

The Doha Development Agenda Impacts on Trade and Poverty

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A collection of papers summarising our assessments of the principal issues of the WTO round, how the outcome might affect poverty, the progress of the negotiations, and the impact on four very different countries.

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5. Preference erosion: helping countries to adjust

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The problem

The very high levels of some tariffs and the restrictions on levels of imports for some goods mean that countries that do not pay those tariffs or that have quotas on the restricted goods, because of preferential access, will suffer 'preference erosion' if tariffs and restrictions are removed or reduced. Not surprisingly, they oppose change, while the non-preferred want reform (see paper *Principal issues in the Doha negotiations*). The original purpose of preferences was to give new exporters an opportunity to increase sales, but some of the quotas are of fixed amounts, at high prices, and seem intended to give poor countries additional revenue, either to relieve poverty directly or to finance development. Both the EU and the US give quotas to some sugar exporters, which offer access and high prices. After 2008, Least Developed Countries (LDCs) will have unlimited entry to the EU. Both also have had quotas on clothing from major exporters (under the Multi-Fibre Arrangement), and the EU has allowed free entry to LDCs. The moves since 2000 to improve preferences, particularly for Least Developed Countries, have increased the potential loss. Countries now giving duty and quota free access for all or essentially all LDC exports include Canada, the EU, New Zealand, Norway and Switzerland. Japan offers free access to about 63% of their exports. The US offers special access to some LDC exports, to most African and Caribbean countries, and a growing number of countries under FTAs. The EU has the Cotonou arrangements plus FTAs. For some countries, with high concentrations of exports in heavily protected commodities, the gains from preferences are very large. The role of concentration means that it is mainly small countries who gain. The exception is Bangladesh whose massive response to the special concessions for LDCs exporting clothing during the period of the MFA now makes it vulnerable to the end of the Arrangement.

It is in manufactures that there was first awareness of preference erosion. The potential impact on those who gain from the MFA has been known since its end was negotiated in 1994. The effects, however, are still largely in the future because full liberalisation was postponed until 2005. Calculations of the effects of the end of the MFA suggest that Mauritius, Bangladesh, Sri Lanka, and the Maldives were likely to be the most serious losers. The major gains would go to India, China, and Pakistan.

In February 2003, the IMF (IMF, 2003) presented striking results, confirmed in their more recent calculations (IMF, 2004, Alexandraki, Lankes, 2004). The major losses are expected to be to Malawi, Mauritania, Haiti, Cape Verde, and Sao Tome and Principe. The

actual value of the exports lost was in total \$530 million (of which \$222 million was for Bangladesh), so that the numbers are not large on a world economy scale (Table 1). The largest effects from preferences are in sugar (42% of the effect for middle-income countries), bananas (19%), and clothing (12%).

WTO response

The first WTO drafts which recognised the problem, in 2003, suggested maintaining 'to the maximum extent technically feasible' nominal margins of tariff preferences and some LDC, ACP, and African positions have supported this (see *Zambia Paper*). It is clearly impossible when preferred countries already face 0 tariffs, and unacceptable to countries like Brazil and India which are attempting to increase their access, and where access will reduce poverty.

Mauritius, the most affected country, on both sugar and clothing, had suggested in January 2003 a compensation mechanism. In mid-2003, the Least Developed and the ACP repeated this, specifying that there should be technical assistance to improve infrastructure, productivity and diversification. The EU and US suggested that it was a problem for the IMF and World Bank.

The July 2004 framework still assumes it can be resolved within the existing agenda. For the worst affected, however, any gains on services, trade facilitation or public health are likely to be smaller than the losses on trade in goods. But for the world economy as a whole and for most poor people living in developing countries, trade liberalisation by developed countries is likely to be strongly positive (China, India, and Brazil will be clear gainers). There is, therefore an international interest in finding a way of transferring some of these gains to the losers, not only as a matter of equity and to ensure a 'development' round, but to avoid blocking by the losers; the WTO requires consensus.

Losses as a result of other types of trade policy change, for example when a regional trade area is formed or if a country wins a dispute, and the 'offending' country does not change its policy, have always been recognised as suitable for compensatory action in the WTO. 'Compensation' in these contexts, however, means some other trade action. There is no WTO provision which allows monetary compensation, although it has been proposed in the disputes procedures, when there are no obvious retaliatory actions to take. Financial compensation for negative consequences of trade liberalisation was implied in the agreement in the Uruguay Round that Net Food Importing Developing Countries (NFIDC), who were expected to be hurt by a rise in food prices as a consequence of the agricultural reforms, should get special consideration. In

practice, no action was taken, by either the WTO or financial and donor institutions, partly because the reforms have not had clear consequences for prices, but also because of the lack of clear allocation of responsibility. The cotton exporters raised the possibility of financial compensation for subsidies.

The question is how to implement compensation, and in particular whether it should be within the scope of the WTO. The failure of the NFIDC provisions (and other parts of the Uruguay Round Agreement which were left to discretion) means that an enforceable mechanism is essential if developing countries are to agree.

Developing countries and protected producers remain divided on whether compensation is a satisfactory substitute for preferences. Many prefer trade mechanisms, as more likely to be durable, and some believe that it would be possible to hold back reform and maintain some of the special arrangements.

Responses from the IMF and World Bank

The IMF saw a need for intervention as soon as it realised the scale of the losses. It first suggested that the losses should be taken into account as part of the normal assessment of balance of payments needs, but in March 2004, it established the Trade Integration Mechanism (TIM) (IMF 2004) designed to 'mitigate concerns that implementation of WTO agreements might give rise to temporary balance of payments shortfalls'. It will provide funding within existing facilities, based on estimates of expected losses from preference erosion, with simplified procedures if these estimates prove too low. The examples given use the same partial equilibrium calculations of losses as in Table 1. It would be on normal IMF terms (i.e. interest bearing). The (normal IMF) criterion of balance of payments difficulties means it is not directly tied to either a country's total loss from preference erosion or its net loss from a WTO settlement (see below).

The World Bank was less convinced that there was a problem, or that it had a responsibility. It (World Bank 2003) emphasised that most poor in developing countries were not in the preference dependent countries or the LDCs, so that measures to help these did not meet development needs. Although it noted the IMF results, it thought that preference erosion could be largely compensated by expansion in other exports (partly because it did not allow properly for sugar quota effects), while trade facilitation and more liberal rules of origin would 'attenuate the impact' (p. 218).

Although it temporarily reversed its position and joined the IMF before and at Cancún in offering to help, it has now returned to opposing special measures. Any needs, including those arising from preference erosion, should be considered as part of general support for countries' development. Providing support for countries on the basis of a particular difficulty would not be consistent with its development criteria, and would leave it open to external pressure for other, non-developmental, concerns. It has still not recalculated the expected outcome of trade liberalisation taking full account of preferences. Both, therefore, have responded in line with their institutional mandates.

Designing a response

It could be argued that there is no case for adjustment assistance: the countries knew that their income depended on preferences, and knew that trade policies could change, so their losses could have been anticipated. There is nothing special about trade losses compared to other impacts on poverty (cf the paper *Trade liberalisation and poverty*). There are two reasons for rejecting this, one practical, one developmental: the first is that if the losers are not offered something, they will have every incentive to delay or frustrate a settlement, which will damage other countries' welfare. The second is

Table 1 Percentage decrease in average export unit values following a 40% cut in preference margins as a result of multilateral tariff reduction (estimate)

Least developed countries		Other developing countries			
Malawi	6.6	Mauritius	11.5	Albania	3.3
Mauritania	4.8	St Lucia	9.8	Nicaragua	3.2
Cambodia	4.1	Belize	9.1	Swaziland	3.9
Bangladesh	3.9	St Kitts & Nevis	8.9	Serbia & Montenegro	2.9
Maldives	3.5	Guyana	7.9	Tunisia	2.2
Haiti	3.3	Fiji	7.8	Côte d'Ivoire	2.2
Cape Verde	3.3	Dominica	5.5	Morocco	2.1
São Tomé e Príncipe	2.7	Seychelles	4.2	Dominican Republic	2.1
Tanzania	2.4	St Vincent & The Grenadines	3.4		
Comores	2.0	Jamaica	3.3		

Source: IMF, 2004

that they are developing countries and need favourable support, in order to be able to make the investments in physical and human infrastructure and in productive capacity to permit alternative production, although this should not disadvantage those who need aid by traditional criteria. The increase in world welfare suggests that there is scope to find funding for them. The relevant 'loss' would not be the total effect of losses from preferences, but the net effect (if negative) from all parts of any WTO settlement, offsetting the preferences lost by any gains; all WTO deals are a mix of losses and gains.

The normal WTO answer to how to set up such a scheme would be that this is a negotiation question: the countries which are requesting trade liberalisation, in this case principally the non-preferred developing countries, such as Brazil and the G20, along with some efficient developed country producers, like Australia and the Cairns Group, have to make an offer that will secure agreement. They can either offer to fund adjustment in the losers themselves or demand that the developed countries do so.

The rhetoric of the Development Agenda suggests that the developed countries should fund it as this would secure gains for the majority and meet the developmental objective of helping the losers increase other exports, not dependent on preferences; it would provide a substitute for the assistance function of preferences. Members could be asked to make 'offers' to contribute to a fund with the amount subject to negotiation and eventual binding, like any other offer in the Round. Although the loss from preference erosion is permanent, adapting to permanent changes in trade patterns or trade policy is normal, so any funding would be for a transition period, like that for the MFA.

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