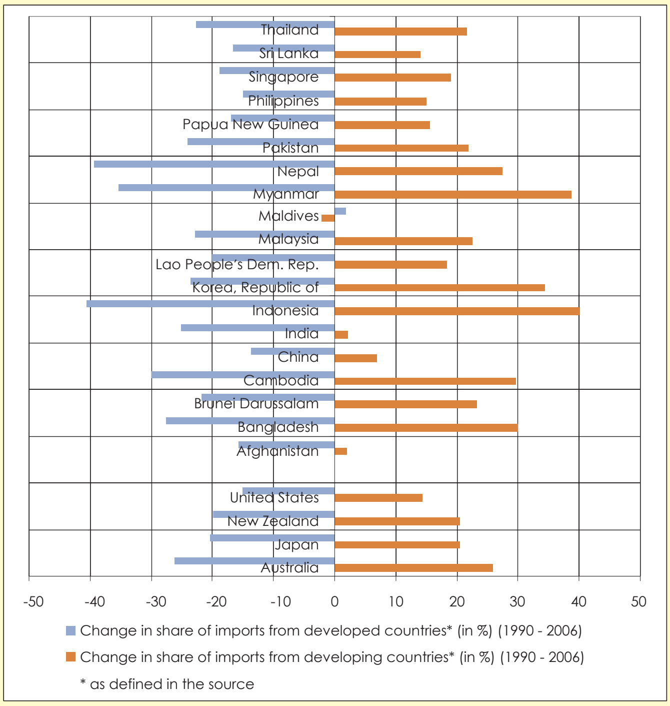
Over the years, developing countries, commonly referred to as "the South,"[1] have emerged as an important player in the world economy as manifested in terms of global GDP, investment, savings, trade, foreign exchange or manufacturing capability. With the increase in the overall growth of the South and its decreasing dependence on trade with developed countries, also referred to as "the North,"[2] trade among countries of the South, also known as "South-South trade," can provide resources for meeting the developmental goals of the South.

Indeed, the volume of total exports from the South in 2005 showed a threefold increase from 1995. Total exports from the South amounted to US$4.5 trillion in 2006 – 37 percent of world exports – and rose to US$5.2 trillion in 2007.[3] While South-South exports rose from 40 to 45[4] percent of the South's total exports from 1995 to 2005, the share of South-North exports declined from 56 percent to 48 percent of the South's total exports during the same period. UNCTAD[5] has pointed out that the South-South trade flows reveal a pattern of a "hub-and-spoke" network, where Asia plays the role of the hub, being both the largest exporter and importer. The intra-Asian trade accounted for about 90 percent of total South-South trade and trade among East-Asian and South-East Asian countries accounted for more than half of South-South trade.

As shown in Figure 1, the share of imports from developing countries to developed and developing countries in the Asia-Pacific region increased during the period of 1990 to 2006. Developing countries in Asia are the major beneficiaries of the changing patterns due to increased exports from China, Republic of Korea and India.

Figure 1: Change in percentage share of imports from 1990 to 2006



Source: UNCTAD Handbook of Statistics 2008

Benefits of South-South Trade

Because the barriers to trade in the South are higher, the liberalisation of South-South trade has a greater potential of welfare gains for the South than the liberalisation of North-South Trade.[6] South-South trade liberalization can have the effect of lowering the price of intermediate imports and eventually allowing South exporters to serve international markets.[7] It has also been pointed out that promoting South-South trade has become a necessity for reducing global imbalances: as the United States and other developed countries are reducing their net imports from the South as a result of the recession, the South must find alternative sources of demand, much of which will have to be come from the South itself. Promoting South-South trade has thus

1 The term "South" includes all Developing Countries, including Least Developed Countries, as such terms are commonly used by the United Nations (UN) (also see footnote 13). The UN created a Special Unit for South-South Cooperation in the late 1970's which supported academic research and voluntary cooperative efforts between southern countries to promote South-South trade and investment. The United Nations General Assembly in 2003 formally opted to use the term South-South in describing cooperation among developing countries.
2 The wealthy and technologically advanced nations of the world are often called "the North" as they are located in the northern hemisphere.
3 UNCTAD, Handbook of Statistics 2008
4 This does not include the exports to the nations which are Economies in Transition as such term is defined in footnote 10.
5 UNCTAD, Development and Globalization: Facts & Figures (2008)
6 Fugazza & Vanzanetti (2006).
7 Fugazza & Robert – Nicoud (2006).

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become a global public good, necessary for the North as well as the South since they have moved away from resource based exports to manufacturing. The global manufacturing capabilities of the South not only provide better and cheaper goods to the consumers of the North, but the South's stronger economic growth has created many backward-forward linkages among industries. The promotion of South-South trade could be instrumental in the sustainable industrialisation of the economies of the South.[8]

Increasing Number of South-South Preferential Trade Agreements

South-South trade has been facilitated by various bilateral, regional and inter-regional preferential trade agreements. In the Asia-Pacific region, a total of 137[9] regional trade agreements have been identified; of these, 79 were entered into between developing countries or economies in transition.[10] More than half of these 137 regional trade agreements have entered into force since 2004. Developing countries in different regions have also established their own schemes of regional economic integration such as the Association of South East Nations Free Trade Area (ASEAN FTA), the South Asia Free Trade Area (SAFTA) and the Asia-Pacific Trade Agreement (APTA) (among many others). In addition, inter-regional integration agreements are also taking shape in the form of India-Brazil-South Africa (IBSA), and the Asia-Africa sub-regional Organisation Conference (AASROC). The Global System of Trade Preference is another example of a South-South preferential trade arrangement with a global perspective as it is open to all developing countries.

Concerns and Options for Enhancing South-South Trade in the Asia-Pacific Region

South-South cooperation to promote trade and investment flows is mutually beneficial. However, there are major disparities among its members and addressing them is a real challenge. Mikic (2007)[11] has observed that preferential trade agreements in Asia and the Pacific leave much to be wished for in terms of meeting established criteria for 'best practice' or model agreements so as to be consistent with the requirements of GATT Article XXIV. A concern has rightly been raised on the number of countries signing multiple agreements with the same partners. It has also been noted that in the Asia-Pacific region, these agreements are either in the form of framework agreements lacking operational details or follow a limited scope or partial reduction in tariffs through preferential trade agreements (APTA, SAPTA) or provide a very long timeframe for tariff liberalisation (10-15 years), thereby delaying the regional integration.

Initial steps towards regional integration have been cautious and did not cover issues such as services, investments, disputes, intellectual property rights, transit etc. The focus was only on goods, even though many complementarities also exist in those other areas. For South-South agreements, therefore, it is essential that the focus be on some combination of full trade liberalization behind low external border protection, greater services deregulation and competition, and proactive trade facilitation measures that together positively affect both intra- and extra-regional trade.

With ASEAN's engagements with China, Republic of Korea, Japan, India, Australia and New Zealand and the accession of China to APTA, the chances of enhancing the trade and investment opportunities have increased. ASEAN's framework agreements with these countries are comprehensive in nature and cover goods, services, investments, intellectual property rights, dispute resolution, trade facilitation etc. Similarly, APTA members are considering the expansion of APTA into services, investments and trade facilitation issues in parallel to the 4th Round of trade negotiations.

South-South Tariffs remain high

The South reduced its tariffs as a result of the Uruguay Round commitments as well as through voluntary liberalization. Though the tariffs have been reduced, in general they are still higher than those of developed countries (see Table 1 below). These higher tariff structures are explained by several factors. First, historically, tariff negotiations began among developed countries before expanding to other countries.[12] Second, unlike in developed countries, tariffs were – and still are – a major source of revenue for Governments in developing countries. Finally, another important reason is that the South needed time to develop its infant industry, attract foreign direct investment inflows as well as provide time for their existing industries to adjust to the challenges of globalisation.

Over the years, many developing countries were able to reduce their tariffs due to fiscal reforms and alternative tax regimes like Value Added Tax, Income Tax or Service Tax which led to lesser dependence on tariffs for revenue collection.

The Special Needs of Least Developed Countries (LDCs)[13]

While South-South trade has increased in recent years, the trade structure of LDCs with both the North and South has been less homogeneous. If one compares LDC export patterns to those of developing and developed countries, one can observe that only Afghanistan, Maldives, Myanmar and Nepal have

[8] RIS Policy Brief No. 27 (2006).
[9] Trade Agreement Database, APTIAD, ESCAP, available at http://www.unescap.org/tid/aptiad/.
[10] Economies in transition are economies which are changing from a centrally planned economy to a free market economy. Countries like Armenia, Azerbaijan, Kazakhstan, Kyrgyzstan, Moldova, Tajikistan, the former Yugoslav Republic of Macedonia, Turkmenistan and Uzbekistan are classified as Economies in Transition as they are neither developed nor developing countries as per the UNCTAD Handbook of Statistics.
[11] Mikic (2007).
[12] A significant feature of tariffs of developed countries is that, although their average tariff is low, tariffs imposed on products of export interest to developing countries – e.g. clothing, leather & footwear, textiles, fishery and agriculture sectors - are relatively high. Historically, this was due to the fact that the North wanted to protect its domestic labour-intensive industry and that since the South was not much engaged in trade negotiations prior to the Uruguay Round, they could not influence the tariff – reduction process in the North on items of their export interest.
[13] The establishment of a category of least developed countries (LDCs) was first advocated at UNCTAD in 1964. LDCs are low-income countries which face severe structural handicaps to growth. The UN applies a simple set of criteria (per capita GDP, share of manufacturing in GDP, adult literacy) in determining a country's eligibility. The current list of countries designated as LDCs is available at http://www.un.org/special-rep/ohrlls/ldc/list.htm.

Table 1 Applied Most Favoured Nation Duties in 2006 – simple average

Country	Simple average	Clothing	Leather & footwear	Textiles	Fish & fish products	Animal products
Australia	3.5	15.4	5.5	6.8	0	0.4
EC	5.2	11.5	4.1	6.6	10.6	25.9
Japan	5.1	9.2	11.2	5.5	5.5	13.9
USA	3.5	11.7	3.9	7.9	1.0	2.7
China	9.9	16.0	13.5	9.7	10.9	14.8
India	14.5	22.2	10.1	20.9	29.6	31.6
Indonesia	6.9	14.4	9.0	9.3	5.8	4.4
Rep. of Korea	12.2	12.6	7.9	9.1	15.8	22.1
Malaysia	8.4	16.0	13.9	10.5	2.2	0.5
Thailand*	10.0	24.5	12.7	8.1	14.5	28.1

* Data for Thailand is only available for the year 2006

Source: World Tariff Profile 2008, WTO

increased their exports to the South during 1990 to 2006. The remaining LDCs have seen a decline of exports to the South over that period. It is worth noting that Bangladeshi and Cambodian exports to developed countries have increased, while exports to the South decreased during that period. In the case of Bangladesh, the growth is due to its increased exports to the European Union, while in the case of Cambodia, the increase is due to increased exports to the United States. The possibility of utilising unilateral trade preferences for LDCs may be the main reason for this trend, especially since both countries' main export is textiles and textile products. It is also worth noticing that despite their main export market being developed countries, they still depend on the South to meet their import requirements.

While South-South regional trade agreements are reciprocal in nature, i.e. each participating country is required to make tariff liberalisation commitments, most also include provisions relating to Special and Differential treatments for LDCs. For example in SAFTA, the LDCs have a larger list of items for which no concessions are to be given and they have a 10% lower value added threshold in rules of origin. In APTA, negotiations are being held on non-reciprocal tariff concessions for LDCs with a lower value added threshold. In AFTA, the new ASEAN members have a longer time frame to liberalize their tariff preference; however, no special and differential treatment is accorded to them in the rules of origin criteria. The scale of economic activity in Cambodia, Lao PDR and Myanmar is much lower than in Thailand, Indonesia or Malaysia and therefore flexible rules of origin for Cambodia, Lao PDR and Myanmar may enhance their preferential exports. The LDCs would thus only gain effective market access if they are provided market access on items that they are actually exporting.

The decision to provide Duty Free Quota Free access to LDCs taken at the WTO Ministerial Meeting in Hong Kong in December 2005 is encouraging. This decision inter alia requires all developed-country WTO members, and developing-country WTO members declaring themselves in a position to do so, to provide duty-free and quota-free market access on a lasting basis for all products originating from all LDCs, by 2008 or no later than the start of the implementation period, in a manner that ensures stability, security and predictability.

In the past, China and the Republic of Korea have announced the implementation of a preferential scheme for LDCs in a limited manner. The Republic of Korea provides concessions on a positive list of products to all LDCs, whereas China provides the concession only to imports from African LDCs who are Members of the WTO. India also implemented a Duty Free Tariff Preference Scheme in August 2008 (see Box 1). Given the fact that the current Doha round negotiations in Geneva are still ongoing and their outcome is uncertain, such schemes will provide a boost to the South-South trade.

BOX – I

DUTY FREE TARIFF PREFERENCE SCHEME OF INDIA: HIGHLIGHTS

India's Duty Free Tariff Preference Scheme is open to all LDCs. Pursuant to this Scheme, the duties on a majority of items will be gradually eliminated over a 5-year period. The Scheme provides preferential market access to 94% of total tariff lines which corresponds to 92.5% of global exports of all LDCs, including for example cotton, cocoa, aluminium and copper ores, sugar cane and ready-made garments. Only 6% of the total tariff lines remain in the Exclusion List on which no preferential duty access will be granted. The items which are kept out of the concession list include poultry, milk & cream, some vegetables, coffee, tea, spirits and some iron and steel products.

In order to get the preferential treatment, the manufactured products should have gone through a "change in tariff heading" between the non-originating raw materials and the finished products and in the process would have generated a value added of 30% in the exporting LDC. This Scheme provides for technical assistance to be given by India to the LDCs on a needs basis for effective implementation of the Scheme. As of now, only few LDCs have opted to avail themselves of this benefit, and some more LDCs are in the process of opting for this Scheme.

Recommendations

Under the present scenario of global trade and the rising importance of South-South trade, some of the important issues that need to be addressed relate to:

- Broadening and deepening trade liberalisation among countries of the South. This could easily be achieved through preferential trade arrangements in which the countries of the South are already participating. Possible options include:
    - o Transforming the Global System of Trade Preference (an inter-regional) agreement where the developing countries could offer deeper concessions on more products and could promote South-South trade in the global context.
    - o Using APTA as a basis to enhance South-South cooperation for overall development in the Asia-Pacific region through expanding its membership, covering a large number of products in the 4th Round concessions and concluding the agreements in services and investment before the next Ministerial Council Meeting in 2009.
    - o Further expanding and inter-linking the ASEAN-plus free trade agreements to achieve a common framework to promote trade and investment flows in this region. ASEAN's bilateral agreements with its trading partners may not lead to regional integration as each agreement may vary in its scope, timeframe for liberalisation, rules of origin and commitments in other areas. This can create another "spaghetti bowl" scenario with ASEAN as its centre! Therefore, it is recommended that a single model comprehensive agreement for ASEAN + 6 be explored.
- Since the developing countries are not a homogeneous group, a 'one size fits all' solution will not work. Therefore, each country must use flexible methods which suit its requirements to promote growth and reduce poverty while taking steps towards its overall trade liberalisation. In order to maximize the benefit, the developing countries should aim to facilitate trade not only through their trade liberalisation but also through 'tariff-plus issues', e.g., non-tariff measures, trade facilitation, and investment.
- The services sector is becoming one of the most dynamic sectors in the South. Development of South-South trade in services would be mutually beneficial as it could assist in bridging the capability and skills gap in some areas.
- Mainstreaming the LDCs in the South-South trade is very important. This could be achieved through unilateral tariff preference schemes to be offered by other developing countries. At the same time, it is necessary that intra-South investment, transfer of technology and technical assistance be provided to LDCs. In the preferential schemes, the rules of origin should be simple and transparent and should be governed by a single set of rules rather than cumbersome sector/product specific rules.

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