Future of Preference Programs

Nonreciprocal trade preference programs face an uncertain outlook and probably will decline in importance in future world trade. Erosion of preferential tariff margins under a multilateral trade liberalization setting is unavoidable. Much of the analysis of trade liberalization done in the past may have given an overly optimistic picture of the trade gains associated with global trade liberalization for developing countries, including least developing countries. The proportion that preferential trade accounts for within the total agricultural exports from beneficiaries to the U.S. and the EU is significant from the perspective of many beneficiaries, so trade models that do not account for the existence of preferences will not accurately capture the impact from cutting MFN tariffs on beneficiaries' trade. Nevertheless, it would be counterproductive from the standpoint of their own interests for many developing countries to oppose tariff liberalization, or to advocate minimal rather than deep cuts, under the misleading notion that their overall exports would decline because of the erosion of preference margins. As we have demonstrated, many important agricultural products of interest to developing-country exporters are currently excluded from nonreciprocal trade preference programs. In addition, trade preferences are not available to all developing countries on an equal basis, whereas all would enjoy the full benefits of MFN tariff reductions.

With the growing number of bilateral reciprocal agreements and advancement in multilateral negotiations, the value of preferential programs is bound to decline. Although this trend gives little comfort to the recipients, the speed and the degree of erosion may be controlled by the length of time over which MFN tariff reductions are implemented. A longer implementation period would allow beneficiary countries more time to continue to take advantage of the available trade opportunities while also easing the process of adjusting to erosion in the preferences.

In a World Bank study, Hoekman et al. (2001) analyzed the potential impact of eliminating tariff peaks (higher than 15 percent) by the EU, U.S., Japan, and Canada on trade with the least developed countries. The average EU tariff peak mostly affects agricultural imports such as meat, fish, sugar, tobacco, and footwear. In the U.S., most of the peaks affect industrial products, particularly apparel and clothing; tobacco and sugar are the most important agricultural commodities in this group. The results showed that the trade gains for LDCs would be much higher than the tariff revenues collected by the donor countries. The EU results showed that the elimination of tariff peaks would lead to a 37-percent increase in LDCs' exports of the peak items. The highest beneficiary export commodity is sugar (64 percent of the gain), followed by cereals, meat, and fruits. The U.S. results showed 35-percent trade gains for the LDCs. Most of the benefits were due to an increase in apparel trade, about 65 percent of the growth; tobacco accounted for the rest of the gains. The summary results of the study showed that if the LDCs were to receive duty-free access to the developed-country markets (U.S., EU, Japan, and Canada), then their total exports would increase by about 11 percent.

The results of the study by Hoekman et al. suggest that although there will be trade and income gains from increased market access and modification of

preferential programs, the gains are expected to be relatively moderate, even without taking into account the offsetting impact of trade regulations. This means that access to developed countries' markets is not a magic bullet. To accelerate the growth in trade and incomes in LDCs requires a host of supports, both internal and external. The internal market conditions of the countries, including the functions of economic institutions, macroeconomic performance, infrastructure, and transportation, would have a much stronger impact on trade and economic performance of the countries than the marginal gains under preference programs. These factors are critical to economic growth, even when there is preferential access to global trade markets (Barro, 1996).

Conclusions

Nonreciprocal trade preference programs have been an important part of the global trading system for the past three decades. The argument for the establishment of these programs under the General Agreement on Tariffs and Trade (GATT) was that the preferences granted would, by giving the developing countries greater access to developed-country markets, cause their exports to expand and, thereby, foster more rapid economic growth and overall development. The justification for making the preferences nonreciprocal, or unilateral, was that equal treatment of unequal partners was not equitable and, therefore, special trade preferences were required to create a level playing field in the global trading environment.

Among developed countries, the United States and the European Union have the largest markets and are important preference-granting donors. Both donors have revised their programs over time, adjusting the country and commodity coverage and other features. They both have revised their rules of origin—program restrictions that specify where and how goods can be produced in order to qualify for preferences—by giving beneficiary countries more leeway to use inputs from multiple countries to produce their products.

While there is a considerable amount of overlap in country and commodity coverage, U.S. and EU programs provide different levels of trade concessions to the recipients. The main beneficiaries from U.S. programs are the Western Hemisphere developing countries, while the countries of Sub-Saharan Africa tend to be the largest beneficiaries of EU programs. In general, the top product categories imported by both the U.S. and the EU under nonreciprocal programs are very similar, reflecting the range of products produced in developing countries. Both import large quantities of fresh and processed fruits and vegetables, sugar, tobacco and tobacco products, and cut flowers under these programs. The main exception was found in the fish and shellfish category, which accounted for almost 30 percent of EU nonreciprocal preferential imports versus almost zero in the case of the U.S. Most U.S. imports of fish and shellfish take place at MFN tariffs that have been bound at zero.

The EU provides the highest margin of preference or price differential under its GSP/EBA program, while the U.S. provides its most favorable tariff relief to CBERA/ATPA beneficiaries. For the least developing countries eligible under EBA, about 98 percent of agricultural product lines can enter duty-free to the EU market, while this share is 88 percent in the U.S. market for CBERA/ATPA countries. Those commodities that are excluded from the preferential programs face stiff tariffs in both markets, average MFN tariffs of 63 percent in the EU market and 42 percent in the U.S. market. Politically sensitive agricultural commodities such as dairy products and sugar, or products containing dairy and sugar, remain highly protected in both markets.

For preferential recipient countries, lower tariffs enhance their ability to be competitive in the EU and U.S. markets, but do not necessarily lead to full utilization of the programs. The benefits accrued by developing countries from tariff preferences are a function of numerous factors, including the extent of product coverage, the size of the margin of preference, the complexity of program rules and regulations, the costs associated with meeting eligibility requirements, and the trade-limiting effect of program

constraints. In addition, for many countries a lack of productive or export capacity limits their ability to take advantage of these preferences.

Despite these factors, nonreciprocal programs get strong support from developing countries. One reason is that the U.S. and EU are very important markets for exports of preference recipient countries. Many countries rely heavily on these programs, as indicated by the sizable share of their exports that receive preferences. In 2002, more than 50 percent of agricultural exports of 21 countries entered the U.S. market under preferential programs. The figure was even higher for the EU, where preferences covered over half of the agricultural exports from 49 countries.

The results indicate that the EU and U.S. programs continue to offer significant market access for selected products to some developing countries. However, the trade gains are not equally distributed among recipient countries and tend to be concentrated in higher income developing countries. To some extent, this is to be expected, as these countries have larger and more efficient agricultural sectors. Despite the incentives associated with these programs, the poorest developing countries have simply not been very successful at exporting agricultural goods to the U.S. They have been more successful at exporting under EU programs, where the product coverage and the margins of preference are higher, although even under EU programs the trade gains are concentrated in a relatively few LDCs. These programs have been most successful in generating large trade flows in products where beneficiary countries have a comparative advantage in production and the productive capacity to expand exports. In these cases, beneficiaries may continue to see their exports to the U.S. and the EU grow, even when the margin of preference is eroded, especially if these exports are constrained by quotas which are allowed to expand.

The uneven gains from these programs are not solely related to the nature of the programs, but also a reflection of the inadequate production capacity of the low-income recipients. For these programs to achieve their potential for LDCs, where production capacity is highly constrained by numerous factors, including poor policies, weak infrastructure, and low-skilled labor, would probably require them to be coupled with increased financial and technical assistance. How to address the problems associated with expanding production and export capacity in the lower income countries in order for them to benefit from trade liberalization will be one of the challenges developed countries will face in the Doha negotiations.