BRIEFING PAPER

CUTS International

TDP 3/2006

Moving from Preferences to Aid for Trade

*Prashmita Ghosh**

Introduction

The side effect of Most- Favoured Nation (MFN) tariffs reduction is leading to preference erosion thereby posing a difficult problem in the trade-development field for the developing world. For many years, developing countries (DCs) have been receiving tariff preferences from the developed countries for exporting their products. As global trade talks are directed towards dissolving the trade barriers, least developing countries (LDC's) in particular, are facing the problem of losing their preferential access to the developed markets.

A general tariff reduction as agreed in the multilateral trade negotiations involves cost in the form of loss of preference margin and benefits in the form of increased access to the world market. In this situation, a policy prescription in the form of Aid for Trade (AFT) is gaining acceptance among the trade negotiators to negate the damages incurred from preference erosion. AFT intends to support the developing countries, so that they could develop their supply-side components, which will in turn strengthen their industrial-distribution-production system, to make them internationally competitive. This paper attempts to understand whether a compensatory measure in the form of 'AFT' could address the losses brought about after erosion of the trade preferences.

Background

Today gobal trade follows the rules set by the World Trade Organisation (WTO), after consensus from all members. WTO trading rules accords MFN status to all WTO members. Under the MFN rule, countries do not discriminate against other WTO member countries, for example, if a country's tariff on bicycle imports is five percent, then it must charge five percent on imports from all other WTO members. The current round of trade negotiations under the Doha Round emphasises trade liberalisation with subsequent tariff reductions in the member countries. Ensuing tariff reductions is a cause of concern for DCs and LDCs as this will lead to eventual loss of preferences.

Preference arrangements came into being to help the developing countries and the LDCs to cultivate their comparative advantages and make them developed in due course. In a preferential trading agreement, countries would offer tariff reductions, though perhaps not tariff elimination to a set of partner countries in some product categories. Since 1960's, preferences have been a feature of the trading system. To take forward the preference arrangement, the United Nations Conference on Trade and Development (UNCTAD) in 1968 formalised the preference arrangement by adopting the Generalised System of Preferences (GSP) to favour the least advanced among the DCs to increase their export earnings, promote industrialisation, and accelerate economic growth rates. Under GSP schemes, selected products originating in DCs are granted reduced or zero tariff rates over MFN rates. The LDCs received special and differential treatment (S&DT) for a wider coverage of products and deeper tariff cuts.[1] GSP schemes have been announced by US, Europe, Japan, Canada to help the economically backward countries in Africa, Asia and Latin America. The middle-income countries on the other hand have been facing discrimination in market access in Organisation for Economic Co-operation

Box 1: Preference Margin

Preference margin is the difference between the MFN tariff rate and the preferential tariff rate. As MFN tariffs are being reduced the world over through successive negotiations, there is a slow but gradual erosion of preference margin as well e .g. a preference giving country levies MFN tariff of 20 percent on country A for shoe imports and levies zero percent preferential tariff on shoe imports from country B. In this case, preference margin is 20 percent. With consequent decrease in MFN tariff, let us assume 20 percent tariff on imports from country A is reduced and MFN tariff of 10 percent is now levied on imports from country A and country B enjoys the preferential tariff rate of zero percent. In such a case, the preference margin comes down to 10 percent. Therefore, with MFN tariff reduction, preference margin also gets eroded.

* *This paper is written by Prashmita Ghosh of and for CUTS International, as part of the Linkages between Trade, Development & Poverty Reduction (TDP) project. The views are personal.*

With the support of

MINBUZA Ministry of Foreign Affairs, The Netherlands & DFID Department for International Development, UK

and Development (OECD) countries since they are not partners in preferential trade agreements (PTA's).

Preferences are temporal in nature. The preference receivers cannot expect to get preferences forever. Preferences are given to strengthen their economy and to develop themselves from LDCs/developing stage to developed country stage. Preferences are a handholding measure whereby the developing countries get preferential access to export their products for their own prosperity. Since preferences (S& D provisions) are not legally enforceable, the preference provider country can repeal the arrangement anytime.

Preference erosion came under spotlight in 2003, when calculations after Uruguay Round showed losses for a few countries from multilateral trade liberalisation. The losses were not accounted before, partly because the preference recipient countries were not actively participating in WTO negotiations and partly because the effects on textile producers were distant and there were delays in implementation. Preference erosion became a negotiating issue by 2003. This was because bigger preferences meant bigger effects, and all countries were actively participating in WTO negotiations. This led to division between preference recipient countries and non-preference receivers since the former did not want to join the multilateral trade negotiations due to the valid fear of losing their preferences.

The developing countries' economies that depend on the PTA's will suffer adjustment losses after preference agreements are replaced by WTO rules. The adjustment losses will be due to factor movements from one sector to another after change in trade policies: other probable problems are retraining labour to provide necessary skills for new employment avenues, temporary loss in income for the labour class due to temporary unemployment etc., because of a change in trade policy. Many of the preference recipient countries, especially the small economies in the Caribbean have been practising mono-cultivation and have specialised in growing one crop e.g. banana, rice which found easy access to the OECD markets, thanks to preferences! After MFN tariff reforms are operational these small economies would have to compete with other major agricultural producers from middle-income countries to get a market share in the global market. Considering the structural deficiencies these countries suffer from, this will inevitably lead to trade losses for them because of their incompetence to stand up to the international competition. The mounting question now in front of trade experts is to effectively address the problem of economic losses of the preference recipient countries.

Box 2: Strong Dependence on Preferences

20 ACP countries have privileged access to EU sugar market. The sugar export is a part of sugar protocol that has been signed by EU and ACP countries in 1975. These countries are mainly small island developing states. Sugar industry is the backbone for these small economies. Sugar production in Fiji is responsible for 90 percent of the total agricultural output, and generates over 17 percent of GDP in Guyana. EU sugar reforms conforming to WTO trade rules will be detrimental for these countries' economies. Inherent climatic conditions in these countries are advantageous for sugar cultivation, hence diversification to some other industries will not be beneficial. Moreover, earlier attempts to diversify from sugar production had been unsuccessful. ACP countries and other preference recipients used to being treated preferentially will find themselves in deep economic problem with the removal of the preferences. Essentially, these beneficiaries are topographically competitive in cultivation of one crop be it rice, sugar, banana, cocoa. The developed countries to grant preferences to the LDCs and to help them grow used this advantage.

Aid For Trade

AFT is being considered as a measure to promote trade and development of the developing countries. AFT comprises of technical assistance, capacity building, institutional reform, investments in trade related infrastructure, and assistance to offset adjustment costs.

Briefly, AFT aims to bolster the developing countries production side capability to enable them to develop. Likewise preference agreements, if not directly but in a holistic way, aimed to help developing countries prosper by giving preferential access to their products. So, both the measures have the ultimate aim to develop the developing countries. It can be said that preferences were a demand side measure i.e. effecting export growth of the developing countries, while AFT is more a supply-side programme i.e. helping the countries to develop their supply-side framework for efficient production with the available resources for development.

The Doha Round launched in 2001 at the WTO Ministerial meeting was called " Development" round to emphasise the development impact of trade negotiations. In this context, to abet the developmental face of the trade negotiations the G8 leaders in July 2005 at Gleneagles mandated World Bank and International Monetary Fund (IMF) to develop proposals on AFT. As a result, the representatives of these two financial institutions presented a paper on Doha Development Agenda and Aid for Trade in the Development Committee meeting in September 2005.The proposal of World Bank and IMF contained the following three elements:

- An enhanced Integrated Framework (IF) with the design and resources to strengthen trade capacity building and merge trade policy with national poverty reduction policy for the developing countries;
- A multilateral fund was proposed by trade negotiators in Geneva to finance country specific Diagnostic Trade Integration Study conducted under IF and to address regional and cross-country trade integration mechanism. However, the World Bank and IMF's staff received this suggestion with scepticism. They ascertained the regional and cross-country aid for trade needs and opined to explore the existing lending instruments for addressing the aid requirements.

- The AFT package asks for a multilateral fund to address adjustment concerns from multilateral liberalization under Doha Round. The Bank and Fund had agreed on strengthening the aid assessment package and its utility but does not acknowledge the requirement of a separate fund to address adjustment concerns.

IF is seen as a potent tool to help countries generate and embed a trade and competitiveness agenda in their national development strategies. IF is a multi-agency, multi donor programme supported by IMF, UNCTAD, International Trade Centre, World Bank, WTO, UNDP. IF aims to assist the LDCs in expanding their participation in the global economy by enhancing their economic growth and integrating trade with poverty reduction strategies. The popularity of the IF model amongst the LDCs and the donor community made it imperative to be used to further AFT.

The debate on AFT was mandated in paragraph 57 in the Hong Kong Ministerial Declaration, 2005, which states, "Aid for Trade should aim to help developing countries, particularly LDCs, to build the supply-side capacity and trade-related infrastructure that they need to assist them to implement and benefit from WTO Agreements and more broadly to expand their trade". AFT is not a substitute for trade liberalisation rather it can be a valuable complement in the pursuit of trade liberalisation under Doha Development Agenda (DDA).

Gains from trade liberalisation are conditional on an environment that allows free mobility of labour and capital, and behind the border reforms[2] in the developing countries. AFT package will be helpful in implementing behind the border reforms in the developing countries. AFT gets the political focus as a prerequisite to fulfil the development promise of DDA and mark its successful conclusion.

In the pursuit of framing a comprehensive AFT policy, WTO had set up AFT Task Force to provide recommendations on how to operationalise AFT and how AFT might contribute most effectively to the development dimensions of the DDA. The Task Force is made up of 13 WTO member countries: Barbados, Brazil, Canada, China, Colombia, European Union, India, Japan, Thailand, United States, Mauritius (co-ordinator of ACP), Benin (African group), and Zambia (LDC group). The approach taken by the AFT Task Force has three components, namely:

- AFT is a complement and not a substitute to Doha Round;
- To utilise Paris[3] principles on aid effectiveness; and
- To focus and address the gaps and inefficiencies in the existing system.

Swedish Ambassador Mia Horn af Rantzien, the chairperson of AFT Task Force in a recent meeting[4] addressed the gaps that exist in the current system. Developing countries are balked down with the problem of lack of integration between the trade policy and overall development strategy. There is need to increase stakeholder participation within the developing countries and there is a lack of national/regional expertise on AFT needs. There is agreement that AFT should reflect the needs identified by developing countries themselves.

Many developing countries have been unable to benefit from existing market access because they lack sufficient productive and trade capacity. AFT provides an opportunity to translate two principles into concrete action: first WTO's mandate to promote coherence in economic policy making and second, the 2005 Paris

Box 3: Rationale behind AFT

Aid for Trade involves flow of development finance from rich to poor countries for the purpose of enhancing the world trading system. Three key questions needs to be addressed to design AFT framework:

What should be funded? – a "Needs" question

In what form should the money be given? – an "instrument" question

Who should manage the transfer? – an "institutional" question

The answers to these questions depend on the purpose of the fund and its relationship to the trading system. The other purposes discussed for trade related development assistance, having implications on the design of AFT mechanism are:

- Political motivation ascribed to rich countries to 'buy' progress in the Doha Round
- Compensation for demands made by preference dependent countries, net food importers, and those facing costs associated by industrial restructuring following the end of textiles agreement
- AFT is seen as a redistribution mechanism through which the reality of the unbalanced outcome can be squared with the rhetoric of the Development Round thereby imbibing fairness within the trade negotiations
- AFT can be seen as a necessary complement to the core market access issues that are at the centre of the round. AFT should be motivated by the imperative to create 'effective market access' by removing internal barriers to trade. This can be attained with improved infrastructure, supply capacity, enabling the DCs to meet the high safeguard standards as required by industrialised nations, meet the crunch in availability of credit, ease the business environment with flexible policy formulation

Preference dependent countries facing adjustment shocks, tariff losses should all receive funding, but adjustment costs should motivate donors and identify recipients, aid disbursements should have the purpose of promoting future exports, not compensating the loss of past exports.

The objective of AFT package should be to put resources into increasing volume and value-added exports, diversifying export products and export markets and attracting foreign investment to generate jobs and exports.

Source: Joseph Stiglitz, Andrew Charlton (2006), Aid for Trade- Keynote Address, Annual Bank Conference on Development Economics Tokyo 2006

Declaration on aid effectiveness. These were the thoughts shared by Valentine Rugwabiza, Deputy Director General, WTO in a recent discussion on AFT.

It is imperative to frame a befitting AFT policy. The Task Force tabled their final recommendations on 27-28 July, 2006 to the General Council, WTO. In the recommendations submitted to the General Council, WTO the Task Force suggested "country ownership and country-driven approaches, as well as a commitment of governments to fully mainstream trade into their development strategies, is key." It emphasises mutual accountability, aligning aid to national development strategies, effective donor coordination, harmonization of donor procedures, and transparency. The report emphasises the need to mainstream trade-related issues into national development strategies. It identifies a number of challenges involved with doing so, such as the lack of private-sector involvement in identifying trade needs, the limited absorptive capacity of recipient countries, ineffective monitoring, and the slow, duplicative and bureaucratic processes in the assessment and delivery of trade-related assistance.[5]

Box 4: Regional AFT

Enhanced IF should address most aid for trade needs by increasing supply side capacity of the country through integration of trade and poverty reduction policies. However, country-focused poverty reduction strategy (PRS) process may not be adequate to ensure follow up on the regional issues. Addressing regional AFT is important for small economies and land-locked countries. Major problem is encountered in transportation of the goods from the manufacturing house to the port and this is often marred with barriers that serves as a severe trade deterrent. Cross-country projects are important for small countries that are dependent on their big neighbours for trade facilitation. For example, Rwanda requires the co-operation of Kenya, Uganda and Tanzania to have road access to the ports of Mombasa or Dar es Salaam -but for these countries, roads in the hinterland maybe a low priority, thereby hampering Rwanda's trade relations. Small economies are likely to face competing demands for existing donor resources within their PRS process and may benefit from cost-effective regional machinery for trade, such as regional infrastructure or regulatory frameworks to support liberalisation in services such as electricity or telecommunications.

Source: Doha Development Agenda and Aid for Trade-Staffs of IMF and World Bank, September 2005

Conclusion

International trade assistance in the form of increased aid can be instrumental in eliminating the discriminatory practice of PTA's and strengthen the path towards MFN liberalisation. Increased deliberation is going on for AFT as a probable measure for facilitating development. In implementing this agenda, it is of utmost relevance to keep a track of the fund flow for effective utilisation. Aid management and implementation practices need to shift towards stronger alignment with country policies, and increased harmonisation of bilateral and multilateral efforts.

AFT is seen as a complement for a successful Doha Round. AFT offers the possibility of developing countries being better off unlike the results from the last trade round. The DCs will gain much more from a successful Doha Round than from any AFT package. However, an AFT package is strongly advocated to address the weak structural drawbacks in the DC's economies. It is widely argued that increased aid is vital for the poor countries if they are to grasp the opportunities provided through trade and absorb adjustment costs after preference erosion.

All countries benefit from one country's trade reforms and trade related investments, and benefits increase when undertaken by a number of countries concurrently!

References

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Endnotes

1 www.unctad.org
2 Behind the Border problems include weak competitive domestic investment climate, poor governance, rigid factor market (labour and capital reallocation restriction), underdeveloped trade facilitation systems and institutions.
3 Paris Declaration on Aid Effectiveness: Ownership, Harmonisation, Alignment, Results and Mutual Accountability was adopted by 90 countries and 27 development institutions at the High Level Forum held in Paris, February 28-March 2, 2005 to improve the quality of aid.
4 http://www.wilsoncenter.org/index.cfm?fuseaction=events.event_summary&event_id=185985
5 http://www.ictsd.org/weekly/06-08-02/story3.htm