The Doha Round and Preference Erosion:
A Symposium

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The trade and welfare impacts of multilateral liberalization on individual countries and groups within countries depend on many factors—including the depth of liberalization by trading partners, the extent of countries’ own reforms, the responsiveness of investors to changes in relative prices and market opportunities, and actions by governments to reduce real trade costs. One consequence of multilateral liberalization is that it reduces the value of preferential access to markets that one or more countries have granted to other countries. Such preference erosion has become more of a policy concern for the least developed countries following initiatives by many Organization for Economic Co-operation and Development (OECD) members to provide duty-free, quota-free access to their markets on a nonreciprocal basis. But erosion will also affect other developing countries that have received preferences, as well as economies that have signed reciprocal trade agreements.

The magnitude of erosion will depend on a variety of factors, including the product and country coverage of preferential schemes, the level of most favored nation restrictions in the markets granting preferential access, the administrative costs associated with using preference programs, the incidence of any preference rents, the depth of liberalization realized in Doha, and the existence of and changes in reciprocal trade agreements. Recent studies of European Union (EU) and U.S. preference arrangements have concluded that the value of preferences—measured by the product of the volume of dutiable exports and the preference margin—is significant for a relatively small number of countries. Thus, U.S. preferences are equal to 5 percent or more of dutiable exports for some 27 countries (Dean and Wainio 2006), while EU preferences exceed 6 percent of dutiable exports for 16 countries (excluding preferential trade area partners; Candau and Jean 2006). These studies conclude that apparel and some agricultural products—especially sugar and bananas in the EU—account for the largest share of the value of preferences. While for some countries, trade coverage is large relative to total dutiable exports to the markets concerned, the aggregate value of the preferences—and thus
potential losses—is relatively small and will diminish when the EU reforms in sugar and bananas are implemented.¹

By enabling disaggregated analysis at the tariff line level, the type of partial equilibrium analysis employed in these studies allows identification of the countries most affected by preference erosion risks and the products concerned—though analysis of the use of preferences by eligible countries is needed for a more complete understanding of the extent of preferential access. Such studies may be misleading, however, insofar as they ignore total exports of the countries concerned, the conditions of access offered to other countries for the same products, and the fact that preference margins are often low because most favored nation tariffs are low or zero. Moreover, the value of preferences is better measured by income earned—what matters is the impact on the price actually received by the exporters because the pass-through of preferential access is likely to be incomplete. Account should also be taken of the incidence of preferences on the costs of administering preference schemes, such as complying with origin requirements, which lowers the actual value of preferences.

The four articles in this mini-symposium focus on the potential magnitude of—and possible solutions to—preference erosion caused by multilateral liberalization, taking into account the factors mentioned above. Francois, Hoekman, and Manchin consider the effects on developing countries of only OECD countries liberalizing on a most favored nation basis—the most appropriate measure of the scope for preference erosion. They find that the loss from full erosion in all OECD markets is some $250 million in real income terms for African least developed countries and Bangladesh. Most of this is “caused by” the EU: the loss from full erosion in EU markets for the least developed countries that lose is some $600 million. The implication is that liberalization by other OECD countries will benefit some least developed countries by reducing the losses in the EU market. Net benefits are likely to be greater if developing countries also liberalize. In another contribution, Anderson, Martin, and van der Mensbrugghe conclude that all low-income countries as a group would see real incomes’ rise by some $16 billion following full global liberalization. For the subset of African least developed countries and Bangladesh, instead of the $250 million loss stemming from OECD liberalization, there would be a gain of some $1.1 billion. Thus, deep global reforms can do much to offset erosion losses in major markets for many countries.

The magnitude of erosion losses also depends on administrative costs—such as rules of origin—and the prevalence of nontariff barriers that constrain or raise the costs of market entry. Francois, Hoekman, and Manchin estimate that the ad valorem equivalent of administrative costs averages about 4 percent. Taking this into account lowers the value of preference programs and implies much lower

¹. Similar findings are reported in Low, Piermartini, and Richtering (2005, 2006) for the Quad economies (Canada, the European Union, Japan, and the United States) as a group.
erosion losses for recipient countries. In a similar vein, Ozden and Sharma estimate that Caribbean exporters capture only two-thirds of the preference margin in the U.S. market, with importers capturing the remainder. Other recent analyses cited in the symposium articles have found that the share of rents captured by exporters under other programs may be much lower.

These findings bolster the conclusions of the disaggregated partial equilibrium studies mentioned above that the absolute magnitude of preference erosion losses is relatively small. Nonetheless, the impact for some countries of substantial liberalization is likely to be significant, raising the question of what could be done to address potential losses.

There are two broad options: seek a solution within the trading system (tied to trade and trade policy) or use nontrade instruments. The most obvious trade-based option is not to liberalize the products that are the most important source of preference rents. This would imply a significant opportunity cost in liberalization forgone and is undesirable from a global welfare perspective. A more efficient trade option is considered by Limão and Olarreaga. They show that shifting from tariff preferences to a system of equivalent import subsidies in OECD countries might encourage additional tariff liberalization and reduce distortions created by preferential trade. Essentially, their suggestion is one way that the concept of aid for trade might be applied to preference erosion. Francois, Hoekman, and Manchin argue in favor of aid for trade to assist countries in dealing with the adjustment costs associated with global trade reforms and improving their capacity to exploit trade opportunities and diversify their economies.

As stressed in the literature, aid for trade should be seen as a complement and not as a substitute for global trade liberalization (Prowse 2006). Anderson, Martin, and van der Mensbrugghe show that the potential positive net effects of global trade reform are considerable and that the partial reforms that may emerge from the Doha Round may do little to benefit developing countries. Their findings that global free trade would benefit most developing countries and that developing countries’ own liberalization is important in the context of the type of partial liberalization that is likely under the Doha Round are particularly relevant from a preference erosion perspective. They imply that 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, which do not already provide full duty-free and quota-free access to markets.

2. For example, Anson and others (2005) document complex rules of origin and low use rates for preferences under the North American Free Trade Agreement (NAFTA). In a detailed study of the costs of rules of origin for Mexican exporters of textiles and clothing under NAFTA, Cadot and others (2005) find that about half the value of preferences is captured by U.S. importers and that U.S. producers of textile intermediate products sell at a higher price in the “captive” Mexican market.

3. Olarreaga and Ozden (2005) find that some exporters under the U.S. African Growth and Opportunity Act get less than 50 percent of the preference margin.
The articles in this mini-symposium are by no means the final word on the value of global trade reform or on the potential magnitude of erosion and its effects. Clearly, such effects are multidimensional, and more research is needed on all of the issues addressed in the articles and on issues that are not. Of particular importance is incorporating into the analysis nontariff policies and the cost of complying with them. This extends beyond rules of origin and includes trade costs in the exporting country (and thus the payoffs to trade facilitation), as well as the differential costs of compliance with destination country product standards and regulatory requirements in each exporting country. The literature effectively ignores trade in services and the policies that affect such services. Clearly, this needs to be remedied, given the increasing tradability of services and the importance of producer services as a determinant of competitiveness.

References


