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UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

**INTERNATIONAL MINISTERIAL MEETING OF LANDLOCKED
DEVELOPING COUNTRIES**

**EFFECTIVE PARTICIPATION OF LANDLOCKED DEVELOPING COUNTRIES
(LLDCs) IN THE MULTILATERAL TRADING SYSTEM**

Report by the UNCTAD secretariat

Part Two

UNCTAD/LDC/2005/3 (PART II)

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Introduction

1. Landlocked developing countries (LLDCs) are among the poorest developing nations. Nearly all LLDCs have a low per capita GDP, reflecting low income levels, limited domestic savings capacity and a generally low level of economic development. Factors such as reduced international competitiveness of LLDCs' merchandise exports due to high transport and related costs, as well as high price volatility on international markets and stagnating global demand for key export products of these countries, help explain the weak economic performance of LLDCs. Moreover, the high transaction costs that these countries incur bear heavily on their export development and limit the range of potential exports and markets in which goods can be traded competitively.

2. By definition, LLDCs have no access to the sea and are bound to trans-ship most of their merchandise exports and imports through foreign territory. This special geographical situation makes LLDCs dependent on neighbouring countries for their external trade: LLDCs depend on their neighbours' transit infrastructure; on good cross-border political relations; on peace and stability in the neighbouring country(ies); and their neighbours' administrative practices.¹ It is therefore in the prime interest of LLDCs to promulgate and implement internationally accepted and binding rules for international trade.

3. Under the auspices of the WTO, the 22 LLDCs that are members of this organization have the right and the opportunity to proactively design and to draft legislation that governs international trade, with account being taken of their special characteristics and constraints.

4. The programme of trade liberalization adopted at the 2001 WTO Ministerial Conference in Doha contains two elements of paramount importance for LLDCs. Firstly, the conference agreed in principle to hold negotiations on trade facilitation, an issue added in 1996 to the WTO agenda, and secondly, it agreed to a work programme to examine issues relating to the trade of small economies. Substantive work on the Work Programme on Small Economies began in April 2002, and negotiations on trade facilitation were launched as part of the July Package on 1 August 2004.

5. The present report was prepared in response to the request made in the Communiqué of the Fifth Annual Ministerial Meeting of Landlocked Developing Countries, held on 27 September 2004 in New York, to help prepare for a meeting of trade ministers from LLDCs on the effective participation of these countries in the new trade negotiations, to be held before the sixth Ministerial Conference of WTO.

6. Part One of this report analysed the situation of the LLDCs in the international trading system in detail and made proposals for long-term policy strategies to mitigate the effects of remoteness from world markets as well as to address constraints related to poor physical infrastructure, weak institutional and productive capacities, small domestic markets and high vulnerability to external shocks.

¹ See Faye M L et al.: The challenges facing landlocked developing countries. *Journal of Human Development*, vol. 5, no. 1, March 2004.

7. Part Two focuses on aspects of the ongoing WTO negotiations which are most relevant for LLDCs. It highlights the approach and positions pursued by those countries in the Doha process with a view to facilitating the process of stocktaking and reflection for a coherent and consolidated negotiation strategy of LLDCs on issues of critical importance to them.

8. As much as the Doha Development Round may help LLDCs mitigate the adverse impact of their specific characteristics and constraints on their participation in the global trading system, it is understood that substantial assistance from bilateral and multilateral donors, in particular regarding infrastructure development and the establishment of competitive productive capacities, is needed in order to accelerate the development process in those countries.

Trade facilitation

9. Since tariffs have been lowered in several rounds of multilateral trade negotiations, costs relating to compliance with customs formalities have become a more critical issue, exceeding in many instances the cost of duties to be paid. In addition, bureaucratic customs and administrative procedures often represent more serious barriers to the participation of SMEs in international trade than tariff barriers. Trade facilitation is therefore an issue of relevance to both developing and developed countries.

10. However, the simplification and the harmonization of international trade procedures, including activities, practices and formalities involved in collecting, presenting, communicating and processing data required for the movement of goods in international trade, one of even greater importance to LLDCs than to other countries, because of their need to pass much of their merchandise trade through at least one transit country.

11. Articles V, VIII and X of GATT 1994 address issues that could help facilitate the expeditious movement of goods in transit, reduce the level of requisite fees and the scope of formalities connected with importation and exportation, as well as ensure the timely publication and impartial administration of relevant laws and regulations. Other agreements such as those on import licensing, technical barriers to trade, sanitary and phytosanitary measures, customs valuation, rules of origin and pre-shipment inspection also contain a number of relevant provisions.

12. Trade facilitation, as a separate topic, was added as an issue to the WTO agenda at the First WTO Ministerial Conference, held in Singapore in 1996. It was reiterated in paragraph 27 of the Doha Declaration. With the adoption of the July Package, the General Council decided to begin negotiations aimed at clarifying and improving relevant aspects of Articles V, VIII and X of GATT 1994 with a view to further expediting the movement, release and clearance of goods, including goods in transit. The negotiations should also aim at enhancing technical assistance and support for capacity building in this area and provide the basis for effective cooperation between customs or any other appropriate authorities on trade facilitation and customs compliance issues.²

13. On the basis of Annex D of the July Package, the work programme on trade facilitation addresses the following:

- Clarification and improvement of relevant aspects of Articles V, VIII and X of GATT 1994; enhancement of technical assistance and support for capacity building; effective cooperation between customs or any other appropriate authorities on trade facilitation and customs compliance issues;
- Special and differential treatment for developing and least developed countries;
- Least developed country members;
- Identification of trade facilitation needs and priorities; concerns related to the cost implications of proposed measures;
- Technical assistance and support for capacity building;
- Working with, and the work of, relevant international organizations.

² WTO document WT/L/579, paragraphs 1 (f) and Annex D, 2 August 2004.

Work on Articles V, VIII and X of GATT 1994

14. Several proposals have been made regarding Articles V, VIII and X of GATT 1994 since the launching of negotiations on trade facilitation.

15. Proposals for Article V refer to (i) the clarification of terms used in that article; (ii) improved transparency of transit requirements, procedures and charges; (iii) the harmonization of transit policies; (iv) the simplification and standardization of documentation, data requirements and procedures applied to goods and means of transport in transit; (v) non-discrimination between means of transport, carriers and types of consignment in relation to transit procedures; (vi) issues related to guarantees required from transit operators; (vii) freedom of transit on the most convenient routes; (viii) the use of ICT and the implementation of efficient customs control systems; and (ix) issues related to coordination and cooperation among WTO member countries.

16. However, the explicit recognition of the transit problems of LLDCs in a strengthened Article V could be an important catalyst for making this article operational and for generating targeted technical assistance from bilateral and multilateral institutions for trade-related infrastructure development and capacity-building

17. Proposals for Article VIII focus on (i) the clarification of its coverage, non-discrimination in the application measures and the avoidance of unnecessary procedural barriers; (ii) the number and level of fees and charges; (iii) the simplification, reduction and standardization of documentation and data requirements; (iv) the establishment of a “single window” facility; (v) the simplification and standardization of clearance procedures, particularly for authorized traders, risk assessment, consignment inspection and related practices; (vi) the use of customs automation systems; and (vii) issues related to the use of securities and greater cooperation among border agencies in general.

18. Proposals for Article X deal with (i) the publication, in particular by electronic means, of related laws and regulations; (ii) the establishment of national inquiry points to provide relevant information and respond to inquiries; (iii) the consultation process on promulgation of new laws and regulations; and (iv) review and appeal procedures.

19. With the adoption of the July Package and the ensuing launching of negotiations on trade facilitation, LLDCs have the opportunity to pursue this issue in a coherent and more focused manner in cooperation with other interested WTO member countries to close existing gaps in the WTO legal framework, particularly on customs procedures and documentation, and transparency. Numerous international agreements and conventions³ that have been concluded since the 1921 Barcelona Transit Convention on Freedom of Transit may provide elements of both text and language that have already found wide acceptance for the multilateral negotiation process. Recognized principles such as clarity, consistency and predictability of trade practices, the

3 For example: Convention on Transit Trade of Land-locked States (New York transit convention), 1965; International Convention on the Harmonized Commodity Description and Coding System, 1983; Convention on the Simplification and Harmonization of Customs Procedures (Kyoto Convention), 1999; Convention on the Harmonization of Frontier Control of Goods, 1982.; Convention on Road Traffic, 1968; Customs Convention on the International Transport of Goods under Cover of TIR Carnets (TIR Convention), 1975; Customs Convention on the International Transport of Goods under Cover of TIR Carnets (TIR Convention), 1975. Convention on the Contract for the International Carriage of Goods by Road (CMR), 1956; Customs Convention on Containers, 1972; International Convention to Facilitate the Crossing of Frontiers for Goods Carried by Rail, 1952; Convention on Customs Treatment of Pool Containers used in International Transport, 1994.

simplification, standardization and harmonization of trade procedures, as well as the limitation of related fees and charges to the approximate cost of the service rendered, should be the underlying approach in WTO negotiations on trade facilitation.

The Work Programme on Small Economies

The setting

20. Although several LLDC member States of the WTO derive benefits from belonging to the category of LDCs, LLDCs as such do not enjoy the privileges of a special category *sui generis* of WTO members. The fact that LLDCs have not obtained a special status in the WTO is due to several factors, including the complexities of the multilateral negotiation process, reluctance regarding a proliferation of new categories of member States with special privileges, problems of definitions and expected problems of eventual graduation, as well as diverging interests among WTO members on this issue.

21. However, there is also a growing recognition among WTO members that being landlocked is an inherent disadvantage that has a negative impact on the trade and international competitiveness of the countries concerned, reduces their ability to diversify production and exports on a sustainable basis, and is one of the main causes of the marginalization of LLDCs in the international trading system, as explained in detail in Part One of this report. Attempts are therefore made to address the geographical handicap of LLDCs in the broader context of disadvantages that smaller developing WTO members in particular face in international trade, with a view to finding internationally accepted policy measures to their mitigate negative effects.

22. The first effort to address the issues of disadvantaged developing WTO members was made at the Geneva Ministerial Conference in 1998.⁴ At the 1999 Ministerial Conference in Seattle, the group of small island developing States (SIDS) raised issues of concern to small States in a separate paragraph of the text of the main declaration.⁵ During the preparations for the Doha Ministerial Conference, the group of SIDS submitted a proposal for the creation of a special programme within the WTO framework to address specific problems of small and vulnerable developing countries.⁶ This proposal led to paragraph 35 of the Ministerial Declaration, in which agreement was reached on the establishment of a Work Programme on Small Economies under the auspices of the General Council to examine issues related to the trade of small and vulnerable economies and to frame responses to the trade-related issues identified for the fuller integration of small and vulnerable economies into the global trading system.

23. Paragraph 35 of the Doha Declaration reads as follows: "We agree to a work programme, under the auspices of the General Council, to examine issues relating to the trade of small economies. The objective of this work is to frame responses to the trade-related issues identified for the fuller integration of small, vulnerable economies into the multilateral trading system, and not to create a sub-category of WTO Members. The General Council shall review the work programme and make recommendations for action to the Fifth Session of the Ministerial Conference."

⁴ Paragraph 6 of the Geneva Ministerial Declaration, WTO document WT/MIN(98)/DEC/1, 25 May 1998.

⁵ See WTO documents JOB(99)/4797/Rev.3, 18 November 1999; WT/GC/W/361, 12 October 1999; and WT/GC/W/373, 15 October 1999; as well as paragraphs 8, 56 and 58 of Annex in WTO document WT/GC/W/441, August 2001.

⁶ WTO document WT/GC/W/441, 6 August 2001.

24. The Framework and Procedures for the conduct of the Work Programme on Small Economies (WPSE)⁷ were set out on 1 March 2002, and substantive work on the WPSE began with the first Dedicated Session (DS) of the CTD on 25 April 2002.

25. Since then, a number of initiatives have been undertaken to better address the concerns of LLDCs in the WTO. In their proposal for the Cancún Ministerial Conference, the group of LLDCs suggested that a reference to “landlocked developing countries” be included in the text of the Ministerial Declaration, and outlined their negotiation objectives and common positions.⁸ Although these efforts did not yield immediate results, they were important for raising the profile of issues of relevance to LLDCs in the WTO.

25. At the 6th Dedicated Session, the representatives of Bolivia, Mongolia and Paraguay, in their respective statements, emphasized the need for progress in the WPSE, despite the failure in Cancún. Paraguay proposed discussion of the recommendations contained in document WT/MIN(03)/W/23 at the next Dedicated Session with a view to addressing particular concerns faced by the LLDCs in the DS and giving this issue "special consideration".⁹

26. Other documents, such as WT/COMTD/SE/W/3 (submitted by the group of SIDS), WT/COMTD/SE/W/10 (submitted by Paraguay, Bolivia and Mongolia) and WT/COMTD/SE/W/11 (submitted by the group of SIDS), contained substantive proposals in line with the objective of paragraph 35 of the Doha Declaration. These proposals covered a wide range of trade issues of market access and preferences for small economies, subsidies, SPS, anti-dumping and countervailing measures, the flexibility necessary for small economies to be able to participate effectively in and secure benefits from the MTNs, and other measures to mitigate the adverse effects of inherent disadvantages, vulnerabilities and structural constraints of small economies, including LLDCs.

27. In parallel, procedural proposals made by the chair of the DS were aimed at moving forward the WPSE. A three-step approach proposed on 25 January 2005 suggested (a) consideration of the use of characteristics to identify what could be accepted as small, vulnerable economies – without naming any group of countries; (b) consideration of those trade-related problems that could reasonably be attributed to those characteristics – without naming any group of countries; and (c) framing of responses to those trade-related problems – without naming any group of countries.¹⁰ This idea was further refined by a proposal to examine the characteristics and problems of small and vulnerable economies by taking a three-pronged approach which segments them into (i) areas where WTO solutions can be found; (ii) areas where WTO solutions may be available, but need to be combined with assistance from other agencies; and (iii) areas where a solution lies elsewhere (outside the WTO).¹¹

28. The July 2004 Framework Agreement reconfirmed that "the trade-related issues identified for the fuller integration of small, vulnerable economies into the multilateral trading system should also be addressed, without creating a sub-category of Members, as part of a work programme, as mandated in paragraph 35 of the Doha Ministerial Declaration".¹²

⁷ WTO document WT/L/447, 5 March 2002.

⁸ WTO document WT/MIN(03)/W/23, 14 September 2003.

⁹ WTO document WT/COMTD/SE/M/6, 14 November 2003.

¹⁰ Chair's statement at the informal meeting on 25 January 2005.

¹¹ Fax from the chairman of the CTD to its members, dated 21 March 2005.

¹² WTO document WT/L/579, 2 August 2004, paragraph 1d.

Assessment

29. In spite of the above efforts, there has been no tangible outcome of the WPSE so far nor have concrete steps been taken in response to the specific needs of LLDCs.

30. The slow progress in the work on the WPSE can be attributed to a number of factors, including:

(a) A major constraint has been the lack of a clear, enforceable and acceptable definition of "small and vulnerable economies", despite several attempts to clarify this issue. In May 2002, for example, a group of countries, including Bolivia and Paraguay, submitted a document (WT/COMTD/SE/W/1/Rev.1) that highlighted *inter alia* key characteristics and constraints faced by small economies. Document WT/COMTD/SE/W/12, issued almost three years later, contained a similar list of characteristics of such economies. The non-agreement regarding which WTO member States are to be covered by the Work Programme is related to the pending definition issue, although there is a common understanding among most of the interested parties that they all share similar constraints due to small size and vulnerability.

(b) Concerned WTO member States differ about the scope and type of characteristics to be used for the purpose of defining "small and vulnerable economies" and related measures to be taken, especially if they do not share this particular characteristic. For example, some member States with relatively large populations are reluctant to stress this issue. Other member States with relatively high per capita incomes, but which face various impediments to trade expansion, object to the inclusion of per capita income levels as a major parameter of smallness and vulnerability, while the LLDCs with their generally low levels of GDP per capita attach to this issue a more prominent role. In addition, some WTO member States have suggested taking non-trade concerns into account in the negotiations, which should be considered in the negotiations and reflected in the WTO rules.¹³

(c) There is a non-agreement on threshold and eventual graduation levels to be applied for quantifiable characteristics of "small and vulnerable economies", which makes the WPSE potentially interesting for WTO member States that *prima facie* might not be considered small and vulnerable.

(d) Different tactics applied by interested WTO member States hamper more rapid progress. While WTO member States that believe themselves to be "small and vulnerable economies" would like to begin to frame responses, other potential beneficiaries of the WSPE prefer first an agreement on both the countries covered by the WPSE and the constraints and disadvantages to be addressed.

(e) Discussions on the WPSE have diverged from its main focus by debating issues that are not directly related to it, such as e-commerce, success stories and the need for seminars and workshops.

The way forward

31. The above assessment leads to several policy proposals that might help LLDCs in the negotiation process regarding the WPSE.

¹³ Paragraphs 16 and 122, WTO document G/AG/NG/R/4, 24 January 2001.

32. As a road map for negotiations, LLDCs need to prioritize issues of importance to them, define their objectives and goals, and decide on which issues discussions should focus on immediately and which could be taken up later. Furthermore, it seems to be plausible, as suggested, to divide the issues to be discussed into three areas: (i) where solutions could be found within the WTO; (ii) where WTO solutions may be available, but need to be combined with assistance from other agencies, and (iii) where solutions lie outside the WTO.

33. The group of LLDCs should cooperate with other WTO member countries that share similar constraints in expanding international trade through a win-win strategy, which emphasizes their interests and objectives without harming the interests of other WTO members.

34. The discussion of characteristics and constraints should lead to results that have a positive impact on the development process in LLDCs, thus living up to the expectations associated with the current Doha Development Round. In this context, attempts to ignore the different levels of development of WTO member States in the outcome of the negotiations by pursuing a "one size fits all" strategy should be opposed.

35. The group of LLDCs should not allow discussions to deviate from key issues and should resist the introduction of issues, that could and should be addressed in other WTO bodies.

36. More efficient and better coordination between the group of LLDCs and other WTO member States and grouping of countries that share similar constraints could be crucial for success in the negotiations. To this end, all LLDC member States in the WTO should constitute themselves into a Consultative Group, which could then coordinate and cooperate with other country groupings that are also interested in the WPSE. Such a mechanism would also allow the LLDCs to express their positions in other WTO bodies and negotiating groups in a coherent manner.

The Indicative List of Specific Characteristics and Problems

37. A group of 16 WTO member States, including LLDCs, communicated on 18 February 2005 an Indicative List of Specific Characteristics and Problems as a basis for consideration under the WPSE with a view to identifying trade-related solutions for fuller participation by small and vulnerable economies in the multilateral trading system.¹⁴

38. These specific characteristics and problems are the following: (i) physical isolation, geographical dispersal and distance from the main markets, many countries being small island or landlocked developing countries; (ii) insignificant participation in the multilateral trading system and a minimal share of total world trade; (iii) small, fragmented and highly imperfect markets; (iv) in general, very open economies; (v) domestic markets with imperfect and highly polarized structures: either a multitude of small and micro enterprises, or cartels/monopolies; (vi) minimal or no export diversification: concentration of exports on very few products (especially commodities, traditional products and low-value-added goods); (vii) insubstantial supply of export services; (viii) dependence on very few export markets; (ix) inadequate infrastructure; (x) high degree of vulnerability; (xi) low competitiveness; (xii) low levels of productivity and insufficient supply; (xiii) economic rigidity with high adjustment costs; (xiv) inability to sustain diversified productions; (xv) considerable difficulties in attracting foreign investment; (xvi) lack of adequate market access opportunities for placing their few export products, and (xvii) high transport and transit costs.

¹⁴ WT/COMTD/SE/W/12, 21 February 2005.

39. At a glance, some of these characteristics and problems seem not to be specific to LLDCs or small economies in general, or not trade-related. However, what makes them specific and unique in this context is (a) the *cumulative nature* of these characteristics and problems in LLDCs, which reinforce each other and affect negatively their trading capacity; and (b) *the very limited capacity of these countries to address them adequately in their efforts aimed at enhancing the international competitiveness of their exportables*.

40. Characteristics and problems that have a special bearing on the trade potential of LLDCs are grouped and analyzed below so as to facilitate the efforts of those countries to design appropriate systemic responses to these problems.

Geographical and infrastructural characteristics and problems

41. All LLDCs are geographically handicapped by the lack of direct access to the sea. Although all LLDCs share this characteristic, the landlocked situation differs from LLDC to LLDC. While Zambia has eight neighbouring countries, some of them landlocked as well, Lesotho by contrast is surrounded by only one transit neighbour. Nepal could also be considered to have only one transit country, since the Himalayan mountains prohibit any transit through its second neighbour – China. Swaziland and Zimbabwe, on the other hand, have a choice of several transit countries, while Uzbekistan is a double-landlocked country, since all its neighbours are landlocked as well.

42. As a consequence of their geographical situation, LLDCs face long distances to seaports and main markets. For LLDCs, the average distance from the sea is 1,370 km, which is almost 50 per cent longer than the distance between the west to east borders of France. Central Asian LLDCs face extreme distances, with Kazakhstan (3,750 km), Kyrgyzstan (3,600 km), Tajikistan (3,100 km) and Uzbekistan (2,950 km) being the most remote countries among all LLDCs. In Africa, Swaziland has the shortest distance to the sea (193 km), while Chad (1,669 km), Rwanda (1,867 km) and Zambia (1,975 km) are among the most remote LLDCs. However, since these point-to-point routes are not always accessible to LLDCs, the actual transit distances are often even longer. For example, when in the 1990s Burundi's principal transit route to the port of Mombasa was closed because of political conflicts, an alternative transit route had to be used, involving a distance of nearly 4,500 km, as well as several border crossings and changes in modes of transport.

43. The trade-hindering effect of long distances is compounded by an inadequate transport infrastructure, both in the LLDCs and in their neighbouring transit countries. For example, a number of LLDCs have no railway infrastructure at all (Afghanistan, Bhutan, Burundi, Central African Republic, Chad, Lao People's Democratic Republic, Lesotho, Niger and Rwanda). More than half of the 20 countries in the world with the lowest road density are LLDCs. This low density of roads and railway lines, and congested ports and generally weak infrastructure maintenance in LLDCs and many of their transit partners, are serious obstacles to efficient trade transactions.

44. Although it is not the only way to enhance the LLDCs' greater participation in the multilateral trading system, the improvement of the transport infrastructure in both the LLDCs and their transit countries is a critical challenge.

High transport and transit costs

45. High transport cost and transit costs remain the key obstacle for most LLDCs to participate competitively in the global trading system. Transaction costs are high mainly because of the following factors and circumstances, which may apply either individually or in combination:¹⁵

(i) excessive transit transport costs and inadequate infrastructure facilities both at border crossings and throughout the journey to seaport; (ii) extra service fees and charges related to transit traffic (e.g. trans-shipment, cargo handling), insurance, banking and translation of documentation; (iii) costly administrative barriers at customs and border-crossing points, as well as delays due to national holidays and temporary unilateral closure of border crossings in transit countries; (iv) compliance costs due to additional technical and documentation requirements; (v) costs due to delays and the inability to fulfil contractual obligations, caused by transit problems; (vi) costs related to the maintenance of stocks and inventories in LLDC, as a precaution against potential transit delays; (vii) the “hassle” factor related to the complexity of transit transactions; and (viii) additional costs related to the unpredictability of trade flows and corruption.

46. Although non-landlocked countries may also incur these costs, the unavoidability of transit dependence places LLDCs at a particular disadvantage and subjects them to their neighbours’ border procedures, infrastructure and political will for bilateral cooperation.

47. Transport costs of LLDCs are influenced by one or all of the following factors, or a combination thereof:

(i) Countries that are located further away from major markets are likely to face higher shipping costs than countries that are nearer. For example, a 10 per cent increase in sea distance is associated with a 1.3 per cent increase in shipping costs, and a 100 per cent increase in distance results in a 20 per cent increase in transport costs.¹⁶

(ii) Overland (rail/road) transport costs tend to be considerably higher than sea freight costs. While an extra 1,000 km by sea may add \$190 to transport costs, a similar increase in land distance may add \$1,380.¹⁷ Thus, for a given distance, countries with a high proportion of transit by land, such as is the case in most LLDCs, tend to have high overall transport costs

(iii) Most exports from LLDCs have to be transported through multimodal transport chains, involving costly changes in the mode of transport. Moreover, the quality of port administration and/or port infrastructure also influences the cost of transport.

¹⁵ Based on the compilation of transaction costs in UNECE, *Trade Facilitation in a Global Trade Environment*, 2002.

¹⁶ Radelet and Sachs (1998). *Shipping Costs, Manufactured Exports and Economic Growth*. John F. Kennedy School of Government, Harvard University.

¹⁷ Limão and Venables (2000). *Infrastructure, Geographical Disadvantages and Transport Costs*. World Bank Research Paper.

(iv) Transport costs will depend on the composition of trade, as well as the type and the processing stage of primary commodities, where, in general, transport costs of higher-value goods represent a smaller proportion than lower-value exports.

48. These factors explain why the transport costs of LLDCs as a group represent about 11 per cent of their total export value, which is on average almost twice higher than those of developing countries in general. On the other hand, the lower transport costs of a few LLDCs that either benefit from the well-developed transport infrastructure of their transit countries (Lesotho, former Yugoslav Republic of Macedonia, Republic of Moldova, Swaziland) or use relatively inexpensive pipelines for their main exports (oil – Azerbaijan, Kazakhstan), or rely on air transport (Botswana) show the critical role of infrastructure development for transport costs of LLDCs.

Domestic market size, supply constraints, difficulties in attracting FDI and low competitiveness

49. Document WT/COMTD/SE/W/12 lists a number of characteristics and problems that relate to the size of domestic markets, local supply capacity and low competitiveness, constraining LLDCs' participation in the global trading system.

50. The size of the domestic markets of LLDCs is determined by the size of their GDP (on average about \$4.7 billion) and, to a lesser extent, by the size of their populations, which mostly varies between 1 and 13 million people.¹⁸

51. The small size of LLDCs' markets, which is reflected in low domestic demand, does not make it possible to benefit from scale effects. However, without economies of scale, production costs are comparatively higher and products are less competitive internationally. Consequently, both local and foreign investors are discouraged from investing in LLDCs, particularly in industries such as automobiles, chemicals, office machinery, mechanical and electrical engineering and others in which competitiveness depends significantly on economies of scale. Part One of this report provides a detailed analysis of constraints on greater FDI flows to LLDCs.

52. The demand-curbing effect of small local markets, which is reinforced by the high transport costs for trade, tends to favour the development of traditional, low-tech industries in LLDCs, such as leather goods, footwear and textiles. With the exception of the extractive industry, most local industries in LLDCs are associated with low levels of productivity, which bear negatively on their international competitiveness. The international competitiveness of goods from LLDCs is further impaired by the transport implications of geographical remoteness, as discussed above. Consequently, LLDCs play only a minor role in international trade. Part One of this report provides further details on this constraint and problem.

53. LLDCs therefore should ensure that the outcome of the current trade negotiations allows for policies that would help overcome constraints related to domestic market size, supply constraints and low competitiveness, such as the promotion of regional cooperation agreements, sector-specific investment incentives, promotion of research and development, and infrastructure development measures.

¹⁸ With the exception of Ethiopia (70 million, Uzbekistan (26 million). Uganda (25.8 million), Nepal (25 million), Afghanistan (23.8 million), Kazakhstan (15.4 million).

Low diversification of exports and export markets, and high economic vulnerability

54. The high export concentration of most LLDCs reflects the above constraints in market size, supply capacity and international competitiveness. Primary commodities, particularly energy, are the single most important category of LLDCs' merchandise exports. Three major oil-exporting LLDCs (Azerbaijan, Kazakhstan and Turkmenistan) accounted for about 42 per cent of total LLDC exports in 2002. Exports of manufactured goods tend to be concentrated in products of low-skill and low-added-value industries.

55. A number of LLDCs have built up productive capacities in response to preferential arrangements granted by developed countries, in particular the EU and the United States. These measures have helped them to accelerate the process of industrialization by providing market access to LLDCs' products, but since the preferences were often granted selectively and sector-specifically, they also tended to increase their vulnerability vis-à-vis external developments that are beyond the control of LLDCs.

56. When the WTO Agreement on Textiles and Clothing (ACT) expired on 1 January 2005, several LLDCs were severely affected by the consequences of this. For example, foreign investors in Southern African LLDCs, which had invested there to take advantage of the tariff-free access to the United States market under the African Growth and Opportunity Act (AGOA), relocated their investments to more competitive countries. In Lesotho, where almost all export earnings used to come from the textile and clothing sector, six factories have been closed since the beginning of January 2005, with the loss of more than 10,000 textile workers' jobs. In Malawi, where nine textile companies operate under AGOA and textile exports were worth \$20 million in 2004, some 2,500 jobs have already been lost and about 11,000 workers face an uncertain future. In Swaziland, where AGOA products constituted 83 per cent of the country's exports, 30,000 jobs are at stake.¹⁹

57. In addition to the level of export concentration, the United Nations Economic Vulnerability Index (EVI) includes elements such as instability of agricultural production, instability in exports of goods and services, the economic importance of non-traditional activities in GDP and economic smallness, measured by the size of the population. However, "landlockedness" does not figure in this composite index.

58. Although the economic vulnerability indicator for the group of LLDCs is much higher than the average for all developing countries and only second to that of small island States, it has not yet been used to emphasize the dimension of this constraint for LLDCs, or small economies, in the WTO. With a view to better highlighting the special situation of LLDCs, these countries could argue for the inclusion of landlockedness in the EVI and ensure its utilization in the WTO, for example on decisions regarding the granting of special and differential treatment.

Special and differential treatment and LLDCs

59. Special and differential treatment (SDT) is based on both the recognition of an inherent inequality in the global trading system that places developing countries in a disadvantageous position in international trade and the need to compensate for these disadvantages by treating these countries differently. This understanding is fundamental to the functioning of the multilateral trading system. It acknowledges the fact that developing countries are at different stages of economic, financial and technological developments and consequently differ in their

¹⁹ South Africa: Textile firms fight for survival, 25 April 2005, www.bharattextile.com/newsitem/1994738.

capacities as compared with developed countries in implementing multilateral commitments and obligations. It also recognizes that different levels of development achieved by WTO members require different sets of policies to achieve economic growth and development.

60. In brief, SDT means that WTO members accept a deviation from the general rule of *quid pro quo*, or reciprocity, for the developing countries. The basic approach to SDT includes primarily the principles of better market access for exports by developing countries and a lower level of obligations for them, as well as different expectations regarding the application of various multilateral trade agreements by developing countries.²⁰

61. Both the concept of SDT and its practical implementation have evolved since the notion of SDT was introduced in the Havana Charter. A milestone was the adoption of the Enabling Clause for developing countries, officially called the “Decision on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries”, under the GATT in 1979, which enables developed WTO members to give differential and more favourable treatment to developing countries.

62. However, while originally STD was a recognition of the special problems of development faced by developing countries, as with the WTO agreements emphasis shifted more towards the special problems that developing countries may face in the implementation of the agreements. Moreover, SDT was further eroded by the fact that the WTO agreements went far beyond the traditional border measures covered under the GATT and included many more areas of domestic economic policy making. Currently, there are over 150 SDT provisions in the WTO Agreements and Ministerial Decisions. Some of these provisions are mandatory, while the others are non-mandatory, or "best endeavour clauses".²¹ The SDT provisions can be classified into six main categories:²²

- 19 provisions deal with transition periods, allowing beneficiary countries to implement and to sequence their trade and trade-related policy reforms at a pace consistent with their trade, development and financial needs, as well as to consider adjustment costs that are involved, and to provide them with time to build up the human and institutional capacities;
- 33 provisions allow for greater flexibility of commitments and of actions, and in the use of policy instruments by developing countries;
- 14 provisions help increase the trade opportunities of developing countries by avoiding or liberalizing restrictions on products of particular export interest to those countries, so as to promote and expand their exports to developed country markets;
- 50 provisions regulate the safeguarding of the interests of developing countries;
- 23 provisions relate specifically to LDCs; and
- 14 provisions address issues of technical assistance.

²⁰ See WT/GC/W/442, 19 September 2001.

²¹ In the legal terminology, mandatory provisions are basically those which contain strong commitments through such wording as "shall" and "mostly", while non-obligatory and "best endeavour" provisions include wording such as "should", "would", "committed to" and "wish to".

²² WTO document WT/COMTD/W/77 and Rev.1 and Add. 1–4.

63. LLDCs that are WTO members benefit in general from SDT provisions, and several of them benefit also from provisions that grant SDT to LDCs, but there are no special provisions that grant SDT because of constraints related to landlockedness or that take this handicap expressly into account.

64. However, within the general SDT provisions, the following appear to be of particular relevance to LLDCs:²³

- GATT 1994, Art. XXXVI – access to world markets for developing countries dependent on exports of a limited range of primary commodities;
- GATT 1994, Art. XVIII and Addendum – granting of government assistance, tariff and other protection to promote infant industries in economies, that can only support a low standard of living and are in the early stages of development;
- Agreement on Technical Barriers to Trade (TBT), Art. 2 – exceptions to the use of international standards, including for reasons of fundamental climatic or geographical conditions; Art. 5 – exceptions to the use by central government bodies of recommendations on conformity assurance of international standardizing bodies, including for reasons of fundamental climatic or geographical factors and fundamental technological or infrastructural problems;
- Implementation of Art. VI of the Anti-dumping Agreement, Art. 6.13 – difficulties faced by small companies and the provision for assistance;
- Agreement on Subsidies and Countervailing Measures, Art. 27 and Annex VII – phasing out of export subsidies; termination of countervailing duty investigations relating to developing country members where the latter are small suppliers;
- Decision of the Doha Ministerial Conference on implementation-related issues and concerns regarding the Agreement on Subsidies and Countervailing Measures – consideration of an extended transition period for developing countries to eliminate certain export subsidies;
- Safeguards Agreement, Art. 9 – non-application of safeguard measures against small suppliers.

65. With a view to improving the current SDT mechanisms, LLDCs should actively participate in the ongoing efforts to establish a concrete and binding SDT regime which is responsive to the development needs of the developing countries by focusing on enhancing market access opportunities for them and providing policy options aimed at unlocking their growth and development potential. However, since these efforts will need to take into account the stipulations of paragraph 35 of the Doha Ministerial Declaration regarding sub-categories of WTO member countries, it appears best for the LLDCs to advance these efforts in the context of the WPSE, which seeks the recognition of characteristics and constraints of small and vulnerable economies by all WTO member countries, so as to facilitate the fuller integration of these economies into the multilateral trading system.

²³ Based on WTO documents WT/COMTD/SE/W/6, 23 October 2002; WT/WGTI/W/119, 11 June 2002; and WT/COMTD/W/77/Rev.1, 21 September 2001.

Negotiations on non-agricultural market access

66. The current negotiations on non-agricultural market access (NAMA) focus on (i) the tariff-cutting formula; (ii) the treatment of unbound tariffs; (iii) the issue of sectoral elimination; (iv) the flexibilities for developing country participants; and (iv) trade preferences.

67. Requests by LLDCs for duty-free and quota-free market access for their exports, particularly to developed countries,²⁴ have not yet been granted, partly because LLDCs as a group may have little to offer in terms of reciprocity. Their imports of capital and intermediate goods already carry zero or minimal tariffs. Moreover, the heavy reliance on trade taxes as sources of fiscal revenue often restricts the extent to which LLDCs are able to reduce these tariffs as concessions in the negotiating process. Nevertheless, the current negotiation process has direct implications for LLDCs.

Implications of the proposed formula approach to tariff reductions

68. The NAMA negotiations attempt to find a formula approach to tariff reductions that reduces tariffs on industrial products while taking into account the needs of developing countries to protect their industries. The proposed “Swiss” formula would aggressively reduce tariffs, and this would have serious consequences for a number of LLDCs that already have low tariff rates. A further overall tariff reduction as a result of the negotiations may result in even lower tariffs, endangering fledgling industries in LLDCs and limiting their policy space for industrial development.

69. This formula operates in a non-linear manner, requiring deeper cuts for higher tariffs. LLDCs that maintain higher bound tariff structures, such as Bolivia, Botswana and Zimbabwe, would be particularly affected by this approach, which may be considered as contrary to the principles of less than full reciprocity and SDT.

70. Technical discussions focus on the methodology for converting non-*ad valorem* duties into *ad valorem* duty equivalents for the purpose of applying the tariff reduction formula. LLDCs such as Botswana, the former Yugoslav Republic of Macedonia, Swaziland and Zimbabwe, which have a share of non-*ad valorem* tariffs in their total tariff lines that is greater than 5 per cent, should pay attention to the methodology proposed for converting their non-*ad valorem* tariff lines into *ad valorem* duty equivalents.

Implications of treatment of unbound tariffs

71. As for the treatment of unbound tariffs, the current proposal suggests that the current applied rates be multiplied by two to have a base level, followed by application of the tariff formula, which will result in new bound tariff levels. As a result of this proposal, the binding coverage is expected to be up to 100 per cent of tariff lines, at an average level that does not exceed the overall average of bound tariffs for all developing countries. Hence, the treatment of unbound tariffs may become an issue of particular concern for some LLDCs with relatively low binding coverage (e.g. Swaziland and Zimbabwe).

²⁴ For example, during WTO Cancun Ministerial Conference (WTO document WT/MIN(03)/W/23, 14 September 2003); in the Almaty Programme of Action and Declaration, August 2003; and in the Communiqué of the 5th Annual Meeting of LLDCs, held in New York (WTO document WT/COMTD/SE/2, 7 October 2004).

Implications of sectoral elimination

72. Elimination of tariffs in seven key sectors (textiles, leather, footwear, fish products, electronics, motor vehicle parts, and gems and precious metals) was proposed. However, these sectors are of particular interest to many developing countries, including LLDCs. Without the current high levels of tariff protection for these sensitive sectors, local industries in LLDCs, particularly SMEs, would not have the capacity to withstand competition from abroad. Therefore, LLDCs may wish to join efforts aimed at exempting developing countries from sectoral elimination of tariffs.

Implications for trade preferences

73. LLDCs derive benefits from several trade preference schemes of developed countries, particularly the Generalized System of Preferences (GSP). Some developing countries also grant preferences within the context of the Global System of Trade Preferences (GSTP) and other multilateral preferential schemes. Preferential regional trading agreements, both with developed and developing countries, also play an important role for several LLDCs.²⁵

74. The granting of trade preferences is an exception to the MFN principle under the GATT. Certain provisions, such as the Enabling Clause, define the modalities of such exceptions, which should be generalized, non-reciprocal and non-discriminatory, as well as help facilitate and promote trade and respond positively to the development, financial and trade needs of developing countries. The WTO Appellate Body reconfirmed these modalities in April 2004.²⁶

75. However, it also pointed out that WTO members are in principle allowed to grant different tariffs to products originating in different GSP beneficiaries on condition that identical treatment is available to all similarly situated GSP beneficiaries. A WTO member that intends to grant additional tariff preferences under its GSP scheme would have to identify on an objective basis the special “development needs” of developing countries (such as “landlockedness”) which can be effectively addressed through tariff preferences.²⁷

76. The implications of this WTO Appellate Body's decision were reflected in the recent initiative of the EU regarding a new system of trade preferences for 2006–2008.²⁸

77. This scheme will focus on the poorest and most vulnerable developing countries that most need trade preferences to access the EU market. LLDCs may specifically benefit from the new “GSP+” tariff preferences granted to vulnerable countries, that meet the criteria regarding sustainable development and good governance. Key features of the new EU GSP scheme are (i) preferences based on clear, transparent and non-discriminatory criteria; (ii) compliance with the 2004 WTO Appellate Body ruling discussed above; (iii) reduction to zero duty for a total of 7,200 products; and (iv) provision of special benefits to vulnerable countries that accept the main international conventions on social and human rights, as well as on environmental protection and good governance.

²⁵ For example, the European Union grants special trade preferences to several LLDCs as these are beneficiaries of the Cotonou Partnership Agreement between African, Caribbean and Pacific (ACP) countries, which contains important provisions on the treatment of landlocked countries.

²⁶ See WT/DS246/AB/R, 7 April 2004.

²⁷ See for more details Communication from the Commission of the European Communities to the Council, the European Parliament and the European Economic and Social Committee, Brussels, 7 July 2004.

²⁸ The EU Generalized System of Trade Preferences, Brussels, 20 October 2004.

LLDCs in the accession process

78. As of 1 January 2005, nine countries of the 31-member group of LLDCs were not contracting parties of the WTO, namely Afghanistan, Azerbaijan, Bhutan, Ethiopia, Kazakhstan, the Lao People's Democratic Republic, Tajikistan, Turkmenistan and Uzbekistan.

79. Seven LLDCs have submitted their formal application for accession to the WTO and are currently in the process of accession negotiations, while Afghanistan has been granted observer status without its having submitted an accession request. Turkmenistan has no status at the WTO.

80. For acceding countries, accession to the WTO is a complex undertaking that often requires changes in their domestic economic policies so as to harmonize national trade legislation with international standards. It may also entail a loss in tariff revenue due to mandatory tariff cuts and the closure of non-competitive local industries as a result of market liberalization. On the other hand, as a member of the WTO, a country is (i) entitled to MFN treatment in the multilateral trading system; (ii) participates in a rules-based and therefore predictable trading regime; (iii) can contribute to the elaboration of international trading rules; and (iv) has access to international trade dispute settlement mechanisms.

81. The Almaty Programme of Action states that the accession of LLDCs to the WTO "should be further accelerated", taking "into account their individual level of development, including special needs and problems caused by the geographical disadvantage. The development partners should provide assistance in this matter."²⁹

82. Although it is possible to carry out simultaneously macroeconomic and trade reforms at a rapid pace in a highly inflationary environment before accession to the WTO, as for example Nepal did, the risk of undertaking reforms in such circumstances is that the acceding country might be forced to go back on its pledge and revert to its previous policies, for example by reversing tariff cuts owing to the lack of requisite resources that could not be mobilized otherwise.³⁰ In order to avoid such complications, it is recommended that acceding LLDCs take into account the following list of indicative elements for consideration in accession strategies:

- (a) Acceding LLDCs should pursue gradual trade reforms. Trade liberalization within the process of accession to the WTO should be sequenced in a manner that both does not harm domestic productive capacities and takes into account the limited budgetary and foreign exchange resources.
- (b) If necessary, structural reforms at the macroeconomic level should be implemented, including the removal of price controls, measures to strengthen the domestic private sector through privatization and elimination of State monopolies in foreign trade, the promulgation of foreign investment laws, liberalization of the foreign exchange market and currency devaluation.
- (c) Quantitative restrictions should be eliminated, while import licences and prohibitions should be reduced as much as possible.
- (d) Before commitments and concessions on tariff cuts are made, acceding LLDCs should find alternative sources of revenue, such as indirect taxes that compensate for the loss of tariff revenues. The introduction of a single, uniform tariff structure across the

²⁹ Priority 3, Almaty Programme of Action.

³⁰ UNCTAD, *The Least Developed Countries Report 2004*.

board, as well as a reduction in the number of tariff bands, could help to rationalize and to simplify the tariff regime and make it more efficient.

(e) Export restrictions should be abolished and measures to facilitate and support exports should be introduced at an early stage in accession negotiations.

(f) As developing countries, acceding LLDCs should not be required to undertake obligations beyond those relating to the strict application of the WTO Agreements.

(g) The accession process of landlocked LDCs (Afghanistan, Bhutan, Ethiopia and Lao People's Democratic Republic) should be accelerated in accordance with to the WTO General Council's Decision.³¹

(h) During the accession process and upon its completion, LLDCs should continue to benefit from specific and targeted technical assistance, and the pace and scope of implementation of obligations and commitments emanating from the WTO Agreements should be linked to the availability of such assistance.

Concluding remarks

83. LLDC members of the WTO have made great efforts to implement their contractual obligations emanating from participation in the multilateral trading system. Although they have derived benefits from the rules-based trading environment under the WTO Agreements, their specific characteristics and constraints of geographical remoteness, transit dependence and economic vulnerability, which cumulatively hamper more development-oriented participation by these countries in international trade, have not yet been fully recognized in the WTO.

84. The preparations for the forthcoming sixth WTO Ministerial Conference provide an opportunity for LLDCs to take stock of achievements so far and to develop realistic objectives for their further participation in the ongoing trade negotiations, in particular regarding paragraph 35 and other relevant parts of the Doha Declaration, as well as the 2004 July Package.

85. Key elements of a road map for the participation of LLDC member countries in WTO negotiations could include the following:

- Trade facilitation needs of LLDCs should be addressed as a priority, in particular through improvements to Articles V, VIII and X of GATT 1994. The explicit recognition of the transit problems of LLDCs in relevant articles could be a critical entry point for enhanced trade-related financial and technical assistance.
- Furthermore, transit WTO member countries and acceding transit countries should be required to apply the principles of national treatment and non-discrimination in their transit policy and in related administrative procedures vis-à-vis transit transport from LLDCs.
- Under the Work Programme on Small Economies and relevant negotiations, LLDCs need to prioritize issues of importance to them, define their objectives and goals and decide on which issues discussions should focus on immediately and which could be taken up later. They also should ensure that agreed rules and regulations are sufficiently flexible to serve the development needs of small and vulnerable economies and take into account the specific characteristics and constraints of LLDCs.

³¹ WTO document WT/L/508, 20 January 2003.

- SDT treatment for LLDCs should be given a concrete and operational content and aimed at increasing trade opportunities for those countries, while safeguarding their legitimate interests and granting appropriate transitional periods for the implementation of new commitments that take into account the availability of resources required for effectively implementing these commitments.
- LLDCs should have better access to markets, in particular those of developed countries, through the extension of duty-free and quota-free market access for their goods and services.
- LLDCs should work towards a decision that supports the continuation and extension of trade preferences and aims at the revision of trade-hampering requirements regarding rules of origin, administrative procedures and non-tariff barriers, including excessive TBT and SPS measures, so as to enhance the effective benefits derived by these countries from trade preference schemes.
- Relevant WTO Agreements should facilitate regional integration efforts by LLDCs and their developing partners.
- The accession process of interested LLDCs should be facilitated, *inter alia*, by providing needed assistance and by ensuring terms and conditions that take into account the level of development of these LLDCs.
- The needs of LLDCs in terms of trade-related technical assistance and capacity building should be better recognized through an integrated, innovative, targeted and effective approach, particularly in the light of the 2004 July Package, which links the implementation of commitments, particularly regarding trade facilitation, to the availability of requisite support.
- LLDC members of WTO may wish to formalize their coordination efforts among themselves by establishing a Consultative Group, so as to enhance their impact in various WTO forums.