Open Markets for the Poorest Countries

Trade Preferences That Work

The CGD Working Group on Global Trade Preference Reform

Kimberly Ann Elliott, Chair

April 2010

Update

After the report went to the printer, we learned that the government of South Korea had changed its preference program for least developed countries to expand product coverage. Rather than 75 percent of tariff lines, as indicated in the executive summary table (page 2) and on page 7, coverage rose to 85 percent on January 1, 2010, and is scheduled to rise again to 95 percent in 2012.

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Report of the CGD Working Group on Global Trade Preference Reform
Final Report • April 2010
http://www.cgdev.org/content/publications/142918

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Affiliations are provided for identification purposes only; members of the working group participated voluntarily in a personal capacity. The report reflects a broad consensus among the members as individuals, although not all members necessarily agree with every word in the report. This text does not necessarily represent, and should not be portrayed as representing, the views of any single working group member, the organizations with which the working group members are affiliated, the Center for Global Development, or the Center's funders and board of directors. Brief biographies of members are available on the working group's website at http://www.cgdev.org/section/initiatives/_active/reformingtradepreferences/global_trade_preference_reform.

*Participated as an observer and does not endorse or reject anything in the report.

ISBN: 978-1-933286-50-1
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Preface

For a variety of historical, political, and economic reasons, trade policies around the world discriminate against the exports of the poorest countries. Thanks to six decades of international trade negotiations, average tariffs in rich countries are in the low single digits, but tariffs are high in sectors where poor countries do well—agriculture and labor-intensive manufacturing products, including apparel and footwear. Rich-country governments promised to rectify this situation in the United Nations Millennium Declaration in 2000 when they committed to provide duty-free, quota-free (DFQF) market access for essentially all exports from least developed countries (LDCs). At the World Trade Organization Ministerial in Hong Kong in 2005, members reaffirmed the commitment and also called on developing countries "in a position to do so" to expand access for LDCs, albeit with more flexibility in implementation.

So progress is being made, but slowly, and the economic and political environment lends urgency to the need to deliver on these promises now. Efforts in the summer of 2008 to bring the Doha Round of global trade negotiations to a conclusion collapsed, and the round is unlikely to be concluded for some time. In the interim, negotiation of bilateral and regional trade agreements could accelerate, increasing discrimination against the smallest and poorest that tend to be excluded from commercially significant agreements. In 2009, poor countries were also being hammered by an economic crisis that they had no role in creating.

In the midst of the crisis, in spring of 2009, senior fellow Kimberly Elliott organized the CGD Working Group on Global Trade Preference Reform to examine how to achieve the Millennium Development Goal of full market access for the poorest countries. The working group analyzed major preference programs around the world, including those in advanced developing countries, and identified key strengths and weaknesses in all of them. In addition to making concrete recommendations for improving these programs, the working group calls on the high-income countries to stop delaying and provide full market access for LDCs now, when they need it most.

Moreover, since removing border measures is necessary but not sufficient to encourage effective integration of LDCs in the global economy, it is crucial to reform programs to also promote real access by ensuring that programs are stable and predictable and that rules of origin and other conditions for eligibility are not barriers themselves. And, given the growing importance of

South-South trade, preference programs in advanced developing countries should adopt the same principles to ensure their programs work effectively. Finally, complementary policies are needed to address other potential obstacles to trade, such as complex regulatory standards, as well as supply-side challenges in poor countries.

While completing the Doha Round remains the key overall trade initiative for protecting the interests of poor countries, its short-term prospects are uncertain at best. Global cooperation to open markets fully to LDC exports could serve as a confidence-building measure and a bridge to future international cooperation on trade. Meanwhile, UN Secretary- General Ban Ki-moon called for 2010 to be the year of sustainable development and urged members to "mobilize to achieve the Millennium Development Goals" (MDGs). While the economic crisis is making it even harder to reach some of the MDGs, full market access for LDCs is one goal that can be met well before the 2015 target. The UN summit in September to review progress toward achievement of the MDGs is the perfect opportunity.

Nancy Birdsall
President
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Acknowledgments

First and foremost, this report would not have been possible without the dedicated involvement of the working group members who contributed their time and extensive knowledge of the issues. It would also not have been possible without the generous financial support of the Hewlett Foundation. We are also grateful to the participants in a series of consultation meetings in India, Bangladesh, London, Kenya, and Washington, D.C., which greatly contributed to the group's deliberations. For help in setting up those meetings, we are especially grateful to Pradeep Mehta, Atul Kaushik, and their colleagues from CUTS; Dr. Debapriya Bhattacharya and his colleagues at the Centre for Policy Dialogue in Dhaka; and Susan Prowse and colleagues at the Overseas Development Institute in London. Summaries and lists of participants in the consultation meetings are available on the working group page on the CGD website. We would also like to thank the excellent CGD communications team, especially Kaci Farrell and Sarah Jane Staats for assisting with outreach and dissemination.

Executive Summary

Trade preference programs are an important and underused tool for stimulating exports, creating jobs, reducing poverty, and promoting prosperity and stability in poor countries. While many rich countries provide special access for exports from the least developed countries (LDCs) to promote these benefits, the trade preferences often do not extend to the products that matter most to LDCs, such as agriculture and clothing. Improving these programs could make a major difference in the lives of the poor, while having minimal effects on production or exports in preference-giving countries because the affected trade is so small: less than 1 percent of global exports are from LDCs. And, in the longer term, improved trade preferences for LDCs will promote shared prosperity and stability in rich and poor countries alike. Recognizing the role of trade in poverty reduction, the UN's Millennium Development Goals (MDGs) for poor countries call on high-income countries to provide duty-free, quota-free market access for the LDCs.[1]

Trade preference programs are powerful tools to promote prosperity in poor countries, but they are underused and often exclude the products that matter most. The time to make preferences work is now.

Now is the time to make preferences work for development. To that end, the Center for Global Development convened a working group made up of members from the academic, nongovernmental, and business communities, as well as observers from key governments, to study the weaknesses in existing preference programs and suggest improvements. Based on our deliberations, we make five recommendations overall; the first three are core elements that high-income countries that have not already done so should implement immediately. The final two would significantly augment the value of preferences programs for poor countries, especially when combined with the first three.

Core recommendations for high-income countries in 2010:

- Expand coverage to all exports from all LDCs.
- Change program rules that raise costs and impede market access for LDCs, especially rules of origin restricting input sourcing.
- Ensure program stability and predictability to encourage investment in potential export sectors, particularly by making the programs permanent or longlasting.

1. There are 49 UN-designated least developed countries with per-capita incomes below US$750 and with other features of vulnerability, such as small size or volatile exports. A list of LDCs may be found in annex c, and information on the selection criteria is available at http://www.un.org/special-rep/ohrlls/ldc/ldc%20criteria.htm.

Because these principles are necessary for preference programs to provide meaningful access, and because the impact would be far more powerful if it promotes South-South trade, we also recommend that

- advanced developing countries with programs should phase in the core recommendations by 2015, the target for achieving the MDGs.

In addition, to ensure that LDCs can take advantage of these opportunities, preference-granting countries should

- create mechanisms for dialogue and cooperation with LDCs to enhance preference utilization by addressing obstacles outside preference programs themselves, such as costly regulatory requirements in preference-giving countries, or supply-side challenges in poor countries that inhibit exporters taking advantage of market access.

While no existing program is perfect, the table below summarizes the strengths and weaknesses of major rich-country preference programs and highlights the features *most* in need of change.

Country or program	*Product coverage*	*Flexibility of rules of origin*	*Program length*
Canada	99%	high	10 years
EU Everything But Arms	100%	low	permanent
U.S. AGOA	98%	high	11 years
Japan	98%	low	10 years
U.S. GSP for LDCs	83%	moderate	usually 1–2 years
South Korea	75%	low	uncertain

AGOA = African Growth and Opportunity Act; GSP = Generalized System of Preferences.

I. The Opportunity

There is a unique opportunity in 2010 to deliver on the longstanding promise to promote trade as a tool for development in poor and marginalized countries. Expanding trade opportunities for the least developed countries (LDCs) can encourage investment, create jobs, raise incomes, and, ultimately, reduce poverty. In recognition of a positive role for trade, the United Nations' Millennium Declaration (2000) sets out goals for reducing hunger and poverty and promoting sustainable development, including a commitment by developed countries to provide duty-free, quota-free market access for LDCs. The communiqué from the World Trade Organization's 2005 ministerial meeting in Hong Kong affirmed the goal and, importantly, members agreed that "developing countries in a position to do so" should also expand duty-free access for LDCs.

While significant progress toward this goal has been made, more remains to be done, and the economic crisis adds to the urgency. The crisis began with a financial market meltdown in the rich world in 2008, but the subsequent drop in demand sent trade flows and commodity prices plummeting in the first half of 2009. For poorer countries that are not well integrated in global financial markets, the drop in export revenues was the principal channel driving their economies down and poverty up. Moreover, with the Doha Round of global trade negotiations already stalled, the focus of trade policy in many countries turned from progressive opening to avoiding protectionism. While the protectionist threat was contained in 2009, it could re-emerge this year if unemployment stays high even as the recovery (one hopes) gains momentum. And, with the Doha Round unlikely to conclude soon, negotiation of bilateral and regional trade agreements could accelerate, thereby increasing discrimination against the smallest and poorest countries that are rarely party to these agreements. To make things worse, the economic crisis will put severe pressure on aid budgets in rich countries.

Expanding trade opportunities for the LDCs will encourage investment and reduce poverty. Progress has been made, but more needs to be done.

Immediate implementation by high-income countries of full duty-free, quota-free (DFQF) market access for LDCs, including changes to rules that create additional obstacles, is an obvious response to these challenges. Improved market access would help to revive LDC exports at minimal budget cost in preference-giving countries. It would also help to mitigate any discrimination arising from regional trade arrangements that exclude LDCs, and in an uncertain atmosphere for trade policy, it would send a positive signal that progress is still possible. While this is the core of the working group's recommendations, further improvements in the programs announced by the large, advanced developing countries, as well as expansion to other developing countries "in a position to do so," would add powerfully to the impact of this initiative.

In assessing the political feasibility of this proposal, it is important to recognize the progress that has been made toward the goal of DFQF market access for LDCs, and the continuing momentum behind it. In the weeks after the working group sent a letter to the G-20 leaders attending the Pittsburgh summit that called for immediate implementation of DFQF access for LDCs, several countries made announcements supporting the general goal. Days after our letter was released in August 2009, the European Union proposed that the heads of state meeting in Pittsburgh should agree to emulate the EU's Everything But Arms (EBA) program, which provides DFQF access for LDCs. In subsequent months, both Brazil and China announced that they would implement or expand duty-free market access for at least some LDCs on most products in 2010. India is in the process of phasing in improved access for all LDCs on more than 90 percent of products, while Turkey provides duty-free access for most industrial products.

Providing LDCs with duty-free, quota-free access to high-income markets is the best way forward. Concerns about the risks of such access are exaggerated.

Despite the progress, none of the existing programs is perfect; all have room for improvement. Outside of Europe, rich-country programs exclude products that could be important for LDCs; the advanced developing-country programs have broader product restrictions and some exclude certain LDCs. The EU's call for other countries to emulate its EBA program is laudable on product coverage—everything but arms—but, if taken literally, it would be a backward step for Canadian and U.S. programs that have far more development-friendly rules for determining product eligibility.

For the high-income countries, the working group concluded that the MDG review summit at the United Nations in September should be the target for delivering on the promise of full DFQF market access for all LDCs. Other MDGs will be difficult for many countries to meet, particularly with the setbacks imposed by the economic crisis, but DFQF market access is easily achievable well before the 2015 target. The expansion of the Canadian-hosted summit in June from the G-8 to the G-20 provides an opportunity to mutually agree on this plan, and for the advanced developing countries to add to the power of the initiative by announcing improvements in their own programs as well.

In coming to these conclusions, the working group also examined the key objections to implementing these recommendations. One source of concern is the potential impact on producers and workers in preference-giving countries, especially in agricultural sectors subject to quantitative import restrictions that are used to prop up domestic prices. But the LDCs account for 1 percent or less of total imports in the major preference-giving countries, and often far less in imports of sensitive products. A second source of concern comes from developing countries that fear the value of existing preferences could

be eroded by expanding preferences for LDCs. Research discussed in the next section suggests that both concerns are exaggerated.

Finally, the working group strongly supports completion of the Doha Round as soon as possible as the best overall trade initiative for promoting economic opportunity and prosperity in developed and developing countries alike. Among other things, a multilateral agreement is the only feasible way to discipline the agricultural subsidies in rich countries that suppress prices for poor producers in developing countries. A Doha Round agreement would also lower subsidies that lead to overfishing in developing-country waters and contribute to the devastation of a key protein source in those countries. And, of interest to developed and developing countries alike, the proposed agreement to facilitate trade would address inefficient customs rules and other administrative obstacles that raise trade costs.

The working group supports completion of the Doha Round and finds that DFQF commitments would support—not undermine—trade negotiations.

Thus, in pushing for early implementation of DFQF commitments, the working group rejects arguments that this initiative would undermine the Doha Round of multilateral trade negotiations. To the contrary, we believe that the more compelling arguments support moving sooner rather than later:

- The 2000 Millennium Declaration calling for DFQF access for LDCs preceded the launch of the Doha Round.
- Preference programs are unilateral, and there has been no indication that the rich countries plan to bind them as part of Doha, so they are not part of the single undertaking.
- The LDCs are not being asked to undertake binding commitments in the round, so DFQF is not a bargaining chip.
- The value of trade preferences erodes every day as a result of unilateral and regional liberalization, and linking DFQF treatment to implementation of the Doha Round reduces the value of this commitment even more.

In sum, the working group believes that the recommendations for making trade preferences work for the poorest countries should be implemented by the high-income countries this year. In addition, advanced developing countries with programs could enhance the benefits substantially by phasing in the same principles for effective preference programs by 2015.

II. Recommendations to Make Trade Preferences Work for the Poorest

Existing trade preferences exclude the products that matter most to LDCs. High-income countries should expand coverage to all products.

Making trade preferences work for LDCs remains important, despite low average tariffs in rich countries, because the highest remaining tariffs are in sectors where poorer countries have a comparative advantage—agriculture, textiles and apparel, and other labor-intensive manufacturing products. Even the preference programs with full product coverage, such as the EU's Everything But Arms, have complex and opaque rules of origin that render nominal access meaningless in practice for many of these same products. Other program elements, such as the length and eligibility conditions, can create uncertainty that undermine benefits. Moreover, the benefits from high-income countries making these changes could be multiplied if the advanced developing countries also gradually implement these changes in their own programs for LDCs. Outside the programs themselves, complex and costly regulatory requirements in preference-giving countries, as well as supply-side challenges, including inadequate infrastructure, weak institutions, and bad policies in preference beneficiaries, prevent LDC exporters from taking advantage of market access opportunities.

Our analysis of the strengths and weaknesses in existing programs around the world leads us to offer five recommendations for making trade preferences more effective for the poorest countries. In order to maximize the impact, we call on the high-income countries to implement the first three, core, recommendations immediately. Advanced developing countries with programs, along with other developing countries "in a position to do so," should aim for implementation of the same principles by the 2015 target for achieving the MDGs.

1. Expand coverage to all exports from all LDCs. *High-income countries that have not already done so should agree at the G-20 summit in Canada in mid-2010 that they will provide duty-free, quota-free market access on all products (excluding arms) for all LDCs by the time of the MDG summit in September 2010.*

Since 2000, there has been significant progress toward the goal of DFQF market access for LDCs. Between 2000 and 2005, when the WTO ministerial in Hong Kong affirmed the goal, Australia, New Zealand, and Norway announced that they were opening their markets to 100 percent of products from LDCs

without delay. The EU implemented the Everything But Arms (EBA) program in 2001 and, after the restrictions on sugar and rice were phased out last year, it now provides full market access for LDCs (except for weapons). After the Hong Kong ministerial, Switzerland implemented an EBA-like program that, as of this year, also provides 100 percent market access for LDCs. Norway and Switzerland also went beyond these initiatives by opening their programs to other small and low-income, or heavily indebted, countries. The key weakness in the European programs for LDCs is a rules-of-origin regime that continues to inhibit exports, as discussed below.

Other high-income countries also improved market access for LDCs in the 2000s, but none achieved full product coverage, usually because of exclusions for sensitive agricultural products. Canada's preference program reform, enacted in 2003, extended product coverage for LDCs to 99 percent of products, excluding only quota-controlled products (dairy, poultry, and eggs). Japan reached roughly 98 percent product coverage, with exclusions for fish, footwear, sugar, and rice, while South Korea expanded its duty-free access for LDCs in 2008, but to only 75 percent of products.[2]

The U.S. story is more complicated. In addition to the Generalized System of Preferences (GSP), which has an expanded list of eligible products for LDCs, the United States also has regional preference programs that offer greater access for some developing countries. In 2001, the same year as the EBA, the United States implemented the African Growth and Opportunity Act (AGOA), which expanded duty-free, but not quota-free, access for African LDCs (and other "lesser developed beneficiary countries") to roughly 98 percent of products. Agricultural products, particularly sugar, peanuts, dairy, and tobacco, are the major exclusions. In 2006, Congress approved the HOPE Act, which expanded preferences under the Caribbean Basin Initiative for Haiti and, after further improvements, provides duty-free access for about 90 percent of products. Both programs go well beyond the 83 percent of products that is available to other LDCs under the regular GSP program for LDCs.

Even under the United States' African Growth and Opportunity Act, remaining exclusions keep potential African agricultural exporters from fully benefiting.

Thus, even under AGOA, the most generous program, the remaining exclusions keep potential African agricultural exporters from benefiting, but the largest impact falls on a handful of Asian LDCs that are effectively excluded from preferences because apparel is not on the list. As a result of the exclusions, the United States collected nearly US$1 billion in import taxes on Bangladeshi and

2. South Korea is a high-income member of the Organisation for Economic Co-operation and Development and is included with rich or developed countries here, even though it continues to claim developing-country status in the World Trade Organization.

Exclusions hit Asian countries especially hard: the U.S. collects more import taxes from Bangladesh and Cambodia than from the UK and France.

Cambodian exports in 2008, more than the total amount collected on imports from the United Kingdom and France. Nepal's exports to the United States of apparel dropped by two-thirds from 2005, when the Multi-Fiber Arrangement controlling trade in textiles and apparel expired, to 2008.

Responding to the various political pressures on countries, trade ministers in Hong Kong in 2005 could only agree that countries should provide DFQF market access for 97 percent of products and strive to reach full coverage at some undefined date in the future. Unfortunately, because both rich-country tariff peaks and LDC exports tend to be relatively concentrated in similar sectors, even a small number of product exclusions can rob the initiative of any meaning.[3]

To underscore the importance of full DFQF market access, the left-hand side of annex table 1 compares the estimated change in exports for 97 percent and 100 percent product coverage in OECD countries. It confirms previous research showing essentially no gain for LDCs from 97 percent coverage, and significant gains for several countries from full coverage. While the magnitude of the gains shown in the two left-hand columns may seem small, they are large relative to similarly estimated gains from either the Doha Round or even from moving to global free trade.[4] Moreover, the general equilibrium approach tends to produce conservative estimates of the gains from trade, so table 1 also shows estimates using a less conservative approach to give an idea of the range of potential gains. Those estimates, for WTO-member LDCs only, suggest that the overall export gain could be as high as US$2 billion. The much larger potential gains if Brazil, India, and China also provide full market access for LDCs are discussed below.

Except for Malawi, which faces a particularly high tariff on its tobacco exports to the U.S. market, there are relatively smaller gains for African LDCs, but that is not surprising since they generally have good access in their major markets. Moreover, the gains for Africa, and others, are likely to be understated because they do not incorporate the potential impact of loosening rules of origin in the EU and other markets where LDCs supposedly have free market access (see next section). The only negative effect among LDCs is for Madagascar, where it is extremely small (-0.03 percent of exports). Moreover, there is no evidence in this analysis to suggest that Africa will lose out overall if the United States extends DFQF market access to other LDCs, as long as it is part of global

3. See Bouet et al. 2010 for the most recent research on this question, as well as references to earlier analyses done in the context of a Doha Round Agreement that come to similar results.

4. See the survey and references cited in Elliott 2006, chapter 1.

reforms like those recommended here. Expanding U.S. preferences to the Asian LDCs would, however, have substantial positive effects on their exports. Nevertheless, the estimates show an impact on other developing countries not receiving DFQF market access that is basically zero.[5]

The impact of 100 percent DFQF on preference-giving countries, which generally have far larger economies than LDCs, is also basically nil, even in sensitive sectors. This, again, should not be surprising, because LDCs account for less than 1 percent of non-oil imports in rich countries. In Canada, for example, the total value of imports of products excluded from preferences coming from LDCs was under US$10,000 annually in 2005-08. In Japan, imports of its excluded products from LDCs were valued at US$5 million in 2007, but that was still a trivial share of total Japanese imports of those products. In fact, if the LDCs diverted *everything* they export to the world in the product categories excluded by Canada to that country, their share of total Canadian imports of those products would rise to only around 7 percent (assuming they complied with food safety regulations). By coincidence, the same is true of LDC exports of products excluded by Japan. Annex table 2 shows the estimated fall in production in sensitive sectors in selected rich countries, and they rarely rise to even 0.50 percent. In the United States, for example, textile production is estimated to fall by 0.45 percent and apparel production by less.

Extending DFQF access would have no substantial negative effects on competitors or on the countries giving the preferences. There is no economic reason to block reform.

Thus, in spite of the improvements, LDCs could still gain significantly from the achievement of full duty-free, quota-free market access in high-income countries. And the minimal impact on competing producers in preference-giving countries suggests there is no economic reason to stop them moving immediately.

2. Change program rules that raise costs and impede market access for LDCs, especially rules of origin restricting input sourcing. *Unilaterally and immediately allowing LDC beneficiaries to "cumulate" inputs from all developing countries and FTA partners under existing rules of origin would provide much of the flexibility needed to ensure effective utilization. "Cumulation" means that beneficiaries could count imported inputs from eligible countries as local content, as long as a substantial transformation still occurs in the beneficiary country. Rationalization and harmonization of rules of origin are also needed, but that is likely to take time, while cumulation could be done more quickly and easily.*

5. Details are available in Bouet et al. 2010.

Strict and complicated rules of origin often nullify the intent of existing preference programs; they need to be changed.

Duty-free, quota-free market access is a necessary but not sufficient condition to create trade opportunities for LDCs. Most notably, the EU's Everything But Arms program is a model program with respect to product coverage, but it failed to deliver on its potential because of rules of origin that still block access for key products. The EBA rule for apparel, for example, restricts imports of woven garments by requiring that the fabric be manufactured locally and then cut and assembled in the beneficiary country to be eligible for access. But textile production is more capital-intensive and requires more skills than the cutting and sewing of apparel, and this rule is impossible to meet in smaller, poorer countries. By contrast, the U.S. rule for "lesser developed" beneficiaries under AGOA allows them to source fabric and other inputs globally and still claim AGOA benefits, as long as the apparel is cut and sewn in the beneficiary country.

Preferential arrangements need rules of origin to prevent goods produced in nonbeneficiary countries from being trans-shipped through beneficiary countries in order to qualify for preferential market access. Eligibility for preferential treatment usually requires that imported inputs must be "substantially transformed" in the beneficiary country, and the rules of origin define what that means. In addition to avoiding transshipment, some argue that origin rules should be used as a form of industrial policy to promote backward linkages, for example encouraging local textile production as inputs for clothing exports. But manipulating rules risks eliminating the benefits of preferences if the rule is too restrictive and raises costs by enough to either prevent exports or render them ineligible for preferential access. More flexible rules may reduce the benefits from preferences, if upstream industries can be developed under a tighter rule, but they do not eliminate them. Moreover, research by Paul Brenton (2003, p. 18) suggests that elimination of benefits is more common and concludes that "there is no evidence that strict rules of origin over the past 20 years have done anything to stimulate the development of integrated production structures in developing countries."

Most countries have different rules for unilateral and reciprocal preferential trade arrangements, and, often, different rules for each program or regional trade agreement, as well as different rules for different products, all resulting in the much debated "spaghetti bowl" of preferential trade arrangements.[6] If done right, simplification and harmonization of rules of origin across preference programs could significantly lower transactions costs and encourage trade. But the best path forward is not entirely clear because of the heteroge-

6. There are three principal types of rules: value-added, set as either a minimum value of local content or a maximum value of imported content; a specific technical process, such as the EU rule for apparel; or a change in tariff heading.

neity of developing countries and the fragmentation of global supply chains, as well as the complexity of existing rules.

For example, setting a single, low figure for locally added value strikes many as an obvious approach, but choosing a threshold that will work for most potential exporters is not so obvious since they vary widely in terms of the conditions they face. The impact of value-added rules can also vary over time, and changes in exchange rates or commodity prices can unexpectedly render an export ineligible for preferential treatment by changing the relative value of various inputs.[7] An alternative to harmonization would be to agree to mutual recognition of origin regimes across developed-country programs, meaning that preference-giving countries would agree that an import eligible in one market would be accepted as eligible in any other. But this approach has not proved politically viable in other regulatory contexts and would also require levels of administrative cooperation and trust across customs agencies that might be difficult to achieve.

Allowing "extended cumulation" would address many of the problems associated with existing rules of origin and could be adopted unilaterally.[8] Cumulation allows inputs to be sourced from a designated set of countries without losing eligibility for the final product, as long as the inputs still undergo some substantial transformation, such as cutting and sewing apparel, in the beneficiary. The key to the recommendation is the definition of "extended" and the working group believes it should apply to any country's goods that would be eligible for duty-free treatment if shipped directly to the preference-giving country. That would allow cumulation from countries that are eligible for unilateral preference programs such as GSP or that are parties to a free trade agreement. Haiti, for example, has continued to have problems fully using preferences in the Canadian market because its apparel exports often contain U.S. fabric or other inputs (because of U.S. rules under its preference programs). Even though the U.S. fabric would be granted duty-free treatment if exported directly to Canada under the North American Free Trade Agreement, it is not eligible for cumulation under Canada's rule for LDC preferences.[9]

Allowing "extended cumulation" would address many of the problems associated with existing rules of origin and could be adopted unilaterally.

7. In addition, extensive documentation of costs is needed, and inadequate paperwork can result in duties being imposed, sometimes years later, creating another source of uncertainty for buyers. For all these reasons, many experts recommend using a change in tariff heading approach, with the headings defined at a relatively disaggregated level to promote flexibility. See Estevadeordal and Suominen 2008, Staples and Harris 2009, Overseas Development Institute 2006.

8. Harris (2008) discusses the pros and cons of extended cumulation in detail.

9. See the letter to the editor of the Ottawa Citizen by working group member Ann Weston, September 12, 2009, at http://www.ottawacitizen.com/business/Canada+should+stop+taxing+jobs+Haiti/2011208/story.html (accessed January 14, 2010).

The most compelling evidence of the importance of reforming rules of origin comes from the 2003 changes in Canada's trade preference program.[10] In addition to removing duties on almost all products in its tariff schedule, Canada lowered the threshold for locally added value in LDCs and also allowed LDCs to cumulate inputs from all developing-country beneficiaries, not just other LDCs. The result was more countries benefiting from preferential access, increased imports to Canada from existing beneficiaries, and an expanded range of imports into Canada from beneficiaries. Over a few years, the LDC share of non-oil Canadian imports nearly tripled. Less dramatically, the market share of beneficiaries under the U.S. AGOA program, which has relatively flexible rules, increased by roughly a third. By contrast, the market share for LDCs not already eligible for the EU's African, Caribbean, and Pacific program stayed flat after introduction of the EBA program with its more restrictive rules.

Extended cumulation thus has the advantage of providing extensive flexibility for preference-receiving countries, and it could be implemented immediately and unilaterally by preference-giving countries. Policymakers could also increase flexibility, and thereby utilization, by allowing firms to choose among two or more equivalent rules—for example, either 35 percent locally added value, or a change in tariff heading. Harmonization and rationalization of rules should also be pursued—for all preferential arrangements. But that requires negotiation, and similar negotiations to harmonize nonpreferential rules of origin have been dragging on at the WTO for years.

Preference agreements should be permanent or long-lasting to reduce the risk to investors. Temporary or uncertain programs breed instability.

3. Ensure program stability and predictability to encourage investment in potential export sectors, particularly by making them permanent or long-lasting. *Any eligibility conditions should also be transparent and narrowly focused so as not to increase risk and uncertainty.*

Stability and predictability of access are key features of effective programs because they encourage international buyers to establish supply relationships in preference countries and firms to invest in potential export sectors. A critical goal of reform should thus be to redesign program elements that may not directly block access, as rules of origin can, but that increase risk and uncertainty. Two sources of increased risk for investors and buyers arise when programs must be renewed frequently, and when eligibility conditions are numerous, nontransparent, or arbitrary in application.

10. Australia has a similar rule for LDCs, but DFQF access there had little impact, perhaps because Australia is such a small market and relatively distant from other major markets.

Both of these elements are, unfortunately, problems in U.S. programs. Since 1993, the U.S. GSP program has been renewed eight times, usually for just one to two years, and sometimes not before the program expired. In one particularly serious case, the program was allowed to lapse for more than a year. The stability of Korea's program is also uncertain because it was created by an executive decree that can be changed or revoked at any time.

By contrast, in recognition of the special problems inhibiting trade and investment in Africa, the U.S. Congress initially authorized the AGOA program for eight years and then extended it in 2004 until 2015. The EU's Everything But Arms program has no expiration date, while Canada and Japan routinely extend their preference programs for LDCs for 10-year periods. It would be helpful in promoting development goals if all preference programs, but especially those for LDCs, had strong legal foundations that authorize them permanently or for long periods to maximize effectiveness in promoting investment, trade, and job creation. U.S. legislation recently introduced to phase in DFQF market access for LDCs recognizes the importance of stability for effective preference programs, and it authorizes that part of the program for a decade, then renews it automatically every five years for countries that are still LDCs.[11]

To avoid undermining preferences, eligibility conditions should be limited and as objective as possible.

Other arbitrary and nontransparent eligibility conditions can also discourage investment and inhibit exports. Most programs in high-income countries have graduation rules for both countries as their incomes rise and products as exports become more competitive. In terms of other conditions for eligibility, only the United States goes beyond egregious violations of human rights (several countries exclude Myanmar from trade preference programs, for example) to include conditions relating to protection of intellectual property, corruption, and a range of other issues, depending on the program. The application of both types of conditions is often arbitrary and unpredictable. In order to avoid undermining the value of preferences, eligibility conditions should be limited and as objective as possible. Graduation conditions should be phased in gradually and should ensure that higher incomes or product competitiveness are not transitory before preferences are revoked. Political conditions should be based on international definitions of standards where they exist and applied sparingly.

4. Pursue high-impact preference programs in advanced developing countries. *Since they are essential to preference programs that convey meaningful benefits, advanced developing countries with programs should phase in the core*

11. H.R.4101, New Partnership for Trade Development Act of 2009, Introduced in House of Representatives on November 19, 2009, by Rep. Jim McDermott (D-WA).

Advanced developing countries are playing a larger role in global trade, and they too should implement DFQF market access for LDCs.

recommendations by 2015, the target for achieving the Millennium Development Goals. An announcement at the G-20 summit in June in Canada providing timelines showing which products would be incorporated, and when, would help to encourage investment in LDCs in potential export sectors.

Trade among developing countries nearly doubled from 12 percent of total world exports in the early 1990s to 22 percent in 2007. Moreover, with the G-20 replacing the G-7/8 as the "steering committee" for the global economy, advanced developing countries are taking on more responsibility in maintaining a strong, stable international trade system. Turkey implemented a limited version of the EBA, excluding most agricultural products, as part of its customs union with the EU. China and India announced programs after the WTO ministerial meeting in Hong Kong that called for developing countries "in a position to do so" also to implement DFQF market access for LDCs (albeit with greater flexibility that developed countries). In December 2009, Brazilian Foreign Minister Celso Amorim announced that Brazil would expand preferential market access for LDCs beginning this year.

While the responsibility to move farthest and fastest rests with the high-income countries, the steps by these countries, taken voluntarily, have the potential to make the DFQF initiative far more powerful. To realize the enhanced opportunities, however, the principles that apply to high-income countries—full product coverage, flexible rules of origin, and stability and predictability—are also important for these programs.

The right-hand side of annex table 1 compares the estimated gains from 97 percent and 100 percent DFQF market access when Brazil, China, and India join the OECD in this initiative. Just as with the scenarios involving the OECD countries alone, limiting coverage to 97 percent of products conveys virtually no benefits to LDCs. Yet the developing-country programs announced so far generally have exclusions on far more than 3 percent of products. Turkey's program excludes most agricultural items, which are particularly important for African LDCs. China initially covered only a small number of tariff lines in its program but recently announced that it would expand duty-free product coverage for African LDCs to 95 percent.[12] India is phasing in duty-free access for 85 percent of products and reduced, but not zero, tariffs for another 9 percent. Though the details are still unclear, Ambassador Amorim said that Brazil's program would begin with coverage for 80 percent of products and

12. Ministry of Commerce of the People's Republic of China, posted November 10, 2009. http://english.mofcom.gov.cn/aarticle/counselorsreport/europereport/200911/20091106608766.html.

phase in full coverage over four years, which could be a model for the program improvements recommended here.

Moving to 100 percent coverage, moreover, substantially improves the outcomes relative to 100 percent market access by OECD countries alone, especially for African LDCs. The estimates in table 1 suggest the range of potential benefits, with export gains increasing by as much as two-thirds for Ethiopia, three-fold for Mozambique, and even more than that for Senegal. Overall, for LDCs as a group, the gains could be as much as US$7 billion, compared to US$2 billion when only OECD countries participate. When the large emerging markets also participate, the small loss for Madagascar becomes positive and the less conservative approach suggests that exports could increase 21 percent.

As with the rich countries, the impact on welfare and overall exports in the preference-giving countries is again basically nil, though the results suggest that India would actually increase its exports. As with the rich countries, the sectoral impacts on production rarely rise to as much as 0.50 percent.[13]

Preference-giving countries should create mechanisms for dialogue and cooperation with LDC beneficiaries to address other obstacles that inhibit trade.

5. Create mechanisms for dialogue and cooperation to enhance preference utilization. *Preference-giving countries should work with LDCs to address market access obstacles arising outside preference programs themselves, such as costly regulatory requirements in preference-giving countries, or supply-side challenges in poor countries that inhibit exporters taking advantage of market access.*

Market access is important, but more than the removal of border barriers and administrative obstacles is needed to ensure that poor countries are able to take advantage of the opportunities offered by trade preference programs. The poorest countries, many of them small, landlocked, and often dependent on agriculture, face an array of other barriers that preference programs cannot directly address. Thus, to make these programs as effective as possible, preference-giving countries should create mechanisms for dialogue and cooperation with LDC beneficiaries to address these other obstacles. It is also important that the dialogue cover two categories of potential obstacles where complementary policies may be needed:

- Regulatory and other policies in preference-giving countries that may, intentionally or not, inhibit trade more than is necessary to serve public purposes

13. The detailed results can be found in Bouet et al. 2010.

- Supply-side challenges in beneficiary countries, ranging from physical infrastructure to policies that raise costs and discourage investment and exports

Extending full DFQF access to LDCs this year would give a boost to the poorest countries, and it would lead to what is in every country's interest: more prosperous and stable countries that are no longer "least developed."

In the first category, regulations to protect human, plant, and animal safety stand out as in need of special attention because well over half of the 49 UN-designated LDCs are in sub-Saharan Africa, where agriculture is the principal source of livelihood for the majority of people. Public policies to ensure the safety of the food supply and to protect plants and animals from pests and diseases are essential, and ensuring their effectiveness in a more global economy is both more important and more difficult. Such standards inevitably affect trade—sometimes intentionally, to provide back-door protection for domestic industries, but more often unintentionally. Standards and associated implementation procedures are typically developed without regard to potential trade effects, which can render them both more costly and less effective than they might otherwise be. In the case of poorer countries, many of them lack the capacity to comply or, in many cases, the capacity to cost-effectively demonstrate compliance.

A dialogue between preference-giving and preference-receiving countries aimed at identifying obstacles LDC exporters face in utilizing preferences could reveal changes that achieve the same level of safety or product quality at lower cost for both countries. Improvements in the transparency of regulations and the policy-making process and increased coordination among countries in implementing regulations would provide benefits to all exporters, but particularly those in LDCs that have the least capacity to certify their compliance. Targeted capacity-building assistance for LDCs should also be better coordinated with preference programs.

More broadly, LDCs face a variety of home-grown obstacles to trade. Dialogue between preference-giving countries and LDC beneficiaries should also aim at identifying the most important bottlenecks preventing preference utilization and potential solutions for addressing them. The annex to this report discusses a few ideas for addressing obstacles to preference utilization that arise outside the programs themselves.

III. Moving Forward

In September 2009, ahead of the G-20 Summit in Pittsburgh, the EU released a position paper recommending policy actions that the G-20 Leaders should address to promote continued global economic recovery. One of those recommendations was that the G-20 Leaders "should adopt the 'Everything But Arms' (EBA) initiative *without delay* to support people in developing countries suffering from the crisis" (emphasis added). This was followed by announcements by China that it would expand its LDC trade preferences for Africa and by Brazil that it would drop its insistence on waiting for the conclusion of the Doha Round and would introduce trade preferences for LDCs this year.

These events underscore the considerable momentum behind the Millennium Development Goal of using trade to promote sustainable development in the poorest countries. They also reinforce the working group position that there are no legitimate obstacles to high-income countries immediately and unilaterally implementing duty-free, quota-free market access for the poorest countries of the world. The policies being adopted by advanced developing countries are also critically important in significantly amplifying the potential benefits of the initiative. And to reiterate the principles for making trade preferences work for development, programs must offer *full product coverage*, they should be *stable and predictable*, and they should have *rules that promote trade* rather than inhibit it.

The economic recovery in much of the world remains fragile, and this initiative could provide reinforcement for it. Extending DFQF market access to LDCs this year would have trivial effects on high-income economies, but it could give an important boost to the poorest countries. And over the longer run, more prosperous and stable countries that are no longer "least developed" would be in everyone's interest. The working group members call on the leaders of the G-20 countries to take advantage of the opportunities this year—at the summits in Toronto in June and at the United Nations in September—to realize the MDG of using trade more effectively as a development tool.

Annex A: Tables

Table 1. Change in Exports from Expanded DFQF Market Access in OECD Markets (percent)

	DFQF Provided in OECD Markets Only			*DFQF Provided in OECD plus Brazil, China, India*		
	General Equilibrium Results		*Partial Equilibium**	*General Equilibrium Results*		*Partial Equilibium**
Country/Region	*97% product coverage*	*100% product coverage*	*Gains from moving from 97% product coverage to 100%*	*97% product coverage*	*100% product coverage*	*Gains from moving from 97% product coverage to 100%*
Bangladesh	0.06	4.16	28.96	0.15	4.82	38.55
Cambodia*	0.05	2.52	31.27	0.06	2.55	32.96
Ethiopia**	0.02	1.35	n.a.	0.22	2.24	n.a.
Madagascar	0.01	–0.03	–0.74	0.07	0.57	20.61
Malawi	0.01	12.97	215.08	0.02	13.91	240.41
Mozambique	0.00	0.39	16.29	0.01	1.41	128.11
Senegal	0.00	1.16	8.46	0.27	9.38	64.83
All WTO LDCs** (percent)			16.97			44.36
All WTO LDCs** (million dollars)			2,108			7,731

* In the general equilibrium analysis, the results are for a regional aggregate including Laos and Brunei, as well as Cambodia dominates.
** Only WTO members included in partial equilibrium analysis.
Sources: Bouet et al. 2010, Laborde 2008.

Table 2. Impact on Preference-Giving Countries of Moving to Full DFQF Product Coverage for LDCs

	*Percent change in production of selected goods**
Canada	
Animal products, meat	−0.01
Milk	−0.03
Japan	
Fish	−0.01
Rice	0.00
Sugar	−0.35
United States	
Sugar	0.01
Textiles	−0.45
Wearing apparel	−0.13

*Product categories overlap but do not exactly coincide with products excluded from current preference programs for LDCs.
Source: Bouet et al. 2010.

Annex B: Complementary Policies and Supply-Side Challenges[14]

The focus of the working group was how to improve trade preference programs for the least developed countries, but the group also recognized that many other policies and structural weaknesses are at least as important for promoting exports from these countries. Detailed recommendations to address these other obstacles are outside the scope of this report, but it is possible to identify key principles that should guide dialogue and cooperation activities, including transparency, information sharing, and improved coordination. And, as noted above, it is important that policymakers pay attention to potential obstacles arising in preference-giving countries, as well as the numerous challenges in LDCs.

In preference-giving countries, a variety of product standards and regulatory requirements pose potential barriers to trade, particularly for poorer countries with limited institutional capacity to regulate and certify compliance themselves. With the majority of LDCs being in sub-Saharan Africa, where the majority of the poor are dependent on agriculture, there is an argument for paying special attention to regulatory requirements for food, animal, and plant safety that pose a particular problem for agricultural exports. Harmonization of sanitary and phytosanitary (SPS) standards globally would lower transactions costs for all involved, but this approach faces both substantive and political challenges. And "special and differential treatment" for poorer countries would not be helpful if it means lowering standards or waiving compliance procedures for them, because that would undermine consumer confidence and harm rather than help exports.

Simplification and coordination of the procedures for certifying compliance with SPS standards would be less politically sensitive than changing the standards themselves and could still significantly lower the costs associated with compliance. The WTO currently provides a degree of transparency and mutual scrutiny of SPS standards, but strengthening these rules would serve several functions—to highlight standards that may be unnecessarily restrictive; to provide information to exporters on what they need to do to comply; and to highlight how the process of setting and enforcing standards might be

14. For further information on the issues raised in this annex, see Arda 2009; Ramachandran 2009; Sekkel 2009; Josling, Orden, and Roberts 2004; Horton and Wright 2008; Zahrnt 2009; and Organisation for Economic Co-operation and Development and World Trade Organization 2009. The working group is also grateful to participants at a dinner held in Geneva on September 30, 2009, to discuss how SPS issues might be addressed, in particular with respect to the problems faced by LDCs.

improved. The EU's official website also provides a model for others with its "export help desk for developing countries," which includes links to information on import requirements and documents.[15] Increased transparency and coordination would help to lower the costs of complying with standards for all countries, but the lack of expertise and other capacity shortfalls would still be a significant constraint to exporting in many LDCs. Targeted capacity-building assistance to help agriculture-dependent LDCs take advantage of duty-free, quota-free market access thus also has an important role to play.

Even with duty-free, quota-free access and attention to other nontariff barriers, exporters in countries without paved roads, or where red tape and inefficient customs hold up trade for days or weeks, will find it difficult to take advantage of preference programs. Building adequate physical infrastructure in countries without it will take years and billions of dollars, but in many cases trade costs can be significantly lowered with far more modest investments in trade facilitation activities. The World Bank reports, for example, that while the strongest reformer on trade facilitation in recent years has been sub-Saharan Africa, that region still lags on most indicators, with the estimated cost to export being twice as high as in East Asia and nearly 50 percent larger than the cost in South Asia.[16] Some of the difference is explained by the large number of landlocked countries in Africa, but by no means all of it.

In addressing these needs, the current budget and economic environment makes the principles embraced in the March 2005 Paris Declaration on Aid Effectiveness more important than ever. The Enhanced Integrated Framework (EIF) is one mechanism for implementing these principles in the aid-for-trade area, particularly country ownership and donor coordination, and it is relevant here because it is reserved for LDCs. The EIF's focus is on helping LDCs identify trade priorities and integrate them in their overall development strategies, and it is a natural forum for the dialogue between preference-giving and -receiving countries recommended here. The EIF could be used, in turn, to help LDCs access and coordinate assistance from the new Trade Facilitation Facility and the Standards and Trade Development Facility, which is specifically aimed at helping developing countries deal with SPS standards.

15. http://ec.europa.eu/trade/creating-opportunities/trade-topics/market-access/export-helpdesk/index_en.htm.

16. http://www.doingbusiness.org/ExploreTopics/TradingAcrossBorders/.

Effective use of trade preferences also requires private sector investment, both domestic and foreign, in export sectors. A creative proposal from earlier Center for Global Development work on private sector development in Africa calls on the World Bank's Multilateral Investment Guarantee Agency (MIGA) to support reforming governments in providing "service guarantees." The idea behind the proposal is to encourage investment in poor countries with weak capacity by addressing some of the upfront risks faced by private investors in those environments, including erratic energy supplies, poor security, and regulatory red tape. Under the proposal the government, backed by MIGA up to a ceiling, would guarantee certain levels of service in designated areas and firms would be entitled to compensation in the case of service shortfalls. While the original proposal covers a broad array of government "services," it could also be applied more narrowly to trade facilitation initiatives, such as faster implementation of customs regulations or reduced port clearance times.[17] This is an example of the sort of risk management tools that have become generally more important in the wake of the economic crisis.

Complementary policies should thus be based on the following principles, with selected examples of how they might be implemented to enhance preference utilization by LDCs:

- **Transparency:**
  - Expand the SPS section of the WTO's Trade Policy Reviews and encourage other major markets to emulate the EU's export help desk website. A thorough analysis of selected regulations that affect a large amount of trade, along with review of certain features of the policy-making process that produced them, could help to identify regulations that are unnecessarily trade-restricting or procedures that are duplicative or overcomplicated. If countries were asked, as part of the WTO review, to specify which of their regulations are based on international standards and to explain the reasons for divergences, it could help to identify areas where convergence might be possible.
  - Increase support for broader dissemination of information about trade preference programs in poor countries—to both ministries beyond trade and to firms and business associations. Analysis suggests that one reason for low utilization of

17. Additional details on the proposal may be found in Ramachandran 2009.

trade preferences is lack of knowledge about the programs. Geneva-based representatives and trade ministers presumably know about these programs, but that information may not be widely available to potential exporters in their countries.

- **Coordination:** Major markets should use the dialogue with LDCs to identify particularly difficult areas where coordinated implementation and certification of SPS or other product standards (not harmonization of the standards themselves) could lower costs for poor countries. Relevant areas might include expanded use of third-party certification services, joint technical assistance and training, and leveraging of private sector activities in harmonization and capacity building.

- **Capacity Building:** Use the Enhanced Integrated Framework as a forum for dialogue with LDCs on how and with what priority to integrate trade into development strategies, and to increase the coordination of trade facilitation and capacity-building assistance.

Annex C: The UN-Designated Least Developed Countries

As of the end of 2009, countries marked with an asterisk were ineligible for some or all U.S. preferences programs for political reasons.

Afghanistan
Angola
Bangladesh
Benin
Bhutan
Burkina Faso
Burundi
Cambodia
Central African Republic*
Chad
Comoros
Congo (DROC)
Djibouti
East Timor
Equatorial Guinea*
Eritrea*
Ethiopia
The Gambia
Guinea*
Guinea-Bissau
Haiti
Kiribati
Lao PDR*
Lesotho
Liberia
Madagascar*
Malawi
Maldives
Mali
Mauritania
Mozambique
Myanmar*
Nepal
Niger*
Rwanda
Samoa
Sao Tome & Principe
Senegal
Sierra Leone
Solomon Islands
Somalia*
Sudan*
Tanzania
Togo
Tuvalu
Uganda
Vanuatu
Yemen
Zambia

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Report of the CGD Working Group on

Global Trade Preference Reform

Copyright © 2010 Center for Global Development
ISBN 978-1-933286-50-1

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