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Deepening India's Engagement with Africa through better Market Access (Policy Brief- January 2015)

Background

Trade is an important component of many Least Developed Countries' (LDCs) development strategy. The ability of LDCs to expand export earnings largely depends on growing world trade, market access and the LDC's ability to diversify their export products. LDCs need substantial increase in their export revenue to maintain their current level of development and to build resilience against any future crises.

To provide such a 'trade' stimulus, developed countries agreed in 2001 during the Doha round to increase market access for exports originating from Least Developed Countries (LDCs). In 2005 in Hong Kong, WTO members agreed that "developed and developing countries shall provide Duty Free Quota Free (DFQF) market access to products originating from LDCs.

India was the first among the emerging economies to launch a duty-free quota free market access scheme for the least-developed countries (LDCs) following the Hong Kong Ministerial Declaration of 2005. The duty-free trade preference (DFTP) scheme, which was announced at the India-Africa Forum Summit in April 2008, became fully operational in October 2012.

The DFTP provided for preferential treatment (duty free or MOP) to 94 per cent of the Indian tariff lines, whereas 6 per cent of tariff lines were in the exclusion list that could be exported to India at MFN tariffs. However, the Indian government announced the revised DFTP scheme in April 2014. As per the revised scheme, the DFTP scheme will now effectively provide duty free treatment to about 98 per cent of tariff lines, up from 94 per cent initially.

However, in the post-DFTP period, excluded products made up for 15 per cent of LDCs' global exports measured in value terms with their share in the total exports of individual countries ranging from 0.1 per cent (Lesotho) to 82.4 per cent (Burundi) (Ancharaz et al. 2014).

However, the 2 per cent of excluded tariff lines comprise products such as fruit and vegetables, cocoa, coffee, tea and maize in which LDCs are known to have a notable comparative advantage.

These exclusions point to some disconnect between the scheme's intent and its actual impact.

Therefore, analyzing the benefits and shortcomings of the DFTP scheme may provide vital policy lessons for India and LDCs.

This policy brief assesses the implementation and impact of the DFTP scheme on three African countries Ethiopia, Uganda and Tanzania.

Rest of the policy brief is structured as follows:

Section II provides a brief introduction of India's DFTP scheme. Section III provides empirical evidence from previous studies.

Section IV provides country-wise impact of DFTP schemes. Section V explains the problems with DFTP scheme and suggests measures for improving the scheme to suit LDC's better. Section VI provides the conclusions.

II. India's DFTP Schemes for LDCs

India became the first emerging economy to announce a tariff preference scheme for LDCs.

The Indian DFTP scheme, which came into force on 13 August 2008 and was open to all LDCs, offering duty-free market access to LDC exports on 85 percent of India's tariff lines, and a margin of preference on another 9 percent (equivalent to 462 products) of tariff lines. The remaining 6 percent of tariff lines (326 items) were excluded from duty preference: these products were subject to MFN rates. 48 LDCs (33 from Africa, 14 from Asia and one from America) were officially beneficiaries of the scheme. The scheme aimed to integrate LDCs into the global economy by allowing greater tariff-free access to the Indian market. The initiative represents India's new engagement with Africa to deepen trade and development cooperation with the continent.

The scheme provides for preferential treatment for several products of particular interest to LDCs, especially African LDCs, such as cotton, cocoa, aluminum ores, copper ores cashew nuts, cane sugar, readymade garments, fish fillets and non-industrial diamonds.

However, the DFTP excludes preferential treatment for 326 items or 6 per cent of total tariff lines. The exclusion list contains a number of products of key exports from LDCs such as fruit and vegetables, cereals, coffee, spices, tea, oil seeds, tobacco products, iron and steel, and other metals.

The fact that the DFTP scheme excludes several products of key export interest of LDCs might limit its effectiveness and impact. In April 2014, the Government of India revised the DFTP scheme. Among the products that have been fully liberalized include rice, maize, most fruits and vegetables (except fresh apples and onions), and waste and scrap of most metals (except copper).

However, the new scheme continues to exclude a number of products of key export interest to LDCs, especially African LDCs. These include milk and cream (with sugar), whole milk powder, some fruits and vegetables (e.g. apples and onions), cashew nuts, coffee, tea, some spices and oilseeds (e.g. linseed, sesame), wheat flour, beer, wine and spirits, tobacco and cigarettes, and copper and related products (e.g. bars, rods, cathodes, waste and scrap).

III. Previous Empirical Evidence

DFQF schemes were first initiated by the developed countries. Available evidence suggests that they have, so far, not been very successful in stimulating higher value-added exports from LDCs. The World Trade Organization estimates that, on the whole, US trade preference schemes allow on average only 82.4 percent of imports duty-free, with pervasive exclusions.

However, this figure is misrepresentative since about 90 percent of all imports recorded under Africa Growth and Opportunity Act (AGOA) are in oil. Most Favored Nation duties on AGOA-excluded products average over 30 percent (Laird, 2013). Ito (2013) examines the impact of DFQF access to the Japanese market. The study finds that in general the LDCs did not benefit from DFQF access to Japanese markets. These findings suggest that for LDCs the tariff barrier is relatively a small obstacle. Trade is affected more strongly by other factors such as infrastructure, NTBs and geographic distances.

Laird, (2012) using a partial equilibrium model examined the impact of providing 100 percent duty-free treatment to LDCs' exports by a selected group of trade partners - (Canada, EU, Japan, US, Korea, China and India).

The results show that LDC exports would expand on average by 2.9 percent, with the biggest impacts coming from India (21.7 percent), Korea (12.9 percent) and USA (11.8 percent). Impact on the rest of the world is negligible.

The study also shows that countries with close-to-full duty-free coverage, such as Canada and EU, will register very small increases in exports from LDCs. The estimated modest impact of extending the Chinese scheme (1.7 percent) seems to be linked to the fact that the bulk of China's imports (90 percent in 2011) from LDCs consist of raw materials and mineral fuels, which already attract little or no duty, while China is also competitive against LDC manufactures generally.

Bouët et al (2010) examines the cost and benefits of DFQF access to LDCs by using computable general equilibrium model. The study finds that 97 percent duty free access provides little benefit for LDCs.

However, with the exception of extremely small losses for Madagascar, the other LDCs show significant gains from 100 per cent DFQF access in OECD markets.

While securing preferential market access can provide important advantages to LDCs, tariff reduction alone is not a panacea. Non-tariff measures, often consisting of regulatory standards such as sanitary and phyto-sanitary measures (SPS) can create even more significant border barriers to LDC exports. And 'behind the border' barriers, including unnecessary regulations, can also reduce or limit market access (Martinez Edo and Heal, 2013).

Further, even when barriers in destination markets are reduced, LDCs can still lack the capacity, in hard or soft infrastructure, to be able to take advantage of export opportunities. Technical assistance and capacity building, for instance under aid for trade, therefore remains necessary.

Efforts to increase this assistance are part of various proposals for improved LDC oriented terms that are being negotiated and also discussed under the Doha Round in a special LDC Package during the WTO Bali Ministerial (2013).

IV. Impact of DFTP on Exports

In this section, we present the impact of DFTP schemes on exports from three countries namely Ethiopia, Uganda and Tanzania. Based on top 30 export products to the world, DFTP covers around 33, 26 and 67 per cent of total exports of Ethiopia, Uganda and Tanzania, respectively. To assess the impact of India's DFTP scheme, we divide Ethiopia's exports pre-DFTP period (2004-2007) with the post-DFTP period (2009-2012), using 2008 as a cut-off point.

Between the two periods considered, the export of duty-free products observed higher growth rate in the post DFTP period for Ethiopia and Tanzania. Similar results were also found for MOP products. However, for Uganda, the exclusion commodities show higher export growth rate in post DFTP period.

Both duty-free and MOP products together still make up for almost 85, 29 and 96 per cent of Ethiopia, Uganda and Tanzania's export basket to India respectively. Overall, it looks like the DFTP scheme has stimulated exports of preference products in Ethiopia and Tanzania to India.

V. Problems with DFTP

Notwithstanding the benefits of DFTP schemes for LDCs, this scheme has many problems. Currently, the exclusion list constitutes 2 percent of Indian tariff lines, but, in value terms, excluded products presented 10-15 percent of post-DFTP LDCs' global exports.

The share of exclusion products in the total exports of individual countries ranges from 0.1 percent (Lesotho) to 82.4 percent (Burundi) (Ancharaz et al. 2014). This 2 percent exclusion list mostly comprises agricultural and food products such as milk and cream (with sugar), whole milk powder, some fruits and vegetables (e.g. apples and onions), cashew nuts, coffee, tea, some spices and oilseeds (e.g. linseed, sesame), wheat flour, beer, wine and spirits, tobacco and cigarettes, and copper and related products (e.g. bars, rods, cathodes, waste and scrap).

In order to be eligible for tariff preferences, exports must comply with rules of origin (RoO) defined by the DFTP scheme. While these rules are relatively clear and simple, they can constitute an important barrier to trade. Indeed, survey data suggests that obtaining a certificate of origin is probably the most burdensome NTB that African firms exporting to India face. Currently, rules of origin present a significant problem as many LDCs have to import raw materials for their industries. Further analysis shows that the margin of preference on many duty-free products versus the MFN regime is rather low. Thus, some beneficiary LDCs may prefer exporting to India outside of the duty-free scheme as the additional cost of scheme compliance may not justify the marginal benefit.

Interviews with key stakeholders during field visits suggest that public officials, policymakers, and the exporter community are, by and large, unaware of the existence of the scheme, much less its finer details. Consequently, exporters in LDCs are unable to benefit from the scheme in products where significant tariff concessions are available. During the interviews, stakeholders in LDCs expressed the view that, even if the DTFP scheme offered full preferential access for exports, LDCs would probably not be able to supply India's large market. This follows from the limited production capacity and limited competitiveness of private sector in LDCs.

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VI. Conclusions

This policy brief assesses the effects of India's DFTP scheme on LDCs export to India by examining export trends of three countries namely Ethiopia, Uganda and Tanzania.

Primary data indicates that despite the fact that exports to India significantly increased in recent years, the effect of the scheme has been limited and varies from country to country.

The study also identifies many limitations of this scheme. Among others, exclusion of agricultural products, rule of origin, and low margin of preference compared to MFN rate and the cumbersome processes have limited DFTP access to Indian markets.

Simulation results suggest that global welfare and welfare of African LDCs would increase by USD 561 million and USD 1201 million, respectively, if India moved to a 100 per cent duty-free quota-free regime.

The loss to India would be a paltry USD 171 million, which, in any case, could be compensated by the resulting dynamic gains from liberalization over the long term (National Council of Applied Economic Research, 2014).

In order to improve the effectiveness of the DFTP scheme, a number of concrete actions and policy changes, by both the Indian Government and LDCs are required.

The first step would be to improve the level of awareness of the scheme through better communication to all stakeholders.

If the Government of India intends on using this scheme as a means to facilitate exports from LDCs, it should increase efforts in communicating with respective stakeholders in LDCs.

Furthermore, given that the scheme excludes products of key interest to LDCs, India could improve the effectiveness of the scheme by extending its product coverage.

Although India revised its DFTP scheme in 2014, still many products where LDCs have competitive advantage remain excluded.

In addition to enhancing the coverage of the DFTP, India can do much to build the productive capacity in LDCs through aid, investment and technological collaboration.

Indian FDI can be a conduit for technology transfer and knowledge spill-overs, and can therefore play an important role in the structural transformation of LDCs.

More importantly, non-tariff barriers need to be removed over time to stimulate exports of LDCs.

KPP is a South-South cooperation programme promoting knowledge sharing in the areas of Food Security, Resource Scarcity and Climate Change; Health and Disease Control; Trade and Investment; and Women and Girls. KPP is funded by the Government of UK's Department for International Development (DFID) and managed by a consortium led by IPE Global Private Limited under its Knowledge Initiative. The main objective of KPP is 'Gathering and uptake of evidence on issues central to India's national development that have potential for replication in LICs and impact on global poverty'.

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