
The Value of Trade Preferences for Africa

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Improving the ability of the least developed countries (LDCs) to participate in world markets can stimulate growth and reduce poverty. To help achieve those goals, industrial countries offer developing countries preferential access to their markets through lower duties. In this note we discuss the magnitude of the preferences granted by the European Union, Japan, and the United States to Sub-Saharan African countries and show that only a small number of countries actually receive substantial preferences.¹

The role of trade preferences

Tariffs introduce a wedge between the world price of a product and the price in the domestic market. The premium normally accrues to the government of the importing country as tariff revenue. Under preferences, however, it may go to the developing country beneficiary, thereby raising returns to the activity that enjoys the preference and, depending on the nature of competition in domestic product and factor markets, stimulate expansion of that activity, with implications for wages and employment.

However, if there is little effective competition among buyers/importers in the developed country then the suppliers/exporters in the developing country may be unable to acquire much of the price premium. Ozden and Olareaga (2005) find that only one-third of the available rents for African exports of clothing to the U.S. under The African Growth Opportunity Act (AGOA) actually accrue to the exporters. In addition, as will be discussed below, the costs of satisfying the rules governing preferences reduces the extent to which they raise actual returns in developing countries.

The arguments underlying trade preferences are that the small scale of industry and low level of development in developing countries lead to high costs, which reduce countries' ability to compete in global markets, and to a lack of diversification, which increases risks. Developing countries, especially least developed countries, face much higher trade-related costs than other countries in getting their products into international markets. Some of these costs may reflect institutional problems in the exporting countries, such as inefficient practices or corruption, which require a domestic policy response. They may also reflect weak transport infrastructure and firms' lack of access to standard trade facilitating measures such as insurance and trade finance.

Trade preferences are expected to provide a premium over the normal rate of return and so encourage investment in these economies. The increase in trade due to preferences leads to more output and, if there are scale economies, to lower costs, further stimulating trade. It is important, however, that the sectors that receive preferences and investment should be those in which the country has a comparative advantage in the long term and that investment not be based on a false comparative advantage derived from the margin of preference.

Adverse effects

Tariff preferences can lead to several adverse effects. When rents do accrue to the developing country, they tend to accrue not to the poorest constituents but to the owners of the most intensively used factors. With agricultural preferences, the main beneficiaries are typically the owners of land. Preferences will typically have a strong impact on poverty only if the landowners are poor. So, even when preferences create substantial transfers for producers in developing countries, they may not stimulate the long-term growth of exports or reduce poverty, and may lead to a less diversified export base. Preferences can create a degree of dependence that constrains flexibility and diversification and results in high-cost production of preferred products (Topp 2001).

Finally, negotiations under the Doha Round have shown that preferences can be used to bolster external support for protectionist policies in industrial countries and to weaken proposals to reduce protection.

The value of preferences offered by the European Union, Japan, and the United States

Table 1 summarizes the calculated value of the preferences of the European Union, Japan and the United States for Sub-Saharan African countries in 2002. We allow for the fact that both the European Union and the United States have schemes that offer enhanced preferences to exporters in Sub-Saharan Africa beyond those of the standard Generalized System of Preferences (GSP). The United States has introduced the African Growth and Opportunity Act (AGOA), while the EU has the Cotonou Agreement and Everything But Arms (EBA) arrangement (a special provision in the EU's GSP scheme) for the least developed countries. The value of the preferences obtained under those arrangements is derived from the value of exports for which preference is actually requested multiplied by the preference margin. This is the implicit transfer of tariff revenue due to the preference scheme, all of which we assume goes to the developing country. This is presented in table 1 as a share of the total value of exports to each market.

The overall value of EU preferences to Sub-Saharan African countries under the Cotonou Agreement and the EBA amounted to just 4 percent of the value of the affected countries' exports to the European Union in 2002 (table 1). The value of

Table 1. Summary of the impact of trade preferences for Sub-Saharan Africa, 2002

Percent	Sub-Saharan Africa (total)			LDCs			Non-LDCs		
	EU	US	Japan	EU	US	Japan	EU	US	Japan
Value of preferences/ total exports	4.0	1.3	0.1	2.3	2.1	0.4	5.1	1.1	0.1
Share of top 5 beneficiaries in total value of preferences requested	59.9	73.9	88.9	73.8	98.8	95.8	76.9	92.9	98.7
Share of top 10 beneficiaries in total value of preferences requested	80.1	95.4	97.7	91.2	100.0	100.0	97.5	99.3	100.0
Share of top sector ^a in total value of preferences	31.3	31.9	41.0	37.1	51.5	70.9	34.5	33.4	31.9
Share of top 3 sectors ^a in total value of preferences requested	56.5	79.6	63.6	68.5	91.3	92.2	65.2	71.3	56.8

^a Defined at the two-digit level of the harmonized system.

Source: Calculated using data from USITC, EUROSTAT and Japanese Ministry of Trade.

U.S. preferences for Sub-Saharan African countries under AGOA and the GSP amounted to 1.3 percent of the value of exports to the United States. Japanese preferences for Sub-Saharan African exporters amounted to 0.1 percent of the value of exports. The value of preferences to non-LDCs is higher than that for LDCs in the EU schemes, while this situation is reversed for the U.S. and Japanese schemes.

The benefits of preferences are highly concentrated on a small number of beneficiaries. Under the EU schemes, 60 percent of the benefits accrue to five countries. For the United States, the top five beneficiaries account for almost three-quarters of the value of preferences, while for Japan the top five account for nearly 90 percent. For the LDCs, the top 10 beneficiaries account for 100 percent of the benefits under the U.S. and Japanese schemes and more than 90 percent of the benefits offered by the EU schemes. Thus, the value of preferences for the remaining 37 countries (although they are not the same countries in each case) is very small.

Preferences are also concentrated on a small number of sectors, especially for the LDCs. In the EU schemes these are mainly agricultural products (sugar, fruits, and processed meat and fish). U.S. preferences are dominated by clothing and mineral fuels. Fish, iron and steel, and nickel dominate Japanese preferences. Almost one-third of the value of EU preferences is derived from sugar, the market for which is highly distorted. These preferences will be affected by the EU's reform of

Table 2. Classification of Sub-Saharan African countries by magnitude of the value of combined (non-oil) preferences in the European Union, Japan, and United States relative to total (non-oil) exports, 2002

Less than 1 percent	Angola, Burundi, Central African Republic, Chad, Congo, Democratic Republic of Congo, Djibouti, Equatorial Guinea, Gabon, Guinea, Liberia, Mali, Níger, Nigeria, Rwanda, Sao Tome and Principe, Somalia, South Africa
Between 1 percent and 5 percent	Benin, Botswana, Burkina Faso, Cameroon, Cape Verde, Comoros, Eritrea, Ethiopia, Ghana, Ivory Coast, Mauritania, Sierra Leone, Sudan, Tanzania, Togo, Uganda, Zambia
Greater than 5 percent but less than 10 percent	Gambia, Guinea-Bissau, Kenya, Madagascar, Mozambique, Namibia, Senegal, Zimbabwe
Greater than 10 percent	Lesotho, Malawi, Mauritius, Seychelles, Swaziland

Source: Based on calculations using data from USITC, EUROSTAT and Japanese Ministry of Trade.

its sugar policies; they should be distinguished from general trade preferences that arise from a tariff preference in otherwise undistorted sectors.

For only five countries do the combined preferences requested in the EU, Japan and U.S. account for more than 10 percent of the value of total non-oil exports (table 2). For 35 of the countries—73 percent of the total in Sub-Saharan Africa—preferences amount to less than 5 percent of the value of exports. For 18 countries preferences are negligible, amounting to less than 1 percent of exports.

Because the trade preferences obtained in the EU, Japanese, and U.S. markets amount to a very small proportion of the value of exports of all but a few countries of Sub-Saharan Africa, the impact of those preferences is likely to be very muted. Only a small number of countries receive substantial transfers under current schemes. These are driven mainly by preferences for sugar in the European Union and for clothing in the United States.

Why do trade preferences fall short of their potential?

Trade preferences have not transformed the export and growth performance of most developing country beneficiaries, although performance may have been worse without them and a few countries may have benefited substantially. Trade preferences have not enabled beneficiaries as a group to increase their market shares in the main preference-granting markets. Why?

First, many products produced in developing countries are subject to zero MFN duties in industrial countries, and therefore no trade preference can be given. Second, products with high duties are typically excluded from preferences or the preference margin is very small. For a small number of products, preference margins are substantial, though usually within strict quantitative limits and only for certain

countries. Some countries that have been granted preferential access for sugar and tobacco, for example, have received large transfers due to preferences.

Third, many of the schemes are surrounded by uncertainty concerning their duration and the discretion that the donors have to exclude countries and products. That uncertainty limits incentives to invest in the beneficiary countries to take advantage of preferences.

Fourth, exporters in developing countries are often hampered in their ability to take advantage of preferences by complex rules of origin, which impose two types of costs: (a) the additional costs of sourcing inputs and designing production structures to ensure compatibility with the rules of origin, and (b) the costs of demonstrating conformity with the rules, in terms of documentation, accounting, and obtaining the relevant certificate.

Here we have concentrated on aspects of the preferential schemes that limit their impact, rather than on limitations in the beneficiaries' capacity to satisfy other requirements for market access, such as public and private standards related to health, safety, and quality, as well as broader constraints relating to transportation, energy, and so on, all of which constrain the supply response to preferences in developing countries, just as they do trade opportunities in general.

Conclusions

Trade preferences are not a panacea for success but rather should be seen as just one part of a strategy for export-led growth. In principle, trade preferences can promote development by providing temporary margins of preference to enable industries to adjust and compete more effectively in global markets. Multilateral trade liberalization contributes to this outcome by ensuring that preferences have a short half-life and that inefficient, high-cost industries with entrenched lobbies do not constrain flexibility and adjustment. Multilateral liberalization is also important for limiting the trade-diverting impact of preferences on other countries (usually other developing countries).

In practice, only a small number of countries receive large transfers as a result of preferences in developed country markets. The values of preferences are largest in the EU market, driven by a narrow range of products and the very high EU price for sugar. In a very few countries, such as Mauritius, preferences appear to have contributed to a relatively strong economic performance and economic diversification (Subramanian and Roy 2003). In some other countries, preferences have led to large transfers, but domestic industries have experienced rising costs and declining output and have accumulated large debts.² But most beneficiaries of European, Japanese, and U.S. preferences have experienced little or no impact. Preferences have done little to stimulate the export of a broader range of products.

Preference schemes would be enhanced by

- Extending coverage to all products and making schemes permanent (as with the EBA).
- Liberalizing rules of origin and simplifying the process of certifying compliance. If all schemes had the same simple and easy-to-apply rules, a producer in a least developed country could make production and investment decisions on the basis of equal and predictable access to all industrial markets.

The impact of preferences on developing countries would be facilitated by

- Improving the domestic investment environment.
- Addressing the internal barriers that raise the costs of trade for developing countries—inadequate and high-priced transport services, inadequate and unreliable energy supplies, inefficient customs practices, and lack of trade-supporting financial and telecommunications services.

The challenge is to find preference schemes that complement the domestic reforms that developing countries must undertake to improve the returns to exports without stifling diversification and multilateral trade liberalization.

Developed countries should not treat trade preferences as a substitute for direct development assistance, which remains crucial in alleviating internal barriers that constrain supply responses to trade opportunities. Nor should they allow allocations of development assistance to be distorted by preferences. While there is a need to address the difficulties that a small number of countries may face from the erosion of preferences under multilateral liberalization, such needs must not be met by redirecting assistance away from the large number of low-income countries that do not benefit from preferences. At the same time, developing countries must not view preferences as an alternative to domestic reforms that are needed to improve investment conditions, promote effective competition, and facilitate integration into the global economy.

Notes

1. This chapter was written by Paul Brenton, Senior Economist, and Takako Ikezuki, Junior Professional Associate Economist, of the International Trade Department of the World Bank. Comments from Elke Kreuzwieser and Faezeh Foroutan on the paper underlying this chapter are gratefully acknowledged.

2. For example, Mitchell (2005) concludes that despite substantial preferences, most Caribbean sugar producers are not competitive and will need to close or restructure once the European Union reforms its sugar policies.

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Further Reading

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