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Reviving the Special and Differential Treatment of Developing Countries in International Trade

Since the inception of the multilateral trading system, optimally articulating international trade liberalization commitments with developing countries' national economic strategies has been a central debate. The launch of the Doha Development Agenda (DDA) in 2001 installed, in theory, the trade and development nexus at the very heart of the WTO negotiations. The principle of Special and Differential Treatment (SDT) asserts the need to adapt international trade rules to the specific economic situation of DCs.
However, forty years after being developed, the main concepts underlying the traditional approach of SDT in the WTO seem largely exhausted. Based on the notions of "preference" and "non-reciprocity" of trade commitments, the SDT embodies a systemic contradiction within a world trading system built upon the basic principles of "non-discrimination" and "reciprocal commitments". The stalemate of SDT and market negotiations over the issues of DC differentiation and preference erosion suggest that the system may have reached the bottom of the contradiction, contributing to hold back the prospects of a successful "development round".
Against this backdrop, this volume addresses two key issues in the development dimension of the DDA, and aims at identifying avenues for a way forward in the WTO negotiations. The first issue is the future of non-reciprocal preferences: what kind of trade and development strategies and insurance against adjustment shocks can be proposed to the countries –in particular members of the G90– facing the threat of preference erosion? The second issue relates to DC differentiation: is it possible to craft a new burden-sharing of global trade responsibilities between developed and emerging economies, in particular G20 leaders?
This book brings together original contributions prepared for the conference on *The Future of Special and Differential Treatment*, organized jointly by the Institut Français des Relations Internationales (Ifri) and the Agence Française de Développement (AFD) on 28 October 2005, in Paris.

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REVIVING THE SPECIAL AND DIFFERENTIAL TREATMENT OF DEVELOPING COUNTRIES IN INTERNATIONAL TRADE

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REVIVING THE SPECIAL AND DIFFERENTIAL TREATMENT OF DEVELOPING COUNTRIES IN INTERNATIONAL TRADE

THE TWIN CHALLENGES OF PREFERENCE EROSION AND DIFFERENTIATION OF DEVELOPING COUNTRIES

Edited by Jean-Marie Paugam and Anne-Sophie Novel

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Contents

Foreword **7**
Peter Kleen

Chapter 1
The Twin Challenges of Preference Erosion and Differentiation of Developing Countries: An Introduction **11**
Jean-Marie Paugam, Anne-Sophie Novel and Serge Perrin

Chapter 2
Are Trade Preferences Good for Development? An Overall Review of the Functioning of the Generalized System of Preferences Schemes **27**
Stefano Inama

Chapter 3
EU Agricultural Trade Preferences with Special Reference to Banana and Sugar Imports from ACP Countries **55**
Hervé Guyomard and Fabrice Levert

Chapter 4
Preference Erosion and the Doha Development Agenda **85**
Bernard Hoekman

Chapter 5
Preference Erosion and Multilateral Liberalization: The Case for Scaling Up Aid for Trade **119**
Serge Perrin

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Chapter 6

Why and How Differentiate Developing Countries in the WTO? Theoretical Options and Negotiating Solutions **151**
Anne-Sophie Novel and Jean-Marie Paugam

Chapter 7

More Differentiated Special Treatment in the Agriculture Agreement: Beyond Concept to Practice **181**
Alan Matthews

Chapter 8

Upholding Special and Differential Treatment for Developing Countries within EU-ACP Economic Partnership Agreements . . **209**
El Hadji A. Diouf

Conclusion

Making Trade Work for Development **231**
Valentine Rugwabiza

Appendix **241**

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Foreword

During the last five years, there has been a renewed interest among both academics and practitioners regarding the question of "special and differential treatment" (SDT) of developing countries in the world trading system. With the adoption of the Doha Development Agenda (DDA) in 2001, SDT has for the first time emerged as a central theme in a multilateral trade round.

In the Ministerial Declaration from Doha it is stated that the needs and interests of developing countries will be placed at the heart of the DDA. Another aim is to strengthen all SDT provisions in the WTO and make them more precise, effective and operational. This has been further reinforced by high-flown rhetoric from some political leaders in the industrialized world. Expectations among the developing countries are therefore high and the big question is whether it will be possible to live up to these promises and pledges.

In September 2005 –a few weeks before the WTO Ministerial meeting in Hong Kong– IFRI and AFD arranged a conference on SDT. The conference concentrated on two of the more contentious issues which confront the negotiators in the WTO: first, the question of preference erosion and, second, differentiation. The main contributions from this conference have been compiled in this book.

Trade preferences have a long history, and all preferences create winners and losers. The successful trade rounds that have taken place between the 1970s and 1990s have reduced the value of trade preferences, at least for manufactured goods.

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This was foreseen from the start and has on the whole been accepted by the main players, who have granted trade concessions in other areas.

However, recent research has shown that for a small number of countries the potential gains, in terms of removal of trade distortions and better market access in the DDA, will be too small to compensate for their preference losses. This situation applies to countries that have enjoyed preferences for some agricultural commodities –preferences which will be diminished or eroded not only as a result of what might ensue from the DDA, but also as a consequence of some dispute cases in the WTO and internal reforms in the EU (sugar and bananas).

This book enumerates different ways to tackle this problem, either through improvements to the present [Generalized System of Preferences (GSP)] schemes or other types of trade concessions within the DDA. A more promising avenue seems to be compensation outside the WTO through non-trade instruments such as financial transfers to target more directly institutional building and to address other factors that constrain trade capacity. This latter option has lately got a boost with various initiatives under the catchword “aid for trade”. It is to be noted that these efforts are directed not only towards the least developed among the developing countries (LDCs) but also to other developing countries with limited administrative capacity and infrastructure.

Another sensitive and also highly divisive issue among the developing countries is whether SDT should be differentiated according to the level of development of individual countries or whether it should be based on other criteria. There are arguments that suggest that more and better differentiation may significantly deepen SDT measures and improve their effectiveness.

Development status in WTO is based on self-selection. The only sub-group that has formally been recognized and approved to be eligible for special treatment horizontally across the board is that of the LDCs. It is hardly to be expected that other groups of developing countries will gain the same status.

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However, differentiation is already a fact of life and treated pragmatically issue by issue in various WTO agreements such as those dealing with tariff concessions, agriculture, subsidies and intellectual property. New groupings depending on special interests in different areas have been introduced –such as Net Food Importing Developing Countries (NFIDC), small economies and newly acceded members.

The pros and cons of differentiation as a tool in the present Doha Round are explored in this book. It remains to be seen whether, as one contribution puts it, "differentiation is likely to stay locked into the quiet realm of economic literature", or whether it could be used constructively to further development strategies, not only in the WTO but also in the steadily growing regional and bilateral free trade areas between developed and developing countries. This of course presupposes that differentiation is not used for tactical reasons by the developed countries, which would give the term a bad name.

My hope is that this important and highly topical book will be read by all the negotiators and policymakers who will have the final authority to determine the scope and contents of SDT in the WTO. The quality of the decisions on solving the problems connected with both preference erosion and differentiation will of course be enhanced if they are based on a better understanding of what the latest research has to say about these matters. At the very least one might hope that this will minimize the risk of repeating past mistakes.

Peter KLEEN,
Former Director General for the
National Board of Trade in Sweden

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Chapter 1

The Twin Challenges of Preference Erosion and Differentiation of Developing Countries: An Introduction

Jean-Marie Paugam, Anne-Sophie Novel and Serge Perrin

Unlike previous trade rounds, the Doha Development Agenda (DDA) relies on no clear and undisputed economic paradigm to govern the principle of special and differential treatment (SDT) of developing countries (DCs) in the WTO. The gods of the past had already been buried when the DDA was launched in 2001: be those the import substitution policies of the 1960s, rooted in the contribution from Prebisch and Singer, the works of the United Nations Conference on Trade and Development (UNCTAD), or the systematic case for unilateral openness derived from the "Washington Consensus" inherited from the 1980s. Today, economists argue over the sense and the robustness of statistical correlations linking openness to growth (Rodrik and Rodriguez 1999). Some also question the contribution of the multilateral trading system to countries' trade performances (Rose 2002). The "trade not aid" mantra underpinning some old approaches of the GATT negotiations is now gone for good following the Monterrey Consensus (2002). The need for aid to manage adjustment costs from liberalization and address supply-side constraints

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to help poor countries benefit from trade rules is now widely acknowledged. The potential scaling-up of Official Development Assistance (ODA) from 80 billion US dollars in 2004 to 130 billion US dollars in 2010 offers a new opportunity for increasing this support without having to compete with other development priorities. The better integration of trade and aid strategies (i.e. "coherence" or "aid for trade") has become the new frontier of development policies.

Their conceptual background being in such disarray, the Doha negotiations on SDT remain unsurprisingly stuck in a stalemate, contributing to holding back the prospects of a successful "development round". Yet the difficulties of the round have also caused a surge of academic interest. Innovative researches have recently been undertaken regarding some of the key negotiating issues underpinning the SDT dimension of the DDA. This academic effort is progressively filling in the gaps of the development literature on trade. Thorny development questions playing a crucial role in the political economy of trade negotiations have started to be dealt with. The purpose of this book is to shed new light on the evolving knowledge on trade and development relations. The following chapters take stock of the recent findings in trade and development literature, and contribute to the identification of new avenues for achieving successful SDT negotiations.

The Trade and Development Nexus in the Doha Development Agenda

The trade and development debate is not a new one. Since the inception of the multilateral trading system, optimally articulating international trade liberalization commitments with the national economic strategies of DCs has been a central debate. In a nutshell, the SDT principle asserts the need to adapt international trade rules to the specific economic situation of DCs. To that end, SDT historically evolved in two different ways.

On the one hand, SDT measures allowed DCs to resort to some discrimination through flexibilities in, or exemptions from, the multilateral trade rules. The trading system has

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historically swung between both. The Tokyo Round (1973-1979) mainly used the exemption method: DCs were given the possibility of opting out of the negotiated "codes" (antidumping, subsidies, non-tariff barriers). The opposite approach was taken in the Uruguay Round (1986-1994), which was based on a "single undertaking" principle, implying that all GATT/WTO members were to adopt the same rules: SDT consequently moved towards implementation flexibilities, particularly through longer transition periods and prospects of increased technical assistance for DCs.

On the other hand, developed nations have been encouraged to provide DCs with enhanced market opportunities, in particular through granting "non-reciprocal trade concessions": such "positive discrimination", derogating from the GATT's most favored nation (MFN) principle has been rooted in the Generalized System of Preferences (GSP) since 1971 and legally based on the "enabling clause" from the Tokyo Round (1979).

According to the "enabling clause", a country acceding to the WTO (or the former GATT) can choose to self-declare its status as a developing country. This status entitles it to the benefit of all SDT measures. Countries classified as least developed according to the UN criteria can also benefit from SDT measures that are specific to their category. As a result, SDT only acknowledges two categories of developing countries. Adding the group of developed countries, the WTO apparently recognizes only three different categories of countries.

Developing countries considered that the SDT provisions from the Uruguay Round had failed both to balance North-South trade concessions and to confront the increasing marginalization of poor countries from world trade. As a condition for launching the DDA negotiations, DCs thus obtained that the existing SDT measures be reviewed in order to strengthen their effectiveness and operational usefulness. The Doha Declaration mandated such a review of the SDT measures embedded in the existing agreements. It covers a spectrum of 145 SDT measures: improved market-access conditions for DCs; special consideration of DC interests in

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particular agreements; lower level of discipline commitments; transition periods for implementation; and “best endeavor” provisions committing developed countries to look out for DC interests and provide them technical assistance. On their own, least developed countries (LDCs) exclusively benefit from 22 other specific SDT measures. In regard to future agreements that meant to be negotiated under the DDA, the negotiating mandate has set SDT as a major objective, aiming at integrating DC needs and interests into future trade commitments both for market access and newly negotiated trade disciplines. The negotiating mandate was initially set to deliver the first DDA “early harvest” by July 2002 on the topic of SDT.

Entrenched North-South oppositions rapidly became embodied in two conflicting approaches of the negotiating mandate. Developed countries promoted a crosscutting conceptual approach of SDT objectives, whereas DCs tabled 88 specific proposals for re-consideration of the SDT provisions adopted during the Uruguay Round. Developed countries refused to agree to specific proposals prior to systematic clarification of the scope and objectives of SDT. DCs refused to give up negotiating specifics against opening an open-ended horizontal discussion. In a classic WTO manner, procedural tricks were therefore invented to try to bridge the gap before the Cancun WTO Ministerial (2003). The 88 SDT requests were broken down into three “baskets”: one for proposals deemed likely to raise consensus (most of them of low development impact); another for measures deemed unlikely to obtain consensus ever; the last basket for measures needing further consideration within other appropriate DDA negotiating committees. Yet, this approach failed to deliver any results, either in Cancun (2003) or Geneva (2004).

Underlying this North-South confrontation on classical SDT approaches of rules and market access, two major challenges have loomed up and turned into major stumbling blocks: the fear of preference erosion on the side of developing countries; and the increasing insistence of developed countries for better DC differentiation under WTO rules. Subsequent chapters in this book intend to draw a complete picture of both these strategic challenges.

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The Challenges of Preference Erosion: From "Fixing" to "Eliminating" Trade Preferences

Vulnerable DCs, particularly in Africa, immensely fear losing the benefit of non-reciprocal tariff preferences underpinning some of their competitive advantages vis-à-vis emerging competitors. Since they aim at lowering the ceilings on MFN tariffs, WTO market access negotiations automatically induce some reduction of the margin of preferences currently enjoyed by the beneficiaries of GSP regimes. Such prospect of "preference erosion" is intrinsic to the dynamic of multilateral liberalization and had previously been accepted as such. The "enabling clause" itself asserts that preferences should not create any obstacle to the progress of MFN liberalization.

Thus, non-reciprocal preferences have long been ignored in quantitative analysis of international trade before starting to attract major attention from economists during the course of the DDA. In chapter 2, Stefano Inama evokes some of the enduring and heated disputes over the economic efficiency of the GSP. He stresses that some of the recent academic work on measuring and assessing trade preferences has unfortunately been influenced by negotiating aims and tactics. The flaws of trade preferences have often been pointed out and their economic impact minimized in order to reduce their "negotiating value" by partisans of broad multilateral liberalization (especially in agriculture and textile trade). Conversely, their development merits have been overstated by partisans of the current WTO *status quo*. Notwithstanding the tactical intentions, Inama's analysis and the subsequent chapters of Guyomard and Levert and of Hoekman (chapters 3 and 4) delineate some mainstream common ground concerning the assertion that, since their implementation in the late 1960s, trade preferences have had a limited development impact overall.

The main issue is that the original principles of the GSP (generality, non-discrimination, non-reciprocity) have seldom been implemented in practice. The GSP resembles more and more a patchwork of non-transparent, unpredictable arrangements based on *à la carte* conditionality for trade

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concessions (selective and discretionary tariff concessions, opaque and complex regulations, restrictive rules of origin). To a certain degree, the various and overlapping systems of preferences today tend to resemble a pre-GATT 1947 situation. Ironically, since 1947, it might be argued that a constant objective of the multilateral trading system has been to try to discipline the colonial legacy of discretionary discrimination in North-South trade regimes.

Some other reasons for the underperformance of trade preferences are systemic –preferences would tend to inhibit the diversification of developing economies, create discriminations between developing countries, favor rent sharing between the exporters of DCs and the importers of developed countries, and drive the opposition of vested interests to trade liberalization.

This is not to suggest that, as a matter of principle, non reciprocal preferences may not be useful *per se*. It has also been argued that preferences have generated selected success stories (such as Mauritius) and that some criticisms that are based on the underutilization of preferences may prove empirically groundless in the agriculture sector (Bureau 2005). Yet since the political economy of the decision-making on preferences remains mostly a North-North domestic issue, their conditions tend to be quite restrictive and of little economic benefit in practice. Furthermore, trade preferences bear an endogenous bias: preferential regimes prove the more significant and efficient for development when and where the MFN protection is higher in developed economies.

Therefore, on average, the GSP remains far from being "general". As remarked by Inama, "in effect, only slightly more than one fourth of dutiable imports receive GSP treatment" from preference-giving countries. Hervé Guyomard and Fabrice Levert specifically investigate the structure and performance of GSP schemes in the agricultural sector through a case study of the relations between the European Union (EU) and African, Caribbean and Pacific countries (ACP). Their findings confirm the existence of wide loopholes in agriculture due to vast exemptions of "sensitive products" from most GSP schemes. It is also worth noting that stringent rules of origins and related

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administrative procedures have often contributed to a substantial underutilization of preferences, especially in the textile sector. For instance different administrative procedures related to certificate of origin are one of the underlying reasons why exporters privilege the ACP (African, Caribbean and Pacific countries) regime over the EU "Everything but Arms" (EBA) GSP initiative for LDCs.

Whatever the overall picture of GSP performance, it has been now widely acknowledged that the problem of preference erosion is both real and important for selected vulnerable countries.

Against this backdrop, Bernard Hoekman and Serge Perrin (chapters 4 and 5) first focus on delimiting the real challenges of preference erosion. They observe that different methodologies have been tested to measure the value of preferences and the costs of their erosion through MFN liberalization. The evaluation of the preferential margins and their economic impact varies significantly according to the considered variables: choice of macro-indicators being considered (total preferential export value/generated welfare or real income); depth of MFN tariff reduction scenario; integration of the compliance costs of preferences (estimated between 1 and 5 percent of the value of covered exports); and offsetting impact of the indirect benefits associated with multilateral trade liberalization. An innovative work from Bouët, Fontagné and Jean (2005) distinguishes between "apparent preference margin" (the difference between preferential and MFN applied rates) and the "true preferential margin" (the difference between the preferential margin enjoyed by an individual country and the average world preference granted to competitors).

Various sources measuring preference erosion estimate the cost is in a range of 0.5 billion US dollars –for African LDCs –to 1.7 billion US dollars annually– for all preference-dependent countries. Within this range, the welfare losses incurred from the elimination alone of the quota rents from textiles are estimated at 1.1 billion US dollars annually. In addition, the following features are commonly found in various estimations of preference erosion. The bulk of losses from preference erosion are expected to fall on a quite

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narrow set of "highly preferred" countries, whose exports are concentrated in a handful of highly protected sectors or products such as bananas, sugar, meat, vegetables and fruits, textiles and apparel. These "big losers" are mostly small islands –including some middle income economies such as Mauritius, St Lucia, St Kitts and Nevis, Belize, Guyana and Fiji– most Sub-Saharan states and some Central-American countries. Most authors note that the erosion of European preferences would account for a significant proportion of the overall costs incurred. Another challenge pointed out in Guyomard and Levert's analysis concerns the intra EU-ACP distributional consequences of preference erosion. In the case of bananas, reform of the EU regime induces a reallocation of market share from Caribbean countries to the Cameroon and Ivory Coast. In the case of sugar, the redistribution may be to the advantage of the LDC countries eligible for the EBA scheme to the detriment of ineligible ACP countries, a point also noted by Diouf (chapter 8).

There is no consensus in the literature regarding the design of solutions to solve the problems of preference erosion and lack of economic diversification. Two broad categories of policy options are available for designing credible strategies for solving the problem of preference erosion: either by "fixing" or "eliminating" non-reciprocal trade preference.

The first type of approach –i.e. "fixing" the problems of trade preferences– primarily builds on some of the positive arguments acknowledging partial successes of trade preferences. It is also derived from a realistic assessment of the world trading system, considering that, whatever the MFN liberalization scenario in the DDA, trade preferences will stay and could function more efficiently. Following on from Inama, a first line of proposal aims at restoring the primacy of the original principles of GSP to achieve better transparency, non-discrimination, and predictability of the preferential regimes. A second axis for improving the existing preferential schemes suggests relaxing and harmonizing the rules of origin based on the most favorable existing regime: this approach underpinned the trade action plan released by the G8 Evian Summit (2003) and the report of the UK Commission for

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Africa (2005). A third line calls for the immediate generalization of LDC duty-free and quota-free regimes based for instance on the model of the EU "EBA" initiative (Dodini 2005). From the Singapore WTO Ministerial to the UN Millennium Development Goals, the international community has repeatedly called for such a global commitment in favor of LDCs. The Hong-Kong WTO ministerial eventually took a decisive step toward its practical implementation in 2008. Unfortunately however, WTO members authorized "flexibilities" to protect their markets from LDC exports, up to 3 percent of tariff lines. This may substantially impair the anticipated development impact of the concessions made. Beyond LDCs, some advocate the extension of such benefits to middle-income countries.

The second broad type of approach –i.e. eliminating the problem of trade preference– aims at stimulating ambitious progress of MFN liberalization: the non-reciprocal trade preferences would thus mechanically disappear to the benefit of an improved and non discriminatory trading system. In 2004, the Sutherland Report on the future of the WTO convincingly reasserted this very classical and orthodox vision of the world trading system as a sort of global public good. Yet, as pointed out by Inama, Perrin, and Hoekman, the odds for such a bold MFN liberalization strategy highly depend upon designing a coherent and integrated supporting financial strategy.

First, political economy analysis suggests that the opposition to MFN liberalization can only be overcome through an appropriate "losers compensation" strategy. Hoekman suggests that such compensation may basically take two forms: it may be either "trade-based and inside the WTO" or "aid-based and outside the WTO". The design of "pure trade compensation" for preference erosion could theoretically rely on offering alternative preferences to the losers –for instance in the area of the Mode 4 commitments of the GATS regarding movement of natural persons for servicing contracts. But the implementation of such "compensatory preferences" would raise the opportunity cost, thus reducing the incentive for broad MFN liberalization. It is therefore considered that the

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design of a financial compensation package could offer a more efficient solution to the problem of preference erosion. However the design of such a solution raises complex issues since it needs to integrate trade negotiations and the mobilization of financial instruments from "outside" the WTO. Also, the nature and magnitude of "transitional" adjustment costs –which go beyond concerns regarding possible balance of payments shortfalls– are not well assessed, and more detailed analysis should be carried out at the country-level. Eventually, the final targets and vehicles of any financial compensation will need to be carefully determined. Any allocation of adjustment aid toward preference-dependent countries should not happen at the expense of other DCs that do not benefit from preferences, and should be additional to existing aid flows.

Second, economic analysis suggests that the potentially positive development impact of MFN trade liberalization will be partly dependent on the implementation of a substantial and appropriate "aid for trade package", aiming at fostering DC capacities. The proposal for an enhanced "integrated framework" for trade-related technical assistance for LDCs may play a key role in the design of such an initiative. Yet Perrin raises several issues regarding the overall governance of this coordinating mechanism between multilateral agencies and bilateral donors: scope of intervention, increased funding, country ownership, and mainstreaming of trade policy into national development strategies. The two financial requirements –for "aid" on the one hand and "compensation" on the other– may also clash in practice: targeting compensation to the beneficiaries of rents from trade preferences would be necessary to overcome their political opposition to MFN liberalization, but may not achieve a good allocation of scarce financial resources from a development priority perspective.

A pragmatic and realistic way of considering the way out of preference erosion could be based on a combination of the two approaches: the "fixing" strategy can certainly provide answers for a transitional period, while the "eliminating" agenda remains the best long-term hope for development.

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Improving SDT Rules: More DC Differentiation Would Better Serve Development Objectives

DCs have long criticized the weaknesses of existing SDT measures, both in terms of implementation needs (lack of institutional and technical capacities) and for preserving the autonomy of their national development strategies (policy space). However, economists strongly disagree over the idea that full and automatic DC exemptions from multilateral trade rules of non-discrimination would end up stimulating development dynamics. The mainstream literature even suggests that such an approach would prove globally damaging for world trade as well as locally inefficient for development strategies. Furthermore, developed countries show that they are politically not prepared to accept further concessions on SDT rules without matching them with a new and realistic update of DC commitments in line with their differentiated economic situation and capacities. A major North-South confrontation has thus developed over the developed countries' call for a greater differentiation of developing countries in the WTO. The matter has turned into an unspeakable taboo contributing *de facto* to the freezing up of SDT negotiations.

Yet, numerous arguments from an emerging body of literature suggest that more and better DC differentiation may significantly help to deepen SDT measures and thus improve their effectiveness and impact on development.

According to Anne-Sophie Novel and Jean-Marie Paugam (chapter 6), there are strong legal and economic arguments for more differentiation within the WTO. The differentiation principle appears not only legally grounded in the "enabling clause", but has also been recognized and interpreted by the Appellate Body of the Dispute Settlement Mechanism, a point also made in Diouf's chapter. Furthermore, the WTO rules already allow differentiation through acknowledging several subcategories of DCs eligible to selected SDT measures. From an economic perspective three arguments are commonly used to justify increasing differentiation. First, as for other international organizations in charge of development, more DC differentiation within the WTO would allow a better targeting of

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SDT measures to the specific needs of DCs. Second, it is considered that the more vulnerable countries often lack an alternative to trade policy instruments for implementing an initial development strategy through lack of sufficient capacities and resources: DC differentiation would help by reserving for them the largest SDT exemptions from WTO disciplines. Third, differentiation would help concentrate the deepest SDT benefits on the smallest and mostly vulnerable players, thus limiting the damaging negative externalities for the trading opportunities of other WTO members (Page and Kleen 2005). The literature on SDT also shows that three broad types of options are theoretically available to achieve differentiation. New DC classification (and graduation) mechanisms could theoretically result from "country-based" criteria, "rules-based" criteria, or a mixing of both.

Since the Uruguay Round, agriculture has been identified as one of the most promising, if not politically sensitive, fields for improving the effectiveness of SDT measures through increased DC differentiation. Major policy concerns over food security and rural poverty have led to establishing the specific category of net food importing developing countries (NFIDC). Since then several theoretical attempts have been made for better targeting the country in need of appropriate SDT measures for food security and rural poverty reasons. As argued by Matthews (chapter 7) while no consensus is yet in reach for country classification, the focus should now turn to "the nature of the deal that has to be made if greater differentiation is to become a reality in the agriculture agreement". To that end, the WTO 2004 Framework Agreement (or July Package) already provides a useful basis for increasing the differentiation of relevant SDT measures under the three negotiating pillars of the Agreement on Agriculture (market access, domestic support, and export subsidies) by framing them in development concerns as "food security, livelihood security and rural development needs". Provided the political will exists, new DC differentiation criteria could be empirically devised to meet these development objectives.

However, in view of the political taboo, DC differentiation is likely to stay locked into the quiet realm of economic litera-

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ture. Anne-Sophie Novel and Jean-Marie Paugam suggest that three prerequisites would be needed to help achieve some political movement on the issue. First and foremost, WTO members should explicitly refer the issue of differentiation to the unique compass of its potentially positive development impact. Differentiation should not be presented nor interpreted as a new tool for balancing market access concessions. Second, negotiators should narrow the scope of any debate on differentiation to the relevant topics where improving SDT trade disciplines would really help development strategies. The main topics possibly justifying more horizontal differentiation are likely to be located in the field of intellectual property and domestic regulations, food security, rural poverty, and industrial policies. Conversely, there is no *a priori* need to devise horizontal differentiation criteria in the fields of market access commitments and trade-related technical assistance. Here, differentiated commitments should merely be based on modulating individual members' commitments in the WTO. Third, it has to be recognized that the prospects for introducing the principle of DC differentiation in the SDT negotiations would heavily depend on the possibilities of positively combining incentives from the SDT and market access negotiations. Considering the mercantilist nature of the WTO negotiations, it is unlikely that the most advanced developing economies would be willing to engage in negotiations that could lead to limiting their eligibility to some SDT benefits without prospects of market access compensation; a point also made by Alan Matthews in chapter 7.[1]

New procedural solutions are therefore needed to that end. One suggestion from Safadi (2005) would be to give up the current "two-track" negotiating process on SDT, compartmentalizing the review of past agreements and the negotiation of future ones. Trade negotiators should be given a chance to consider simultaneously the full SDT packages and implications of each set of propositions within the relevant sectoral negotiating forums. Another suggestion from Novel and Paugam proposes agreeing on new negotiating modalities for SDT as part of the concluding results of the DDA. The

1. See also Safadi (2005).

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WTO members would then need incentives to expeditiously carry out the leftovers from SDT negotiations. To maintain negotiating incentives, some of the commitments for market access implementation could be conditionally suspended for the entry into force of a new SDT agreement.

Lastly, Diouf argues that differentiation conceals major development stakes for the design of future EU-ACP relations under the framework of economic partnership agreements (EPAs) currently being negotiated. He observes that, in the absence of specific disciplines applying to "mixed regional trade agreements (RTAs)" (i.e. a bilateral or regional trade agreement between developed and developing partners), WTO rules forbid the design of a trade regime simultaneously based on preferential treatment, non-reciprocity and discrimination. Future EPA agreements would thus underpin the SDT treatment currently enjoyed by ACP countries in the general WTO regime. Diouf thus recommends exploring new legal avenues for upholding the possibility of specific SDT measures for ACP countries in the EPA agreements. To that end, one possible way would involve designing new and specific disciplines governing the WTO compatibility of "mixed RTAs" (by amending GATT article XXIV and GATS article V). Another possible way would build on the WTO Appellate Body ruling on the European GSP, designing new and objective criteria allowing legal differentiation of ACP partners in EPAs.

Conclusion: Time for a Strategic Overhaul of SDT

Forty years after being developed within UNCTAD the main concepts underlying the traditional approach of SDT in WTO seem largely superseded. Based on the notions of "preference" and "non-reciprocity" of trade commitments, the SDT embodies a systemic contradiction within a world trading system built upon the basic principles of "non-discrimination" and "reciprocal commitments". The stalemate of SDT and market negotiations over the issues of DC differentiation and preference erosion suggest that the system may have reached the extent of the contradiction and would now need a

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strategic overhaul. From such a perspective, the future of preference erosion and DC differentiation appear much intertwined. First, because differentiation has already been implemented unilaterally by developed countries through the "graduation" mechanisms of their trade preferences schemes. Second, because deeper and more effective SDT provisions, possibly based on further differentiation in the WTO, could be an avenue for providing meaningful trade compensation to countries losing out from preference erosion. Third, because there is probably no credible incentive for developed countries to improve the existing preferences schemes (i.e. "fixing the problem") without offering further differentiation of beneficiaries. Fourth, because confronting both challenges will partly rely on designing appropriate "aid for trade" packages and integrated strategies. Developed and developing countries would gain by giving up old SDT agendas and should start overhauling SDT by confronting these strategic challenges.

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Chapter 2

Are Trade Preferences Good for Development? An Overall Review of the Functioning of the Generalized System of Preferences Schemes

Stefano Inama[1]

The Prebisch tenet that "treating unequals equally simply exacerbates inequality" has been perceived as a challenge to the Most Favored Nation (MFN) principle, the cornerstone of the modern international trading system. Trade economists have at times defined preferences as perverse since, on the one hand they divert developing countries' attention away from MFN negotiations and, on the other, few benefits have accrued to such countries by relying on preferential market access.

It should be recalled that trade preferences were in place before the MFN principle and are largely a legacy of former colonial trade agreements that featured in the original General Agreement on Tariffs and Trade (GATT) 1947.

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In particular, paragraph 2 of article 2 of GATT 1947 admitted existing colonial preferences into the GATT system.[2]

Few would remember today that the original Prebisch proposition establishing the Generalized System of Preferences (GSP) had the intended objective of imparting discipline to the wide array of competing preferences that originally featured in the GATT 1947. According to Prebisch's vision, former discriminatory trade preferences were to be replaced by a unique set of preferences granted to all developing countries based on a principle of self selection.

In spite of the inevitable shortcomings that occur when a vision has to be translated into policy instruments, this attempt largely succeeded. After the establishment of the first GSP schemes in 1971[3] there was a relatively long period when preferences were mostly channeled through the GSP schemes, with the notable exception of the preferences granted by the EU to African, Caribbean, Pacific (ACP) countries under the Lomé Conventions, and lately the Cotonou Partnership Agreement.

Since the mid-1990s there has been a progressive proliferation of non-reciprocal trade preferences whereby the traditional non-discriminatory character of the GSP schemes has been modified by a policy of differentiation among developing countries that benefit from the schemes. These special preferences granted under the GSP schemes initially took the form of special additional preferences granted to Andean Countries and were later extended to Central

2. Art. 2. Para 2 of GATT 1947: The provisions of paragraph 1 of this Article shall not require the elimination of any preferences in respect of import duties or charges which do not exceed the levels provided for in paragraph 4 of this Article and which fall within the following descriptions:
(a) Preferences in force exclusively between two or more of the territories listed in Annex A, subject to the conditions set forth therein;
(b) Preferences in force exclusively between two or more territories which on 1 July 1939, were connected by common sovereignty or relations of protection or suzerainty and which are listed in Annexes B, C and D, subject to the conditions set forth therein;
(c) Preferences in force exclusively between the United States of America and the Republic of Cuba;
(d) Preferences in force exclusively between neighboring countries listed in Annexes E and F.
3. The EEC was the first to put into effect the First GSP scheme in 1971 while the US put into effect its GSP scheme in 1976.

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American Countries under the EU GSP scheme. This tendency later evolved to initiatives similar to the GSP schemes targeted to a specific group of countries like the African countries in the case of the African Growth and Opportunity Act (AGOA).

Thus if one has to discuss the future of trade preferences it should first be observed that the current scenario of overlapping and competing trade preferences resemble, in a paradoxical manner, a pre-1947 situation where trade preferences were granted taking into account geopolitical interests rather than development concerns.

Trade preferences and their erosion is a traditional topic, which appears on the negotiating table whenever a round of multilateral negotiations aiming at reducing MFN tariffs is launched. Erosion of trade preferences was not a contentious issue during the Uruguay Round and did not impede an enhanced participation of developing countries in the negotiations.

The preferences issue made a return to the negotiating table at the multilateral level in the aftermath of the failed Seattle Ministerial. Ministers agreed in the Singapore Ministerial declaration to duty-free and quota-free treatment for products originating in least developed countries (LDCs).

Initially, developed countries and more so developing countries found it difficult to fully implement this commitment. Bracketed texts on this issue are still present in the Hong Kong Ministerial, currently in draft.

The EU with its "Everything but Arms" (EBA) initiative and Japan and Canada, who made substantial improvements to their GSP schemes, honored the initial commitment. However the US preferential treatment of LDC exports fell short of expectations since textile and clothing are still excluded from the scope of the US GSP after more than 30 years of its operation. Textile and clothing products are, however, covered under AGOA.

Most recently the issue of preferences and their erosion has been high on the agenda during the preparations for the Hong Kong Ministerial. LDCs and other developing countries that attach importance to trade preferences have made it clear

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that a solution to preference erosion had to be found if the Doha Development Agenda (DDA) is to go ahead with their consent.

Lessons learned from the reactions of cotton producing countries caused by the inability of major trading partners to respond to their demands undoubtedly contributed to the failure of the Cancun Ministerial. This prompted early efforts by the international community to avoid a similar embarrassment with the issue of preference erosion and, in turn, explains the increased attention paid by researchers and institutions to the issue of preference erosion in the post-Cancun scenario.

Paradoxically these recent debates and studies on the issue of erosion of preferences acknowledge principles and findings that just a few years ago in the context of the debate and negotiations in the United Nations Conference on Trade and Development (UNCTAD) Special Committee on Preferences would have been simply unthinkable or labeled as unrealistic and radical.

To sum up the following principles are now widely recognized:

– Erosion of trade preferences may create transitional adjustment costs in some beneficiary countries, and gains from the DDA are not necessarily automatically replacing the benefits of trade preferences.

– The international community should provide "aid for trade" assistance to overcome supply side constraints and transitional adjustment costs so as to reach a successful consensus on the DDA,[4] which would permit developing countries to reap the benefits of increased market access.

Following a grudging admission that some sort of compensation[5] was necessary and justified in light of the "public good" of the DDA, recent studies have focused on quantifying the value of trade preferences in order to put a dollar figure

4. See Development Committee, World Bank, 2005.

5. This term seldom appears on studies or papers on this issue, but in essence this is the crude reality. Some researchers referred to the term of "buying out" trade preferences.

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on the bill that will have to (eventually) be paid and on discussing the merits of finding a possible solution either within the WTO (a trade solution) or outside the WTO (a financial solution).

During this process some of the arguments and issues affecting trade preferences left unresolved from 30 years of GSP schemes have been finally recognized. However recognition of these shortcomings has at times been used as an argument to diminish the value of trade preferences and consequently the amount or the extent of the transitional adjustments.

For instance low utilization of preferences due to stringent rules of origin and burdensome documentary evidence is a topic that has featured in the debates of the UNCTAD Special Committee since the late 1970s. Yet rather than address the stringency of rules of origin as part of a trade solution, in some instances low utilization has being raised just to reduce the value of trade preferences and therefore the amount of the transitional adjustment.

These GSP rules of origin have not been changed since the 1970s in spite of the current fragmentation of production and the lowering of MFN rates in a series of multilateral rounds. In spite of much writing and discussion on this issue, the last draft ministerial text at the time of writing[6] still reads that "Developed members shall, and Developing countries members in a position to do so should: [...] (b) Ensure that preferential rules of origin applicable to imports from LDCs are simple and transparent, and contribute to facilitating market access"

It does not require much legal or WTO experience to realize that such language is a "best endeavor" sentiment that, as for many other cases, will have little or no effect on the present stringency of the rules unless further action is taken. The afore-mentioned text does not provide any indication for how the objectives in the statement might be implemented or

6. WTO document, Job(05)/298/rev.1 of 1 December 2005, Annex F, Page F-1; and WT/MIN(05)/W/3 of 7 December 2005, <www.wto.org/english/thewto_e/minist_e/min05_e/draft_text3_e.pdf>.

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establish any working group or monitoring mechanisms. Neither is the clause written as a legally enforceable obligation.

This paper is divided into three sections. The first section deals with the first two decades of GSP schemes, which draws from the analysis made during that period by the UNCTAD Special Committee on Preferences. The Special Committee on Preferences was the designated UNCTAD intergovernmental machinery that reviewed and monitored on an annual basis the implementation of the GSP schemes from the early 1970s till its dissolution in 1996, at the time of the restructuring of the UNCTAD Secretariat. It will include an assessment of the GSP based on the experience gained by the GSP study program and recent analysis.

The second section will look at the evolution of the GSP schemes in the last decade and the increasing divergence from the original objective of the GSP and the absence of an intergovernmental machinery in which to consult and debate the development aspects of the preferences like the former UNCTAD Special Committee on preferences.[7]

The third section will examine recent developments, especially the EU GSP scheme recently approved under the vision of the EU Commission for the functioning of the EU GSP scheme from 2006 to 2015.[8] It will attempt to make some predictions on the future of unilateral trade preferences and the GSP schemes.

GSP Preferences from 1971 to 1994

As stated in UNCTAD Conference resolution 21(II), "...the objectives of the generalized, non-reciprocal, non-discriminatory system of preferences in favor of the developing countries, including special measures in favor of the least

7. Obviously trade preferences are also discussed in the relevant WTO bodies. However given the non-specific mandate of these bodies on the issue of preferences the extent of the analysis and discussion is intrinsically limited.
8. Communication of 7 July 2004 from the Commission to the Council, the European Parliament and the European Economic and Social Committee on "Developing countries, international trade and sustainable development: the function of the Community's generalized system of preferences (GSP) for the ten-year period from 2006 to 2015" [COM(2004) 461 final - Official Journal C 242 of 29.9.2004].

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advanced among the developing countries, should be: (a) to increase their export earnings; (b) to promote their industrialization; (c) to accelerate their rates of economic growth."

The three basic principles were not fully observed from the outset and divergence from them has been growing over time. The first principle –generality– called for a common scheme to be applied by all preference-giving countries to all developing countries. In practice, there are wide differences among the various GSP schemes in product coverage, depth of tariff cuts, safeguards, and rules of origin. While a certain degree of harmonization exists in the area of product coverage, some schemes do not cover the textiles and clothing sector entirely. In the case of rules of origin, different sets exist.

The second principle –non-discrimination– implies that all developing countries should be covered and treated equally under the schemes. In this connection, only a "positive" differentiation among beneficiaries has been allowed since the inception of the GSP schemes, as reflected in the enabling clause for special measures for LDCs. As will be shown later in the second section, actual practice has increasingly departed from the spirit of non-discrimination.

The third principle –non-reciprocity– means that beneficiaries are not called upon to make corresponding concessions in exchange for being granted GSP status. However, some preference-giving countries place conditions on eligibility and have withdrawn preferences directly or indirectly. This action implies a degree of reciprocity of concessions or demands to conform with a certain pattern of behavior.

In the case of the United States, adequate and effective protection of intellectual property rights and internationally recognized workers' rights have been conditions since the inception of their GSP scheme for designating developing countries as beneficiaries. The argument is that the GSP objective of aiding economic development would not be adequately achieved without parallel development of adequate intellectual property rights and workers' rights.

A General Accounting Office (GAO) report in 1994 determined that when GSP was reauthorized in 1984 "the

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[United States GSP] program became more reciprocal in nature.[9]" The 1984 Act stated that the GSP was intended to promote the economic development of beneficiaries, noted that trade, rather than aid, is a more effective way of achieving this goal, and pointed out that the amended GSP law was meant to integrate developing countries into the international trading system with its attendant responsibilities in a manner commensurate with their development. The report further stated that GSP had an increased focus as a leveraging tool that could be used to encourage desired behaviors in beneficiaries in exchange for continued GSP benefits. However, developing countries have characterized these "conditionalities" as inappropriate when attached to what is, in effect, a trade assistance program that traditionally required no reciprocal action by beneficiaries.

The European Union's 1995 scheme marked a drastic departure from the previous schemes since it started to grant additional preferences to beneficiary countries that comply with certain prescribed, internationally-recognized environmental and social standards from 1997 onwards. These additional benefits were expected to improve the quality of development in beneficiary countries through the application of more advanced social and environmental policies, and to compensate partly for the supplementary costs required to attain these policies. Reservations have indeed been expressed in some quarters regarding the appropriateness of this new approach. The inclusion of broader development criteria such as social and environmental concerns may attach further conditionalities to an instrument which has been traditionally developed within the trade context as well as create practical difficulties for implementation. Few developing countries have requested the extension of such additional benefits.

Like the US scheme, a provision has been added to the GSP scheme of the European Union to allow for withdrawal of a beneficiary country from its scheme if, inter alia, it manifests cases of unfair trading practices, workplace discrim-

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9. See, *International trade: assessment of the generalized System of trade preferences program* (GAO/GGD-95-9, Nov 9, 1994).

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ination, and failure to comply with obligations under the Uruguay Round to meet agreed market access objectives.

GSP Preferences from 1994 to Present

Departure from the agreed principles of "generalized", "non-discriminatory" and "non-reciprocal" GSP schemes has significantly increased in recent years. On the positive side, a number of initiatives have emerged to implement the commitment to provide duty-free and quota-free access to LDC countries given at the Singapore Ministerial meeting. These initiatives have been progressively implemented, for example under "Everything but Arms" (EBA) and in recent measures adopted by Canada in 2002 and Japan in 2001 and 2002.

Special preferences for LDCs fall within the original objectives of the GSP, which has always provided for the possibility of granting more generous preferences to these countries.

As mentioned earlier, in addition to "general" GSP schemes and special preferences for LDCs, other unilateral initiatives have provided better market access to selected beneficiary countries. Such initiatives had a regional scope and were undertaken under or outside the GSP umbrella, serving trade policy objectives not falling within the original scope of GSP objectives and principles. Due to their discriminatory nature, these arrangements do not comply with the enabling cause. Ad hoc waivers have to be sought as in the case of the Cotonou Partnership Agreement.

The Andean Trade Preferences Act (ATPA) and the Caribbean Basin Initiative (CBI) are covered by a waiver, while AGOA was not and was therefore in legal limbo[10] till recently. In the case of the EU, special incentives are provided to beneficiaries adhering to a number of international conventions on workers' rights.

10. AGOA legislation was first enacted as part of the Trade and Development act of 2000. Curiously enough, AGOA legislation is an amendment of Chapter 12 of the Trade act of 1974, subchapter V- titled Generalized System of Preferences. Obviously AGOA does not conform to GSP criteria on non discrimination. It was only after five year of operation of AGOA that the US requested a waiver to the WTO: see WTO document G/C/509 of 1 March 2005.

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Obviously these initiatives diminish substantially the value of trade preferences granted under the normal GSP since these special trade preferences offer better product coverage, wider tariff cuts and more favorable rules of origin to beneficiary countries than under GSP schemes.

It has been observed[11] that, while the overall value of imports under the US GSP program diminished during the 1992 to 2000 period, imports under the Caribbean Basin Economic Recovery Act (CBERA) and ATPA increased during 1992 and 2000 as did imports under AGOA.

As a deviation from the multilateral and non-discriminatory nature of the preferences granted under the GSP these regional unilateral preferences contained strengthened features of reciprocity.

In fact neither the GSP nor these additional preferences have come for free. Since the inception of the GSP, a number of preference-giving countries have made GSP benefits more and more conditional upon compliance with social, humanitarian or other conditions that are not related to trade. The range of practices and circumstances that can trigger the withdrawal of benefits is rather extensive, depending on the preference-giving countries and the program.

Most recently, the reciprocal elements of the US program have also been given a boost by a key change in the rules of the global trade regime.[12] While the Uruguay Round produced very significant gains for the United States in the form of agreements on each of the new issues (i.e. services, investment, and intellectual property rights), the revised dispute-settlement rules make it far more difficult for the United States to pursue its interests through unilateral action

11. See GAO report "Comparison of US and EU Preference programs" June 2001 GAO-01-647.

12. Even before the US 1985-1987 general review process, the GSP allowed groups to bring complaints regarding "country practices", including trade issues such as alleged restrictions on market access or failure to protect intellectual property rights. Although these consultations were not identified as "GSP negotiations" so as not to violate the nonreciprocal nature of the program, they constituted negotiations for all practical purposes. The general review afforded US negotiators an opportunity to raise issues with their counterparts in several countries, with the results of these consultations leading to continued GSP privileges for some countries, and reduced preferences for others. See "Handbook on the Scheme of the United States of America" (UNCTAD/ITCD/TSB/Misc.58/Rev.1).

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such as under section 301. There nevertheless remain some loopholes in the system. It would generally be prohibited under WTO rules for the United States to retaliate against a WTO member country without first obtaining authorization from the WTO Dispute Settlement Body. However, this general rule does not apply if the retaliatory action does not itself violate the WTO rights of the target country. In this respect, it is extremely important to note that the preferences extended under the GSP are *privileges* rather than enforceable *rights*.[13]

In fact, the "Enabling Clause" allows the legal existence of GSP in the WTO context as a departure from the MFN Art. 1, GATT 1994. However, it does not bind preference-giving countries to grant GSP benefits.

Thus, the United States has increasingly employed the GSP and other preferential trade programs as a substitute form of enforcement authority. This has applied to cases involving established trade issues such as intellectual property rights, as well as new issues such as labor rights.

In similar circumstances the EU has also used the GSP as a retaliatory mechanism, most recently, during a dispute with Russia.

Other preferences granted by the US like ATPA, CBI and the recent AGOA also contain different eligibility requirements.[14]

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13. See Craig Van Grasstek, Preference and preference erosion for Least Developed countries, paper prepared for UNCTAD secretariat, 2004.

14. First of all, any AGOA beneficiary country must be eligible under the normal GSP program. Additional eligibility requirements under AGOA: the president is authorized to designate as an eligible beneficiary a sub-Saharan African country if the country has established or is making progress along all of the following dimensions: (a) The country must have established, or be in the process of establishing: (1) A market-based economy that protects private property rights, incorporates an open rules-based trading system, and minimizes government interference in the economy; (2) The rule of law, political pluralism, and the right to due process, a fair trial and equal protection under the law; (3) The elimination of barriers to US trade and investment, including by; (4) The provision of national treatment; (5) The protection of intellectual property rights; and (6) The resolution of bilateral trade and investment disputes; (7) Economic policies to reduce poverty, increase the availability of healthcare and educational opportunities; (8) A system to combat corruption and bribery; (9) Protection of internationally recognized worker rights; (b) The country must not engage in activities that undermine US national security or foreign policy interests; (c) The country must not engage in gross violations of internationally recognized human rights; (d) The country must have implemented its commitments to eliminate the worst form of child labor (ILO Convention No. 182).

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A Brief Assessment of the GSP

The original objectives of the GSP –to accelerate economic growth, promote industrialization and to increase export earnings– were conceived as an interim goal on the way to a broader goal of promoting development and the integration of developing countries into the global economy. While the GSP has produced unmistakable benefits in terms of export growth in beneficiary countries, various restrictive measures have been subsequently introduced which have affected its potential usefulness. Limited product coverage, insufficient tariff cuts, graduation measures and excessive stringency of rules of origin continue to hamper the GSP from becoming an effective tool for development. It has long been argued that preferences could prove detrimental to the interests of the benefit-receiving country in that they could lead to over-investment in an industry and give rise to adjustment problems when the preferences were eroded or removed. They could also generate a dependence on uncompetitive sectors which would otherwise have ceased activity and whose resources could have been shifted to sectors with an underlying comparative advantage.

There is no question that preferences could turn out to be a ‘poisoned chalice’, particularly where guaranteed market access in the preference-giving country, almost regardless of competitiveness vis-à-vis other producers, is offered. But the GSP is unlikely to have caused these perverse effects, given that beneficiaries’ exports have generally enjoyed low preferential margins. The three largest schemes have all used *a priori* mechanisms to limit GSP utilization on individual products by competitive countries. The countries affected by these restrictions all have well-diversified export industries. There is no evidence that the small countries (measured in terms of their market penetration in the preference-giving countries) have unduly concentrated on particular export industries on the strength of GSP preferences. *A fortiori* the evidence that the GSP has generated investment in such industries is patchy and anecdotal. On the contrary, the principal disappointment with the GSP is that it has not achieved more in helping beneficiary countries, especially the weaker ones, develop a strong and diversified manufacturing as has been the case for certain Asian countries.

The reality is that preferences have been useful to some developing countries that have been able to use them in conjunction with domestic reforms aimed at attracting investment and developing an export-based industry.

On the other hand it has to be recognized that preferences alone are not a panacea and cannot develop per se the supply capacity that has been preventing African countries from exploiting the trading opportunities offered by preferential market access.

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The regionalization of trade preferences has relegated multilateral trade preferences under GSP to a minor role. Once principles of non-discrimination and general trade preferences were systematically eroded it was natural that the last pillar of the GSP principles –non reciprocity– had to succumb under new trade initiatives aiming at establishing reciprocity within free trade areas.

The FTAA (Free trade Areas of the Americas) initiative will progressively replace unilateral preferences granted under GSP, CBI and ATPA. The Central American Free Trade Area (CAFTA) is the first stepping stone. The Economic Partnership agreements (EPAs) will gradually replace former unilateral preferences granted under the Cotonou Partnership Agreement and the EBA.

The 1976 to 1994 Period - Trends

Total imports of preference-giving countries from GSP beneficiary countries in 1993 amounted to 438.6 billion US dollars, of which 304.8 billion US dollars of imports were dutiable (see annex, table 1). However, only 171.6 billion US dollars, or 56.3 percent, of dutiable imports were covered by the various schemes and, of this, only 82.2 billion US dollars of imports or 47.9 percent, were actually granted preferential treatment. In effect, therefore, only slightly more than one fourth of dutiable imports received GSP treatment. In 1993 the share of the three largest schemes, those of the European Union, Japan and the United States, accounted for more than four-fifths of both GSP-covered and preferential imports from beneficiaries.

Between 1976 and 1993 the total value of preferential imports under the OECD schemes rose from 10.4 billion US dollars to 79 billion, an average annual growth rate of 12.7 percent. Although this growth rate falls to 8.4 percent when adjusted for inflation it still represents a significant achievement. In this context it should be noted that, because of changes in the composition of developing countries' exports, the proportion of dutiable exports in total exports has risen significantly – from under 40 percent in 1976 to over

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70 percent in 1993. However, this trend has not resulted in a comparable improvement in the coverage ratio for all OECD schemes, which rose from 45.8 percent in 1976 to 55.9 percent in 1993. This finding suggests the continued existence of a mismatch between the export structure of GSP beneficiaries and the product coverage of the OECD schemes.

Another feature of the GSP that has become progressively more pronounced under the three major schemes, and thus for the GSP as a whole, is that a limited number of beneficiary countries account for the greater part of GSP and preferential imports. In 1992 the twelve largest beneficiaries in the European Union scheme supplied 80 percent of preferential imports; the seven largest in the Japanese scheme supplied 75 percent of Japan's preferential imports; and the six largest beneficiaries in the United States scheme accounted for 71 percent of that country's preferential imports, although these beneficiaries were affected by limitations in the form of quotas, tariff ceilings and maximum country amounts.

Growth rates of preferential imports from the LDCs in the period 1976-1993 were on average lower than those for all beneficiaries taken together. They rose on average by 11.6 percent annually for all OECD schemes, as opposed to 12.7 percent for all beneficiary countries. Under the European Union scheme, preferential imports from the LDCs grew at an average rate of 16.6 percent as opposed to 14.3 percent for all beneficiaries. The comparable figures for the Japanese scheme were 24.2 percent and 12.8 percent, respectively. However, under the United States scheme, preferential imports from the LDCs fell at an average rate of 0.6 percent while those of all beneficiaries rose by 11.3 percent.

The share of imports into OECD preference-giving countries from GSP beneficiaries fell from 20.2 percent of their imports from all sources in 1976 to 17.1 percent in 1993. This outcome has been interpreted by some as a setback for the GSP concept since preferential treatment did not contribute to an increase in exports from beneficiaries. However, this argument must be considered in the light of the fact that almost half of dutiable imports from beneficiaries are not covered by GSP schemes, and more than half of covered

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imports do not receive preferential treatment. Thus, the degree to which exporters in beneficiary countries were not able to make use of the GSP because of limited product coverage and *a priori* restrictions cannot be taken as a measure of the ability of the GSP to meet its goals of export promotion, industrialization and growth. This holds particularly true when one considers that, in the areas where GSP was not subject to the above-mentioned restrictions, the annual growth rate of OECD preferential imports over the period 1976 to 1993 was 12.7 percent.[15]

1994 to Present - Trends

Table 1 below shows that there is a persistent trend of low utilization rates in the GSP schemes for non-LDC beneficiaries.

Not only has utilization for non-LDC countries remained at half its potential since 1994, but it has also been steadily declining. The biggest decline was registered between 1997 and 1998 when graduation policy came into effect in the EU GSP scheme. In any event, this data shows that in 2001, the MFN rate of duty rather than the preferential rate has been levied on 110 billion US dollars of trade potentially covered by trade preferences. Thus, there is a tremendous scope for improving the utilization of currently available trade preferences.

The constant feature and trend that may be inferred from table 1 is the persistent decrease in trade that receives trade preferences: from a peak of 106 billion US dollars in 1995, the amount of trade that receives preferences declined to 66 billion US dollars in 2001.

This rather drastic shrinking of the amount of preferential trade is mainly due, as noted above, to an aggressive policy of graduation introduced over time by the EU and the US. The EU has progressively graduated[16] some export sectors from

15. See UNCTAD reports, 1998.

16. In this case the EU graduation is mainly carried out under a country –product graduation approach. Under this approach a country triggering a formula for country– product graduation is excluded from GSP preference for that particular sector but continues to maintain eligibility for other exports not falling within the graduated sector.

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Table 1. Imports of Preference-Giving Countries from Non LDCs Effective Beneficiaries of GSP Schemes, 1994-2004
(million US dollars)

Country	Year	Total Imports	Dutiable Imports	GSP Imports		Percentages		
				Covered	Receiving	(5)/(4)	(6)/(5)	(6)/(4)
1	2	3	4	5	6	7	8	9
Canada [a]	1995	17,890.8	6,704.7	3,858.4	2,411.6	57.5	62.5	36.0
	1996	18,577.5	6,684.6	4,185.8	2,636.6	62.6	63.0	39.4
	1997	20,574.9	7,366.0	4,455.7	2,939.0	60.5	66.0	39.9
	1998	18,534.9	6,851.7	3,579.0	2,387.4	52.2	66.7	34.8
	1999	24,044.6	7,102.6	4,016.5	2,552.0	56.5	63.5	35.9
	2000	31,014.2	8,472.4	4,803.3	3,080.6	56.7	64.1	36.4
	2001	27,882.3	8,883.4	5,365.0	3,255.1	60.4	60.7	36.6
	2002	32,139.1	10,111.7	6,417.4	3,882.4	63.5	60.5	38.4
	2003	33,592.8	10,661.8	7,066.8	4,113.8	66.3	58.2	38.6
EU [b]	1994	209,056.3	130,657.3	96,045.3	47,050.3	73.5	49.0	36.0
	1995	254,630.4	164,570.1	121,667.0	68,946.3	73.9	56.7	41.9
	1996	268,981.6	166,971.1	101,936.0	61,292.8	61.1	60.1	36.7
	1997	275,961.8	176,245.0	113,050.9	64,013.8	64.1	56.6	36.3
	1998	275,629.4	163,286.6	86,593.1	41,528.2	53.0	48.0	25.4
	1999	242,277.3	132,576.1	74,885.4	36,010.0	56.5	48.1	27.2
	2000	299,630.0	141,307.3	78,139.6	37,848.8	55.3	48.4	26.8
	2001	291,093.2	138,020.7	79,099.1	38,365.6	57.3	48.5	27.8
	2002	306,460.3	146,768.8	85,774.4	47,861.6	58.4	55.8	32.6
	2003	390,471.4	193,931.5	101,202.0	71,037.6	52.2	70.2	36.6
	2004	553,368.6	263,145.4	102,569.4	68,431.8	39.0	66.7	26.0
Japan [c]	1994	142,081.2	87,165.4	36,933.0	16,733.9	42.4	45.3	19.2
	1995	162,201.5	92,475.8	40,766.5	16,927.1	44.1	41.5	18.3
	1996	183,270.5	103,866.0	42,102.8	17,664.5	40.5	42.0	17.0
	1997	171,846.2	92,707.5	39,710.9	16,789.6	42.8	42.3	18.1
	1998	140,244.5	73,583.4	55,462.2	13,105.2	75.4	23.6	17.8
	1999	164,569.2	85,031.7	63,717.7	14,187.4	74.9	22.3	16.7
	2000	148,004.5	77,027.8	60,842.5	12,872.0	79.0	21.2	16.7
	2001	140,288.3	71,639.0	71,639.0	11,769.8	100.0	16.4	16.4
USA	1994	91,212.3	61,740.5	26,968.1	17,959.4	43.7	66.6	29.1
	1995	98,180.9	62,835.8	26,428.8	18,015.2	42.1	68.2	28.7
	1996	103,868.4	65,632.1	27,044.8	16,708.9	41.2	61.8	25.5
	1997	95,731.9	61,543.5	36,406.6	14,528.7	59.2	39.9	23.6
	1998	98,456.6	59,277.1	31,540.0	14,393.2	53.2	45.6	24.3
	1999	106,315.2	55,871.0	17,731.7	11,370.2	31.7	64.1	20.4
	2000	130,994.4	69,783.1	19,443.5	12,983.3	27.9	66.8	18.6
	2001	116,337.9	65,385.5	20,130.7	13,167.5	30.8	65.4	20.1
	2002	139,860.3	82,252.1	18,668.8	14,986.2	22.7	80.3	18.2
	2003	158,766.6	97,316.8	20,724.1	16,881.6	21.3	81.5	17.3
	2004	200,646.1	118,593.5	21,568.3	18,648.3	18.2	86.5	15.7
TOTAL [d]	1994	442,349.8	279,563.2	159,946.4	81,743.6	57.2	51.1	29.2
	1995	532,903.6	326,586.4	192,720.7	106,300.2	59.0	55.2	32.5
	1996	574,698.0	343,153.8	175,269.4	98,302.8	51.1	56.1	28.6
	1997	564,114.8	337,862.0	193,624.1	98,271.1	57.3	50.8	29.1
	1998	532,865.4	302,998.8	177,174.3	71,414.0	58.5	40.3	23.6
	1999	537,206.3	280,581.4	160,351.3	64,119.6	57.1	40.0	22.9
	2000	609,643.1	296,590.6	163,228.9	66,784.7	55.0	40.9	22.5
	2001	578,733.6	283,517.6	175,672.1	66,383.5	62.0	37.8	23.4

Source: Notifications and UNCTAD secretariat calculations.
a] Figures for 1994 not available. b] Figures for 1994-1995 exclude Austria, Finland and Sweden. c] Fiscal years. d] Total figures for 1994 do not include Canada.

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China and other performing exporters, while the US has excluded China since the inception of its own GSP program and graduated Mexico and Malaysia in 1994 and 1998 respectively.

Trade data recently released by the EU shows a consistent increase of trade volume in the two most recent years (2003 and 2004). More analysis and cross-checks with other data sources will need to be carried out to identify what countries and products are responsible for this increase. At the time of writing it was not possible to carry out such an analysis, and therefore figures for 2003 and 2004 are for reference only.

As far as the trade effects of the GSP are concerned a report by the UNCTAD secretariat in the late 1980s summarizes various studies on the economic effects of the GSP.[17] These studies suggest that the increase in the value of beneficiary trade attributable to the GSP, including both trade creation and diversion, might be within a range of 7 to 22 percent of preferential exports. The studies also concluded that enhanced export earnings had permitted increased investment but that it was not possible to be more precise about the specific contribution of the GSP.

This analysis should be considered alongside studies, sponsored by UNCTAD and the Economic and Social Commission for Asia and the Pacific (ESCAP), of the effects of product graduation on four jurisdictions in South East Asia (Singapore, Hong Kong, Republic of Korea and Taiwan) and the effects of these graduations on neighboring countries. The studies considered the experiences of the four jurisdictions, which have been arguably the most constrained by quantitative restrictions, in the form of both tariff quotas and product graduation, on their access to the benefits of the EU and US schemes.

The studies found that product graduation (and tariff quotas and ceilings under the European Union scheme) led to a loss of market share. It did not, however, lead to higher exports by the less competitive beneficiaries; it was rather the

17. See Craig Mc Phee, "A Synthesis of the GSP study programme," UNCTAD/ITP/19 of 5 December 1989.

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advanced industrial countries or other major beneficiaries who gained. When country graduation excluded Singapore, Hong Kong, the Republic of Korea and Taiwan from the United States scheme, the shares of Indonesia, Malaysia and Thailand in both covered and preferential imports rose faster than these countries' shares of total US imports. Examination of individual products supports these conclusions from the overall statistics.

As shown in table 2, total imports of LDCs into QUAD countries (United States, Canada, European Union, Japan) receiving GSP treatment have been much smaller, amounting to almost 5 billion US dollars in 2001.[18]

The biggest improvement recorded in the LDC trade flows in the 1994-2001 period occurred between 1997 and 1999 when a surge of more than 1 billion US dollars was recorded. However a closer look at the trade flows reveals that such an improvement was mainly due to imports of petroleum from Angola to the US market. In order to implement the commitments made at the Singapore Ministerial, the United

Table 2. QUAD Imports and Utilization of GSP Schemes from all LDC Effective Beneficiaries[1]
(thousand US dollars)

Year	Total Imports	Dutiable Imports	GSP Imports		Percentages		
			Covered	Receiving			
(1)	(2)	(3)	(4)	(5)	(3)/(4)	(4)/(5)	(3)/(5)
A	B	C	D	E	F	G	H
1994	5,347.0	3,917.3	2,071.0	999.0	52.9	48.2	25.5
1995	6,087.8	4,706.1	2,564.3	1,361.2	54.5	53.1	28.9
1996	9,956.3	7,451.1	2,985.0	1,517.9	40.1	50.9	20.4
1997	10,634.1	8,163.4	5,923.1	1,788.2	72.6	30.2	21.9
1998	9,795.7	7,915.1	5,564.2	2,704.5	70.3	48.6	34.2
1999	10,486.5	8,950.4	5,869.3	3,487.5	65.6	59.4	39.0
2000	13,359.2	11,715.5	7,836.0	4,990.2	66.9	63.7	42.6
2001	12,838.2	11,523.9	7,662.1	4,919.9	66.5	64.2	42.7

1. LDC effective beneficiaries means in the case of the EU that the trade flows of the ACP LDC countries are not counted since they export under the ACP preferences granted under the Cotonou Partnership agreements.
Source: UNCTAD secretariat calculations.

18. For a more in-depth analysis of the preferential trade flows of LDCs see "Trade preferences for LDCs: An early assessment and possible improvements", UNCTAD 2003.

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States extended in 1997 the product coverage of some 1,700 products for LDCs including petroleum products.[19]

At the time of writing the following data available for the EU, the main market for LDCs, shows that most of the products exported to the EU are already duty-free under MFN conditions. The EBA improvements to LDC market access have yet to generate substantial export increases, although an increase of more than 10 percent of received trade preferences was recorded in 2002 and 2004. More analysis will have to be carried to identify what countries and products have been benefiting from EBA.

Table 3. Imports of Least Developed ACP Countries into the European Union under the Lomé/Cotonou Partnership Agreement (1998-2004)[1]
(million US dollars)

Year	Total Imports	Dutiable Imports	ACP Imports		Percentages		
			Covered	Receiving	Coverage	Utilization	Utility
(1)	(2)	(3)	(4)	(5)	(4)/(3)	(5)/(4)	(5)/(3)
A	B	C	D	E	F	G	H
1998	5,619.4	2,154.0	2,153.1	1,467.4	99.9	68.1	68.1
1999	5,676.1	1,943.8	1,932.5	1,578.7	99.4	81.6	81.2
2000	7,572.5	1,719.5	1,710.2	1,226.5	99.4	71.7	71.3
2001	8,060.7	2,063.5	2,059.8	1,570.4	99.8	76.2	76.1
2002	8,440.7	2,237.1	2,162.6	1,768.0	96.6	81.7	79.0
2003	8,112.9	2,206.4	2,096.8	1,563.6	95.0	74.6	70.9
2004	9,166.4	2,721.5	2,498.0	1,766.6	91.8	70.7	64.9

1. Due to a data format change in the EU the trade flows under the ACP preferences and under the EBA for the years 2003 and 2004 are cumulated.
Source: UNCTAD secretariat calculations.

19. The bulk of benefits from the US expansion of product coverage in 1997 relates to exports of petroleum from Angola. Angola has not yet been designated as an AGOA beneficiary. This trend was accurately indicated in the declassified version of an investigation carried out by the US International Trade Commission, upon request from United States Trade Representative C Barshefsky. The investigation measured potential implications of the expansion of product coverage of the US domestic industry and benefits to the recipient countries. It included economic considerations and statements from interested parties such as the following testimony: "Chevron Corp., a multinational U.S. energy exploration and production company with operations in Angola and Zaire, expressed support for GSP treatment for crude petroleum from the LDBCs, especially Angola and Zaire. Chevron stated that such treatment would benefit the economies of these countries and, in turn, further U.S. policy of assisting the LDBC economies. Chevron stated that GSP treatment would stimulate U.S. investment in the energy industries of Angola and Zaire. Chevron asserted that GSP treatment would have no measurable effect on U.S. crude producers or consumers."

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Some Conclusions and Possible Actions

As stated at the beginning of this paper the world map of trade preferences today resembles a pre-1947 situation where preferences are allocated according to geopolitical interests or political economy considerations. The original multilaterally agreed principle of the GSP has been significantly eroded.

Ironically, in a multilateral trading system becoming increasingly rules-based and pro-development oriented, the most concrete form of special and differential Treatment (i.e. unilateral trade preferences) is left to the discretion of preference giving countries and to the opaque formulation of the enabling clause dating back to 1979.

Ideally, the Doha Development Agenda should provide the opportunity for a comprehensive review of the trade preferences granted under GSP and other unilateral and non-reciprocal trade preferences.

For the time being, attention has been almost exclusively focused on how to deal with the issue of preference erosion in a manner that does not create an obstacle to reaching consensus at the ministerial in Hong Kong. At present it seems that a trade solution to the erosion of trade preferences has not been envisaged. On the one hand, the recent improvement to the preferences granted to LDCs has left little room for improvement of preferential market access. On the other hand, attention has been focused on assisting the trade mechanism. There are, of course, legitimate reasons to impart priorities and sequencing during negotiations. However, this tactical approach should not impede an overall reconsideration of the whole spirit and objectives of unilateral trade preferences.

Important aspects on the future of trade preferences and of the GSP are yet to be addressed: i.e. what is the future of unilateral North-South trade preferences besides the issue of erosion and duty-free and quota-free for LDCs? What rules should govern South- South trade preferences?

Middle income and vulnerable countries have substantially benefited from trade preferences and are going to be considerably affected by the erosion thereof. Enhanced preferential market access under an enhanced GSP could still

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provide significant trading opportunities for these countries. However the current trend indicates that trade preferences in favor of these countries are likely to be granted under regional initiatives or reciprocal free trade agreements rather than under the umbrella of a multilateral instrument like the GSP schemes.

The draft ministerial declaration provides that developing countries "in a position to do so" should also provide duty-free and quota-free treatment to LDCs. Annexes to a WTO secretariat report[20] on market access to LDCs listed a number of developing countries that grant trade preferences to LDCs under different trade arrangements such as the Global System of Trade Preferences (GSTP) and other regional South-South trade agreements. By their very nature trade preferences granted under these latter arrangements are available only to countries that are members of GSTP and under other such South-South agreements.

In this context it may be noted that as early as June 1999 WTO members agreed to a waiver[21] to provide an instrument for developing countries to offer preferential tariff treatment to products of least-developed countries.

At it emerges from paragraph 2 of this waiver, trade preferences granted to LDCs by developing countries were to have a non-discriminatory and non reciprocal nature: "2) Developing country Members wishing to take actions pursuant to the provisions of this Waiver shall notify to the Council on Trade in Goods the list of all products of least-developed countries for which preferential tariff treatment is to be provided on a generalized, non-reciprocal and non-discriminatory basis and the preference margins to be accorded. Subsequent modifications to the preferences shall similarly be notified."

However at the time of this writing it seems that only South Korea[22] has utilized the provision of this waiver to grant non-discriminatory and non reciprocal trade preferences to LDCs.

20. WTO document WT/CMTD/LDC/W/35 of 13 October 2004.
21. See WTO document WT/L/304 of 17 June 1999.
22. See WTO document WT/COMTD/N/12 rev. 1 of 28 April 2000.

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Once the findings about South-South trade from the above-mentioned report are analyzed and matched with the existence of the waiver, it is clear that South-South preferences have been implemented under regional initiatives or using the GSTP rather than as a non-discriminatory, non-reciprocal instrument as originally envisaged in the 1999 waiver.

Ultimately, the ruling of the appellate body in the India-EU GSP case has opened the way for legally justifiable preferences *à la carte*. The new EU GSP scheme for the period 2005 to 2008[23] is actually exploiting the present flexibilities in the multilateral trading system to implement special incentives for sustainable development and good governance "based on an integral concept of sustainable development as recognized by a series of international conventions and instruments".[24]

In principle it may be argued that flexibility and the need to adapt trade preferences to the evolving international trading system largely justify the approach that may result in significant additional trade preferences made available to developing countries and LDCs. The principles and objectives of the GSP might also be revisited to take into account the evolving nature of international trade.

The striking fact, however, is the absence of a multilateral debate and multilaterally agreed criteria and rules on how to operate and implement unilateral trade preferences in the present international trading system. This is even more surprising when the agenda of the international community is focused on development issues.

Trade preferences are here to stay for a while in spite of MFN tariff liberalization. They may be controversial, perverse

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23. See Council regulation 980/2005 of 27 June 2004 applying a scheme of generalized tariff preferences, Official Journal L 169 of 30 June 2005.
24. Such as the UN Declaration on the Right to Development of 1986, the Rio Declaration on Environment and Development of 1992, the ILO Declaration on Fundamental Principles and Rights at Work of 1998, the UN Millennium Declaration of 2000 and the Johannesburg Declaration on Sustainable Development of 2002. Consequently, developing countries that, because of a lack of diversification and insufficient integration into the international trading system, are vulnerable while assuming special burdens and responsibilities due to the ratification and effective implementation of core international conventions on human and labor rights, environmental protection and good governance should benefit from additional tariff preferences. See preambles to Council regulation 980/2005.

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and sub-optimal from an economic point of view. However, they are, like antidumping laws, part of the trade landscape. As multilateral rules govern antidumping, discretionary practices and arm-twisting practices, the same should apply to preferences.

Under this perspective, there is room for strengthening the multilateral profile of trade preferences and imparting discipline to them so that they can better fulfill their role. The adjustments proposed may lead to a reinforcement and a revisited multilateral GSP instrument over the plethora of existing trade preferences.

In the case of LDCs some of the shortcomings of the GSP schemes have been addressed and the proposal to "multilateralize" the EBA[25] could be a good starting point for bringing GSP discussions into the multilateral scenario.

However, for many other developing countries benefiting from the normal GSP arrangements, the original GSP limitations still remain and are largely unchanged since the late 1970s.

Improvements to the GSP schemes may imply further graduation measures at country and product level since it would be hardly justifiable from a preference-giving country point of view to grant improved preferences to large and internationally competitive developing countries.

This latter point may prove to be a controversial subject, if not a taboo, to address, but the price for not confronting it is unilateral practices by preference giving countries. Most concerned developing countries should open a debate on these issues.

For a start, three further precepts might constructively add new strength to a revisited GSP's underlying principles: these are transparency, stability and predictability.

Transparency implies, for example, that *a priori* restrictions on the availability of GSP treatment to a country's

25. See Dodini Michaela, "Duty and Quota-Free Access to LDCs: the multilateralisation of EBA", EU Commission, Presentation, IFRI-AFD Oct. 28, 2005.

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exports of a particular good, or in a particular sector, should clearly differentiate the issue of whether that country has become competitive, and thus no longer needs GSP treatment, from concerns over damage to the preference-giving country's domestic industry. It would rule out any discretionary decisions excluding specific products from certain countries.

Predictability would require a continuity of benefits without abrupt interruption and also allow sufficient warning periods prior to changes, as individual exporters generally have no way of knowing whether GSP status will be allowed on a particular consignment. In a broader sense, predictability would require that each preference-giving country was committed to continuing its scheme for a sufficient period to make investment in benefiting export industries viable.

There is also a need for greater consistency in applying the existing principles of generality and non-discrimination, which imply that preferences including new preferences granted according to development criteria such as sustainable development should be multilaterally agreed.

As for the contents of renewed GSP schemes, the recent experience of beneficiaries and the intergovernmental deliberations in UNCTAD have been drawn upon to formulate some policy options designed to strengthen the GSP over the existing pattern of *à la carte* trade preferences. These concern product coverage, depth of tariff cuts, graduation mechanisms, safeguards, special treatment for LDCs and the rules of origin.[26]

Product coverage should be extended to all products. Temperate-zone agricultural products, and some tropical products such as rice and tobacco can be straightforwardly incorporated in the GSP. In some cases the tariffs are set at very high levels providing meaningful preferential margins. Textile products should likewise be introduced into all GSP schemes for all beneficiaries. In including new sectors, there may initially be justification for some modulation so that the tariff

26. See UNCTAD Ways and means of enhancing the utilization of trade preferences by Developing countries, in particular LDCs as well as further ways of expanding trade preferences. TD/b/com.1/2o.

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margin is less than the full MFN tariff and the impact on domestic industries of preference-giving countries cushioned. Other sectors excluded from certain schemes could in many cases be incorporated. Sometimes exclusions persist owing to the lobbying activities of industrial groups or through historical inertia rather than because of any serious threat to the domestic industry. Detailed examination of particular sectors is, therefore, called for in all schemes.

The general rule on the *depth of tariff cuts* should be full exoneration from tariffs. However, in the interests of transparency and predictability some modulation of tariff cuts is preferable to maintaining *a priori* restrictions. The avowed purpose of these restrictions –that is the redistribution of the benefits of the GSP from competitive producers to smaller producers– can best be achieved through clear country-product graduation mechanisms coupled with expansion of product coverage for the remaining beneficiaries. Where tariff modulation is used, the resultant preference margin must be of a commercially meaningful dimension, or exporters will find that the transaction costs of applying for GSP status on their exports will not justify the benefits.

The criteria for *country-product graduation* should be based on the objectives underlying the GSP. These imply that, if the ultimate objective of country-product graduation is the exclusion of "competitive" products, the principal criterion should be the share of that country's exports in the total worldwide imports of the preference-giving country, not only those imports benefiting from the GSP.

The competitiveness criterion should, moreover, be supplemented by development criteria, which could include (a) a measure of income per capita; (b) the share of manufactured exports in total exports; and (c) a measure of export diversification, such as that developed and regularly published by international organizations. If the withdrawal of GSP treatment were to result in a significant reduction in that beneficiary's exports of graduated products to the preference-giving country, GSP treatment should be reestablished.

The level of aggregation of products to be excluded for the purposes of country-product graduation must be clearly

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defined. It should ideally be defined at the six-digit HS level or the national tariff line level to avoid the risk that a country is graduated across a sector, or broad range of products, when in fact it is only competitive in value terms in specific products included in that sector, and to avoid excluding items produced either downstream or upstream. A narrow classification could, however, risk graduating specific products where imports in the preference-giving country are small and/or where the sources of those imports are a small group of countries. This situation could be dealt with through the insertion of a *de minimis* clause as in the case of the schemes of the European Union and United States.

Criteria for *country graduation* should also be based on multilaterally agreed principles. This may imply that, in addition to the development criteria mentioned above, they should also include other measures of standard of living, including social indicators and poverty. In this context, the UNDP Human Development Index, which incorporates health, education and standard of living components, might be considered a possible source of complementary criteria.

As with country-product graduation, country graduation should be reversible if the criteria are not satisfied at any period after graduation. GSP status should only be withdrawn after the criteria have been satisfied for at least three successive years. In addition, GSP benefits should be withdrawn gradually over at least three years, through the digressive application of preference margins.

The application of *safeguards* should be distinct from graduation. Safeguard measures modeled on Article XIX of the GATT and the WTO Agreement on Safeguards are appropriate when surges of preferential imports cause, or threaten to cause, injury to domestic industry. Neither *a priori* limits on preferential treatment nor product or country-product graduation mechanisms should be used as safeguard measures. The former should be replaced by tariff modulation as in the new scheme of the European Union in order to impart predictability and transparency to GSP users. Tariff modulation should, however, result in meaningful GSP

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margins. The country-graduation mechanism should be based on a strict test of competitiveness as discussed above.

As far as *rules of origin* are concerned, the work of the Technical Committee of the World Customs Organization (WCO) and the Committee on Rules of Origin has developed a harmonized set of non-preferential rules of origin. Negotiations are still ongoing and at times the whole process has been considered as a failure. This is simply wrong since most of the technical work has been carried out and final agreement is kept hostage of a few delegations on the implications of the harmonized set of rules of origin on other WTO agreements, notably antidumping. The technical work carried out by these committees could be taken as a guide and reference for harmonizing unilateral preferential rules of origin. This was the strategy originally envisaged and agreed at the last UNCTAD Intergovernmental Group of Experts on rules of origin held in 1994.

Member states may wish to resume such a course of action for rules of origin applying under unilateral trade preferences. A working group established in the WCO secretariat with the participation of UNCTAD could be entrusted with the mandate to develop a harmonized set of preferential rules of origin used under unilateral trade preferences. In addition, simplification and improvement of the administrative aspects of the rules of origin should also be addressed by the same working group. It is quite ridiculous that, while developing countries have been asked to implement trade reforms in the context of the negotiations on trade facilitation, no comparable efforts have been asked of preference giving countries to facilitate preferential trade flows.

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Chapter 3

EU Agricultural Trade Preferences with Special Reference to Banana and Sugar Imports from ACP Countries

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As a way of providing aid to developing countries, the European Union (EU) has granted specific non-reciprocal trade preferences to African, Caribbean and Pacific (ACP) states under the EU-ACP partnership and to least developed countries (LDCs) under the "Everything but Arms" (EBA) initiative of 2001. Most LDCs are eligible for both schemes. Out of a total of 49 LDCs, only 9 are not ACP states. Programs include preferential access to high-priced and protected European markets for selected agricultural products, in particular bananas and sugar. There is increasing pressure for the EU to reduce trade-distorting agricultural policies, notably price support and import tariffs on which these one-way trade preferences are based. In that perspective, this paper analyses to what extent European agricultural preference

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erosion would be a serious concern for the ACP states and the LDCs with special reference to agricultural products, more specifically bananas and sugar.

The paper is organized as follows. The first section presents an overview of EU preferential trade arrangements with special attention to the EU-ACP partnership and the EBA initiative. The second section shows that exports of ACP states and LDCs are still highly dependent on the EU market, notably for bananas and sugar. The third section provides an assessment of the EU-ACP partnership and the EBA initiative by reviewing the literature on the subject. Within this framework, we examine to what extent forthcoming changes in European banana and sugar policies, be they unilateral or multilateral, could adversely affect ACP states and LDCs. The fourth section deals with bananas and the next one with sugar. The last section concludes.

EU Preferential Trade Arrangements: An Overview

The EU has a long history of granting trade preferences not only to developing countries but also to developed states. Only a very few countries (Australia, Canada, Japan, New Zealand, South Korea, Singapore, Taiwan and the United States) have been allowed Most Favored Nation (MFN) treatment for access to the EU market.

The European Economic Area (EEA) agreement extended the EU Single Market (SM) to three out of the four members of the European Free Trade Area (EFTA), i.e., Iceland, Liechtenstein and Norway (Switzerland is not a party). However, the Common Agricultural Policy (CAP) does not extend to the EEA, and agricultural trade remains governed by bilateral agreements essentially though import tariff quotas. In 2000, specific bilateral agreements were put in place with Romania and Bulgaria in view of their future accession to the EU, as well as with Albania, Bosnia-Herzegovina, Croatia, Kosovo, the Former Yugoslav Republic of Macedonia and Serbia-Montenegro. These agreements abolished import restrictions into the EU with a few exceptions, essentially for some sensitive agricultural products (beef, wine and sugar). The EU is also in the process of concluding bilateral

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association agreements with its twelve Mediterranean partners. These Euro-Mediterranean partnerships are governed by the so-called Barcelona process launched in 1995, which aims to establish a free trade area consistent with the WTO between the EU and its Mediterranean partners by 2010. Other bilateral agreements have been signed, for example in December 1995 between the EU and four South American countries (Argentina, Brazil, Paraguay and Uruguay –the MERCOSUR countries) and in March 1999 between the EU and South Africa. As far as trade relationships between the EU and the four states of MERCOSUR are concerned, a particularly difficult dossier remains agriculture as the South American countries consider that European concessions are still too modest.

In addition to preferences granted to Mediterranean countries, the EU is offering one-way trade preferences to developing countries essentially through two schemes: first to most of the developing countries under the Generalized System of Preferences (GSP) of the so-called Enabling Clause of the WTO, second, and more specifically, to 79 ACP countries currently under the Cotonou Convention (the ACP signatories of the Cotonou Convention are listed in the CAP Monitor, 2005, Section 3, Appendix 2, page 3-15).[3] The EU GSP includes the so-called EBA initiative adopted in February 2001, which eliminates import quotas and tariffs on EU imports, except for arms and ammunition, for the 48 poorest countries of the world.

We first detail the EU-ACP partnership from the moment of its creation with the 1957 Treaty of Rome. We then discuss the EU GSP, and more specifically the EBA initiative. Special attention is given to agricultural products.

The EU-ACP partnership

In 1957, the signatories of the Treaty of Rome committed to contribute to the prosperity of their colonies and overseas territories. Between 1963 and 1975, cooperation was governed

3. The WTO Enabling Clause allows general preferences for all developing countries and additional preferences for the LDCs as defined by the United Nations.

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through a series of successive conventions signed essentially with former French colonies. The various Yaoundé Conventions included one-way trade preferences, free movement of capital and European Development Fund (EDF) aid. In 1973, the United Kingdom joined the EU. This first enlargement of the EU led to the signing of the wider Lomé I Convention, which was in force between 1975 and 1980 and included 46 ACP countries. Three similar conventions followed: Lomé II in 1979, Lomé III in 1984 and Lomé IV in 1989, each time applying to an increasing number of ACP countries. The Lomé IV Convention was replaced in June 2000 by the Cotonou Convention, which is stated to be valid for twenty years, with the possibility of review every five years. The Cotonou Convention recapitulates most of the arrangements included in earlier conventions. Objectives are clearly more ambitious. The Cotonou Convention aims in effect at "reducing and eventually eradicating poverty consistent with the objectives of sustainable development and the gradual integration of the ACP countries into the world economy" (European Commission 2002, quoted in [Yu and Jensen 2005]). To that end, it proposes a comprehensive and integrated approach based on five pillars: participatory approaches, a focus on poverty reduction, a political dimension, a reform of financial cooperation and a new framework of economic and trade cooperation. The trade provisions of the Cotonou Convention set out the framework for the EU and appropriate groups of ACP countries to negotiate Regional Economic Partnership Agreements (REPAs), which should theoretically enter into force by 1 January 2008 at the latest, with transition to a full Free Trade Area (FTA) spread over twelve years. As a result, preferences would become reciprocal (Panagariya 2002). During the transition period, 2000-2007, they continue to be non-reciprocal and the specific protocols on bananas, beef and sugar still apply.

As a result of these series of successive conventions, virtually all industrial products from ACP countries can now enter the EU market duty free. This is not the case for many agricultural commodities, in particular those "CAP" products that are still highly supported and protected in the EU. There are specific agricultural exceptions, however, notably for

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bananas, sugar and beef. For these products, EU imports from ACP countries are governed by three specific protocols. The Banana Protocol provides duty-free access for ACP bananas within a specific tariff-quota of 750,000 tons. ACP bananas can also enter the EU market within the MFN quota of 2.653 million tons (EU-15), still at a zero duty (the MFN in-quota tariff is 75 euros per ton). Similarly, the Sugar Protocol guarantees duty-free access for 1.3 million tons of ACP sugar. It also guarantees an import price of sugar equal to the domestic support price (considerably higher than the world price). Finally, the Beef and Veal Protocol defines country-specific import quotas for six ACP countries totaling 52,100 tons annually. Imports under these quotas are subject to 8 percent of the full EU import tariff.

The EU GSP and the EBA initiative

There are two essential exceptions to the WTO MFN principle: Free Trade Areas and GSP schemes. Broadly speaking, a GSP allows developed countries to provide trade preferences to developing countries. These trade preferences are autonomous, non-reciprocal and non binding. They do not necessarily cover all products and do not necessarily involve duty-free access to the developed country market.

The EU GSP is implemented for cycles of ten years. The EU was the first to implement a GSP in 1971. At that date, preferences were granted under the form of import quotas and ceilings. From 1995, quantitative restrictions have been removed and preferences have been implemented through tariff reductions that vary according to the sensitivity of the product. Five arrangements have been in force under the 1996-2005 GSP.[4] All beneficiary countries have enjoyed the benefit of the general arrangements. LDCs have enjoyed the most favorable treatment of the special arrangements, also known as the EBA initiative (cf. infra). The special incentive arrangements for sustainable development and good governance have provided supplementary benefits for

4. The new EU GSP adopted on 27 June 2005 through Council Regulation (EC) N° 980/2005 follows the same guidelines.

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countries implementing certain international standards in human and labor rights, environmental protection, the fight against drugs and good governance. The special incentive arrangements for the protection of labor rights and for the protection of the environment have been available on request of countries implementing, respectively, certain labor standards and certain standards for the sustainable management of tropical forests. Under the general arrangements of the 1996-2005 GSP, non-sensitive products have enjoyed duty-free access to the EU market while sensitive products have been subject to reduced tariffs relative to MFN rates, 3.5 percentage points for ad valorem duties and 30 percent for specific tariffs.

The EBA initiative of February 2001 is an extension of the EU GSP. It gives all 49 LDCs an unlimited and duty-free access to the EU market for all products, with the exception of arms and ammunition.[5] However, for three sensitive agricultural products (bananas, rice and sugar), the unrestricted access to the EU market is delayed, from January 2006 for bananas, from July 2009 for sugar and from September 2009 for rice. In the case of sugar, duties should be eliminated in three stages with a 20 percent reduction from July 2006, a 50 percent reduction from July 2007 and an 80 percent reduction from July 2008. In the case of cotton, duties should also be reduced within a three-stage schedule with a 20 percent reduction from September 2006, a 50 percent reduction from September 2007 and an 80 percent reduction from September 2008. To compensate for these delays, duty-free import quotas for sugar and rice have been open from 2001-2002 based on the best figures for LDC exports during the 1990s, plus 15 percent. These quotas will be increased by 15 percent per year during the transitional period. In 2008-09, they will reach 6,696 tons for rice and 197,335 tons for sugar. LDC export potential is rather low except perhaps for three sensitive agricultural products.[6] Seven years of gradual transition to unrestricted access to the EU market were

5. The only restrictions are the usual ones on rules of origin, provisions against fraud and possible suspensions in case of massive increases in imports.
6. Rice and sugar are the major agricultural products (in volume) of the LDCs.

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therefore agreed in order to give time for necessary adjustments, both inside the EU and in non-LDC ACP states.

EU Agricultural Trade with ACP States and LDCs[7]

The EU and the US are the largest agricultural exporters, each accounting for more than 62 billion euros worth of exports in 2002. Nearly 33 percent of EU agricultural exports are shipped to developing countries. The EU is also one of the largest agricultural importers, accounting for 62.5 billion euros worth of imports in 2002 of which 59 percent came from the developing world. The EU thus is the largest agricultural importer from the developing world. However, EU imports of agricultural products from developing countries have been growing more slowly than those of the US: the comparative figures between 1995 and 2002 are 26 percent for the EU and 73 percent for the US. Nearly 40 percent of EU agricultural imports from the developing world come from only four countries: Brazil (20 percent), Argentina, South Africa and Thailand (USDA 2003). The EU is, however, of crucial importance for ACP states and the LDCs, which remain highly dependent on agricultural products and rely heavily on access to the EU market.

EU trade flows with ACP states

The share of ACP countries in world trade is tiny and continues to fall. Despite preferential access to the EU market, the share of ACP countries in EU total imports has also been declining, from 7.7 percent in 1980 to 2.7 percent in 2000. However, the ACP trade balance with the EU is positive, whereas it is negative with the rest of the world. In 2003, ACP exports to the EU were equal to 43.8 billion euros while ACP imports from the EU were equal to 41.4 billion euros. Between 1995 and 2003, ACP exports to the EU grew by 5.8 percent per year. But whereas exports of industrial products as well as fish and fishery products grew by

7. Most figures presented in this section are from the Directorate General Trade of the European Commission (trade statistics > bilateral trade relations > sectoral issues > trade in agricultural goods and fishery products > trade partners).

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7.7 percent per year, those of agricultural products increased by only 3.1 percent per year. As a result of these trends, the share of agricultural products in ACP total exports to the EU declined from 26.4 percent in 1995 to 21.4 percent in 2003. However, the ACP agricultural trade balance with the EU is positive and has remained constant over the last ten years. In 2003, ACP agricultural exports to the EU were equal to 9.4 billion euros while ACP agricultural imports from the EU were equal to 4.5 billion euros. ACP agricultural exports to the EU are concentrated in a few raw products, mainly tropical products (4.6 billion euros in 2003), sugar (864 million euros in 2003) and fruits and vegetables, notably bananas (484 million euros in 2003). ACP exports of CAP commodities to the EU are much lower: for example, in 2003, 79 million euros for beef meat, less than 3 million euros for dairy products and also less than 3 million euros for cereals. Export specialization varies according to the geographic zone (cacao, coffee, tobacco, fruits and vegetables, sugar and tea for the African ACP countries; sugar, bananas and rice for the Caribbean ACP countries; and palm oil, sugar and coffee for the Pacific ACP countries). Overall, it should be emphasized that the ACP states remain even today highly dependent on agricultural products and the EU market. Their agricultural exports are concentrated in a few raw products, making many ACP countries, notably the smallest states, very dependent on a reduced number of agricultural commodities, notably bananas and sugar.

EU trade flows with LDCs

The picture is globally the same for the LDCs, which are also highly dependent on the EU market.[8] However, these countries are relatively less dependent on agricultural commodities than ACP countries.

The LDC trade balance with the EU is positive (a surplus of 570 million euros in 2003) but the LDC agricultural trade balance with the EU is negative (a deficit of 670 million euros

8. Remember that, out of a total of 49, only 9 LDCs are not ACP states.

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in 2003). Between 1995 and 2003, LDC agricultural imports from the EU grew by 4.6 percent per year while LDC agricultural exports to the EU decreased by 4.1 percent annually. Over the same period, LDC exports of industrial as well as fish and fishery products to the EU increased by 9.3 percent per year. As a result, the share of agricultural products in LDC total exports to the EU declined, from 25.4 percent in 1995 to 10.6 percent in 2003. By comparison, the share of agricultural products in ACP total exports to the EU was still 20.6 percent in 2003. LDC agricultural exports to the EU are concentrated in a few raw commodities, mainly tropical products, tobacco, cotton, fruits and vegetables as well as sugar. Interestingly, it can be shown that LDC exports of sugar to the EU exhibit a positive trend, from 43 million euros in 1995 to 115 million euros in 2003. By contrast, LDC exports of cotton and bananas are decreasing.

Assessing the EU-ACP Partnership and the EBA Initiative

As regards the EU-ACP partnership, aggregate results are clearly disappointing. Over the last twenty years, the share of ACP exports in EU total imports has not stopped declining (cf. supra) and economic growth has been much weaker in the ACP zone than in other developing countries. ACP exports have not diversified sufficiently and they continue to be highly dependent on the EU market. In particular, almost 100 percent of ACP banana exports and nearly 75 percent of ACP sugar exports are still shipped to the EU. As noted by Bureau *et al.* (2005), even the European Commission has expressed doubts about the effectiveness of the ACP preferential regime, more specifically the Cotonou Convention.

This globally negative picture is somewhat misleading however. The average preferential margin currently enjoyed by the ACP countries relative to the EU GSP is low, at the very best only a few percentage points. But there are wide variations among products. In a general way, commodities that have benefited from higher preferential margins have also revealed a greater dynamism. In the case of agricultural products, this applies to, for example, fruits and vegetables, flowers and tobacco. In the same way, the global picture masks

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the fact that there are wide variations in the use of ACP preferences for the different ACP countries. For a large part, this uneven use reflects the export structure of the different ACP countries. Kennan and Stevens (1997) have analyzed the implications for the ACP countries of losing their preferential access to the EU market. To that end, they have assumed a transfer to the general EU GSP at the end of the Lomé IV Convention in 2000. Simulation results show that non-LDC ACP countries would be adversely affected by this transfer scenario to the benefit of middle-income and developed countries. In a more recent study, the same authors conclude that African countries have benefited from trade preferences granted in textile and agriculture, and that the roots of the problem lie rather in the various restrictions embedded in preference regimes, notably limited product coverage (Stevens and Kennan 2004).[9] Persson and Wilhelmsson (2005) have used a gravity model to estimate the effect of EU trade preferences on EU imports from developing countries. Their preliminary results suggest that EU preferences, and in particular ACP preferences, have had a positive impact.[10] In conclusion, they underline that "for countries under the Lomé Convention, the effect of gaining preferences has been much larger that what is perhaps commonly thought."

The EBA agreement is a recent development. There is therefore little data available for a historical analysis of trade flows. Despite this restriction, it should be noted, however, that there is no clear evidence to indicate that the EBA agreement increased trade flows from LDCs to the EU between March 2001 and March 2003 (USDA 2003). Various simulation studies also show that the EBA agreement will probably not generate sizeable trade and welfare gains for the LDCs. For example, Yu and Jensen (2005) estimate that the LDC welfare gains would be less than 300 million US dollars per year, even after complete removal of access restrictions to the EU market for LDC bananas, sugar and cotton. This does not mean that

9. Stevens and Kennan (2004) do not restrict their analysis to the EU-ACP partnership. They consider all trade preferences enjoyed by Africa.
10. Similarly, Carrère (2004) uses a gravity model to evaluate the impact of trade preferences on trade flows. His estimates are larger than those of Persson and Wilhelmsson (2005) because he uses a larger sample including North-North and South-South trade.

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the macroeconomic effects of the EBA initiative would be negligible for the beneficiary countries. Percentage changes in Gross Domestic Product (GDP) would range from 0.3 percent in Uganda to as much as 4.7 percent in Malawi. Interestingly, the Yu and Jensen results suggest that a large part of these welfare and GDP gains would be linked to these three sensitive products that are subject to gradual liberalization.[11] The most notable changes would be for sugar, whose exports would reach 117 million US dollars in Malawi, 183 million US dollars in Tanzania, 164 million US dollars in Zambia and 472 million US dollars in Sub-Saharan Africa (by comparison, over the reference period, sugar exports of EBA countries were equal to 68 million euros). Sugar production would be multiplied by two in Malawi and Zambia. It would increase by more than 10 percent in Tanzania and Sub-Saharan Africa. EBA country exports of rice, cereals as well as dairy products would also increase by large percentages, because pre-EBA tariffs were very high. But pre-EBA exports were very low for these "CAP commodities". As a result, high increases in percentages do not translate into significant increases in volume and value.

The Case of Bananas

Globally, bananas are the most traded fruit in volume and the second, after citrus, in value. The world banana market is segmented and concentrated. On the demand side, three consumption areas (the EU, the US and Japan) represent nearly 75 percent of world imports. On the supply side, five countries (Ecuador, the Philippines, Costa Rica, Colombia and Guatemala) account for nearly 80 percent of world exports. But while the Philippines export essentially to Japan and South Korea, the Latin American four top exporters, like other smaller Latin American suppliers, export to both the US and the EU. The US market offers free access and US imports originate quasi-exclusively from Latin America. By contrast, the EU market is highly protected and EU imports originate from both Latin America

11. When the three sensitive products are excluded, welfare gains for the LDCs are reduced to 55 million US dollars.

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(around 80 percent) and ACP sources (around 20 percent).[12] Virtually all ACP banana exports are shipped to the EU.

The EU banana trade policy

The EU banana market is highly regulated and protected. Prior to 1993, EU Member States had their own trade regimes. Germany imported bananas duty free. Six countries (France, Greece, Italy, Portugal, Spain and the United Kingdom) gave preferential access to producers from EU territories and/or ACP states. Only five countries (Belgium, Denmark, Ireland, Luxemburg and the Netherlands) applied the standard regime of the common external tariff of 20 percent on third-country imports, ACP states being exempt from this duty. The Single European Market of 1992 provided the impetus to eliminate EU internal border protection. The solution adopted in 1993 was a combination of tariffs and quotas, while EU producers were guaranteed a minimum income through deficiency payments up to 840,000 tons per year.

The Common Market Organisation for Bananas (CMOB) was heavily disputed from the very beginning, and several complaints to the WTO have necessitated successive reforms of the EU banana trade regime (see, for example, Read 2001, Josling 2003). However, as noted by Read (2001), from 1993 to 2001, "very little was changed with respect to the critical issue of the use of restrictive tariff quotas and, as such, the (modified) banana regime did not appear to comply with the WTO rules either." It was only in 2001 that the EU committed itself, as part of its WTO agreements reached with both Ecuador and the US, to replacing its tariff-rate quota policy by a tariff-only regime that should enter into force theoretically no later than 1 January 2006. From that date, a single tariff should be applied to EU imports originating from MFN suppliers while ACP bananas should continue to enter duty free. During the transitional period between 2002 and 2005, bananas have continued to be imported under a tariff-

12. In addition, the EU produces nearly 20 percent of its domestic consumption from the French overseas territories of Guadeloupe and Martinique, the Canary Islands (Spain), Madeira and the Azores (Portugal) as well as Crete (Greece).

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rate quota system with a general quota open to all countries and a specific quota reserved to ACP states. The tariff applied to EU imports within the general quota of 3.113 million tons (EU-25) was 75 euros per ton with a tariff preference of the same amount granted to ACP bananas. In addition, ACP exports could enter the EU market duty free under the specific quota of up to maximum of 750,000 tons per year. Over-quota tariffs (680 euros per ton for MFN bananas and 380 euros per ton for ACP bananas) have proved to be prohibitive.

Impacts of the EU banana trade policy on EU imports since 1993

Between 1990 and 1992, EU territories supplied the EU-15 with 714,000 tons of bananas per year (18.2 percent of the EU market). Over the same period, ACP suppliers accounted for 633,000 tons (16.1 percent) and MFN suppliers for 2.578 million tons (65.7 percent). Total EU consumption amounted to 3.925 million tons.

The supply structure of the EU market remained stable over the period 1990-2003 (Figure 1). Between 2002 and 2003, total EU consumption amounted to 4.097 million tons, which represents an increase of 172,000 tons relative to 1990-1992. The income support policy granted to European suppliers has resulted in a positive growth rate of exports from EU territories. EU territories account nowadays for a little over 772,400 tons, which corresponds to a market share of 18.8 percent (average 2002-2003). ACP banana exports to the EU increased between 1993 and 1996. They decreased during the three following years. They now oscillate around 750,000 tons per year, which represents 18.5 percent of the EU market (average 2002-2003). After a significant decrease in the immediate aftermath of the 1993 CMOB, EU imports from MFN countries stabilized around 2.45 million tons between 1995 and 1998. They have slightly increased following the reforms of the CMOB implemented in 1999 and 2001 so that they now account for 2.568 million tons (average 2002-2003). Although the growth rate of MFN exports to the EU was slightly positive over the period 1993-2003 (0.3 percent), the share of MFN exports in EU total consumption has continuously decreased, with a more important decline

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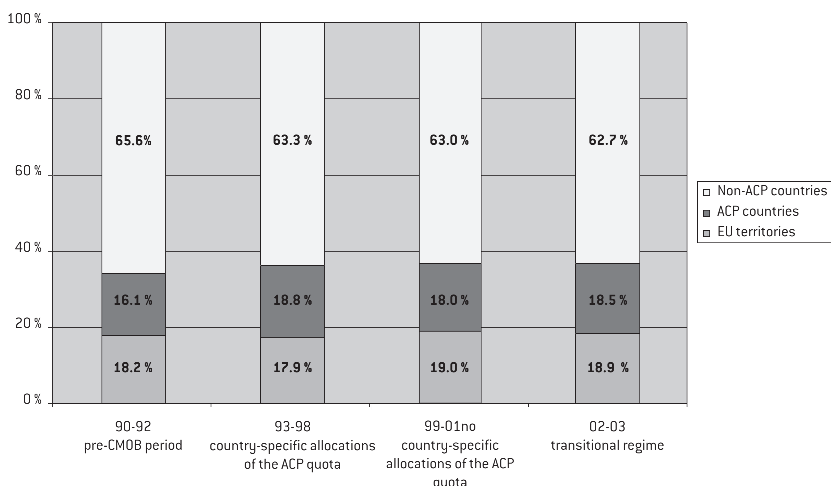
Figure 1. Structure of the EU Banana Market



Source: Guyomard *et al.* (2005).

over the five years between 1993 and 1998 corresponding to the first CMOB (from 65.6 percent over 1990-1992 to 63.3 percent over 1993-1998, 62.9 percent over 1999-2001 and 62.7 percent over 2002-2003).

Overall, the CMOB has stabilized the total supply of bananas in the EU market. Over-quota tariffs have always been prohibitive and there have been no over-quota imports. Although open to bananas from all origins, the general quota has been almost fully used by MFN suppliers quasi exclusively, which suggests that it has been binding on them. By contrast, ACP exports to the EU remained significantly lower than the specific ACP quota until 2001. The gap has narrowed following the reduction of the ACP quota by 100,000 tons from 2002 so that it is safe to assume that the current ACP quota of 750,000 tons is now binding, at least for the most competitive ACP suppliers (Cameroon, Ivory Coast and the Dominican Republic) who seem to be constrained from expanding their exports to the EU because of the non-availability of licenses under the ACP quota (NERA and OPM 2004).

Changes to the EU banana import regime since 1993 have contributed to changes in the market shares for the three categories of exporters (EU territories, ACP states and MFN

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countries). But these changes can be viewed as cosmetic relative to what happened within the ACP country category (Figure 2). While the aggregate amount of imports from ACP countries remained globally constant over the period between 1993 and 2003, two traditional ACP countries (Cameroon and Ivory Coast) and one non-traditional ACP state (the Dominican Republic) experienced strong growth.[13] By contrast, exports from traditional Caribbean ACP suppliers dramatically decreased. Changes have not been linear and the various versions of the CMOB clearly have had differentiated impacts on exports from the traditional Caribbean ACP states and the two West African ACP countries. More specifically, the decline in traditional Caribbean exports to the EU appears to have been much more pronounced after the cancellation of country-specific allocations of the ACP quota from 1999. Inversely, exports from Cameroon and Ivory Coast mainly increased after that date. Over the 1990-1992 period, the shares of the traditional Caribbean states and of the two West African countries in total ACP exports to the EU were equal to 58.5 percent and 34.7 percent, respectively. Between 1993 and 1998, they were equal to 44.9 percent and 44.0 percent. They are nowadays equal to 24.2 percent and 61.8 percent (average 2002-2003). One non-traditional ACP state, the Dominican Republic, has also substantially increased its exports to the EU since 1993. It now represents 13.7 percent of total ACP exports to the EU (average 2002-2003) while it accounted for 2.6 percent over 1990-1992 and 8.7 percent over 1993-2001. For the large part, the export supply of the Dominican Republic corresponds to organic and/or fair trade bananas exported to the United Kingdom. Likewise, within the MFN supplier category, three exporters (Ecuador, Costa Rica and Colombia) have experienced strong growth, winning EU market shares away from Panama, Honduras and other smaller Latin American producing countries. However, these changes should not be entirely attributed to the EU banana trade policy and its successive reforms. Other factors (weather related

13. The twelve traditional ACP producing countries are Belize, Cameroon, Cape Verde, Dominica, Grenada, Jamaica, Ivory Coast, Madagascar, Somalia, St Lucia, St Vincent and the Grenadines, and Suriname. The first versions of the CMOB distinguished the traditional ACP states from the non-traditional ACP countries.

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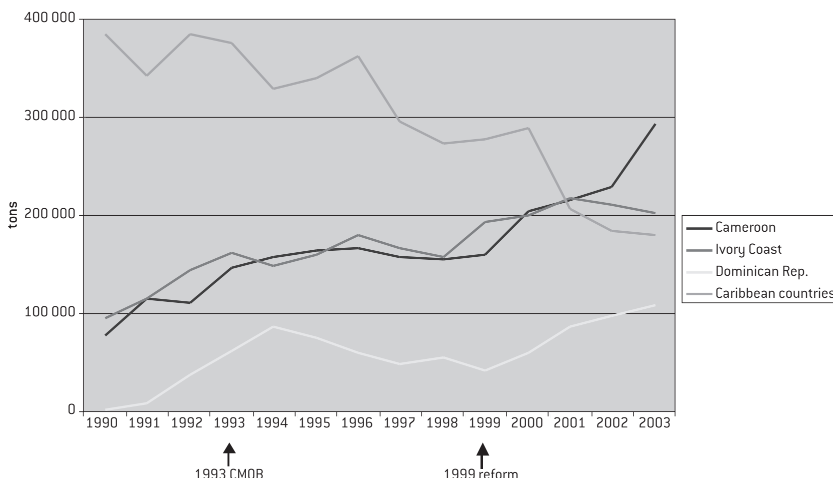
Figure 2. ACP Banana Exports to the EU



Source: Guyomard *et al.* (2005).

events, industrial disputes, crop diseases, increasing irrigation costs, increasing sanitary costs due to higher black sigatoka infestation) have contributed to decrease supply and exports from Panama and Honduras (FAO 2003).

Potential impacts of the tariff-only EU policy for ACP banana exports

Overall, the various forms of the CMOB in force since 1993 have thus limited total banana supply in the EU by putting a ceiling on imports from MFN suppliers. The second effect of the CMOB has been to modify the banana supply structure within the ACP category, in favor of Cameroon and Ivory Coast and to the detriment of ACP Caribbean suppliers. In that context, the immediate challenge the EU has to face is to set the tariff for MFN bananas at an "acceptable" level. That is, a level that ensures that European production will be protected maintains a level of preference to the ACP countries equivalent to that afforded by the enlarged EU-25 and offers satisfactory access for bananas from non-preferential country suppliers. Of course, the ACP countries have called for a tariff that is as high as possible, arguing that a level of at least

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275 euros per ton is necessary in order to protect them from competition from the MFN countries. On the other hand, MFN suppliers unsurprisingly call for a tariff that is as low as possible, more precisely a zero tariff or, at worst, at a level equal to the current in-quota tariff level of 75 euros per ton (Agra Europe London, 11 April 2005).

On 31 January 2005, the EU (more specifically the European Commission) notified WTO members of its intention to set the MFN tariff at 230 euros per ton. A first WTO arbitration award issued on 1 August 2005 ruled against the EU. It considered that such a tariff level would not result in at least maintaining EU market access for MFN banana suppliers. On 12 September 2005, the EU presented its revised proposal consisting of a MFN duty of 187 euros per ton and a tariff quota of 750,000 tons for bananas originating from ACP sources. At the request of the EU the WTO arbitration panel was asked to reconsider, yet this second WTO arbitration award issued on 27 October 2005 ruled again against the EU. The latter having exhausted its arbitration rights, its next move is unclear.

In both cases, the arbitrators, while acknowledging the use of the price-gap methodology to calculate the tariff to be applied on MFN bananas, questioned the validity of the prices used by the European Commission.[14] In their first award, they criticized the choice of FAO (Food and Agriculture Organization of the United Nations) data for internal prices. In their second award, they mainly expressed reservations against the change in the source of price data made by the European Commission for external prices. In practice, they considered that the arguments put forward by the European

14. The price-gap approach is codified in the Attachment to Annex 5 of the Uruguay Round Agreement on Agriculture (URAA). The price gap should be measured as the difference between an internal price and an external price. The internal price should be a representative wholesale price predominant in the domestic market or where adequate data is not available, an estimate of that price. External prices should ideally be CIF unit values in the importing country. Where such values are not available or appropriate, external prices can be evaluated either by CIF unit values in a nearby country or from FOB unit values in an appropriate exporting country adjusted by adding an estimate of insurance, freight and other relevant costs to the importing country. The tariff should be calculated using data from a three-year time period. WTO practice is to use the most recent three-year period for which data is available.

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Commission for departing from the initial use of EUROSTAT CIF (Cost, Insurance and Freight) unit values for external prices were not sufficiently convincing. The arbitrators' awards are incomplete, however. In particular, they fail to explain why CIF import unit values in the EU-15 from MFN countries are so high relative to FOB (Free on Board) export unit values in the same MFN countries, more precisely, why they are much higher than FOB prices adjusted by insurance, freight and other relevant costs that should theoretically be added to transform FOB into CIF prices. One reasonable explanation to this apparent paradox is that CIF import unit values in the EU-15 from MFN suppliers are very likely to include at least part of the general quota rent (on this point, see NERA and OPM 2004).

Under this assumption, Guyomard *et al.* (2005) estimate that the import protection granted to ACP bananas in 2003 by the tariff-rate quota policy was equivalent to a MFN duty of 227 euros per ton. Furthermore, five-year dynamic simulations incorporating time shifters in supply (productivity changes) and demand (per capita consumption trends) suggest that it would be necessary to set the tariff equivalent at a higher level (about 250 euros per ton) in order to maintain in 2008 the situation that prevailed in 2003. Applying the static tariff equivalent of 227 euros per ton on non-ACP bananas over the five-year period between 2003 and 2007 would lead to a decrease in the EU average import price (from 603 euros per ton in 2003 to 582 euros per ton in 2008) and to an increase in EU-25 consumption (from 4.6 million tons in 2003 to 5.1 million tons in 2008). This consumption increase would benefit both the non-ACP suppliers and the two West African ACP countries. With respect to 2003 levels, their exports to the EU would increase by 327,000 tons (non-ACP countries) and 97,000 tons (Cameroon and Ivory Coast). In percentages, the export increase would be higher for the two West African countries (plus 24.1 percent) than for the non-ACP countries (plus 9.9 percent). By contrast, EU imports from the Caribbean countries would decrease by about 5,200 tons (minus 3.3 percent) as compared to 2003. Guyomard *et al.* (2005) results also show that a relatively low tariff (say 100 euros per ton) would severely affect the Caribbean banana industry.

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With respect to the situation that prevailed in 2003, their exports to the EU would decline from 157,200 tons to less than 100,000 tons in 2008, i.e. a cut of 37 percent. A relatively high tariff (say 300 euros per ton) would allow ACP countries to expand their exports to the EU by 276,300 tons, from 642,400 tons in 2003 to 918,700 tons in 2008. This increase would essentially benefit Cameroon and Ivory Coast insofar as exports of Caribbean countries to the EU would rise by 18,800 tons only.

More generally, studies that have attempted to estimate the degree of protection equivalent to EU tariff-rate quota policy can be divided into two groups according to the price used for analysis. On the one hand, studies based on use of CIF prices conclude that the MFN tariff should be set at a low level, for example 64 euros per ton for Borrell and Bauer (2004). On the other hand, analyses that employ adjusted FOB prices find that the MFN tariff should be set at a high level, for example 259 euros per ton for NERA and OPM (2004). To a large extent, these discrepancies can be explained by the fact that CIF price studies assume that EU CIF import prices are not influenced by quota rents while other studies assume that at least some part of quota rents is reflected in EU CIF import prices. The issue of quota rent estimation and its allocation among the various actors of the banana chain clearly needs further research. In that perspective, information currently available in the public domain is notably insufficient. This is the case in particular for production costs and prices at which import licenses have been traded under the various forms of the CMOB.

Despite this lack of reliable information, there is consensus on the fact that Caribbean bananas are less competitive than Latin American and West African bananas. Given the importance of the banana industry for the Caribbean islands and the importance of the EU market for their banana exports, a key question to be addressed is the future of the Caribbean industry if the EU is not able to resist to pressure from low-cost exporting countries and ultimately sets the tariff at a level that does not allow Caribbean bananas to compete with Latin America or West Africa.

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The Case of Sugar

The EU, Brazil and India are the largest producers of sugar.[15] Over the 1997-2002 period, they accounted for nearly 45 percent of world production. Over the same period, ACP production was equal to 6.2 million tons, less than 5 percent of world production. Around 70 percent of world production is cane sugar and around 30 percent is beet sugar. While Brazil, India and ACP production is cane sugar, EU production is essentially beet sugar. Brazil is the largest sugar exporter (around 25 percent of world exports) followed by the EU (around 21 percent of world exports for the EU-25). The ACP states account for nearly 8 percent of world sugar exports. This percentage represents a little less than 3 million tons. The EU exports around 16 percent of its production. The ratio of exports on production is much larger for several ACP states, notably some ACP states that are eligible for the Sugar Protocol. Over the 1997-2002 period, Mauritius exported 98 percent of its production, Fiji 89 percent, Guyana 92 percent and Swaziland 86 percent.

The EU sugar policy

The Common Market Organisation for Sugar (CMOS) has remained practically unchanged for almost forty years. However, on 24 November 2005, EU agriculture ministers reached political agreement for an in-depth reform of the CMOS that will progressively enter into force from 2006-07.

The CMOS still in force in 2005-06 includes guaranteed prices that do not apply at the beet or cane producer level but to the processed product. Over the past years, guaranteed prices have been two or three times above world prices. Price support is restricted to production within national quotas but there is the possibility of producing sugar at the world price under the condition that corresponding production, the

15. For a very clear and synthetic presentation of the world sugar market, see Gillson *et al.* (2005). Like this paper, Gillson *et al.* (2005) address the issue of EU preference erosion for bananas and sugar. It also proposes different solutions for an effective transitional package in favor of developing countries which would suffer from forthcoming changes in EU banana and sugar policies.

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so-called C sugar production, is exported to the world market without export subsidies. Very high import duties are used to prevent imports from third countries, except for those that benefit from trade preferences under the Sugar Protocol of the EU-ACP partnership, the Special Preference Sugar (SPS) scheme or the EBA initiative.[16] Export restitutions cover the difference between domestic and world prices. They apply not only to domestic production of quota sugar in excess relative to domestic consumption, but also to sugar produced from preferential sources. This very complex policy has made the EU not only the second largest sugar importer but also the second largest sugar exporter.

The sugar reform adopted in November 2005 includes a 36 percent support price cut spread over four years and beginning in 2006-07, and partial compensation to farmers under the form of decoupled direct aid that will be included into the Single Farm Payment (SFP) scheme introduced by the June 2003 CAP reform. The intervention price will be abolished after a four-year phase-out period. It will be replaced by a reference price supported by a private storage system acting as a safety net in case the market price falls below the reference price. The agreement includes a voluntary restructuring scheme consisting of a payment to encourage factory closure and the renunciation of quotas, as well as to cope with the social and environmental impact of the restructuring scheme. Sugar beet producers affected by the closure of factories could use part of this fund. The reform does not include changes to EU trade policy. As a result, ACP states and LDCs will continue to enjoy preferential access to the EU market at prices that remain above world prices. However, these attractive prices will be substantially reduced with

16. Like the Sugar Protocol, the SPS scheme of 1995 is a government-to-government agreement. But unlike the Sugar Protocol, it is a non-binding agreement under which an additional quantity of sugar, determined annually by the European Commission on the basis of market forecasts, is exported to the EU. Over the past years, this additional quantity averaged 300,000 tons per year. The first 75,000 tons of the SPS scheme go to the four ACP states (Ivory Coast, Malawi, Swaziland and Zimbabwe) which traditionally supplied this quantity to Portugal. The rest is divided between the Sugar Protocol states pro rata with Sugar Protocol quotas.
In addition, the EU grants duty-free access for all products, including sugar, from the Balkan States. From 1 July 2005, import sugar quotas are equal to 1,000 tons for Albania, 12,000 tons for Bosnia-Herzegovina, and 180,000 tons for Serbia-Montenegro.

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respect to current levels. To cope with the adverse consequences of this decreased attractiveness, ACP countries that need it will be eligible for an assistance plan worth 40 million euros in 2006. Furthermore, the European Commission claims that further assistance will be secured for the 2007-2013 period (European Commission 2005b). The scale of this assistance is not detailed, however, and immediately, many observers have compared unfavorably the level of compensation granted to EU producers and factories with the 40 million euros earmarked for the ACP Sugar Protocol countries in 2006.

EU sugar policy developments and developing countries

Sugar trade preferences granted by the EU to some ACP states and the LDCs clearly discriminate against sugar exporters that are not eligible to either the EU-ACP sugar partnership or the EBA initiative. Not only do these non-preferential sugar exporters have no access to the EU market because of prohibitive MFN tariffs, but they also face lower world prices because of EU preferential imports which are eventually fed into the world market via larger subsidized EU sugar exports. The findings of the WTO panel challenging the EU sugar export regime, as upheld by the Appellate Body on 28 April 2005, have clarified the conditions under which the EU may conform to its WTO commitments. The international commitments of the EU were clearly the main drivers of changes adopted in November 2005 (European Commission 2005a).

The total quantity the EU has committed to import under the ACP Sugar Protocol is equal to 1.3 million tons (quantity unchanged from 1995). This quantity is allocated between country beneficiaries under the form of country-specific quotas (country-specific quotas unchanged from 1995, except for Barbados, Kenya, Mozambique and Zambia). Figure 3 compares production, exports and Sugar Protocol quotas for India and the different ACP states which are eligible under the Sugar Protocol. Mauritius is the main beneficiary with a quota of 491,030.5 tons annually. This country exports quasi-exclusively to the EU (over the 1997-2002 period, it exported 550,947 tons of sugar per year). Other main beneficiaries are Fiji (quota of

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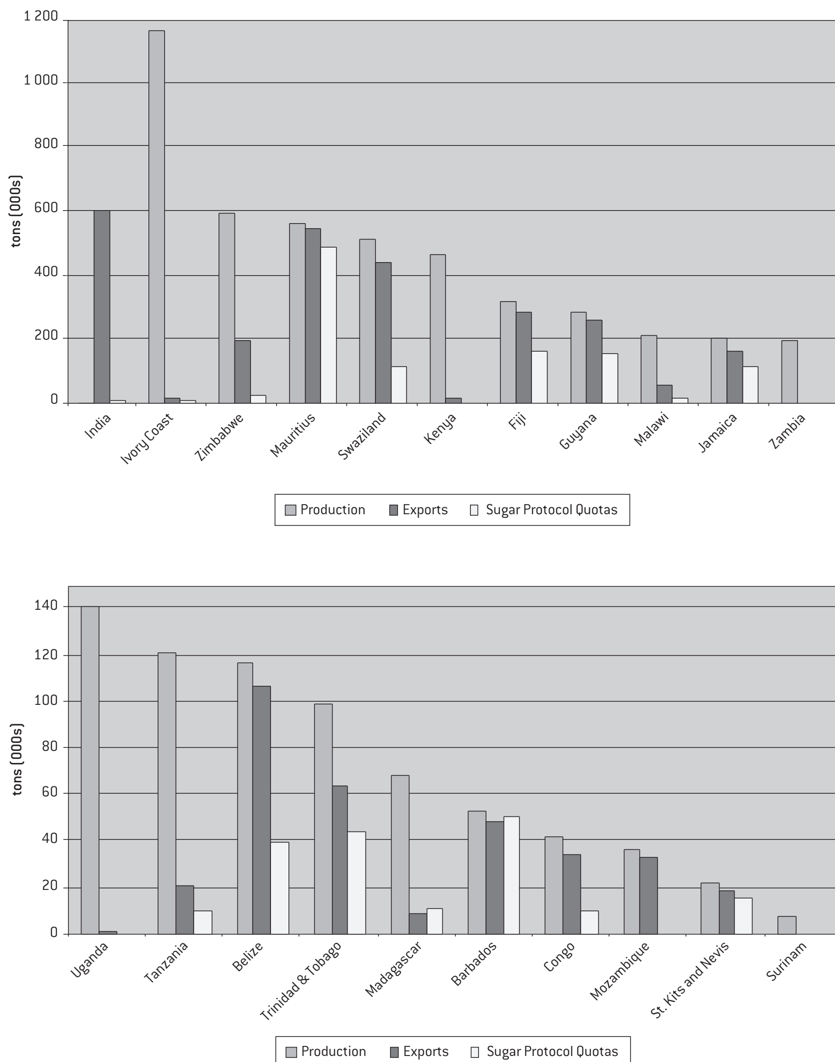
165 348.3 tons), Guyana (quota of 159,410.1 tons), Jamaica (quota of 118,696.0 tons) and Swaziland (quota of 117,844.5 tons). These four countries are relatively less dependent on the EU market, but do rely specifically on the Sugar Protocol. Over the 1997-2002 period, the ratio of sugar exports to quotas was of

Figure 3. ACP Sugar: Sugar Protocol Quotas, Production and Exports (average 1997-2002)



Sources: Gillson *et al.* (2004) for production and exports; CAP Monitor (2005) for Sugar Protocol quotas.

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173 percent for Fiji, 167 percent for Guyana, 138 percent for Jamaica and 375 percent for Swaziland. Even if these countries have been able to export large volumes of sugar to non-EU countries, their sugar exports to the EU are still an essential source of foreign exchange earnings. According to Gillson *et al.* (2004), the total transfer generated by the Sugar Protocol is about 500 million US dollars annually, Mauritius receiving about one third of this transfer and the five largest quota holders (Mauritius, Fiji, Guyana, Jamaica and Swaziland) about 75 percent. Many Sugar Protocol countries are thus highly vulnerable to developments in sugar preferential trading in the EU.

The process of bringing EU sugar prices down closer to world price levels will automatically reduce the income earned on ACP sugar exports to the EU. The support price cut is the first mechanism by which the reform of the CMOS will decrease the value of sugar trade preferences. With a guaranteed price cut of 36 percent, annual income losses would be equal to around 244 million euros from 2009-10 The larger the quota, the greater the income loss. As a result, Mauritius would be the biggest loser, with an income decrease of 93 million euros per annum from 2009-10.

The previous analysis assumes that Sugar Protocol quotas are unchanged and binding. This is also the assumption retained by the European Commission in its impact assessment of the reform of the CMOS (European Commission 2005a).[17] The European Commission analysis predicts an increase in EU sugar imports of 1.6 million tons by 2012-2013. At that date, the EU would import 3.9 million tons of sugar, of which 33 percent (1.3 million tons) would be under the Sugar Protocol and 56 percent (2.2 million tons) under the EBA initiative or the SPS scheme.[18] The increase in EU sugar imports would be quasi-exclusively driven by the positive impact of the zero tariff arrangements of the EBA initiative for the LDCs.[19] Current EBA net exporters would be the main

17. This is an assessment of the European Commission proposals of June 2004 with a guaranteed price cut of 39 percent (the price cut finally adopted in November 2005 is 36 percent).
18. Interestingly, it should be noted that a no-reform scenario would increase EU sugar imports by 2.9 million tons by 2012-2013. At that date, the EU would import 5.2 million tons of which 3.5 million tons under the EBA initiative or the SPS scheme.

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beneficiaries (Malawi, Zambia, Ethiopia, Sudan and Mozambique). Some ACP Sugar Protocol countries would have to reduce their exports to the EU. This shortfall would be replaced by exports from lower cost producers (Swaziland, Zimbabwe, Zambia, Malawi and Mozambique) so that the Sugar Protocol quota would remain globally binding. The European Commission recognizes that there is a lot of uncertainty. What is clear, however, is that the EBA initiative should have different impacts on EBA Sugar Protocol countries and non-EBA Sugar Protocol countries. In a general way, non-EBA Sugar Protocol countries have an interest in gaining equivalent treatment for sugar as the EBA offers to the LDCs. This is notably the case for Swaziland, Belize, Guyana and Fiji. A final remark is in order. In the case of sugar, the safeguard mechanisms allow the EU to suspend the preferences entirely if imports cause too serious disruptions inside the EU. These mechanisms can be used to restrict sugar imports from the LDCs under the EBA initiative. In such a scenario, EBA sugar exports could be much more modest than those presented above under the assumption that the safeguard provisions are not used to limit imports.

In a general way, many analysts claim that alternative forms of aid could deliver greater economic benefit and higher growth paths to countries that currently enjoy preferential access to the EU (as well as, but to a lesser extent, other developed country markets).[20] Levantis *et al.* (2003) address this issue for the specific case of Fiji a sugar-dependent ACP country.[21] First, they show that the immediate impact of a complete removal of preferential access to the EU sugar market would be to decrease the real GDP of Fiji by 1.1 percent. The impact is lower than the value of the transfer

19. In the case of sugar, the EBA initiative distinguishes two periods. During the interim period, from 2001-2002 to 2008-2008, the agreement is implemented through zero duty import quotas. In 2001-2002, the EBA quota was of 74,185 tons. This amount will be increased by 15 percent each year. From 1 July 2009, it will be abolished and LDC sugar will have unrestricted access to the EU market.

20. When trade preferences are granted under the form of tariff-rate quotas, there is in addition a lot of uncertainty as to who actually captures quota rents and finally reaps the benefits of trade preferences.

21. According to Levantis *et al.* (2003), sugar production in Fiji in 2001 accounted for 7.0 percent of GDP.

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(2.9 percent of GDP) thanks to resource reallocation in other activity sectors. However, after ten years, real GDP would still be 0.4 percent lower than the level that would have been achieved without changes. As an alternative way to provide aid to Fiji, they consider two additional scenarios where the sugar subsidy is replaced by a budgetary aid of equal value to the Fiji government. In the first alternative where the budgetary aid is used to reduce domestic taxes and import taxes, the immediate impact would be to increase real GDP by 1.0 percent. After ten years, real GDP would be 1.7 percent above the level that would have been achieved without changes. In the second alternative scenario where budgetary aid is used to finance infrastructure investments, real GDP would be 2.0 percent above the level that would have been achieved without changes. This simulation exercise can be criticized on several fronts, for example the modeling of the labor market or the estimated impact of investments in public infrastructure on total factor productivity growth. However, as noted by the authors of the study, "what is clear in the quantitative analysis is that the loss of preferential access will lead to considerable structural change with the rural poor incurring the bulk of the burden of structural change." They add that "it could take many years for there to be sufficient alternative employment opportunities for the rural poor and it is these people who will be least capable of adjusting to changing labor market conditions."

Concluding Remarks

The specific cases of bananas and sugar have been used to illustrate the issue of the lowering of EU trade preferences, more specifically the decreasing of EU trade preferences currently enjoyed by the ACP states under the Cotonou Convention. Both the banana and sugar cases show the need to consider each ACP country individually, and not to treat all ACP states as a single group. EU trade preference schemes can be criticized on several grounds, but any reform of these schemes should take into account the notion that beneficiary countries are not homogenous. As a result, the reform should be country differentiated. It should also be gradual, i.e. spread

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out over a sufficient number of years to give time for necessary adaptation. In some banana and sugar dependent countries, the transition process has already been happening in anticipation of forthcoming changes in EU trade preferences. Furthermore, unchanged EU import quotas did not provide a basis for growth in the banana or sugar industry, or for economic growth in general. It remains that several ACP states are still highly dependent on the EU market and agricultural commodities, bananas and sugar in particular.

In a general way, Anderson and Martin (2005) claim that "preference erosion may be less of an issue than commonly assumed." This because their Doha scenario simulation results "overstate the benefits of tariff preferences for LDCs since they ignore the trade-dampening effect of complex rules of origin and the grabbing of much of the rents by developed-country importers." The first point is likely to be of low importance for agricultural raw commodities. The second point is clearly an issue that has to be addressed in further research, notably for bananas and sugar. Furthermore, Anderson and Martin (2005) show that a large part of welfare gains would be generated by agricultural policy reforms. On the other hand, Bouët *et al.* (2005) estimate that a Doha agreement restricted to agriculture would lead to very modest welfare gains, in any case much lower than those derived from "similar" studies. They also show that preference erosion would be a serious concern, notably for Sub-Saharan Africa. They conclude that "in order to make the results of a Doha Round more consistent with Pareto-improvement principles, more differentiation between developing countries should be allowed." This remark applies in general and more specifically in the case of agricultural products.

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Chapter 4

Preference Erosion and the Doha Development Agenda

Bernard Hoekman[1]

Non-reciprocal trade preferences have long been granted by industrialized countries to various developing countries. In 1968, the UN Conference on Trade and Development (UNCTAD) recommended the creation of a "Generalized System of Preferences" (GSP) under which industrialized countries would grant trade preferences to all developing countries on a non-reciprocal basis, not just to former colonies. Since then a plethora of non-reciprocal preferential access schemes have been put in place by OECD countries, including national GSP programs, GSP-plus programs for the least developed countries (LDCs) such as the EU "Everything but Arms" (EBA) initiative, and special arrangements for subsets of developing countries such as for African, Caribbean and Pacific (ACP) countries (under various conventions with the EU), African countries only (the US African Growth and Opportunity Act – AGOA), and the Caribbean (the US Caribbean Basin Initiative).[2]

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The author is grateful to the conference's participants for their helpful comments. This paper draws in part on Hoekman and Prowse (2005).
2. In practice, non-reciprocity is a bit of a misnomer as the preferential access is often conditional on non-trade-related actions or behavior by the recipient countries.

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Trade preferences are a central issue in ongoing efforts to negotiate further multilateral trade liberalization in the Doha Round. Middle-income countries are increasingly concerned about the discrimination they confront in OECD markets as a result of the better access granted to "more preferred" countries, not to just developing but also to other industrialized countries because of free trade agreements. Conversely, LDCs and non-LDC ACP countries worry that general, most-favored-nation (MFN)-based liberalization of trade will erode the value of current preferential access regimes. Preference receiving countries are also concerned about the potential negative terms of trade effects of multilateral liberalization insofar as it might raise the price of their imports, especially of goods that currently benefit from subsidies and protection in OECD markets, by more than the price/quantity of their exports.

Preference erosion has been ongoing for years as a result of trade liberalization in preference-granting countries and the pursuit of regional trade agreements. The most recent example of a significant preference erosion shock was the implementation of the Agreement on Textiles and Clothing (ATC) on 1 January 2005, which confronted all countries with the prospect of much greater competition from the lowest-cost suppliers of textiles and apparel –especially China– as quantitative restrictions on exports were removed. While this was not due to the removal of a program that was explicitly aimed at granting preferential access, the effect of the quotas was to give less competitive producers an advantage in contesting a highly restricted market.

Preferences were designed to be an instrument to promote trade. To the extent that they generate rents for exporters they act as a mechanism to transfer resources from OECD consumers. By raising returns, they imply a financial transfer –an improvement in the beneficiary countries' terms of trade. Inasmuch as they encourage investment in "nontraditional" activities –a major rationale for these programs when they were designed in the 1960s– they may also stimulate export diversification. The extent to which they achieve the latter objective may be affected by the magnitude of rents available

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in traditional products: by encouraging trade in sectors where there are rents, preferences induce specialization in those sectors, which may work against export diversification objectives. In assessing the magnitude of the effects of erosion, much will depend not only on the depth of liberalization by preference-granting countries –e.g. the extent to which sectors such as sugar, beef, rice and apparel are opened up– but also on what other countries do and the actions of the preference-receiving country itself to improve the productivity of national firms and farmers.

A premise of this paper is that non-discriminatory liberalization by WTO members has the characteristics of a global public good. Preferences are distortionary and help generate increasing preferential trade in the world trading system as excluded (less-preferred) countries confront incentives to negotiate reciprocal free trade agreements (FTAs) with major donor countries. This is not to deny that preferences are legitimate or to say that they do not benefit recipients. What is needed is an explicit transition strategy that moves the trading system back towards nondiscrimination. This strategy must recognize the adjustment costs this shift will impose on the beneficiaries of preferences and include a credible commitment that alternative instruments will be used by rich countries to offset the losses associated with a move towards nondiscriminatory trade policies.

The plan of the paper is as follows. Section 1 briefly reviews some of the literature, assessing the value of preference programs and potential losses from erosion. Section 2 turns to potential policy responses. It argues that from a "mercantilist" perspective what matters is that the loss of benefits stems from the removal of a specific policy that has been put in place by OECD countries, and that these countries should therefore offer compensation for these losses. Moreover, such compensation should occur outside the WTO system, i.e., not involve new forms of discrimination in trade. Section 3 argues that assistance for preference erosion should be considered as part of a broader response by OECD countries to calls to make the trading system more supportive of economic development. One reason for this is that erosion has

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been and will continue to be an ongoing process, with or without a Doha Round. More important is that many developing countries have not benefited greatly from preferences. This suggests the focus should be on identifying actions and policy measures that will improve the ability of developing countries to use trade for development. This spans not just an expansion of "aid for trade" but also different approaches to special and differential treatment of developing countries in trade agreements, which is briefly discussed in Section 4. Section 5 concludes.

Preferences: Stylized Facts and Recent Research

The rationale for nonreciprocal preference programs was elaborated by Raúl Prebisch and Hans Singer in the late 1950s and early 1960s (see UNCTAD 1964).[3] Their main argument was that developing countries needed to foster industrial capacity both to reduce import dependence and to diversify away from traditional commodities that were subject to declining long-run terms of trade and adverse price volatility in the short-term. Part of the recommended policy prescription was to erect trade barriers to protect infant industries –i.e., import-substitution industrialization. At the same time, it was recognized that exports were needed to generate foreign exchange and that local markets are generally too small for domestic industry to capture the economies of scale that accompany industrial expansion. Preferential market access would help bolster the needed exports.

By the 1960s most of the problems associated with the implementation of preference programs had already been recognized, even by the proponents of such programs. Thus, UNCTAD (1964) noted that preferences could have negative impacts on the process of multilateral MFN-based trade liberalization. It also foresaw one of the problems that has plagued the implementation of preference programs, namely, which countries should be eligible and for how long? The report argued that preference margins should decrease as the income levels of beneficiaries increased, and recognized that adminis-

3. UNCTAD was founded in 1964, with Raúl Prebisch as the first Secretary-General.

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trative issues such as documentary requirements could reduce the benefits of preference programs.

Gardner Patterson (1965) elaborates in detail many of the criticisms that have been raised repeatedly against preferences since the mid 1960s. He questions whether preferences are the most efficient way to help developing countries, noting that: preferences could lead to specialization in products in which the beneficiary country did not have an inherent comparative advantage, resulting in socially wasteful investment; and that they might generate political frictions among beneficiary and non-beneficiary countries, as well as among developing countries that are at different stages of development. He also noted that OECD parliaments would have to get involved in the process of granting preferences, opening the gates to excessive conditionality and tailoring of the product coverage of programs to assuage protectionist pressures. In this connection, Johnson (1967) noted that preferences would yield the highest benefits to developing countries in sectors that are the most protected in high-income countries –making it difficult to implement meaningful preference schemes. In practice, agricultural products, textiles and apparel frequently have been excluded from preference programs. Johnson was also concerned that donor countries would use preferences for political purposes "to reward and punish the recipients for their behavior and performance" in non-economic areas (p.199). Hudec (1987) argued that because under the General Agreement on Tariffs and Trade (GATT) preferences were not contractual obligations, their value was limited in that the moment beneficiary countries increased their exports considerably they were likely to lose eligibility, i.e. be "graduated" out of the program.

Researchers have returned again and again to these issues. They note that exclusions reduce the value of preferences and that preferential access can only have an impact if there is a non-zero tariff in the importing market. Two-thirds of the major items Africa exports to Canada, for example, already faced zero MFN tariffs before the 2003 initiative in favor of LDCs. Similarly, before EBA was introduced in 2001, some 69 percent of EU imports from Africa (by value) were in items facing zero MFN duties (Stevens and Kennan 2004).

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Research has also documented that compliance costs (e.g. paperwork, red tape, documenting origin) are significant. The average estimate in recent empirical literature is that documentary requirements account for costs of some 3-5 percent of the value of processed goods (Brenton and Manchin 2003, Brenton and Ikezuki 2004, Anson *et al.* 2003, Candau *et al.* 2004, Carrère and de Melo 2004). This requires MFN tariffs to exceed 4 percent on average for preferential access to be meaningful. Given that the average MFN tariff in OECD countries is only 4 percent or so, preferences can only matter where there are tariff peaks or quotas (Hoekman, Ng and Olarreaga 2002).

Moreover, to the extent there is market power on the part of either importers (Francois and Wooton 2005) or the transport and logistics sector (Francois and Wooton 2001), the terms of trade benefits of preferential tariff reductions may be captured in part by these intermediaries rather than the exporters (although any diversification benefits will remain). If preferences apply to highly protected sectors in donor countries, they will result in high rents for those able to export free of trade barriers. However, buyers will be aware of these rents, and if they have the ability to set prices (have market power), the rents may predominantly be captured by distributors or other intermediaries (Tangermann 2002). There is evidence, based on the AGOA preference scheme, that the pass-through of preference margins is indeed partial at best. Olarreaga and Özden (2005) find that the average export price increase for products benefiting from preferences under AGOA was about 6 percent, whereas the average MFN tariff for these products was some 20 percent. Thus, on average exporters received around one-third of the tariff rent. Moreover, poorer and smaller countries tended to obtain lower shares –with estimates of the share of the rent ranging from a low of 13 percent in Malawi to a high of 53 percent in Mauritius.[4]

4. See Ozden and Sharma (2004) for a similar analysis of the US CBI program. Francois and Wooton (2005) obtain similar size-dependent results in an analysis of the incidence of mark-ups along the distribution chain.

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Finally, numerous researchers have argued that for preferences to have value, the beneficiary countries need to have an export capacity in the products for which preferential access is granted (e.g., Page and Kleen 2005). Many low-income countries simply do not have the capacity to exploit preferences: either they do not have productive facilities at all or are not able to compete even with the price advantage offered by the preference due to internal transactions and operating costs. Preferences were conceived as instruments to assist countries with supply capacity to diversify and expand their exports. They have little value for countries that do not have such capacity yet.

Estimates of the impact of erosion due to a Doha Round

The available research suggests that erosion of all remaining preferences, both GSP and the deeper, more recent, preference programs such as EBA and AGOA, would have a substantial impact on some countries, especially those with a high concentration of exports in heavily protected commodities. The biggest impact, in relative terms, would be on small island economies and a number of countries that specialize in sugar, bananas and to a lesser extent garment exports (IMF, 2003; Stevens and Kennan, 2004). These are the commodities where protection and therefore preference margins are high. It has been argued that, of the LDCs, Cape Verde, Haiti, Malawi, Mauritania, and São Tomé and Príncipe are most vulnerable to preference erosion (IMF, 2003). Alexandraki and Lankes (2004) conclude that a small number of middle-income countries –Belize, Fiji, Guyana, Mauritius, St. Kitts and Nevis, St. Lucia– would also be significantly affected, with predicted export declines ranging from 11.5 percent for Mauritius to 7.8 percent for Fiji.[5]

The costs of preference erosion need to be set against gains from MFN liberalization –both for the recipient country

5. The only large country expected to suffer from preference erosion is Bangladesh, which has benefited significantly from the textile quota restrictions imposed on other large competitive developing countries such as China, and which were removed at the end of 2004 under the WTO Agreement on Textiles and Clothing. However, as discussed below, these costs are already "sunk" in that the shock has already occurred.

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and other developing and least developed countries. While preferred countries stand to lose from tariff reductions in sectors or products where preferences matter, they also stand to benefit from improved access to global markets– including the restrictive markets of other developing countries. Thus, preference erosion will be offset by the compensatory effect of broad-based multilateral liberalization. In addition, research suggests that what matters most in terms of reform by recipient countries is the pursuit of complementary reforms and public investments that enhance the productivity of firms and farmers (World Bank and IMF 2005). Finally, implementation and transition periods also matter, as do the depth and scope of global reforms. Erosion will take time –any MFN reforms will be implemented gradually over several years.

What follows discusses briefly some recent studies that quantify the potential income effects of preference erosion. It is helpful to start with an assessment of the value of the transfers being generated by preferential regimes.[6] The simplest measure of these transfers is the difference between the applied tariffs facing a country and the MFN tariffs that would apply on its exports in the absence of a preferential agreement. This measure is an upper bound on the transfers since many countries may receive preferences, implying that the true preference margins for a country should be adjusted for the preference margins being received by other countries (Low *et al.* 2005). Unfortunately, little analysis has been done on these "true" preference margins, forcing one to rely on the "non-adjusted" simple margin of preference as an indicator of the overall per unit value of preferences (table 1).

There are some important conceptual differences between the measures presented in table 1. Those calculated by Brenton and Ikezuki (2005) give the margin relative to the overall value of exports from the country to the granting market. By contrast, Low, Piermartini and Richtering (2005) refer to the margin only on those exports for which there is a non-zero duty and a positive apparent preference. Despite these methodological differences, table 1 suggests substantial

6. What follows draws on Hoekman, Martin and Primo Braga (2005).

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consistency between the alternative measures. The average margins generally tend to be higher in Europe relative to the other markets, while average preference margins are lower in Japan than in the EU or the US. There are surprisingly small gaps between the preference margins granted to LDCs and to developing countries as a whole (i.e., the GSP) in the EU, the US and Japan. In contrast, Canada and Australia appear to give substantially higher margins of preference to the LDCs, with the margin more than twice as high for LDCs as for developing countries as a whole. A similar result was found in the World Bank and IMF Global Monitoring Report (2005) using a measure of the overall tariff equivalent of the trade policies. The latter measure includes non-tariff measures such as health and safety standards (sanitary and phytosanitary measures) applied by the OECD countries –policies that are not affected by preference programs.[7]

A measure of the overall value of preferences corresponding with the preference margin numbers in table 1 can be obtained by multiplying the margins by the value of imports to which they apply. Table 2 reports such figures, using the Low, Piermartini and Richtering (2005) margins and

Table 1. Estimated Preference Margins for Developing Countries
(percentage points)

Granting Countries / Beneficiaries	EU	EU	US	US	Japan	Japan	Canada	Aust	Quad + Aust
LDCs	6.6[a]	4.1[d]	3.2[a]	2.6[d]	2.6[a]	10.9[d]	4.2[d]	3.6d	4.6[d]
Sub-Saharan Africa	4.0[b]		1.3[b]		0.1[b]				
African LDCs	2.3[b]		2.1[b]		0.4[b]				
LIX	3.8[c]		0.5[c]						
All	3.8[a]	3.4[d]	2.6[a]	2.6[d]	2.0[a]	3.4[d]	1.6[d]	1.5d	3.4[d]

Notes: Aust: Australia. LDCs refer to the UN list of Least Developed Countries. LIX refers to World Bank Low Income Countries excl. India. All refers to all potential recipients of GSP; Quad = Canada, EU, Japan and US.
Sources: a. Subramanian (2003, p.8); b. Brenton and Ikezuki (2005, p.27); c. van der Mensbrugghe (2005); d. Low, Piermartini and Richtering (2005).

7. Indeed, the analysis of overall OECD trade restrictiveness concludes that non-tariff measures account for over half of total trade restrictiveness, suggesting that this should be a much more prominent focal point for policy.

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Table 2. Estimated "Value" of Preferences to Developing Countries
(million US dollars)

	EU	US	Japan	Canada	Australia	Quad+
LDCs	287	131	49	14	0.4	587
All	4,945	3,953	743	215	46	11,565

associated trade numbers, as that study has both disaggregated and up-to-date estimates of the imports subject to preferential treatment.

Table 2 provides some perspectives on the source of potential gains from preferences. Of the total of 587 million US dollars, the estimated potential value of the preferences to LDCs, 287 million US dollars, or almost half, is provided by the EU. The US is the next largest provider, at 131 million US dollars per year. Japanese preferences amount to almost 50 million US dollars per year, while those of Canada and Australia are much smaller at 14 million US dollars and 0.4 million per year. The comparison of the preferences received by LDCs and other developing countries shows that the bulk of preferences accrue to non-LDCs, reflecting the small share of LDCs in total developing country exports.

Such simple trade value calculations provide little information on the impact of preference programs on economic variables such as real income or welfare. Focusing on the LDCs and using a global general equilibrium model and the latest version of the Global Trade Analysis Project (GTAP) database that incorporates data on the major OECD preference programs (Bouet *et al.* 2004), Francois, Hoekman and Manchin (2005) conclude that complete preference erosion due to MFN reforms in the EU –including in agriculture– would impose a welfare (real income) loss of some 460 million US dollars on African LDCs and an additional 100 million US dollars on Bangladesh. This assumes away the fact that compliance costs reduce the effective value of preferences for manufactured products. Limão and Olarreaga (2005) also undertake an analysis of the welfare effects of complete preference erosion. They calculate what the income transfer to LDCs would need to be so as to be

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equivalent to the transfer implied by existing preference programs. They conclude that for LDCs the figure is 266 million US dollars. This is a one-year, short-run effect –everything else remaining equal the net present value would be several times higher. This brings their results in line with those of Francois, Hoekman and Manchin (2005), although the results are not strictly comparable given that Limão and Olarreaga use partial equilibrium methods.

Using a variety of techniques, Grynberg and Silva (2004) estimate the losses in income transfers to producers in trade-preference-dependent economies at 1.7 billion US dollars annually. They argue that producers will require 14 to 20 years to adjust, implying a total net present value of losses ranging from 6 billion US dollars to 13.8 billion. An important feature of this analysis is that it includes the impact of abolishing quotas on exports of textiles and clothing. This accounts for 1.1 billion US dollars of the total 1.7 billion loss estimate. Van der Mensbrugghe (2005) concludes that existing preferences generate an additional 1.6 billion US dollars in income for low-income developing countries, as compared to a counter-factual MFN-only regime. Here also the inclusion of ATC quota rents accounts for a major portion of the benefits. In contrast, the erosion of ATC quota rents is included in the baseline scenario in Francois, Hoekman and Manchin (2005). Francois *et al.* note that if the ATC abolition is included, this would impose erosion costs on negatively affected developing countries that are some ten times larger than the potential overall erosion of remaining preferences under a Doha Round. The estimated losses reflect a combination of greater competition from China and loss of quota rents. To some extent this erosion has already been incurred, as liberalization of quotas started at the end of the Uruguay Round.[8]

If the analysis centers on preference erosion in the broader context of potential tariff reduction by all OECD countries –or all WTO members, including developing countries– the

8. ATC restrictions implicitly favored smaller, higher-cost developing country suppliers at the expense of exports from China. While implementation of the ATC was taking place, the major importing countries heavily back-loaded implementation, resulting in a much greater than necessary adjustment shock at the end of the 10-year transition period than was necessary.

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magnitude of the total erosion loss is generally reduced. This reflects the fact that the EU has been the most intensive user of preferences and that it is also the entity that has the most extensive trade-distorting policies in a key sector for poor countries: agriculture. Preference programs in other OECD countries have tended to be subject to more exceptions in terms of product coverage (an example is the non-inclusion of apparel in US GSP programs). Thus, the gains associated with MFN tariff reductions by non-EU OECD countries would partially offset losses due to MFN liberalization by the EU. In the case of Sub-Saharan Africa, Francois, Hoekman and Manchin (2005) conclude that overall losses could be reduced by a factor of four –to 110 million US dollars, with low-income countries in Asia standing to gain substantially.

If compliance costs are also considered in the analysis, the incidence and magnitude of preference erosion change further, as such costs vary across commodities. For Bangladesh, which is specialized in high tariff categories like clothing that are subject to restrictive rules of origin, the inclusion of compliance costs substantially reduces the magnitude of potential erosion. For some countries such as Madagascar, potential losses turn into potential gains, reflecting the substantial export capacity in apparel. For countries specialized in agriculture, however –Malawi and Zambia for example– the effects of accounting for compliance costs are much smaller as such costs are not a big issue for relatively unprocessed products (Stevens and Kennan 2004, Bouet *et al.* 2006, Candau *et al.* 2004).

Ignoring compliance costs and the incidence of the distribution of rents, estimates of total preference erosion losses for low-income countries therefore are in the range of 500 US dollars –1.7 billion US dollars, with much depending on whether the ATC is included in the analysis or not.[9] Estimates of preference erosion from even an ambitious Doha Round tend to be less than the erosion that is associated with elimination of textile and clothing quotas on developing

9. Figures are higher if the focus extends to middle income countries, some of which –e.g., Mexico– stand to suffer potentially substantial losses as preferential access to the US and Canada is eroded. The focus in this paper is primarily on low-income, weak and vulnerable economies.

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country exports. For example, Francois, Spinanger and Woertz (2005) find that the removal of ATC textile restrictions is detrimental for sub-Saharan Africa, although the impact is smaller than for Asian countries such as India and Vietnam. However, the ATC-induced negative impact on Africa is smaller than the estimates of the potential magnitude of Doha Round preference erosion found by Francois, Hoekman and Manchin (2005) if no account is taken of compliance costs. If such costs are considered –which they estimate to average 4 percent– the potential Doha trade preference losses are smaller than those associated with lifting of ATC textile and clothing quotas. One reason is that the rents associated with the latter were equivalent to tariffs well above any realistic threshold value of compliance costs.

A key conclusion that emerges from the literature is that future losses will largely be due to the elimination of rents that were created by quota-determined access to specific markets (sugar, bananas). The magnitude of the transfers associated with these products for preferred countries is a multiple of the value of preferences on other goods for most countries. The quota-driven benefits to those countries that get them are essentially equivalent to a financial transfer –there are no export diversification effects associated with these preferences.

Possible Policy Responses

Taking into account supply capacity constraints, the costs of satisfying documentary requirements, and the fact that rents will be shared with intermediaries in the importing country, recent studies conclude that the aggregate (net) magnitude of erosion for poor countries will be limited. However, the stand-alone impact of the removal of preferential access to the most distorted markets (mostly those in the EU) will be significant for a relatively small number of countries. This then raises the policy question of whether the focus should be on the overall economic net effects taking into account possible (feasible) policy responses, or whether the focus should be on the loss incurred in those markets where preferences matter, ignoring any possible offsetting effects. From a narrow 'compensation' perspective the second

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focal point is arguably the more appropriate metric of the magnitude of erosion of benefits that stem from removal of a specific policy put in place by OECD countries. The work summarized briefly above suggests that the magnitude of losses to LDCs is in the order of 600 million US dollars, with perhaps a similar amount for preference-dependent middle-income countries.

Abstracting from the important issue of how to determine the amounts involved –a question that clearly must be negotiated[10] –various approaches can be identified for responding to preference erosion losses. One is to seek compensation *within* the trade negotiating agenda or trade regime– i.e. negotiate measures that will improve market access and the terms of trade of the countries affected by preference erosion. Another is to address this matter *outside* the WTO and to rely on non-trade instruments.

"Within" solutions

Possible solutions within the ambit of the trade regime include non-liberalization of products that are of greatest value from a preference point of view. While no doubt an approach that will resonate with the vested interests in the OECD that are seeking to maintain the status quo, clearly this would impose a significant opportunity cost from a global efficiency perspective –essentially reducing the potential global gains from a Doha Round substantially. Other options "within" the trading system are to expand preferential access to major emerging markets, to reduce the costs of rules of origin –through harmonization towards the most liberal common denominator (Commission for Africa 2005) – or to provide discriminatory access in other areas– e.g., better access for service suppliers through mode 4 under the General Agreement on Trade and Services (GATS). The latter is already occurring on a bilateral basis, outside the WTO, as reflected in special arrangements or relationships between OECD members and specific developing countries.

10. Hoekman and Prowse (2005) discuss several options that could be used as the basis for quantification of erosion.

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Arguably, efforts to move down such discriminatory paths in the WTO are not desirable, the exception being an immediate and substantial simplification and liberalization of rules of origin.[11] A major rationale for seeking to shift away from using preferential trade as a form of aid is that it undermines the fundamental principle of non-discrimination as well as creates incentives to impede MFN liberalization.[12] Of course, non-discriminatory solutions could also be pursued within the trading system. An example would be to target MFN liberalization on goods and services that developing countries have a comparative advantage in. Another is to ensure that MFN liberalization proceeds gradually to allow for adjustment to occur over a number of years. Yet another would be to rewrite rules so that they benefit poor countries more, even if it comes at the expense of rich country interests. Much of what is discussed in the WTO under the heading of "special and differential treatment" and in relation to implementation of negotiated commitments revolves around perceptions that the existing rules are not fully supportive of development prospects. As discussed later in this paper, a willingness to address these concerns could help to offset preference erosion losses. While this would be beneficial –and indeed desirable in its own right to make the WTO more "development friendly"– it is not easy to identify trade-based solutions that are consistent with the MFN principle while appropriately targeting those countries that are most affected by the preference erosion. Solutions within the trade area therefore will generally have to be premised on continued acceptance by WTO members of discrimination across trading partners.

The adoption by all OECD countries as well as larger emerging markets of an analogue to the EU's "Everything but Arms" (EBA) initiative to grant duty and quota free access to

11. This would be of transitional value to beneficiaries, and could for a period of time act to maintain *effective* preference margins insofar as the relaxation of rules of origin lowers the threshold under which it is too costly to comply with origin requirements thereby offsetting the reduction in MFN tariffs that are agreed in the Doha Round. However, as MFN rates fall to zero, rules of origin will become irrelevant. In the WTO negotiations agreement on relaxed rules of origin could be sought through the WTO rules group (as part of a revision of Article 24) or the special session of the Committee on Trade and Development (as part of the talks on SDT).
12. See Limão (2005) for some recent empirical evidence for such a stumbling block effect.

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all goods exported from all LDCs illustrates this. It is a "within-trade" solution that has been put forward by a number of WTO members and has been endorsed by the international community as a target to be achieved in the pursuit of the Millennium Development Goals. While it would be of some value to the LDCs, many of the poorest countries today have not managed to diversify and expand exports *with* the preferences they already receive as a result of supply capacity or competitiveness constraints. This suggests that granting preferences in additional markets for the poorest countries is unlikely to yield much benefit. Moreover, such an expansion will not do much to offset the loss in rents associated with the quota-guaranteed access to highly distorted EU markets for products such as sugar and bananas, as emerging markets do not maintain such programs.[13]

Solutions "outside" the trading system

The major alternative solution to erosion is to use a non-trade instrument –financial transfers, i.e. development assistance. One reason for pursuing this avenue is that the research summarized above finds that in monetary terms the primary negative impact of erosion follows from the removal of specific trade barriers in specific OECD countries. That is, the erosion problem is primarily a bilateral issue that should therefore be resolved on a bilateral basis, in the sense that those imposing the costs should bear the burden of offsetting them.

A number of initiatives have been taken in recent years to assist countries to better exploit trade opportunities and deal with adjustment pressures. These include the Integrated Framework for Trade-Related Assistance (IF) and the IMF's Trade-Integration Mechanism (TIM). In addition to these trade-specific initiatives, multilateral development banks support trade-related investments and provide technical assistance when requested by client governments. While such

13. As mentioned previously, if the country reach of preferential access programs is expanded, it is important that they be associated with simple, liberal rules of origin. Here again, however, it should be borne in mind that these are only important for processed goods –not the commodities that many LDCs export.

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assistance has been expanding in both absolute and relative terms –see World Bank and IMF (2005)– these institutions do not provide earmarked funding for trade adjustment purposes.

The one exception is the TIM. It was developed to help countries expecting short-tem balance of payments difficulties in coping with the effects of multilateral liberalization (IMF 2004). The TIM is intended to address not only preference erosion but also covers balance of payments shortfalls as a result of removal of apparel export quotas under the ATC and the possible impact on net food importing developing countries of higher food import prices following agricultural policy reforms in OECD countries. The TIM is not a new facility but operates through existing IMF instruments. This ensures that the impact of possible adjustment costs resulting from specific shocks such as preference erosion is considered and placed in the context of a country's overall macroeconomic policy framework. The usual IMF policy conditionality and terms and costs of lending apply. Therefore the impact of assistance on a country's external debt burden would need to be taken into account.

The IF focuses much more on the "structural" agenda as opposed to dealing with short-term macroeconomic impacts of external shocks. Limited to the LDCs, the IF brings together the six key multilateral agencies working on trade development issues –the IMF, the International Trade Centre, UNCTAD, the UN Development Programme, WTO and the World Bank– and seventeen bilateral donors (including Canada, the EU, Japan and the US). The basic purpose is to embed a trade agenda into a country's overall development strategy, usually the Poverty Reduction Strategy Paper (PRSP). The process starts with a diagnostic analysis. This assessment looks at a number of issues, including the complementary policy agenda necessary to support successful trade reform, and generates a proposed action matrix of trade-related capacity building and assistance needs. Funding for the trade capacity building priorities is sought through the Consultative Group and Round Table meetings associated with the PRSP process where donors (both multilateral and bilateral) are asked to make financing pledges for specific projects/

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programs. Given that trade-related priorities must compete with other priority sectors, financing is not ensured.

These existing mechanisms do not directly address the concerns of developing countries regarding preference erosion. The TIM involves loans, and implies therefore that the costs of adjustment to erosion will be borne by the countries that lose preferential access to markets. Moreover, the focus is on the short term macroeconomic effects –that is the *net* effects taking into account all policy changes and responses, not just the removal of preferential access. Thus, there is no element of "offsetting" the losses incurred– the bilateral nature of the problem is ignored. The IF focuses purely on the national trade-related agenda of LDCs, whatever the underlying causes.

The most direct and simplest solution to erosion concerns would be for donor countries to agree to directly transfer resources to address preference erosion losses incurred as a result of MFN trade reforms (Page 2004, Page and Kleen 2005). The rationale for doing so is that this would help realize the potential global efficiency and welfare gains associated with an ambitious Doha Round outcome by offsetting the associated impact losses for developing countries. Page and Kleen (2005) argue that as global liberalization is a public good, it would be incorrect to consider the compensation as aid. They therefore propose that a compensation fund be housed at the WTO and not with development institutions. How donor countries would provide resources would be a matter of "choice", although the level of contributions would be determined by various criteria (for example share of trade, income, past commitments and use of preferences). Given that the funds would be regarded as compensation for the removal of a prior benefit, funding should be allocated without conditions to beneficiary countries according to the estimation of loss of preferences. The fund would need to be secure, leading Page and Kleen to argue that voluntary commitments need to be made "legally irrevocable" i.e. constitute a binding (WTO) commitment.

Grynberg and Silva (2004) have made a similar proposal. They suggest the establishment of a Special Fund for Diversification (SFfD) to mitigate the impact of the erosion of

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preferences due to MFN liberalization. A distinct feature of this proposal is that financing (from pooled donor funds) "commensurate with preference losses" would be provided for private sector-led export diversification investments. A share of SFfD funds would be set aside for a private sector window to facilitate investment start-up expansion by small and medium-sized enterprises (SMEs), restructuring or rehabilitation in non-traditional sectors. Remaining funds would be provided for a public sector window for enabling infrastructure investments, as well as for optional technical assistance and social safety net windows. The emphasis on the private sector as a recipient of preference loss compensation funds would go some way to addressing a specific aspect of preference programs –that they directly benefit exporters. Under their proposal this constituency would have the prospect of some direct compensation.

Another option has been suggested by the UN Millennium Taskforce on Trade (2005), which argues that one element of a solution could involve income support programs for farmers and producers of specific goods that have benefited from high rates of protection. While such programs are targeted at the *domestic* producers of preference granting countries, and are intended to be a vehicle to facilitate a shift away from production support, negatively affected producers in developing countries that benefited from preferential access could also be assisted by including them in the support program. Elements of this approach could be extended to other highly distorted markets where preferences matter and where producers will confront adjustment costs as market price supports are lowered. There is an obvious political economy rationale for such programs, and extending support to affected producers in developing countries would also take seriously the arguments made by groups in OECD countries that continued preferences (and thus market price support) are needed to assist producers in developing countries.[14]

14. A small step in this direction was taken by the EU in its most recent reform of its sugar regime, under which ACP producers were allocated €40 million in income transfers. This compares to 1.5 billion euros in compensation payments to EU producers.

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All of these types of programs raise concerns in that those who have benefited the most from preferences are not necessarily the poorest or most vulnerable. Indeed, by definition assistance will be granted to those who have been most able to benefit from preferences. Within recipient countries, some of these beneficiaries will be located among the higher income groups in society, raising equity considerations. In addition, the suggestions for a dedicated preference erosion compensation mechanism of some kind go against principles of aid effectiveness and enhancement of international policy coherence (IMF and World Bank 2004). Approaches along these lines were explicitly rejected in IMF and World Bank (2005), a paper discussed at the 2005 annual meetings of the governors of these institutions. The view taken there was that existing mechanisms should be used to address the adjustment costs of erosion, on the basis of a case-by-case assessment.

As a development tool, stand-alone specific funds and associated mechanisms are unlikely to find widespread support among donors and development institutions if they are not integrated into national poverty reduction and development strategies. This suggests funding for aiding adjustment and for enhancing competitiveness should be provided within the context of an overall country development program –as is the case under the IF (for the LDCs). However, from a trading system (and Doha negotiation) perspective, a counter-argument is that if concerns about the erosion of trade preferences are not addressed explicitly and credibly, non-discriminatory trade liberalization by WTO members may become less feasible and be less deep than it otherwise might be and/or that "solutions" will be sought elsewhere within the trading system. Thus, there may be a significant opportunity cost associated with not dealing with this issue up front. Given that global liberalization has some of the characteristics of a global public good –everyone benefits in the medium term from the increase in efficiency that results from the removal of global distortions in prices– there is a case for taking action to achieve this outcome.

Zedillo *et al.* (2005) suggest that the aforementioned considerations justify transfers from preference-giving

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countries/trading blocs to each recipient that are equivalent to the assessed value of their current preference programs. Specifically, a binding commitment could be sought through which preference-giving countries/trading blocs accept to transfer the assessed value of current preference programs in the form of financial aid. This implies that assistance would be specific for each beneficiary country. Although such earmarking is generally not regarded as good aid policy, the global public good dimension of deep global reforms provides a justification in the case of preference erosion.

If such an approach is pursued, an alternative to establishing a separate fund and a parallel institutional structure would be to disburse commitments for each beneficiary country through the existing mechanisms under which aid is allocated, on the basis of a framework that places trade needs within a country's overall development program. In the case of ACP countries the possibility exists of integrating the required compensation from the EU –which the research suggests will account for a large share of total potential erosion– into negotiations on the magnitude and structure of the 10th EDF (European Development Fund)– which is to cover the post 2007 period. In terms of quantifying the value of preferences, there is a (political economy) case that the transfers should be the equivalent of the bilateral "partial equilibrium" value of preferences received, that is, to ignore the general equilibrium effects of other policy changes in other countries or the country itself (Hoekman and Prowse 2005).

Whether there should be stand-alone funding mechanisms to address specific areas of concern is a question that extends beyond preference erosion. Another example is trade facilitation –a negotiating area where an explicit link has already been established in the Doha Round between implementation of new commitments by developing countries and the provision of financial and technical assistance. The latter could also be addressed via an expanded IF-type mechanism as long as this is extended to go beyond the LDCs, but specific funds may address the technical issues concerned in a more timely manner, as well as be more effective or credible in addressing political and negotiating concerns.

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It is important to recognize that industries and households around the developing world have to manage adjustment costs as a result of both policy decisions and changes in tastes and technologies. The associated shocks either could or will be of greater magnitude than erosion. Adjustment to MFN liberalization will affect many countries, not just those that have benefited from preferences. The need to diversify is not unique to economies that have benefited from preferences but is common to numerous countries. Moreover, compensation will do little for those countries that have not been able to benefit from preferences. Any bilateral compensation will by necessity target only those countries that have successfully exploited preferential access opportunities. This last point suggests that whatever may be decided on compensation for preference erosion, countries that have proved unable to benefit much from such programs –which include many of the poorest countries– should be assisted through expanded aid for trade. The assistance needs of these countries in the trade area clearly are much greater than any estimate of the value of current preferences.

Aid for Trade and Complementary Policies

The diversification and development of exports was the primary motivation for preferences. Many countries in the past have benefited from preferential access and have graduated from bilateral programs, and others continue to benefit. But many of the poorest countries have not managed to use preferences to diversify and expand exports. Given the systemic downsides, limited benefits, and historical inability of many poor countries in Africa and elsewhere to use preferences, a decision to shift away from preferential trade as a form of aid towards more efficient and effective instruments to support poor countries could both improve development outcomes and help strengthen the multilateral trading system. Tariffs are just a part of the overall set of factors constraining developing country exports –other variables include transport costs and non-tariff measures that are often more costly per unit of output than those confronting firms located in more developed countries. The same is true with respect to internal

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transactions and operating costs in these countries, which reduce competitiveness of firms. With or without preferences, benefiting more from integration into the trading system requires instruments aimed at improving the productivity and competitiveness of firms and farmers in the poorest countries. Supply constraints are the primary factors that have constrained the ability of many African countries to benefit from preferences.[15] This suggests that one need is to improve trade capacity and facilitate diversification. In part this can be pursued through a shift to more, and more effective, development assistance that targets domestic supply constraints as well as measures to reduce the costs of entering foreign markets.

A Doha reform package can be expected to generate sizeable gains to both industrialized and developing countries. The overall magnitude of such gains is difficult to assess accurately –much depends on what is agreed and how it is implemented, and how much of the gains are transferred to compensate domestic losers through expanded income support, for example. However, even under the most conservative estimates, the aggregate global gains will be significant. In absolute terms, high-income countries will gain more than developing countries, providing the means to engage in increased support and development assistance. What is important is recognition of need (additional resources for trade adjustment and integration) against the potential global benefits arising from further multilateral liberalization.

In undertaking trade reform and to participate effectively in the global trading system, poorer countries are faced with a gamut of economic and political concerns. On the economic side, adjustment costs will arise before offsetting investments are realized in other (new) sectors. Preference erosion is just one element of these costs. Some countries may confront deterioration in their terms of trade (e.g. some net food importers). Countries where tariff revenues make up a significant proportion of total fiscal resources will need to

15. See, for example, Commission for Africa (2005), Page (2004), and Stevens and Kennan (2004).

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undertake tax reform. Adjustment costs are a function of policy changes –as mentioned previously, those associated with preference erosion will be gradual and tariffs are just one of the hurdles facing exporters. A fundamental issue is that many of the poorest developing countries are ill equipped to take full advantage of new and existing trade opportunities due to supply side, administrative capacity and institutional constraints. Improved market access without the ability to supply export markets competitively is not much use. Gains from trade liberalization are conditional on an environment that allows the mobility of labor and capital to occur, that facilitates investment in new sectors of activity –requiring, among other factors, an efficient financial system, and good transportation/logistics services. Inevitably for most poor countries this requires complementary reforms prior to and in conjunction with the trade reforms.

On the political side, even accepting that trade is likely to generate global gains, the distributive and re-distributive dimensions of trade integration need to be taken into account if the political viability of the process is to be assured. Providing sizeable assistance has historically been of considerable importance in helping persuade countries of the benefits of integration. It played a significant role in building support for the liberalization measures undertaken as part of the creation of the European Economic Community. The post-war Marshall Plan was instigated in large measure to facilitate global economic recovery by, among other things, neutralizing the forces moving Western Europe away from multilateral trade.

Recognizing the importance of complementary policy actions and the need for support for adjustment and integration to achieve successful trade reform in low-income economies does not imply that the Doha Round should be any less ambitious or deliberately slowed. The reverse is true. Moving ahead multilaterally on a non-discriminatory basis will do most to help development. Trade reform undertaken in conjunction with concomitant "behind the border" policy measures and investments has significant potential to generate additional trade opportunities that would help lift a large number of people out of poverty (UN, 2004; World Bank and

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IMF, 2005). But it should be complemented by actions to redistribute some of the global gains to help address trade and growth agendas in the poorest countries and make these more of a priority in aid programs –in the process helping to attain the original objective motivating preferential access regimes.

G8 countries have committed themselves to provide additional aid for trade. The issue now is to determine how such an expansion of resources will be managed and assistance delivered. At the September 2005 IMF/World Bank annual meetings, agreement was reached on expanding the Integrated Framework for Trade-Related Technical Assistance by providing it with additional resources to undertake analyses of trade needs and to ensure that these trade needs be considered by governments and donors through existing development assistance mechanisms –the PRSP and consultative groups/donor roundtables. There was also agreement to consider extending the approach to span additional countries and an acknowledgment of the need to consider whether there should be a mechanism to address regional integration-related needs, not just country-specific actions.

There are several important open questions here that need to be considered:

– How to expand the IF approach to non-LDCs? There is a general recognition that aid for trade must go beyond the LDCs. In the case of the Economic Community of West African States (ECOWAS), for example, there are several non-LDC members –it makes no sense for these to be excluded. Whether the IF is the right instrument must be determined by WTO members given that the IF is a "WTO instrument" (it was set up by WTO members, and targets the only general sub-grouping of developing countries that is defined in the WTO –the LDCs). In practice a similar, parallel mechanism for non-LDCs may be the most logical way forward.

– Related to this is whether there should be a mechanism to address regional integration priorities. This is an important issue in many regions given that such integration has become a trade policy objective of many countries. Should this be made a part of an expanded IF –through the creation of regional window? Or is it more appropriate to develop stand-alone

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regional funds managed by the relevant regional bodies, in the process making it easier to extend aid for trade to non-LDCs?

– Finally, the issue of whether there should be greater dedicated grant based funding for trade needs –to ensure that trade priorities will be financed on a timely basis. That is, should the process continue to rely on existing mechanisms (the Consultative Group/Roundtable donor process and multilateral lending)?

Addressing such questions must be pursued in parallel with the Doha negotiations, so that by the time the round is concluded there are effective mechanisms in place through which additional resources are made available to developing countries to help them implement their trade strategies and benefit from trade opportunities.

WTO Rules and Procedures: Towards Helping to Meet Development Goals

Although it was argued above that seeking to address preference erosion costs within the WTO system is not desirable, there are actions that could be taken to enhance the development relevance of WTO rules. One of the important questions facing policymakers in the Doha Round concerns the circumstances, if any, under which developing countries should be allowed to use trade policies to pursue development (for example by using import barriers to protect domestic industries). While the basic trade policy rules of the WTO arguably make good sense for all countries, high-income and developing alike, these rules ignore the fact that governments may be forced to use trade policy because more efficient instruments are not available (for example, a country's weak tax base may preclude the government from using subsidies). Compliance with basic WTO rules is also more costly for low-income than for high-income WTO members, insofar as the negotiated rules reflect the status quo prevailing in industrialized countries.

Providing exemptions for the use of trade policies by developing countries –the traditional WTO approach and the focus of much of the Doha negotiations on special and differential treatment– is not the best way to help achieve

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development objectives. Instead of focusing exclusively on exemptions to allow the use of trade policy instruments, the trading system can be made more supportive of development by the provision of independent monitoring of the development impact of trade and trade-related policies, together with the proposed aid-for-trade integration mechanism. What is needed is to more actively assist developing countries attain their trade-related objectives, and to move away from the exclusive reliance upon negotiating exceptions and exemptions for developing countries.

This could be achieved by creating a mechanism in the WTO that focuses on a country's trade agenda and priorities and establishes linkages between these to the enhanced aid-for-trade integration program noted above. The objective would be to reduce governments' perceived need to use costly trade policy tools, to place the implementation of WTO disciplines in a national context and to monitor the effects of trade and related policies. Different, complementary options might be considered to put this idea into practice. A partial solution is to build on the agreement that was reached in the area of trade facilitation, with implementation (enforcement) of negotiated disciplines being conditional on adequate assistance being given by industrialized countries to developing countries. More ambitious is to establish a multilateral mechanism to help developing countries to pursue national objectives through instruments that do not distort trade. One specific proposal that would do this would be for WTO members to agree to a set of "core" disciplines that apply to *all* members, and to allow developing countries to invoke a "development defense" in disputes alleging violation of non-core rules (Hoekman 2005a). Agreement to consider options that would move in this direction is one way in which the WTO can help achieve the goal of greater policy coherence for development.

Such a general mechanism could complement specific rule changes of the type being sought by developing countries in negotiations on WTO rules and special and differential treatment (SDT). Unfortunately, to date many if not most of the proposals put forward by developing countries will arguably do little to promote development prospects as they

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will not go far in addressing binding trade constraints. This is not to say specific rule changes cannot be identified that would make a difference. Two examples of direct relevance to the preference erosion issue are rules of origin and the rules on regional integration. On the first, as already mentioned, there is a case for substantial relaxation of such rules to allow goods to benefit from existing preference programs as long as a minimal amount of labor value has been added. Current rules of origin for processed goods tend to require excessive local content in terms of intermediates, or else require that such inputs be sourced from the country granting the preference. This works against the exploitation of comparative advantage and the need to specialize in narrow parts of the value chain –a key feature of the current pattern of trade (for example, global production sharing) that has emerged over the last 20 years. The experience with AGOA for those countries benefiting from relaxed rules of origin has illustrated that such rules can be a binding constraint on the development and expansion of manufactured exports.

The second example concerns the design/requirements for North-South regional integration. Here a rule change that would require Southern members of such agreements to pursue MFN liberalization but not move to free trade would be beneficial (Hoekman, 2005b). This is preferable to complete preferential (discriminatory) liberalization by avoiding trade diversion costs while also attenuating the fiscal impacts –giving more time to put in place alternative tax collection mechanisms. To my knowledge neither proposal is being actively considered in the Doha talks, illustrating the importance of moving towards an approach that allows for greater case-by-case policy flexibility when it comes to WTO rules– in practice, the challenge for developing countries of identifying ex ante what types of rules or exemptions to rules are beneficial is significant.

Concluding Remarks

Preference erosion is a significant economic issue for a relatively small number of developing countries. It is also a bilateral issue, suggesting that the countries and trading blocs

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that reduce the value of past preferential access commitments should use transfers to offset losses that will be incurred by the affected countries. Such compensation for losses should take place outside the WTO so as to help make the trading system less distorted. Avoiding additional new preferences and distortions in the trading system is a compelling reason to address preference erosion explicitly and separately. This will not imply the end of discrimination –many low-income countries will benefit from continued assistance to achieve export development and diversification objectives. The view taken in this paper is that the key objective should be to reduce the use of trade-distorting policy instruments, to promote MFN-based global trade reform and to accept that discriminatory trade policy should not be used as a form of aid. Instead, the emphasis should shift to other mechanisms, including financial assistance to target more directly the factors that constrain trade capacity, and a greater willingness to consider the reasons why developing country governments may use second-best (trade) policies.

Binding commitments could be sought –as part of a Doha Round agreement– to assess the magnitude of preference erosion and to transfer equivalent financial resources to the affected countries. Whether it is desirable to create a stand-alone fund to compensate for erosion of preferences –whether inside or outside the WTO– or instead integrate such funding into the broader "aid for trade" effort is something that must be determined by WTO members. A good case can be made from an aid effectiveness perspective that the associated resources should be allocated through existing mechanisms that have been established to provide funds for trade-related priorities identified by developing countries, with the ultimate uses of the funds determined by the governments concerned, based on a policy agenda for trade and growth that is consistent with a country's development strategy (Hoekman and Prowse 2005). This does not preclude country-specific transfers that are motivated on the basis of erosion losses.

To deal with the adjustment costs associated with erosion losses each country needs to make its own trade reforms and complementary investments and measures to reduce

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transactions costs, improve the investment climate, and enhance productivity and competitiveness of farmers and firms. But more assistance is needed more generally to bolster the capacity to exploit trade opportunities. In the process, those countries that have proven unable to benefit from existing or past programs could be assisted in attaining the original objective of trade preference programs –export development and diversification. A broader "aid for trade" effort would allow the objectives of preferences to be pursued more effectively and across a broader group of countries– by recognizing that market access is not the main variable constraining export growth in many developing economies. Dealing with the supply side constraints will require not just financial resources but also the adoption of policies that address specific government and market failures that prevent a supply response from emerging. As argued in the recent literature, although the case for trade policies in this context is very weak, the types of domestic policies might be most appropriate and effective may not be obvious, suggesting that experimentation and learning should be encouraged (Rodrik, 2004). This suggests there is a link between the aid for trade agenda and the issues of "policy flexibility" and "special and differential treatment" in the WTO (and regional) trade agreements. Given the presumption that trade policy cannot do much to address the sources of market and government failure that impede supply responses, international cooperation in the form of trade agreements, for example, can help by creating institutional mechanisms to help identify policies that are effective and efficient in attaining specific goals set by governments, and by increasing the transparency of policies and their effects through multilateral monitoring.

(Revised January 2006)

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Chapter 5

Preference Erosion and Multilateral Liberalization: The Case for Scaling Up Aid for Trade

SERGE PERRIN[1]

In the run-up to the 6th WTO Ministerial Conference in Hong Kong, a number of proposals in support of Aid for Trade have been made (Hoekman and Prowse 2005; Prowse 2005; Oxfam 2005; Phillips, Page and Velde 2005). In the words of the WTO Director-General, Pascal Lamy, an ambitious market access package in the Doha Development Agenda (DDA) will need to be accompanied by Aid for Trade (AfT) to address structural problems that many developing countries confront, i.e. "insufficient human, institutional and infrastructural capacity to participate effectively in international trade and expand the quantity and quality of goods and services that they can supply to world markets at competitive prices."[2] Peter Mandelson, the EU Trade Commissioner, also declared that "Aid for Trade must be both an important element of the

1. Economist, Agence Française de Développement, Paris (France).
2. *Aid-for-Trade: helping developing countries benefit from new trading opportunities*, by Pascal Lamy, DACNews Nov-Dec 2005.

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'Development Package' for this Ministerial and a vital complement to the ongoing negotiations in the DDA."[3] Even if multilateral trade liberalization has the potential to generate significant global gains in the long run, larger than total aid flows,[4] some countries –including many of the least developed countries (LDCs)– may stand to lose or face difficulties in the adjustment process. This explains the widespread agreement that more and better Aid for Trade is necessary to help ensure that the more vulnerable countries are also able to benefit from this "Development Round".

What is the scope of Aid for Trade? In practice, AfT covers five main activities (Nielson, 2005): technical assistance, capacity building, institutional reform, infrastructure, and assistance with adjustment costs. This agenda is not really new, although it has expanded from the initial focus on trade policy-making, participation in WTO negotiations and implementation of WTO agreements, to encompass trade adjustment assistance –notably for countries facing preference erosion as a result of most-favored nation (MFN) tariff reductions[5]– and to address supply-side constraints. What is new is the push in favor of scaling up Aid for Trade and making it more effective. Given the need to enhance the negotiating dynamics of the Doha Round, there is a political economy motivation for designing credible responses to meet the most vulnerable countries' concerns on the implications of MFN liberalization, without which they may have little incentive to subscribe to the current round. Also, the projected scaling-up of Official Development Assistance (ODA), from 80 billion US dollars in 2004 to 130 billion US dollars in 2010, provides a window of opportunity for increasing trade-related assistance. According to OECD/WTO estimates, the total volume of aid for trade-related technical assistance and capacity building has increased steadily since the launch of the Doha Round in 2001 to reach 3 billion US dollars in 2004.

3. *Aid for Trade : Remarks by Commissioner Mandelson at the IMF/World Bank Panel Discussion*, Hong Kong, 13 December 2005.
4. For a recent discussion on global trade liberalization estimates, see Elliot (2005).
5. Other trade adjustment concerns are related to the risks of adverse changes in the terms of trade of net food importers as agricultural subsidies are cut, and tariff revenue losses.

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The purpose of this paper is to address the two main sets of concerns which motivate a substantive Aid for Trade package. First, we examine the economic justification behind the call for adequate short-term assistance to help countries facing trade adjustment. The focus is on preference erosion, perceived by some WTO observers as a potential obstacle to completing the Doha Round, as beneficiaries of trade preferences have an incentive to resist reductions in MFN tariffs. Beyond the debate on the "size of the problem", which turns out to be relatively small on a global scale, we argue that more attention should be paid to country-level impacts and at assessing the extent of adjustment costs, which is a far more complex agenda on which little has been done so far. Second, the AfT agenda calls for more long-term steps to alleviate supply-side constraints and strengthening developing countries' trade capacity. What has been the experience of trade-related technical assistance and capacity building programs? Did existing mechanisms, such as the Integrated Framework for Trade-Related Technical Assistance (IF), effectively deliver trade capacity building efforts, and manage to better integrate trade policy into the development agenda ? Since the proposal of an 'enhanced' Integrated Framework is the main pillar of the new AfT initiative, it is important to assess the strengths and weaknesses of this channel. Much remains to be done to improve what is often perceived as a donor-driven agenda, and to respect the principles of aid effectiveness –i.e., ownership, alignment, harmonization, and managing for results–, as adopted in the Paris Declaration in 2005.

Preference Erosion and the Challenge of Trade Adjustment

Recent studies on preference erosion attempt to identify which countries and sectors will be most hit and how large the potential shock would be. Unlike commodity shocks, losses from preference erosion are permanent, they can be anticipated *ex ante*, and they are likely to be spread out over time (IMF 2003). These quantified assessments give an useful indication of the magnitude of the problem, and contribute to the debate on whether there should be or not a dedicated Aid

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for Trade fund to support developing countries (DCs) facing the implications of multilateral trade liberalization.

Assessing the impact of preference erosion

There is much debate on the value of trade preferences granted by rich countries to exporting developing countries. Numbers vary greatly across preference regimes and depend notably on whether actual utilization is factored into the calculation. However all estimates agree that preferences are heavily concentrated in a small number of countries and sectors. In sub-Saharan Africa for example, 60 percent of the benefits under the EU schemes accrue to only five countries and the top sector represents one-third of the total value of preferences (Brenton and Ikezuki 2005). For the US, the top five beneficiaries account for nearly three-quarters of the value of preferences. There are five countries –Lesotho, Malawi, Mauritius, Seychelles, Swaziland– for which the combined value of preferences in the EU, Japan and US is greater than 10 percent of their total exports.[6]

Considering that the EU has the widest range of trade agreements among the Quad and given its importance for DC exports –the EU absorbed 63 percent of LDC exports to the Quad in 2003 and nearly 70 percent of their agricultural exports–, it is interesting to more specifically attempt to quantify the value of EU trade preferences. Assuming full utilization, Candau and Jean (2005) estimate that tariff preferences offered by the EU amount to 182 million euros for sub-Saharan African LDCs, 521 million euros for non-LDCs in SSA and 510 million euros for other LDCs (table 1). This represents a sizeable share –around 10 percent– of their dutiable exports to the EU. Accounting for under-utilization does not change the results much, except for non-African LDCs. This analysis suggests that EU preferences were fairly well utilized, particularly in sub-Saharan Africa, and is consistent with the conclusion that EU preferences have had a

6. For another eight countries (Gambia, Guinea Biss., Kenya, Madagascar, Mozambique, Namibia, Senegal, Zimbabwe), the value of preferences is also quite significant (greater than 5 percent and less than 10 percent).

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significant positive impact on a relatively small number of African countries that were able to export preferred products (Stevens and Kennan 2004). However the "Everything but Arms" (EBA) initiative appears to have been under-utilized, given the constraints imposed by rules of origin on textile and clothing exports by South-Asian LDCs.

The threat of preference erosion should therefore not be underestimated. Bouët, Fontagné and Jean (2005) calculate that the "true" preferential margin –i.e., the difference between one country's and the world's average preferential margin– in agriculture is above 1 percentage point for 47 DCs and above 2 points for 33 countries. Lesotho has the highest true preferential margin (25 percent), pointing to a strong specialization in highly protected products. Tariff rate quota rents, notably for most sensitive products, can also be quite substantial: 14 sub-Saharan and Caribbean countries earned such rents amounting to more than 0.5 percent of their GDP in 2001, with Guyana, Fiji and Mauritius figuring among the top three recipients.

In complement to the controversial debate on the "true" value of preferences, a number of recent studies have attempted to estimate the potential costs of preference erosion. The IMF evaluated the overall impact on LDC exports from preference erosion arising from MFN tariff reductions by the Quad countries, using a partial equilibrium model (IMF 2003).

Table 1. The Average Value of EU's Trade Preferences by Group of Partners

	Value in M euros		As a % of country's dutiable exports to the EU		As a % of country's total exports	
Group of partners	Assuming full utilization	Accounting for under-utilization	Assuming full utilization	Accounting for under-utilization	Assuming full utilization	Accounting for under-utilization
SSA LDC	182	168	8.9	8.2	0.7	0.6
SSA non LDC	521	491	13.2	12.4	0.9	0.9
Other LDC	510	251	12.1	6.0	2.3	1.1
GSP PRE	1,646	1,422	6.7	5.8	0.2	0.2
GSP non PRE	1,828	1,285	1.9	1.3	0.1	0.1
Non GSP PRE	7,747	6,604	5.2	4.5	1.0	0.8

Note: "GSP PRE" include countries benefiting from both the GSP and a preferential agreement (except those in the categories above).
Source: Candau and Jean (2005).

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The scenario assumes a 40 percent cut in preferences, homogeneous products and constant world market prices. It finds that the potential aggregate loss is small, around 1.7 percent of total LDC exports. However, some countries will face more significant losses due to the concentration of their exports in products that enjoy deep preferences. Of these, Malawi, Mauritania, Haiti, Cape Verde and Sao Tome and Principe are found to be the most vulnerable to preference erosion (see table 5). The estimated loss for Malawi would amount to 11.5 percent of total exports, and between 5 and 9 percent for the next four countries. The losses for countries such as Cambodia, Madagascar and Senegal would be around 3 percent of their total exports. The total decline in exports value for all LDCs is 530 million US dollars, with Bangladesh accounting for a large part (222 million US dollars).

Building on this framework, Alexandraki and Lankes (2004) extend this analysis by focussing on middle-income countries and the impact on key export products. Their conclusions converge somewhat with the previous one: they find an overall small impact, in the order of 0.5 and 1.2 percent of total exports of the middle-income countries considered. Shocks are nevertheless likely to be significant for a narrow range of countries, notably small island economies. For six middle-income countries in particular –Mauritius, St. Lucia, Belize, St. Kitts and Nevis, Guyana, and Fiji– preferences add around one-fourth or more to the value of exports. Two products, sugar and banana, account for three-fourths of the value of preferences received by the largest beneficiaries.[7] Textiles and clothing follows in a distant third position, with a 8 percent share. Assuming the same hypothetical 40 percent reduction in each country's preference margin as a result of MFN liberalization, the results show that several countries could experience significant declines in export revenues. Mauritius would be the most exposed (-11.5 percent, equivalent to 200 million US dollars) due to the highly preferential terms on which it exports sugar to the EU. The policy implication is that any potential adjustment does not need to

7. The largest beneficiaries are 18 countries with average preference margins greater than 5 percent.

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have a broad focus but should instead target those countries and products that are more vulnerable.

These studies focus only on trade effects, so there is little indication on the extent to which a significant shock to merchandise exports will translate into a sizeable macroeconomic shock. Using a global general equilibrium framework, Francois, Hoekman and Manchin (2005) estimate the impact of full preference erosion on the incomes of LDCs. EU preferences are find to be very important for sub-Saharan Africa, potentially worth 460 million US dollars annually. Asian countries benefit less, except in the case of Bangladesh (loss of 100 million US dollars). Other low-income countries, such as India and Vietnam, stand to gain significantly as they are "less preferred" in EU schemes. It is important to note that when trade liberalization in other OECD countries is considered, the gains associated with non-EU tariff reductions partially offset losses due to EU liberalization. Global losses for African LDCs are reduced by a factor of four, to 110 million US dollars, and represent a fraction of the expected global gains of 1.8 billion US dollars. If compliance costs are taken into account –the administrative burden is estimated at around 4 percent[8]–, the magnitude of preference erosion will change across countries. For example, Bangladesh, which is specialized in high tariff lines that are subject to restrictive rules of origin, the magnitude of potential erosion is cut by half, from 138 million US dollars to 77 million US dollars. Overall, there is no longer any real loss for all African LDCs, although some countries may still be hurt (e.g., Zambia, Mozambique, Malawi).

What happens when the erosion of ATC quota rents is included in the analysis? Grynberg and Silva (2004) estimate the losses in income transfers for sugar, beef, bananas, textiles and clothing producers in trade-preference-dependent economies at 1.7 billion US dollars annually. In the textiles sector alone, potential annual losses in income transfers of quota rents account for 1.3 billion US dollars. They assume

8. This implies that preferences will only matter for those products where the difference between MFN and preferential tariffs is higher than 4 percent.

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Table 2. Summary of Recent Estimates on the Potential Costs of Preference Erosion

Authors	Countries	Methodology	Trade or Real Income Effects
IMF (2003)	LDCs	Partial equilibrium. 40% cut in tariffs.	Aggregate loss of export revenues amounts to US$ 530 million (1.7% of total LDC exports).
Alexandraki and Lankes (2004)	Middle-income	Partial equilibrium. 40% reduction in preference margin.	Reduction in export value less than 1.2% of total exports.
Grynberg and Silva (2004)	DCs	Partial equilibrium. Various scenarios.	Income transfer loss of US$ 1.7 billion (US$ 402 million in agriculture).
Francois, Hoekman and Manchin (2005)	African LDCs	General equilibrium. Full preference erosion.	Welfare loss of US$ 460 million for African LDCs after EU MFN liberalization, but total loss of US$ 110 million with other OECD trade liberalization. US$ 198 million loss for all LDCs.
Low, Piermartini and Richtering (2005)	LDCs	Simulate a MFN tariff cut in NAMA.	US$ 170 million loss for LDCs (0.8% of imports), notably Bangladesh, Cambodia, Haiti, Lesotho, Madagascar.

that producers will require 14 to 20 years to adjust, and yield total net present value of financing between 6 billion and 13.8 billion US dollars, which gives an indication of a hypothetical donor financing envelope.

As these studies rely on different assumptions or use different methodologies, it does not really make sense to draw direct comparisons between the various results. Nevertheless, they provide an indication of the potential losses, which can range from up to 200 million US dollars for LDCs to 1.7 billion US dollars annually for all preference-dependent countries. These simulations are clearly illustrative as the real costs of preference erosion will depend on the outcome of the Doha Round. One key conclusion of these empirical studies is that the potential losses turn out to be relatively small on a global scale, especially if we compare them to the global gains

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expected from MFN liberalization.[9] Beyond the aggregate numbers, more attention should be paid to country-level impacts and to assessing short-run adjustment costs in the most vulnerable countries –a far more complex agenda.

Dealing with trade adjustment

Given the need to enhance the negotiating dynamics of the Doha Round, there is a strong political economy case for designing specific responses to meet the most vulnerable countries' concerns on the implications of multilateral trade liberalization. The potential adjustment costs faced by DCs as a result of trade reforms were recognized in a September 2003 joint letter from the President of the World Bank and Managing Director of the IMF to the WTO Director-General, who promised the support of their organizations, notably in assessing the nature and magnitude of adjustment needs and managing the impact on affected population groups.[10]

Economists have usually focused on the long-run impact of trade liberalization and have therefore neglected the short-term adjustment costs, as these were considered to be relatively small and could be managed by supporting policies (such as social safety nets).[11] This also raises methodological issues related to the definition and measure of adjustment costs, which are multi-dimensional and go from private sector labor markets shifts to public sector loss of revenue (table 3). The experience of trade adjustment in OECD labor markets shows that adjustment costs appear to be higher for trade-displaced workers than for other job losers: in both the United States and Europe, workers displaced from manufacturing jobs facing intense global competition are slower to become

9. These potential gains are in the neighbourhood of USD 128-228 billion for static gains alone, see Elliot (2005).

10. A joint note by the staffs of the IMF and the World Bank to the Development Committee states that "demand for, and capacity to absorb, 'aid for trade' still exceeds available resources". For these reasons, they see a "strong case for increased assistance, in the form of grants or loans, to cover the gamut of needs in aid for trade from technical assistance to budget support or investment lending. Such resources should be genuinely additional to existing aid budgets" (IMF and World Bank 2005).

11. According to early work in the context of developed countries. For a review, see Bacchetta and Jensen (2003).

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re-employed and experience larger wage losses once re-employed than do job losers in other sectors (OECD 2005). Special schemes covering trade-related adjustment exist in OECD countries, such as the US Trade Adjustment Assistance program and the European Social Fund.[12]

More detailed assessments and specific design of related supporting policies in the context of DCs are needed for at least three reasons:

– DCs have higher protection levels on average and are more dependent on tariff revenues: e.g., about one-quarter of all government revenues in sub-Saharan Africa. Baunsgaard and Keen (2005) estimate that for each dollar of trade tax revenue lost, low income countries recover, at best, only 30 cents.

Table 3. The Nature of Adjustment Costs

Private sector	**Labor**	Opportunity costs of unemployed labor Obsolescence of skills and skill specificity Lower wage levels Retraining costs Personal costs (such as psychological suffering) Other costs (e.g. rent seeking)
	Capital	Opportunity costs of under-utilized or unemployed capital Cost of capital rendered obsolete (capital write-offs) Transition costs of shifting capital from one activity to another
Public sector		Shift in tax revenue base Social safety net spending (e.g. unemployment benefits) Erosion of benefits from preferential treatment Efforts to ensure macroeconomic stability Implementation costs of trade reform Non-trade concerns: food security, support to rural areas, environmental concerns

Source: Fernandez de Cordoba *et al.* (2005).

12. Obviously the rejection of the European Constitution by a majority of French and Dutch citizens in 2005 revealed growing fears that globalization poses a threat to their working conditions. In October 2005, the European Commission released a report entitled "European Values in a Globalized World", which mentions the possibility of creating a "globalization adjustment fund" to tackle the social and economic consequences of globalization for EU workers.

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Middle-income countries perform better, with a recovery in the region of 45-60 cents.

– DCs are less diversified and thus have fewer opportunities to reallocate displaced factors in other sectors.

– DCs often lack strong institutions to support the costs of transition and implement adjustment assistance policies.

The need for specific trade-induced adjustment assistance has gained ground and has emerged as a recommendation in a number of influential reports and high-level public statements. One of the conclusions of the working group chaired by Peter Sutherland on "The Future of WTO" acknowledges that developing countries often cannot afford adjustment mechanisms, induced by trade liberalization, to cushion the impact on employment and social welfare. Therefore "international development agencies, chiefly the World Bank, should have, or should improve, programs to fund adjustment assistance to developing countries" (Sutherland *et al.* 2004). In a somewhat more straightforward declaration, the EU Trade Commissioner, Peter Mandelson, stated in February 2005: "There is an urgent need for the world's richest countries to establish a special Trade Adjustment Fund. Existing efforts by the IMF and World Bank are inadequate. If the G8 is unwilling to make such a move, then it will fall to the EU to consider what it can do on its own."[13] The establishment of a temporary Aid for Trade fund to support countries in addressing adjustment costs associated with the implementation of a Doha reform agenda was also one of the recommendations by the Millennium Project Task Force on Trade (2005).

Page and Kleen (2004) consider a "public good" argument for an international fund to compensate those countries that are likely to experience a negative outcome from MFN liberalization: since the reduction of trade distortions will increase world welfare, there is scope for "winners" to compensate "losers" through direct funding. It is also a matter of equity. One key issue relates to the estimation of the relevant loss:

13. "Trade at the Service of Development: An action plan for 2005 for the EU Trade Commissioner", lecture given at the London School of Economics, 4 February 2005.

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should it be the total effect of losses from preferences or the net effect, i.e. offsetting the preferences lost by any potential gains, from a general WTO settlement? The calculation of a net effect may not be relevant for many preference-dependent countries, which are mostly focused on a few export commodities and have little prospects of immediate gains for other goods or services.

What would be the size and scope of an AfT fund? Page (2005) suggests 500 million US dollars per year to finance "investments in physical and human infrastructure and in productive capacity to permit alternative production." Puri (2005) also considers more than just adjustment support[14] and estimates the need for 1 billion US dollars as "seed money." These figures concur with the preference erosion estimates reviewed above; however, as pointed out, they should not be taken as adjustment costs. Regarding potential sources of financing, there is a consensus that such funding should be additional to current aid flows. The Millennium Project Task Force on Trade (2005) and Hoekman (2004) argue that it could be financed out of the tariff revenue that is presently collected by OECD and higher income developing countries on imports that will be subject to Doha reduction commitments. The total revenue available would automatically decline over time, which is coherent with the idea of a temporary facility to facilitate adjustment. The length of the transition period should be discussed on a case-by-case basis, yet the experience of the Multi-fiber Agreement (MFA) suggests that it could take more than ten years.

In a joint note to the Development Committee in September 2005, the IMF and the World Bank rejected the possibility of creating a dedicated fund to address specific

14. In fact, the target areas suggested by Puri (2005) are quite broad: adjustment support for example to meet commodity prices related shortfalls, post-ATC adjustment in textiles or food import financing schemes for net food importing developing (NFID) countries; compliance and benefit-related institution-building including hardware and software; productive supply capacity and competitiveness building, renewal and retooling for viable diversification –horizontal, vertical and diagonal– into dynamic and new sectors of international trade; trade-related infrastructure funding –including help to fund warehouses, cold chains, grading systems, marketing and promotion bodies, roads and port infrastructure, energy grids; transfer of publicly funded technology or building research and development capacity in key areas.

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adjustment costs under the DDA. They believe that adjustment needs should be considered "as part of an overall package of domestic policy reforms and economic planning" (IMF and World Bank 2005), and stress that existing channels of assistance, such as the IMF Trade Integration Mechanism (see box) and World Bank structural adjustment lending, can address potential adjustment problems, especially since they will be limited to relatively few countries. The World Bank also stressed the scaling-up of its lending for trade activities, from 0.8 billion US dollars in FY98-00 to a projected 3 billion US dollars in FY04-06, with a large component dedicated to trade facilitation. In addition, the twin Washington D.C.-based institutions fear that the cost of setting up a new fund could detract from availability of funds, notably to strengthen the Integrated Framework.[15] In line with this argument, Hoekman and Prowse (2005) suggest that the creation of a separate fund targeting one specific structural adjustment need would run counter to a more harmonized approach to development assistance.

In sum, there is a consensus that trade adjustment costs –notably preference erosion– need to be addressed in the short and medium term. Although it seems reasonable that any trade adjustment assistance should be conceived and given within an overall aid framework for the beneficiary country, there is nevertheless a need to secure trade-related assistance, otherwise some developing countries may have no incentive to favor a WTO settlement (political economy argument). As Jagdish Bhagwati rightly puts it: "Country aid programmes have lots of competing claimants. How can we be sure the dog-fights will leave enough funds for aid-for-trade programmes?"[16] Providing trade adjustment assistance raises several issues that need to be carefully addressed:

– There is still much uncertainty on the extent of adjustment costs due to MFN liberalization and its potential impact on domestic redistribution. The question is whether we can truly separate trade effects from other shocks in the process of

15. This point will be examined in the next section.
16. *The Financial Times*, Letter to the Editor, 26 September 2005.

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The Trade Integration Mechanism

In response to the concerns that the implementation of WTO agreements might give rise to temporary balance-of-payment shortfalls, the IMF introduced the Trade Integration Mechanism (TIM) in April 2004. This device is designed to provide financial assistance to member countries facing adjustment pressures that might result from the implementation of Doha Round agreements (IMF 2004): i.e., the erosion of the margin of tariff preferences, adverse changes in the terms of trade of net food importers as agricultural subsidies are cut, and more intense competition in textiles and clothing markets following the end of quotas under the Agreement on Textiles and Clothing (ATC).

It is important to note that these three developments relate to the implications of multilateral trade liberalization and not to changes in the country's own import regime[1]. The TIM is not a stand-alone facility that will provide new resources. It is in fact merely a policy operating through the conventional lending facilities of the Fund, like the Poverty Reduction and Growth Facility (PRGF). The mechanism can provide a country with rapid "topping-up", of up to 10 percent of its Fund quota. Two countries, Bangladesh (78 million US dollars) and the Dominican Republic (32 million US dollars), have so far applied and obtained support under the TIM.

What has been presented as a "new initiative", or an "insurance policy", by the IMF, turns out to be rather limited in scope, with an exclusive focus on short-term balance-of-payment problems[2]. It remains to be seen whether it will be sufficient for countries facing a more permanent preference erosion shock, as opposed to a temporary commodity shock. Also, this policy may not be adequate for indebted countries which do not need to incur more debt to adjust from MFN liberalization.

1. The IMF has defined a set of somewhat arbitrary vulnerability indicators related to these three events: an estimated 2 percent or larger decline in export unit values associated with a 40 percent erosion of preferences; net food imports represent more than 20 percent of total exports (17 countries in 2001); a composite measure of vulnerability based on the concentration of exports of textiles and clothing, quota utilization rates and capacity for adjustment.
2. However, it is coherent with its institutional mandate.

globalization. This implies that International Financial Institutions (IFIs) and the governments concerned should better monitor at the country level the effects of trade libera-

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lization, which will not only affect preference-recipient countries, in order to prepare adequate transitional measures.

– It is clear that any proposal for compensation, which can be perceived as a way to buy off DC opposition to further trade liberalization, incurs the risk of politicization and can lead to a costly bargaining game. As discussed above, determining the extent of compensation is a highly complex task, leaving much room for endless conflicting arguments among experts. Any allocation of adjustment assistance to preference-dependent countries should not come at the expense of other DCs that did not benefit from preferences, and should be additional to existing aid flows.

– The option of a multilateral (grant-based) trade facility has been promptly discarded by the IMF and the World Bank and gained little support in the donor community in general. The risks of not being able to earmark significant Aid-for-Trade funds and the potential frustration of some developing countries exist, but the transaction costs of setting up a new fund are given more weight in the balance. Key questions related to the implementation of a trade fund are notably: how to ensure credible and predictable financing, and whether or not it should be housed in the WTO. Obviously, regardless of whether or not there will be a dedicated fund, being able to address adjustment needs on an individual basis is paramount. These could also be treated as a bilateral issue, by those countries granting the preferences. The most obvious response might be to convert the value of preferences into direct aid transfers during a given period of time, which has the advantage of not distorting trade flows.

Apart from the trade adjustment issue, which should be addressed by short and medium-term measures, any Aid-for-Trade agenda calls for more long-term measures to alleviate supply constraints and strengthen DC trade capacity. Clearly, limited production capacity, minimal diversification and severe infrastructure deficits still prevent many developing countries from maximizing their development gains from trade. Trade-related technical assistance and capacity building programs aim to tackle these supply constraints and better integrate trade policy into the development agenda.

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Strengthening Trade Capacity for Development: What Does it Mean?

The Doha Declaration stresses that technical assistance and capacity building are core elements of the development dimension of the multilateral trading system. According to the OECD DAC Guidelines (2001), "the new approach focuses on building capacity by facilitating a country-driven participatory trade policy process as part of a comprehensive approach to overall development goals and poverty reduction strategies." This contrasts with past interventions by donors in trade development, which were more limited in scope –i.e. export marketing through support of trade promotion organizations (1970s), trade liberalization as part of structural adjustment programs (1980s and early 1990s), and trade facilitation. It is quite clear that if developing countries are to benefit from further trade liberalization, more needs to be done –aside from market access and adjustment costs issues– to address supply-side constraints and trade capacity building.

The purpose of Trade-Related Technical Assistance and Capacity Building (TRTA/CB)[17] is to enhance the ability of developing countries to :

– formulate and implement a trade development strategy and create an enabling environment for increasing the volume and added value of exports, diversifying export products and markets and increasing foreign investment to generate jobs and trade;

– stimulate trade by domestic firms and encourage investment in trade-oriented industries;

– participate in and benefit from the institutions, negotiations and processes that shape national trade policy and the rules and practices of international trade.

The latter may imply a genuine objective of rebalancing relations in trade negotiation forums, but there may well also be a political economy interpretation –that is, providing trade-related assistance to make further trade liberalization more palatable to DCs. What does this mean in practice? Do donors share a common understanding of the objectives, and do they

17. As given in WTO/OECD (2004).

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co-ordinate their interventions? We shall first provide some basic facts on what has been done on TRTA/CB activities, then go on to examine the challenges linked to the role of the Integrated Framework for Trade-Related Technical Assistance.

A consolidation in trade capacity building commitments

The Trade Capacity Building (TCB) database was launched in November 2002 by the WTO and OECD Secretariats to monitor commitments by the donor community under the DDA and ensure better coordination through information sharing at both the national and international level.[18] It provides an useful indication of the volume and nature of TRTA/CB support by over 40 bilateral donors and multilateral agencies. Projects and programs are divided into three main categories: trade policy and regulations, trade development,[19] and infrastructure.[20] According to OECD estimates, the share of TRTA/CB in total aid commitments rose, from 3.6 percent in 2002 to 4.4 percent in 2003, while infrastructure accounted for 25 percent in 2003.

Figure 1 shows a marked increase in trade-related technical assistance in 2003-2004 compared to 2001-2002. Commitments to support developing countries in preparing for greater integration in the multilateral trading system increased by 25 percent from 2001 to reach 811 million US dollars in 2004, while aid earmarked for business development and trade promotion rose by 60 percent to reach 2.2 billion US dollars. Noteworthy is the sharp rise in trade policy and regulations support for the Africa region, of which 74 percent went to sub-Saharan Africa in 2003. Trade facilitation, which is mainly channeled via multilateral agencies, more than

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18. For more details, see WTO/OECD (2004, 2005), OECD (2005a). All data is taken from these sources.
19. This heading should be interpreted with caution. Activities recorded under this category may only have a small trade component, under a general objective of industrial or agricultural development. Some donors may isolate this component whereas others may report the whole project as trade-related.
20. Since it is difficult to estimate to what extent infrastructure focuses on international trade, it is excluded from TCBDB data collection. Data on aid to infrastructure comes from the OECD's Creditor Reporting System, and the WTO/OECD assume that all infrastructure aid boosts international trade.

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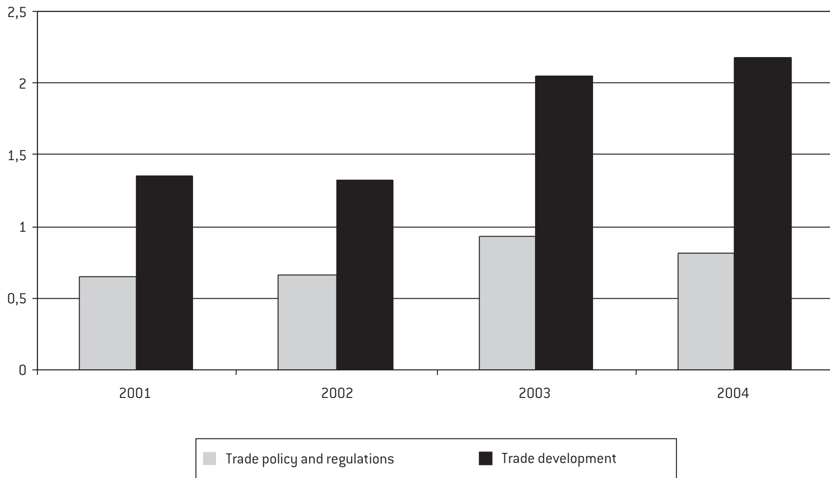
tripled between 2001 and 2004, and accounts for almost half of the total commitments to trade policy and regulations. Assistance to build infrastructure –transport, energy, telecommunications– remained stable in 2001-2002 (around 8.5 billion US dollars per year) and is concentrated in Asia. Donors committed 9.3 billion US dollars in 2003, and aid for infrastructure in Africa increased by 50 percent from 2002 and represented a third of total aid for infrastructure. Contributions to the multilateral trust funds also increased from 26 million US dollars in 2001 to 45 million US dollars in 2004. The estimated value of commitments by bilateral and multilateral donors are given in the appendix.

Figure 1. Trade Assistance Commitments (2001-2004)
(billions US dollars)



Source: WTO/OECD database.

France launched its trade capacity building strategy (*Plan d'accroissement des capacités commerciales des pays en développement*) in 2002, which includes multilateral contributions (DDA Global Trust Fund, Integrated Framework…) and a bilateral component with a 30 million euros budget.[21] The

21. The point should also be made that many projects, which are not officially part of TCB strategies, help to build export capacity. According to the WTO/OECD database, France's contribution in 2002 was over 100 million US dollars (ranking second only to the United States among bilateral donors), a much higher involvement in TCB than the 30 million euros figure would tend to suggest.

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objectives are to improve the export capacities of DCs, notably through private sector and SME development, and to support their participation in trade negotiations. The Agence Française de Développement (AFD) is currently managing, with the Ministry of Economy and Finance, the Program for the Strengthening of Trade Capacities (PRCC). Initially designed for a three-year period (2002-2005), the program is under way in ten countries (Cambodia, Vietnam, Senegal, Ghana, Laos, Madagascar, Algeria, Guinea, Ethiopia, Mauritania), and has been extended for another three years.

Who benefits most from TRTA/CB programs? Using the TCB database, we can identify the top five recipient countries in terms of number of activities. Not surprisingly, table 4 shows that emerging Asian economies attract a large number of aid commitments, which are split relatively evenly between trade policy and trade development. However, the volumes committed are not huge with respect to the size of these economies: from 0.01 percent of GDP for China to 0.3 percent for Vietnam. Overall, the top recipients of French aid for *trade development* in 2003-04 were Vietnam (14.7 million US dollars), Senegal (8.9 million), Tunisia (8.6 million), and for *trade policy and regulations* : Africa regional (3.2 million), Cambodia (2 million), Laos (1.5 million).

More important is the case of LDCs which are likely to be the most affected by preference erosion. Do they benefit from significant efforts from the international community? According to the IMF (2003), countries such as Malawi and

Table 4. Top Five Recipients of TRTA/CB Commitments
(as of September 2005, by number of activities)

	No. of activities*	Trade policy & regulations	Trade development	Total/GDP
China	461	63.7 (198)	92.5 (157)	0.01%
Indonesia	445	40.2 (226)	37 (190)	0.03%
Vietnam	403	42.3 (183)	82.9 (155)	0.3%
Thailand	345	15.7 (161)	15.1 (121)	0.02%
Philippines	315	24.4 (138)	61.6 (139)	0.1%

* Total number of activities include partial data for 2004 and 2005. The data on trade policy and trade development represents cumulated commitments between 2001-2003 (million US dollars and number of activities).
Source: WTO/OECD database.

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Table 5. Losses from Preference Erosion in Some LDCs and TRTA/CB Commitments

	Estimated decline in export values (IMF)		Cumulated commitments (2001-2003, US$ millions and number)			Aid dependency
	%	US$ mn	Trade policy & regulations	Trade development	Total/ GDP	ODA/GNI 2001-03
Malawi	11.5	48.6	15.7 (61)	30.2 (48)	2.7%	24.72
Mauritania	8.8	40.4	11 (64)	10.1 (18)	1.7%	26.29
Haiti	6.4	3.9	5.9 (47)	25.9 (16)	1.1%	5.57
Cape Verde	6.3	0.9	10.3 (37)	7.1 (19)	2.1%	15.29
Sao Tome & Principe	5.2	1.1	9.2 (27)	0.78 (19)	16.6%	73.13
Tanzania	4.5	28.9	19.4 (86)	55.1 (112)	0.7%	14.65
Bangladesh	4.4	222.4	24.5 (96)	36.7 (66)	0.1%	2.17
Comoros	3.9	0.3	3.6 (16)	0.037 (4)	1.2%	11.03
Cambodia	3.7	53.6	21.3 (128)	19.7 (77)	1.0%	12.32

Sources: IMF (2003), WTO/OECD database, OECD.

Mauritania would experience the largest decline in export values due to preference erosion. Those countries are also the more vulnerable and highly aid-dependent, with an average ODA/GNI ratio of some 25 percent. Accumulated TRTA/CB commitments over 2001-03 represent a sizeable volume, over 1 percent of their GDP, except for Bangladesh and Tanzania.

Enhancing trade-related capacity in poor countries can be controversial and it is not always clear what kind of capacity donors should aim to strengthen (Solignac Lecomte, 2003). TRTA/CB often seems to be delivered on a 'random' basis and sometimes without a clear vision of the recipient country's priorities. Some donors may focus on the trade policy process, while others emphazise private sector and SME development. Also, the risk of biased aid is well known (Deere, 2004). Given the political economy considerations of trade-related assistance, rich countries might be tempted to introduce either negative discrimination (i.e. donors avoid helping activities that could hurt their commercial interests), positive discrimination (donors focus on operations that might assist their domestic economies), or tied-aid in favor of their own companies and consultants. In other words, trade capacity building incurs the risk of being more donor-driven than demand-driven. Lack of donor co-ordination –despite

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improved consultation and some joint programs– may result in a fragmented micro-based approach. This is why donor coordination should be an essential part of policy, which is one of the main purposes of the Integrated Framework.[22]

The Role of the Integrated Framework: Towards an Enhanced IF

At the Spring 2005 meetings in Washington, "the need for aid for trade" was stressed and the World Bank and the IMF were asked to develop detailed proposals to help developing countries take advantage of the Doha Round. Following a Geneva-based consultation process,[23] the staffs of the Bank and the Fund proposed that a strengthened Integrated Framework (IF), with additional funding, should be central to a new Aid for Trade initiative. The IF –a joint program launched in 1997 by the IMF, the International Trade Center, UNDP, UNCTAD, the World Bank and the WTO– has two major objectives: to mainstream trade into LDC national development plans and the Poverty Reduction Strategy Papers (PRSPs); and to assist in the coordinated delivery of trade-related technical assistance in response to needs identified by the LDCs (UN 2005).

The first stage of IF implementation is the Diagnostic Trade Integration Study (DTIS), usually led by the World Bank, which aims at assessing the overall competitiveness of a country's economy and identifying sectors with the greatest export potential and supply-side constraints. A plan of action, or Action Matrix, is then presented with TRTA/CB recommendations, which are to be incorporated into the country's national development plan (such as the PRSP). The results of this process can be discussed within the context of consultative group meetings and round tables where both multilateral and bilateral donors are invited to exchange ideas. The IF Trust Fund (IFTF), managed by UNDP, has two instruments: Window I for the financing of the DTIS process (up to

22. Another relevant trade program is the Joint Integrated Technical Assistance Program (JITAP), developed by the WTO, the ITC and UNCTAD in 1998 to provide technical assistance to African countries. For more details, see http://www.jitap.org.
23. This consultation process was coordinated by the Permanent Mission of Rwanda and the Permanent Mission of Sweden in Geneva.

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300,000 US dollars per country study), and Window II to launch priority follow-up technical assistance activities (a ceiling of 1 million US dollars was set for each country due to strong demand) outlined in the Action Matrix.[24]

What has been achieved so far? As of end of May 2005, cumulative pledges by 17 donors to the IFTF amounted to 30.2 million US dollars (Window I: 16.0 million US dollars and Window II: 14.2 million). By the end of 2005, 21 countries will have completed their DTIS, 7 new LDCs are scheduled to resume their process, and 9 others will be technically reviewed by the beginning of 2006.[25] A total of 33 Window II projects have been submitted, with total financing requirements of 10.7 million US dollars, of which 22 have already been allocated funds amounting to 8.1 million: e.g. product and market development of agro-based projects in Lesotho, enhancement of trade negotiating capacity in Ethiopia and Madagascar, fruit and vegetable export promotion in Yemen, etc. These projects account for only a fraction of the needs outlined in the DTIS.

In November 2003, the Capra-Trade Facilitation Office Canada Consortium (Capra-TFOC) released an evaluation of the IF, which concluded that "considerable progress has been made, especially at the agency and planning levels, but fine-tuning is required to move to a robust implementation stage, where concrete in-country results can be achieved within more countries."[26] The evaluators noted the fundamental soundness of the IF approach and its potential to reduce poverty as the level and extent of socio-economic intervention increased. However, from this report and the World Bank's Operations Evaluation Department own assessment (World Bank 2004),[27] a number of important shortcomings have also been stressed.

– *IF scope: how big is IF or how big should it be?* The central issue is whether IF should be a broad funding source or whether it should remain as a relatively small mechanism to

24. For further details on the IF, see http://www.integratedframework.org.
25. The remaining LDCs are: Bhutan, Cape Verde, Eritrea, Guinea-Bissau, Kiribati, Myanmar, Samoa, Solomon Islands, Timor-Leste, Togo and Tuvalu (IMF and World Bank, 2005).
26. Final Report of the Evaluation of the Integrated Framework, WT/IFSC/6/Rev.2/Add.1, WTO.
27. Based on six countries: Mauritania, Cambodia, Yemen, Senegal, Madagascar, and Malawi.

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help LDCs identify their comparative advantages and weaknesses, along quantified needs for funding, which are then presented to donors with specific requests for funding. It appears that differences of perception should be clarified between the donors and some LDCs with respect to supply-side constraints; otherwise it induces a gap between available resources and the expectations of LDCs.[28]

– *Slow implementation of post-DTIS commitments.* While Window II projects are being implemented, other parts of the action plan are often delayed due to lack of donor awareness, developing countries' action and adequate implementation plans for the matrices. Country studies need to be made more operational, with a clear assessment of the priorities and estimated costing. The bridging funding of 1 million US dollars per country falls short of the needs identified in the DTIS, and financing of the matrix remains uncertain. Donors' interventions in trade capacity building do not necessarily follow the country's action plan, which may indicate a lack of ownership of the DTIS process among donors and/or diverging strategies.

– *Country ownership varies greatly and is generally weak.* Where in-country participation was strong, the IF usually did well. This depends notably on the local authorities' representative for the IF ("Focal Point") and the resources available.[29] The IF is often conducted by trade ministries and usually does not involve finance and planning ministries, which may explain why trade issues still translate insufficiently into national development plans. Also, the private sector and civil society usually have not been closely associated with the IF process. Local consultants should be encouraged to take part in the studies and work hand in hand with international consultants.

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28. At the 10th meeting of the IF Steering Committee, the representative of Bangladesh expressed concerns that there was no recommendation in the Capra-TFOC report on how the IF could address supply-side constraints of LDCs (Report on the 10th meeting of the IFSC, 27 October 2003, WT/IFSC/M/9, WTO). The evaluators recommended that "the IF Steering Committee develop guidelines to establish the limits of IF-defined activities, including the scope, coverage and parameters of supply-side constraints".

29. In the case of Cambodia, considered as an "IF success story", the conjunction of the IF process and the WTO accession processes, as well as strong local government commitment, played a key role.

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– *Mainstreaming trade policy into national development strategies.* Since the relationship between trade, development and poverty is quite complex and not well established empirically, trade-related assistance may have a "legitimacy problem". Who benefits within the recipient countries from TCB? Is it at the expense of other sectors/actors? According to Hewitt and Gillson (2003),[30] the extent and depth of trade coverage in PRSPs is limited. When PRSPs do encompass trade content, it is rarely underpinned by poverty analysis, which makes it difficult to see how international trade-related conditions such as fiscal reform, supplementary trade taxes, tariff reductions and standard trade facilitation measures are justified if they are not backed by *ex ante* analysis of the likely poverty impact brought about by trade reform. A more selective approach is to look only at those countries that have completed their DTIS and see whether the IF has influenced the content of their PRSPs. Since only 8 of the 20 IF countries reviewed had validated their DTIS, no conclusive evidence on this point may be available at this stage. Nevertheless, it is interesting to note that of these eight countries, three (Cambodia, Mauritania, Nepal) managed to integrate the conclusions of the DTIS in their PRSPs while two countries (Ethiopia, Guinea) were working on it. Malawi, Lesotho and Senegal did not incorporate the recommendations of the DTIS into their PRSPs (IMF and World Bank 2005).

– *There is a need to focus on improved trade outcomes, rather than on the processes alone.* The IF should establish concrete country-level outcomes and related trade performance indicators to improve the level and content of aid for trade policies, and enhance donors' collaboration in this process. The Capra-TFOC evaluation focused on operational results, not developmental results (i.e. in terms of poverty reduction attributable to increased trade and growth), not only because it was obviously too early but also because there was a lack of measurable objectives to conduct this exercise.

– *Trade concerns need to be better reflected in donors' country strategies.* Regarding the World Bank's experience in the IF,

30. Their study investigates the trade and poverty content of existing PRSPs and loan-related documents for 17 countries (nine in Africa, four in the Western hemisphere, two in Asia, all developing, and two transitional).

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the OED report notes that the program –managed by the Development Economics Vice Presidency– needs to collaborate effectively with regular Bank operations so that trade-related assistance is better reflected in country assistance strategies (World Bank, 2004). Also, there is a gap in the perception of needs between trade experts working on the studies and the Bank's country and field specialists which should be addressed. One should not underestimate the general lack of information and coordination between different ministries and agencies within donor countries on trade and development issues. Despite a highly publicized debate, there is still little concern within development agencies on trade aspects –and limited human resources–, in addition to which the development agenda is often neglected by trade ministries.

Given these salient shortcomings, the need for an enhanced IF, with additional funding, emerged from the Geneva consultation process. In September 2005, the staffs of the IMF and the World Bank recommended that the Development Committee and IMFC endorse the proposal of an enhanced IF, requiring "predictable, multi-year financing, with resources increased to a sum in the order of 200-400 million US dollars, disbursed over an initial five-year period"[31] (IMF and World Bank 2005). This enhanced IF would notably finance project preparation in priority areas to strengthen the link between large-scale needs outlined in the DTIS (for example, trade-related infrastructure) and donor funding. As to eligibility, the IF could be extended to other low-income countries (e.g. IDA-only eligible countries[32]). Since LDCs are likely to express concern over the possible dilution of limited funding, a specific window could be created to finance non-LDCs. Another suggestion is the implementation of regional DTIS, under a separate window, to examine regional or cross-country obstacles to trade development (such as regional transport corridors, standards, disease issues). The idea of a dedicated multilateral fund to provide co-financing for regional aid for trade projects is to be explored as well.

31. This estimate is based on 40 active clients in the program.
32. There are 18 IDA-only countries: Cameroon, Rep. of Congo, Ivory Coast, Ghana, Kenya, Mongolia, Tonga, Vietnam, Guyana, Honduras, Nicaragua, Sri Lanka, Albania, Armenia, Georgia, Kyrgyz Republic, Moldova, Tajikistan.

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The Development Committee endorsed the proposal for an enhanced IF, including expanding its resources and scope, reflecting a consensus among donors that the IF should remain the main pillar to coordinate TRTA/CB actions, notwithstanding its limitations. In the draft Hong Kong Ministerial Declaration (18 December),[33] high priority was given to the effective implementation of the IF in the Doha work program, and donors were urged to significantly increase their contributions to the IF Trust Fund. There was agreement that an enhanced IF, which will be effective by 31 December 2006, should be based on three elements: increased, predictable and additional funding on a multi-year basis; strengthened capacities in IF beneficiary countries; and improved IF governance; i.e. decision-making and management structure.

In the run-up to the Hong Kong Ministerial Conference, a consensus emerged among donors to commit a credible package on Aid for Trade, showing an 'enhanced' political interest for scaling up AfT.[34] The European Union announced that it would raise Aid for Trade spending to more than 2 billion euros a year from 2010.[35] This followed the declaration by Mr. Barroso, President of the European Commission at the G8 meeting in Gleneagles, namely, that the European Commission would increase its annual spending on trade capacity building from 700 million euros to 1 billion from 2007. European Member States have committed to matching that commitment from 2010, and the UK announced that it would contribute a major share (100 million pounds, or the equivalent of 146 million euros).

Regarding specific funding of the IF, the suggested figure of 200-400 million US dollars over five years would need some justification. In the words of the Zambian trade minister, acting as chairman of the LDC group at the WTO, this increase in

33. WTO draft Ministerial Declaration, WT/MIN(05)/W/3/Rev.2, 18 December 2005.
34. "We also invite the Director-General to consult with Members as well as with the IMF and World Bank, relevant international organizations and the regional development banks with a view to reporting to the General Council on appropriate mechanisms to secure additional financial resources for Aid for Trade, where appropriate through grants and concessional loans", WTO draft Ministerial Declaration.
35. These funds do not include the money the European Union provides for infrastructure projects in Africa such as road building and energy and water: currently more than 800 million euros a year.

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resources spread over 40 countries can "hardly be called a significant enhancement". One question is whether donors will be willing to increase their participation to the IF Trust Fund as they may also have a national trade-related assistance plan to pursue. Several bilateral donors –such as Finland, France, Ireland and The Netherlands– do not contribute to Window II. Even with increased funding, resources dedicated to the IF are likely to limit the scale of the projects. Given this constraint, it may be premature at this stage to extend the IF to non-LDCs, and the first priority should be to make the IF process more effective for LDCs. Another important issue in the IF reform, which has only been touched on so far, is measuring performance. Standard evaluations primarily focus on projects or groups of projects, but it would seem more relevant to adopt a wider scope and include sector-based and geographical evaluations. The challenge is to shift from the micro-level in order to assess the macroeconomic impact of trade capacity building programs, i.e. do these programs have a significant impact on economic development through increased trade in LDCs? This implies a joint approach with other donors; otherwise, individual estimations of the impact on the recipient countries' export performance are likely to prove relatively meaningless.

Conclusion

One central policy implication that emerges from the debate on preference erosion is that any potential adjustment assistance does not need to have a broad focus but should instead target those countries and products that are more vulnerable. Beyond the controversial debate on the value of preferences, there is still great uncertainty as to the extent of adjustment costs due to MFN liberalization and its potential impact on domestic redistribution. This implies that IFIs and the concerned governments should better monitor at the country level the effects of trade liberalization, which will not only affect preference-dependent countries, in order to prepare adequate transitional measures.

Evidently, preference erosion and trade liberalization concerns contribute to the current push to scale up Aid for Trade. Along the rocky road to make this new agenda

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operational, some basic principles can be stressed: (i) any allocation of adjustment assistance to preference-dependent countries should not come at the expense of other DCs that did not benefit from preferences, and should be additional to existing aid flows; (ii) trade adjustment assistance should be conceived and given within an overall aid framework for the beneficiary country –with credible and predictable funding– hence the need to better align trade and development priorities within national strategies; (iii) an enhanced and better focused Integrated Framework must be given wide support, provided that it manages to address fully its existing shortfalls; (iv) effective monitoring of results is essential to legitimize Aid for Trade actions, which may have to compete with other development priorities, and assess country-level impacts on economic growth, poverty reduction and development through trade. Building on these principles, an Aid for Trade package should be a necessary complement to, not a substitute for, an ambitious pro-development round.

(Revised February 2006)

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Appendix

Table A1. Commitments of TRTA/CB by donor from 2001 to 2004
(million US dollars)

	2001			2002			2003			2004		
	Trade policy & regulations	Trade development (a)	*Contributions to Trust Funds (b)*	Trade policy & regulations	Trade development (a)	*Contributions to Trust Funds (b)*	Trade policy & regulations	Trade development (a)	*Contributions to Trust Funds (b)*	Trade policy & regulations	Trade development (a)	*Contributions to Trust Funds (b)*
Australia	8.9	5.3	*0.0*	2.7	8.8	*0.2*	11.6	2.7	*0.4*	11.8	1.2	*0.3*
Austria (c)	-	0.2	-	0.1	0.3	*0.2*	0.5	0.9	*0.2*	0.4	3.0	*0.2*
Belgium	0.7	8.4	*0.0*	1.5	6.9	*0.9*	1.7	56.9	*0.5*	0.5	47.5	*0.3*
Canada	38.3	44.1	*1.5*	9.7	20.9	*1.7*	51.2	33.3	*2.8*	21.4	31.1	*3.2*
Denmark	0.0	9.2	*1.8*	-	3.7	*1.5*	0.4	38.7	*3.5*	1.0	3.0	*2.7*
Finland (d)	1.3	2.3	*0.9*	3.7	2.6	*0.6*	2.0	8.6	*0.9*	-	-	*1.0*
France (e)	0.8	7.2	*0.9*	5.2	113.0	*0.7*	13.7	82.3	*2.7*	14.5	55.5	*1.3*
Germany	0.6	80.7	*1.3*	9.0	62.6	*1.8*	12.8	90.0	*2.5*	16.8	66.1	*3.4*
Greece (c)	-	-	*0.0*	-	-	*0.1*	0.4	0.1	-	0.6	-	*0.0*
Ireland	0.5	-	*0.4*	0.3	-	*0.4*	0.6	-	*0.5*	0.7	-	*0.3*
Italy (f)	0.2	6.0	*0.2*	1.0	2.8	*1.3*	0.4	2.3	*1.6*	0.7	7.8	*0.5*
Japan	20.6	35.8	*0.0*	16.1	34.9	*1.5*	43.6	33.9	*0.7*	7.8	30.5	*0.9*
Netherlands (g)	14.3	23.9	*3.5*	4.2	45.5	*3.3*	12.7	129.9	*3.3*	18.6	60.7	*3.5*
New Zealand	0.9	5.7	-	0.9	6.3	*0.2*	1.0	7.8	-	1.5	11.2	*0.2*
Norway (h)	4.1	33.0	*1.8*	0.9	7.6	*3.6*	4.7	38.6	*4.6*	6.1	30.2	*6.8*
Portugal	0.0	1.0	-	0.1	14.5	-	0.1	2.7	-	0.2	1.6	-
Spain (i)	0.3	0.6	*0.1*	1.5	0.7	*0.2*	2.8	2.8	*0.4*	0.5	1.4	*0.3*
Sweden	5.1	4.1	*2.0*	2.7	1.6	*4.1*	11.3	9.4	*3.8*	4.7	6.4	*2.6*
Switzerland	7.6	30.7	*5.7*	8.1	55.7	*5.4*	3.8	87.4	*6.1*	11.5	82.3	*6.3*
United Kingdom (j)	33.1	38.5	*1.2*	19.0	27.4	*2.6*	46.0	50.2	*1.4*	19.3	28.6	*3.0*
United States	179.2	376.3	*1.2*	179.4	436.2	*1.7*	187.6	520.6	*2.9*	198.8	596.3	*3.2*
Total DAC	**316.5**	**712.9**	22.7	**266.1**	**852.1**	32.1	**408.8**	**1 199.0**	38.9	**337.4**	**1 064.6**	40.1
Korea	0.6	1.8	*0.3*	0.6	0.3	*0.3*	0.8	0.4	*0.2*	1.0	1.3	*0.2*
Thailand	0.7	0.0		-	0.2		0.6	0.3		0.2	0.2	
Other bilateral (k)	2.0	1.2	*0.9*	8.2	3.0	*0.4*	15.8	2.3	*0.6*	0.5	0.1	*0.3*
Total bilateral	**319.8**	**715.9**	23.9	**274.9**	**855.5**	32.8	**426.0**	**1 202.0**	39.7	**339.1**	**1 066.2**	40.5
APEC	0.3	-	-	0.8	-	*0.0*	0.9	-	-	0.4	-	-
AsDB (d)	3.3	0.6	-	59.3	1.4	-	1.1	0.2	-	-	-	-
EC (j)	309.9	507.0	*0.6*	292.3	419.3	*0.0*	428.9	613.5	*1.0*	296.3	883.5	*0.2*
IDA	7	108	*0.2*	7.8	25.5	*0.8*	44.0	199.9	*1.3*	135.9	201.1	*1.5*
IDB (l)	-	-	-	0.0	-	-	0.1	-	-	10.6	0.1	-
IMF (d)	2	-	-	1.5	-	-	1.3	-	-	-	-	-
Isl.Dev Bank	-	-	*0.0*	-	0.1	*0.0*	3.4	-	*0.0*	0.2	-	-
UN (m)	5.0	6.4	*1.1*	7.2	9.4	*1.8*	8.8	12.0	*1.7*	5.7	11.5	*0.8*
Other multilateral (n)	0.4	0.9	*0.7*	0.7	0.9	*0.8*	1.8	0.7	*1.4*	1.2	0.9	*1.7*
Implemented by ITC	0.6	16.2		1.2	19.9		3.2	19.4		2.4	20.3	
Implemented by WTO	2.5	-		11.4	-		14.9	-		18.9	-	
Total multilateral	**330.2**	**639.0**	2.5	**382.1**	**476.6**	3.4	**508.3**	**845.7**	5.3	**471.7**	**1 117.4**	4.2
TOTAL	**650.0**	**1 354.9**	26.4	**657.0**	**1 332.1**	36.3	**934.3**	**2 047.8**	45.0	**810.9**	**2 183.7**	44.8

Notes:

(a) A number of donors isolated the trade component of each activity, whereas others reported the whole activity marking it trade-related. The total amounts of TRTA/CB in this category should therefore be interpreted with caution.

(b) Contributions to multilateral TCB Trust Funds (Integrated Framework, ITC, JITAP, WTO).

(c) Austria and Greece did not report to the TCBDB in 2001 and 2002. Austria's figures for these two years include only activities implemented (and reported) by multilateral agencies.

(d) Finland, the Asian Development Bank and the IMF did not provide data in 2004.

(e) The *Agence Française de Développement* (AFD) did not provide data in 2001.

(f) Italy did not report its 2003 and 2004 bilateral activities to the TCBDB. Hence, 2003 and 2004 totals shown in the table include only activities funded by Italy and implemented (and reported) by multilateral agencies.

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(g) Include as from 2002 the Dutch Program for Cooperation with Emerging Markets (PSOM), which is considered as 50 percent trade-related.
(h) Norway did not provide complete reporting for 2002; totals for this year are thus partial.
(i) Spain did not provide complete data in 2004.
(j) The decrease in 2004 is due to the periodicity of programming cycles of the EC and the UK. Preliminary EC 2005 figures estimate that commitments to trade policy and regulations will recover to 456 million US dollars and those to trade development will amount to 442 million.
(k) Includes countries that did not report but funded activities implemented by international organizations or contributed to TCB trust funds.
(l) The Inter-American Development Bank did not provide data from 2001 to 2003. Amounts for these years include only activities implemented (and reported) by another donor.
(m) Includes ESCAP, ESCWA, FAO, UNCTAD, UNDP, UNECE and UNIDO.
(n) Includes various other agencies which funded activities reported by other multilaterals or which contributed to TCB Trust funds. The EBRD and the IBRD provide non concessional loans; their commitments are thus not included in the table.
Source: WTO/OECD (2005).

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Chapter 6

Why and How Differentiate Developing Countries in the WTO? Theoretical Options and Negotiating Solutions

Anne-Sophie Novel[1] and Jean-Marie Paugam[2]

The topic of differentiation amongst developing countries in the WTO has become a totem for developed countries, and a taboo for developing ones. As in the classical Freudian scheme, the mythological origins of the totemic character have long been forgotten, but the sacred nature of the taboo prohibition stands enshrined beyond discussion.

How did it happen? The Doha Declaration extensively resorts to the concept of "special and differential treatment" (SDT) of developing countries (DCs) but does not even spell the word "differentiation".

Since the inception of the Doha Development Agenda (DDA), a North-South opposition has been embodied in two conflicting approaches of the SDT negotiating mandate.

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Developed countries promoted a crosscutting conceptual approach of SDT objectives, whereas developing countries tabled 88 specific proposals for re-consideration of the SDT provisions adopted during the Uruguay Round. Developed countries would not agree with any specific proposal prior to global clarification of the scope and objectives of SDT. DCs would refuse to give up negotiating specifics before entering an open-ended horizontal discussion. In classical WTO manner, procedural tricks were invented to bridge the gap. The 88 SDT requests were broken down into three baskets: one for measures likely to achieve consensus (most of them of low development impact); other for measures unlikely ever to obtain consensus; and the last one for measures needing consideration in appropriate DDA sectorial negotiating committees. Yet the breakdown approach failed twice to deliver negotiating results, in Cancun (2003) and Geneva (2004).

Developed countries have increasingly asserted that they would not grant the same SDT concessions to all DCs, whatever the economic size and diversity of these latter. In a nutshell, they claim that the "one size" of WTO rules "does not fit all" the diverse developing economies. Thus differentiation has emerged as a political issue. Negotiators representing developed countries have voiced their claim more and more emphatically following the failure of the WTO Cancun Ministerial. US Trade Representative, Robert Zoellick, explicitly made a case for differentiation in a letter to his WTO colleagues.[3] EU Commissioner for External Trade, Peter Mandelson, later echoed and reinforced the argument in his first major address on trade and development.[4] Both saw SDT negotiations and differentiation of DCs as communicating vessels: an ambitious SDT regime may only be achieved on the condition of a better differentiation of beneficiaries. Less differentiation would mean less SDT.

Developing countries unanimously rejected differentiation in principle. They have acted accordingly. Mexico and South Korea, both DCs in the WTO and OECD members, torpedoed

3. 11 January 2004.

4. Trade at the service of development. Lecture at the London School of Economics, 4 February 2005.

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the OECD's research initiative on economic calibration of countries. India launched a major WTO dispute against the European "Drug-GSP",[5] alleging discriminatory differentiation amongst DCs. In the run-up to the Geneva "July 2004 package" agreement relaunching the DDA negotiations, DCs stonewalled all attempts to make mention of differentiation.[6] The "package" therefore ended up with vague and insubstantial language on SDT, without specific objectives and measures. From then on, SDT negotiations have remained essentially deadlocked. All things remaining equal, chances are that this deadlock will not be broken.

Against this political backdrop academic research has been undertaken to help rationalize the totem and the taboo and to identify possible ways forward in the negotiations. This paper reviews the literature on differentiation. It aims at taking stock of its main findings in order to contribute to designing achievable negotiating solutions. The paper's main focus falls on differentiation under WTO SDT rules rather than on market access preferential regimes. The first section outlines the legal and economic cases for more differentiation in the WTO. The second section reviews and assesses alternative theoretical options for differentiation of DCs. The third section discusses the political economy of differentiation in the WTO context in order to suggest a way forward in the framework of the DDA negotiations.

Differentiation in Principle: Laying Out the Legal and Economic Cases

The legal WTO basis of SDT is the "Enabling Clause"[7] inherited from the Tokyo Round (1973-1979). Under current WTO rules, developing country status, which gives entitlement to SDT benefits, is simply obtained through self-declaration. Based on this mechanism, the WTO acknowledges 112 self-declared DCs out of 148 members. Of these, 32 have least

5. A special Generalized System of Preferences scheme providing trade incentives to countries engaged in combating drug production and trafficking.
6. ICTSD, February 2005. Doha Round Briefing Series, Special and Differential Treatment.
7. Differential and more favourable treatment reciprocity and fuller participation of developing countries, Decision of 28 November 1979.

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developed country (LDCs) status providing access to extended SDT rights. The 80 remaining "pure" developing countries' legal group gathers countries as diverse in size, population, wealth and trade capacities, geographic and political conditions as, for instance, Nigeria, Saint Lucia and China. From such a blatant discrepancy between legal uniformity and economic diversity, one may infer that more legal fine-tuning may contribute to better operation of trade rules. Yet, is the intuitive case for differentiation strong enough to deserve official WTO consideration? The answer in the literature is a clear yes. The WTO system entails no insuperable legal provision opposing differentiation between developing countries: on the contrary, it already resorts to legal differentiation. Moreover, there are good enough economic reasons for it, considering that the current SDT legal regime has been far from successful in delivering development.

The differentiation principle in the WTO: Not only legally based but already implemented

The content of special and differential treatment has evolved through the GATT and WTO history. Prior to the Uruguay Round, developing countries received special and differential treatment (SDT) in six different areas. The first from Article XVIII of GATT 1947 gave DCs the right to protect infant industries and to use trade restrictions for balance-of-payments purposes. The second may be identified in three articles (XXXVI, XXXVII and XXXVIII) under Part IV of GATT 1964 which recognized the special needs of DCs in the trading system and exempted them from making reciprocal tariff concessions. And the remaining four areas may be found in the 1979 framework agreement, commonly known as the Enabling Clause.[8]

Legal common sense suggests that the notion of "special" *and* "differential" treatment does not epitomize a merely pleonastic mantra but rather two different sources of legal meaning. A "special" treatment should automatically be "differ-

8. For a detailed review of the origin and evolution of SDT in the GATT/WTO, see OECD (2001), The Development Dimensions of Trade, OECD, Paris.

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ential": thus the question is how the two words relate to each other. From the Oxford English Dictionary, "differential" means "constituting or depending on a difference, differing or varying according to circumstances or relevant factors": this suggests that a differential status should be grounded on objective facts. Under the provisions of the Enabling clause, the adjective "special" is exclusively associated with the category of LDCs, be it for consideration of their "treatment", "economic difficulties", or "particular situation". In contrast, the notion of "differential and more favorable" treatment applies to the broader category of DCs.[9] Therefore, both the legal and linguistic contexts provide clues that objectively differentiating the treatment of DCs according to their level of development may be intrinsic to SDT.

Beyond contextual clues, various WTO rules and practices indicate that the system legally admits and implements differentiation amongst DCs.

First, the Enabling Clause explicitly asserts the dynamic and evolving nature of SDT. "The Enabling Clause provides specific legal cover for the Generalised System of Preferences (GSP), for special and differential treatment under the Tokyo Round Codes, for regional arrangements among DCs, and for special treatment in favor of the least developed countries."[10] The title of the decision itself sets the twin objectives of "reciprocity and fuller participation of Developing Countries": this suggests a causal linkage between increased trade participation of DCs and their progression toward reciprocal trade commitments. Paragraph 7 of the decision details the expectations toward DCs: "their capacity to make contributions or negotiated concessions or take other mutually agreed action" will improve with their economic development; "and they would accordingly expect to participate more fully in the framework for rights and obligations". Paragraph 9 of the Enabling clause eventually invites WTO members to "bear in

9. The UN also commonly refers to the global relation between developed and developing countries through the "common but differentiated responsibilities" in the Rio Agenda for sustainable development.
10. In Laird, Sam, Raed Safadi and Alessandro Turini, "The WTO and Development," in Douglas Nelson (ed.). The Political Economy of Policy Reforms, Elsevier, 2004.

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mind" its ultimate goal and rationale, which is: "to meet the development needs of DCs and the objectives of the GATT", implying the reciprocity of trade commitments. Thus, the principle of DCs graduation from SDT is embedded in its legal base.

Second, one major ambiguity in the Enabling Clause has been clarified by the WTO Dispute Settlement Appellate Body. The appellate body acknowledged the principle of differentiation between DCs and specified its legal status and conditions in a 2004 ruling. India had disputed the European special GSP providing special trade preferences to DCs engaged in combating drug trafficking. India argued that such a differentiating regime was incompatible with the GATT (article I) non-discrimination principle. The appellate body ruling clarified two major points regarding the legal relation between the Most Favored Nation (MFN) provision and the Enabling clause. First, it established that the Enabling Clause constituted an exception to the GATT-MFN provision, and not a "Lex Specialis" creating an autonomous and equal legal regime. Second, the appellate body clearly laid out the conditions authorizing differentiation between DCs in preferential trade regimes: "we conclude that the term 'non-discriminatory' (...) does not prohibit developed-country Members from granting different tariffs to products originating in different GSP beneficiaries, provided that such differential tariff treatment meets the remaining conditions in the Enabling Clause. In granting such differential tariff treatment, however, preference-granting countries are required, by virtue of the term 'non-discriminatory', to ensure that identical treatment is available to all similarly-situated GSP beneficiaries, that is, to all GSP beneficiaries that have the 'development, financial and trade needs' to which the treatment in question is intended to respond".

Third, various WTO agreements have already established differentiated sub-categories of DCs. The category of LDCs proceeds from the Enabling clause itself. The Uruguay Round also established new DCs sub-categories eligible for specific SDT provisions. The Agreement on Subsidies and Countervailing Measures (SCM) recognized a specific sub-

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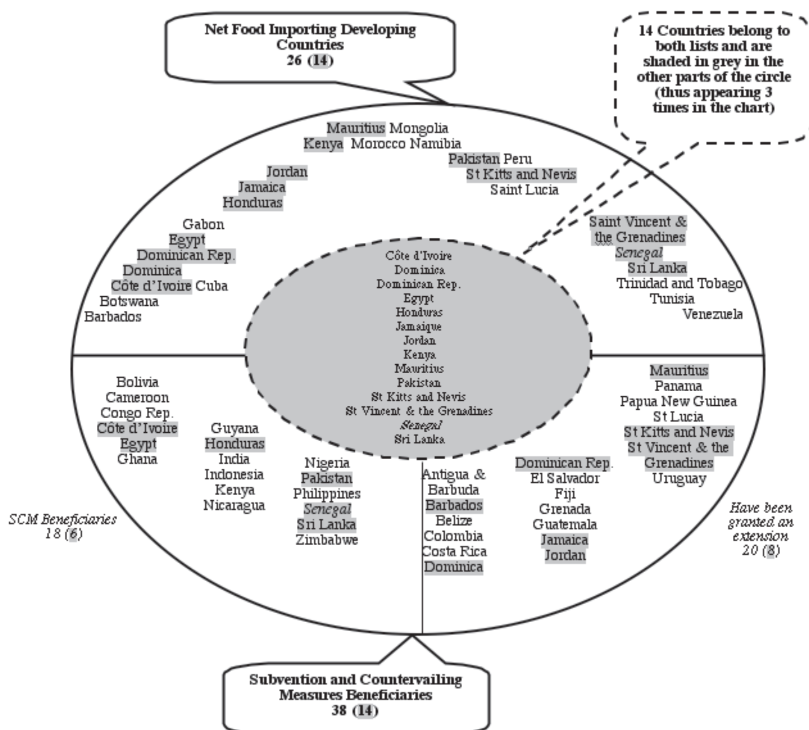
Graph 1. Differentiated WTO Sub-Categories for Food Security and Exports Subsidies SDT



Source: Authors, from WTO (2005), Keck and Low (2004). Except for Senegal (recently added to the list) LDCs are not taken into account in this graph since they automatically benefit from the measures at stake.

category of DCs (listed in its Annex VII)[11] for countries with a GNP per capita inferior to 1000 US dollars per year.[12] These countries may use export subsidies for a product, as long as their exports remain below a threshold of global market share (3.25 percent of world exports of the product). The specific group of the "net food-importing developing countries" (NFIDCs) was also established[13] in recognition of their

11. Beyond this the SCM agreement also provides to "Members in the process of transformation from a centrally-planned into a market, free-enterprise economy" transitory flexibilities for exports subsidies.
12. This threshold has been adopted during the Uruguay Round Negotiations. No document is available on the roots of this figure, but some highlights about the methodology can be found on the WTO website. See in particular document G/SCM/38.
13. Decisions adopted by the Trade Negotiations Committee on 15 December 1993 and 14 April 1994. Agriculture: measures concerning the possible negative effect of the reform program for "net food-importing countries" and LDCs.

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particular food security needs, justifying corresponding SDT measures.

The following graph confronts both sub-categories of DCs under current WTO rules: it shows that only 14 states simultaneously belong to both categories; 24 states are only eligible for SCM; and 12 states are only eligible for NFIDCs. Others DCs are not considered in need of these particular SDT benefits.

Albeit not concluded yet, the DDA has already created another category of members under the framework of the Trade-Related aspects of Intellectual Property rights (TRIPS) agreement. The decisions adopted in Doha (2001) and Geneva (2003)[14] recognize special rights for the category of "WTO members with insufficient or no pharmaceutical manufacturing capacities". Furthermore, some higher-income developing countries have "voluntarily" accepted to exclude themselves from the benefit of the flexibilities introduced in the new intellectual property regime.

Fourth, while not legally created under WTO disciplines, several differentiated DCs groups are politically recognized in the WTO negotiations. Their special interests are expressed in several official documents. For instance, the Doha Ministerial Declaration creates a work program on "small –and vulnerable– economies", albeit explicitly rejecting the creation of a new sub-category of members. Other developing countries groups assert particular economic interests in their negotiating stances: for instance, the Small Island Developing States (SIDS), while not being defined through legal criteria (Encontre 2004), act as a political category within the WTO and benefit from particular preferences in the developed countries GSP schemes (Inama 2004).

Far from preventing differentiation amongst developing countries, the WTO legal system pragmatically encourages it when needed.

14. Ministerial Declaration on the TRIPS agreement and public health, 14 November 2001. Implementation of paragraph 6 of the Doha Declaration on the TRIPS Agreement and public health, Decision of the General Council, 30 August 2003.

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The economic case for developing country differentiation in the WTO: Improving the development impact of SDT

The economic case for better DC differentiation in the WTO is built upon three major arguments.

"One size does not fit all"

All international economic organizations (multilateral and bilateral) carrying a development mandate differentiate DCs according to their situations and development needs, in terms of economic vulnerability, trade development or poverty reduction. For instance, such criteria determine eligibility for borrowing from the World Bank based on per capita income, social indicators, creditworthiness, and economic and social policy performance. Furthermore, borrowing from the International Bank for Reconstruction and Development (IBRD) is at market terms, and borrowing from the International Development Association (IDA) is at concessional terms. Yet for "small island states" the Bank mitigated the impact of its IDA cut-off threshold by granting special access to IDA resources for selected island states that would have otherwise graduated based on their per capita GDP.[15] This suggests that differentiation of countries sharing comparable conditions is relevant for the efficiency of development policies.

Table 1 superposes the WTO's and other DC classifications to illustrate the difficulty of framing developing countries diversity under uniform SDT rules.

The claim that "one size does not fit all" in the WTO finds significant support in the literature.

Yet differentiation cannot be considered itself a "silver bullet" for delivering economic development out of international trade. For instance, while most preferential market access schemes do implement some graduation mechanisms involving differentiation, mainstream economic analysis concludes that these schemes have delivered mixed or poor

15. "World Bank Support for Small States", Background Paper N°2, Submission by the World Bank. UN Commission on sustainable development, twelfth session, April 2004.

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Table 1. WTO Members and International Countries Classifications

Developed Countries in the WTO (36)	*Small Island Developing States (SIDS) (30)*	Underlined Countries: OECD (30)
LDCs (32 WTO members and 11 WTO observers)	**Land Locked Developing Countries (LLDCs) (31)**	* WTO Observers (32)

Low Income (55) - (Income Per Capita: $765 or less)			
Afghanistan *	Equatorial Guinea *	**Mali**	Senegal
Angola	**Ethiopia ***	Mauritania	Sierra Leone
Bangladesh	Gambia, The	**Moldova, Rep.**	*Solomon Islands*
Benin	Ghana	**Mongolia**	Sudan *
Bhutan *	Guinea	Mozambique	**Tadjikistan ***
Burkina Faso	*Guinea-Bissau*	Myanmar	Tanzania
Burundi	*Haiti*	**Nepal**	Togo
Cambodia	India	Nicaragua	**Uganda**
Cameroon	Kenya	**Niger**	**Uzbekistan ***
Central African Rep.	**Kyrgyz Republic**	Nigeria	Vietnam *
Chad	**Lao PDR ***	Pakistan	Yemen, Rep. *
Congo	**Lesotho**	*Papoua New Guinea*	**Zambia**
Congo, Dem. Rep	Madagascar	**Rwanda**	**Zimbabwe**
Côte d'Ivoire	**Malawi**	*Sao Tomé et Principe **	

Lower Middle Income (52) - (Income Per Capita: $766–3,035)			
Albania	Djibouti	*Jamaica*	*Samoa **
Algeria *	*Dominican Republic*	Jordan	Serbia *
Armenia	Ecuador	**Kazakhstan ***	South Africa
Azerbaïdjan *	Egypt, Arab Rep.	**Macedonia, FYR**	Sri Lanka
Belarus *	El Salvador	*Maldives*	*Suriname*
Bolivia	*Fiji*	Montenegro *	**Swaziland**
Bosnia and Herzegovina *	Georgia	Morocco	Thailande
Brazil	Guatemala	Namibia	*Tonga **
Bulgaria	*Guyana*	**Paraguay**	Tunisia
*Cape Verde, rep. **	Honduras	Peru	Turkey
China	Indonésia	Philippines	**Turkmenistan**
Colombia	Iran, Islamic Rep. *	Romania	Ukraine *
Cuba	Iraq *	Russian federation *	*Vanuatu **

Upper Middle Income (33) - (Income Per Capita: $3,036–9,385)		
Antigua and Barbuda	Gabon	Panama
Argentina	*Grenada*	Poland
Barbados	Hungary	Saudi Arabia *
Belize	Latvia	*Seychelles **
Botswana	Lebanon	Slovak Republic
Chile	Libya *	*Saint-Kitts-et-Nevis*
Costa Rica	Lithuania	*Sainte-Lucia*
Croatia	Malaysia	*Saint-Vincent-and-the-Grenadines*
Czech Republic	*Mauritius*	*Trinidad and Tobago*
Dominica	Mexico	Uruguay
Estonia	Oman	Venezuela, Bolivian Republic of

High Income (40) - (Income Per Capita: $9,386 or more)		
Andorra *	Hong Kong, China	New Zealand
Australia	Iceland	Norway
Austria	Ireland	Portugal
*Bahamas, The **	Israel	Qatar
Bahrain, Kingdom of	Italy	Singapore
Belgium	Japan	Slovenia
Brunei Darussalam	Korea, Rep.	Spain
Canada	Kuwait	Sweden
Cyprus	Liechtenstein	Switzerland
Denmark	Luxembourg	Chinese Taipei
Finland	Macao, China	United Arab Emirates
France	Malta	United Kingdom
Germany	Netherlands (for the Kingdom and…	United States
Greece	*…the Netherland Antilles)*	

Sources: Authors, derived from the World Bank, WTO, OECD, UNCTAD, and Swedish Board of Agriculture.

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results for development.[16] Major obstacles to their economic efficiency stem from legal unpredictability of unilateral preferences, restrictiveness and complexity of preferential rules of origins, exemptions of sensitive products corresponding to major DC exports and insufficient supply-side capacities.

Differentiation is more widely seen as an issue for improving the efficiency of SDT rules. Most empirical assessments tend to conclude that the majority of SDT rules have proved poorly effective and operational as is also implicitly acknowledged in the Doha Declaration. The "best effort" commitments of developed countries from the Uruguay Round have not been properly monitored and indeed failed to materialize since they were not legally binding. Furthermore, several research works described in the second section suggest that the existing WTO DC sub-categories do not fully reach their development targets. These authors specifically point at weak correlation between the granting of legal benefits from SDT measures and the actual development problems that they are meant to solve.

Trade policy as a second-best development instrument

A significant body of literature concludes that, by itself, trade policy is not an efficient instrument to achieve such development objectives such as industrial and technological development, poverty reduction, food security, social development, support to farm incomes and rural activity. Bhagwati (2002) has long argued against the folly of trying to "kill two birds with one stone": market failures and imperfections should better be addressed directly through appropriate policies, than indirectly through trade policy distortions. Hoekman (2003), Keck and Low (2004), review the shortcomings of the "infant industry" argument for trade policy distortions. For them, the few success stories of strategic trade policies favoring industrial development are usually associated with other policy factors: institutional governance, investment in infrastructures and human capital, improvement in the tax system and market regulations. Rodrik *et al.* (2003) also argue that the quality of institutions holds the first role in the dynamics of growth and development.

16. Amongst many, see for instance: Michalopoulos (2002), Stevens (2002), Whalley (2002), Winters (1987), World Bank (2003).

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However, Hoekman *et al.* (2003) recognize a specific case for the poorest countries endowed with low resources and institutional capacities. For these, trade policy instruments may offer a good second-best –if not unique– option to achieving their development objectives. Exemptions from WTO trade rules may also legitimately be preferred when and where their implementation would prove too resource intensive (as for intellectual property protection, competition rules or trade facilitation) and thus unsuited to local needs.

Therefore, the cost/benefit analysis of trade distorting policies in DCs supports the economic case for differentiation. SDT exemptions from trade rules should primarily benefit the most vulnerable countries deprived from alternatives to trade policy instruments. Technical assistance commitments and transition periods should also be grounded on a realistic assessment of rules implementation capacities.

Negative externalities for others

Stevens (2002), Page and Kleen (2005) consider SDT as a compromise between the public good resulting from predictable trade rules, and the costs of derogations granted to DCs. Exemptions from general trade rules inflict economic harm on others. The expected benefits of the additional "policy space" granted to DCs through SDT measures must be checked against their potential negative externalities for trading partners. Odds are great that the negative externalities from the smallest trading powers will be negligible, whatever the importance of SDT rules exemptions. But important negative externalities are anticipated from granting the same SDT treatment to the poorest countries and the emerging trading powers. It is therefore unlikely that ambitious and efficient SDT provisions be agreed upon without further differentiating DCs. As discussed in the third section, this trade-off lies at the heart of the political economy of current DDA negotiations on SDT.

Differentiation in Theory: Assessing the WTO's Options

Differentiation aims at grouping DCs more fairly and efficiently to achieve the first objective of SDT: development. Intellectually, theoretical options for differentiation range

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from full uniformity ("one size fits all") to case-by-case approaches for individual countries' strategies ("each one its size"). In between, the literature suggests three types of approaches: country-based differentiation; rules-based differentiation; or an empirical mix of both.

Calibration and graduation: The country-based approaches

Country-based approaches aim at grouping countries sharing similar objective development situations, identified through geographic criteria or socio-economic indicators.

Geographic criteria

A first possible geographic differentiation may rely on regional groupings. The UN system identifies six world regions: Latin America and the Caribbean, Sub Saharan Africa, East Asia and the Pacific, Europe and Central Asia, Middle East and North Africa, and South Asia. Yet the diversity of development levels and trade situations within each region makes such a classification hardly relevant to the purpose of SDT in the WTO (box 1).

A second approach considers geographic criteria independent from trade such as relief, climate, natural resources, and exposition to natural disasters. Vulnerability indexes for countries can be elaborated by combining such criteria. The purpose of SDT measures would then be to compensate for the natural handicaps of vulnerable countries where "geographic diseases" concentrate. Such a rationale has modestly been introduced into the WTO, for instance through the notion of "small and vulnerable economies" in the Doha mandate. Political action of the Small Island Developing States or the Landlocked Developing Countries (LLDCs) also provides examples of an effort toward geographic classification.

Yet, the case for geographic differentiation in the WTO is weak. For instance, "smallness" is a vague and open-ended notion since it may characterize the size of a country's territory, population or economy. Page and Kleen (2005) underline the lack of established correlation between unfavorable geographical conditions and poverty or economic

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Box 1. Country-Based Approaches and Trade Criteria

The FAO establishes four trade-related categories of countries: "net food importing" (NFIM - 105), "net food exporting" (NFEX - 43), Net Agricultural Importing (NAIM - 85) and Net Agricultural Exporting (NAEX - 63). Confronting these categories with other possible classifications illustrates the difficulty of importing other organizations' criteria into the WTO.

Geographic criteria

Regions: East Asia and Pacific include NAEX, NFIM and NAIM countries. 75 percent of DCs in South Asia are NFIM and NAIM. Latin America and the Caribbean countries import food and agricultural products. All but three are SIDSs. In Europe and Central Asia, countries are net importers as well as net exporters. Middle East and North Africa countries are all NFIM and NAIM (except one). 60 percent of Sub-Saharan African countries are net importers, and 40 percent are net exporters.

Geography: SIDSs and LLDCs claim recognition in the WTO. They suffer from several handicaps, usually are NFIM and NAIM, and considered food insecure countries. But the criteria they present are not sufficient to define new sub-categories. They may be treated more easily under the category of NFIDCs.

Socio-economic criteria

GDP per capita: UNCTAD, OECD and the World Bank classify low-income, middle-income and high-income countries. The thresholds differ from one organization to another.

Net Trade Position: the majority of DCs falls into NFIM and NAIM categories, half of them are low-incomes. 43 percent of DCs are NAEX, and more than half of them are low-income countries. One third of DCs are NFEX, spread over different income categories. The UN defines another group: "low-income food deficit countries" (LIFDCs - 58). They all belong to the Low Income countries category. Two-thirds of the LIFDCs and all the LDCs are NFIM.

Human development: The UN Human Development Index classifies countries in low/middle/high human development groups. The criteria may be taken into account for SDT benefits, but are not sufficient alone.

Source: FAO, SBA, UNDP, WTO.

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performance. They point out that every single country may virtually exhibit at least one criterion of geographic vulnerability. Special trade measures thus can hardly provide *a priori* adapted answers to geographic diseases.

Socio-economic indicators

Unlike geographic criteria, socio-economic indicators can explain the dynamic of economic development. The World Bank, UNDP, UNCTAD, and OECD use classification matrixes based on economic criteria (GNP per capita, vulnerability index), social criteria (human development indexes) or institutional criteria (governance, freedom index). Trade related indicators are used in the UN definitions of LDCs, "low income food deficit countries" and "transition markets". The Food and Agriculture Organization (FAO) defines four categories of DCs based on their net trade agricultural position (box 1).

However, most of these indicators do not specifically address the overall trade situation nor the integration of DCs in the global trading system: most of them would therefore be unsuited to the WTO context. The LDCs category is an understandable exception since these countries accumulate economic and social problems but hold a very small share of world trade. Thus WTO members can reasonably accept the UN category as a good proxy for targeting a group of countries legitimately entitled to special trade measures, without imposing significant negative externalities on international trade.

Country criteria could be technically adapted to the WTO by better weighting in trade characteristics. Developed countries unilaterally developed such criteria for "graduating" countries out of their GSP schemes. The graduation is usually triggered by macro-economic and trade specific thresholds, combining country-based approaches (whole eligibility of a country to preferential programs) and product-based approaches (exclusion of a country's sector or product that has become internationally competitive).

Yet, elaborating cross-country criteria to create new horizontal WTO sub-categories of developing members is generally considered politically impossible, since major distributional consequences are anticipated. Keck and Low (2004)

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thus report that "a calibration exercise that has recently been undertaken by the OECD was put on the back burner by OECD members, supposedly because whatever statistical approach chosen, some developing countries were always grouped together with developed countries and others with LDCs."

"Implicit thresholds": The rules-based approaches

The second type of approach to differentiation aims at defining objective criteria for SDT eligibility on an agreement-by-agreement basis. For Stevens (2002) these approaches are "based on the premise that eligible countries must share a set of "differences" that are directly related to the rules for which SDT is proposed". For Hoekman *et al.* (2003) they "involve country-based criteria that are applied on an agreement-by-agreement basis to determine whether (and when) agreements should be implemented".

The starting point is thus opposite to country calibration. It starts by confronting WTO disciplines with the SDT stated objectives. The first step involves designing relevant criteria for the purpose of each specific SDT measure. The second step requires identification of the targeted group of countries corresponding to the final SDT objective. This approach intends to ensure that SDT measures are finely tuned to specific development needs under diverse WTO disciplines. As for the country-based approaches, a graduation based on objective economic criteria is inherent to the system. But the graduation is not horizontal: a country may graduate from a specific SDT measure while remaining eligible for others.

Stevens (2002) and Keck and Low (2004) developed enlightening case studies of this "implicit threshold approach". They illustrate how specific SDT provisions require specific eligibility criteria and country groupings to efficiently achieve their purpose.

Stevens analyzes how SDT measures in the WTO Agreement on Agriculture effectively articulate with the food security objectives recognized in the decision on LDCs and "net food importing developing countries". He shows that countries actually benefiting from Agriculture SDT measures

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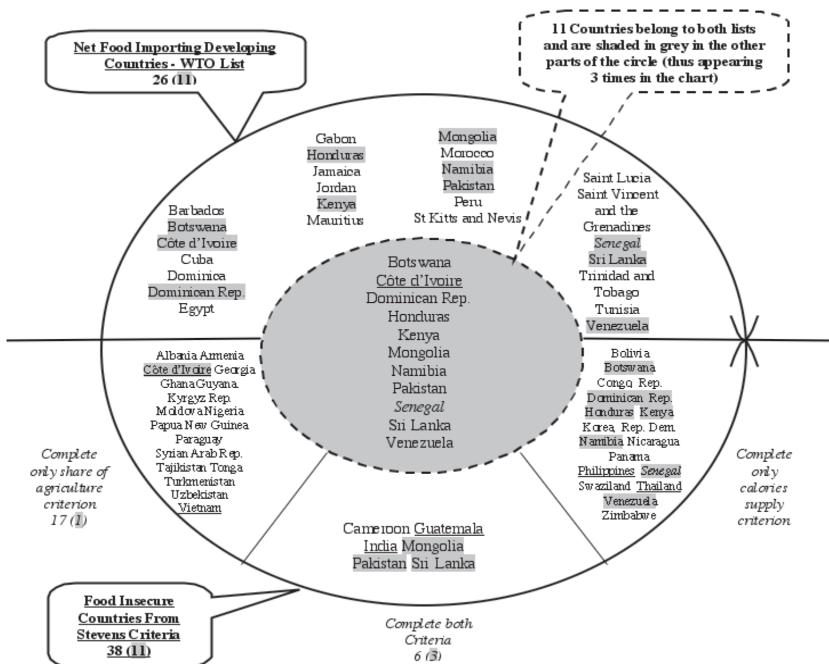
do not always correspond to countries in need (except for LDCs) according to objective food insecurity criteria.

Keck and Low apply a similar methodology to elaborate eligibility criteria for the benefit of SDT under Article 27.4 of the SCM Agreement.[17] They show that using Stevens' country groupings for food security to determine eligibility for the SCM measure would lead to the exclusion of 19 countries from the current WTO list of beneficiaries. Reciprocally, using the SCM Annex VII list to determine eligible SDT beneficiaries for food security reasons would exclude 19 objectively deserving countries. Only half the countries in both lists actually overlap. Graph 2 compares the WTO official NFIDCs list with the group of countries obtained with Stevens' food insecurity criteria (see also box 2 on next page for explainations).

Graph 2. Stevens' Methodology: Food Security and SDT in Agriculture



Sources: Authors, from Stevens (2002), FAO (2005), World Bank Online Database on Development Indicators. The same remark than for graph 1 applies here concerning LDCs and Senegal's status.

17. This provision allows selected countries to use certain types of export subsidies (see "The differentiation principle in the WTO: Not only legally based but already implemented").

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Box 2. Stevens' Methodology: Food Security and SDT in Agriculture

A country is deemed suffering from food insecurity when its food production does not ensure its population's needs and when it depends strongly on imports. *Stevens shows that the LDCs and NFIDCs categories that currently benefit SDT measures for food security are not appropriate.* Low GDP and reliance on food imports are necessary but insufficient criteria of food insecurity. *Other WTO members should be eligible for the specific SDT measures, based on another set of objective food insecurity criteria.*

Stevens' methodology first identifies the WTO agriculture rules that may adversely impact food security policies of WTO members (e.g. domestic subsidies). Second, he identifies countries potentially vulnerable to a tightening of the considered rule. To that end, he selects objective criteria reflecting food insecurity conditions.
– *First, the daily calories supply (DES)*: the threshold is fixed at 2500 calories a day (or less). From this indicator we find that 12 out of 51 selected countries are neither LDCs nor NFIDCs WTO members. Conversely, some LDCs and NFIDCs carry calories supply above the 2500 calories threshold of food insecurity.
– *Second, agricultural dependence*: the criterion relates food insecurity to agricultural income and/or domestic production. Over 20 percent of GDP in agriculture makes a country potentially prone to food insecurity. Combining this criterion with DES leads to selecting 77 countries. As almost all LDCs verify the criteria (except for 14 of them for which no recent information on DES is provided) and as they are presumed to qualify for SDT in this case, we focus on DCs. 27 states belong neither to the LDC nor the NFIDC group; among them, 10 have a share of agriculture superior to 20 percent. Thus, as Stevens asserts, "*the LDC and NFIDC categories appear to overlap only partially with these other criteria of vulnerability*". Only 11 countries on the 26 listed in the NFIDCs suffer from food insecurity (as defined by Stevens).
– *Third, trade vulnerability index* (share of agricultural exports in world agricultural exports) confirms that the existing WTO categories are not appropriate to target food security needs.

NB: The pie graph updates Stevens' results with the latest available statistics from his selected sources. Therefore the countries' list is slightly different here from his but his fundamental conclusions are still verified.

Two conclusions arise. First, the more specific the thresholds are, the more SDT measures can effectively achieve their development target. Second, specific eligibility criteria to a particular SDT measure cannot be relevantly duplicated in another rules context.

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The "rule of thumb": An empirical approach to differentiation

Some WTO regulatory disciplines may generate significant implementation costs and prove unsuited to particular DC situations, especially low-income countries. According to Hoekman (2003), "countries may lack the scale needed for benefits to exceed implementation costs". For these countries the domestic conditions must be improved before implementing the concerned WTO rules.

Hoekman *et al.* (2003) consider that SDT measures should be reserved to such cases. Hence they propose a "rule of thumb" approach by mixing "country-based" and "rules-based". First, they identify a group of countries mostly in need: *prima facie* that group would include LDCs, the other low-income countries, and small economies with weak institutional capacities. This "LDC+" group would essentially be required to comply with the "core" WTO principles (non-discrimination, prohibition of quantitative restrictions, tariffs binding, and transparency). Countries in the group would be left an option for opting out of the "non-core" WTO disciplines, either because they require resource intensive implementation (such as TRIPS) or because they may hinder development priorities (such as public health or food security). A "right of appeal" would allow others DCs, excluded from the "LDC+" group, to make their case for selected SDT benefits. For these countries a "tailor made approach" would be needed, based on regular audit and examination of their needs.

The "rule of thumb" thus suggests a bottom-up approach to SDT, essentially based on an income level criterion. Reserving SDT to the "LDC+" group would likely inflict minor harm to others WTO members, due to their limited economic size and trade capacities. Yet for other DCs, the approach would rely on a transparent peer-review of SDT measures effectively needed to support their development strategy. Such a process could be technically linked with the Trade Policy Review Mechanism and supported by technical assistance from international agencies.[18] Yet, its implementation in the

18. Enhancing and extending the Integrated Framework for LDCs may be an option to that end.

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WTO may prove difficult, time-consuming and costly. From that perspective, the "rule of thumb" differentiation would induce important legal uncertainty and significant transaction costs. Another critical issue with this approach would be delineating some as "core WTO agreements" and others as "non-core". Opponents consider these consequences as major drawbacks in the "rule of thumb" proposition making it impractical.

Differentiation in the DDA: Assembling the Negotiating Tool-Kit

The political economy of differentiation in the WTO context

All theoretical approaches to differentiation aim at improving the "development impact" of SDT rules.

Yet assessing their respective merits and feasibility requires consideration of the WTO "real world" political economy. Any valuable WTO discussion on differentiation should first and foremost focus on politically achievable options. To that end, four political economy parameters must be weighted in.

– *"Development impact" (SDT efficiency):* the literature suggests that the development impact of SDT will be highly correlated with the accuracy of the economic indicators selected to proxy the reality of DC trade situation and development needs. In a nutshell, fine-tuning through detailed differentiation indicators will improve the efficiency of SDT measures. From that perspective, the rules-based approaches are expected to deliver higher development results than the country-based approaches.

– *Distribution costs.* Country-based classifications would induce important horizontal distributional consequences compared to the current status quo, since some countries would immediately graduate out of SDT. As noted in Page and Kleen (2005) "even if indicators could be agreed, the fact that SDT represents a balance between a country's needs and damage to others means that the boundary must be negotiated. In any definition of criteria, the choice of criteria will be influenced by countries' knowledge of where they will

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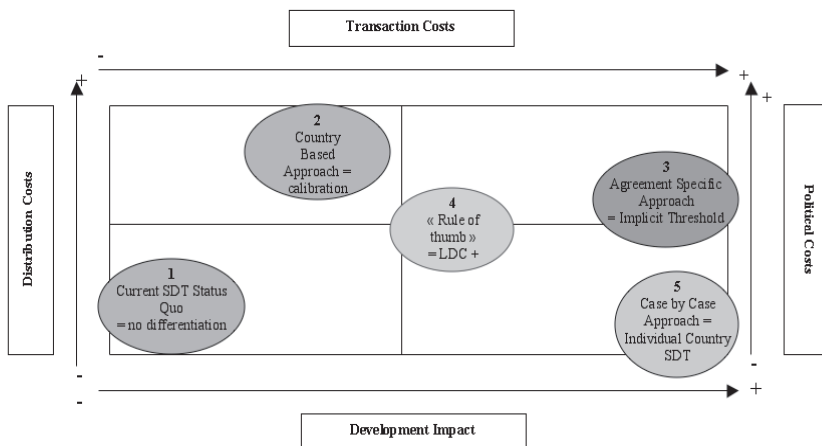
fall". Under a rules-based approach the distribution effects would be scattered by various specific agreement's thresholds triggering-off graduation, thus harder to anticipate and measure.

– *Transaction costs.* All the proposed differentiation methodologies would generate important transaction costs in the WTO. A rules-based approach would mobilize a considerable amount of preparatory work and negotiating capital before achieving a political consensus on economic threshold definitions for each WTO agreement or relevant SDT measure. A "rule of thumb" approach to SDT would minimize these transaction costs ex-ante but generate others ex-post due to the need for tailor-made decisions on SDT benefits for individual countries. The "right of appeal" would carry three risks that are difficult to manage: political deadlocks, legal unpredictability and possible discriminations between countries in a similar situation.

– *Political costs.* Due to uncertainties about their distribution impact, differentiation negotiating proposals stir major North-South and South-South confrontations. The political economy of the "rule of thumb" essentially bets on the probability of reaching a WTO consensus for concentrating SDT on more vulnerable countries. The rules-based option bets on the possibility of moving the traditional lines of North-South confrontation by multiplying possibilities of trade-offs: each

Graph 3. Political Economy of Alternative Differentiation Approaches in the WTO



Source: Authors.

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DC may be eligible for SDT specific measures in the context of one agreement while not in another.

The matrix in graph 3 shows how these parameters would intuitively combine.

Principles for achieving differentiation in the DDA

A political "rule of thumb" is certainly needed to draw a path to starting effective WTO negotiations on differentiation. Yet three principles may contribute to defining the scope of a politically acceptable and technically manageable discussion.

Principle #1 – Confidence-building: Differentiation should be exclusively development oriented

Developing countries that are members of the WTO need to acknowledge that their individual development capacities and trade opportunities widely differ. To that end they must gain confidence that a WTO negotiation on differentiation would not lead to a dramatic upheaval of current member status, balances of commitments, and trade benefits. Hence DCs must receive clear assurances from developed countries.

First, differentiation should not primarily be considered as a negotiating tool for balancing trade concessions. Consequently, developed countries should clearly recognize that any discussion on DC differentiation must be driven by the sole consideration of its development impact. Yet all WTO members should recognize that there is no global economic consensus on how best to achieve a positive development impact through recourse to SDT measures in international trade. For instance, the infant industries or food security arguments for maintaining trade protection in poor countries remain highly controversial. Recognizing such dissent may help considering that differentiated ways to development are needed under trade rules.

Second, developed countries should avoid upfront suggesting the design of new horizontal country-based criteria for differentiation. Focusing the differentiation debate on the creation of new horizontal categories of WTO developing country members would not be politically acceptable due to

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the anticipation of major distribution costs. Nor would it be optimal for the development impact of SDT.

Third, WTO members should acknowledge that there is no "magic wand" for achieving a development friendly approach to differentiation. Workable options lie somewhere between the political (i.e. "rule of thumb/LDC+") and the legalistic (i.e. "implicit thresholds") approaches. Both carry important shortcomings and transaction costs that must be minimized. Hence a viable approach to differentiation will need to pragmatically combine a set of complementary options.

Principle #2 – Narrowing the scope: Differentiation should focus on selected development objectives

The one and only objective of differentiation is to better tailor SDT rules to specific development stakes. Thus the scope of a possible negotiation on differentiation may shrink to manageable proportions by focusing selectively on its real development stakes.

First, market access must be distinguished from rules. As remarked by Stevens (2002), "achieving differentiation through national schedules presents either an unfeasibly large negotiating burden or substantial post-agreement risks". This consideration fully applies to negotiating differentiated SDT rules. However, there is no need for elaborating principles of differentiation for market access. In that field DC differentiation can be achieved through the national schedules of commitments. On a first level, horizontal provisions providing for "less than full reciprocity" in future DC market access commitments can be agreed, without involving further DC differentiation. Here, SDT provisions must be part of the market access formulas and flexibilities. Beyond these, a direct "request and offer" negotiation between developed countries and major emerging economies could make room both for further market access differentiation amongst DCs and further market access concessions from developed countries to meet their priority interest. The results of such "requests and offers" going beyond the horizontally agreed market access formulas would be integrated in the individual schedules of

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commitments of the biggest economies. These additional concessions involving selected significant trading powers would then be bound and extended to all others WTO members on an MFN basis.

Second, authors remark that the purpose of SDT is not to compensate for obsolete rules, admittedly hindering development. In such cases there is no rationale for DC differentiation: the bad rules should simply be renegotiated rather than tinkering with SDT. Such rationale underlies the negotiation of a 'TRIPS' amendment to provide flexibilities for compulsory drug licensing in the event of a health crisis.

Third, negotiating new criteria for differentiation is only relevant for "pure" trade policy rules that may constrain development strategies. Other trade commitments essentially return to building implementation capacities through development aid and technical assistance. For these a *de facto* differentiation should merely proceed from an objective WTO and aid agencies assessment of individual country needs.

Fourth, the development stakes of differentiation do not involve every WTO rule. Four major development topics justifying DC differentiation have really emerged with the DDA: food security (AOA), industrial policies (TRIMS and SCM), intellectual property, and trade facilitation and domestic regulatory capacities (SPS, TBT, customs valuation, pre-shipment inspections, and antidumping). WTO members should therefore explicitly agree upon selected development stakes before entering a negotiation on DC differentiation

Principle #3 – Sequencing the political trade-off: Negotiating modalities for differentiation should be adopted as an element of the DDA conclusion

It is economically impossible to trade off rules against market access. The value of rules must be judged on their legal merits and economic benefits. Market access concessions must balance reciprocal trade opportunities. Trying to trade off rules against market access in the overall balance of commitments has proved a major hurdle to the whole progress of the DDA (Paugam 2003). It currently deadlocks the SDT negotiations.

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Yet the trade-off is politically inescapable for WTO members. Since SDT can generate potential negative externalities for trade, developed countries try to proportionate their market access concessions to the harm that they anticipate. Resolving this mercantilist conundrum supposes the design of a new negotiating sequence embedding new incentives for WTO members to reach a successful conclusion.

First, the 88 SDT negotiating proposals may conceptually break down into two major categories: one for provisions principally focusing on market access,[19] the other for provisions principally focusing on rules or technical assistance commitments. Since the first category directly impacts the overall balance of market access concessions, related provisions should be negotiated within the relevant market access negotiating bodies (Agriculture, NAMA, Services).

Second, a clear distinction must be drawn between the rules and market access dimensions of the negotiations. On the one hand, market access concessions –including the above mentioned category of market access SDT provisions– must reach their own satisfying balance in the North-South context (achieving DC differentiation would be possible here through adjustment of national schedules of commitments). On the other hand, the new SDT rules commitments (flexibilities, WTO procedural requirement, technical assistance) must be balanced with a better differentiation of beneficiaries. Once the two compromises are separately reached, a political trade-off between both may be considered.

Third, it must be acknowledged that the two dimensions of the negotiation may not progress at a similar pace.

Balancing market access concessions means resorting to classical GATT/WTO deal-making practices. Conversely, achieving principles for differentiation requires important technical analysis and preparatory works. An agreement on differentiation under SDT rules may not realistically be concluded simultaneously with market access commitments, without considerably delaying the conclusion of the DDA.

19. As for instance the proposal of extending a full duty and quota free market access to LDCs following the European Everything But Arms initiative.

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There is no strong reason why the principle of a "single undertaking" in the DDA should be interpreted as "simultaneous conclusion of all agreements". A sequenced phasing-in of the various DDA negotiating results could be envisioned while conforming to the legal framework of single undertaking.

First, an overall agreement would need to be reached on market access liberalization (including market access-related SDT provisions). Once fully agreed upon and detailed in the schedules of commitments, the implementation of the market access commitments could be split into two phases.

For developed countries, 50 percent of their market access commitments would be immediately and unconditionally implemented over the first phase (say 3 years). But the implementation of the remaining 50 percent of the commitments would remain conditionally triggered by the entry into force of a new WTO agreement on SDT, including DC differentiation.

For developing countries, implementation of their market access commitments would be postponed to the end of a grace period corresponding to the first phase of developed countries implementation (3 years). By the end of the grace period DCs would unconditionally implement 50 percent of their own market access commitments. The implementation of the remaining 50 percent would also be conditionally triggered by the entry into force of the SDT agreement.

Second, an agreement would need to be reached for new SDT negotiating modalities, as part of the concluding results of the DDA. These modalities would explicitly assert the principle of DC differentiation according to the development needs.

In a nutshell: to conclude the Doha Round, new SDT rules and DC differentiation should be left for further negotiations under the single undertaking. In order to maintain incentives for WTO members to negotiate, it would simultaneously be decided that only half of the DDA market access commitments would enter into force as long as WTO members would fail in reaching an agreement on SDT and differentiation.

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Conclusion

Our general conclusion from this overview is that DC differentiation in the WTO would be legally possible, economically desirable and technically workable in the framework of the DDA. The biggest challenge therefore remains turning the "big" political issue of differentiation into a rather technical one. To overcome currently entrenched North-South opposition the WTO needs to refer negotiators to one unique compass: the consideration of the potentially positive development impact of an improved DC differentiation. Using this compass, the WTO members may start considering DC differentiation coolly and in good faith. Yet it is true that both developed and developing WTO members share at least one common and undifferentiated feature: coolness and fairness hardly dominate their natural behaviors in trade negotiations.

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Chapter 7

More Differentiated Special Treatment in the Agriculture Agreement: Beyond Concept to Practice

ALAN MATTHEWS[1]

Special and differential treatment (SDT) was part of the Uruguay Round Agreement on Agriculture (URAA) in 1994 but the substantive meaning of the term has grown since then. The preamble to that agreement committed developed country members, in implementing their commitments on market access, to "take fully into account the particular needs and conditions of developing country Members by providing for a greater improvement of opportunities and terms of access for agricultural products of particular interest to these Members, including the fullest liberalization of trade in tropical agricultural products as agreed at the Mid-Term Review, and for products of particular importance to the diversification of production from the growing of illicit

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narcotic crops." It also noted that commitments under the reform program should "[have] regard to the agreement that special and differential treatment for developing countries is an integral element of the negotiations, and [take] into account the possible negative effects of the implementation of the reform programme on least-developed and net food-importing developing countries". These general precepts give little guidance as to the purpose or objective of SDT in the agricultural sector.

Developing countries have argued that the balance of advantages in the URAA was very tilted towards developed countries. When new negotiations started, a rebalancing of commitments was one of their main objectives. At the very beginning of the agriculture negotiations mandated by Article 20 of the URAA, in June 2000, a group of developing countries presented a proposal for a "development box" which set out their broad objectives and concerns with respect to the negotiations, including the need to provide adequate flexibility for these countries to adopt measures to enhance domestic food production and protect the livelihoods of the rural poor and small farmers (WTO G/AG/NG/W/13). Underlying these proposals was the belief that indiscriminate trade liberalization in agriculture negatively affects food security in developing countries and undermines the livelihoods of the rural poor, thus increasing poverty and inequality in the developing world.

These concerns were reflected in Paragraph 13 (agriculture) of the Doha Ministerial Declaration, which stated that "special and differential treatment for developing countries shall be an integral part of all elements of the negotiations [...] so as to be operationally effective and to enable developing countries to effectively take account of their development needs, including food security and rural development." SDT was seen not just as something required to ease the integration of developing countries into the trading system (by providing longer transition periods to cope with weaker adjustment capacities, for example), but in addition as something (possibly more permanent) which should be built into the rules themselves to enable developing countries to

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Table 1. General SDT Objectives Contained in the July 2004 Framework Agreement

Paragraph 1	These [specific trade and development related needs and concerns] of developing countries, including relating to food security, rural development, livelihood, preferences, commodities and net food imports, as well as prior unilateral liberalization, should be taken into consideration, as appropriate, in the course of the Agriculture and NAMA negotiations.
Paragraph 2	[...] the modalities to be developed will need to incorporate operationally effective and meaningful provisions for special and differential treatment for developing country Members. Agriculture is of critical importance to the economic development of developing country Members and they must be able to pursue agricultural policies that are supportive of their development goals, poverty reduction strategies, food security and livelihood concerns.

achieve their food security and rural development objectives. The General Council Decision of 1 August 2004 (the July Framework Agreement) was even more explicit that special treatment of developing countries is justified in order to address their food security, rural development, poverty reduction and livelihood concerns (table 1).

The demand for differentiation

This broadening of the role for SDT in the agriculture agreement was accompanied by a growing demand to differentiate the special treatment accorded to developing countries, especially after the failure of the Cancun Ministerial (Paugam and Novel 2005). In the Agreement on Agriculture (AoA), commitments are differentiated on the same basis as in other WTO Agreements –between developed, developing and least developed countries. However, the AoA did introduce a further category of “net food-importing developing countries” (NFIDCs).[2] Although this is the only group to be defined on the basis of a specific food availability indicator, being a net food importer is poorly correlated with indicators of food

2. It is also worth noting that China was denied the full entitlement to developing country SDT on its accession to the WTO in that its domestic support *de minimis* was limited to 8.5 percent of its value of agricultural output rather than the agreed 10 percent otherwise available to developing countries.

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security status (Diaz-Bonillo *et al.* 2002). The twenty-three NFIDCs are a diverse group with only three "low-income" countries, eleven "lower-middle income" countries, eight "upper-middle income" countries and "one high-income" country as classified by the World Bank (Kasteng *et al.* 2004). Not too much should be read into the NFIDC grouping as the commitments made in terms of technical and food aid assistance and the treatment of export credits are largely of a best-endeavor variety.

Differentiation for the purposes of special treatment has been raised in general terms in the discussions on SDT in the Committee on Trade and Development.[3] However, the US-EU proposal in August 2003 was the first explicit proposal for differentiation between the developing countries in the agricultural negotiations (EU-USA 2003). It said that substantial improvements in market access should be given to developing countries "most in need" but made no attempt to define this group. It stated that: "Negotiations should therefore provide increased access opportunities for all and in particular for *the developing countries most in need* and take account of the importance of existing and future preferential access for developing countries". It went on to state that "*Having regard to their development and food security needs*, developing countries shall benefit from special and differential treatment, including lower tariff reductions and longer implementation periods". On the other hand, the EU/US proposal also argued that "as far as S&D treatment for developing countries is concerned, the rules and disciplines will need to be adjusted for *significant net food exporting countries*" [emphasis added].

This proposal was reiterated in US trade negotiator Robert Zoellick's January 2004 letter to his WTO colleagues after Cancun. This letter argued that "as we design flexibilities for countries or even types of countries or regions with special problems, we will be stymied if every provision automatically applies to some 100 or more countries –including some that are highly competitive in a sector". Specifically with reference to the agriculture negotiations, Zoellick proposed that the use

3. See, for example, European Communities (2002).

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of special products in agriculture should be restricted to "[...] *certain* developing countries that are concerned about harming rural development and subsistence farmers" while calling for "substantial openings in markets of developed and developing countries, *especially those that are competitive in sectors of agriculture and with stronger economies*" [emphasis added].

The Lamy-Fischler letter to WTO Members in May 2004 setting out the EU's response to the Cancun failure echoed the same theme but in a more generous spirit. While stressing the need for greater commitments by the more competitive developing country exporters, they coupled this with a proposal to extend non-reciprocity beyond the LDCs to the much wider group of the G-90. "More generally, we have all accepted the principle of 'less than full reciprocity', but it needs to be made more operational. This means that developing countries should undertake commitments in line with their importance in world trade [...]. Therefore, on agriculture and NAMA, we propose that the least developed countries *and other weak or vulnerable developing countries in a similar situation –essentially the G90–* should not have to open their markets beyond their existing commitments, and should be able to benefit from increased market access offered by both developed and advanced developing countries."

The new EU Trade Commissioner, Peter Mandelson, reiterated the EU approach to the poorer developing countries in a speech in February 2005. His speech included the further suggestion, already built into the Framework Agreement, that the more advanced developing countries, in turn, might offer SDT to other developing countries including the LDCs. "Europe will demand practically nothing from the poorest G90 countries in terms of market access, apart from some binding of tariffs. Last July's Geneva framework is clear with regard to LDCs. By Hong Kong, we need to be clear too on what the developed countries are offering to all weak and vulnerable WTO members, who remain weak because of their dependence on preferences or their national Treasuries' fears of loss of tariff revenue on which they depend. There must be real flexibility about the market opening commitments they are asked to enter into. Some should probably not be required

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to commit at all." He went on to add that "[...] it is also an issue of whether advanced developing countries are willing, in turn, to open their markets, not only to us but also to the smaller developing countries, by cutting their high industrial tariffs and removing barriers to services."

Greater differentiation in the AoA?

Paugam and Novel (2005) identify three main arguments for greater differentiation. One is the "one size does not fit all" argument that differentiation would help to improve the efficiency of SDT provisions. In other words, the circumstances where general WTO rules conflict with or place a burden on underlying development objectives would be limited to countries with particular characteristics. The differentiation of rules should thus be limited to the group of countries likely to be adversely affected. Although they do not explicit state this, the assumption being made is that more far-reaching, deeper SDT is likely to be agreed where the benefits are more targeted, and thus the direct costs to those agreeing in terms of market access foregone are less. In the case of agriculture, if the purpose of SDT is to improve a country's ability to meet its food security, rural development and sustainable livelihood goals, then it should be limited to those countries facing food insecurity and poor agricultural performance.

A second argument is that trade policy may be a second best development instrument for countries with weak institutions and a small resource base to tackle their development objectives. The threat of food insecurity to producers in the face of a sudden drop in world prices or an import surge provides a good example. While a first best solution might be to use market-based risk management mechanisms or insurance schemes or social safety nets to offset the income risk, these may simply be out of reach for very poor countries with many resource-poor farmers. The ability to implement safeguard tariffs may then be the only realistic option to provide relief in these circumstances. SDT is thus required to provide sufficient policy space for developing countries in these circumstances.

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A third argument is that targeting of SDT will reduce the negative externalities for others and the systemic or indirect costs of agreeing exemptions from general trade rules. Where SDT concessions are restricted to the poorer developing countries because their share of world trade is low the trade impacts will also be low.[4] Some observers fear that extensive SDT could prove a particular hindrance to the growth of South-South trade.

Developing countries have to date resisted all efforts, both more generally within the WTO and specifically within the agriculture negotiations, to introduce differentiation. They perceive an interest in being grouped together as a bargaining force in the negotiations and consider that differentiation would undermine their influence, even though the existence of a variety of developing country groupings indicates that they do not all speak with one voice (FAO, 2005). Also, there is no mention of differentiation in the July Framework Agreement –although there are references to commitments to address specific problems faced by sub-sets of countries, such as "recently acceded members", "economies where cotton has vital importance", and the trade-related issues identified in paragraph 35 of the Doha Work Program for the fuller integration of small, vulnerable economies into the multilateral trading system. However, the decision explicitly rules out in this latter connection the creation of a new sub-category of members.

This does not mean that further differentiation between developing countries cannot be part of the ongoing agricultural negotiations. Greater differentiation is relevant in negotiating any of the individual modalities of the agriculture agreement. This paper explores the status of the individual negotiations to investigate the way in which greater differentiation might be implemented. This immediately raises the issue of what criteria to use for differentiation. Paugam and Novel (2005) classify eligibility criteria into country-based

4. However, even a small overall trade impact may have large consequences for a neighboring small country as the country where access does not increase could be its major market or because it is excluded from the benefits of enhanced preferential access to higher-income markets where a competitor gains such access.

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approaches, agreement-specific or rule-based approaches, and a hybrid negotiated approach to differentiation. Country-based approaches refer to eligibility criteria based on geographic or broad socio-economic criteria. Agreement-specific approaches attempt to classify countries according to the particular SDT objectives in that agreement. In the case of an agriculture agreement, this would relate to indicators of food security or rural development need. Thus the first section is a survey of the literature which has attempted to define groups of developing countries based on these agreement-specific criteria. The second section examines where greater differentiation might have a specific function in the individual modalities of the agricultural negotiations, taking into account what the July 2004 Framework Agreement has to say on SDT. A possible way to break the deadlock on SDT is proposed in the concluding section.

Before beginning, it is necessary to confront one argument which bedevils discussion of SDT in agriculture. SDT measures cover preferential access to developed country markets, longer transitional periods to implementing commitments, permanent exemptions from agreed commitments in the spirit of non-reciprocity to provide greater policy space for developing countries, and promises of development assistance. There is strong disagreement over whether greater flexibility in WTO rules (to allow greater policy autonomy or policy space in the formulation of agricultural trade and support policies) would actually contribute to the desired goals of increased food security and rural development.[5] We do not attempt to answer this question in this paper, concentrating instead on the realpolitik of responding to developing country demands for more operationally effective SDT measures if they are to be persuaded to sign up to a new agreement.[6]

5. Reflecting this skeptical view, the European Communities (2002) notes that "All SDT proposals should be evaluated against the following basic criterion: will this aid the economic development of developing countries and their fuller integration of developing countries into the trading system, as opposed to creating what has been described as permanent exclusion or second tier Membership of the system?"
6. The arguments are reviewed in Matthews (2005a).

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Designing Criteria for SDT Eligibility

In this section, we look briefly at ways in which greater differentiation might be introduced into the commitments undertaken in the agriculture agreement. We survey a number of suggested approaches in the literature, ranging from the use of simple per capita income measures to more complex statistical techniques. Using the suggested classification outcome from one comprehensive study conducted by the Swedish Board of Agriculture (Kasteng *et al.* 2004), we explore the political economy barriers to going further down this road in a new agreement.

Using per capita income to rank countries is an obvious way to differentiate countries according to their ability to take on additional commitments. One approach has been suggested by the International Food and Agricultural Trade Policy Council (IPC), which has proposed a three-fold distinction based in a modified way on the distinctions drawn by the World Bank and the IMF on per capita income (IPC 2004). But while the World Bank distinguishes between low income, lower middle income and upper middle income developing countries, the IPC proposes to distinguish between least developed countries, lower middle income and upper middle income countries. The LDC grouping would be based on the UN definition (which includes institutional constraints as well as per capita income) but, in addition, would include all countries with a per capita income less than 900 US dollars (the World Bank uses a threshold of 765 US dollars per capita to distinguish between low income and lower middle income countries). It also suggests a flexible mechanism whereby countries facing particular constraints, such as small island states, land-locked countries or vulnerable economies, could apply for classification into the next lower category if their per capita income does not take into account unique vulnerabilities. It then argues that the degree of SDT treatment should be differentiated over these three groups, rather than two as at present. For example, with respect to market access, it suggests that upper middle income countries should accept the same tariff reductions as developed countries but with a longer implementation period; the lower middle income countries

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might be offered both lower reduction commitments and a longer implementation period; while LDCs would not be required to make reduction commitments.

Alternative approaches focus more directly on the food security objectives of SDT in the agriculture agreement and seek to explicitly distinguish between food insecure, food neutral and food secure countries. This implies that food security is defined at the national level, but there is no consensus on how to do this. Ruffer *et al.* (2002) examine the classification of countries on the basis of seven plausible criteria to define a food insecure country. These criteria include GDP per capita; the contribution of agriculture to GDP; calories or protein per capita; the Food and Agriculture Organization (FAO) classification of "low-income food-deficit countries" which takes into account a combination of GNP per capita and the net food trade position of a country (based on calories traded, not value); and the ratio of total exports (including merchandise and services) to food imports. For the continuous variables, each indicator is associated with a threshold to determine a country's food security status. They find, remarkably, that only seven countries (of which only four are WTO members) meet all criteria for food insecure countries where data exists. This indicates that the classification question is not an innocent technical question but is likely to prove highly controversial.

Also starting from the concept of national food insecurity, Stevens and Kennan (2003) (building on earlier papers by Stevens [2002a, 2002b]) link calorie supply, agricultural dependence, export market share and vulnerability to identify countries with the greatest potential need to support their domestic agricultural sector (and, hence, not to be restricted in the use of subsidies) and those most vulnerable to world market changes that would follow significant OECD liberalization (and hence in need of adjustment support).

Diaz-Bonilla *et al.* (2000) use various methods of cluster analysis for 167 countries to identify groups of countries categorized according to five measures of food security: food production per capita, the ratio of total exports to food imports, calories per capita, protein per capita, and the share

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of the non-agricultural population. Their results identify 12 clusters of countries according to their similarities in their food security profiles. On the basis of the identified clusters, countries are placed in one of the following three categories: (1) food insecure; (2) food neutral, and (3) food secure. Their classification of food insecure countries covers almost all LDCs, with the exceptions of Cape Verde, the Maldives and Myanmar. However, their system of differentiation also includes in the food insecure group many countries not covered by the Marrakesh Decision which distinguishes LDCs and the NFIDCs.

In a study for the Swedish Board of Agriculture, Kasteng *et al.* (2004) take this classification as their starting point to develop a typology of developing countries, which separates out two further groups of developing countries. The first is a group of high income advanced developing countries, generally with low dependence on agriculture, which in their view "might be given the same conditions as the developed countries in the field of agriculture". The second is a group of significant net food exporting countries, as suggested in the EU/US proposal presented before the Cancun Ministerial. Using a classification developed by the WTO Committee on Agriculture of significant exporters, which are countries representing more than five percent of the total global export of a certain product or product group, they identify nine developing countries which fall into this category. However, as four of these countries fall into the food insecure group as defined by Diaz-Bonilla et al, and a fifth is Hong Kong which overall is a significant net food importer (it is included in this group because its share of world exports of poultry meat exceeds the five percent threshold), this leaves just four countries which they classify as net agricultural exporters: Argentina, Brazil, China and Thailand. The overall system of differentiation proposed by the Kasteng *et al.* study is shown in table 2.

The table illustrates the nature of the deal which will have to be made if greater differentiation is to become a reality in the agriculture agreement. Essentially a group of advanced developing countries and a smaller group of significant net

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Table 2. Differentiation Between Developing Countries: Swedish Board of Agriculture Proposals

	Low-income countries	Middle-income countries	High-income countries
Food insecure countries, including LDCs	**Angola**, Azerbaijan, **Bangladesh**, **Benin**, **Bhutan**, **Burkina Faso**, **Burundi**, **Cambodia**, Cameroon, **Central African Republic**, **Chad**, Congo (Brazzaville), **Congo (Kinshasa)**, Ivory Coast, **Equatorial Guinea**, **Ethiopia**, **Gambia**, Georgia, Ghana, **Guinea**, **Guinea Bissau**, **Haiti**, India, Kenya, **Laos**, **Lesotho**, **Madagascar**, **Malawi**, **Mali**, **Mauritania**, Mongolia, **Mozambique**, **Myanmar**, **Nepal**, Nicaragua, **Niger**, Pakistan, Papua New Guinea, **Rwanda**, **Samoa**, **Sao Tome & Principe**, **Senegal**, **Sierra Leone**, **Solomon Islands**, **Sudan**, Tajikistan, **Tanzania**, **Togo**, **Uganda**, Vietnam, **Yemen**, **Zambia**, Zimbabwe	Albania, Armenia, Bolivia, Botswana, **Cape Verde**, Cuba, **Djibouti**, Dominican Republic, El Salvador, Grenada, Guatemala, Honduras, Iraq, **Maldives**, Namibia, Peru, Philippines, Seychelles, Sri Lanka, St. Kitts & Nevis, St. Lucia, St. Vincent & the Grenadines, **Vanuatu**	
Developing countries with special need for rural development	Indonesia, Kyrgyzstan, Moldavia, Nigeria, Uzbekistan	Algeria, Belize, Bosnia & Herzegovina, Chile, Colombia, Costa Rica, Dominica, Ecuador, Egypt, Fiji, Gabon, Guyana, Jamaica, Jordan, Kazakhstan, Lebanon, Macedonia (FYR), Malaysia, Morocco, Mauritius, Mexico, Panama, Paraguay, Qatar, Romania, Saudi Arabia, Serbia & Montenegro, Suriname, Swaziland, Tonga, Trinidad & Tobago, Tunisia, Turkey, Uruguay, Venezuela	
Significant net-agricultural exporting countries		Argentina, Brazil, China, Thailand	

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	Low-income countries	Middle-income countries	High-income countries
Advanced developing countries		Antigua & Barbuda, Bahamas, Bahrain, Barbados, Brunei, Hong Kong, Israel, Kuwait, Macao, Oman, Singapore, South Korea, Taiwan, United Arab Emirates	
Developed countries, including observer countries		Belarus, Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Russia, Slovak Republic, South Africa, Ukraine	Andorra, Australia, Austria, Belgium, Canada, Cyprus, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Japan, Liechtenstein, Luxembourg, Malta, Netherlands, New Zealand, Norway, Portugal, Slovenia, Spain, Sweden, Switzerland, United Kingdom, USA.

Explanations to the table: Countries in bold: **LDC** category. Countries underlined: WTO developed countries category. WTO members not included due to lack of data: Bahrain, Cyprus, Liechtenstein, Macao, Oman, Qatar, Singapore, Taiwan. WTO observers not included due to lack of data: Andorra, Bahamas, **Bhutan**, Bosnia & Herzegovina, **Equatorial Guinea**, Holy See (Vatican), Iraq, **Samoa**, **Sao Tome and Principe**, Serbia & Montenegro, Tonga.
Source: Kasteng *et al.* (2004).

agricultural exporting developing countries would be asked to forgo taking advantage of SDT measures to which they might otherwise be entitled under the July 2004 Framework Agreement. Two elements are necessary to persuade them to do this. For the significant net agricultural exporting developing countries, they may be prepared to accept this condition if it unlocks a significant market-opening offer by the developed countries from which they will benefit. To persuade the other advanced developing countries, the developed countries would have to make clear that this would lead to deeper SDT measures being offered to a wider group of low- and middle-income developing countries than just the LDCs that are defined as suffering from food insecurity.

If this political deal were made, a number of technical issues would still need to be clarified to make it operational in a new agreement. More simple and transparent objective

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criteria to distinguish between the food insecure countries, including LDCs, and developing countries with a special need for rural development, would need to be developed, which would nonetheless produce more or less the same ranking of countries. This would also facilitate the development of graduation criteria, which are a necessary accompaniment to any move to greater differentiation. In the following section, we turn to examine where such a, more differentiated, classification of developing countries might be applied in the negotiations on a new agriculture agreement.

Applying Greater Differentiation in the Agriculture Agreement

Market access

By common consent, the market access pillar is proving the most difficult to negotiate. The Framework Agreement set out a number of agreed principles to guide the negotiations. These were: a high level of ambition in the overall outcome; that highest tariffs would be reduced the most; that a tiered approach would be used; that special treatment would apply to sensitive products; and that SDT would apply to developing countries. However, no numbers were provided to show how these principles would be made operational. The SDT provisions under this pillar are summarized in table 3.

Since then, a number of proposals have been made regarding the structure of an appropriate formula, including submissions by the G20, Canada, Australia, the US and the EU. In the absence of numbers, the likely outcomes from these proposals cannot be compared. The G20 proposal can be seen as forging a middle ground between the radical liberalizers (such as the US and the Cairns Group, which advocated the use of the Swiss formula with a low tariff cap) and the reluctant liberalizers (such as the G10 and the EU who favored the Uruguay Round approach). The outcomes are further complicated by the provision in the Framework Agreement concerning sensitive products. The debate on sensitive products is linked to the degree of flexibility included in the tariff reduction formula. To ensure a significant degree of

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Table 3. SDT Provisions Relating to Market Access in the July Framework

Paragraphs 27 and 29	Members also agreed that special and differential treatment for developing Members would be an integral part of all elements in the [market access] negotiations [...] Each Member (other than LDCs) will make a contribution. Operationally effective special and differential provisions for developing country Members will be an integral part of all elements.
Paragraph 39	Having regard to their rural development, food security and/or livelihood security needs, special and differential treatment for developing countries will be an integral part of all elements of the negotiation, including the tariff reduction formula, the number and treatment of sensitive products, expansion of tariff rate quotas, and implementation period.
Paragraph 40	Proportionality will be achieved by requiring lesser tariff reduction commitments or tariff quota expansion commitments from developing country Members.
Paragraph 41	Developing country Members will have the flexibility to designate an appropriate number of products as Special Products, based on criteria of food security, livelihood security and rural development needs. These products will be eligible for more flexible treatment. The criteria and treatment of these products will be further specified during the negotiation phase and will recognize the fundamental importance of Special Products to developing countries.
Paragraph 42	A Special Safeguard Mechanism (SSM) will be established for use by developing country Members.
Paragraph 43	Full implementation of the long-standing commitment to achieve the fullest liberalization of trade in tropical agricultural products and for products of particular importance to the diversification of production from the growing of illicit narcotic crops is overdue and will be addressed effectively in the market access negotiations.

market opening, it is accepted that tariff rate quotas (TRQs) would have to be increased to compensate for a lower tariff reduction. However, there is disagreement about whether the tariff reduction/TRQ expansion combination should be related to the main formula for tariff reduction or not.

Tariff reduction formulas and policy space

As noted, many developing countries want to retain the maximum amount of policy space to pursue domestic food and agricultural policy objectives. Leaving aside the LDCs

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where there is already agreement that they will not be asked to make tariff reduction commitments, an important issue for other developing countries is how to reconcile a harmonizing formula approach to tariff reductions with special and differential treatment. SDT in the Uruguay Round meant that commitments by developing countries averaged two-thirds of those undertaken by developed countries. If this is to be repeated in the Doha Round, the question is whether this commitment is built into the formula to be used or into the objective to be achieved. There is great variation in initial tariff structures across countries, with many developing countries which opted for ceiling bindings having much higher bound rates than developed countries. Application of a differentiated formula could even lead to the perverse outcome whereby poorer developing countries are asked to make proportionately greater reductions given the initial structure of their tariffs.[7]

Interpreting the actual outcome of any formula for an individual developing country is complicated, as for developed countries, by the number and treatment of sensitive products that will be allowed. According to the Framework Agreement (paragraph 39), developing countries will benefit from special and differential treatment (SDT) in the designation and treatment of sensitive products. This would imply that these countries may designate more sensitive products and undertake lesser commitments with respect to tariff reductions and tariff rate quota expansion than may otherwise be required.

Because of the rather arbitrary way in which the average cuts required of developing countries will be distributed under any of the formulas publicly proposed to date, the scope for applying greater rule-based differentiation is not clear. One way to get around this conundrum would be for each country to place its tariff into three (or more) tiers, where the reduction coefficient is decided for each tier but the thresholds are flexible and determined in such a way that the overall reduction (including taking sensitive products into account)

7. See Matthews (2005b) for further discussion. Examples of differing tariff structures for individual countries are given in Jales *et al.* (2005).

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meets the average target established for the country group with which a country is associated. This would allow the average target to be differentiated according to a country's food security status if appropriate eligibility criteria were agreed.

Special products

In addition to being able to designate sensitive products, the Framework Agreement foresees (paragraph 41) that "Developing country Members will have the flexibility to designate an appropriate number of products as Special Products, based on criteria of food security, livelihood security and rural development needs. These products will be eligible for more flexible treatment." This guarantees that developing countries will have access to this flexibility in a revised agreement on agriculture and it clarifies that the basic criteria that should guide the designation of "special products" (SPs) will be food and livelihood security, and rural development needs. On the other hand, the text establishes limits to the possible scope of SPs, for instance, by requiring that only an appropriate number of products can be so designated. How this number should be determined is left to further negotiation, as is the treatment of SPs.

From the point of view of greater differentiation, the key issue is whether all developing countries should have the same potential access to SPs, regardless of how defined or how treated. Two criteria to limit the number have been proposed: a certain number of tariff lines, or imports accounting for a specified proportion of the value of imports. The latter would allow a country to choose between a small number of products accounting for a sizeable share of imports and a larger number of less significant products in import value terms. Ruffer (2003) suggests varying these numbers by the level of per capita income. Alternatively, the criteria for choosing special products could be made more generous for more food insecure countries. Note that even holding the same threshold for all countries would imply some differentiation in practice. Small countries with undiversified

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production may only need a small number of SPs to provide significant protection to their domestic agriculture; a larger country with a more diversified agriculture may need a larger number of SPs. To the extent that smaller countries are more likely to be food insecure, some desirable differentiation would occur in practice even if the same thresholds were applied to all developing countries.

Special safeguard mechanism

Developing countries have been concerned that trade liberalization could leave them vulnerable to import surges or a price collapse on world markets, in a situation where they have very limited ability to protect producers through purely internal measures. Paragraph 42 of the Framework Agreement states that "a special safeguard mechanism (SSM) will be established for use by developing country Members." While this represents substantial progress by developing countries in the negotiations to date, no guidance is given as to the design of this mechanism.

The G33, an alliance of developing countries formed to promote the need for a SSM and SPs, has argued that a SSM should have the following features: the safeguard measure should be automatically triggered; it should be available to all agricultural products; both price and volume-triggered safeguards should be considered; both additional duties and quantitative restrictions should be available as remedies; and the mechanism should be simple, effective and easy to implement. On the other hand, developed countries (and some developing countries) have argued for restricted product coverage and more limited triggers and remedies.

The disagreements in relation to product eligibility revolve around a number of issues: whether to limit SSM use to a specific number of tariff lines or allow access to all tariff lines; whether to use multilaterally agreed, development-related criteria or to allow self-designation; and whether access to the SSM should be related either to the depth of the tariff cuts and/or the final level of the bound tariff. Developed countries suggest that the SSM should apply only to staple food products or products necessary for food security that are

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produced in the developing country concerned, and to products that already have low tariffs, in order to facilitate the overall liberalization process.[8]

Greater differentiation could apply to various elements of the SSM. Food-insecure countries could be allowed to designate a greater number of eligible products, could be allowed easier triggers, could be allowed to apply stronger remedies, and for a longer duration. The most likely element for differentiation concerns the number of eligible products. All products might be deemed eligible for food-insecure countries, while more advanced developing countries might be restricted to a limited number. The general discussion on the criteria for differentiation in the previous section remains relevant here.

Domestic support

Few developing countries have entitlements to provide trade-distorting domestic support beyond *de minimis* levels. The Framework Agreement (paragraph 6) recognizes that "Special and differential treatment remains an integral component of domestic support. Modalities to be developed will include longer implementation periods and lower reduction coefficients for all types of trade-distorting domestic support and continued access to the provisions under Article 6.2." It also states (paragraph 11) that "Reductions in de minimis will be negotiated taking into account the principle of special and differential treatment. Developing countries that allocate almost all de minimis programs for subsistence and resource-poor farmers will be exempt". Crucially, this goes beyond the exemptions in Article 6.2 in allowing coupled direct payment programs if a country has the budget resources and sees a need for these.

It is unlikely that further differentiation beyond that implied by this exemption for targeted domestic support will be sought or required, as the current *de minimis* provisions

8. The 2003 US-EU joint proposal stated that a special agricultural safeguard (SSM) shall be established for use by developing countries as regards import-sensitive tariff lines.

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for developing countries are quite generous.[9] The Framework Agreement, in fact, makes it possible for developing countries to agree to a reduction in *de minimis* levels, knowing that for the majority such a reduction would have no impact in practice. This is because the bulk of their *de minimis* support is allocated to subsistence and resource-poor farmers. FAO (2005) acknowledges that defining these terms is problematic, both conceptually and in terms of data availability. It suggest that countries with more than a specified proportion of their population (say 50 percent) working in agriculture and with a certain proportion of the population with income below a certain level would automatically qualify for exemption under this heading. Whatever the criteria, the point is that a workable means of differentiation has been established in the domestic support pillar, if countries are prepared to use it.

Export competition

Because few developing countries are entitled to use export subsidies, they have few defensive interests in this pillar (see table 3 for a list of relevant SDT provisions in the Framework Agreement). However, developing countries are likely to continue to want to make use of price intervention schemes as part of their agricultural policy. Experience in Europe shows how difficult it can be to keep support prices in line with market trends. Where countries build up stocks as a result of price stabilization or price guarantee policies, the issue of how to dispose of surpluses will arise. The Framework Agreement allows developing countries to continue to provide (for a period to be negotiated) export subsidies for transport and marketing as allowed under Article 9.4 of the existing Agreement on Agriculture. Some developing countries have proposed expanding the types of export subsidies they are allowed to use under Article 9.4. They want to see exemptions along the lines of Article 27 and Annex 7 of the Subsidies

9. FAO (2005) interprets this provision to mean that national and multilateral programs specifically targeted at subsistence and resource-poor farmers would receive additional SDT beyond that prescribed for all developing countries. But a plain reading of the text suggests that developing countries where these farmers are the main focus of domestic support avoid reductions in *de minimis* levels, but do not get to increase them beyond these levels.

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Agreement (which allow developing countries with a per capita GNP of less than 1,000 US dollars to provide export subsidies, as well as longer phase-out periods for other developing countries). Differentiation for any such extension would be meaningless as it is only the more advanced developing countries that are in a position to contemplate subsidizing their exports in the first place.

Other developing countries are concerned that the disciplines on export competition measures, including export credits and food aid, could have negative implications for meeting humanitarian and development needs. The Framework Agreement states that such disciplines will provide for differential treatment in favor of the least developed *and net food importing countries*, without compromising the objective of eliminating their trade-distorting effects. It refers to the Marrakesh *Decision* in favor of these countries to maintain food aid levels, but without acknowledging the

Table 4. SDT Provisions Relating to Export Competition in the July Framework

Paragraph 22	Developing country Members will benefit from longer implementation periods for the phasing out of all forms of export subsidies.
Paragraph 23	Developing countries will continue to benefit from special and differential treatment under the provisions of Article 9.4 of the Agreement on Agriculture for a reasonable period, to be negotiated, after the phasing out of all forms of export subsidies and implementation of all disciplines identified above are completed.
Paragraph 24	Members will ensure that the disciplines on export credits, export credit guarantees or insurance programs to be agreed will make appropriate provision for differential treatment in favor of least-developed and net food-importing developing countries as provided for in paragraph 4 of the Decision on Measures Concerning the Possible Negative Effects of the Reform Program on Least-Developed and Net Food-Importing Developing Countries.
Paragraph 25	STEs in developing country Members which enjoy special privileges to preserve domestic consumer price stability and to ensure food security will receive special consideration for maintaining monopoly status.
Paragraph 26	In exceptional circumstances, which cannot be adequately covered by food aid, commercial export credits or preferential international financing facilities, ad hoc temporary financing arrangements relating to exports to developing countries may be agreed by Members.

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structural flaws in the *Decision* that have prevented its implementation.

Some developing countries also have interests in the State Trading Enterprises (STE) debate. Although state marketing boards are now much less prevalent in developing countries than used to be the case, disciplines on the financing of STEs, and on the use of monopoly export powers, will affect some countries. Kenya has proposed that developing country STEs be exempt from disciplines because of the role they play in development. The Framework Agreement proposes that "STEs in developing country Members which enjoy special privileges to preserve domestic consumer price stability and to ensure food security will receive special consideration for maintaining monopoly status." Given this qualification on the bodies eligible for special treatment, differentiation does not appear to be an issue in this area either.

Least developed countries and other poor developing countries

The Framework Agreement recognizes more differentiated special treatment for LDCs in two ways (paragraph 45). First, LDCs are not required to undertake reduction commitments. Second, there is an exhortation that developed members, and developing country members in a position to do so, should extend duty-free and quota-free access to LDCs.

Implicit in this latter exhortation is some form of differentiation on a voluntary basis, although the best-endeavor language means that it is a very soft commitment. Nonetheless, it could be build upon in various ways. For example, the EU has proposed that the exemption from undertaking reduction commitments should be extended to other low-income developing countries, generally interpreted to be the G-90. It has also gone further than the Framework Agreement text and proposed that duty-free and quota-free access be offered to all low income countries, and not just the LDCs. Very little attention or analysis has been given to this potentially radical proposal, giving the impression that the EU does not take it very seriously. Yet it does suggest a way

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forward from the current impasse, as discussed in the concluding section. In either case, a clear legal definition of the G90-similar countries based on objective criteria of their food-insecure status as discussed above will be required.

Conclusion

Special and differential treatment has the potential to emerge as a major stumbling block to the successful conclusion of the Doha Round agricultural negotiations. On the one hand, without further differentiation of the beneficiaries of special treatment, developed countries are unlikely to offer much beyond rather shallow SDT and will also be reluctant to make a significant market-opening offer. On the other hand, low-income developing countries may veto an agreement if they feel that it does not provide them with the policy space they believe to be necessary to pursue their food security, rural development and poverty alleviation objectives.

This paper explores how greater differentiation of special treatment for developing countries might be applied within the agreement on agriculture under negotiation in the Doha Round. Although greater differentiation has been proposed primarily by developed countries as a way of limiting the cost to them of extending SDT, it would be a desirable outcome if it encouraged the offer to low-income developing countries of more operationally effective SDT by the developed (and possibly, more advanced developing) countries, and because it would limit the collateral damage of deeper SDT if fewer countries were able to avail themselves of it.

SDT in the agriculture agreement is increasingly justified in the context of its contribution to promoting food security, poverty alleviation and rural development. This suggests that any attempt to differentiate further between developing countries should seek to do so on the basis of food security and agricultural performance data. One immediate issue is that indicators of food security are not necessarily relevant to judging rural development needs. Even focusing on a single criterion, such as food security, does not make the selection of countries easier, as studies have shown that a country's food

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security standing is greatly influenced by the particular indicator used to measure this status. Naturally, WTO member countries armed with the information on how well they will do from the negotiations beforehand will have every incentive to select an index which shows their case in a favorable light. Differentiation also has the potential to create a moral hazard problem if it encourages developing countries to neglect food security and agricultural development policies so as to avoid the requirement to take on more onerous WTO disciplines.

One way to reduce the impact of index sensitivity is to have a larger number of eligible tiers but with stepped percentages for the reduction commitments or exemptions from rules that are ultimately agreed. This would minimize the adverse effects of falling outside a favored group, and thus minimize the extent of lobbying in the event of an unfavorable outcome. It would also minimize the moral hazard problem, but at a much heavier transactions cost for the negotiations.

Our review of the state of the negotiations has shown that the Framework Agreement already includes a mechanism for greater differentiation in the domestic support pillar if the political will is there to use it. A mechanism for differentiation in the export competition pillar has also been agreed in the few areas where it might be relevant (retaining the monopoly status of export STEs and protecting vulnerable countries from any prohibition on export credits). It is in the market access area (either defensively, in terms of maximizing the policy space available to a developing country, or offensively, in terms of granting more favorable preferential access) where the means for greater differentiation remains unclear. In effect, the controversial areas are the size of the overall tariff reduction commitments, the number of special products and access to the special safeguard mechanism.

The empirical work shows that differentiation criteria can be devised if there is evidence of political will to continue down this road. The difficulty is that it is not obvious why the more advanced developing countries should accept differentiation. They are likely to be offered only shallow SDT in any case. In the mercantilist world of WTO trade negotiations, the more advanced developing countries would immediately face

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what would be perceived as greater costs of membership with nothing to show in return. Paugam and Novel (2005) suggest that the way to break this deadlock is to refer negotiators to one unique compass: the consideration of the potentially positive development impact of greater differentiation.

Presumably the main incentive for the more competitive agricultural exporters among the developing countries (the four countries Argentina, Brazil, China and Thailand identified by Kasteng *et al.* [2004]) is significantly enhanced market access to developed country markets. If this offer of significantly enhanced market access is dependent on these countries also making significant commitments, these countries may be prepared to accept this trade-off. Most of the other more advanced developing countries are not agricultural exporters and would not benefit from a significant market-opening offer in agriculture. It needs to be brought home to these countries that their insistence on availing themselves of extensive SDT puts in jeopardy a more generous SDT offer for low-income countries.

One way to do this is for the developed countries to outline the more ambitious SDT offers they are prepared to make to recognize developing countries' concerns on food security and rural development; in return, the more advanced developing countries could make clear that they would not seek to make use of these greater flexibilities. A more ambitious SDT offer should recognize that many low-income countries (and not just LDCs) are food-insecure (perhaps embracing the EU offer to give the G-90 countries the round "for free"), and accept that even food-neutral developing countries will have rural development goals which could justify rule exemptions. Such an offer could help encourage the more vulnerable developing countries to break ranks and to put pressure on the more advanced developing countries to reach a deal. Without the framework for a more generous SDT package on the table, it is hard to see what incentive there is for the more advanced developing countries to forego the benefits of SDT to which they are entitled under the Framework Agreement.

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Chapter 8

Upholding Special and Differential Treatment for Developing Countries within EU-ACP Economic Partnership Agreements

El Hadji A. Diouf[1]

Trade preferences in the World Trade Organization (WTO) run contrary to one of the central pillars of the system –the most-favored nation (MFN) clause,[2] which stipulates that any trade advantage granted by one country to the other shall be accorded immediately to all other contracting parties. The clause has two characteristics. It is general. This means it applies not just to tariffs, but to all external or domestic measures adopted by a state to regulate export and import flows. It is also unconditional, which implies its enforcement is non-negotiable among states. Exceptions to this principle are strictly circumscribed in WTO rules and require a specific decision. The two types of exceptions that can be granted relate closely to regional trade agreements (RTAs), and specifically concern agreements on regional economic integration. These are agreements by which a group of countries mutually agree reciprocal preferential trade advantages, such as a

1. International Centre for Trade and Sustainable Development (ICTSD), Geneva (Switzerland).
2. Article I.1 of the GATT entitled: General Most-Favoured Nation Treatment.

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reduction in customs duties. Such advantages are reserved only for signatories and exclude all non-members. The second type deals with trade "preferences" accorded to developing countries. These are more favorable trading arrangements aimed at enhancing the development of these countries. This type of trading arrangement exempted from the MFN clause is recognized by WTO agreements under the Generalized System of Preferences (GSP).[3]

According to GATT Article XXIV, regional trade agreements (RTAs) are organized either in free trade areas[4] or in customs unions,[5] with this latter arrangement being more closely integrated to the point of applying a common external tariff. The end of the Lomé Convention[6] era brought grim prospects for African countries in two areas: a return to global reciprocity in their relations with Europe, as was the case before with the Yaounde Conventions,[7] or resignation at the prospect of seeing the preferences they had enjoyed exclusively extended to other developing countries. This alternative exposes the hard reality of the Economic Partnership Agreements (EPAs) being negotiated between countries belonging to the African, Caribbean and Pacific Group of States (ACP) and the EU, since the decision to return to reciprocity has been confirmed.[8]

3. WTO preferential treatment is based on both the GSP of 1971, and on what is commonly referred to as the Enabling Clause of 1979.
4. A free trade area consists of a group of countries that have eliminated tariffs and other trade-restrictive measures amongst themselves without necessarily amending the barriers that each country places for countries outside that group. By all indications, the future Economic Partnership Agreements between the European Union Countries and ACP countries will take the form of a free trade area.
5. A customs union is a group of countries forming a single customs territory in which duties and other restrictive trade measures are waived for substantially all, or the totality of trade in products originating from such countries. A customs union also applies a common external tariff to other countries.
6. EU/ACP trading relations have been governed for 25 years by the Lomé Conventions. Four such conventions were signed between 1975 and 2000. They have operated on the basis of non-reciprocity to enhance duty-free and sometimes zero-quota access of ACP products to the European territory.
7. The Lomé Conventions mentioned above were preceded by the two Yaounde Conventions. Unlike their successors, the Yaounde Conventions were signed on the basis of reciprocal trading relations between ACP countries and the EU.
8. The entry point for this return to reciprocity, after the interlude of the Lomé Conventions, is the Cotonou Agreement, signed on 23 June 2000 between the EU and ACP countries.

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As a consequence, African nations face the challenge of reconciling the legal standards enshrined in WTO rules with their economic need for preferences to ensure their progressive and gradual integration into the international trading system. They are concerned about how to maintain preferential treatment in trading relationships governed by the principle of reciprocity. EPAs, as currently envisaged, offer them no convincing answer.

It may be useful at this point to consider why EPAs should include special and differential treatment for the ACP group of countries. The trade preferences frameworked in the Lomé agreements have had little impact. One is tempted to say ACP countries would be better to join the multilateral trading system and be governed by its common rules, rather than demand differential treatment.

This study's basic premise rests on another line of logic. First, any SDT is intended to correct economic inequalities through appropriate legal measures. These may be longer periods of delivery or waivers on certain international trade rules. The bottom line in any case is to have a differential framework able to prepare developing countries to enter the system. The life-cycle and provisions in such frameworks depend on the economic level of beneficiaries. Viewed in this light, ACP countries have a rightful claim to flexibilities in EPAs, as their current economic situations are not conducive to full free trade with European Union Countries.

Secondly, ACP countries have no commercial or political incentive in maintaining a regional free trade system with Europe under conditions less favorable than those in the WTO. Let us not forget that ACP countries choose freely to sign these EPAs, so they shall not get locked into any more restrictive economic commitments.

Thirdly, even if ACP countries aim ultimately to enter the trading system nothing stops them from creating enough room for maneuver to prepare their economies for free trade. They may do so by negotiating provisional legal measures by which they transition progressively and steadily towards neoliberal globalization.

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Therefore, demanding special and differential treatment (SDT) in EPAs in no way denotes a chronic need for unlimited assistance. ACP countries simply want to set the pace at which they open their markets, as the industrialized countries did at some point in their history. It should come as no surprise if some call on the WTO to debate on the nature of SDT, claiming it should go beyond a series of special dispensations and become a structural measure for economic recovery in countries of the South.

All things being equal, the legal grounds for trade-compensating measures are enshrined in WTO agreements. The legal basis for according trade preferences, both within the GSP and in RTAs, is governed by the Enabling Clause and GATT Article XXIV. In their current state, these instruments make no provision for special and differential treatment in mixed RTAs, such as the EPAs planned between the EU and ACP countries.

Does this mean the bilateral arrangements between the EU and ACP developing countries may undermine the SDT, which the latter enjoy in the WTO? This question raises both the problem of how to deal with the WTO's "legal void" concerning mixed RTAs between developed and developing countries, as well as the issue of coherence in the international trading system. RTAs are supposed to complement the multilateral system, reinforcing rather than weakening it. The existing advantages of developing countries should not be jeopardized due to a lack of legislation not based on systemic choice, but rather on a contextual framework out of phase with current realities.

There are some indications that it should be possible to maintain preferential, non-reciprocal, or at least discriminatory measures benefiting ACP countries vis-à-vis other developing countries. This will be explored in part II. Assessing this possibility supposes first revisiting the GATT/WTO system of preferences to understand which aspects of substantive law, jurisprudence or the practices of Members suggest evidences that SDT could be deprived of legal grounds for the future EPAs, as will be examined in part I.

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The Lack of Legal Grounds for Special and Differential Treatment in EPAs

There is no legal basis for SDT in future EPAs, as evidenced by these three arguments: mixed RTAs are not covered by WTO rules; the strict prohibition of cumulating preferences, non-reciprocity and discrimination (the so-called "preferential triptych") in multilateral trading relations; and legal challenges to specific preferences within the WTO.

A system of preferences excluding mixed RTAs from WTO rules

GATT preferences for developing countries have been formalized over the years through a slow, yet continuous process of development. These preferences, designed in various formats, have never extended to the area of mixed RTAs.

Amendments adopted as far back as 1955 during the review of article XVIII of the GATT were the first to introduce the notion of differential treatment for developing countries. These measures revolve around a certain number of preferences accorded to these countries in order to enhance, among other things, the creation of a specific area of production that would raise the population's overall standard of living.

However, the initial GATT document made no provision for preferences in favor of developing countries. The only trade-balancing measure was reciprocal free trade within customs unions and free trade areas, as stipulated in article XXIV. This is the origin of the prohibition on cumulation of non-reciprocal and discriminatory preferences (see below). Preferential imports from developing countries could not come under the provisions of this article because they carried no reciprocal measures. Similarly, due to the small volume and number of commodities concerned by such trade preferences, the requirement in Article XXIV that free trade areas must cover "substantially all the trade" could not be met. One can then conclude that under initial GATT regulations, trade preferences for developing countries were simply illegal.[9]

9. http://www.fao.org/DOCREP/004/Y2732F/y2732f08.htm

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Part IV of GATT, negotiated in 1964, brought only a partial solution to this problem by introducing the principle of non-reciprocity as an exception to the MFN Clause. Part IV merges the need for development (SDT) and the core principles of the international trading system, codifying the notion of non-reciprocity in trading relations between developed countries and developing countries. To grant more substantial preferential treatment to imports from developing countries, developed countries had to use a specific exemption with regard to GATT Article XXIV.5 in the form of a waiver. This exemption is the Generalized System of Preferences of 1971, which was designed in substance to allow developed countries to grant preferential tariff treatment to products from developing countries and territories without according such treatment to similar commodities originating from other contracting parties.

Durable trade preferences were introduced in 1979 with the Enabling Clause. This clause stipulates, inter alia, that "notwithstanding the provisions of Article 1 of the General Agreement [GATT], contracting parties may accord differential and more favorable treatment to developing countries, without according such treatment to other contracting parties".[10] While the legal grounds for trade preferences have clearly been established, let us not forget that donor countries enforce them only if they are willing to do so. The only real limitations lie in the ban on discriminating between potentially beneficiary developing countries.

Another limitation is that the clause covers the preferences accorded by developed countries and the reciprocal preferences accorded mutually among developing countries, but says nothing about the specific interests of least-developed

10. It applies to the following aspects: preferential tariff treatment accorded by developed contracting parties in conformity with the GSP; differential and more favourable treatment on non-tariff measures governed by multilaterally negotiated instruments under the GATT; regional or global arrangements concluded among developing countries with a view to reducing or eliminating tariffs on a mutual basis, and –in accordance with criteria or conditions that could be prescribed by the parties– to the elimination or reduction of non-tariff measures affecting commodities that these contracting parties import from one another; and special treatment accorded to LDCs in the context of all general or specific measures in favour of developing countries.

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countries (LDCs) or the trading relations between developed countries and developing countries within an RTA arrangement. A General Council Decision issued on 15 June 1999 by WTO Member states found a remedy to this problem by stipulating that "the provisions of paragraph 1 of Article I of the GATT 1994 shall be waived until 30 June 2009, to the extent necessary to allow developing country Members to provide preferential tariff treatment to products of least-developed countries, designated as such by the United Nations, without being required to extend the same tariff rates to like products of any other Member [...] on a generalised, non-reciprocal and non-discriminatory basis." This implies that LDCs can benefit from non-reciprocal preferential treatment from developed and developing countries. Ultimately though, there is no legal basis for specific preferences like those accorded to ACP countries by the EU either in this decision, in the Enabling Clause, or any other exemptions.

It is clear therefore that Article XXIV of the GATT does not explicitly define a trade-balancing system for developing countries in mixed RTAs. Nor does the Enabling Clause include provisions for mixed RTAs. Article V of the General Agreement on Trade in Services (GATS) is the only WTO provision that covers SDT in favor of developing countries engaged in mixed RTAs. In such a legal vacuum, it is hard to envisage EPAs with non-reciprocal preferences.

The Doha Round rekindled interest in SDT, making it an integral part of the system and one of the building blocks for trading relations between developing countries and developed countries. Mixed RTAs, however, remain outside the legal provisions in force. One cannot consider therefore that the flexibilities in EPAs result from a voluntary systemic direction that would render them incompatible with trade liberalization. WTO rulings that have found such flexibilities contrary to the MFN Clause[11] have implicitly chosen to remove mixed RTAs from the coverage of Article XXIV, stating that preferences granted in an RTA framework are discriminatory for other countries at the same level of development. It would have

11. See the Banana Case below.

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been interesting to adopt an innovative approach to determining whether what is not expressly authorized by law is *de facto* prohibited. With the lack of clear legal provisions for mixed RTAs, Members have preferred to reaffirm the coherence of the system through an enhancement of the principle of non-discrimination.

Article 34.4 of the Cotonou Agreement provides that "economic and commercial co-operation shall be implemented in full conformity with the provisions of the WTO, including special and differential treatment". This provision sets the WTO level of special and differential treatment as the legal ceiling for SDT in EPAs. If ACP flexibilities are not expected to exceed those in force at the WTO for the sake of compatibility, they should not be less far-reaching either. The provisions of GATT Article I (MFN Clause) and Article 34 of the Cotonou Agreement cancel each other out and pave the way for a quasi standard SDT in EPAs. However, special and differential treatment for ACP countries modeled on that of the WTO would amount to exactly the same as MFN rights and would only be a minimum requirement that applies to all developing countries, well beyond those of the ACP.

Furthermore, the differences in time needed to conclude these two processes leaves ACP countries with just a small margin. If, in a best case scenario, the Doha Round can be wrapped up by December 2006, negotiations on EPAs may go on until 2007.[12] This means that if ACP countries are to have an acceptable level of flexibilities in EPAs, they must obtain positive and consistent results in the ongoing WTO talks on SDT at a level ambition stated in the Doha Declaration.

The triangle of impossibilities: preference, non-reciprocity and discrimination

The preferential approach to international trade rests on a mutually reinforcing triumvirate of factors. One can hardly imagine a trading system that is preferential, discriminatory and non-reciprocal at the same time, considering the range of

12. It is already known already that the future EPAs will enter into force in January 2008.

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frameworks that govern the modalities for according trade preferences in world trade.

Part IV of the GATT, negotiated in 1964, codifies the notion of *non-reciprocity* in trading relations between developed and developing countries. It reconciles development requirements (SDT) with WTO principles in order to redress inequalities in development. It also allows developed countries to accord advantages without expressly receiving any in return, and enjoins them to accord such advantages only to developing countries –and all developing countries at that. This essentially prohibits discrimination between potential beneficiary countries that are at the same level of development.

The GSP of 1971 and the Enabling Clause of 1979 build on the same line of legal logic. While the latter is a long term solution and the former simply a temporary measure, both regimes reaffirm that contracting parties can accord differential and favorable treatment to developing countries, without doing so to other contracting parties.

GATT Article XXIV, which governs RTAs and issues conditions for granting advantages in trade, stresses two points: symmetry of concessions and discrimination towards non-members of customs unions or free trade areas. Preferences in this regard are no longer unilateral but reciprocal. The "private" nature of the transaction justifies acceptance of discrimination towards non-members.

All GATT/WTO provisions organize the triangle of impossibilities without saying so expressly. There is a permanent feature –the preferential measure itself –on the one hand, and two variables on the other –discrimination and reciprocity. If the preference is coupled with reciprocity, discrimination towards other beneficiaries remains possible. If the preference is coupled with discrimination, there must be reciprocity among beneficiary members. Whatever the case, discriminatory preferences must be reciprocal, otherwise they are illegal.

Beyond the issue of differentiation between developing countries, this legal situation has an immediate effect on the

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application of global reciprocity in EU/ACP relations. It underscores the differences in levels of development within ACP countries. The future framework of EPAs, as it appears today, leaves no space for a trade-balancing system that would adjust economic inequality between EU and ACP countries. However, the "Everything but Arms" (EBA) initiative offers a preferential framework for LDCs. It maintains their asymmetrical trading relations to the detriment of ACP developing countries that cannot benefit from this flexibility. The key point is to know how useful it would be for ACP LDCs to sign EPAs that would not help them to broaden their trade preferences, or at least to maintain them. To safeguard and preserve the interests of LDCs, the European Commission seems to be in favor of EPAs[13] with measures on issues well beyond standard market access.

Reviewing WTO-specific preferences: the banana case[14]

General trade preferences were formerly designed at UNCTAD and enforced by the GATT. Such preferences are general, impersonal and open to all developing countries self-designated as such. They fall under the province of the Enabling Clause (above).

In contrast, within the framework of the EEC/ACP Convention, most African countries benefit from special preferences because they are poor and have historical links with their former colonial capitals. Europe offers preferential treatment based on the principle of non-reciprocity enshrined in the different Lomé Conventions. Article 25, Chapter 4 of Lomé I stipulates that the general trading system is based on

13. Bilal Sanoussi, "Who Will Negotiate with the EU? In search of an ACP-EU negotiating framework". Trade Negotiations Insights, Vol. I, No. 1, February 2002.
14. European Union Countries - Regime for the Importation, Sale and Distribution of Bananas, Reports of the Panel, WT/DS27/R/USA, WT/DS27/R/ECU, WT/DS27/R/GTM and WT/DS27/R/HND (22 May 1997), as amended by the Appellate Body, WT/DS27/AB/R (9 September 1997) adopted on 25 September 1997; Arbitration Report WT/DS27/15, 7 January 1998; Arbitration - Recourse by the US to Article 22.7 of the DSU, WT/DS27/49, 9 April 1999; Arbitration - Recourse by the EC under Article 22.6 of the DSU, WT/DS27/ARB, 9 April 1999; Report of the Panel - Recourse to Article 21.5 by the EC, WT/DS27/RW/ECU (12 April 1999) adopted on 6 May 1999; and Arbitration - Recourse by the EC under Article 22.6 of the DSU, WT/DS27/ARB/ECU, 24 March 2000.

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the principle of free access of ACP products to the European market. Considering the current development needs of ACP countries, "it does not include reciprocity in terms of free access". Article 174 in the chapter on co-operation in trade reiterates this principle in similar terms.

In 1993, the Latin American states' complaint on the EC's banana import regime led to the creation of a special group,[15] which ruled that the system was incompatible with provisions of the GATT. However, the decision was not enforced for want of a consensus. A few months afterwards, the WTO Dispute Settlement Body confirmed the decision in the wake of the Marrakech Agreement.

Lomé was incompatible with the multilateral trading system, because its measures ran contrary to GATT Article I (MFN Clause). Contrary to what the EC and some of its ACP partners affirmed, the Lomé preferences could not be justified under Article XXIV of GATT on free trade areas and customs unions either. This is because the system is based on unilateral liberalization –a provision that does not conform to the requirement for reciprocity in paragraph 8(b) of Article XXIV. Consequently, the EC, its member states and the ACP countries can no longer maintain their preferential trading system due to the means to exert pressure that new WTO provisions make available to countries that suffer discrimination caused by the granting of preferences.[16]

The change in direction undertaken with the signing of the Cotonou Agreement does not solve the problem of incompatibility between the EU/ACP trade arrangement and WTO requirements. Most of the provisions deemed illegal by the Dispute Settlement Body (DSB) are maintained in the Cotonou Agreement, leaving the issue of incompatibility untouched. To keep from jeopardizing this new trade arrangement, the EU and ACP states had to ask the WTO for

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15. To have a good idea of the Banana case in the WTO, as it links to the Cotonou agreement, see Abou Abass, the Cotonou trade regime in the context of WTO rules, United Nations Observer, N° 12, 2002.
16. Abou Abass, The Cotonou trade regime in the context of WTO rules, United Nations Observer, N° 12, 2002.

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a special waiver to maintain the Lomé regime during the transitional period.[17]

According to the waiver "Article I, paragraph 1 of the General Agreement shall be waived [...] to the extent necessary to permit the European Union Countries to provide preferential tariff treatment for products originating in ACP States as required by Article 36.3, Annex V and its Protocols of the ACP-EC Partnership Agreement, without being required to extend the same preferential treatment to like products of any other Member". The waiver runs until 31 December 2007, which is the deadline for the transitional period of the Cotonou Agreement. Apart from its legal aspect, the waiver also has a political basis that was taken into consideration at the Doha Ministerial Conference. This includes the fact that the Cotonou Agreement seeks to improve the standard of living and economic development of ACP countries, and that the preferential treatment aims to promote growth in trade and economic development for beneficiaries in line with WTO objectives.[18]

Towards SDT in EPAs?

Despite rigid legal provisions, there are still chances of introducing SDT in the future EPAs by reforming the legal framework and interpreting RTA rules in a more flexible manner. The WTO DSB's recent decision that enshrines a possible differentiation between developing countries in the multilateral trading system may offer grounds to initiate and facilitate these efforts.

Extending the interpretation of RTA rules

The WTO's Committee on Regional Trade Agreements (CRTA) is at the heart of controversies related to the interpretation of rules for establishing RTAs in GATT Article XXIV. To implement the Doha mandate, the committee has to "clarify and improve the disciplines and procedures in existing WTO

17. Abass, *op. cit.* [16].
18. Idem.

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provisions applying to regional trade agreements", while also taking their "developmental aspects" into consideration.[19] Three sensitive issues are of particular interest to ACP countries.[20] These include the introduction of development issues into mixed RTAs, the scope for application of RTAs, stated in paragraph 8 of GATT Article XXIV (what do the liberalization measures provided in RTAs apply to?); and the problem of transitional periods under Article XXIV.5(c) which raises the issue of the time period for implementing the liberalization measures provided in RTAs. A broad or even possibly supple interpretation of the WTO provisions on these issues may enable ACP countries to envisage the implementation of future EPAs with a great deal of flexibilities.[21]

Article XXIV lacks adequate provisions on development-related aspects of RTAs signed between developed and developing countries. ACP Members say they do not understand why Article 5 of the GATS makes explicit provision for SDT in economic integration agreements involving developed and developing countries, whereas article XXIV, the matching provision in the GATT, is silent on the issue. ACP countries are demanding redress for what they see as a "gap" through an agreement that SDT shall be formally and explicitly granted to developing countries in keeping with GATT Article XXIV paragraphs 5 to 8 in the context of regional agreements signed between developing and developed countries.

The European Union Countries defend a similar position on this, and consider coherence and logic to be lacking in the treatment of different types of RTAs involving developing countries. The main reason is that "existing rules do not permit equitable treatment of different types of RTAs according to their impact on development and the extent to which they encourage developing countries' participation in world trade." Therefore, these rules need to be made clearer

19. Doha Ministerial Declaration (WT/MIN (01)/DEC/1), paragraph 29.

20. See Compendium of Issues Related to Regional Trade Agreements (TN/RL/W/8/Rev.1) drawn up by the WTO Secretariat.

21. Some of the most significant proposals for negotiations on development issues in RTAs were presented by the European Union Countries (TN/RL/W/14), Turkey (TN/RL/W/32, and Jamaica (WT/GC/W/369), in addition to the main proposal presented by Botswana on behalf of the ACP countries.

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and more explicit, with particular attention paid to the tangible advantages of economic integration through more ambitious RTAs between developed and developing countries.

Defining the scope of free trade areas also raises the issue of liberalization levels, assessed through the notion of "substantially all the trade". In mixed RTAs, like those between the European Union Countries and ACP countries, the interpretation of this notion is particularly important for those countries of the South that consider their economies not advanced enough to fully open their markets. Although not advocates of protectionism, these countries use the same basic arguments that brought recognition of special and differential treatment to the GATT and the WTO. It would indeed be inconsistent to deny developing countries the flexibilities frameworked in mixed RTAs and recognized already by the multilateral trading system. The notion of "substantially all the trade" should be interpreted differently, according to whether one deals with RTAs involving countries at similar levels of development or mixed RTAs.

Well aware of this, ACP countries ask developing countries to address this issue with appropriate flexibility, at both the quantitative and the qualitative levels. In quantitative terms, global trade with Northern partners within a free trade area should not surpass a certain threshold. To evaluate the scope for applying an RTA in the context of GATT or the WTO,[22] a percentage of trade is preferably used. While there is wide agreement that "substantially all the trade" should cover 80 to 90 percent of trade between RTA parties, such a proportion would not serve the interests of developing countries. Officially, no reference is made to quantity. ACP countries are already stressing the need for a favorable method and inferior threshold levels when assessing trade levels.

In qualitative terms, the trade level also implies choosing which commodities to target. The need to protect certain local sectors and to encourage the emergence of competitive industries is incompatible with liberalizing sectors where the EU would like to see enhanced market access. To promote food

22. Report of the WTO Secretariat, WT/REG/W/46, p.5.

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security and/or rural development, some agricultural products cannot be subjected to competition. Similarly, some branches sidelined in the Doha Round for obvious economic reasons cannot be tabled for liberalization outside the system. For example, opening an agenda to liberalize investment and competition in EPAs would amount to ignoring the profound economic reasons why ACP countries are exempted from opening up these areas, as well as a denial of differential treatment.

Whether quantitative or qualitative methods are used to set a threshold for liberalization in keeping with GATT Article XXIV.8 (b), it should not be forgotten that special and differential treatment arises from the will to give developing countries a legal and economic framework that raises their standards and prepares them for the international trading system.

To meet their specific needs, ACP countries should insist on a precise and broad definition for terms such as "major sector". They could also ensure lists of exemptions from the obligation to waive tariffs and other trade-restrictive measures covered in Article XXIV.8 (a) (i) and 8(b), as well as work on eventual seasonal restrictions, special sectoral safeguards and tariff rate quotas adapted to their situation.

This is where the issue of the transition period mentioned in GATT Article XXIV.5(c) becomes important. It concerns the implementation deadline that can be given for the delivery of a RTA. There are several ways of understanding what makes a "reasonable length of time". A consensus seems to be emerging on a prescribed timeline that should not "exceed 10 years except in exceptional cases."[23] For ACP countries, the key issue is the interpretation of the term "exceptional circumstances", which should be clarified so that developing countries could more easily get a transition period of over 10 years as a legitimate entitlement. The proposal

23. During the Uruguay Round, Members explained that this prescribed time "should exceed ten years only in exceptional cases". However, the 2002 report of the Secretariat (WT/REG/W/46, p.22) showed that with regard to the RTAs that entered into force in the second part of the 1990s, "it [was] rare for transitional periods to exceed ten years". On the other hand, and with respect to the several RTAs signed recently, transitional periods largely exceed ten years. These cases are becoming the norm, rather than the exception. See proposal presented by the European Union Countries on RTAs, document TN/RL/W/179 of 12 May 2005.

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ACP countries[24] have developed purposely in this regard would be at least 18 years, taking into account ACP countries' level of trade, development and finance.[25]

Discrimination and differentiation: India's complaint on GSP

The debate on conditions for according preferences to developing countries took an interesting twist during a case brought recently before the WTO Dispute Settlement Body. In the absence of convincing answers from the negotiations, WTO jurisprudence made it possible to refocus the interpretation of the conditions provided in the Enabling Clause of 1979.

Challenging the EU "GSP Drug" preferential scheme that granted special preferences to countries like Pakistan to fight drug trafficking, India maintained that such arrangements were discriminatory, because the advantages granted by the EU were available only to certain specific developing countries. India advanced that the countries excluded from the regime suffered negative effects on certain exports to the EU. It stressed, in particular, that Pakistan's entry into the scheme had affected India's textile exports to the tune of 250 million US dollars as the customs duties India paid for these exports to enter the European market were higher than those levied on equivalent Pakistani products.

The significance of this dispute extends well beyond the drug scheme. This was actually the first dispute around the Enabling Clause, one of the most significant forms of "special and differential" treatment in favor of developing countries provided in the WTO Agreement. Consequently, the decision issued by DSB had the potential to determine the viability of the General Systems of Preferences (GSP) applied by several donor countries.

In the beginning, the dispute settlement panel went along with India's line of reasoning, considering that the European Union Countries had infringed its obligations as the drug-fight-

24. Paper presented by the ACP Group of countries, TN/RL/W/155 of 28 April 2004.
25. Paper presented by the ACP Group, TN/RL/W/155 of 28 April 2004, paragraph 11 ii).

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ing measures were incompatible with the MFN Clause, and unjustifiable under the Enabling Clause. The Council Regulation that had been called into question was considered to cancel or compromise the advantages flowing from WTO agreements. As a result, the European Union Countries were asked to withdraw the preferences accorded to certain Latin American countries, as well as Pakistan, under the drug control program.

In a spectacular turn of events, the WTO's Appellate Body ruled that WTO rules did not prohibit developed countries from levying different customs duties on commodities originating from different developing countries in the GSP, provided that this differential treatment fulfilled certain conditions in the Enabling Clause.

The panel had understood the term "non-discriminatory" in the Enabling Clause to mean that identical tariff preferences in GSP systems must be granted to all developing countries without differentiation. The Appellate Body refused this interpretation and concluded that the term "non-discriminatory" did not prohibit developed countries from levying different customs duties on products originating from different beneficiaries of GSP, "on the condition that this differential tariff treatment fulfilled the remaining conditions of the Enabling Clause."[26]

The Appellate Body noted in its analysis that, even if developing country needs for improved market access were to be taken collectively, they had changed over time to the point that the common interests of sub-groups of developing countries should be addressed on the basis of their specific requirements. In light of this, the way it interpreted the expression "without discrimination" required no "identical tariff preferences" and allowed the possibility of additional preferences for developing countries with particular needs.[27]

26. This new thinking on the issue of differentiation allows the EU to maintain the drug-related arrangements after making the necessary amendments. In his response to the decision, the EU Trade Commissioner, Pascal Lamy, said: "The decision issued today shows clearly that we will continue to accord trade preferences to developing countries, based on their situation and their specific needs, on condition that this is done in an objective, non-discriminatory and transparent manner."
27. Report of the Appellate Body, paragraph 169.

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The Appellate Body's ruling established four criteria to govern any donor seeking to defend a GSP program that offers different levels of preferences to different developing countries.[28] The beneficiary countries must not be in a similar situation[29] to the extent that countries receiving a higher level of preferences must provide justification for their *special development needs*. Moreover, *all* developing countries with these special needs should benefit. In addition, the differentiation conceded should be achieved through tariff preferences used *as means* to address the special needs in an efficient manner. Finally, all conditions or performance requirements imposed on eligible countries should be objective, transparent and non-discriminatory.

The Appellate Body nevertheless underlined that the similar treatment should be available to all beneficiaries of the GSP placed in an identical situation and have the same "development, financial and trade needs" that the treatment in question is designed to address.[30]

Such a decision has obviously had a considerable impact on the conditions for according preferences. By considering that discrimination among developing countries could be accepted –even if it is based on objective and pre-established criteria– WTO jurisprudence for the first time set a legal basis for cumulating unilateral and discriminatory trade preferences. This interpretation introduces another level of differentiation that exceeds the generic category of developing

28. See Robert Howse, Bridges, Vol. 8, No. 4, April 2004.

29. To determine the degree of similarity between developing countries, the Appellate Body suggested that the arbitrator of implementation should seek precise criteria in WTO rules, as well as other development-related multilateral instruments. This can be taken as the WTO's attempt to be more open by taking account of aspects that could highlight issues not centered exclusively on trade.

30. It is on this basis that the Appellate Body's decision, despite its generally progressive nature, did not endorse Europe's preferential arrangement for drugs. This latter does not set specific criteria for beneficiary countries that could justify discrimination towards other developing countries, in this case India. The Appellate Body noted that the drug regime itself provides no clear pre-conditions –or "objective criteria"– which, if fulfilled, would enable other developing countries "affected in a similar way by the drug problem" to be included among beneficiaries of the drugs scheme. The European Commission indicated in its own submission that "the preferences provided under the Drug Arrangements are not 'conditional'." Similarly, the drug regime establishes no criterion by which a beneficiary could be excluded specifically from the drug arrangement on the grounds that they are no longer "affected in a similar way by the drug problem".

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countries and should be articulated within the ongoing WTO debate on this subject. For African countries, this opens new prospects on two counts. First of all, it offers them an opportunity, in the EPA framework, to seriously envisage a non-reciprocal and discriminatory partnership with the EU. In any case, the ruling would legitimize special and differential treatment in whatever form it takes and in a format compatible with WTO requirements, but on the condition that there is a common denominator that justifies a preferential regime that other developing countries would not be able to enjoy. Second, it opens bright prospects for areas other than trade, such as food security or fighting desertification, which could justify granting special and differential treatment not exclusively based on the development factor, but also on the basis of Africa's specific needs.

WTO legal framework reform

As mentioned earlier, the key problem caused by the lack of a non-reciprocal preferential system in the future EPAs results from the failure to address mixed RTAs in WTO rules. There are two possible ways of handling this: revising Article XXIV and extending the scope of the Enabling Clause.

Revising article XXIV

The main reason for revising article XXIV would be to reach a broad definition of RTAs that would no longer consider that preferential treatment between developing and developed countries participating in a free trade is discriminatory.

The wording of Article XXIV was negotiated at a time when very few North-South RTAs were in place.[31] This might be one reason why mixed agreements and development-related issues were omitted. Although special and differential treatment has become central to the WTO's legal architecture, Article XXIV provides no de jure preferences for developing

31. The only amendment made to Article XXIV to this day is the Understanding on its interpretation in the GATT 1994. It helped clarify the provision on the period of transition, but makes no mention of the new reality of mixed RTAs.

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countries.[32] Some have said this article contains "some de facto flexibility [...] arising from the ambiguity in terminology used therein, and in the permissive practices evolved over the years of particularly the GATT history and now the WTO."[33] These implicit flexibilities, which result from a broad interpretation and lack of close oversight, should not suffice to ACP countries, or make them presume that any unilateral preferences they could negotiate in EPAs would be WTO-compatible. Not only is there no way of guarding against a complaint for violation of the MFN Clause, but experience suggests that complaints filed by other developing countries on the basis of non-discrimination are upheld by WTO jurisprudence. We must not forget that in the banana case, Article XXIV offered no shield for Europe's preferential regime in favor of ACP countries. In *Turkey Textiles*[34] as well, the Appellate Body issued a ruling that considerably restricted the legal applicability and scope of de facto flexibility in Article XXIV. In this case,[35] the Appellate Body gave an interpretation of the notion "substantially all the trade", which considered that sub-paragraph 8(a)(i) of Article XXIV offered "some flexibility" to constituents of a customs union in liberalizing their internal trade. It cautioned, however, that the degree of "flexibility" provided in sub-paragraph 8(a)(i) was limited by the requirement that "customs duties and other restrictive regulations of commerce" should be "eliminated with respect to substantially all" internal trade. ACP countries' reading of this interpretation is far from mistaken. This is a clear indication that the principled provision remains a quite high level of liberalization not particularly mindful of the specific needs of developing countries.

In reforming Article XXIV, a "codification" of a formal broad interpretation would be achieved, as well as the redressing of the trend of restrictive interpretation of WTO jurisprudence. This would ensure more predictable legal provisions and an exceptional regime for developing countries engaged in mixed RTAs.

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32. Paper presented by the ACP Group, TN/RL/W/155 of 28 April 2004, paragraph 8.
33. Idem, paragraph 8.
34. *Turkey - Restrictions on the importation of textile commodities and clothing.* Report of the Appellate Body, 22 October 1999 (WT/DS34/AB/R).
35. Idem, paragraph 48.

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Extending the scope of the enabling clause

The Enabling Clause is a SDT provision that covers regional trade arrangements. Its paragraph 2(c) deals with preferential treatment applicable to "regional or global arrangements entered into amongst less-developed contracting parties for the mutual reduction or elimination of tariffs". Regional trade-balancing measures do thus exist, but they are limited to trade between developing countries.

Since the clause sets a general exception to the MFN rule in favor of developing countries, ways of extending its advantages to mixed agreements might be looked at to legalize the preferential measures that could go into them. At the same time, this would prevent subjection of mixed RTAs to the current provisions of article XXIV without offering them the same advantages. This would provide legal grounds for all preferential treatment included in EPAs in favor of ACP countries, re-install non-reciprocity and confirm that regionalism is an efficient means for developing countries to progressively establish themselves in the global economy.

Apart from these preferential benefits, the reform would clarify the scope of regional trade arrangements by placing them under the Enabling Clause and thus automatically exclude them from the coverage of Article XXIV, which has been the basis of all legal challenges regarding EU preferential treatment for ACP countries.

Conclusion

WTO legal provisions on RTAs were designed at a time when commercial realities took no account of mixed free trade areas between developed and developing countries.[36] Consequently, denial of a preferential regime in mixed RTAs does arise from a systemic approach based on the core

36. Even if a GATT-frameworked preferential regime is germane to the respective Lomé conventions, the discriminations European Union Countries have accorded to ACP countries result mostly from the "lethargic" system in place. None of the countries this situation discriminates against had deemed it useful to raise the point. These specific European preferences have really never been legally rooted in GATT/OMC.

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principles of the WTO. Today, more than ever before, ACP countries need flexibilities and adjustments that enable them to position themselves better in the multilateral trading system. They have faced considerable erosion of preferences resulting from the continuing reduction in MFN tariffs to the point that if the new EPA regime includes no discriminatory measures on market access, these countries run the risk of being marginalized in the trading system. Underlying this situation is the problem of differentiation between developing countries and that of coherence between bilateral and multilateral agreements. New and innovative criteria are needed to fine-tune SDT measures to the needs of developing countries carrying vastly differing economic capacities. There is a case for adapting WTO disciplines on RTAs in order to keep the regional option attractive for developing countries.

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Conclusion

Making Trade Work for Development

Valentine Rugwabiza[1]

For some time the World Trade Organization and its members have been looking at the linkages between trade and development, including in the context of the Doha Development Agenda, with the objective of ensuring that global trade, and the rules that govern this trade, facilitate development. Even though perceptions differ as to what is really meant by "development" and what should be the means to achieve the end goal of "development" –trade and development are increasingly perceived as being inextricably linked. It is in such a complex and evolving environment that the role of trade in fostering development needs to be assessed and analyzed.

The linkage of trade and development, and the role that the WTO can play in facilitating development through trade, assumes even greater significance when viewed in the perspective of the fact that developing countries account for more than two thirds of WTO's Membership. Moreover, the vast majority of poor people also live in these very countries and if they are to be lifted out of poverty then economic

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growth and development need to be pushed in these countries, including through trade. While the share of developing countries in world trade may still be small, it is growing quickly, and has a vast, unleashed potential. These countries therefore have key interests and a central role to play in all trade negotiations in the WTO; a fact recognized in the DDA, which placed development at the centre of the new Round of negotiations. However, at the same time, it also needs to be borne in mind that developing country economies, relative to developed country economies, are typically characterized by institutional constraints such as lack of a social-safety net, inadequate infrastructure, governance problems, widespread unemployment and poverty that make them more vulnerable to changes. These countries therefore often do not have the requisite capacity and require a certain degree of flexibility and assistance in effectively exercising their right and implementing their obligations.

In such a scenario can the WTO be an effective engine for growth and development? Before I answer this question let me emphasize that there is an increasingly shared feeling today that trade has a very important role to play in development. Obviously, trade cannot be the only engine of growth; many other pieces will have to fall into place if national developmental objectives are to be achieved. But there can be little argument over the fact that trade will be an integral part of any such strategy. And therefore by implication, the WTO, as the body which facilitates multilateral rules in this area, has an important role to play in engineering growth and development. Admittedly, there was a time when many people questioned the ability of a global trading system to deliver on development. Many said, and some still do, that trade has, and will always be mercantilist and therefore trying to achieve development through trade was like fitting a square peg in a round hole. The skepticism for such a view has lessened, perhaps because trade and development are increasingly being accepted as being related to each other. Moreover, the WTO and its Members have consciously tried to strengthen this linkage by launching the Doha Development Agenda (DDA) in 2001. This was not only a reflection of the collective acknowledgement of WTO

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Members that the concerns expressed by developing countries must be addressed upfront, but equally importantly this was also reflective of the recognition that trade and development are inextricably linked.

Development is much more than just further trade liberalization and policy reform, especially since we often tend to overlook the institutional and systemic gains that will also be realized through a successful conclusion of the Doha Development Round. However, we also need to be clear that this is easier said than done. There is no doubt that the ongoing round of negotiations provides us with the best way of delivering development; though for that to happen, we would first need to have agreement amongst the WTO Member states if we wish to realize the longer term economic gains or the hopes of many of the world's governments for developmental gains. But as is often the case, when the time comes to convert good intentions into legally binding commitments, we tend to falter. It is at such times that the process requires a huge dose of political will. It requires a long-term vision, a vision that is at times sacrificed for short-term political objectives. If any ground is given, then more often than not it does little to address the core problem. But this is where the political challenge comes in. It is about convincing today's leaders, heads of state and key decision makers that this Round is about more than just freer trade.

Reducing poverty, promoting growth, helping developing countries to integrate into the global economy – surely these goals are shared by everyone. It is not in our national, regional or global interest to see poor countries going backwards economically, to observe starvation, civil war or environmental degradation. Our efforts to open markets, to improve trade disciplines that create a more level playing field and to expand trade will be a key contribution to achieving the developmental objectives which we all share; and I have little doubt that the WTO can be an engine for this growth and development.

To assess the WTO's efficacy role as an engine of development then, one would need amongst other things to look at the development dimension of the DDA. Even a

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cursory glance at the agenda that Ministers set out at Doha will show that development is a very broad and cross-cutting issue and that benefits would accrue to developing countries in many areas through a successful completion of the DDA. There is a lot to gain, especially from a developing country perspective, if the objectives of the Round can be achieved. And the gains would not only be economic. Institutional and systemic gains would build a more solid basis for development, boost the rules-based system of the WTO and establish greater trust among nations. They would also demonstrate that nations can work together to solve their collective problems. Development, or rather the lack of economic development, is exactly such a collective problem. It is not only a national problem but a regional and global issue that affects all nations. Even though the WTO is not a development organization, its contribution in fostering new trading opportunities against a background of predictable rules allows the institution to make a vital contribution to development.

The ongoing Doha Development Round is a rare opportunity and one that must be seized now. If not, we risk having to wait a long time before the pieces can fall into place once again. It is a chance to reform sectors, such as agriculture, which have long been shielded from market forces and international competition. And it is precisely in reforming current agricultural policies, mainly in industrialized countries, where the WTO has a major role to play because many of these trade distortions are unlikely to be addressed in bilateral or regional trade deals – the significance of which increases even more when viewed in light of the fact that it is in this sector that many developing countries stand to gain the most.

At the same time, especially in the context of the linkage between trade and development, the importance of opening up South-South trade should not be lost sight of, since this too is an area where there is a large potential for market access.

Clearly, the biggest contribution to development will come from ambitious results in each one of the area's negotiations and especially from the greater market access opportunities in

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agriculture, where developing countries are the most competitive and industrialized countries the most protective, from NAMA where tariff escalation presents another barrier to developing country exports, and from services liberalization where mode four or the movement of natural persons remains highly restricted in many industrialized countries.

A discussion on the development dimension of the DDA would be incomplete without a mention of special and differential treatment (SDT) in the WTO rules. Though the concept of SDT has a long pedigree, it was the last Round of trade negotiations, the Uruguay Round, that made SDT an integral part of the WTO Agreements, a fact reiterated in the Doha Declaration. The Uruguay Round, which culminated in the establishment of the World Trade Organization, saw the introduction of a number of provisions aimed at promoting the participation of developing and least-developed countries in international trade and at addressing their particular concerns. Developing countries obtained a number of new and strengthened SDT provisions, in the form of less onerous commitments, exemptions from certain disciplines, extended transitional time frames for implementation of the new rules and technical assistance. At the same time, developed countries committed or made best endeavor offers to improve market access for products and service sectors of interest to developing countries, and to implement the agreements in ways that took into account the interests of developing countries. Special provisions for LDCs were also included.

However, as time passed, certain problems relating to the effectiveness and operationability of these provisions emerged. The recognition in the Doha Ministerial Declaration of the need to review the SDT provisions is a reflection of these concerns. Paragraph 44 of the Doha Ministerial Declaration reaffirmed that "provisions for special and differential treatment are an integral part of the WTO Agreements" and directed that "all special and differential treatment provisions shall be reviewed with a view to strengthening them and making them more precise, effective and operational".

Though this work has been going on since the early part of 2002, there is no doubt that progress has been limited.

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There are many reasons for this, including the fact that there are differences in perception about how to operationalize the mandate contained in paragraph 44 of the Doha Declaration. In its report to the General Council in February 2003, the Special Session reported that "an important area of difference has been the interpretation of some aspects of the Doha Mandate. While Members recognized the importance that Ministers attached to the SDT work program, and accepted the need to review all SDT provisions, there were significant differences on how this could be achieved. Some Members considered that one way to make SDT provisions more precise, effective and operational was to make them mandatory by changing the existing language of some of the 'best endeavor' provisions, and that doing so was part of the mandate. Others did not wish to consider amending the text of the Agreements or otherwise altering what they considered to be the existing balance of rights and obligations. Some delegations held the view that such proposals might be best referred to negotiating bodies, while others did not consider that this was a course consistent with the Doha Mandate."

Some Members feel that it is necessary to differentiate further amongst the rather heterogeneous group of developing countries, as this would make it easier to find solutions to address specific concerns of some developing countries facing specific problems. However, others oppose it strongly. Although a detailed discussion on this issue has not taken place in the WTO, whenever it has been touched upon it has evoked strong and sensitive reactions. Even the deliberations in the Special Session of the CTD have focused on looking at provisions that would provide flexibilities to all developing countries, albeit with a more targeted approach towards the LDCs. What is clear is that differentiation is still a very sensitive issue, and one for which it may not be easy to find a universally acceptable solution; making it therefore difficult to design precise and effective solutions to specific problems faced by specific countries.

If SDT provisions are to be made more precise, effective and operational, as mandated under the DDA, they may benefit from a process involving policy analysis and accoun-

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tability on all sides. I lay stress on the word "accountability" because while it is important to address the problems faced by developing countries, especially those that are related to their capacity constraints and make it difficult for them to implement and benefit from WTO Agreements, it is equally important, if not more so, to ensure that the multilateral rules-based system is not weakened in any way. Any new approach to the issue of SDT in the WTO, apart from being focused and targeted, needs to avoid getting bogged down over claims for total opt-outs on the one hand, and offers of arbitrary transition periods on the other. Rather, a pragmatic and realistic middle ground needs to be explored; one that would increase the receptivity both among potential "beneficiaries" and among "benefactors" by accepting that a well rationalized, more targeted and less open-ended approach to SDT is called for.

In some ways progress along these lines was made at Hong Kong, where Members agreed to a set of targeted measures for the LDCs. The LDC package included measures which took into account the specific concerns and constraints of these countries, while at the same time focusing on their development needs by providing them with real market access, including by providing products from LDCs duty-free and quota-free access.

Development, as I have explained earlier, is a very broad concept. Trade, and by implication the WTO, can only fulfill one aspect of this broad objective. The WTO is one of the many actors in the global arena, all of whom would have to act in unison and in a concerted manner if the developmental aspirations of the developing countries are to be achieved. To be sure, the WTO will have to do its bit, but until all the others also engage, satisfactory results will be elusive. There is no doubt that the WTO's biggest contribution to development lies in its role as a rule-making organization for trade liberalization and removal of trade barriers. That is what the WTO does; that is its core role. But developing countries, especially the poorest among them, also need help to benefit from the market access openings that trade liberalization provides. They also need assistance to make the system work for them

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–to negotiate agreements and to use dispute settlement so that they can defend their rights. And, in order for them to implement the commitments under the agreements, some of which require regular technical notification to trading partners, they need financial and more technical assistance. They also need help with building the necessary capacity to take advantage of more open markets –everything from roads and railways, to services and suppliers, simplification of border red tape or the ability to match food standards.

This is the rationale for Aid for Trade which is not a substitute for market access but a necessary complement. The Hong Kong Declaration and the new WTO work program on Aid for Trade is a recognition that we have a shared responsibility to contribute to a world trading system where all countries, including the poorest, can benefit. A meaningful Aid for Trade package can play an important part in helping us translate the development potential of the Round into reality. One of the challenges will be to agree on how to operationalize the Aid for Trade mandate in the context of the end of the Round. To do this, we will need to do three things: examine the kind of assistance that is needed; assess where reinforcement is necessary and where new funding beyond existing mechanisms might be necessary; and, above all, ensure that developing countries themselves are full partners in the process. Because unless developing countries feel ownership of any Aid for Trade initiative –and are empowered to benefit from it– this initiative cannot, and will not, succeed. The WTO is neither a financial nor a development agency and cannot deliver or implement the Aid for Trade outcomes. Hence the need for coherence policy at national, regional and global levels between national and Trade, Development and Finance ministries and international agencies.

In this regard, Aid for Trade is not only a unique opportunity but also a test and a challenge to both trade, development and finance communities, of their capacity to work together at making trade an engine for economic growth, poverty reduction and development in LDCs and developing countries.

In conclusion, let me restate the importance of the need for the global community to work collectively to achieve the devel-

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opmental objectives that we have all set ourselves, including as part of the Doha Development Agenda and the Millennium Development Goals. The international community has taken major steps towards debt relief and increasing aid. Similar initiatives now need to be taken in the field of trade, including as part of the ongoing round of negotiations. Only then can trade become an effective tool for facilitating development. We have to do it, because we owe it to the developing countries to deliver on the promise that we made on development when we launched the Doha Round.

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Appendix

Program of the International Conference

Trade for Development: The Future of Special and Differential Treatment of Developing Countries

Ifri, Paris – 28 October 2005

The Future of Trade Preferences: the Poorest Countries' Stakes in the Doha Round

8 : 30 - *Seminar Presentation* - Welcome address by Jean-Marie Paugam, Senior Research Fellow, Ifri, and Serge Perrin, Researcher at AFD.

8 : 40 - *Opening Speech* by Mrs. Christine Lagarde, French Trade Minister.

9 : 00 - 10 : 45 - ***Session 1 - The Future of Trade Preferences: What is at Stake for Developing Countries?***
Chairman: Dani Rodrik, Professor of International Political Economy, J.F.K. School of Government, Harvard University.

Stefano Inama, Manager, Senior Trade and Customs Expert, UNCTAD – *Are Trade Preferences Good for Development? A Theoretical and Empirical Overview of the Economic Impact of Trade Preferences*

Jean-Christophe Bureau, Director of a Joint Research Team in Public Economics, INRA and Research Associate, CEPII – *Preferences Erosion: Who Wins, Who Loses?*

Hervé Guyomard, Senior Researcher at INRA, Head of the INRA Department of Social Sciences – *A Case Study: Selected Agricultural Products in EU/ACP Relations.*

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11 : 00 - 12 : 45 - ***Session 2 - The Future of Trade Preferences: Coping with the Threat of Preference Erosion?***

Chairman: Jean-Marie Metzger, Director of the Trade Directorate, OECD.

Bernard Hoekman, Research Manager of the International Trade group in the Development Research Group of the World Bank – *Combining Trade Preferences Reform with Multilateral Liberalization?*

Serge Perrin, Economist at AFD – *Preference Erosion: What Role for Aid*

Michaela Dodini, Expert in Development Issues at the Directorate General for Trade, European Commission – *The Multilateralization of the Everything But Arms Initiative for LDCs.*

Differentiating Developing Countries in the WTO: the Challenges of SDT for Emerging Economies

14 : 30 - 17 : 00 - ***Session 3 - Differentiating Developing Countries in the WTO: Legal and Economic Aspects***

Chairman: Peter Kleen, Trade Policy Consultant and Former DG of the National Board of Trade, Sweden

Anne-Sophie Novel, Research Assistant, Ifri, and PhD Student, Sciences Po, and Jean-Marie Paugam, Senior Research Fellow, Ifri – *Why and How Differentiate Developing Countries within the WTO? Lessons from Theory and Solutions for Negotiations.*

Alan Matthews, Jean Monnet Professor of European Agricultural Policy, Head of the Department of Economics, Trinity College, Dublin, Ireland – *A Case Study: Differentiation in the Agricultural Sector?*

Raed Safadi, Chief of the Trade Policy Dialogue Division, OECD - *SDT: Objectives, Tools and Options for the WTO.*

17 : 00 - *Final Address:* Mrs. Valentine Sendanyoye-Rugwabiza, WTO Deputy Director General –- *Delivering Development through the DDA: A Political Way Forward?*

NB: A French version of the introduction, some presentations and some other articles are available on Ifri's website.

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