

20 March 2009

Background Note

How is the Credit Crunch Affecting the Least-Developed Countries?

Nobody has much doubt that the least-developed countries (LDCs) will suffer significantly from the financial crisis and the global economic slump. Even if, so far, the impact has not been as great as that in developed countries, any damage to already fragile economies can be disproportionately severe in social and business terms. Certainly the economic situation of the LDCs will worsen before circumstances improve.

With much of the political focus on the OECD area – including unprecedented efforts to bolster the financial sector as well as massive economic stimulus packages – little attention is being paid to the plight of poorer nations in the wake of the broader crisis. AITIC has tried, in this note, to tie down some of the ramifications for LDCs in the trade and development sector. Data is neither clear nor always current. Further, almost every forecast made since the US recession started a year or so ago has proved over-optimistic. Hardly a day goes by without a new estimate that takes any previous forecast in a more negative direction. Nevertheless, we have sought to answer ten questions through the limited and often questionable statistics and estimates available. Our ten headlines would be as follows:

- i. **Trends in LDC Exports** to major developed markets have so far been mixed; broadly the clothing producers experiencing some downturn and the commodities suppliers tracking global trends.*
- ii. **Future Trade Impacts** will worsen; by how much depends on how quickly the financial system recovers and on the effectiveness of stimulus packages being introduced in major markets, including China.*
- iii. **Commodity Prices** in the agricultural sector are predicted to remain well above those of the 1990s, while metals will fare less well until industrial activity turns back up in the advanced economies. The consequent impacts on highly commodities-dependent LDCs will be serious.*
- iv. **Tourism** is likely to be the service sector most severely damaged in LDCs while their limited, locally-owned, banking and insurance industries are largely insulated from the global financial turmoil.*
- v. **Remittances** have tended to remain stable in past financial crises, but worst-case scenarios this time see significant numbers of overseas workers returning to LDCs.*
- vi. **Foreign Direct Investment Flows** in general are collapsing although LDCs with oil, gas and minerals reserves may see continued or even increased FDI, notably from major energy companies and China.*

- vii. **Trade Finance** is a serious concern for LDC exporters although the International Finance Corporation, regional development banks and others are stepping in to provide the necessary guarantees to help keep trade moving.
- viii. **Official Development Assistance (ODA)** looks certain to be cut back, perhaps severely if precedent is followed. It remains unclear how that will affect LDCs and whether Aid for Trade will take more or less of the strain.
- ix. **Trade Preferences** for LDCs appear, for the moment, not to be at risk – but reduced demand for goods may make them less valuable.
- x. **A Short-Term Doha Conclusion** is both unlikely and of doubtful value for LDCs in combating the impact of global recession – but some elements of a reduced ambition package will be valuable in the long term.

Contents

I.	How has LDC Trade been Affected so Far?	3
II.	What are the Forecasts for Future Trade Impacts on LDCs? How do LDC Trade Opportunities Relate to Economic Downturn in Major Developed Markets?	4
III.	What are the Likely Trends for LDC Raw Materials/Agricultural Commodity Exports?	5
IV.	What is the Likely Fall-out in Services Trade – Especially Tourism - for LDCs?	7
V.	How Badly will LDCs Suffer from Diminished Remittances from Overseas Workers?	8
VI.	What are the Prospects for Foreign Direct Investment Inflows to LDCs?.....	9
VII.	How is the Squeeze on Trade Finance, Export Guarantees etc. Affecting LDCs?	10
VIII.	Will Official Development Assistance, in General, and Aid for Trade (AFT), in Particular, be Cut Back at the Expense of LDCs?	11
IX.	Are LDC Trade Preferences at Risk?	13
X.	In the Light of the Financial Crisis does a Doha Result Become More or Less Important to LDCs?	14
	Acronyms	15

I. How has LDC Trade been Affected so Far?

1. In a speech to the Ministerial Conference on “Aid for Trade: an Industrial Agenda for LDCs” in Cambodia last November, Director-General Pascal Lamy stated:

The current financial crisis will no doubt have profound, and possibly prolonged effects on the LDCs, whose recent good economic performance has been heavily dependent on external factors. First, LDCs' exports — mainly oil, minerals, agricultural commodities, textiles and clothing, as well as tourism — are likely to see a substantial reduction as global demand declines. As a result, medium-term growth prospects for the LDCs are grim. LDCs, which as a group registered higher than world average growth rates of over 7 per cent in 2005 and 2006, are likely to see a slowdown this year. Growth for Sub-Saharan Africa is projected to slow down from 6.8 per cent in 2007 to 5.5 per cent in 2008, and to 5.1 per cent in 2009. The average growth rate among Asian developing countries is also expected to drop from 10 per cent in 2007 to 8.3 per cent in 2008 and 7.1 per cent in 2009.

2. For the moment, little data is available to confirm a broad negative view of the trade effect on LDCs of the global recession. The monthly statistics that have been published suggest a very mixed impact so far. The following indications are drawn from US, Japanese and Canadian official sources. Wherever possible, we have made a comparison between the fourth quarter of 2008 and the corresponding figures for the same period in 2007 when the recession in the United States is generally reckoned to have begun. In each case, monthly figures have been averaged for the quarter.

Table 1: LDC Exports to the United States¹

Million US Dollars

	Q4 2007	Q4 2008
Angola	1056	1023
Bangladesh	258	303
Mali	2	0.43
Cambodia	202	185
Laos	0.9	2.76
Liberia	10	11.5
Mozambique	0.55	1.3
Uganda	2.5	1.9
Zambia	5.2	2.9

3. As an oil supplier, Angola has seen no impact to date of reduced demand in the US. As major clothing producers, Cambodia and Bangladesh have seen their exports to the US hold up, while Laos has clearly gained market share. African countries generally appear to be suffering despite the AGOA (African Trade and Opportunity Act) preferential relationship. However, given the strengthening of the US dollar during the latter half of 2008, export earnings expressed in local currencies may look much healthier than appears here.

¹ US Census Bureau, Foreign Trade Statistics. Monthly averages for the quarter

4. As points of reference, it can be noted that between the same periods, monthly average EU exports to the US fell from USD31.16 billion to USD28.6 billion while US exports to the EU market were stable at around USD22.2 billion. However, the US dollar also recovered against the Euro from mid-year onwards.

Table 2: LDC Exports to Japan²

Billion Yen

	Q4 2007	Q4 2008
Bangladesh	6.6	7
Cambodia	5.4	4.1
Laos	0.34	0.6
Nepal	0.42	0.54

5. Between the same two quarters, Japan's exports to the EU fell from around Yen4.31 trillion to Yen3.28 trillion – or, in US dollar terms at the time, from USD38.7 billion to USD33.8 billion. Trade in the opposite direction rose slightly; from the equivalent of USD24.7 billion a month to USD25.6 billion.

Table 3: LDC Exports to Canada³

Million Canadian Dollars

	Q4 2007	Q4 2008
Bangladesh	37	54.8
Cambodia	14.7	22.9
Uganda	90.3	141
Zambia	21.9	24.6

6. Meanwhile, Canada's imports from the US increased from C\$17.5 billion a month to C\$19 billion and its exports to its southern market moved from C\$28.1 billion to C\$29.7 billion. However, during the same period the USD/C\$ exchange rate dropped substantially; from around 1 USD = C\$0.96 to 1USD = C\$1.21.

7. None of the results above suggest collapsing LDC exports, at least to the end of 2008. Import demand in the EU may have been dampened more than that in other large developed markets. At the same time, the performance of LDC exports priced in US dollars will often have looked better in local currencies.

II. What are the Forecasts for Future Trade Impacts on LDCs? How do LDC Trade Opportunities Relate to Economic Downturn in Major Developed Markets?

8. What may appear to have been a rather modest impact on the trading fortunes of LDCs so far certainly cannot be taken as an indicator of future performance. Much depends on the efforts of governments in OECD and major emerging markets to stimulate their economies, master the financial crisis and tame protectionist instincts. Since the situation is virtually unprecedented, governments themselves are unsure of the appropriate policy responses and of their impact. Thus, attempts to make predictions on the state of the global

² Ministry of Finance, Japan

³ Statistics Canada

economy are hazardous. LDCs will likely know the impact of the recession when they experience it.

9. For what it is worth, the IMF⁴ now sees global gross domestic product (GDP) growth falling 0.5 per cent in 2009 with a tentative recovery in 2010. The worst impact of the downturn will be seen in advanced economies while growth in emerging and developing economies will roughly halve from about 6.25 per cent in 2008 to 3.25 per cent in 2009. Growth in sub-Saharan Africa is projected at 3.5 per cent this year rising to 5 per cent in 2010. Trade prospects for LDCs are largely tied to demand in developed economies and a few emerging markets, notably China. The IMF sees the imports of advanced economies falling by over 3 per cent (volume) in 2009, creeping back towards nearly 2 per cent growth next year.

10. That is discouraging but not necessarily as bad as it looks for LDCs. Much of the strain in lost exports will be taken by China which, at the end of 2008 was reporting year-on-year export growth of less than 15 per cent compared to the 25 per cent and above performances in preceding periods. The World Bank⁵ has also projected China's export growth rate at just 3.5 per cent this year. However, the situation appears to be worsening almost daily. It is reported that China's imports plunged by over 43 per cent in January (over January 2008), the sharpest drop since 1995. Exports shrank 17.5 per cent in the same period; the third monthly fall in a row, and the sharpest in 13 years. Further, the IMF projection of falling import demand in major economies already looks over-optimistic. On February 27, the Department of Commerce announced real imports of goods and services by the US had decreased 16 percent in the fourth quarter of 2008 compared with the third quarter (the Q2 to Q3 fall was 3.5 percent).

11. Reports of widespread garment and textiles factory closures in China are obviously a worrisome sign for LDC suppliers. Cambodia (see above) was already experiencing an export downturn to the US market late last year, though that was not the case for Bangladesh. Naturally, the situation could worsen seriously if the US or other major OECD importers chose to protect their domestic producers. However, at a time of significant consumer pressures for lower prices, it would be politically difficult for governments deliberately to take action that put up clothing costs. It seems possible, therefore, that importers and retailers in Europe and North America will continue to purchase from low-cost producers, with demand at that end of the market perhaps even increasing as big-name branded goods become unaffordable.

III. What are the Likely Trends for LDC Raw Materials/Agricultural Commodity Exports?

12. According to UNCTAD, the dependence of low-income countries on commodities exports has remained stable over the past decade, at around 70 per cent (nearer 60 per cent if oil is excluded).

⁴ *World Economic Outlook Update*, January 28, 2009

⁵ *China Quarterly Update*, November 2008, World Bank

13. Soft (agricultural) commodities saw big price increases in early 2008 that have partially fallen back since. The World Bank⁶ believes prices will continue to fall this year; for instance, fats and vegetable oils prices are anticipated to drop by 27 percent in 2009 and another 5 percent in 2010 while beverages are projected to decline 18 percent and 4 percent, respectively. Despite these gloomy projections (which have been borne out by markets in the first two months of 2009), the Bank expects food prices to remain much higher than during the 1990s and more than 60 percent higher than their levels in 2003. Fertiliser prices have also slipped from their 2008 peaks. Much will now depend on the availability of financing for crop planting in the developed economies. If this remains tight and global stocks fall, then prices may well recover earlier than expected. Naturally, for most LDCs as net food importers, lower food prices tend to be welcome.

14. Several LDCs have a particular interest in cotton – either as exporters or importers. The US Department of Agriculture provided its own trade forecasts in late February. It saw world cotton consumption in 2008/09 at 112.6 million bales, down 10.0 million bales (8.2 per cent) from the 2007/2008 marketing year. This represents the largest year-to-year consumption decline since 1937/38, says the United States Department of Agriculture (USDA). Driven by this contraction in global consumption, total 2008/09 world import demand is expected to drop by 23 per cent to 29.3 million bales - the largest year-to-year percentage decline in world trade since 1940/1941. Double digit declines for imports are forecast in seven of the top ten importing markets, led by a 44-per cent decrease in China. Prices are falling - the A-index (Far East) has averaged about 63 cents per pound thus far this season, compared with 70 cents for 2007/08 – but remain above those for 2006/2007. In addition to the higher world stocks-to-consumption ratio, a general decline in commodity prices is affecting the global cotton market. USDA tentatively forecasts a mild recovery in 2009/2010 but in doing so recognizes the uncertainties in the current global economic situation. The agency also suggests that the US will increase its share of a smaller world market for cotton this year; presumably because most US cotton subsidy practices remain in place.

15. Those hard commodities exporters among LDCs will likely continue to suffer from reduced export revenues as lower global demand and high stocks continue to weigh on prices. *The Economist Intelligence Unit* (EIU) forecasts average base metals prices falling by nearly 50 per cent in 2009 with a modest recovery of around 12 per cent in 2010. Average natural rubber prices are set to fall by 44 per cent this year according to the EIU. While all these falls follow much larger price increases over recent years, they may well be underestimates. In recent weeks most prices in the metals markets (outside gold and silver) have been dropping sharply as demand plummets (notably in China) and stocks increase. Each piece of news about global growth and demand prospects impacts these markets instantaneously, mostly for the worse.

⁶ *Global Economic Prospects 2009*, December 2008, World Bank

IV. What is the Likely Fall-out in Services Trade – Especially Tourism - for LDCs?

16. In terms of export revenues, tourism is the key services sector for most LDCs and the one most likely to suffer seriously from the global economic downturn. While tourism revenues are often paid – and stay - outside the holiday destination, many poorer nations have based much of their economic growth strategies on developing the tourism business through hotel and other infrastructure construction. For some, eco-tourism has become a successful up-market segment with the most exotic destinations providing an attractive alternative to well-trodden tourist venues elsewhere.

17. Tourism worldwide stagnated in 2008, according to the UN World Tourism Organization (UNWTO), with relatively healthy first-half growth giving way to a marginal decline in the July-December period. The overall annual growth of under 2 per cent followed four years of rapid expansion well above the long-term trend. While part of the tourism explosion in the period 2003-2007 reflected the ability of the burgeoning middle-classes of Asia to travel for the first time, other travellers looked for new locations and found them in Africa and parts of South East Asia, including Laos and Cambodia.

18. Quite how tourist habits will change in the new economic circumstances is not clear yet. The UNWTO expects 2009 international tourism to be in the range of 0 per cent to a 2 per cent decline. Its January 2009 International Tourism Barometer states:

“Along with the Americas, Europe will be the most affected region in terms of overall tourism results as most of its source markets are already in, or entering into, recession. In Asia and the Pacific results are expected to be positive, although growth will continue to be much slower compared with the region’s performance in recent years; the same applies to Africa and the Middle East.”

19. This may prove to be an optimistic outlook. While LDCs are not likely to feel much impact from the substantial cut-backs in business travel, some hotels will feel the effect of conference and convention cancellations. More particularly, tourists appear set to travel less often, less far and for less time, many taking their holidays in their home countries. According to the International Air Transport Association (IATA), passenger traffic fell 5.6 per cent in January 2009, compared with a year earlier, while air cargo shipments dropped 23.2 per cent. This was the fifth consecutive monthly drop in passenger traffic and the eighth straight monthly decline for cargo. Asian carriers led the decline in passenger demand in January with an 8.4 per cent drop, followed by North American carriers with a 6.2 per cent decline. Africa was down 19.8 per cent, Latin America declined 17.2 per cent and the Middle East dropped 6.1 per cent. According to IATA airline losses exceeded USD4 billion in the fourth quarter of 2008 alone and USD8 billion for the complete year.

20. Few other services sectors affect the export revenues of LDCs so directly. However, the extent to which business services and financial firms, like banks and insurance companies, set up branches and do business in poorer markets can have an important impact on the competitiveness of local firms and SMEs. It may

be more comfortable for local services suppliers, but an absence of inward investment by large and efficient foreign firms does not often assist SMEs or stimulates a healthy business environment. That, however, is likely to be the situation for some years to come as the big international banks and insurers recover from the devastation of the financial crisis.

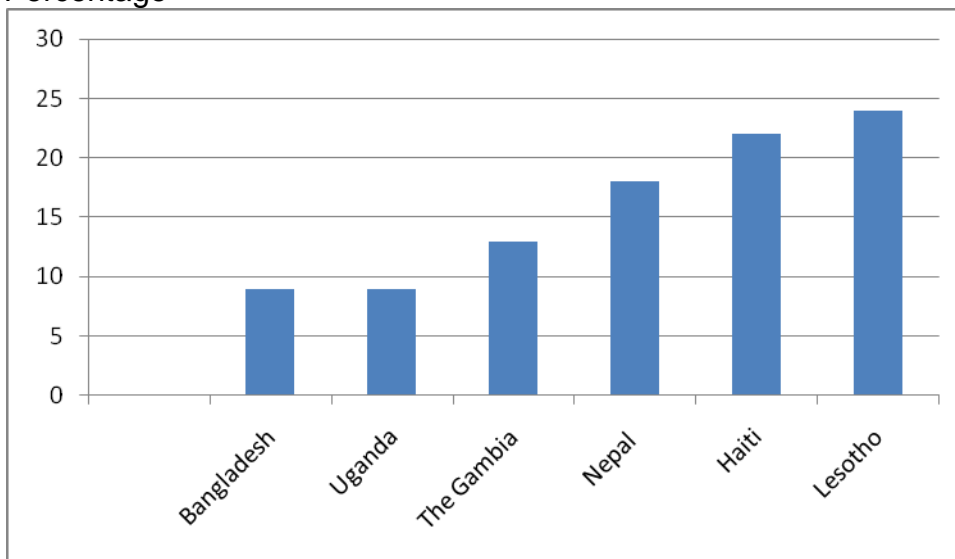
V. How Badly will LDCs Suffer from Diminished Remittances from Overseas Workers?

21. Of all the financial strains that LDCs may need to face as the global recession deepens, those from lost or diminished remittances from their nationals working abroad may be among the more severe. One official of the Inter-American Development Bank is quoted as follows:

"Remittances are the single strongest poverty-reduction tool that many countries have. This could translate into a great deal of hardship for a lot of people, which I think is underappreciated."

22. Remittances can account for a significant share of GDP. Chart 1 illustrates those LDCs with the heaviest dependence in 2006.

Chart 1. Remittances as a proportion of GDP for selected LDCs in 2006⁷
Percentage



Source: The World Bank

23. The World Bank⁸ has recently estimated that remittance flows in 2008 rose 6.7 per cent to a total of USD283 billion. However, these flows slowed significantly in the final quarter of last year. Further, because of the fall in the average value of the US dollar between 2007 and 2008, the result for the year represented, in real terms, a reduction for recipient countries from an average 2 per cent of their GDP to 1.8 per cent. The Bank forecast a drop in global remittances in US dollars of 0.9 per cent in 2009 as its base case. However, a worst case scenario (see below) would generate a fall of almost 6 per cent before a modest recovery in 2010.

⁷ *Migration and Remittances Handbook 2008*. The World Bank

⁸ *Outlook for Remittance Flows 2008-2010*, Migration and Development Brief, November 2008

24. One of the most marked current influences on remittances appears to stem from the price of oil. Thus, remittances from countries of the Gulf Cooperation Council are expected to fall by 9 per cent in 2009, with Bangladesh (among LDCs) noticeably affected along with Pakistan and the Philippines. Some 44 per cent of remittances flowing to Sub-Saharan Africa originate in the European Union. Remittances from this area are forecast to decline by more than 7 per cent as the Euro exchange rate falls against the US dollar.

25. It is worth noting that some developing countries (e.g., India, Malaysia, Russia, and South Africa) are both migrant-receiving and remittance-source countries. Developing countries host almost half of the emigrants from all developing countries and account for at least a tenth of recorded remittance flows to developing countries in US dollar terms.

26. The World Bank points out that historically remittances have remained relatively stable during troubled times. A number of reasons are suggested, including that remittances are normally a small part of migrants' income which they continue to send despite hardship. Normally, migrant numbers do not fall during economic downturns. Indeed, the World Bank base case forecast assumes migrant numbers in host countries remain largely as they are, even if new inflows slow. However, the worst case scenario in present circumstances foresees significant numbers of migrants returning home – for instance, 8 per cent of those in the EU and 10 per cent of those now working in the Gulf Cooperation Council (GCC) countries. Indeed, in December 2008, Citigroup in the Philippines was already reporting a 6.8 per cent fall in the headcount of Filipinos working abroad. Even if such returnees repatriate their savings, the longer term impact in their home countries may be serious.

VI. What are the Prospects for Foreign Direct Investment Inflows to LDCs?

27. One of the first casualties of the international financial crisis was FDI. That is no surprise; major companies are retrenching, credit has dried up or is too expensive, mergers and acquisitions are a rarity. For the moment, most investment strategies have been filed away to await better times. UNCTAD reports⁹ that global FDI flows fell 20 per cent in 2008 and are set to drop much further this year – a view largely shared by the IMF¹⁰. The impact of reduced investment intentions by companies could easily be compounded by protectionist policy responses by governments; in particular, short-term subsidy support conditioned by requirements to maintain jobs in the home country. France started down that road with its rescue package for the automobile sector, but seems to have changed course under pressure from the EU Commission and other EU member States. Similar initiatives by governments in the US, Japan and even China may be problematic.

28. LDCs attract a small share of FDI worldwide. The most recent UNCTAD statistics¹¹ show FDI inflows to these countries climbing steadily in the years 2005

⁹ UNCTAD Investment Brief, No 1 2009

¹⁰ The *Implications for Low-Income Countries of the Global Economic Crisis*. IMF. March 2009

¹¹ UNCTAD FDI/TNC database.

(USD7.14 billion), 2006 (USD12.8 billion) and 2007 (USD13.4 billion). These results are the equivalent of around 2 – 3 per cent of the total flows to all developing and transition economies. However, as the OECD reports¹², these inflows can be the principal source of capital resources for some LDCs; that is the case, for instance, for Chad, Mauritania, Sudan and Zambia.

29. In normal times, FDI has much attraction for LDCs; financing current account deficits without creating external debt. However, during financial crises it may be a different story. As the OECD comments, reduced FDI outflows can exacerbate the impact of major economic downturns for countries with a high dependence on this form of capital resource: global FDI outflows fell 50 per cent during the 2000-2001 period when economic strains were far less severe than those being experienced currently. Further, FDI profit remittances can hit small, poor economies hard. Indeed, in 2005, the OECD reports, such remittances were already larger than new inflows for low-income countries. In brief, in times like these, FDI can compound the difficulties faced by LDCs.

30. This is not to say that new FDI will dry up completely, even in LDCs. Many companies will continue to invest for the future, judging that the present crisis will end at some point, economic growth will restart and the process of globalisation continue anew. That is the case for energy companies; even with the current lower oil price, most have cash reserves for capacity-enhancing investment. They take the long-term view and know that prices will inevitably recover as demand takes off again. Thus, LDCs with energy resources will likely see new investment in the sector or, at least, a lesser retrenchment than in other parts of their economies.

31. The same may be true for extractive industries outside oil and gas. Major OECD countries are quietly turning back towards nuclear power, thus stimulating demand for Uranium in the longer term. Other minerals – for instance, Lithium for electrically-driven automobiles – are the focus of additional demand and investment. These are expensive and long-term investments that are unlikely to be significantly disturbed by temporary financial difficulties, especially where companies have adequate cash reserves. Thus, Chinese minerals companies have recently taken large stakes in major international mining firms (for example, Australia's OZ Minerals and Rio Tinto) and look intent on securing access to raw materials that will be needed once China's earlier higher rates of economic growth are again viable. Much of this investment will continue to flow into LDCs, especially those in Sub-Saharan Africa, which also benefit from accompanying loans and other aid flows from China.

VII. How is the Squeeze on Trade Finance, Export Guarantees etc. Affecting LDCs?

32. LDCs are not alone in feeling the impact of the financial crisis through the constraints it has placed on trade credit. Exporters almost everywhere rely on trade finance which covers some 80 per cent to 90 per cent of global trade transactions. Traditionally, trade finance instruments (letters of credit, guarantees etc.) cover exporters for the period between shipment and receipt of payment. But trade finance requires that financial institutions in the exporting country (normally

¹² Policy Insights No. 86, December 2008. OECD Development Centre.

providing the trade finance) have confidence in financial institutions in the importing country (through which payment is made). The problem right now is that financial institutions everywhere have little confidence in each other. Thus, either liquidity is not present – a USD25 billion shortfall among the largest suppliers was estimated for 2008 out of a total market of USD10 trillion for trade financing¹³ – or the finance available is expensive. Spreads on short-term trade credit facilities reached to 300 to 600 basis points above LIBOR¹⁴ in 2008, compared to 10 to 20 basis points in normal times. This, despite the fact that trade financing is regarded as among the most risk-free financial operations.

33. The problem has been felt most acutely by the large emerging market exporters – including, Brazil, India, Indonesia, Korea, South Africa and China – and SMEs almost everywhere. Central banks and export credit agencies are increasingly stepping in to provide additional support. This does not necessarily assist exporters in LDCs the response to whose trade financing problems is coming from the International Finance Corporation (IFC) of the World Bank and the regional development banks. The IFC's Global Trade Finance Program (GTFP) now provides USD3 billion (up from USD1.5 billion recently) to support banks delivering trade financing covering exports to “*new or challenging markets where trade lines may be constrained*”. The IFC works with issuing banks in almost all LDCs¹⁵ and confirming banks in the OECD countries and emerging markets. The GTFP guarantees are transaction-specific and may cover letters of credit, trade-related promissory notes, accepted drafts, bills of exchange, guarantees, bid and performance bonds and advance payment guarantees.

34. The GTFP is replicated at the regional level through the Inter-American Development Bank (USD1 billion) and the Asian Development Bank (USD1 billion). Will these additional programmes be sufficient? At the meeting on trade finance, last November, Pascal Lamy, WTO Director-General, commented:

“It is therefore important that all of us press hard to ensure that priority is accorded to trade finance over the coming weeks, as a sort of lifeline for the economic activity in many of your countries.”

VIII. Will Official Development Assistance, in General, and Aid for Trade (AFT), in Particular, be Cut Back at the Expense of LDCs?

35. The IMF has recently begun sounding warning bells about the dangers of the financial crisis in low-income countries (LICs) and their inevitable need for additional external financing. A recent report stated:

“Uncertainty about aid flows, potential declines in donor support, and tighter financing conditions are likely to impose further pressures on LICs’ budgets. In about half of the countries, the ratio of aid to current spending

¹³ “*Improving the Availability of Trade Finance during Financial Crises*”, World Trade Organization 2008, Staff Paper

¹⁴ A basis point is 0.01 per cent. LIBOR is the main interest rate that banks charge each other for short-term loans.

¹⁵ See: <http://www.ifc.org/ifcext/gfm.nsf/Content/TradeFinance>

exceeds 20 percent, and in 14 countries this proportion surpasses 50 percent. [...]The additional financing needs of LICs resulting from the crisis could amount to about US\$25 billion in 2009, and could rise much further.”¹⁶

36. According to the OECD¹⁷, global ODA from all donors for 2007 was nearly USD104 billion with the EU and its Member States accounting for about half the total. When they met in Gleneagles in 2005, G8 members promised to increase aid by USD50 billion by 2010. The undertaking looked shaky even before global recession struck; now, even maintaining past levels of ODA looks difficult. Experience certainly suggests that financial crises bring cuts in aid. For instance, during an economic crisis in the early 1990s, Finland – a major donor – reduced its official assistance by 62 per cent. The decade-long economic slump in Japan, through the 1990s, was accompanied by an ODA fall-off of 44 per cent.

37. Some EU governments have already acted; the Irish budget for 2009 contains a 10 per cent cut in ODA, Italy has announced a reduction of 56 per cent and Latvia has terminated all overseas aid. The United Kingdom has not actually announced real ODA cuts, however, the charity Catholic Agency for Overseas Development (CAFOD) has calculated that implementing the pledge to provide aid equivalent to 0.7 per cent of GDP could generate disbursements over the next seven years USD41 billion less than those envisaged before the impact of the crisis on British economic output became critical.

38. Great uncertainty surrounds the US commitment to ODA; normally the second largest, amounting to about USD22 billion in 2007. During his campaign, President Obama said annual foreign assistance would be doubled. By October, his running mate, Joe Biden, suggested that such an increase might be slowed due to the gathering crisis. Observers now suggest even maintaining recent levels of US ODA will be a challenge.

39. Where does this leave Aid for Trade and the various programmes that come under the AFT umbrella, like the Integrated Framework? The Secretary-General of the OECD, Angel Gurría, is in no doubt that AFT is now more important, not less¹⁸:

“Especially at a time of slack demand combined with increased competition, aid for trade is critical to improve the supply side response. Thus, donors need to honour their aid for trade pledges, particularly to the poorest developing countries, who might well be confronted by cuts in other sources of development finance.”¹⁹

40. Evidently, much will depend not just on the trend in overall ODA commitments and disbursements, but the extent to which assistance that might otherwise be directed towards AFT is rerouted towards humanitarian causes, or *vice versa*. Certainly, some may argue that emphasising poverty reduction through enhanced exports during a global recession and collapsing international trade may be a pointless exercise. Others will certainly respond that the long-term necessity

¹⁶ *The Implications of the Global Financial Crisis in Low-Income Developing Countries*, IMF, March 2000, pp. 23 & 34.

¹⁷ *Aid Targets Slipping out of Reach?* OECD Development Assistance Committee, November 2008

¹⁸ Address to the OECD Policy Dialogue on Aid for Trade, November 2009, Paris

¹⁹ http://www.oecd.org/document/45/0,3343,en_2649_34487_41623213_1_1_1_1,00.html

of improving the trading capacities and competitiveness of poor countries is no less now than before the financial crisis.

41. The second Global Review of Aid for Trade will take place in July 2009.

IX. Are LDC Trade Preferences at Risk?

42. For the moment, at least, the answer to that question appears to be “No”. Naturally, much depends on how severe is any protectionist response to the economic crisis, especially in the OECD and major emerging markets. For some years now, broadly-based unilateral preference schemes – notably the Generalised System of Preferences (GSP) – have been politically sensitive. The drive in the US and EU for the inclusion of labour rights requirements has gained momentum while the removal of countries judged to be too economically advanced for special trade benefits is politically popular. It is easy to imagine this tendency being reinforced as such schemes come up for renewal and as calls to suppress imports grow in response to reduced domestic demand and prices. On 2 March, *The President’s Trade Agenda 2009*²⁰ was published in Washington. It included the following statement on preference programmes:

“Trade preference programs help entrepreneurs in developing countries compete effectively in the world trading system. Many of our nation’s trade preference programs are coming due for legislative review. We will work with the Congress and public stakeholders on their renewal and reform. We will give careful consideration to proposals to concentrate benefits more effectively on the poorest countries and those that need the margin of preference to compete.”

43. Thus, the treatment of LDCs is probably a case apart. Tariff-free, quota-free treatment under “Everything but Arms” in the EU and similar efforts in other major economies are, for the most part, neither especially challenging in terms of extra competition for domestic producers, nor unpopular. On the contrary, any OECD government seeking to reverse the benefits offered to LDCs would likely face a serious local political backlash. Duty-free, quota-free treatment in the US remains problematic because of textiles industry opposition. A conclusion of the Doha negotiations would crystallise the issue for the new Obama Administration. But, absent that, a move to introduce such treatment independently of Doha, while not impossible, is hardly likely to be a priority. Thus, some LDCs will continue to have greater or lesser benefits from GSP while others take whatever advantage remains from preferential arrangements like AGOA in an environment of collapsing demand in the US market.

44. Broadly, then, while LDCs can probably rely on their preferences remaining in place, the value of these benefits may be very much less than in recent years. One compensating factor may be further efforts by advanced emerging markets, like India and China, to broaden their own preferential arrangements for LDCs.

²⁰ See: www.ustr.gov

X. In the Light of the Financial Crisis does a Doha Result Become More or Less Important to LDCs?

45. Assertions that the world needs a Doha deal more than ever, because of the financial crisis, have diminished in recent weeks; with good reason. First, there is no evidence that, even if a deal is suddenly and unexpectedly struck on agricultural and NAMA modalities, the economic impact of future implementation will be great enough or soon enough to make a difference. Second, with or without encouragement from the G20 in April, there is no reason to believe a deal *will* be struck quickly. The new US Administration has sent only the weakest of signals on what it wants of Doha, while large sections of the private sector are calling for a complete re-think. Indian elections are due in April/May, making a change in approach in New Delhi unlikely in the short term. A new EU Commission should be installed in November; thus deal-making in Geneva is more problematic for Europe than ever. Third, as OECD countries and China plough increasingly large sums of public money into propping up key financial structures and major industrial firms, the likelihood of them accepting new market opening is reduced, if not wholly absent.

46. The case for seeking to secure some limited Doha settlement this year or early next is twofold. First, if WTO rules – and the dispute settlement system – are seen as a bulwark against a severely protectionist response to the crisis, then the institution's credibility needs reinforcing. A Doha deal – even if much reduced in ambition, which would unavoidably be the case – would help. Second, even a very limited package could have real practical benefits, including for LDCs.

47. It is worth noting that three leading business and agriculture organisations in the US (the National Association of Manufacturers, the American Farm Bureau Federation, and the Coalition of Service Industries) wrote to President Obama in late February 2009 suggesting that, since the negotiations were clearly in trouble, “alternative paths” should be considered to realise imminent concrete benefits for all WTO members (e.g. separate agreements on trade facilitation and capacity-building). However, Ron Kirk, U.S. Trade Representative designate recently rejected the idea of an “early harvest” of relatively minor agreements in the Doha Round of negotiations ahead of a global conclusion.

48. Most obviously, the US would be obliged to implement the duty-free/quota free treatment of LDCs contained in the Hong Kong Ministerial text. Of course, that will have a mixed impact; benefiting countries like Cambodia and Bangladesh while cutting the value of preferences enjoyed by some Sub-Saharan nations provided through AGOA. Another beneficial component of a package would likely be a WTO trade facilitation agreement. That, along with the technical assistance and support funding that would go with it, could help transform LDC export potential when the global trade downturn eventually corrects itself. Further, a limited Doha deal would encourage WTO Members to maintain levels of AFT funding, much of which will be directed towards LDCs.

49. Quite what would remain of practical substance on agriculture and NAMA is impossible to tell. Outside of textiles, clothing and footwear (sectors in which protectionist interests in developed countries remain strong), the latter is unlikely significantly to benefit LDC interests – although, as an earlier AITIC note argued,

poor countries may have some limited interests in a few sectoral agreements²¹. In agriculture, a deal on tropical products should be of value and, for some, the new disciplines on export support will bring opportunities for the vitality of domestic markets as well as export potential. The cotton producers of West and Central Africa are more likely to make gains through the pursuit, by Brazil, of the dispute settlement case against the US, than through any currently foreseeable Doha terms.

50. Of course, this is all largely speculation. For the moment, the call in Geneva is for Doha, all of Doha and nothing but Doha. It is not a sentiment that attracts much resonance or even interest outside the halls of the WTO. Public statements suggesting otherwise come and go. There is nothing bankable for LDCs yet, nor is there likely to be in the near future. LDC trade interests, as the crisis deepens and spreads, can only marginally be improved by the WTO. In truth, they remain almost entirely dependent on the success of the OECD countries and major emerging market governments in adequately addressing the crisis (jointly and separately), without resorting to protectionism.

Acronyms

AFT	Aid for Trade
AGOA	African Trade and Opportunity Act
CAFOD	Catholic Agency for Overseas Development
EIU	The Economist Intelligence Unit
FDI	foreign direct investment
GCC	Gulf Cooperation Council
GDP	gross domestic product
GSP	Generalised System of Preferences
GTFP	Global Trade Finance Program
IATA	International Air Transport Association
IFC	International Finance Corporation
IMF	International Monetary Fund
LDCs	least-developed countries
LIBOR	The London Interbank Offered Rate
LICs	low-income countries
NAMA	non-agricultural market access
ODA	Official Development Assistance
OECD	Organisation for Economic Co-operation and Development
SMEs	small and medium enterprises
UNCTAD	United Nations Conference on Trade and Development
UNWTO	UN World Tourism Organization
USDA	United States Department of Agriculture

Copyright © AITIC 2009. All rights reserved. Permission to copy and distribute this document is hereby granted provided that AITIC is given credit.

²¹ AITIC Background Note, *NAMA Sectorals – Should LDCs be Concerned?*, 5 January 2009.