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THE POTENTIAL FOR GSTP TRADE EXPANSION

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I. INTRODUCTION

This note looks at the possible impact on trade within the Global System of Trade Preferences among Developing Countries (GSTP) of adopting a 30-per-cent or 50-per-cent linear tariff reduction for the next round of GSTP negotiations between member countries. It also looks at the importance of trade with other developing countries which do not participate in the GSTP. This note is intended to provide countries participating in the GSTP with technical information on the effects of possible negotiating techniques under this scheme.

II. CHANGING TRADE POLICIES AND TRADING PATTERNS IN GSTP MEMBER COUNTRIES

There have been major changes in the trade policies and trade patterns of GSTP member countries since the initial GSTP negotiations. The great majority of countries participating in the GSTP have undertaken substantial economic reforms which have enhanced the efficiency of their economies, increased their international competitiveness and enlarged the role of the business sector. Most countries participating in the GSTP have either achieved major trade liberalization or implement programmes to that end. As a result, in many, though not all, of the countries participating in the GSTP exchange-control measures, quantitative restrictions and many other non-tariff measures have virtually disappeared. Most of these countries have also reduced and simplified their MFN (most favoured nation) tariffs, which will be further reduced when the commitments undertaken during the Uruguay Round are implemented. MFN tariffs will range between zero and 20 per cent for the bulk of their imports. The new setting for GSTP negotiations will therefore be characterized by much more liberal trading conditions, which implies, in principle, less scope for preferential tariff margins than in the past. On the other hand, this scope has rarely been exploited to any significant extent: GSTP preference margins were tiny and provided only small price advantages for suppliers from participating countries. The new setting in which substantially lower trade protection is offered to domestic producers, could make preferential trade negotiations much more straightforward: the new situation is more transparent, the effectiveness of tariff preferences is less likely to be impaired by a variety of other trade barriers, and benefits and risks are easier to evaluate than in the highly protectionist situation prevailing when the GSTP was introduced. The increased competitiveness of domestic producers reduces the need for protection, as well as reduces pressures against trade liberalization.

Subregional and regional economic integration groupings of developing countries have gained renewed impetus, with some of them now at the stage where there is free trade among their members. Others have intensified and expanded their programmes for regional integration and widened the scope of economic cooperation. Groups such as the Southern Common Market (MERCOSUR) or the Association of South-East Asian Nations (ASEAN) have made substantial progress and have had a major effect on trade and investment among members. They support the usefulness of trade preferences if a broad-based linear and relatively deep liberalization commitment process is pursued. The members of such groups now have substantial experience of the effects of subregional trade liberalization on trade, production, investment and employment, as well as of managing related problems. The switch from product-by-product or sectoral trade liberalization methods to generalized across-the-board liberalization has sparked off a wide diversification of the products and enterprises now involved in trade among their member countries.

The progress of trade liberalization within such groups, or the setting of new goals to implement programmes for free trade between their members by the early years of the next decade, creates room for interregional preferences within the GSTP. Future GSTP goals can now be more ambitious, while remaining compatible with progress at the subregional and regional levels. The interregional role of the GSTP is also becoming more pronounced: its main potential lies in trade between the regions and in building bridges between the various subregional and regional integration groupings of developing countries. Technological progress supports this role of the GSTP: the new information and telecommunication technologies facilitate the search for new partners in distant regions and communication with them. In this process, certain subregional groupings have already assumed an important role in furthering progress in GSTP negotiations and in broadening its membership. It may be useful to explore in what way concerted action between such groups of developing countries could be mobilized to further the GSTP process and extend it to the remaining developing countries and groups of developing countries that are still outside the scheme.

Many countries participating in the GSTP are members of large groupings comprising the world's leading trading nations, such as the Free Trade Area of the Americas (FTAA), the Asia-Pacific Economic Cooperation forum (APEC) or the network of bilateral free-trade areas and preferential arrangements of the European Union (EU), which comprise reciprocal commitments to achieve free trade and investment among all member States. While the form of the liberalization process differs substantially from one group to another, it is envisaged that developing countries should also achieve full trade liberalization during the period 2005-2020. In parallel, multilateral negotiations are likely to advance towards the worldwide liberalization of trade in goods and services, and a multilateral investment framework is under consideration. Various forms of interaction between global, regional and subregional liberalization processes seem feasible. Under the principle of "open regionalism" of the APEC type, progress in smaller frameworks could accelerate the multilateral liberalization process. The tendency of developing countries to embark on fully reciprocal trade and investment liberalization with the world's major trading nations reflects their growing confidence in the competitiveness of their economies. This increased confidence should also facilitate the GSTP negotiating process and make it possible to adopt more efficient and far-reaching approaches and commitments.

GSTP trade coverage

Trade among GSTP participants, outside their main subregional integration groupings, was estimated at about US$ 93 billion in 1996, or slightly more than 10 per cent of their total imports. This trade has expanded rapidly over the past five years, at a rate of 25 per cent a year.

The commodity composition of trade among GSTP participants has undergone major changes since the beginning of the arrangement. Petroleum trade no longer dominates interregional trade among developing countries, but accounts for only a little over 10 per cent of trade between them. Mutual trade in other commodities and agricultural products expanded at a sustained rate of 13 per cent annually between 1990 and 1995. The main source of growth, however, was trade in manufactures, which grew by almost 30 per cent annually. Thus, by the mid-1990s, manufactures constituted the bulk of trade between GSTP participating countries and accounted for almost two-thirds of their world imports.

Trade barriers

The scope and strength intensity of trade barriers are now relatively low in most GSTP countries, as compared to the situation in the mid-1980s. Highly complex and restrictive import policies which relied on a variety of import restrictions have in most participating countries given way to tariffs as the main instrument for controlling imports. However, a significant number of quantitative restrictions still subsist in some GSTP countries: their progressive relaxation at the MFN level is envisaged but may take some time to take effect. At the same time, average and maximum tariffs have been reduced substantially by many GSTP countries. These reforms have increased transparency and made it easier to assess the potential effects of tariffs and tariff concessions, and will thus facilitate trade negotiations.

In the industrial sector, the majority of GSTP countries for which data are available will apply post-Uruguay Round rates averaging between 7 and 14 per cent *ad valorem*, with higher rates for consumer goods (frequently between 20 and 35 per cent). For one in four of these countries, average industrial tariffs range between 20 and 29 per cent. A few GSTP countries, notably Singapore, impose very low MFN tariffs on imports (in that country tariffs are as low as 0.4 per cent).

Agricultural tariffs vary widely between individual subsectors and products. Tariffication of quantitative restrictions and other import barriers as a result of the Uruguay Round has brought about very high MFN tariffs for sensitive products. For other agricultural products, average tariffs frequently range between 8 and 14 per cent. In one-third of GSTP countries, the average agricultural tariffs are relatively low (i.e. 5 per cent or less), while in a few countries the average rates exceed 20 per cent.

III. ESTIMATES FOR THE TRADE POTENTIAL OF THE GSTP

Preferences exchanged during the first round of GSTP negotiations cover only about 1 per cent of the participating countries' global non-fuel imports. Preference margins are also low, amounting in most cases to less than five percentage points of the MFN rates, so that the tariff value of GSTP preferences may be estimated at about 0.03 per cent of the non-fuel imports of participating countries. The possible effects of these GSTP preferences on prices, tariff revenues and trade remain, therefore, very limited. Past preference margins are largely offset by the cost of additional customs procedures for obtaining access to preferences, such as origin certification. Higher preference margins would be warranted by the high transport costs for interregional trade and trade between distant subregions, which are characteristic of the GSTP. On the other hand, autonomous tariff reduction programmes, the implementation of the Uruguay Round commitments and the implementation of subregional liberalization programmes or free-trade area agreements with the major developed countries tend to erode price margins and the effectiveness of these preferences.

In accordance with the GSTP Agreement, future negotiations on increasing preference margins and enhancing the economic effectiveness of the GSTP could continue on the basis of product-by-product negotiations, or could take the form of sectoral arrangements or across-the-board tariff reductions. This note attempts to estimate the potential effect of two working hypotheses:

(a) A linear 30-per-cent reduction in MFN tariffs on all products; and
(b) A linear 50-per-cent reduction in MFN tariffs on all products.

These two options do not necessarily constitute alternatives, but could represent consecutive stages in the process of increasing GSTP preference margins in the near future. From this perspective, even the more intensive option is broadly compatible with liberalization within the existing integration groupings of developing countries, taking into account the progress achieved or targeted by them, as well as the goals of APEC, FTAA and the EU Euro-Mediterranean agreements. The estimates in this study are based on the trade of participating countries outside their major integration groupings (such as MERCOSUR, ASEAN, the Latin American Integration Association (LAIA) and the Arab Maghreb Union (UMA), whose member States have not negotiated GSTP preferences among themselves).

The simulation of the effects on trade of the two hypotheses is based on UNCTAD's trade policy simulation model, which has traditionally been used to estimate the effects on trade of tariff changes in multilateral or preferential negotiating frameworks. The simulation uses, to the extent possible, trade and tariff data at the most detailed tariff-line basis available for 1995 or 1996. Detailed and up-to-date trade and tariff data are currently available in UNCTAD's TRAINS (Trade Analysis and Information System) data base for about 70 per cent of trade among GSTP participants. Some estimates have nonetheless been included for the remaining countries on the basis of data for broader product groups. Furthermore, certain limitations are inherent in the simulation model itself; for example, there are no data and no variables available for domestic production which would allow the effect of preferential imports on it to be evaluated; nor does the model take account of the dynamic effects of preferences. There is also a need to update estimates for price elasticities to take into account the changed international trading conditions. In view of these data limitations and the limitations of the model, the results of the estimation process should be interpreted with caution. They are, nevertheless, indicative of the possible ranges of effects and of their possible order of magnitude.

Results

A 30-per-cent preferential across-the-board tariff reduction among the present GSTP participants could result in an increase in trade between them of between US$ 7.4 and 8.5 billion. This would correspond to an 8-9 per cent increase in trade between them and close to 1 per cent of world imports of the countries participating in the GSTP. This estimate assumes that price elasticities remain within a prudent range, as customs costs and the costs associated with the large distances involved diminish the effectiveness of preferences. For example, a 30-per-cent preference on MFN tariff rates of 5, 10, 15 or 20 per cent *ad valorem*, which are now frequent in the tariff structures prevalent in developing countries, would represent a price advantage of respectively, 1.4, 2.7, 3.9 and 5 per cent. Only from a price margin of 3-5 per cent upwards (implying MFN rates of 12-20 per cent), GSTP preferences might be expected to lead to more substantial trade reactions. The estimate includes also a modest estimate for some of the initial dynamic effects of tariff preferences: on the basis of subregional experiences, it can reasonably be expected that once a certain threshold of preferences has been attained, substantial linear preferences will lead to the diversification of existing trade flows to new preferential export markets as well as to the entrance in the market of new firms and products.

If a 50-per-cent linear tariff cut were to be made, mutual trade could increase by US$ 15-18 billion, or 16-19 per cent of GSTP trade, which would raise the share of GSTP countries' imports in world imports from 10 to 12 per cent. (This estimate allows for slightly higher elasticities and greater diversification effects than the 30% version.)

Trade would be likely to increase mainly in the area of manufactured products, which account for about two-thirds of the increase. A quarter of the trade expansion would be accounted for by agricultural products and one-tenth by industrial raw materials and refinery products.

The potential trade expansion would be distributed over a wide range of products. About 30 product groups of the Harmonized System would have significant trade values and shares of more than 1 per cent in the total estimated trade expansion. Major agricultural products which could benefit from the preferences include vegetable oils, sugar, canned fruit and vegetables, oil cakes and other by-products of the food processing industry, as well as fishery products. Among the industrial products, various machines and electrical equipment could be expected to take major shares. Other products which could benefit substantially include: steel and other metal products; organic chemicals, fertilizers and plastic products; rubber, leather, wood products and paper; various clothing and textile articles; and cars and other transport equipment.

The largest preferential trade increases would be likely to occur in India, the Republic of Korea, Bangladesh, Thailand, the Philippines, Mexico, Pakistan, Brazil and Indonesia. The preferential import increases would generally be more evenly distributed among member countries than their global imports: the top 10 GSTP countries account for about half of total preferential import increases, but for two-thirds of the worldwide imports of GSTP countries. Nonetheless, the extent of preferential import increases would vary substantially between countries, being higher for countries with a high share of imports from GSTP sources and which applied high tariffs on products sourced from participating countries. The impact on trade of projected reductions of 30 per cent and 50 per cent in GSTP tariffs are shown for selected countries in the annex.

The remaining quantitative restrictions in certain participating countries continue to act as a substantial limitation on the potential effects of trade expansion under the GSTP. This is particularly the case for certain consumer goods and food items which are of major export importance for smaller and medium sized GSTP participants. To achieve a balanced outcome under linear tariff preferences, importing GSTP countries would need to implement liberalization of GSTP imports in advance of their multilateral trade liberalization programmes.

IV. POTENTIAL EXPANSION OF COUNTRY COVERAGE

The effectiveness of the GSTP could be considerably enhanced by extending participation to other developing countries and China. Non-participating developing countries include several Arab countries (notably Saudi Arabia and the other Gulf States), many African countries south of the Sahara (including South Africa), the member States of the West African Economic and Monetary Union, several Central American, Caribbean and Pacific countries, as well as China and the Central Asian countries. More generally, the great majority of least developed countries do not yet participate in the GSTP.

Trade between GSTP countries and non-participating developing countries is equivalent to about 40 per cent of trade between GSTP participants. The participation of several of these non-participants could therefore contribute to a substantial expansion of trade within the GSTP. China is now one of the world’s leading importers; its global imports were worth US$ 140 billion in 1996, and they have been growing by 17 per cent annually - and by two-and-a-half times in value - since 1990, although they remain subject to relatively high import tariffs. South Africa’s imports exceeded US$ 30 billion in 1996 and grew at a rate of 9 per cent annually between 1990 and 1996. Saudi Arabia’s imports reached US$ 28 billion in 1996, and those of the United Arab Emirates reached US$ 23 billion in the same year. Western Asian non-participants offer a combined market worth of US$ 86 billion, although their tariff levels are relatively low. Other important medium-sized developing-country markets include the Central American Common Market (CACM) and the West African Economic and Monetary Union (WAMEU).

The pattern of non-participation by the developing countries suggests that the GSTP process would benefit from a more determined commitment by integration groupings to enhance GSTP preferences and broaden its membership. As in the case of the accession of MERCOSUR as a single unit, such commitment could have a major impact on the dynamism of the process. Direct contacts between participating and non-participating countries which belong to the same subregional groups, such as most of the African groups, CACM, the Caribbean Community (CARICOM) or the Cooperation Council for the Arab States of the Gulf (GCC), could bring closer the original GSTP objective of covering all developing countries. Countries participating in the GSTP and such a group could be effective catalysts for informing and convincing non GSTP participants of the potential advantages of the GSTP.

China

China’s imports from GSTP participants amounted to US$ 29 billion in 1996 and grew at an annual average rate of 30 per cent between 1990 and 1996. Almost one-quarter of those imports consisted of agricultural products and other commodities, which grew at a rate of 17 per cent a year during the same period. Manufactured goods accounted for US$ 18.3 billion, or 64 per cent of the imports in 1996 and recorded a 37-per-cent annual growth rate between 1990 and 1996. Crude petroleum and other fuel products accounted for some US$ 3.6 billion in 1996.

If China joined the GSTP, trade within this arrangement would rise by one-third. Under the hypothesis of a 30-per-cent linear tariff reduction, Chinese imports from present countries participating in the GSTP would increase by almost 10 per cent, or about US$ 2.6 billion. A 50-per-cent reduction would raise Chinese imports from these countries by 18 per cent, or about US$ 5 billion. More than 80 per cent of this increase would be in the form of manufactures: plastic products, synthetic fibres and machinery would each account for over 10 per cent of this increase in preferential trade. Other important products include special and knitted fabrics, iron and steel products, paper, electrical equipment and cars, agricultural inputs for industry, vegetable oils and cereals.

Chinese exports to GSTP countries amounted to US$ 24 billion in 1996 and have been growing at a rate of over 20 per cent since 1990. The share of manufactured goods is even more pronounced in China's exports, reaching almost 80 per cent; they amounted to US$ 18.4 billion in 1996 and have risen by an average of 28 per cent annually since 1990. Commodities constituted 13.5 per cent and fuels another 7 per cent of China's exports to GSTP participants. Substantial GSTP preferences would primarily enhance Chinese exports of machinery products, chemicals, metal products and a wide range of other manufactured goods.

Least Developed Countries

Only 9 of the 48 least developed countries (LDCs) currently participate in the GSTP or are negotiating to become members of it. Their global imports can be roughly estimated at about US$ 14 billion, corresponding to 1.5 per cent of the global imports of GSTP member countries. The few participating LDCs for whom estimates are possible are highly dependent on GSTP sources for their imports - perhaps for as much as one-third of their total imports. The increased trade that could be expected to result from linear tariff cuts of 30 and 50 per cent could reach 20 per cent and 33 per cent respectively, of their present GSTP imports.

The remaining 39 LDCs which are neither GSTP participants nor negotiating for access to it have a very small share of world trade. Their combined global imports amount to less than US$ 20 billion; together, they account for 2.2 per cent of world imports of GSTP participants. They have a substantial foreign trade deficit and their global exports reach only US$ 12.4 billion, or 1.4 per cent of global GSTP exports, which is broadly comparable to the GSTP exports of Colombia. The two largest exporters from this group of LDCs export petroleum, together accounting for 40 per cent of the group's exports. The exports of 20 of the remaining LDCs are each valued at between US$ 100 and 600 million; the exports of the other 17 LDCs are each valued at less than US$ 100 million.

The imports of GSTP countries from non-participating LDCs are estimated to have been worth about US$ 1.7 billion in 1996. About half of these LDC exports to GSTP destinations consisted of industrial materials and fuels, about 30 per cent of manufactured goods, and 20 per cent of other agricultural products. Their exports therefore cause little effective competition to domestic production or to trade with other GSTP partner countries. More detailed data on the trade flows of the 39 LDCs and on their tariffs are scarce. Examples of LDCs currently participating in the GSTP tend to indicate, however, that the granting of reciprocal concessions by LDCs can have a relatively strong impact on their imports and tariff revenue.

The GSTP Agreement provides in principle for the possibility of granting special and non-reciprocal concessions to LDCs. Some concessions already exist which are exclusively in favour of participating LDCs. Various mechanisms could be envisaged for the implementation of this principle under a linear tariff preference, such as differentiated percentage reductions, longer periods for implementation or the exemption of LDCs from linear tariff commitments for a certain period or until the time when their exports to GSTP participants reach a certain level. At present, participating countries continue to expect LDCs to provide tariff concessions, and have put forward request lists to interested LDCs.

A new approach was adopted on the occasion of the recent High-level Meeting on Integrated Initiatives for Least Developed Countries' Trade Development, at which several developed and developing countries declared their readiness or intention to extend non-reciprocal tariff preferences to all, or at least a large number of, LDCs for their major export products at an early date. They included a number of GSTP participants: Egypt, Morocco, the

Republic of Korea, Indonesia, Malaysia, Singapore, Thailand and Chile announced their commitment or intention to introduce such unilateral and genuinely non-reciprocal provisions, some of them referring specifically to the framework of the Generalized System of Preferences (GSP) or GSTP for their implementation. Most of them announced that detailed product lists and details of the depth of tariff preferences and conditions of application would be communicated in the near future. (Turkey has implemented its scheme of LDC preferences as of 1 January 1998.)

Subsequently, the Trade and Development Board of UNCTAD recommended in its decision on the implementation by UNCTAD of the outcome of the High-level Meeting (Decision 445 (Ex-16)), that the Secretary-General of UNCTAD should convene an ad hoc meeting as early as possible on GSP, GSTP and new initiatives for LDCs in the area of market access, to provide an opportunity for officials and experts from member States to discuss the major new developments in their national GSP schemes, including review of their special provisions in favour of LDCs, propose measures to extend the necessary advisory services to enhance GSP/market access utilization; and follow up and monitor the announcements made in this regard during the High-level Meeting. The expert group will include a limited number of experts specially invited by the Secretary-General, but will remain open-ended to allow all interested member countries to participate. The report of the expert group will be an important contribution to the debate at the next session of the Commission on Trade in Goods and Services, and Commodities, scheduled for September 1998. In the light of these developments, GSTP participants might wish to consider modalities for mobilizing increased interest of LDCs in the GSTP, as well as ways in which the announcements made at the High-level Meeting by some members could be followed up in the GSTP context.

ANNEX

Table 1

Estimated increase in GSTP imports of selected GSTP participants if GSP tariffs were reduced by 30% or 50%

	Total imports 1996 (US$ billion)	Total GSTP imports 1996 (US$ billion)	GSTP trade increase if tariffs reduced by 30%		GSTP trade increse if tariffs reduced by 50%	
			In millions of US$	Share of total GSTP trade (%)	In millions of US$	Share of total GSTP trade (%)
Argentina	23.8	1.1	102	9.6	230	21.7
Brazil	56.9	4.1	306	7.5	770	18.9
Chile	17.8	1.1	96	8.5	216	19.1
Colombia	13.7	0.5	60	12.2	134	27.3
Mexico	62.2	2.9	332	11.3	755	25.8
Venezuela	9.9	0.2	19	10.6	41	22.8
Bangladesh	6.6	2.3	543	23.2	1 201	51.3
India	37.4	6.6	765	1.5	1 717	25.9
Indonesia	42.9	5.4	285	5.3	644	11.9
Republic of Korea	150.3	19.3	736	3.8	1 670	8.7
Malaysia	78.4	6.1	189	3.1	433	7.1
Singapore	131.3	7.7	220	2.9	505	6.6
Sri Lanka	5.4	1.2	152	13.1	341	29.7
Thailand	73.5	5.2	506	9.7	1 158	22.1
Egypt	13.0	1.8	127	7.0	393	21.7