Background

The symposium was attended by more than 150 participants (representing 31 country delegations and state bodies, 28 international organizations and NGOs, and 9 universities) to discuss the impacts of and policy responses to preference erosion.

The first day of the symposium assessed the value of current preference schemes in each of the Quad countries plus Australia, terminating with a global assessment of the impact of MFN liberalization on preference erosion. The second day built on the factual information provided in the first, and looked towards the future. Two main approaches to addressing preference erosion were discussed: aid and multilateral trade policy responses. The final session discussed different responses to the issue of preference erosion and how to integrate the learnings of the symposium into the current DDA negotiations.

June 13

Preference Erosion: What is at Stake?

The Chair, WTO Deputy Director-General Dr. Rana, welcomed the participants and asked Ambassador Stephenson of Canada to introduce the topic of the symposium. Ambassador Stephenson focused on the critical importance and timeliness of the symposium for the DDA negotiations in gaining an understanding of the impacts and policy responses to preference erosion. He emphasized that although the magnitude of preference erosion may be small in macroeconomic terms, it was imperative to assess its impact in human terms. Finally, he reminded participants that preferences are a means to achieve the objective of development, not an end in themselves.

Carlos Braga, on behalf of The World Bank, outlined The Terms of the Debate and provided a brief historical overview of preferences. He underlined the mixed development results achieved by preferences and described the problems in calculating the magnitude of preference erosion. He underscored the differences between de facto and de jure preferences and how different methodologies and counterfactual liberalization experiments influence the estimates available.

Faizel Ismail, Representative of South Africa, talked in his personal capacity. The title of his presentation was Overcoming the Fear Factor: Small, Weak and Vulnerable Economies in the DDA. He stated that the multilateral system needs to support small, weak and vulnerable economies facing the challenge of preference erosion and proposed ten possible courses of action by the WTO and developed countries. These include enhancing market access (in particular increased access for the temporary movement of workers and eliminating tariff peaks and escalation on goods), establishing a mechanism to institutionalize flexibility in implementing rules and disciplines, addressing non-tariff barriers in the area of product standards, and capacity-building.

In the ensuing debate the following were highlighted:
The discussant, Professor Messerlin from Sciences Po, stated that the issue of compensation could be looked at from either a backward-looking perspective or a forward-looking perspective. The former would involve difficult compensation calculations and political negotiations, and the latter would focus on addressing and investing in behind-the-border constraints.

Interventions from Kenya and Sri Lanka expressed concern at the erosion of preferences. Costa Rica replied that some developing countries should not be discriminated against or made to pay for the preferences developed countries provide to other developing countries.

Sheila Page, ODI, referred to the possibility of providing preferences in services. Ambassador Stephenson underlined the need for achieving a consensus that works for all member-states. Rubens Ricupero, FAAP, Brazil, highlighted the growing importance of reciprocal preferences in the context of bilateral and regional trade agreements as an additional source of preference erosion.

The Value of Preferences I

The Chair, William Martin from The World Bank, introduced the three presentations on US, EU and Japanese preference schemes. Analyzing the US’ Preferential Regime, Judith Dean from USITC found utilization of regional preference schemes is typically high, but varies widely across agreements and countries. This variation appears unrelated to coverage, size of preference margin, and volume of exports. Average tariff preference margins are relatively low for most products and countries, with the exception of those on apparel and on non-agricultural imports from AGOA. The value of regional preferences is significant for a large number of beneficiary countries, with non-agricultural preferences most important in Sub-Saharan Africa (driven by apparel), and agricultural preferences most important in CBERA countries. Further research is needed to explain variation in preference utilization.

Sebastien Jean from CEPII analyzed The EU’s Preferential Regime and concluded that there was high utilization by developing countries of at least one of the several EU preference schemes available. Imperfect utilization of schemes with higher preference margins indicates constricting Rules of Origin requirements. High take-up of preferences by sub-Saharan countries suggests that preferences are effective in boosting their agricultural exports.

Norio Komuro from Kobe University Law School highlighted three factors that made The Japanese Preferential Regime ineffective for preference recipients: narrow GSP coverage, high conditionality restricting GSP utilization, and the increasing number of FTAs. He emphasized that the two key priorities to enhance developing country access to Japanese markets are to reduce MFN tariff levels and to convert specific tariffs to ad valorem equivalents due to their greater relative impact on cheaper imports.

In the ensuing debate the following were highlighted:

The discussant to the US paper, Marcos Jank, from ICONE and USP, Brazil, addressed the dynamic effects of liberalization that may lessen the impact of preference losses estimated by static models. He also highlighted the protectionist-generating tendency of preferences (comparing developing country alignment on cotton to the disagreements on sugar) and that preference revenue may not always go to the intended beneficiaries. He urged developing
countries to focus on achieving a real outcome to the DDA and to avoid over-emphasizing exceptions.

- The discussant to the EU paper, Stefano Inama, from UNCTAD, focused on the potential factors affecting the choice of ACP countries across alternative EU preferential regimes.

- The discussant to the Japanese paper, Bijit Bora, from WTO, underlined that preferences are associated with particular countries and particular products. His analysis of the impact of non ad valorem (AV) rates on LDC exports into Japan reiterated the importance of MFN reform, through abolishing nuisance duties and converting to AV duties, rather than preferential reform.

- Sri Lanka, Mauritius and Malawi indicated that more attention is needed on why utilization remains low in certain areas (in particular understanding Rules of Origin constraints) and highlighted the need to use S&DT to protect vulnerable farmers. Kenya suggested that economies need to advance to a certain level before being asked to forgo preferences. St Lucia asked why developed nations are pursuing FTAs so actively if preferences are a second-best policy-tool.

- Rubens Ricupero highlighted the importance of supply-side issues in being able to exploit preferences, using the example of mobile Asian entrepreneurs in the textile sector. Sheila Page underlined that the purpose of preferences was to drive industrialization and diversification, not to alleviate poverty.

**The Value of Preferences II**

The Chair, Ambassador Toufiq Ali of Bangladesh, introduced Douglas Lippoldt from OECD, who presented *The Australian Preferential Regime*. According to Lippoldt, the regime has limited impact on developing nations’ exports since Australia imports only 3% of these flows and because the scale of the preference utility is modest. Australia extends MFN duty-free treatment for many products exported by developing countries to Australia, which decreases the importance of preferences for many suppliers. Very few countries exhibit significant reliance on Australian preferences. The Australian preference regime has experienced considerable preference erosion due to unilateral MFN rate reductions, which contributed to shrinking preference margins and a decline in the value of the estimated forgone duties under preferential arrangements by about half between 1996 and 2002.

Similar results were reported on *The Canadian Preferential Regime* by Przemyslaw Kowalski from OECD. The low Canadian share of developing country exports and the high percentage of these exports that enter at MFN levels mean that both the value of preferences are small for most countries and that there is a developing country constituency pushing for MFN reduction. The exception to this trend is the few textile and clothing exporters who have taken advantage of the deeper preferences on these items since 2003.

In the ensuing debate the following were highlighted:

- The discussant to the Australian paper, Kym Anderson from The World Bank, underlined that half of the world’s poor are in countries that are not preference-dependent and that trade-related aid is the first-best way to help directly the poor. He also highlighted that much of the rents of current preference schemes go to middle income countries.
One of the discussants to the Canadian paper, Simon Evenett from the University of St. Gallen, indicated two general concerns with all the papers’ low estimates of preference values: they neither take into account possible increases in future competitiveness of developing countries’ export sectors nor the possibility that a relatively high cost of production could result in entire industries being wiped out by preference erosion. Dominique Njinkeu from ILEAP stated that the losers from preference erosion need to be protected although probably through other support for development. The key issue is therefore identifying the package that can address the problems of these countries.

Jamaica expressed concern that there were a lot of inconsistencies and contradictions in the debate assessing the value and impact of preferences. Kenya emphasized the need to enhance preference utilization and provide support for adjustment. Sri Lanka indicated that the plight of the countries facing high MFN tariffs should also be addressed.

Douglas Lippoldt explained that due to differences in preferential schemes among the main preference-granting countries, MFN liberalization -- whilst creating preference erosion losses for some preference-reliant countries in their main export market -- will in many cases increase opportunities for these countries in the other main industrialized markets. He also pointed out that the 2003 Australian liberalization of Rules of Origin for LDCs did not result in increased uptake. Ambassador Ali concluded that the key determinant of preference effectiveness is the extent to which the private sector can respond to the incentives created by the preference margin.

The Value of Preferences III

The Chair, Joseph K. Ingram from The World Bank, introduced Dominique Van der Mensbrugghe from The World Bank. His paper on The DDA and Preference Erosion: Modeling the Impacts used a CGE model to understand the global impact of preference erosion from MFN liberalization on different regions. The estimated “value” of preferences for low income countries excluding India is $4bn and the loss of these preferences through erosion reduces the predicted gains from full merchandise trade liberalization by 50% for these countries. Preference margins, however, are relatively small and concentrated in a few countries and sectors. Moreover, they are minor in comparison to other factors, for example logistics costs.

Caglar Ozden from The World Bank presented his and Paul Brenton’s paper on Rules of Origin and Apparel Preferences in the US and the EU. His opening remarks framed the preferences debate in a different light: the term “discrimination” should replace the term “preference”. He highlighted the differential impact of Rules of Origin on the utilization and the type of apparel preferences, the impact of MFA quota removal in shrinking the margin of preference, the competition between preference-receiving exporters, and the substitution effect of African exporters turning from EU markets to US markets due to AGOA’s more lax Rules of Origin.

In the ensuing debate the following were highlighted:

- One of the discussants to the first paper, Sam Laird from UNCTAD, indicated that if current preference regimes were simplified and deepened, income in Africa could increase by 2%. He underlined the importance of getting data on a microeconomic level (using household surveys) to analyze the true impact of preference erosion on the poor. An exit strategy from
preferences is needed since they are a cheap way for developed countries to pay off developing countries. **Raed Safadi** from **OECD** stated that it was important for realistic DDA scenarios to be analyzed in CGE modeling exercises.

- The discussant to the second paper, **Professor Jaime de Melo** from **Université de Geneve**, addressed the issue of rent-capture in bilateral FTA preferences due to the administrative and distortionary costs of Rules of Origin. He indicated that an LDC would require a 5-10% preference margin just to make up for these additional costs associated with preference conditionality.

- **Kenya** asked how the DDA can help achieve the objective of effective preference utilization. **Mauritius**, talking on behalf of the **Africa** and **ACP groups**, argued that trade preferences have never impeded MFN liberalization. The fear for the preference-dependent countries is that they lose their industry overnight. **Costa Rica**, following this statement, underlined that a multilateral solution to preference erosion is necessary, but not at the cost of other developing countries. He considered that preference protection is a defensive S&DT approach and is less related with real development than establishing offensive interests to attract investment and gaining market access.

**June 14**

**Financing Preference Erosion**

The topic was introduced by the Chair, **Ambassador Jara of Chile**, and the analysis was provided by **Bernard Hoekman** from **The World Bank** who presented his joint work with **Susan Prowse** from **DFID** on **Policy Responses to Preference Erosion**. Three policy approaches were discussed: reliance on current adjustment assistance mechanisms (e.g. the IMF’s TIM); a stand-alone compensation fund; or dedicated funding channeled through a multilateral mechanism such as the Integrated Framework. The pros and cons of each approach were outlined, including the difficulty in quantifying the transfer and that adjustment and capacity needs go beyond erosion losses.

In the ensuing debate the following were highlighted:

- The first discussant, **Werner Corrales Leal** from **ICTSD** underscored the necessity for the multilateral system to give developing countries the policy space to create links between the export sector and the rest of the economy and to encourage diversification through fostering innovation. **Edwin Laurent**, Adviser to the **Commonwealth Secretariat**, reviewed the Commonwealth’s proposed modalities for donor assistance to support the adjustment process in preference-dependent economies, including eight principles for assistance and a structure to provide financing to preference-dependent economies through the private sector, public sector and a social safety net. He argued that one issue of critical importance to many of these economies is access to credit since many are unable to attract FDI in a significant way.

- **Malawi** agreed that an infrastructure focus was important for exports. **Mauritius** emphasized the need for a holistic policy solution across agencies and donors and that any solution needs to be flexible and very quick.

- **Bernard Hoekman** stated that there appeared to be broad agreement on the policy proposals presented indicating a broad consensus that the key issue on addressing preference erosion is
increasing competitiveness. Joe Ingram, of The World Bank, emphasized that the key challenge in integrating trade into the PRSPs is how to create the local constituency for reform to drive the process bottom-up.

**Multilateral Trade Solutions to Preference Erosion**

The Chair, Ambassador Smith of Jamaica, introduced the WTO research team, Patrick Low, Roberta Piermartini and Jurgen Richtering, who presented their findings on the impact of MFN liberalization - using a Swiss formula - on non-agricultural exports of developing countries. They found that the value of preferences is reduced when adjusted to take into account existing reciprocal preferential agreements, thereby mitigating or even reversing the preference erosion losses from NAMA liberalization. They also assessed the scope for provision of additional preferences and found it was quite small since over 80% of LDC exports are duty-free.

In the ensuing debate the following were highlighted:

- The first discussant, Richard Newfarmer from The World Bank, stated that the few available trade solutions to preference erosion include increasing utilization rates of preference schemes and developing countries extending preferences to LDCs, but that aid is a necessary part of the policy response. The second discussant, Andrew Mold from UNECA, suggested that the results highlighted by Low, Piermartini and Richtering needed to be extended to include agriculture if the numbers were to have any relevance for African countries. He also highlighted the importance of looking the whole range of trade problems for developing countries, and stated that although the problem of preference erosion was of serious concerns for a limited number of countries (e.g. Mauritius), it might be considered a minor problem in comparison to other concerns including deteriorating terms of trade. He emphasized that more attention is needed on providing guidance on diversification of export structures.

- The Eastern Caribbean States asked how ex ante to identify the comparative advantage of a country. Sri Lanka asked about the role of preferences in rewarding social and environmental standards and to help the most vulnerable countries. Ethiopia suggested that developed nations should provide non debt-creating funding to support the adjustment process in countries who will suffer from preference erosion.

**The Way Forward**

The Chair, Uri Dadush from The World Bank, welcomed the panelists and stated this was the opportunity to get practical learnings for the DDA on preference erosion. Richard Bernal, CRNM Director-General, discussed four sets of timely and tangible solutions to preference erosion that are needed to prevent the issue becoming an obstacle to DDA negotiations. These solutions included the recalibration of preferences, restructuring preference-dependent economies, redimensional development finance, and revitalizing private sector trade capacity.

Michael Hadjimichael from the IMF indicated there are two responses available to preference erosion and, more importantly, supply-side problems: a trade response, through negotiating down MFN levels, and a response in Aid for Trade. The IMF can support these policies by providing concessional financing assistance for balance of payment problems or reforms and by supplying technical assistance.
Sheila Page from ODI emphasized that preferences have positively affected a significant number of countries over the past 35 years. She highlighted the importance of achieving the public good of a WTO-led multilateral liberalization and that therefore the issue of preference erosion for the lower-middle income countries needed to be solved (e.g. by offering preferences in services). She underlined the fact that preferences are of limited use to LDCs and that aid is required in these situations. Trade solutions to address preference erosion have some utility, but they are limited since preferences essentially discriminate against other developing countries. The WTO and the multilateral system must offer developing countries more scope to experiment with domestic production measures, as long as these do not harm other countries.

Sok Siphana, Cambodian Secretary of State, emphasized the importance of local private sector involvement to address behind-the-border issues. Each developing country needs to be proactive in developing a vision of its sectoral and national export strategies and understand its own investment climate. He reiterated that a substantive outcome in the DDA should not be jeopardized by defensive protectionism of preference margins.

Rubens Ricupero offered two new ideas. First, the importance of making the most of current preferences in FTAs by broadening and deepening preferences, including more countries, and binding them in the round. Second, the necessity for the WTO to develop a mechanism similar to the US’ Trade Adjustment Act which provides adjustment-assistance funds for both retraining and safety-nets. He proposed that the Trade Policy Review Mechanism currently in place in the WTO could help in advancing this agenda.

In the ensuing debate the following were highlighted:

- Canada reminded other member-states of the current TPRM review as a channel to present new proposals. Chile proposed that developing countries provide market opening opportunities to LDCs, with zero tariffs and relaxed Rules of Origin. Mauritius emphasized that weak and vulnerable economies need support. Canada sounded a note of caution on Aid for Trade that the trade specialists get the development community onboard and integrated into the process. UNECE reminded the participants of the need to consider WTO-acceding countries and the importance of hearing more voices of the constituencies affected by preference erosion.

- The US emphasized the importance of technical training when implementing FTAs/preferential schemes both to government and to the private sector. Sheila Page strongly agreed and, in her opinion, this was a reason why AGOA had been used effectively.

Uri Dadush concluded the conference and thanked all the participants. He stated that preferences were clearly important for some countries in some sectors, insignificant for most, and injurious for others. Preferences are rapidly being eroded by liberalization at all levels (national, regional and multilateral), but the key source is from the active pursuit of FTAs by the Quad rather than the DDA, which is unlikely to lead to significant preference erosion unless the negotiations become a lot more ambitious. Some can be done to compensate erosion through trade policy solutions, including liberalization in Mode IV, increased South-South liberalization and agricultural reform in the Quad. Moreover, much can be done to achieve the original purpose of preferences – diversification of the export-base – through Aid for Trade in focusing on the supply-side. Finally, a significant part of the solution is to continue to build a domestic constituency for supply-side and trade reform in developing countries.