

Quantifying the Value of Preferences and Potential Erosion Losses

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World Bank

July 2008

The multilateral trade system rests on the principle of non-discrimination. The most-favored-nation (MFN) clause embodied in Article I of the General Agreement on Tariffs and Trade (GATT) was the defining principle for a system that emerged in the post-World War II era largely in reaction to the folly of protectionism and managed trade that contributed to the global economic depression of the 1930s. From its origins, however, the GATT allowed for exemptions from the MFN rule in the case of reciprocal preferential trade agreements. It also permits granting unilateral (non-reciprocal) preferences to developing countries.

Unilateral preferences granted by OECD countries create an inevitable tension between “more preferred” developing countries – typically beneficiaries from pre-existing colonial regimes – and other developing countries with respect to the effects of MFN liberalization by preference-granting countries. Concerns about preference erosion have become one of the key points of debate in the negotiations surrounding the Doha Development Agenda. Similar concerns have arisen in the past. In the 1970s, for example, the impact of Tokyo Round-related liberalization on the benefits derived by developing countries from the Generalized System of Preferences (GSP) was extensively debated.² Although erosion is a long-standing concern for many developing countries, in the last few years the scope and coverage of unilateral preferential regimes has increased significantly, especially for the least developed countries (LDCs).³ In the past, concerns about erosion were not a particularly strong constraint on MFN-based reforms in the GATT/WTO because GSP programs typically gave a *preference* and not duty- or quota-free access. Thus, even if MFN rates were lowered, it was possible to maintain a given

¹The views expressed are personal and should not be attributed to the World Bank Group, its Executive Directors, or the countries they represent.

² See, for example, Ahmad (1977).

³ This is a group of the poorest countries defined by the United Nations, with inclusion based on specific criteria. At the time of writing, 50 countries are classified as LDCs by the United Nations.

preference margin by lowering the preferential tariff and/or expanding the coverage of the scheme. But such new programs as the European Union's Everything but Arms (EBA) or the US African Growth and Opportunity Act (AGOA) feature duty- and quota-free access for (virtually) all products and therefore *any* reductions in MFN tariffs lower the preference margin. It is therefore not surprising that preference erosion has attracted a great deal of attention in the current round of multilateral negotiations.

To provide some background for the debate on the potential extent and implications of preference erosion, the papers in this volume review the "value" of preferences for beneficiary countries, assess the implications of preference erosion under different global liberalization scenarios, and discuss potential policy responses. One set of papers focuses on the non-reciprocal preference schemes of individual industrial countries, particularly the United States, the European Union, Japan, Canada and Australia. A second set of papers considers sectoral features of these preference schemes, such as those applying to agricultural and non-agricultural products, and the important arrangements for textiles and clothing. A final set of studies considers the overall effects of preferences, and the options for dealing with preference erosion resulting from non-discriminatory trade liberalization.

In this introduction, we first briefly discuss the genesis of non-reciprocal preferential trade regimes and describe the mechanics their operation. We then summarize the main findings of the contributions to this book and compare and relate these to the results of other recent research on preference erosion. We conclude with a discussion of possible policy responses by preference-granting and receiving countries to erosion losses.

Unilateral, Non-Reciprocal Trade Preference Regimes

The rationale for granting preferential market access to developing countries by industrial countries grew out of the arguments favoring special and differential treatment (SDT) for developing countries. The underlying justification for this reflected development thinking in the late 1950s and early 1960s – most notably in work by Raúl Prebisch and Hans Singer. This approach was premised on the argument that developing countries had to foster industrial capacity, both to reduce import dependence and to diversify away from

traditional commodities that were subject to long-term declines in terms of trade (and often also affected by short-term price volatility). This gave rise to the policy prescription of protecting infant industries—that is, import-substitution industrialization.

At the same time, exports were recognized as important given that the domestic market could be too small to enable local industry to achieve economies of scale. The second plank of the SDT agenda therefore revolved around calls for a general system of preferences that would give developing countries better than most-favored-nation (MFN) treatment in the major industrial markets of the world. The GSP, the framework for providing such preferences, was established under the auspices of the United Nations Conference on Trade and Development (UNCTAD) in 1968.⁴ The EU and the US passed legislation establishing their GSP regimes in 1971 and 1974, respectively. Although other OECD countries implemented their own GSP regimes, the EU and the US have been, and continue to be, the most important markets for the developing countries.⁵

As discussed at greater length in Hoekman and Ozden (2006), early evaluations of preferential regimes questioned whether preferences were an efficient way of helping developing countries, noting that producers in beneficiary countries had to be able to compete with domestic producers in the donor country as well as other exporters.⁶ Subject to debate was the extent to which a 5-7 percent preference margin would make a significant difference (the GSP involved *preferences*, not duty- and quota-free access of the type now accorded to the LDCs by many OECD countries). Furthermore, analysts pointed out that even in sectors where preferences would make a difference, they might lead to specialization in sectors where the beneficiary country did not have an inherent comparative advantage; this, in turn, would result in socially wasteful investment. Other concerns included the potential political friction between beneficiary and excluded countries; administrative costs such as rules of origin; the danger that preferences might reduce incentives for global MFN liberalization as beneficiaries became concerned about the erosion of preference margins; and, more generally, the politicization of trade policy

⁴ UNCTAD (1964), a report written under Prebisch's direction, outlines the arguments in favor of trade preferences. The primary role of unilateral preferences was to support infant-industry policies, with expansion of exports of manufactured goods being a part of the overall industrialization process.

⁵ See Onguglo (1999) for a review of schemes in operation at the end of the 1990s.

⁶ See, for example, Patterson (1965) and Johnson (1967).

insofar as donor countries used preferences “to reward and punish the recipients for their behavior and performance” in other non-economic areas (Johnson 1967, p. 199).

The GSP conflicted with basic GATT rules. In recognition of this, GATT members approved special waivers for the GSP—temporarily in 1971 and permanently in 1979 through the “Enabling Clause” (part of the Tokyo Round set of agreements). This followed on the creation of a Committee on Trade and Development and the addition of several articles to the GATT that addressed development issues in the mid- 1960s – Part IV of the GATT (on Trade and Development).⁷ Part IV encompassed the new principle that reciprocity in multilateral negotiating rounds should be limited to whatever was consistent with the development needs of developing countries (Article XXXVI). The 1979 Enabling Clause (formally Differential and More Favorable Treatment, Reciprocity and Fuller Participation of Developing Countries), which gave permanent legal cover for the GSP, included language on “graduation” – indicating that SDT policies were to be phased out as the recipient countries reached a certain level of economic development. However, criteria for SDT eligibility and for graduation remained undefined. A recurring concern expressed by developing countries has been that SDT provisions are “best endeavors” commitments and are not enforceable through the dispute-settlement mechanism of the WTO. Eligibility and graduation criteria, as well as product coverage and the type of preferences, are left to donor countries to determine unilaterally.⁸

Basic Analytics of Preferences and Preference Erosion

The simplest measure of the value of preference programs for an exporter is the difference between the applied tariffs facing a country and the MFN tariffs that would apply on its exports without a preferential agreement. This measure can overstate the value of the associated transfers as it ignores the fact that many other countries frequently

⁷ See GATT (1994) for the texts on Part IV of the GATT and the Enabling Clause.

⁸ Such conditions may comprise trade and non-trade conditionality, either *de jure* or *de facto*. The Enabling Clause only applies to non-reciprocal preference programs covering all developing countries or the LDCs. No other tariff discrimination between countries in the application of preferences is formally permitted. Until the early 1990s this requirement was not enforced. This changed with the report of a GATT panel dealing with the EU banana import policy, which found the EU regime for banana imports from members of the ACP (Africa, the Caribbean, and the Pacific) violated the GATT MFN rule. As a result, the EU was obliged to request waivers for the Lomé Convention in 1994, and its successor, the Cotonou Convention in 2000.

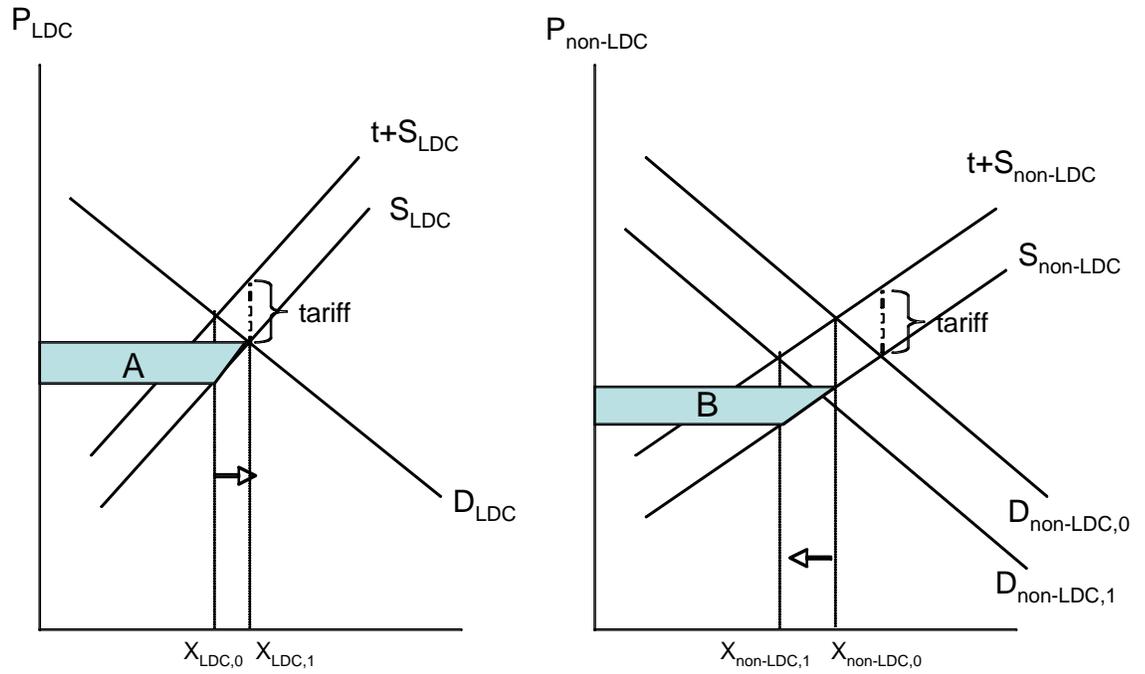
also receive preferences. The “real” preference margins for a given country may need to be adjusted for the preferences that other countries are granted. Moreover, administrative costs must also be taken into account. We will return to these considerations below. In what follows, we first focus on the simpler, traditional margin of preference as an upper bound on the value of preferences per unit of exports.

To understand the effects of preference, it is helpful to briefly review the economics of discriminatory application of trade policies. Figure 1 characterizes the import market for a particular product, where a high-income country imports varieties of good X from two suppliers, indicated as S_{LDC} and $S_{non-LDC}$. Initially, the price in the LDC market required to induce any given level of exports is given by the curve $S_{LDC}+t$. The impact of granting tariff preferences to the LDC is represented in the top left panel of Figure 1 by a downward shift of the LDC supply curve, with exports by the LDC expanding from $X_{LDC,0}$ to $X_{LDC,1}$. The benefit for the LDC exporter is represented by area A. Because the cost of imports from the LDC supplier is now lower, there is a shift in demand away from the non-preferential supplier. This is shown in the upper right panel of Figure 1 and results in a loss in this exporter’s surplus equal to area B.

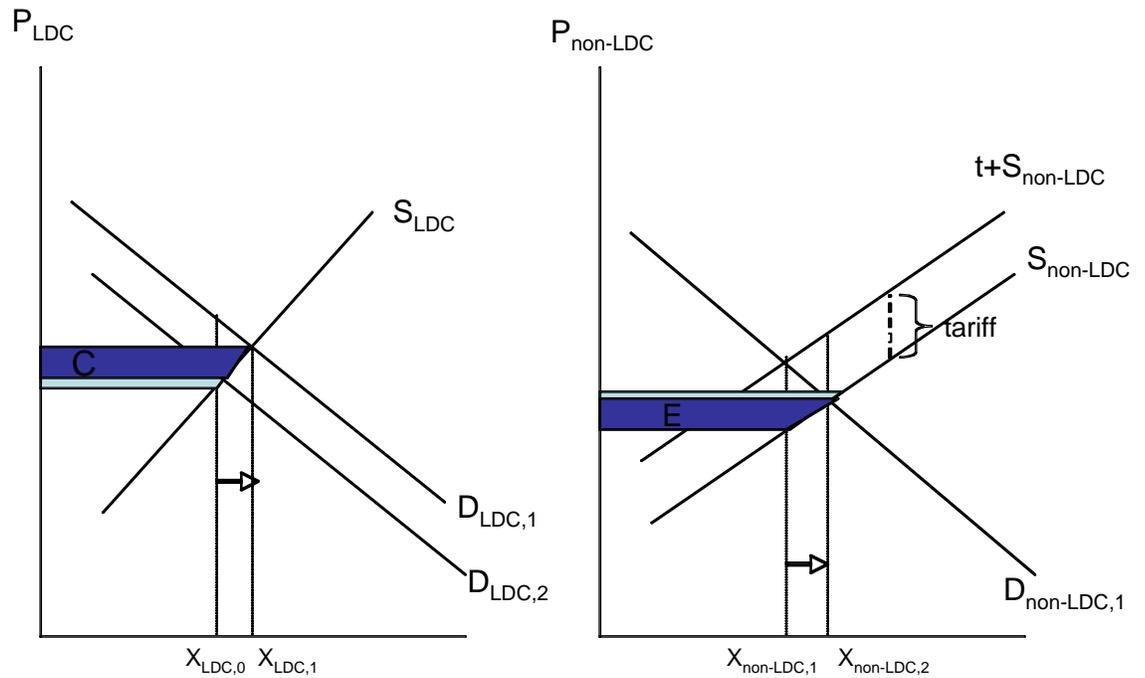
Thus, trade preferences involve a mix of benefits for preferred exporters and costs for excluded exporters of identical products or close substitutes. There are potential losses for the importer as well.⁹ The magnitude of the costs and benefits for affected exporters depends on the responsiveness (elasticity) of export supply and import demand to price changes, as well as the degree of substitution between preferential and non-preferential suppliers. The less close the varieties are as substitutes, the smaller the reduction in demand for the non-LDC supplier following the implementation of preferences for the LDC. If either the supply or the demand curve for the products being considered were perfectly elastic, then the simple measure of the gain to the exporting country with preferences would be bigger than that illustrated in Figure 1: it would equal the area of the rectangle defined by the tariff (or preference margin) times the quantity exported (as the increase in the price received by the exporter would equal the preference margin).

⁹ We will not focus on the welfare implications of preferences for the importer, which will be determined by a mix of terms of trade, trade creation and diversion effects.

Figure 1: The mechanics of preferences and preference erosion



Source: Francois, Hoekman and Manchin (2006).



The case of horizontal demand curves seems quite appropriate for situations where small countries are supplying relatively homogenous products to much larger economies – as in the case of LDCs supplying raw agricultural products to the US or the EU. In practice a crude measure of the value of preferences defined as the product of the preference margin and the quantity exported provides an upper limit on the potential losses from preference erosion.¹⁰

Preference erosion involves the reduction or elimination of tariffs on the non-preferential supplier. This is illustrated in the bottom two panels of Figure 1. Removing the tariff on other suppliers means that third-country exporters see their exports increase from $X_{\text{non-LDC},1}$ to $X_{\text{non-LDC},2}$. In the new equilibrium, there is a gain in their exporter surplus of area E, which may be greater or less than their original loss of exporter surplus resulting from the preferences, area B. The LDC experiences a drop in demand from $D_{\text{LDC},1}$ to $D_{\text{LDC},2}$. This results in a partial, though generally not full, loss of the benefits from the original preference scheme. This is represented by area C, which is shown as being less than area A. The reason the loss is not complete is that preferences generate some trade creation as well as the trade diversion that is the focus of Figure 1. For this reason, preference erosion generally yields a partial, not full, loss of the original benefits of the preference scheme. At the same time, third-countries recover some of the costs originally imposed by the preference scheme.

If buyers or intermediaries in the importing country have market power the benefits of the preferential tariff reductions may be captured, at least in part, by them rather than the exporters.¹¹ In addition, administration costs related to the implementation of preferential trade programs – such as rules of origin – will eat up some of the benefits. The empirical literature assessing the magnitude of the costs associated with rules of origin and other administrative requirements concludes that on average such

¹⁰ This crude measure overstates the gain, even in this case, because it ignores the costs involved in increasing exports. In a general equilibrium analysis, second-best considerations also need to be taken into account. Fukase and Martin (2002) note that improved market access may generate second-round welfare gains by allowing the country to increase the volume of imports over its trade barriers.

¹¹ There is evidence, based on the AGOA preference scheme, that the pass through of preference margins is partial. Olarreaga and Özden (2005) find that on average exporters received around one-third of the tariff rent, with poorer and smaller countries tending to obtain lower shares. Özden and Sharma (2006) analyze the US Caribbean Basin Initiative (CBI) program and find that CBI exporters are able to retain about two-thirds of the preference margin they are granted in the US market.

costs are on the order of 3 to 4 percent.¹² While not shown in Figure 1, this implies deadweight losses involving parts of areas A and C. In the case of market power, the result is a redistribution of the benefits of preferences to importers. With administration costs, the share of the gains that is lost is not redistributed, but is a deadweight loss. In both cases, the trade effects of preference programs will be less as well.

Trade preference programs of major OECD countries

To assess the potential impacts of MFN liberalization by preference-granting countries it is necessary to have a good understanding of the design and incidence of the programs that are in place: which countries are eligible, what criteria are imposed, how extensive is the product coverage and what is the depth of the preference offered? In addition, it is necessary to estimate the relevant demand, supply and substitution elasticities discussed above. The chapters in Part 1 of this volume describe the nonreciprocal preferential trade regimes of five OECD economies with long-established non-reciprocal preferences for developing countries: the EU, Japan, the US, Canada and Australia.

Chapter 2 by Judith Dean and John Wainio provides a detailed assessment of the preferences provided by the US for both agricultural and non-agricultural imports from developing countries. They find that over 140 countries were eligible for preferences, with eligibility rules for preferences more liberal for the least-developed-countries than for other developing countries. The value of the preferences is increased by the fact that US preferences provide duty-free treatment, but the preference margins remain low on average because the MFN tariffs on most goods with preferences are low (except for textiles and apparel). Access to preferences is, however, reduced by the exclusion of products deemed import sensitive, agricultural products subject to tariff-rate-quotas, and products that exceed “competitive needs limits”. Despite this, utilization rates are generally relatively high, and for 29 countries, the value of tariff preferences was 5 percent or more of their dutiable exports to the United States.

Chapter 3 by Fabien Candau and Sébastien Jean focuses on EU trade preferences, with an emphasis on their value to countries in Sub-Saharan Africa. The paper highlights

¹² See for example, Anson et al. (2005), Brenton and Manchin (2003), Cadot et al. (2006), and Francois, Hoekman and Manchin (2006).

the proliferation of trade agreements involving the EU. Two categories of preferences are provided depending upon whether the good is sensitive or non-sensitive. Non-sensitive products enjoy duty-free market access and account for about 32 percent of all tariff lines. Most sensitive products receive a flat 3.5- percentage-point reduction from the applicable MFN rate. These products account for some 36 percent of tariff lines.¹³ As sensitive products generally carry high MFN rates, the proportional impact of the preference can be rather small.

The EU GSP program is the most inclusive of its preference schemes for developing countries. However, graduation measures are taken when the country becomes more competitive, with all countries classified as high income by the World Bank losing eligibility. Further, the rules of origin tend to be restrictive, with no cumulation among participants. For LDCs, the Everything-but-Arms (EBA) initiative provides duty and quota-free access for virtually all products. A key feature of EBA is that, in contrast to the GSP, preferences are not subject to periodic review. The EU has other preference programs. Until 2008, the most notable were those accorded to ACP countries under the Cotonou Convention, which offered preferences that often exceeded those available under the GSP.¹⁴

Chapter 4 by Norio Komuro considers the preferential trade regimes of Japan. He finds that GSP coverage is narrow despite expansion of LDC-specific duty-free items. In the agricultural sector, most products remain excluded. Likewise, in the industrial-sector, labor-intensive items such as textiles, footwear, and leather related goods are also excluded. Imports of many industrial goods, covered under the GSP, are subject to GSP ceiling values or quantities. He also finds that the GSP utilization ratio is low frequently because of the costs of complying with GSP rules of origin and certification. Looking forward, he believes that GSP preferences will be eroded due to reciprocal trade agreements with current GSP beneficiaries including Mexico, Chile and the main

¹³ See E.C. Council Regulation No.2820/98, December 21, 1998 and E.C. Council Regulation No.2501/01, December 10, 2001 for details of the EU programs.

¹⁴ This is an international treaty that provides a framework for cooperation between the EU and former colonies of EU member states. The associated commitments are binding and cannot be unilaterally modified by a signatory. The Cotonou Convention superseded earlier treaties, the Yaoundé (1963-75) and Lomé (1975-99) conventions. As of January 2008, market access into the EU for ACP countries is either governed by reciprocal Economic Partnership Agreements or the Everything but Arms initiative (for LDCs).

ASEAN countries. Given these features, he argues that the focus should not be merely on improving the existing GSP by widening its coverage and reforming its rules of origin and certification procedures, but also lowering MFN tariffs for items of export interest to GSP beneficiaries.

Chapter 5 by Przemyslaw Kowalski finds that NAFTA countries are the dominant partners for Canada, supplying 65 percent of its total imports, as against 18.6 percent for developing countries outside NAFTA. Of imports from these developing countries, 74 percent entered Canada under MFN treatment at an average tariff rate of 5.8 percent, 15 percent under GPT treatment at an average tariff rate of 2.2 percent and 0.7 percent under LDCT treatment at an average tariff rate of 0 percent. The main beneficiaries of Canadian preferences include more advanced developing countries such as Mexico, South Korea, China, India, Brazil, Israel, Malaysia Hong Kong-China and some LDCs such as Bangladesh, Cambodia and Haiti. Expressed as a percentage of each beneficiary's exports to the world the value of preferences does not typically exceed 1 percent. However, the importance of the Canadian market for LDCs seems to have increased substantially because of the 2003 extension of the LDC scheme to textiles and clothing. A simplified model assessment suggests that the welfare impact of Canadian preferences is very small for most developing countries, largely because of their generally small shares of preferential trade with Canada. For this reason, this chapter concludes that preference erosion does not appear to be a major hurdle to further reduction of Canadian MFN rates.

Chapter 6 by Douglas Lippoldt concludes that the Australian market for exports from developing countries is very small relative to the Quad economies that were the focus of chapters 2-5 (Canada, the EU, Japan, and the US). Preferences are also relatively unimportant because Australia's trade regime is relatively open. Australia has an array of preferential schemes for developing countries, including a general developing country scheme, an LDC scheme, and arrangements for Papua-New Guinea and Pacific countries. Since 2002, the scheme for LDCs has provided duty and quota-free access with rules of origin that allow inclusion of materials from all developing countries and Australia. The product coverage of preferential programs is relatively high: few products exported by developing countries to Australia are not eligible for some preference. The

use of these preferences is relatively low, however, as a consequence of low or zero MFN tariffs. While the preferential schemes provided additional access opportunities, the share of imports from developing countries that enter under non-preferential rates rose from around 40 to around 60 percent between 1996 and 2004. However, a few of the smaller countries in the region have come to rely relatively heavily on the Australian preferential regime.

Assessing the magnitude of potential preference erosion

A key difficulty in undertaking empirical analysis of the effects of preferences (and erosion) is the difficulty of identifying the specific impact of preferences as opposed to other factors. The observed growth rate of exports from recipients to the preference-granting countries, for example, is not informative without controlling for other factors. Common approaches have included using simulation methods to estimate trade creation/diversion (which are sensitive to assumptions regarding elasticities) and gravity regressions where preference status is captured by a dummy variable. To the extent that exceptions in preferential regime are often defined at a highly disaggregated product level, the absence of elasticity estimates at this level of disaggregation—as well as the difficulty of finding the right controls to include in regressions—adds to the controversy surrounding available studies. These data and methodological problems help explain why the policy-oriented literature has tended to rely heavily on descriptive indicators.¹⁵ Four indicators are particularly common:

- calculation of preference *margins* – the difference between MFN and preferential tariffs for products;
- *potential coverage* – the ratio between products covered by a scheme and the dutiable imports originating in beneficiary countries;
- *utilization* – the ratio between imports that actually receive preferential treatment and those that are in principle covered, a measure of how effectively beneficiaries are able to use preferences; and

¹⁵ Progress has recently been made in improving data, including the development of a comprehensive set of import demand elasticities at the HS 6-digit level (Kee, Nicita and Olarreaga, forthcoming) that will allow future research and analysis to be undertaken on a more solid analytical foundation.

- *utility* – the ratio of the value of imports that receive preferences to all dutiable imports from that exporter. The lower this ratio, the less generous the preference scheme.¹⁶

Focusing on these variables, however, provides at best a partial perspective of the economic value of a preferential regime. To get a more precise estimate of the value of preferences, one has to take into account the extent to which others have preferential access; the costs of compliance in terms of documentation (e.g., in proving conformity with rules of origin); the economic costs of sourcing inputs from more expensive sources to comply with origin requirements; the various limitations and constraints embodied in preferential schemes; and the distribution of related rents.

Chapters 7 and 8 by Patrick Low, Roberta Piermartini and Jurgen Richtering consider the preferences provided on non-agricultural and agricultural products by the Quad countries (plus Australia in the case of non-agricultural trade). They develop a consistent methodology that takes into account not just the beneficiary's preferences relative to MFN tariffs, but the preferences provided to all other suppliers as well. With this methodology, they evaluate the potential extent to which erosion of preferences might impose costs on individual developing countries. Another key question asked by these authors is whether "trade" solutions to such preference erosion problems might be feasible. The authors find that developing countries are able to export a much higher fraction of their exports duty free than the LDCs (52 percent versus 20 percent). However, the LDCs benefit from preferential duties on 61 percent of their exports, rather than 16 percent. This makes the LDCs more vulnerable to preference erosion, and contributes to a finding that developing countries would gain \$2 billion from liberalization along the lines of a so-called Swiss formula,¹⁷ while the LDCs would suffer a net loss of \$170 million. LDCs that would lose from preference erosion include Bangladesh, Cambodia, Haiti, Lesotho, and Madagascar. Much of the preference erosion problem appears to arise from preferences on clothing. Their analysis suggests that trade solutions to preference erosion such as improving utilization rates; expanding

¹⁶ For further discussion, see UNCTAD (2003) and Brenton and Özden (Chapter 9).

¹⁷ This formula cuts high tariffs more than tariffs that are already low (see Ch 7 for further discussion).

preferences to other product lines or expanding the availability of preferences to other markets, have relatively little potential on the basis of current trade flows.

In Chapter 8 Low, Piermartini and Richtering examine agricultural trade with the Quad countries using a similar approach to Chapter 7. They show that the share of dutiable agricultural exports entering the Quad countries under preferential trade arrangements is much higher for LDCs, where almost 90 percent of dutiable exports are covered, than for other developing countries, where only 37 percent are covered. The estimated benefit to all developing countries is only \$267 million, of which just \$10.4 accrues to the LDCs. However, the risk of preference erosion is much more concentrated in terms of countries and products than it is for non-agricultural products, with bananas, sugar and beverages and spirits accounting for a large share of the potential losses.

Chapter 9, by Dominique van der Mensbrugghe, provides a synthesis of the global and national impacts of preferences that builds on the earlier studies. He concludes that the margin of preference is 3.8 percent on exports into the EU, and 0.5 to 0.7 percent on imports into other rich countries. Considering not just the current value of preferences, but also increases in trade induced by a global trade reform of the type being negotiated in the Doha Round, he concludes that preferences may account for 0.3 percent of income in the lowest-income countries. However, he finds that these countries as a group would benefit from high-income countries setting all tariffs to zero: the gains from greater market access would outweigh the loss in preferences.

Table 1 collects estimates of average non-reciprocal preference margins in the Quad and Australia compiled by Low, Piermartini and Richtering and by van der Mensbrugghe. It also reports estimates from other recent research by Subramanian (2003) and Brenton and Ikezuki (2005). Although there are significant conceptual differences between the measures presented in Table 1,¹⁸ they provide a consistent message: margins are rather small for most countries. The average margins generally tend to be higher in Europe relative to the other markets. In most studies, average preference margins are lower in Japan than in the EU or the US, except in the Low et al. papers, which are

¹⁸ The figures 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, the results based on the Low, Piermartini, and Richtering papers refer to the margin only on those products for which there are exports, a non-zero duty, and a positive apparent preference.

affected by very high preferences on imports of manufactures from Cambodia (more than 150 percent), as well as margins of preference of about 50 percent on imports from Bangladesh and Mauritius.

Table 1. Estimated Nonreciprocal Preference Margins (percentage points)

<i>Granting countries</i>	EU	US	Japan	Canada	Aust	Quad+Aust			
<i>Beneficiary countries</i>									
LDCs	6.6 ^a	4.1 ^d	3.2 ^a	2.6 ^d	2.6 ^a	10.9 ^d	4.2 ^d	3.6 ^d	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	1.5 ^d	3.4 ^d

Notes: LDCs refer to the UN list of Least Developed Countries. LIX refers to the World Bank Low Income Countries group, excluding India.

Sources: (a) Subramanian (2003, p.8); (b) Brenton and Ikezuki (2005, p.27); (c) van der Mensbrugge (Ch 10); (d) Low, Piermartini, and Richtering (Ch. 7 and Ch. 8).

There are surprisingly small gaps between the preference margins granted to LDCs and to developing countries as a whole under the EU, Japanese, and US preference schemes. By contrast, Australia and Canada 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. The gap between the two measures may reflect different coverage of products, with narrower coverage of products from non-LDCs—a difference that will be reflected in the measures of the overall value of preferences.

While the average rates of assistance to developing country exports suggested by Table 1 are relatively small, the studies presented in this volume highlight the substantial variation in the preference margins between countries. Candau and Jean (Chapter 3) show that EU preference margins were more than 10 percent of the value of exports in two countries—Dominica and Seychelles—even after allowing for less than complete utilization of preferences. For two other countries—Senegal and St. Lucia—preference margins accounted for more than 5 percent. Dean and Wainio (Chapter 2) show an even more divergent pattern in U.S. preferences. Even though the average value of US preferences is only 0.5 percent of the value of exports, two small countries—Lesotho and

Swaziland—had preference margins exceeding 15 percent in 2003, primarily because of apparel preferences.

Table 2. Upper Bound Estimates of the Value of Preferences (US \$ million)

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

Note: Quad = US, EU, Japan, and Canada; Quad + = Quad + Australia.

Source: Compiled by the authors based on data from Low, Piermartini, and Richter.

In Table 2, we present upper-bound estimates of the value of preferences, calculated on the basis of the simple product of the average preference margin and the value of exports supplied by beneficiary countries. These numbers are based on the Low, Piermartini, and Richter datasets, which provide precise estimates of the value of imports subject to preferential treatment. It is important to stress that these are “maximum” estimates as they ignore compliance costs and assume full utilization of preferential programs. The results reported in Table 2 reveal that of a total of \$587 million estimated potential value of preferences to LDCs, \$287 million, or almost half, is provided by the EU. The US is the next largest provider, at \$131 million annually. Japanese preferences amount to some \$50 million a year, while Canada and Australia are much smaller at \$14 million and \$0.4 million a year, respectively. The comparison of the preferences received by LDCs and other developing countries shows that the vast majority of preferences go to non-LDCs. Only one-twentieth of the value of total preferences appears to go to the LDCs, despite the importance of the EU EBA and the U.S. AGOA programs in offering benefits to these countries.¹⁹ For preferences overall, the EU is again the largest contributor by a wide margin, accounting for more than 40 percent of the total.

¹⁹ These numbers do not imply that preferences have not helped stimulate diversification into manufactures for certain developing countries. The case of apparel illustrates that preferences can have this effect, as AGOA has led to substantial increases in imports from a number of sub-Saharan Africa countries. However, the scope for preferences to facilitate diversification into the apparel sector is limited by the lack of consistency across the different preference schemes. As pointed out by Brenton and Özden in Chapter 9, an apparel product from Africa that can enter under one country’s preference scheme often will not be able to enter under another because of differences in rules of origin.

As mentioned above, commonly used measures of preference margins that involve comparing the preferential tariff to the MFN rate will overestimate the “effective” preference for a country insofar as other countries also have preferential access. Indeed, other countries may have better access. It is important to take this into account when assessing the value of a given preference program for an exporting country. One way to do this is to define the effective preferential margin as the difference between the bilateral trade-weighted preferential tariff imposed by an importer on a beneficiary country and that which confronts other exporters of the same bundle of goods to that country (Hoekman and Nicita, 2008). This counterfactual can be constructed by first calculating the tariffs that an importer (say the US) imposes on the focus country (say Mexico) using weights appropriate for its exports²⁰. This weighted average can then be compared with the weighted average tariff imposed on other countries’ exports calculated using the same weights²¹

Calculations of the average effective preferential margins by region show that all regions have positive effective preferential margins for intra-regional trade (Table 3). This reflects the prevalence of regional free trade agreements. The most “effective” regional agreements in terms of preferences appear to be in Latin America, where countries enjoy an effective preferential margin of about 3 percent. Latin America both enjoys and provides a substantial preferential margin to the US and Canada, reflecting trade agreements with the US (NAFTA) and within the region (MERCOSUR, etc). Effective preference margins are much smaller for other regions. Sub-Saharan African countries have an average effective preferential margin of only about 0.5 percent in the EU, reflecting competition among themselves and from other countries to which the EU

²⁰ These weights might be the shares of each product in its exports to the US, or they might, as in Hoekman and Nicita (2008), take into account both the trade shares and the price-responsiveness of each export product.

²¹ See Hoekman and Nicita (2008) for details of the calculation and Kee, Nicita and Olarreaga (forthcoming) for the methodology used to estimate import demand elasticities. A simpler alternative measure calculated by Low, Piermartini and Richtering (chapters 7 and 8) is to compare the (US) import weighted average tariff imposed on a country (Mexico) with that imposed on all other countries. A problem with this method is that by using total imports (by the US) at the HS 6 digit level as weights it disregards product composition: if Mexico’s export composition to the US is not representative of the composition of US imports (e.g., Mexican exports to the US are mainly agriculture, while US imports mainly manufacturing), using exclusively US imports as weights in the calculation of the counterfactual would likely lead to biased results. This approach also ignores the sensitivity of import demand to prices (tariffs). As shown by Bouët, Fontaigne and Jean (2006), the product composition effect can be very important.

provides preferences. Overall, these data illustrate that on average preferential margins are much smaller than the upper bound estimates reported in Tables 1 and 2.

Table 3: Effective Preference Margins, 2006, percentage points

	Exporters						
	East Asia	East Europe Central Asia	Latin America	Middle East and North Africa	South Asia	Sub-Saharan Africa	High Income Countries
Importers							
East Asia	0.22	-0.06	-0.09	-0.02	-0.03	0.01	-0.03
East Europe Central Asia	-0.01	0.45	-0.37	0.39	-0.20	0.04	-0.15
Latin America	-2.54	-1.88	2.98	-0.51	-2.13	-1.22	1.69
Middle East and North Africa	-0.29	-0.24	-0.25	0.91	-0.22	0.10	-0.03
South Asia	-0.21	-0.08	-0.04	-0.26	2.03	-0.15	-0.05
Sub-Saharan Africa	-0.10	-0.03	-0.06	-0.02	-0.12	0.30	-0.06
High Income Countries	-0.46	0.42	0.71	0.19	-0.46	0.13	0.08
Australia + New Zealand	-0.18	-0.61	-0.28	-0.08	-0.23	0.11	0.10
Canada	-1.00	-0.85	1.75	0.01	1.79	0.02	1.01
European Union	0.05	1.07	0.98	0.64	-0.70	0.51	-0.50
Japan	0.34	0.02	0.07	0.00	0.70	0.08	-0.13
USA	-0.67	-0.03	1.01	-0.08	0.22	0.11	-0.03

Source: Hoekman and Nicita (2008).

One reason for this is that much erosion has occurred in recent years. One factor here has been the spread of reciprocal free trade agreements. Another has been the unilateral reform of major preferential programs in the EU, in particular the sugar and bananas regimes, following WTO panel and Appellate Body rulings against the EU. Yet another factor was the implementation of the Agreement on Textiles and Clothing, under which import quotas and equivalent quantitative export restrictions were abolished in 2005. The latter has been an important source of erosion losses for many developing countries. In Chapter 10, Paul Brenton and Caglar Ozden examine carefully the preference erosion associated with abolition of the binding textile quotas imposed on exports from the most competitive exporters by the Uruguay Round Agreement on Textiles and Clothing (ATC). A key finding is that the prices of exports from these countries had actually begun declining prior to the abolition of the quotas, reducing the need for concern about adjustments to the preference erosion following their abolition.

Estimating the Magnitude of Preference Erosion

Table 4 summarizes key results from several of the chapters as well as other recent studies of preference erosion. The findings associated with the non-reciprocal schemes alone generally produce results that are less than the full potential value of preference estimates presented in Table 2. As is true of estimates of the value of preference margins, the reported estimates are not strictly comparable—not only because of the different methodologies (partial-equilibrium versus general equilibrium) and focus (welfare or income effects versus trade effects) but also because they tend to operate with distinct liberalization scenarios to estimate the potential for preference erosion.²² The estimates also tend to overestimate the value of existing preferential regimes because they typically do not take into account the costs of compliance with preferential regimes.

Subramanian (2003) uses a partial equilibrium framework to examine the overall impact on the exports of LDCs of preference erosion arising from trade liberalization by the Quad. Assuming a 40 percent cut in protection by the Quad and free access by LDCs to these markets, Subramanian concludes that the potential loss at the aggregate level amounts to 1.7 percent of total LDC exports. Individual LDCs, however, may suffer a more significant losses from preference erosion because of their concentration on exports in products that enjoy deep preferences. Subramanian (2003) estimates that Cape Verde, Haiti, Malawi, Mauritania, and São Tomé and Príncipe are the most vulnerable to preference erosion. Malawi would experience a loss of 11.5 percent of total exports, the next four countries between 5 and 10 percent, and another 10 countries between 3 and 5 percent. The total (aggregate) value of lost export revenue would be about \$530 million (of which two-fifths would be accounted for by Bangladesh). While these are small numbers from a global perspective – less than one percent of annual flows of official development assistance (ODA) – they are significant for some of the countries concerned and may mean substantial adjustment requirements for them.

²² Lippoldt and Kowalski (2005) provides further insights on the impact of preference erosion across the globe by adopting a 50 percent cut on all merchandise tariffs in separate experiments: first, unilateral liberalization by each of the five major preference-granting countries/regions (Australia, Canada, European Union, Japan, and US); second, plurilateral simultaneous liberalization in these regions; and third, multilateral liberalization. For most countries, potential negative effects are mitigated as the liberalization experiment is widened.

Table 4. Estimates of Losses from Tariff Preference Erosion

Authors	Affected Countries	Granting Countries	Simulated Liberalization	Net change in:		How measured?
				Exports	Real Income	
				\$m	\$m	
Limão and Olarreaga (2006)	LDCs	Triad	33% cut in MFN tariffs	-624	-88.6	Partial Eqm
Subramanian (2003) ^a	LDCs	Quad	40% cut in MFN tariffs	-530	-265 ^b	Partial Eqm
Alexandraki and Lankes (2006) ^a	Middle-Income countries	Quad	40% cut in preference margins	-914	-457 ^b	Partial Eqm
Amiti and Romalis (2007) ^c	African LDCs	EU + US	40% cut in MFN tariffs	-21		Partial Eqm
" " "	Non-African LDCs	EU + US	40% cut in MFN tariffs	683		Partial Eqm
" " "	Other developing countries	EU + US	40% cut in MFN tariffs	18,547		Partial Eqm
Low, Piermartini, and Richterling (Chapter 7)	LDCs	Quad+ Australia	Swiss formula, coefficient of 10; non-agricultural products	-170		Partial Eqm
	Other developing countries	Quad+ Australia	Swiss formula, coefficient of 10; non-agricultural products	2,087		Partial Eqm
Low, Piermartini, and Richterling (Chapter 8)	LDCs	Quad	G20 proposal ^f	10.4		Partial Eqm
	Other developing countries	Quad	G20 proposal ^f	256		Partial Eqm
Grynberg and Silva (2004)	Developing countries	Quad	Elimination of preferences		-570 ^d	Partial Eqm
Francois, Hoekman, Manchin (2006)	African LDCs	EU	Full MFN Liberalization		-458 ^e	General Eqm
" " "	African LDCs	OECD	Full MFN Liberalization		-110 ^e	General Eqm
" " "	African + Asian LDCs	OECD	Full MFN Liberalization		-198 ^e	General Eqm

^a Elasticity of export supply equals 1.0

^b Because the elasticity of supply of exports is 1.0, the real income effect is exactly half the change in the value of exports.

^c Infinite elasticity of substitution.

^d Excluding estimated effects of implementation of the Agreement on Textiles and Clothing.

^e Not considering the effects of rules of origin. If these are included, losses turn into net gains.

^f The G-20 proposal (G-20, 2005) for agricultural market access involves placing tariffs in four tiers rising with the height of the original tariffs, and making progressively larger cuts in these tiers. In the industrial countries, the boundaries of the tiers were at 20, 50 and 75 percent and the cuts were 45/55/65 and 75 percent in the four tiers. For developing countries, the boundaries of the tiers were at 30, 80 and 130 percent and the cuts 25/30/35/40 percent.

Also using a partial equilibrium approach, Limão and Olarreaga (2006) estimate that LDCs would lose some \$624 million from a 33 percent reduction in MFN tariffs by the triad (EU, Japan and the US). Their somewhat higher estimate than what was found by Subramanian (2003) is due to a higher average estimated supply elasticity of five (as opposed to the unitary elasticity assumed by Subramanian) and the inclusion of ad valorem equivalents of specific tariffs in the analysis.

Alexandraki and Lankes (2006) analyze potential erosion impacts for middle-income economies. They include the effects of textile quota elimination and the EU banana and sugar programs for ACP countries. Their analysis suggests that the potential erosion problem is heavily concentrated in small-island economies that are dependent on quota-type preferences and the associated rents in these sectors.²³ Their paper illustrates that the problem is as much commodity-specific as it is country-specific: losses are concentrated in product areas where OECD protection and thus preference margins are the highest.

In another partial equilibrium study, Amiti and Romalis (2007) provide an integrated treatment of the impacts of preference erosion on both LDCs and other developing countries. They assume an infinite export supply elasticity for developing countries (that is, all countries are treated as price takers). Their methodology improves upon that employed by Subramanian and by Alexandraki and Lankes by allowing for substitutability across products. They find that African LDCs would lose slightly as a result of a 40 percent cut in MFN tariffs by the EU and US, but that other countries would benefit, in particular non-LDC developing countries.²⁴ LDCs that would stand to lose in terms of exports include Lesotho (-9.3%), Haiti (-4.6%), Cape Verde (2.5%) and Madagascar (-2.7%). Among other developing countries, losers include Belize (-4.4%), Cameroon (-4.9%), Dominica (-21.8%), Jordan (-8%), Jamaica (-3%) and St. Lucia (-37%). These losses are offset by large gains that would accrue to other countries.

²³ Preference-dependent or sensitive countries include Cambodia, Cape Verde, the Comoros, Haiti, Malawi, Maldives, Mauritania, Mauritius, Sao Tome, and Tanzania. The only large country expected to suffer from preference erosion is Bangladesh, which has benefited significantly from the quota restrictions on textiles and clothing imposed on such other large competitive developing countries as China. The potential impact of the removal of quotas on non-quota controlled textile and clothing exporters has been on the agenda since the negotiation to end the MFA in the Uruguay Round.

²⁴ One reason these authors find smaller effects is that they assume the tariff reductions by the EU for imports of sugar, bananas and rice for LDCs have already been implemented.

Barbados, Brunei Darussalam, Cambodia, Fiji, Guyana, Macau, Mongolia, Myanmar, Serbia, Uruguay and Zambia are all estimated to see an export boost of over 10 percent. This study concludes-- as do Chapters 7 and 9 by Low et al. and Van der Mensbrugghe, and virtually all of the CGE analyses of the impacts of further multilateral trade liberalization--that MFN liberalization would greatly benefit non-LDC developing countries as a group.

Turning to the partial equilibrium, cross-country studies included in this volume, Low, Piermartini and Richter estimate that the Doha Round liberalization proposals put forward by the G-20 in 2005 would have a negative impact on LDC non-agricultural exports of \$170 million, and essentially have no net impact on exports of agriculture. As mentioned previously, these estimates take into account the fact that other countries also have preferential access to the major markets, thus reducing the magnitude of the estimated impacts of MFN reforms. This study, as do Amiti and Romalis, concludes that preference erosion losses will be substantially smaller than those estimated on the basis of “upper bound” methodologies.

From a welfare perspective the estimates of trade impacts are not particularly informative. Efforts to assess the real income effects of preference erosion include Limão and Olarreaga (2006) and Grynberg and Silva (2004). The latter estimate that the losses in income transfers for sugar, beef, bananas, and textiles and clothing producers in trade-preference-dependent economies would add up to \$1.72 billion a year. These estimates are heavily influenced by the weight of disappearing quota rents associated with the phase-out of the Agreement on Textiles and Clothing (which accounts for \$1.1 billion of the loss estimate).

Computable general-equilibrium (CGE) estimates of the value of preference erosion can provide additional insights into the effects of MFN liberalization on preference receiving countries. These models allow terms-of-trade effects, improved market-access opportunities in non-preference-granting countries, and the asymmetrical impacts of preference erosion in different markets to be considered. The asymmetrical effects of preference erosion arise because of the different hierarchy of preferences in OECD markets, which span not only non-reciprocal programs but also reciprocal preferences resulting from free trade agreements. One implication of such agreements –

already captured in the effective preferential margins reported in Table 3 – is that they lower the value of non-reciprocal preferences, and, thus, estimates of the preference-erosion effect. Francois, Hoekman, and Manchin (2006), for example, estimate that full EU liberalization on an MFN basis would translate into real income losses of \$460 million for African LDCs. This figure, however, drops to \$110 million when the experiment is extended to OECD-wide liberalization.

Estimates of the potential impacts should also take account of the administrative costs that may result in underutilization of preferences and reduce the *net* value of the programs to developing countries. Francois, Hoekman, and Manchin (2006) estimate that the *ad valorem* equivalent of administration costs averages about 4 percent. If this cost is included in the analysis, they find that MFN liberalization will raise, not lower the real income of Africa LDCs. If account is taken of the fact that exporters will not capture all of the rents created by preference programs, the magnitude of likely losses will also fall. As mentioned, Ozden and Sharma (2006) estimate that Caribbean exporters capture only two-thirds of preference margin in the U.S. market, while Olarreaga and Ozden (2005) conclude that the share of rents captured by exporters under AGOA are even lower.

Notwithstanding differences in approaches the studies included in this volume and related research therefore comes to similar overall conclusions. The chapters on the EU and the US confirm earlier findings that the value of preferences – measured by the product of the volume of dutiable exports and the preference margin – is significant for a number of countries. Thus, US preferences are equal to 5 percent or more of dutiable exports for some 27 countries, while in the EU case, the value of non-reciprocal preferences exceeds 6 percent of dutiable exports for 16 recipient countries. Specific products such as apparel and some agricultural products – especially sugar and bananas in the EU – tend to account for the largest share of the value of preferences. While trade losses for some countries are large relative to their total dutiable exports to the markets concerned, the overall, aggregate value of the preferences – and thus potential losses – continues to be relatively small, and, in the case of the EU, will diminish when reforms in sugar and bananas occur in 2009. Similar findings are reported in the Low, Piermartini and Richter chapters for the Quad as a group.

Dealing with Preference Erosion: Potential Policy Responses

The basic conclusion emerging from the research on the magnitude of erosion is that this will be very small overall relative to the total potential gains from global MFN liberalization. However, for limited number of preference dependent countries, deep global reforms will have significant costs. The precise absolute potential magnitude of erosion remains open to debate, and much depends on what is eventually negotiated in the Doha Round. As important perhaps as what happens in the WTO is the spread of reciprocal free trade agreements, which also imply erosion for those developing countries that have preferential access to the markets concerned. Much also depends on the sectoral composition of the potential impacts, which is critical in determining the incidence and distribution of adjustment costs within countries.

What could be done to address potential losses? There are two broad options: seek a solution within the trading system (i.e., tied to trade and trade policy) or use non-trade instruments. The most obvious trade-based “solution” is not to liberalize the products that are the most important source of preference rents. The draft Modalities in the Doha negotiations adopt an element of this approach by providing for delayed liberalization of products subject to long-standing preferences (WTO 2008a,b). A problem with exclusion or delay in liberalization of these products is the opportunity cost in terms of MFN liberalization forgone. A far more desirable alternative is to frame multilateral trade concessions to address the negotiating priorities of preference-dependent countries in other areas on an MFN basis, either in terms of market access, rules or other non-trade assistance. Such a solution has for many years been advocated by many observers (e.g., Hudec 1987).

Trade-based options also include enhancement of existing preferential programs; improvements in the rules of the game for access to preferential regimes (e.g., adoption of harmonized liberal rules of origin and diminution of compliance costs) and/or through the extension of coverage of preferential regimes, leveraging utilization rates, and increasing the effectiveness of preferences (Stevens and Kennan, 2004). Such enhancements could partially offset the economic impact of preference erosion. Finally, given that the papers by Low, Piermartini, and Richter in this volume show that there is limited scope for expanding preferential schemes to additional product lines in major

OECD markets, consideration could be given to implementing a new preferential trade regime by non-OECD importers – as is called for in the 2008 draft proposals for liberalization under the Doha Agenda (WTO 2008b).

Some action along these lines could be beneficial. In Chapter 10 of this volume, Paul Brenton and Çağlar Özden find that apparel is an important case where preferential programs have contributed to export diversification in poor countries, and where liberal rules of origin appear to have particularly major impacts on success in using preferences. When rules of origin have been relaxed—as was the case of “lesser-developed” countries under the US Africa Growth and Opportunity Act—exports of apparel have grown rapidly. This suggests there would be value to recipient countries of a more general relaxation of rules of origin to allow greater use of imported inputs, as well as greater harmonization of the specific rules used by different OECD importers.

Trade based initiatives will not do much to help those developing countries that are not competitive in world markets because of supply constraints and high cost operating environments. In Chapter 11, Hoekman and Prowse (2005) argue in favor of “aid for trade” to help countries deal with both the adjustment costs associated with global trade reforms and improve their capacity to exploit trade opportunities and diversify their economies. They note that preferences have not done much to help the poorest countries use trade as a development tool, and are unlikely to do so without these countries acting to improve their investment and business environment. Aid for trade can help do so.

Aid for trade should be seen as a complement, not a substitute, for global trade liberalization (Prowse 2006). One reason is that the overall potential positive net effects of global trade reform are significant and will more than offset preference erosion losses (as shown in Chapter 9 by Van der Mensbrugge). That is, losses to preference recipients from OECD liberalization can be offset by gains in other markets – those of other developing countries and those of OECD members that do not already provide full duty-free and quota-free access to markets.

The limited number and small size of most of the economies concerned with preference erosion suggest that measures to help mitigate the problem should be closely targeted at the countries at risk. Existing instruments, such as the IMF’s Trade Integration

Mechanism (TIM)²⁵ for adjustment financing, could be supplemented by bilateral donor funds. A number of proposals have been made to establish new stand-alone, grant-based compensation funds.²⁶ While such proposals have not found support among the development community, some progress along these lines has been made. The Integrated Framework for trade-related technical assistance for LDCs has been enhanced with a larger dedicated trust fund – at the time of writing comprising some \$200 million – and the donor community has committed itself to providing more resources to help countries improve their trade competitiveness.

Concluding Remarks

The debate about how best to address preference erosion in the context of multilateral negotiations is an important component of the negotiations on the development dimension of the Doha round. Although one could argue that the jury is still out in terms of the developmental impacts of trade-preferences, there is growing support for the idea of de-linking development assistance from trade policy, shifting from “trade as aid” to “aid for trade” as discussed in Chapter 11 by Hoekman and Prowse. This growing consensus, however, is challenged by parallel efforts to deepen existing preferential regimes and/or introduce new preferential initiatives. Multilateral trade negotiations provide additional ferment to the debate to the extent that they foster alliances between protectionist interests in OECD countries and preference-dependent industries in developing economies.

Recent preferential initiatives have deepened the scope of preferences offered and simplified administrative procedures, with significant impact on some countries. The EU (reflecting the magnitude of the preference margins offered, the extensive scope of preferences given and its importance as a destination market for many preference-dependent countries) stands out as the largest provider of preferences and the one where preference erosion is likely to be the most serious problem in the case of MFN liberalization. While preferences have been instrumental in promoting some developing countries’ export diversification into textiles and clothing, the track record of unilateral

²⁵ See IMF (2004).

²⁶ See, for example, Page and Kleen (2004), Grynberg and Silva (2004), and Page (2005).

preferential systems as mechanisms to promote integration of developing economies into the world economy has been mixed at best. In part this is because rules of origin and other forms of “conditionality” remain a major constraint on further expansion in some regimes. But, more fundamentally, it reflects supply capacity constraints in many beneficiary countries.

Arriving at consensual estimates of the degree of preference erosion is difficult since these estimates are a function not only of the methodology adopted but also of the liberalization scenarios considered. Moreover, the reference-point for compensation (e.g., whether to focus on reductions in the potential *de jure* transfer or on the *de facto* economic value of transfer, taking into account compliance costs and eventual offsetting measures) is an issue open to debate. The limited scope for expanding preferential schemes to additional product lines in major OECD markets as a trade-related solution to preferences, and the supply constraints just mentioned, suggests that aid-related solutions to preference erosion are preferable to trade solutions that involve continued or additional preferential access to markets.

Summing up, preferences are clearly important for some countries in some sectors, insignificant for most, and injurious for others. Preferences are being eroded by liberalization at all levels (national, regional, and multilateral), but the Doha Round is likely to lead to relatively limited preference erosion unless the negotiations become a lot more ambitious (Hoekman, Martin, Mattoo and Newfarmer 2008). Independent of the debate on the magnitude and impact of preference-erosion, a re-orientation of trade policies away from procedures that tend to hollow out the multilateral trade system would clearly be welfare-enhancing at the global level. The aid for trade agenda provides a potential framework for addressing preference-erosion concerns.

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