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Committee on Rules of Origin

UTILIZATION OF TRADE PREFERENCES BY LEAST DEVELOPED COUNTRIES: 2015-2019 PATTERNS AND TRENDS

NOTE BY THE SECRETARIAT[1]

1 INTRODUCTION

1.1. Previous calculations of utilization rates by the Secretariat have highlighted that significant proportions of preferential imports originating in Least Developed Countries (LDCs) do not receive tariff preferences despite being eligible for preferences under at least one preferential scheme. The *under*utilization of trade preferences by LDCs is in fact spread across preferential schemes, sectors and LDCs, even for products subject to simple rules of origin.

1.2. Previous analyses, however, focused on individual years.[2] As a result, one argument could be that the levels of underutilization observed reflected circumstantial rather than structural patterns. In other words, the *under*utilization of trade preferences could be explained by annual variations and, as a result, no general conclusions could be drawn. This note intends to investigate that possibility. It reports *under*utilization rates for the 2015-2019 period to verify some of the findings described in previous notes.

2 DATA CONSIDERED IN THIS NOTE

2.1. The schemes reviewed in this note are non-reciprocal preferential trade arrangements for LDCs (LDC-PTAs, henceforth). Import statistics for five years (2015-2019) were considered for all those preference-granting Members who have submitted notifications to the WTO as described in Table 1. For greater consistency, bilateral annual imports at the national tariff line level of a value lower than USD 1,000 have been ignored. As a result, a total of 101,587 observations were considered.[3]

2.2. The LDC-PTAs of the following preference-granting Members could not be considered since no preferential import statistics have been notified: Eurasian Economic Union (Armenia; Kazakhstan; Kyrgyz Republic; and the Russian Federation[4]); Iceland; Montenegro; New Zealand; and Tajikistan. Data for Turkey could not be considered because it has been notified recently but not yet integrated in the WTO databases. In addition, import statistics were available for India for one year only (2015) and two years for China (2016 and 2018).[5] Given in particular the importance of China, and to a lesser extent of India; New Zealand; the Russian Federation; and Turkey as an export destination to many or some LDCs, these limitations hampered the ability of the Secretariat to identify comprehensive patterns and trends across the time period of 2015-2019.

[1] This document has been prepared under the Secretariat's own responsibility and is without prejudice to the positions of Members or to their rights and obligations under the WTO.

[2] See in particular documents G/RO/W/179; G/RO/W/185; G/RO/W/187/Rev.1; and G/RO/W/203.

[3] An "observation" refers to a single tariff line for which preferential trade is recorded in a given year between a preference-granting importing Member and an exporting LDC.

[4] It should be noted that the members of the Eurasian Economic Union have implemented a comprehensive reform of their LDC-PTA in 2019. As a result, an analysis of import statistics for the years before that date would not have reflected the conditions applicable at present.

[5] Document G/RO/W/163/Rev.8 contains a full summary of the availability of information regarding preferential rules of origin, tariffs and import statistics.

Table 1: List of PTAs included in the analysis

Preference-granting Member	Availability of tariff and import statistics	Preferential Trade Arrangement
1. Australia	2015-2019	GSP-LDC
2. Canada	2015-2019	GSP-LDC
3. Chile	2015-2019	LDC-specific
4. China	2016 & 2018	LDC-specific
5. European Union	2015-2019	GSP-LDC
6. India	2015	LDC-specific
7. Japan	2015-2019	GSP-LDC
8. Korea, Republic of	2015-2019	LDC-specific
9. Norway	2015-2019	GSP-LDC
10. Switzerland	2015-2019	GSP-LDC
11. Chinese Taipei	2015-2019	LDC-specific
12. Thailand	2015-2019	LDC-specific
13. US (GSP)	2015-2019	GSP-LDC
14. US African Growth and Opportunity Act (AGOA)	2015-2019	AGOA

Source: Preferential Trade Arrangements database (http://ptadb.wto.org).

2.3. It is worth recalling that, in line with existing notification requirements, preference-granting Members notify to the WTO Secretariat total annual imports from each LDC partner at the tariff line level.[6] The result is that calculations only show average rates of utilization/*under*utilization across all economic operators in a single year. That can be misleading and conceal significant variations in utilization over the months of the same year or across economic operators. For instance, 44% of all jewellery imports (HS 711311) originating in Nepal did not receive any tariff preference in the EU in 2018 (i.e. an *under*utilization rate of 44%).[7] Nevertheless, it is not possible to infer from that figure that the *under*utilization of preferences was 44% for all economic operators importing jewellery into the EU that year. A few operators might have received tariff preferences on all their imports (an *under*utilization rate of 0%) while a few others might not have claimed or received preferences on any of their transactions (an *under*utilization rate of 100%). More detailed statistics such as transaction-level data (not notified to the WTO) would have the advantage of allowing for a more precise examination of patterns of utilization among businesses.

3 VOLATILITY IN LDC IMPORTS UNDER NON-RECIPROCAL PREFERENCES

3.1. Despite significant annual fluctuations, preferential imports from LDCs to preference-granting Members have increased from 2015 to 2019 under most LDC-PTAs as can be seen in Table 2 below. The European Union is by far the largest preferential market for LDCs, followed by China. The United States; India; and Japan are also important destinations by value of preference eligible trade. Imports under more recent schemes, such as those of Chile (in force since February 2014) and Thailand (in force since April 2015), witnessed a substantial progression. Variations of trade under the US PTA-LDC scheme and AGOA (in particular the decrease of imports in 2019) are attributable to a reduction in imports of crude oil from Angola and Chad.

Table 2: Imports eligible for PTA benefits included in the analysis in million USD

	2015	2016	2017	2018	2019	average annual growth 2015-2019
Australia	775	805	803	876	981	6%
Canada	1,968	2,146	2,332	2,546	2,887	10%
Chile	133	108	148	184	404	41%
China	n.a.	4,748	n.a.	11,345	n.a.	
EU	25,942	28,000	30,361	33,973	34,917	8%
India	5,657	n.a.	n.a.	n.a.	n.a.	
Japan	3,031	3,403	3,519	4,366	4,583	11%
Korea, Republic of	2,175	1,750	2,067	2,165	1,894	-2%
Norway	247	287	319	351	363	10%

[6] These notification requirements arise from the Preferential Trade Arrangements Transparency Mechanism (WT/L/806).

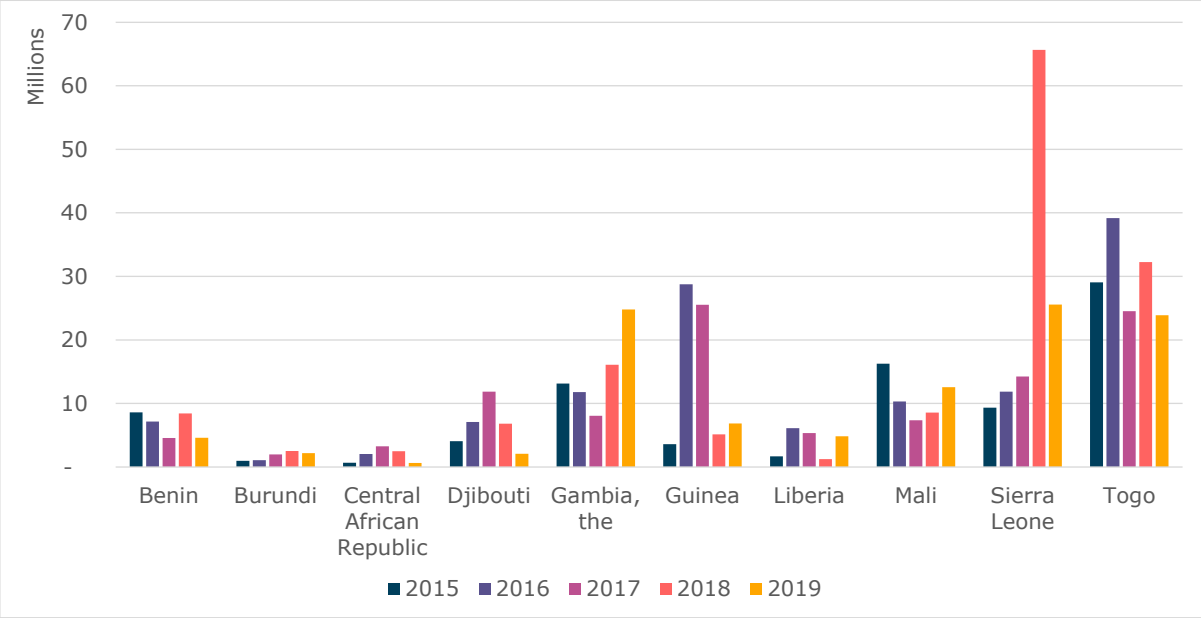
[7] See Table 2 of document G/RO/W/203.

	2015	2016	2017	2018	2019	average annual growth 2015-2019
Switzerland	620	727	918	1,059	1,159	17%
Chinese Taipei	18	17	16	22	32	18%
Thailand	495	699	799	743	795	14%
USA (AGOA)	4,817	3,898	3,816	3,893	1,839	-18%
USA (GSP)	4,755	3,787	3,897	4,331	3,363	-7%

Source: Preferential Trade Arrangements database (http://ptadb.wto.org).

3.2. Much greater heterogeneity can be observed when examining individual LDCs, (Figure 1): average annual growth has been 4.4% for total LDC preferential exports over the 2015-2019 timeframe. Bangladesh and Cambodia are, by far, the largest exporting LDCs and both experienced a stable increase of their exports under preferences. Similarly, a relatively steady increase of exports can also be observed for Afghanistan; Burkina Faso; Lao PDR; Madagascar; and Senegal. However, total preferential exports decreased for 16 LDCs (43% of the group). For others, as illustrated in Figure 1, significant annual fluctuations can be observed.

Figure 1: Total trade eligible for preferences, by origin, selected LDCs, in million USD



Source: WTO Integrated Database, 2021

Note: All annual trade values above USD 1,000, all goods, in USD million for the years 2015-2019. Data for China and India are excluded from this figure since data is not available for all years.

3.3. In general, greater fluctuations can be observed for smaller export values. In other words, given the small values of preferential trade originating in many LDCs, a new export product or its absence in a given year can lead to significant fluctuations. Such fluctuations have an impact on utilization rates and confirm that a multiple-year analysis can be useful to identify general patterns.

4 VOLATILITY IN THE *UNDER*UTILIZATION OF PREFERENCES BY LDCS

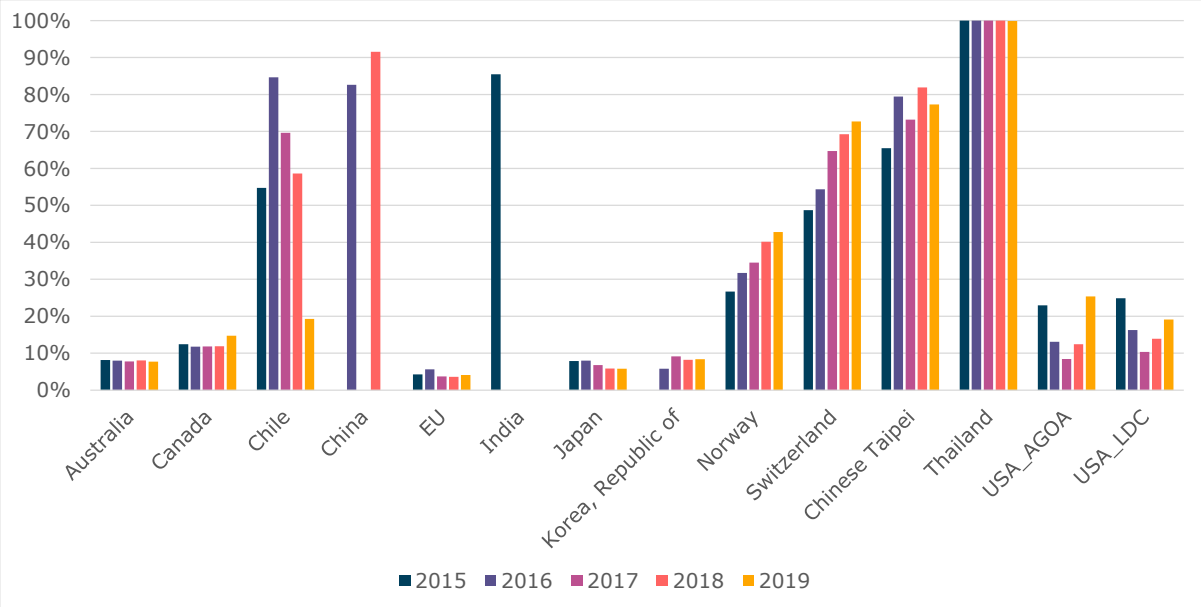
4.1. When the analysis focuses specifically on *under*utilization rates[8], a similar picture emerges: small annual variations are observed in *under*utilization rates when preference-granting Members are analysed (importer side) but much greater fluctuations in *under*utilization can be observed for individual LDCs (exporter side).

4.2. On the importer side, Figure 2 shows the *under*utilization rates for each LDC-PTA. As can be seen, *under*utilization of trade preferences is relatively stable for Australia; Canada; the EU; Japan;

[8] All *under*utilization rates presented in this note are trade weighted.

and Korea, slightly more variable for the United States[9], and more fluctuating only in the case of Chile. Although trade statistics are only available for two years for China, an increase in *under*utilization can be noted. Similarly, *under*utilization rates have been steadily increasing under the LDC-PTAs of Norway and Switzerland. A trend for India cannot be described since preferential import statistics are available for a single year only.

Figure 2: Preference *under*utilization, by preference-granting Member, in percent



Source: WTO Integrated Database, 2021

Note: All annual trade values above USD 1,000 for all goods are considered in the calculation, *under*utilization in percentage for the years 2015-2019.

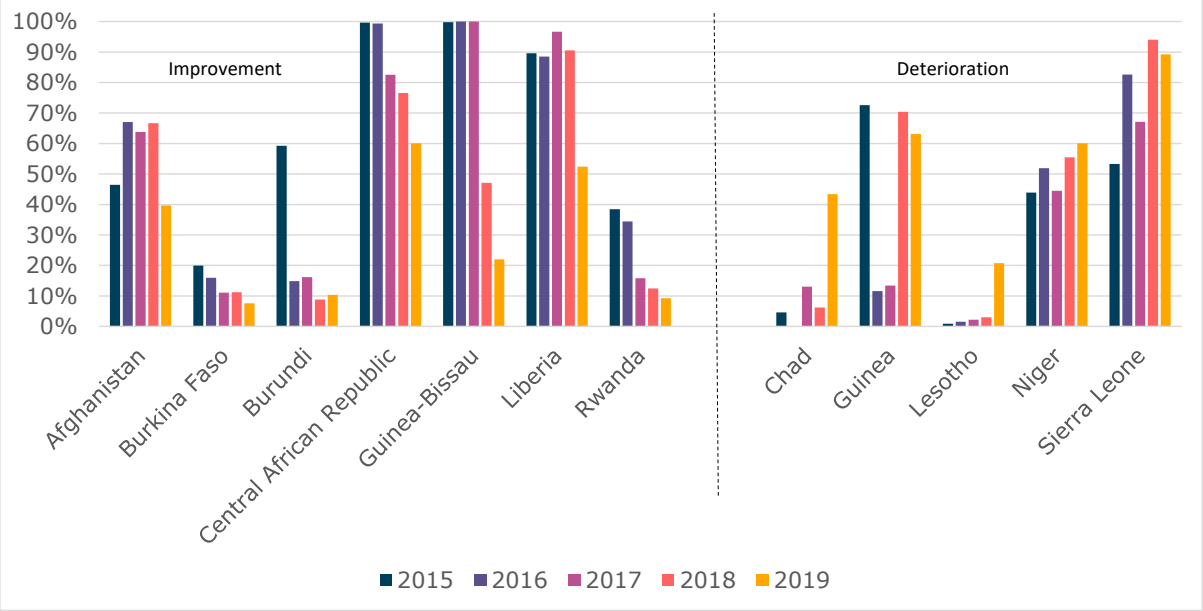
4.3. On the exporter side, greater fluctuations can be observed. Generally speaking, it is possible to affirm that the higher the fluctuation over time is in values of preference eligible trade, the higher the fluctuation is in *under*utilization rates as well.[10] However, no clear correlation of higher trade values with the fuller utilization of trade preferences can be observed.

4.4. In fact, LDCs can be split into three different groups: those that were able to better utilize trade preferences since 2015 (lower average *under*utilization in 2018-2019 is lower by more than 5 percentage points when compared to the average of 2015-2017), those for which the *under*utilization of preferences remained relatively stable (a fluctuation of not more than 5 percentage points) and those for which the utilization of preferences deteriorated (average *under*utilization in 2018-2019 is higher by more than 5 percentage points when compared to 2015-2017). Figure 3 illustrates the case of 12 LDCs whose preference *under*utilization improved or worsened. As can be seen, there is a noticeable improvement in the utilization of trade preferences in the case of Afghanistan; Burkina Faso; and Rwanda, for instance. However, there is also a noticeable deterioration of *under*utilization rates for some LDCs, such as Lesotho; Niger; and Sierra Leone. Annex 1 shows the variations in *under*utilization rates for all LDCs.

[9] In the case of the United States, as noted above, the higher overall *under*utilization rates are driven by petroleum and oil imports.

[10] The relationship between fluctuations in *under*utilization rates and in import values over time can be compared and correlated to verify the type of mechanics that exist between both. At the level of importer, exporter and tariff sub-heading, the coefficient of variation of value of imports eligible for preferences, is correlated with the coefficient of variation of the value of imports eligible but, paying MFN duties despite being eligible for preferences. This correlation equals to 0.55 and suggests that there is in fact a significant positive correlation between the two variables. Variations in value lead to variations in *under*utilization rates. This is also true if measured at tariff line level (correlation equals 0.45) or at the heading level (correlation equals 0.65).

Figure 3: LDCs with improvement or deterioration of *under*utilization, in percent



Source: WTO Integrated Database, 2021.

Note: Trade values above USD 1,000 for all goods are considered in the calculation, *under*utilization in percentage for the years 2015-2019. Information on all LDCs can be found in Annex 1. Data for China and India are excluded from this figure since data is not available for all years.

4.5. Fluctuations in utilization rates are difficult to explain, especially at the aggregate level. There were no significant changes to the rules of origin during the period being analysed. Consequently, deterioration or improvement of utilization cannot be explained by changes to the applicable rules of origin. The EU; Norway; and Switzerland introduced the REX System of self-certification for registered exporters. However, the previous "Form-A" certificates were still accepted during a transitional period, so the statistics do not reflect these changes yet. Thailand engaged in a comprehensive review of its LDC-PTA but the process started after 2019 only. Japan simplified certain origin criteria, but the changes only concerned articles of HS Chapter 61 and were introduced in 2015. Canada also implemented some changes to its requirements for apparel in 2017, but the changes were limited. During the 2015-2019 period, some preference-granting Members also introduced additional cumulation possibilities. Having considered these developments, it is not possible to attribute fluctuations in utilization to changes in origin requirements.

4.6. A potential mechanism about *under*utilization rates over time is that exporting and importing firms learn by doing, i.e. they improve their capacity to utilize trade preferences year after year. As a result, *under*utilization rates should gradually fall. This is indeed be observed in at least one case: LDCs made steady progress in better utilizing Chile's new PTA-LDC (*under*utilization rates dropped from 85% in 2016 to 19% in 2019 as seen in Figure 2). Similarly, there has been steady improvement in the utilization of preferences for imports originating from Afghanistan; Burkina Faso; Burundi; the Central African Republic; Guinea-Bissau; Liberia; and Rwanda. However, and more surprisingly, *under*utilization of trade preferences also worsened in the case of many LDCs, including Chad; Guinea; Lesotho; Niger; and Sierra Leone. In the case of other LDCs, annual fluctuations are such that it is difficult to judge whether changes can be clearly classified as either a deterioration or an improvement.

4.7. A particularly interesting case is Rwanda, which managed to increase the total value of preferential exports (from a mere USD 3 million in 2015 to USD 28 million in 2019) while at the same time making better use of trade preferences (*under*utilization rates were reduced from 38% to only 9%). Interestingly, the utilization of trade preferences improved with almost all preferential trade partners and in most sectors, including in sectors subject to more complex origin requirements, such as textiles, clothing and footwear.

4.8. Better studying these fluctuations and better understanding the differences in utilization among LDCs would provide insights about the factors that drive or hinder the utilization of trade preferences by LDCs.

5 *UNDER*UTILIZATION: A SECTORAL ANALYSIS

5.1. Previous notes by the Secretariat analysed two sectors: agricultural products (with a focus on fresh fruits and vegetables)[11] and minerals and metals[12]. In both sectors, trade preferences were *under*utilized. For instance, it had been noted that 82% of all imports of fruits, vegetables, and plants originating in LDCs did not receive any tariff preference. It had also been noted that *under*utilization in these sectors was counterintuitive because both sectors were subject to the simple "wholly-obtained origin criterion".

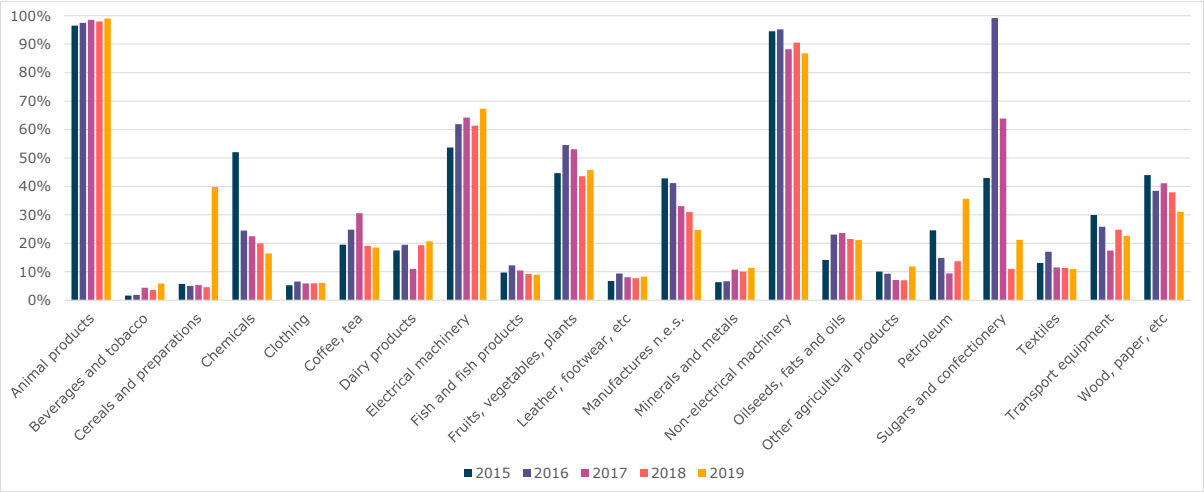
5.2. A multi-year analysis confirms those findings. LDCs faced difficulties in fully utilizing trade preferences particularly in the case of agricultural products. The EU and Thailand are, by far, the two largest importers of fruits and vegetables originating in the LDCs. In the case of the EU, there is almost full utilization (an *under*utilization rate of only 3-5% in 2015-2019). However, there is almost no utilization of preferences under Thailand's PTA-LDC (an *under*utilization rate of close to 100% throughout this period).[13] More generally, and, despite relatively small trade values, a deterioration of utilization is observed under all other LDC-PTAs (Australia; Korea; Norway; Switzerland; and US). A deterioration of utilization is also observed for China (only 2016 and 2018 considered). As a result, it is reasonable to conclude that there are structural reasons explaining that utilization of preferences in this sector is challenging. In addition, it is also possible to conclude that low levels of utilization for these products are not related to the origin criterion (wholly obtained rules). Instead, direct consignment obligations, certification requirements or other factors not related to origin must explain these challenges.

5.3. In the case of minerals and metals, the phenomenon of *under*utilization is more circumscribed. On the one hand, trade preferences are almost fully used (*under*utilization rates of 10% or below) in the EU; Japan; Republic of Korea; and the US. On the other hand, preferences are not heavily utilized under the PTA-LDCs of Australia; Canada; Chile; China; Switzerland; Chinese Taipei; and Thailand. China is by far the largest importer of metals and minerals from LDCs so overall utilization rates in this sector are driven by the performance of LDCs in that market. While statistics for China are available only for two years, calculations indicate an *under*utilization of 96% and 99% (2016 and 2018 respectively). Given that polarization, LDC-PTA-specific features may be influencing *under*utilization rates, such as specificities related to direct consignment or certification obligations.

5.4. Figure 4 below provides an overview of *under*utilization rates in all 22 sectors[14]. It aggregates all LDCs and all LDC-PTAs. As can be seen, *under*utilization rates are very high, above 50%, in several sectors (for instance: for animal products; non-electrical machinery; electrical machinery, fruits and vegetables; sugar and confectionery; and wood and paper). Interestingly, *under*utilization rates are low in some sectors known for having restrictive or complex rules of origin such as clothing; textiles; leather and footwear; and fish and fish products. In the textiles and clothing sectors, the good performance of LDCs can be explained mainly by the intense use of trade preferences by Bangladesh and Cambodia in the EU. This could suggest that it is the ability of economic operators to comply with rules of origin (rather than the type of the rule) that influences utilization. While this may be an obvious statement, it highlights the importance of focusing policy makers' attention on two factors. First, deploying efforts to strengthen the capacity of economic operators to ensure they can comply with preferential origin requirements. Second, facilitating administrative procedures related to origin (e.g. facilitating the documentary requirements, reducing administrative costs and improving access to a proof of origin).

[11] See document G/RO/W/185.
[12] See document G/RO/W/203.
[13] It is likely that these observations for Thailand's LDC-PTA stem from a statistical inaccuracy (imports under free trade agreements, such as ASEAN, might not be reflected in the statistics notified to the Secretariat).
[14] These sectors correspond to the 22 "Multilateral Trade Negotiations" product categories used in the Uruguay Round and used in various statistical reports prepared by the WTO Secretariat. See page 40 of the World Tariff Profiles for a breakdown of the sectors and list of HS codes covered in each of them (Available here: https://www.wto.org/english/res_e/booksp_e/tariff_profiles20_e.pdf)

Figure 4: Preference *under*utilization by MTN sector, 2015-2019, in percent



Source: WTO Integrated Database, 2021.

Note: Trade values above USD 1,000 are considered in the calculation, *under*utilization in percentage for the years 2015-2019. Data for China and India are excluded from this figure since data is not available for all years. Cotton, the 22nd MTN sector is not reflected because preferential imports were only recorded in 2019.

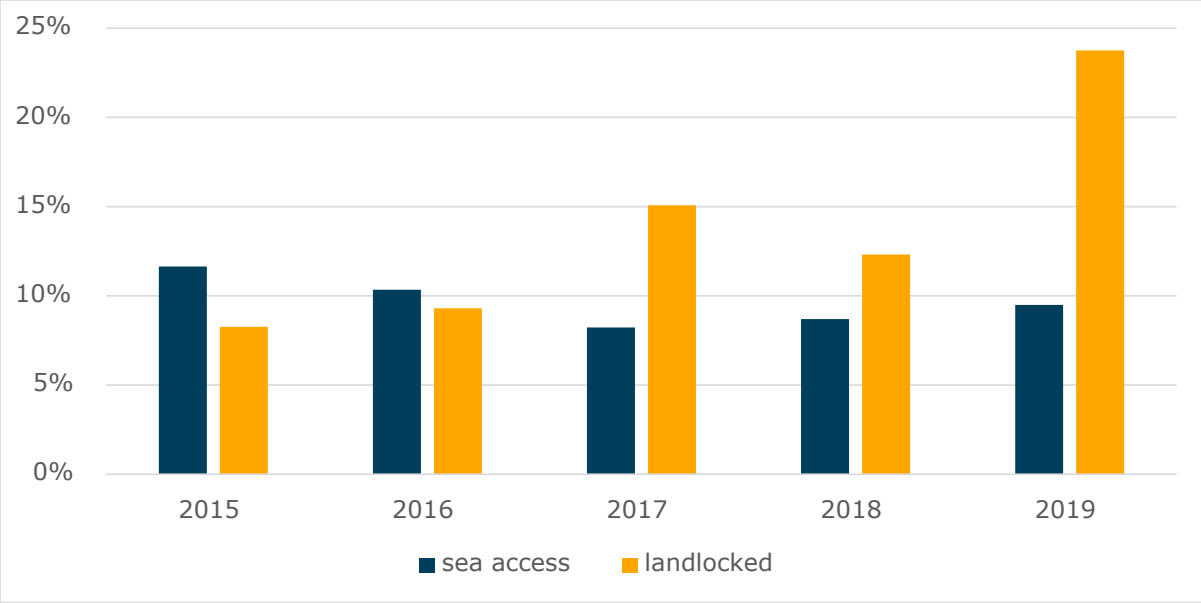
6 *UNDER*UTILIZATION RATES BY LDC GROUPS: LANDLOCKED VS SEA ACCESS

6.1. In a previous note, the Secretariat discussed direct consignment requirements and associated such requirements to the *under*utilization of trade preferences.[15] Sharp differences in *under*utilization rates between the EU, Norway and Switzerland, for instance, were attributed to such requirements. Figure 5 shows the *under*utilization rates for landlocked LDCs and compares it with the rates for LDCs with sea access over the 2015-2019 period. As can be seen, the difference in *under*utilization between both groups has been widening since 2017, becoming very significant in 2019. LDCs with sea access have slightly improved their ability to utilize trade preferences since 2015 (aggregate *under*utilization rates dropped from 12% to 9%). On the contrary, however, *under*utilization rates increased for landlocked LDCs in the same period (*under*utilization rates increased from 8% to 24%).

6.2. The steep increase of *under*utilization for landlocked LDCs in 2019 is driven mainly by higher *under*utilization rates for petroleum products primarily from Chad and, to a lower extent, higher underutilization for fruits and vegetables, plants as well as beverages and tobacco. It should be noted, again, that in the absence of full statistics for India and China, these figures are strongly influenced by imports into the EU. Interestingly, a calculation for the two years for which data is available for China confirms that landlocked LDCs face higher impediments to utilizing trade preferences in that market too (on the basis of the data reported by China, the *under*utilization of trade preferences of landlocked LDCs was 88% in 2015 and 93% in 2019, as opposed to 78% and 91% for LDCs with sea access). This confirms a clear pattern of deterioration of preference utilization by landlocked LDCs from 2015 to 2019.

[15] See document G/RO/W/187/Rev.1.

Figure 5: Preference *under*utilization, LDCs with sea access vs landlocked LDCs, in percent



Source: WTO Integrated Database, 2021.

Note: Trade values above USD 1,000 for all goods are considered in the calculation, *under*utilization in percentage for the years 2015-2019. Data for China and India are excluded from this figure since data is not available for all years.

6.3. Another interesting observation is that *under*utilization rates are strongly binary: either full or close to full utilization or no utilization at all. All in all, 26% of observations have full utilization (*under*utilization <=1%) and 47% of observations have no utilization at all (*under*utilization >=99%). As a result, there is "some" utilization of trade preferences in only 27% of observations. This could be another indication that the utilization of trade preferences does not depend on the ability of LDC firms to adjust their suppliers to comply with minimum requirements related to originating materials and components. Instead, it seems to hinge on the ability of firms to comply with "all or nothing" obligations, such as direct consignment or certification requirements.

6.4. Further analysis on the impact of direct consignment obligations on preference utilization would require the collaboration of preference-granting Members. For instance, Switzerland, after a detailed examination of its imports from LDCs, reported that directly consigned goods received trade preferences in almost all cases (close to full utilization) but indirectly consigned goods did not (high *under*utilization).[16]

7 POSSIBLE CONCLUSIONS

7.1. Following the analysis of *under*utilization rates in the 2015-2019 period, it is possible to affirm that:

a. Volatility of trade values and *under*utilization rates are significant for LDCs, which confirms the benefits of examining multiple years in order to identify structural patterns and trends. This also reinforces the need for the timely notification of comprehensive data to the WTO Secretariat (data covering all years, all preferential trade, including under reciprocal preferences (RTAs) and covering all preference-granting Members);

b. The examination of 2015-19 data confirms that there is ample scope to improve preference utilization and that *under*utilization rates do change over time. *Under*utilization is widespread across sectors, and can be significant for some PTA-LDCs and some sectors;

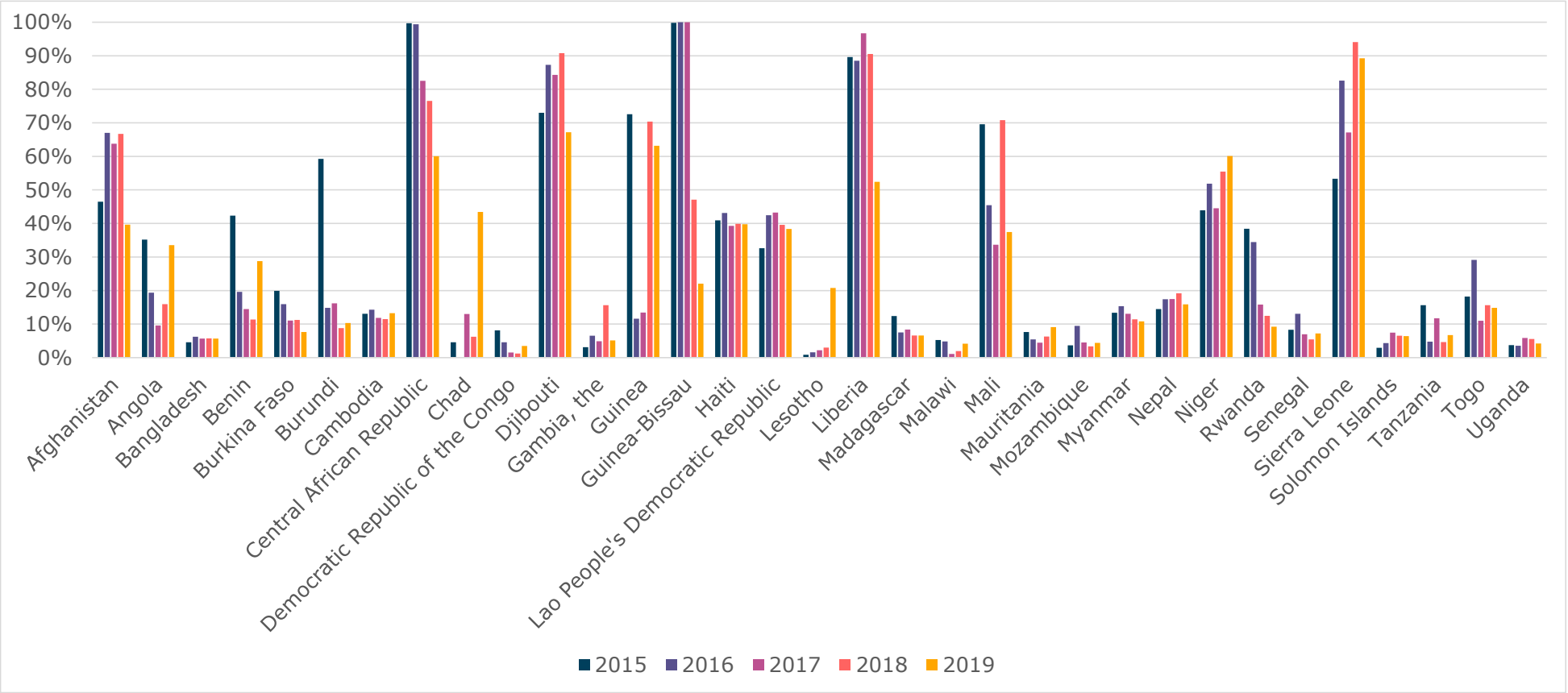
[16] See paragraph 3.33 of document G/RO/M/74.

c. In this respect, the analysis also confirmed that the utilization of trade preferences varies greatly from one LDC to another. Better understanding these differences – and particularly the case of LDCs who managed to improve their utilization rates (e.g. Afghanistan or Rwanda) - can yield useful insights about the mechanics behind better preference utilization. Similarly, this note showed that there might be a "learning by doing effect" in the case of at least one PTA-LDC (i.e. Chile). It would be useful to study in greater detail the measures that were deployed to increase awareness about and compliance with preferential origin requirements;

d. The analysis also confirmed that landlocked LDCs find it more difficult to benefit from trade preferences. In fact, the analysis showed that there is a slight improvement in utilization by LDCs with sea access, while a noticeable deterioration in the case of landlocked LDCs can be observed. It is important to investigate further this deterioration and identify possible solutions to reverse this trend;

e. Finally, during the 2015-2019 period, there were no major reforms of rules of origin, so it is difficult to identify the specific impact that product-specific rules of origin might have had. This seems to confirm that direct consignment and certification obligations could have a strong influence on the utilization of trade preferences by LDCs. Better understanding such linkages could also help identify best practices.

ANNEX 1 – *UNDER*UTILIZATION RATES OF TRADE PREFERENCES 2015-2019: BY LDC BENEFICIARY, IN PERCENT



Source: WTO Integrated Database, 2021.

Note: Trade values above USD 1,000 for all goods are considered in the calculation, *under*utilization in percentage for the years 2015-2019. Data for China and India are excluded from this figure since data is not available for all years.