Summary

Context and aims

- It is widely accepted that trade preferences have not yielded the benefits (in terms of scale or country coverage) that were expected when schemes were introduced.
- Preferential trade and preferences are important for some developing countries and products, and very important for a restricted set of countries and products.
- Countries that will be affected by preference erosion brought about by further multilateral tariff liberalisation, as well as countries with a limited window to gain any further benefits from preferences, are concerned to know how to offset the effects of preference erosion and/or increase the effectiveness of preferences.
- The central aims of this study are to investigate the likely impact of further preference erosion on the exports of countries that are dependent on preferences, and to evaluate the policies and measures that can be adopted to increase the effectiveness of preferences and offset the adverse effects of preference erosion.

Nature and evolution of preferential schemes

- The main trade preference providers are the QUAD countries (EU, USA, Japan and Canada), but preferences are also offered by a range of other countries.
- The preferences offered by the EU and USA are under various schemes that differ in terms of their product coverage, margin of preference, quantity restrictions, rules of origin and treatment of developing and least developed countries (LDCs).

Extent and trade coverage of preferential schemes

- The non-reciprocal preferences offered by the major industrial countries to developing country exports cover a substantial proportion of developing countries' trade. However, the provisions are complex, because of the variety of schemes, different product and country coverage, differential rules of origin and safeguard provisions.
- Many of the restrictions on eligibility for preferential treatment apply in product areas of particular interest to developing countries, that is, agricultural products, textiles and other labour-intensive manufactures. However, restrictions also apply in relation to specific sensitive products.

- The Generalised System of Preferences (GSP) schemes of the QUAD countries account for the bulk of preferential trade; the EU is the largest preferential export market and the bulk of preferential trade is in non-agricultural products.
- Given the restrictions on eligibility, other constraints and wide variability in peak tariffs across products and variations in export composition across countries, there are marked variations in the extent and value of preferential trade across recipient countries and products.

Extent of preference margins

- Unadjusted preference margins are already relatively small on average, ranging from 0.7 per cent for developing countries to 6.4 per cent for LDCs on non-agricultural products and from 1.3 per cent to 2.5 per cent on agricultural products, but they can be much larger for specific products. The significance of preference margins for beneficiary countries is affected by the level of preference utilisation and the degree of competition from non-beneficiary countries.
- Some of the recipient countries recording the highest preference margins are among the countries with the lowest preference utilisation rates.
- The implicit rents generated by preferences (preference margins x the value of preference-receiving exports) vary enormously across developing and least developed countries. For example, five LDCs and five non-LDCs account for 75 per cent of the total preference rents going to LDCs and non-LDCs from the EU preferences.

Benefits of trade preferences

- General preferences, as included within preferential trade agreements (PTAs) or the GSP, have limited effects in increasing developing country (and LDC) exports.
- Targeted preference schemes are more effective in increasing developing country (and LDC) exports; there is evidence of positive trade effects from the Lomé Convention, African Growth and Opportunity Act (AGOA) and EU-Mediterranean agreements.
- The benefits of EU trade preferences to the African, Caribbean and Pacific (ACP) group of countries have tended to be concentrated on a few beneficiaries, notably those producing sugar and bananas.
- AGOA has had a significant impact, although the volume of exports generated has tended to be quite small and concentrated in a few countries (notably South Africa, Lesotho, Madagascar, Mauritius and Kenya) and products (especially coffee, tea, maté, spices and knit apparel). Overall, US imports under AGOA more than doubled in the first six years of the scheme (up to 2007), albeit from a relatively low base.

Costs of preference erosion

- The costs of preference erosion associated with the general tariff reductions proposed under the Doha Round of the World Trade Organization (WTO) will be concentrated on a relatively small number of developing countries and LDCs. The developing countries that have experienced or are facing high losses are typically island economies, most of them in the Caribbean and Pacific, especially those dependent on sugar or banana exports to the EU, or countries in north Africa, also with preferential access to the EU, for apparel and agricultural products. The LDCs facing the highest losses are mostly African countries that benefit from the Lomé Convention or Asian exporters of textiles and apparel.
- The most vulnerable countries are those that export a narrow range of products with high preference margins, primarily given by the EU. Some of these have already experienced a loss of preference margins (e.g. ACP exporters of sugar and bananas to the EU). Although other countries face preference erosion, they have more diversified export structures and are more competitive producers.

Implications of evidence on costs and benefits

- The benefits of preferences to developing countries and LDCs are susceptible to changes in the terms on which they are offered, in particular rules of origin and product standards requirements. These requirements limit the utilisation and benefits of preferences.
- Complex (ill-defined and/or costly to comply with) rules of origin are one reason why preferences have not been fully utilised. This is especially true for the EU, where restrictive rules of origin have limited the growth of ACP exports, especially for garments. AGOA has generated benefits for African exporters to the USA, partly because of fairly lax rules of origin (although these have been tightened for apparel).

Implications of current trade negotiations

- Cuts in most favoured nation (MFN) bound tariffs in agricultural and non-agricultural goods, following a Doha Round agreement and its implementation, will lead to preference erosion.
- Substantial costs associated with this erosion of preferences are likely to be restricted to a relatively small number of developing countries and LDCs: specific island economies that benefited from ACP provisions; specific African countries that benefited from both ACP provisions and AGOA; and specific Asian countries with preference benefits concentrated on apparel. Indeed, for some, especially relatively competitive exporters among the preference-receiving countries, there are likely to be offsetting (even net beneficial) impacts arising from improved multilateral market access.

- It would be possible to slow down the rate of preference erosion associated with MFN liberalisation by affording preference-giving countries some flexibility to shield specific products from the normal cut and phasing rules. This would of course be an unpopular measure among non-preference-receiving developing countries.
- The impacts of other regional and preferential trade policy developments on preferences and the benefits of preferences are ambiguous. Some concerns have been expressed about reduced preferences and tightening of rules of origin under AGOA, but the rules of origin under Economic Partnership Agreements (EPAs) may be relaxed relative to those previously affecting ACP exports to the EU.

Improving preference schemes

- The impact of preference erosion can be ameliorated by actions by the preference-giving countries to improve the design of their preference schemes, specifically:
  - Relaxed rules of origin requirements with value addition set in line with technological realities and development needs, and with greater scope for regional cumulation;
  - Combined with reduced tariff escalation, this would support the development of further export potential in new product areas;
  - Lower non-tariff barriers (NTBs) to the market access of preference-receiving (and other) exports by developing countries and LDCs;
  - Reduction of tariff peaks on products excluded from preference schemes and/or the extension of product coverage of schemes;
  - Greater incentives to utilise (and invest in the utilisation) of preferences by the relaxation of safeguard and graduation provisions, and by deterring the capture of preference rents by states other than the preference-receiving countries.

Policy improvements in the preference-receiving countries

- The preference-receiving countries need to create favourable business and investment environments. This includes regulatory reform and institutional strengthening to:
  - Reduce transactions costs and encourage production and investment;
  - Make it quicker and easier to establish a business or make new investments;
  - Give improved access to finance and financial services;
  - Make property rights more secure and the enforcement of contracts more effective.

Trade policy negotiating strategies

- Developing countries can negotiate as part of multilateral trade negotiations to increase the value of preferences. The lowering of MFN tariffs by the preference-giving countries could be smaller and/or more gradual in the case of products of particular importance to the preference-receiving countries (subject to the specific interests of non-preference-receiving developing countries).
- The product coverage of preference schemes could also be targeted in bilateral trade negotiations. Reducing the number of products excluded from schemes would provide opportunities for additional preferential trade, as long as MFN tariffs were positive.
- The utilisation and effectiveness of preferential schemes could be improved by relaxing the 'terms of access' for preferential exporters. Negotiations should therefore focus on reducing the complexity and increasing the transparency and predictability of rules of origin. They should also focus on reducing unnecessary barriers associated with product standards and other NTBs.

Trade facilitation and investment strategies

- The utilisation and value of preferences could be increased by supporting export development in the preference-receiving countries. Investment in infrastructure and institutional development and reform (improved customs procedures, port management, export marketing support, etc.) are central to improving trade facilitation programmes in these countries.
- Improving transport and distribution facilities is particularly important for remote and landlocked economies, but reducing trade costs is necessary for all preference-receiving countries.
- Co-ordination of trade facilitation programmes and the associated investment requirements on a regional basis is likely to increase the effectiveness of trade facilitation measures.

Aid for trade and export development

- Aid for trade (AFT) initiatives signal recognition by bilateral donors and multilateral agencies of the need for comprehensive and co-ordinated support for adjustment and export development.
- The preference-receiving countries threatened with the need to adjust in the face of preference erosion need to direct more support to encouraging export diversification. This may require some aspects of AFT support to be available for a wider set of countries and to extend beyond LDCs.

- Increasing the effectiveness of AFT will require additional funding, including core funding for the Integrated Framework (IF). It will also require a strong co-ordination function. Although the WTO is not a development agency, giving it an enhanced co-ordination and technical capacity in this area would support the mainstreaming of trade development support in trade negotiations.