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Introduction

Increased access to industrial country markets through reduced trade barriers has been and remains a major objective of developing countries and has been included in the Doha Round of WTO negotiations. However, such trade liberalisation is likely to have an uneven impact across developing countries. While most countries recognise the benefits of reducing barriers to trade in general, preference-dependent countries are apprehensive regarding the (potential) impact of recent further tariff reductions by industrial countries – the loses and adjustment costs associated with preference erosion. One of the core issues is that most of the G-90 group of developing countries already enjoy preferential market access for at least some of their exports to developed countries under various preference schemes. These aimed in part to encourage export growth in recipient countries by giving them a trade advantage over their competitors. Trade liberalisation in the form of tariff cuts in developed country markets will erode the value of these trade preferences. Consequently, some preference-dependent countries may suffer losses unless they are able to lower their production costs and/or diversify their exports and markets, and address structural problems reflected in high trade costs and supply-side rigidities.

An assessment of the potential losses associated with current trade negotiations is essential to identify appropriate planning and policy responses. This report provides such an assessment by reviewing the recent literature (in particular in the last five years) on the benefits of preferences and the actual and potential costs of preference erosion. It will be useful where possible to distinguish between cases where preferences have already been eroded, even if the costs have not been specifically calculated, and cases where current negotiations may lead to preference erosion. Examples of the former include apparel, with the change in the multilateral regime from the Multi-Fibre Agreement (MFA) to the Agreement on Textiles and Clothing (ATC), and sugar, where reforms to the EU sugar regime have reduced the prices offered to beneficiaries of the Sugar Protocol. The principal example of the latter is the general tariff reductions being negotiated under the auspices of the WTO.

1.1 Context and issues

Many commentators have argued that trade preferences have not yielded the expected benefits to recipient countries and have questioned the efficacy of using trade preferences to address the problems of developing countries. There is evidence that developed countries' tariff preference programmes yield fewer benefits to recipient countries than expected, and that the gains are limited to relatively few countries and products. It is unclear, however, whether this implies that preferences are poor instruments *per se* or that existing schemes have been badly designed. Low *et al.* (2005) show that the benefits of tariff liberalisation would outweigh the potential losses for developing countries in general, but that least developed countries would suffer the largest losses due to preference erosion. Karingi *et al.* (2007) show that MFN tariff cuts would lead to welfare, output and trade losses for some sub-Saharan African countries, partly due to preference erosion. Bureau *et al.* (2005) find that preferences granted to poor countries have a disappointing outcome, despite the absence of quota and tariff restrictions, coupled with high import shares of agricultural and food products, in EU and US preference schemes. Nevertheless, countries that are heavily dependent on preferential trade schemes are understandably concerned about preference erosion caused by further trade liberalisation in preference-granting countries.

Although there is a substantial literature on trade preferences, its impact on policy tends to be limited, in part because there are so many studies, typically with different approaches and methods applied to different preference schemes, and also because of their technical nature. The aims of this study are to synthesise the findings of the existing research and present them in a manner that is accessible to policy-makers. The study will focus on the implications of the limited impact of preferences on export performance, and thus the costs of preference erosion, for the policy options and actions required to increase the effectiveness of preferences and/or adjust to their loss.

1.2 Aims of the study

The study reviews the literature analysing the (prospective) impact of preference erosion on the export performance of preference-dependent countries in an attempt to determine the practical policies and other measures that these countries and the international community should take in order to increase the effectiveness of preferences and offset the adverse effects of preference erosion.

Key questions addressed are:

- What has been the impact of non-reciprocal preferential trade arrangements on the trade performance of preference-receiving countries?
- What are the key factors that constrain recipient countries' ability to benefit from trade preferences?
- What measures can be taken to help mitigate the negative impact of these constraints?
- Which countries and products or sectors will be most affected by the erosion of major preferences caused by further trade liberalisation?
- What policy measures are needed at the national and international level to address any potential effects of preference erosion?

1.3 Outline of the report

Chapter 2 reviews the nature and evolution of the various preference schemes offered by developed countries. It provides an overview of how much preferential trade is currently taking place, and how this differs across preference-receiving countries and export products. Information on the coverage of preferential trade is matched to the margin of preferences received and how this has evolved over time.

Chapter 3 reviews studies on the effectiveness of preferences in stimulating export growth, including those granted by preferential trade agreements and under specific preference schemes, and looks at estimates of potential losses caused by preference erosion. It examines both the quantitative and case study evidence in the academic and policy literature. The literature review provides an opportunity to assess the effectiveness of preferential schemes. The chapter also identifies the countries that are most exposed to losses from preference erosion.

Chapter 4 reviews the prospects for preference erosion under multilateral trade negotiations and associated MFN tariff reductions, and the types of policies that would make preference schemes more effective. The implications for preferential margins and trade are discussed, together with options for offsetting preference erosion or enhancing preferential schemes.

Chapter 5 sets out trade negotiating strategy issues for preference-receiving countries and policy recommendations for addressing and adjusting to preference erosion. This provides a basis for the consideration of types of compensation and/or support that the multinational community can provide to support export development in preference-receiving countries.