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## **Erosion of trade preferences and Aid for Trade initiative: towards a new paradigm?**

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## 1 Introduction

Erosion of trade preferences is a "refrain" of multilateral tariff negotiations on market access. Every time that multilateral negotiations have been launched aiming at reducing MFN tariffs, countries beneficiaries of trade preferences have expressed their concerns over the possible impact that the reduction of MFN rates would have over the preferential margin granted under preferential tariff systems.

The debate over the value of trade preferences, especially in the case of market access negotiations on agricultural goods, has become a highly divisive issue among developing countries. At present, disagreements have been expressed among developing countries in the negotiating group on market access for non-agricultural products (NAMA) and the proposals in the Committee on Agriculture on Market Access.

These differences among developing countries are now widely reflected in the draft Ministerial Hong Kong Declaration of last 18 December<sup>1</sup>.

The lessons learned from the Cotton issue at the Cancun Ministerial have prompted the international community to pay early attention to preference erosion as some developing countries placed great emphasis on it during negotiations and debate on the road to Hong Kong. Almost in parallel to the negotiations, a number of studies have been undertaken on the value of trade preferences. The debate over trade preferences has now stretched to opposing poles in the economic literature on the trade effects and economic implication of trade preferences: from perversity<sup>2</sup> to real and undervalued trade instrument.<sup>3</sup>

The landscape of trade preferences has also considerably evolved from the last decade. Graduation has drastically reduced the value of trade preferences for some developing countries. Thus, it is quite normal that an increasing number of developing countries are actually devoting

more attention to market access negotiations at WTO than to the issue of preference erosion.

On the other hand, tariff preferences have been gradually improved for the remaining developing countries either through preferences à la carte or under the initiative for LDCs (Least Developed Countries). This evolution of trade preferences is increasingly polarizing the debate among different groups of developing countries. Some are still attaching great importance to trade preferences while others are more inclined to spend more negotiating capital on modalities that are directly targeting MFN tariff peaks and tariff escalation.

Ultimately, for the range of countries that are actually benefiting from tariff preferences or attach considerable importance to their maintenance in the context of current WTO negotiations, it may be crucial to assess the value of trade preferences in the general context of the market access negotiations.

This article aims at clarifying some conceptual issues on the erosion of trade in the framework of the ongoing debate of the Doha Round.

This article is divided in two parts. The first part aims at clarifying the concept of erosion of trade preferences and provides some methodological insights on how to measure preference erosion.

The second part summarizes some major initiatives recently undertaken by the United States, Japan and the European Union in the area of preferences and discusses the issue of preference erosion in the context of the current Doha Round.

## 2 Erosion of trade preferences: Demystifying some myths

The concept of granting trade preferences to Developing countries in order to attain development goals goes back to the original studies of Prebisch and Singer.

The Prebisch tenet that "treating unequals equally simply exacerbates inequality" has been perceived as a challenge to the MFN principle, the cornerstone of the modern international trading system. Trade economists have at times defined preferences as perverse since, on one hand they distorted Developing Countries attention away from MFN negotiations and, on the other hand, little benefits were accrued to them by relying on preferential market access

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<sup>1</sup> See Wt/Min/(05)/W/3Rev2 of 18 December, see in particular paragraph 19 of annex A on Agriculture and paragraph 29 and 30 on NAMA

<sup>2</sup> See Ozden, C. and Reinhart, E. (2002) "The perversity of preferences", World Bank, mimeo.

<sup>3</sup> See Rose, Andrew K., "Do we really know that the WTO increased trade?" Working Paper 9273, NBE Working Paper Series, October 2002.

As stated in UNCTAD Conference resolution 21(II) establishing the GSP, "...the objectives of the generalized, non-reciprocal, non-discriminatory system of preferences in favour of the developing countries, including special measures in favour of the least 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 have not been fully observed from the outset and divergence from them has been growing over time. The first principle, i.e. 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 allowed since the inception of the GSP schemes and as reflected in the enabling clause for special measures for LDCs which are justified by their particular economic and development situation. As it will be examined later in the second section this principle of non-discrimination has recently suffered from increased departure from its original spirit.

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

At present there is a wide variety of unilateral trade preferences that are eroding the value of trade preference granted under non discriminatory instrument as the GSP. From mid-nineties there has been a progressive proliferation on non-reciprocal trade preferences where the traditional non discriminatory character of the GSP schemes have been modified by inserting a differentiation policy among developing countries

benefiting 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 American Countries under the EU GSP scheme. This tendency later evolved to parallel initiatives to the GSP schemes targeted to a specific group of countries like the African countries in the case of AGOA.

In order to illustrate some basic concepts on how trade preferences works and are operated the GSP instrument has been taken here as a reference since the same methodologies could be used to assess the value of other trade preferences.

Reciprocal trade preferences granted under free trade area initiatives are inherently different from the objectives of unilateral trade preferences. This latter do not fall under the scope of this article even if the preferences granted under these arrangements will also be eroded by MFN liberalization.

The Generalized System of Preferences (GSP) is a preferential tariff system like many other preferential tariff systems. It differentiates amongst exporters and provides incentives to beneficiaries through the elimination of reduction or rate of duty in their favour. Under the GSP like other tariff preferences, preferential reduction in the Most Favoured Nation (MFN) tariff in favour of beneficiary countries are the catalysts which are expected to increase exports. The MFN treatment is based on Article 1 of the GATT 1994, which deals with reciprocity. Under the MFN concept in the GATT 1994, any concession negotiated between any two or more WTO Members is automatically granted to all WTO Members.

It follows that any preference like the GSP is a radical departure from this rule in that it is based on non-reciprocity

The difference between the MFN rate of duty and the GSP or preferential rate of duty is called the preferential margin. Thus, if an MFN duty was at ten percent, and it was reduced to zero under GSP or other preferential arrangement, there will be a ten per cent preferential margin.

The basic question is how GSP like any other preferences work. Importers in preference giving countries are profit maximizers. If a developing country can provide a substitute product, the importer would have the incentive to divert his

order from a non-beneficiary country, which must pay the full MFN rate of duty to a preference-given country.

So, the removal or reduction of the MFN tariff as a price effect which affects the allocation of resources in a market economy context. Several questions arise concerning how preferences work in practice and who is capturing the rents. Who gets the tariff revenue foregone is a common question, the exporter, the importer, or is it shared? In the majority of cases, it is the importer who pockets the tariff revenue foregone, which arises as a result of the GSP or other trade preferences. It is precisely this incentive, which causes him to divert his order in favour of developing countries. Some developing countries have, after having established a good working relation with the importer negotiated a share of tariff revenue foregone.

As earlier pointed out the issue of preference erosion arises whenever multilateral trade negotiations are being launched. There have been successive multilateral trade negotiations, i.e., the Dillon Round, the Kennedy Round, the Tokyo Round, the Uruguay Round and currently the Doha Development Agenda. All of these negotiations have led to liberalization in the form of tariff reductions. If the MFN rates decline then it follows that the preferential margins also decline and the preferences become less important. However, this concern has to be qualified. While indeed, average tariffs have declined tariff peaks and tariff escalations still exist on products of export interests of developing countries. Furthermore, the tariffication process brought into being by the Agreement on Agriculture created additional room for preferences. The generalization that low MFN tariffs make GSP and preferences ineffective also need to be qualified. Depending on the price elasticity, or price sensitivity of the product, even a small tariff margin may become an important incentive for importers to divert orders to developing countries.

Moreover, during and immediately after the Uruguay Round, the conventional argument was that the value of trade preferences to developing countries was decreasing because of the lack of legal stability of the GSP rates and the erosion of the preferential margins as a result of MFN tariff reductions.

However, a post-Uruguay Round assessment<sup>4</sup> proved that in most cases the erosion of preferential margins had been rather limited, since major tariff liberalization had taken place in sectors of interest to Developed Countries. This being said there is no question that current negotiations on market access on agriculture and NAMA will surely lead to preference erosion and Developing countries that are dependant on trade preferences may be affected.

Another point to be clarified is that,<sup>5</sup> traditional methodology utilized to calculate the value of trade preferences and the possible erosion of such preferences assumed that preferences were fully utilized.

Market access for developing countries was often analysed on the assumption that MFN rates were, on one side, not considered a real market access obstacle because of existing trade preferences. On the other side, this assumption was leading to an overestimation of the impact of erosion of trade preferences. Contrary to this conventional wisdom, the mere granting of tariff preferences or duty-free market access to exports originating in beneficiary countries does not automatically ensure that the trade preferences are effectively utilized<sup>6</sup>. Preferences are conditional upon the fulfilment of an array of requirements mainly related to rules of origin, which, in many instances, beneficiary countries may not be able to comply with.

The total value of imports receiving preference and revenue foregone has also been used as indicators of the value of trade preferences. The former is simply the total dollar value of goods that have benefited from a partial or total reduction of import tariffs under the terms of the relevant GSP schemes. The latter can be utilized as a rough indication of the "order of magnitude" of each scheme since it is larger, the wider the margin of preference and the higher the total value of goods receiving preference.

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<sup>4</sup> See UNCTAD TD/B/Com.1/20 of 21 July 1998.

<sup>5</sup> See Inama, S. "Market access for LDCs, issues to be addressed", *Journal of World Trade*, Vol. 36, No.1, February 2002 and UNCTAD "Improving market access for least developed countries", UNCTAD/DITC/TNCD/4, 2 May 2001.

<sup>6</sup> See Inama, *supra*

It has been suggested that in addition to these traditional indicators other benchmarks could be used<sup>7</sup>.

These indicators are common to all trade preferences and have been used for a number of years in the UNCTAD context.

These benchmarks could be defined as follows:

**Product coverage** defined as the ratio between imports that are covered by a preferential trade arrangement and total dutiable imports from the beneficiaries' countries. The higher the percentage, the more generous the preferences may appear depending on the structure of dutiable imports of the beneficiary countries. Coverage does not automatically mean that preferences

are granted at the time of customs clearance. This ratio is shown in column F of table 1.

**Utilization rate**, defined as the ratio between imports actually receiving preference and covered imports. Depending on the preference giving country this rate is often based on the customs declaration made by the importer at the time of importation. There are strong indications that higher or lower utilization rates are mainly the result of the stringency and/or complexity of rules of origin and ancillary requirements. In some cases, exporters may have not submitted the necessary documentation (such as a certificate of origin or through bill of lading) to get preferential treatment due to lack of knowledge or incorrect information. This ratio is shown in column G of table 1.

**Table 1**  
**Imports of least developed ACP countries into the European Union under the Lomé/Cotonou Partnership Agreement (1998–2004, millions USD)**

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

Source: UNCTAD secretariat calculations.

<sup>7</sup> See Unctad ,Improving Market access for LDCs, UNCTAD 2001 and Inama ,Improving market access for LDCs-issues to be addressed, Journal of World Trade , January 2002.

**Utility rate**, defined as the ratio of imports actually receiving preference and all dutiable imports (covered or not), refers to the percentage of total dutiable imports, which receive preferences. A low level of this ratio means that a large part of dutiable imports (either covered or not) pay MFN rate. This ratio is shown in column H of table 1.

As pointed out current negotiations on NAMA and market access on Agriculture will entail MFN liberalization with consequent inevitable erosion. A real dilemma that a number of beneficiaries' countries should solve is to what extent they wish to continue to claim compensation for erosion of trade preferences or they should be rather battling for improving them and making them more effective.

Another indicator that should be used in the measurement of the erosion of trade preferences is the percentage of dutiable products with respect to the amount of total imports.

As shown in columns 2 and 3 of table 1 it can be easily observed that out of total imports from ACP-LDCs into the EU market equal to an average of around 8,5 billion in the period 2000 to 2002 dutiable products were just around an average of 2 billions.

Thus there is scope for preferences and preference erosion only for one fourth of exports from ACP-LDCs to the EU since the other exports are already duty free on a MFN basis.

This finding has to be kept in mind by some negotiators since a closer analysis at country level may show that some countries that are extremely vocal on preference erosion may realize that in fact most of their exports are already duty free on MFN basis.

A forthcoming UNCTAD study<sup>8</sup> identifies the country-product specific tariff lines that have been most utilizing trade preferences. These country /product pairs are those most likely to be most affected by erosion of trade preferences

In fact it is impossible to provide a definitive answer on the value of trade preferences without taking into consideration the actual structure of production and exports of the country con-

cerned and the utilization rate of the existing trade preferences.

Ultimately, such an analysis should be carried out at country level and, on this basis; an assessment of negotiating priorities should be imparted as national negotiating strategy.

This assessment could be summarized as follows:

- The lower the utilization rate, the most MFN rate is applied and the country is supposed to register benefits from MFN liberalization
- The higher the utilization rate, the most the country may be exposed to potential trade diversion and loss of preferential margin since the preferences are effective.

Beneficiaries' countries with low utility rate and low utilization rates will be likely to experience little loss or trade diversion effects from the reduction of preferential margins since their trade is, for the reasons explained above, taking place under MFN conditions.

Beneficiaries' countries with a high utility rate and high utilization rate may be expected to face trade diversion deriving from an erosion of trade preferences unless there are significant sectors where utilization rate is minimal or erosion is compensated by other forms of aid.

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<sup>8</sup> The study is expected to be released in course of first quarter of 2006

### 3 Major preferential schemes granted by the United States, Japan and the European Union and the current debate on erosion in the context of the DDA

#### The Major US preferences

The US GSP programme provides for duty-free entry to all products covered by the scheme from designated beneficiaries. The scheme has been in operation since 1976, initially for two 10-year periods, and then it has always been renewed every one or two years. A renewal, which did not introduce amendments to the scheme, was approved in December 1999 and it reauthorized the scheme through September 2001, with retroactive effect from June 1999. The latest renewal occurred when the Trade Act of 2002, signed in August 2002, officially reauthorized the scheme through December 2006, after it had expired in September 2001.

A significant improvement in the US scheme was recorded in 1997, when 1,783 new products originating in LDCs were granted duty-free treatment.

However it later turned out that this extension of the list of products eligible for GSP treatment mostly benefited one country and one product: petroleum oils extracted by Chevron in Angola

The US Government, through the GSP Subcommittee, conducts annual reviews of the list of eligible articles and beneficiaries. Certain articles, such as textiles, watches, footwear, handbags, luggage, flat goods and work gloves, are excluded from the list of eligible products. Furthermore, any article determined to be import-sensitive cannot be made eligible. Such ineligible products include steel, glass and electronic equipment.

The granting of duty-free access to eligible products is subject to "competitive need limits". The US scheme provides for ceilings for each product and country. A country will automatically lose its GSP eligibility with respect to a product if competitive need limits are exceeded.<sup>9</sup>

<sup>9</sup> The "upper" competitive limits are exceeded if, during any calendar year, US imports of that product from that country: (a) account for 50 per cent or more of the value of total US imports of that product; or (b) exceed a certain dollar value, which is annually adjusted in proportion to the

However, competitive needs can be waived in several circumstances. In particular, all competitive limitations are automatically waived for the GSP beneficiaries, which are designated as LDCs.

The US scheme also provides for a graduation mechanism. The GSP law sets out per capita GNP limits, and advances in beneficiaries' level of economic development and trade competitiveness are regularly reviewed. In considering graduation actions, the GSP Subcommittee reviews:

- (a) the country's general level of development
- (b) its competitiveness in the particular product
- (c) the country's practices relating to trade, investment and workers' rights; and
- (d) the overall economic interests of the United States.

#### *The African Growth and Opportunity Act*

The African Growth and Opportunity Act (AGOA)<sup>10</sup> is the most recent United States initiative authorizing a new trade and investment policy towards Africa. AGOA heralded a new era in US preferences since it provided duty-free access for textile and clothing products to all sub-Saharan Africa. Textiles and clothing products have been statutorily excluded from GSP preferences since the inception of the US GSP programme. Only the Caribbean Basin Initiative (CBI) and the Andean trade preferences provide for preferences for textiles and clothing subject to rules of origin requirements.

Under Title I-B of the Act, beneficiary countries in sub-Saharan Africa that will be designated by the President as eligible for the AGOA benefits

change in the nominal GNP of the United States. In addition, products which are found to be "sufficiently competitive" when imported from a specific beneficiary country are subject to the "lower" competitive limit. In this case, eligibility is terminated if imports exceed 25 per cent or a dollar value set at approximately 40 per cent of the "upper" competitive need level.

<sup>10</sup> AGOA, which is part of the Trade and Development Act of 2000, was signed into law by the President of the United States on 18 May 2000. The AGOA implementation regulation was published on 2 October 2000.

will be granted what could be called a “super GSP”.

While the current “normal” GSP programme of the United States contains several limitations in terms of product coverage, AGOA amends the GSP programme by providing duty-free treatment for a wider range of products. Even the 1997 enhanced coverage for LDCs mentioned above does not match the product coverage of AGOA. The latter includes, upon fulfilment of specific origin and visa requirements, certain textile and apparel articles that were heretofore considered import-sensitive and thus statutorily excluded from the programme.

Since the Act provides for a series of preconditions and requires positive actions on the part of the 48 potential beneficiary sub-Saharan African countries,<sup>11</sup> the actual utilization

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<sup>11</sup> First of all, any AGOA beneficiary country must be eligible under the normal GSP programme. As additional eligibility requirements, under AGOA, as an eligible beneficiary the President is authorized to designate a sub-Saharan African country if the country has made or is making progress in all of the following respects:

- (a) The country must have established, or be in the process of establishing:
- (i) A market-based economy that protects private property rights, incorporates an open rules-based trading system, and minimizes government interference in the economy;
  - (ii) The rule of law, political pluralism and the right to due process, a fair trial and equal protection under the law;
  - (iii) The elimination of barriers to United States trade and investment, including by:
    - (iv) The provision of national treatment;
    - (v) The protection of intellectual property rights; and
    - (vi) The resolution of bilateral trade and investment disputes;
    - (vii) Economic policies to reduce poverty, increase the availability of health care and educational opportunities;
    - (viii) A system to combat corruption and bribery;
    - (ix) Protection of internationally recognized worker rights.
  - (b) The country must not engage in activities that undermine United States national security or foreign policy interests;

of the trade benefits is also dependant on the capacity at institutional level to satisfy those pre-conditions and undertake the requested actions.

### The Japanese GSP scheme

The Japanese scheme of generalized preferences was recently reviewed and extended for a new decade, until 31 March 2014.

Table 2 summarizes the main feature of the Japanese GSP schemes. It provides selected preferences with reduction of MFN duties for agricultural products according to a positive list approach. Most industrial products are covered and granted duty-free subject to ceiling and maximum country amounts. Ceilings are limitations on preferential treatment.

Once that the ceiling is reached MFN rates of duty is reintroduced. Ceilings are administrated on first come first served basis. However one single county cannot benefit from GSP treatment for more than one fourth of the amount of ceiling.

During fiscal year 2001/2002,<sup>12</sup> the special treatment granted to LDC beneficiaries was improved by adding a number of tariff items for duty-quota-free treatment for their exclusive benefit. In addition, all 49 LDCs will be able to benefit from these preferences.

LDCs enjoy the following special treatment for all products covered by the scheme:

- Duty-free entry;
- Exemption from ceiling restrictions; and
- An additional list of products for which preferences are granted only to LDC beneficiaries.

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(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 labour (ILO Convention No. 182).

If an eligible country does not continue to make progress in complying with the above requirements of AGOA country eligibility, the President shall terminate the designation of the country. The President has designated 36 countries out of 48 to be eligible for AGOA benefits (see appendix 1).

<sup>12</sup> For detailed information on the current scheme, see the Handbook on the Scheme of Japan 2002/2003 (UNCTAD/ITCD/TSB/Misc.42/Rev.2), also available on the Internet.



Japan further improved its GSP scheme in 2003. The number of LDCs' agricultural and fishery products under duty-free and quota-free treatment were increased to around 500 items from around 300 existing items: the additional 200 items include prawns and frozen fish fillets. As for LDCs' industrial products, almost all items have already been given duty-free and quota-free treatment.

According to the Japanese Government, this expansion is bringing the percentage of products

under this treatment in the total import value from LDCs, including industrial products, from around 80 per cent to over 90 per cent.

In addition, the number of products under the GSP, which benefit not only LDCs but also other developing countries, have been increased; around 120 new items, almost all of which are agricultural products, such as dried prunes, coconut (copra) oil, avocados and papayas, are to be added.

**Table 2**  
**Summary of the main features of the Japanese GSP scheme (UNCTAD)**

	Product coverage		Tariff cuts	Safeguard
Agricultural products	Annex 2 products (Annex 5 products are only for the benefit of LDC beneficiaries)		Various tariff reductions	Escape clause
Industrial products	All products, excluding products in Annex 3 (Annex 5 products are only for the benefit of LDC beneficiaries)	Annex 4 products	100 ~ 20 per cent cut	Ceiling (Annex 6)
		Other industrial products	100 per cent cut (duty-free)	Escape clause

### The major EU preferences

The Unilateral preference granted by European Community (EC) for developing countries exports are regulated by two main trade arrangements:

- (a) The EC GSP scheme recently extended<sup>13</sup> till 2008. The new EU GSP scheme for the period 2005 to 2008 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 se-

ries of international conventions and instruments.

- (b) The EC GSP Scheme includes the "Everything But Arms" – EBA initiatives that provides, for an unlimited period of time, duty-quota-free treatment for all products originating in LDC beneficiaries, except for arms and ammunition and with special provisions applicable to three sensitive products, namely rice, sugar and fresh bananas (where customs duties will be phased out over specific transitional periods), and;
- (c) The new ACP–EC Cotonou Partnership Agreement<sup>14</sup> (the CPA, successor to the

<sup>13</sup> See Council regulation 980/2005 of 27 June 2004 applying a scheme of generalized tariff preferences ,OJ L 169 of 30 June 2005

<sup>14</sup> The Partnership Agreement between the EU and 78 African, Caribbean and Pacific States was signed at Cotonou, Benin, on 23 June 2000. Pending the

Lomé IV Convention), which basically provides for an eight-year roll-over of the previous preferences granted under Lomé IV with minor improvements, until 2008.<sup>15</sup>

The basic structure of the new EU GSP scheme is essentially unchanged since the products are divided among two categories sensitive and non-sensitive as under the previous scheme. However it has to be noted that three hundred new products mainly in fishery and agricultural have been added to the product coverage.

Non sensitive products are granted duty free treatment while sensitive products are granted a reduction of 3,5 percentage points. Clothing and textiles are granted of 20 per cent reduction.

The major innovation of new EU GSP scheme is the special incentive arrangement for sustainable development and good governance. Under this arrangement countries benefiting from this incentive are granted duty free entry for sensitive products as opposed to the 3,5 percentage cut.

Countries wishing to benefit from this incentive should apply to the Commission and has to fulfil a series of commitments linked to the application and implementation of international conventions on sustainable developments and good governance<sup>16</sup>

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ratification process, the Agreement was put into provisional application on 2 August 2000, according to the modalities laid down in Decision No 1/2000 of the ACP-EC Council of Ministers of 27 July 2000 (2000/483/EC, Official Journal L 195 of 1.8.2000, p. 46).

<sup>15</sup> Under the Cotonou Partnership Agreement, the EU had anticipated the EBA initiative by entering into a commitment whereby it would *«start a process which, by the end of multilateral trade negotiations and at the latest 2005, will allow duty-free access for essentially all products from all LDCs, building on the level of the existing trade provisions of the Fourth ACP-EC Convention and which will simplify and review the rules of origin, including cumulation provisions, that apply to their exports»* (article 37, paragraph 9, of the Cotonou Partnership Agreement).

<sup>16</sup> In order to benefit from 'GSP+', countries must have: – ratified and implemented key international conventions. 23 of the most important international conventions relating to core political, human and labour rights must have been ratified, including: the elimination of discrimination against women; the prohibition of torture; the right to strike; the banning of child labour, the environment, good

The introduction of the EBA amendment to the EC GSP scheme has brought about a substantial improvement in the GSP treatment granted to LDC beneficiaries, which has made it a more favourable programme in terms of product coverage, depth of tariff cuts and stability of market access than the Lomé/Cotonou trade regime. It has to be noted that the EBA is an integral part of the Council Regulation of the EU GSP scheme.

It is worth noting that, before the implementation of the EBA initiative, ACP LDCs had traditionally enjoyed more generous market access conditions and legal certainty under the Lomé regime. As a matter of fact, the only effective LDC users of the EC pre-EBA GSP scheme have been those LDCs that are not members of the ACP group, namely Afghanistan, Bangladesh, Bhutan, the Lao People's Democratic Republic, Cambodia, Nepal, Yemen, Maldives and Myanmar (the latter has been temporarily excluded from GSP benefits).

The main difference between the tariff preferences provided to LDCs by the EC under its pre-EBA GSP scheme and the Lomé trade regime lay in the different legal nature of the two preferential arrangements and the scope of the preferences.

While the GSP was conceived as a unilateral, non-reciprocal, unbound grant by industrialized countries aimed at contributing to the economic

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governance and the fight against drug production and trafficking, must have been ratified by the end of October 2005. The remaining conventions must be ratified within the lifetime of the regulations i.e. by December 2008. These conventions include the Kyoto Protocol, the Convention on International Trade in Endangered Species and the UN Convention against Corruption.

- provided comprehensive information concerning ratification of the conventions, the legislation and measures to implement the conventions required for GSP+, and made a formal request to qualify for GSP+ before 31 October 2005.
- demonstrated that their economies are "dependent and vulnerable". Dependence is defined as meaning that the five largest sections of its GSP-covered exports to the Community must represent more than 75% of its total GSP-covered exports. In addition, GSP-covered exports from that country must also represent less than 1% of total EU imports under GSP.

development of the developing States, the Lomé/Cotonou preferences are an integral part of a broader international treaty which is legally binding upon the two parties (the EC, on the one hand, and the ACP States, on the other hand) and by which the EC has committed itself on a contractual basis to ensure until 2008 non-reciprocal preferential market access conditions for ACP products. With a view to giving greater stability to the EBA-GSP preferences for LDCs, the EC has also undertaken to maintain the special preferential treatment in favour of LDC products for an unlimited period of time, exempting such treatment from the periodical reviews of the basic GSP scheme.

Before the introduction of the EBA amendment, which substantially improved the market access conditions of LDCs, the extremely high trade-weighted coverage (99.9 per cent)<sup>17</sup> appeared to provide little scope for improving market access for LDC products. However, a closer analysis of the preferential treatment provided under the Lomé/Cotonou Agreement and former GSP trade revealed that the product coverage and preferential rates granted to LDCs were not necessarily equivalent to duty-free access.<sup>18</sup>

The EBA considerably improved the preferential market access granted to LDCs beyond the preferences provided by the Cotonou Partnership Agreement (CPA) and the European Union GSP for LDCs. Under the EBA, all products will be admitted duty and quota-free for an unlimited period of time, except bananas, sugar and rice, in respect of which customs duties will be phased out over a transitional period. All dutiable products that were previously granted only a margin of preference or were subject to quantitative limitations under ACP preferences are now given duty-quota-free treatment. Most importantly, the amendment abolished the specific duties and entry prices that were previously applicable to certain categories of agricultural and processed foodstuffs under both the CPA and the GSP.

Another important feature of the EBA is the stability given to these preferences. In fact, even though the EBA is an integral part of the European Union GSP scheme, its duration is not subject to the periodic GSP reviews or to time limits. By the same token, the initiative is subject to all the disciplines and various limitations of the GSP scheme, such as the unilateral and unbound character of the GSP, the provisions on temporary withdrawal of the preferences (Article 22 of Regulation 2320/98, specially reinforced by the EBA amendment itself), strengthened safeguard provisions and rules of origin.

In particular, a significant limitation of the current initiative may be found in the absence of improvement in the field of rules of origin since previous GSP rules are still applicable. Thus, given the cumulation regime applicable under the GSP, some ACP/LDCs countries may be placed in an unfavourable situation with respect to the cumulation regime granted to LDCs under the Cotonou partnership Agreement, this latter being more favourable.

#### 4 Some conclusions and possible actions

As earlier pointed out the issue of preference erosion proved highly divisive among Developing countries during the Hong Kong Ministerial. This is proved from the excerpts here below from the reports of Chairman of the Agricultural and Nama (Non-Agricultural Market Access) negotiating committees as contained in annexes A and B of the Ministerial Declaration showing the extent of the debate:

##### ***Para 19 of the Report by the Chairman of the Special Session of the Committee on Agriculture to the TNC***

*«19. The importance of long-standing preferences pursuant to paragraph 44 of the July 2004 Framework is fully recognised and concrete proposals regarding preference erosion have been made and discussed. There seems not to be inherent difficulty with a role for capacity building. However, while there is some degree of support for e.g. longer implementation periods for at least certain products in order to facilitate adjustment, there is far from convergence on even this. Some argue it is not sufficient or certainly not in all cases, while others that it is not warranted at all.»*

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<sup>17</sup> Trade-weighted coverage is given by matching a covered product with LDC trade (this is the main indicator utilized in the study to assess the relevance of the preferential schemes for LDCs).

<sup>18</sup> A detailed analysis of the preferences granted under the Lomé/Cotonou agreements will be provided in a forthcoming UNCTAD publication.

**Para 29 and 30 of the Report by the Chairman of the Special Session of the Committee on Agriculture to the TNC**

Non-reciprocal preferences (paragraph 16 of the NAMA framework)

«29. In response to calls by some Members for a better idea of the scope of the problem, the ACP Group circulated an indicative list of products (170 HS 6-digit tariff lines) vulnerable to preference erosion in the EC and US markets as identified through a vulnerability index. Simulations were also submitted by the African Group. Some developing Members expressed concern that the tariff lines listed covered the majority of their exports, or covered critical exports to those markets and were also precisely the lines on which they sought MFN cuts. As a result, for these Members, it was impossible to entertain any solution which related to less than full formula cuts or longer staging. In this regard, concern was expressed by them that non-trade solutions were not being examined. For the proponents of the issue, a trade solution was necessary as this was a trade problem. According to them, their proposal would not undermine trade liberalization because they were seeking to manage such liberalization on a limited number of products. »

«30. This subject is highly divisive precisely because the interests of the two groups of developing Members are in direct conflict. Additionally, it is a cross-cutting issue which makes it even more sensitive. While, the aforementioned list of products has been helpful in providing a sense of the scope of the problem and may help Members to engage in a more focused discussion, it is clear that pragmatism will need to be shown by all concerned. »

In the road to Hong Kong the issue of preferences and their erosion has been high on the agenda. LDCs and other Developing countries that are attaching importance to trade preferences made clear that a solution to preference erosion had to be found if the Doha round has to go ahead with their consent.

Lessons learned from the spiralling reaction chain of the 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.

Since it was progressively admitted that a sort of compensation<sup>19</sup> for preference erosion was necessary and justified in light of the "public good" of the Doha round recent studies focus on quantifying the value of trade preferences. Some of these studies put a dollar figure on the bill that will have (eventually) to be disbursed and on discussing the merits of finding a possible solution either within the WTO (A trade solution) or outside the WTO (a financial solution).

In the case of LDCs a strengthened Integrated Framework, an improved market access and the Aid for trade initiative are the preliminary results emerging from the draft Hong Kong Ministerial.

The value of such combinations of trade and financial elements may need to be tested in the forthcoming months during 2006 and perhaps beyond. However at the time of this writing even on the most promising area of consensus among donors like the Integrated Framework there is no dollar figure on how financially is going to be strengthened.

Even in the area of market access for LDCs the outcome of the Hong Kong Ministerial text reads as follows:

*«We agree that developed-country Members shall, and developing-country Members declaring themselves in a position to do so should:*

- (a) (i) *Provide duty-free and quota-free market access on a lasting basis, for all products originating from all LDCs by 2008 or no later than the start of the implementation period in a manner that ensures stability, security and predictability.*
- (ii) *Members facing difficulties at this time to provide market access as set out above shall provide duty-free and quota-free market access for at least 97 per cent of products originating from LDCs, defined at the tariff line level, by 2008 or no later than the start of the*

<sup>19</sup> This term seldom appear on studies or papers on this issue but in essence this is the crude reality. Some researcher resorted to the term of "buying out" trade preferences.

*implementation period. In addition, these Members shall take steps to progressively achieve compliance with the obligations set out above, taking into account the impact on other developing countries at similar levels of development, and, as appropriate, by incrementally building on the initial list of covered products.*

*(iii) Developing-country Members shall be permitted to phase in their commitments and shall enjoy appropriate flexibility in coverage.*

*(b) Ensure that preferential rules of origin applicable to imports from LDCs are transparent and simple, and contribute to facilitating market access.»*

The value of the increased market access under a (i) is mainly deriving from further concessions to be made by US and Japan under their respective GSP schemes for LDCs by including textiles and clothing in the case of the US and Rice and other agricultural products in the case of Japan. The implementation of such a commitment will remain to be assessed as well as its timing since the definition of duty free and quota free for at 97 per cent of products defined at tariff level may provide room loopholes in the values of the concession. There is not mention of binding trade preferences as originally requested by LDCs

The issue of rules of origin and its impact on utilization of trade preferences has, once again not being addressed. The wording under (b) is not legally enforceable and does not provide for the establishment of any working group or modalities to make sure that rules of origin are not an obstacle to utilization of trade preferences

Other than providing for a work plan and convene a meeting of the General Council next July 2006 the draft Ministerial does not contain much details on the extent and implementation of the "Aid for Trade" initiative.

Be this as it may it may be argued that some of the instances raised by LDCs have been partially addressed. However this argument remains largely subject to a meaningful and sincere implementation of the commitments contained in the Draft Ministerial.

On one hand the recent improvement that the US and Japan will have to make to their current trade preferences granted to LDCs have to be

commercially meaningful and subject to a monitoring mechanism.

It may be observed that such mechanism is already provided in the Ministerial text:

*«Members shall notify the implementation of the schemes adopted under this decision every year to the Committee on Trade and Development. The Committee on Trade and Development shall annually review the steps taken to provide duty-free and quota-free market access to the LDCs and report to the General Council for appropriate action.»*

However such reporting mechanisms is not an enforceable right of the LDCs and does not seem to provide at this point in time recourse to the DSU for those members that have not fulfilled the commitment.

On the other hand expectations have been focused on an aid for trade mechanism. The "Aid for Trade" is a laudable initiative since it is aimed at addressing the perennial problem of limited supply capacity of Developing countries, especially LDCs. However little is known about how concrete and valuable this initiative may get and the text of the Ministerial is limited at providing a work program rather than being translated into accountable commitments.

There are of course legitimate reasons to impart priorities and sequencing during negotiations. Perhaps the Multilateral trading system needed a breakthrough in Hong Kong however minimal it could have been.

However such a pragmatic approach should not impede an overall reconsideration of the whole spirit and objectives of unilateral trade preferences. This holds especially true when one considered that no trade solution has been envisaged in the Ministerial text

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 initiatives in favour of LDCs? Can erosion be compensated by improved GSP schemes for middle income and vulnerable countries? What rules should govern South-South trade preferences?

Middle income and vulnerable countries have been substantially benefiting from trade preferences and are going to be considerably affected by the erosion of trade preferences. Improved preferential market access under an enhanced GSP could still provide significant trading opportunities for these countries.

However the current trend indicates that trade preferences in favour 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<sup>20</sup> on market access to LDC listed a number of Developing countries as granting trade preferences to LDCs under different trade arrangements such as the GSTP and other regional South-South trade agreements. By their very nature trade preferences granted under these latter arrangements are available only to countries members of GSTP and to member of such South-South agreements.

In this context it may be noted that as early as June 1999 WTO members agreed to a waiver<sup>21</sup> to provide the instrument for developing country Members to offer preferential tariff treatment to products of least-developed countries. So far it appears that only South Korea<sup>22</sup> has availed itself of this opportunity. According to WTO notifications it appears that most of the preferences to LDCs have been granted under the GSTP or other regional agreements

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<sup>23</sup> 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".<sup>24</sup>

<sup>20</sup> WTO document WT/CMTD/LDC/W/35 of

<sup>21</sup> See WTO document WT/L/304 of 17 June 1999

<sup>22</sup> See

<sup>23</sup> See Council regulation 980/2005 of 27 June 2004 applying a scheme of generalized tariff preferences ,OJ L 169 of 30 June 2005

<sup>24</sup> 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 which due to a lack of diversification and insufficient integration into the international trading system are vulnerable while assuming special burdens and responsibilities due

In principle it may be argued that flexibility and the needs to adapt trade preferences to the evolving international trading system largely justifies such approach resulting in significant additional trade preferences made available to Developing countries and LDCs.

However the present world map of trade preferences today resemble to a pre-1947 GATT situation where preferences are allocated according to geopolitical interests or political economy considerations rather than on Development considerations .

The original multilaterally agreed general, non-discriminatory and non reciprocal principle of the GSP has been significantly eroded to be replaced by a plethora of ad hoc unilateral arrangements having a regional discriminatory scope. Under these new arrangements the elements of reciprocity and criteria for eligibility are much more stringent that under the GSP preferences. Ultimately unilateral preferences are simply replaced by reciprocal Free trade areas. This is indeed the case of the Economic Partnership Agreements (EPAs) replacing the ACP preferences and the FTAA (Free trade area of the Americas) replacing former US unilateral arrangements. Obviously these latter initiatives are encompassing issues going well beyond tariff preferences and should not be solely assessed from this perspective.

However this should not divert attention from the issue at stake. Ironically in a multilateral trading system becoming increasingly rules-based and pro development oriented the most concrete achievement of Special and preferential 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.

In this context the principles and objectives of the GSP that gave rise to Enabling Clause may need to be revisited to take into account the evolving nature of international trade and new multilateral rules should replace the Enabling Clause placing the future of Unilateral trade preferences firmly under the check and balance system of WTO rights and obligations. Above all

to the ratification and effective implementation of core international conventions on human and labour rights, environmental protection and good governance should benefit from additional tariff preferences. See preambles to Council regulation 980/2005

the most striking factor in the current debate about trade preferences is the absence of a forum for a multilateral and transparent 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.

## Acronyms

MFN	Most Favored Nation
LDC	Least Developed countries
QUAD	Quadrilateral countries EU, US , Japan, Canada
GSP	Generalized system of Preferences
AGOA	Africa Growth and Opportunity Act
NAMA	Non- Agricultural Market Access
ACP	African, Caribbean Pacific countries
DDA	Doha Development Agenda
GNP	Gross national Product
EBA	Everything But Arms
CPA	Cotonou Partnership Agreement

*About the author:*

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