Center for Global Development

CGD Brief

April 2010

Making Trade Preferences Work for the Poorest Countries

Kimberly Ann Elliott*

Trade preference programs can reduce poverty and promote prosperity and stability in the world's poorest countries, but they often fall short of their intended goals. They regularly exclude commodities that poor countries can produce competitively, such as agricultural products and clothing, and many programs must be frequently renewed, creating uncertainty and discouraging investment. Extending comprehensive, usable, and predictable quota-free market access to all least developed countries could provide a critical boost to the world's poorest people with only trivial effects on preference-giving countries. G-20 leaders should embrace trade preference reform this year to promote growth and stability in the world's poorest countries.

Why Preference Programs Matter to Poor Countries . . . Especially Now!

Expanding trade opportunities for the world's least developed countries encourages investment, creates jobs, and ultimately reduces poverty. The UN Millennium Declaration in 2000 called on rich countries to provide duty-free, quota-free market access for least developed countries' exports, a commitment that was reaffirmed at the 2005 World Trade Organization Ministerial in Hong Kong. The Hong Kong communiqué also encouraged "developing countries in a position to do so" to implement or expand duty-free access for the poorest countries.

While there has been progress, preference programs for least developed countries still need improvement (Table 1). Many programs exclude exports that matter most to least developed countries, such as agricultural goods and clothing; others have overly strict rules of origin or require frequent renewal, which undermines investor confidence.

Today's economic and political environment heightens the urgency of improving preference programs. The global financial crises of 2008–09 hammered poor countries by decreasing trade flows and commodity prices. While bilateral and regional trade negotiations may accelerate in the absence of a Doha Round agreement, they rarely include the least developed countries. Furthermore, high unemployment in rich countries may lead to protectionist trade measures, and tight budgets may reduce their willingness to provide development aid. These factors increase the risk that the poorest countries will be further marginalized in the global economy.

---

*This brief is based on the final report of the Global Trade Preference Reform Working Group. For more information, visit http://www.cgdev.org/section/initiatives/_active/reformingtradepreferences/global_trade_preference_reform. Kimberly Elliott is a senior fellow at the Center for Global Development and chair of the working group. She wishes to thank Kaci Farrell, policy and outreach assistant and John Osterman, publications coordinator, for their contributions to this policy brief. CGD is grateful for contributions from the William and Flora Hewlett Foundation in support of this work.

There are unique opportunities in 2010 to make progress on the promise to promote trade as a tool for development—the G-20 summit in June and the UN Millennium Development Goal review summit in September. Leaders at these events should embrace trade preference reform as a development measure to reduce poverty and promote growth and stability in the world's poorest countries, to the benefit of all concerned.

How Can Preference Programs Better Serve the Poorest Countries?

The Center for Global Development convened the Global Trade Preference Reform Working Group to analyze existing preference programs and identify areas for improvement. The group focused on five practical policy recommendations to make trade preferences work for the world's poorest people.The first four recommendations should be implemented by rich countries immediately; the fifth should be adopted by advanced developing countries over time to amplify the benefits of reform.

1. Expand coverage to all exports from all least developed countries

Rich-country trade policies restrict market access by taxing imports and limiting the allowed quantity of sensitive agricultural products. The highest tariffs are often concentrated in sectors in which poorer countries have a competitive advantage—agricultural and labor-intensive industries such as textiles, clothing, and footwear. For example, the average U.S. tariff on certain labor-intensive manufactured products is more than three times the average tariff on all other imports. Rich countries that have not already done so should immediately extend full duty-free, quota-free access to all least developed countries to remedy this key weakness.

Extending duty-free, quota-free market access for least developed countries is economically feasible and would promote shared benefits around the world. The effects on competing producers in rich nations would be minimal because the poorest countries account for less than 1 percent of their non-oil imports. Declines in rich-country production, even in sensitive sectors, are estimated to be well under 1 percent in almost all cases (Table 2).

2. Relax restrictive rules of origin

Even programs that allow open market access can prevent poor countries from taking full advantage of the trade opportunities. The rules governing where and how a product is made are often complex, opaque, and overly restrictive. These rules of origin often weaken preference programs because many small, poor countries cannot produce the wide variety of components and materials necessary for a final product to be eligible. Preference programs should allow beneficiary countries to source product inputs globally.

Rules of origin are complex and vary greatly across countries and programs. Harmonizing these rules would be helpful, but this process may prove substantively and politically difficult. The working group therefore recommends increasing flexibility in the application of the rules. This could be most readily done through a technique called extended cumulation, which allows exporters to incorporate inputs from a broad group of countries, as long as the inputs are domestically transformed into a substantially new product. Specifically, preference programs should permit least devel-

Table 1: Major Preference Programs Have Unique Strengths and Weaknesses; All Have Room for Improvement

Country (Program)	Product Coverage	Flexibility of Rules of Origin	Program Length
Canada	99.5%	High	10 years
European Union (EBA)	100%	Low	Permanent
U.S. (AGOA)	98%	High	11 years
U.S. (GSP for LDCs)	83%	Moderate	Usually 1–2 years
Japan	98%	Low	10 years
South Korea	85%	Low	Uncertain

EBA = Everything But Arms; AGOA = African Growth and Opportunity Act; GSP for LDCs = Generalized System of Preferences for the least developed countries.

oped countries to use materials from nations that are parties to other preferential arrangements, whether unilateral or reciprocal, such as regional trade agreements.

3. Make trade preference programs permanent and predictable

Preference programs must be predictable and stable to work effectively. Investors and buyers take on substantial risk when preference programs must be renewed frequently and when eligibility conditions are numerous, nontransparent, or arbitrary. Since 1993, for example, the U.S. Generalized System of Preferences (GSP) program has been renewed or modified eight times, typically for one to two years, and sometimes only after the program expired. Korea's program was created by an executive decree that can be changed or revoked at any time. To avoid undermining the value of preferential access, programs for the least developed countries should be authorized either permanently or for long periods of time. Eligibility conditions should be clear and transparent.

4. Promote cooperation between countries giving and receiving preferences

Preference-giving countries should work closely with beneficiaries to identify and address obstacles to fully utilizing preference programs. Such barriers may include costly regulatory requirements in rich countries or supply-side challenges in poor countries, including inadequate infrastructure and weak institutions that inhibit exporters from taking advantage of market opportunities. Countries on both sides should create a mechanism for cooperation and dialogue aimed at making the most of preference programs. Also, preference-giving countries should better coordinate and target capacity-building assistance for the poorest countries.

5. Encourage advanced developing countries to implement trade preference programs that adopt the principles above

Preference programs are not just rich-country tools. Trade among developing countries nearly doubled from 12 percent of total world exports in the early 1990s to 22 percent in 2007. Four major developing countries—Brazil, China, India, and Turkey—recently announced or adopted trade preference programs for least developed countries. While a welcome step forward, these programs would provide far greater benefits if they gradually incorporated the recommendations above—full product coverage, flexible rules of origin, predictability, and cooperation (see Figure 1). As in the high-income countries, implementing these recommendations would have a negligible effect on production and overall export levels in the countries providing preferential access. Phasing these principles in by 2015, the target for achieving the Millennium Development Goals is an appropriate goal.

Table 2: Expanding 100 Percent Duty-Free, Quota-Free Access to Least Developed Countries Will Not Harm Rich-Country Producers

Country and Sector	Estimated Percent Change in Production
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
Clothing	-0.13

Source: Bouet, Antoine, et al., "The Costs and Benefits of Duty-Free, Quota-Free Market Access for Poor Countries: Who and What Matters," CGD Working Paper, Center for Global Development (2010).

Box 1: Rules of Origin Can Obstruct or Facilitate Market Access for the Poorest Countries

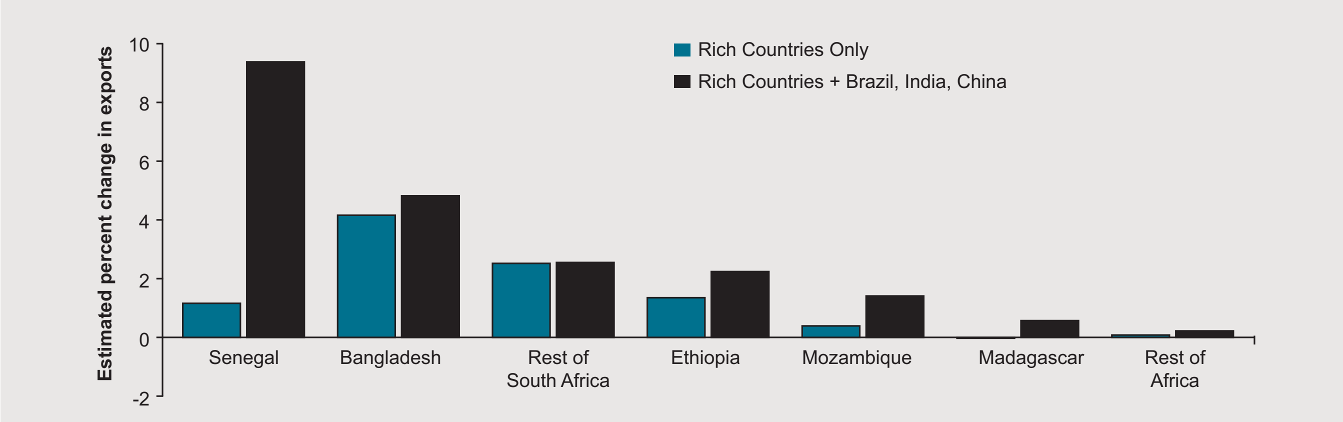
The European Union's "Everything But Arms" (EBA) program provides full market access for least developed countries' products (except weapons) but requires more of a final product to be produced locally than many poor countries can manage. The rule for woven garments, for example, specifies that the fabric must be manufactured, cut, and assembled in the exporting country to be eligible for preferential treatment. In contrast, the U.S. AGOA program allows eligible African countries to source fabric and other inputs globally. The final apparel is eligible for preferences as long as it is cut and sewn in the beneficiary country. Canada reformed its preference program for least developed countries in 2003 to eliminate most product exclusions and relax rules of origin to allow more global sourcing of inputs. The least developed countries' share of Canadian non-oil imports subsequently tripled.

The **Center** for **Global Development** works to reduce global poverty and inequality through rigorous **research** and active engagement with the **policy** community to make the world a more prosperous, just, and safe place for us all. The policies and practices of the United States and other rich countries, the emerging powers, and international institutions and corporations have **significant impacts** on the developing world's poor people. We aim to improve these policies and practices through research and policy engagement to expand opportunities, reduce inequalities, and **improve lives** everywhere.

Moving Forward

Comprehensive, flexible, and predictable trade preference programs have the potential to stimulate prosperity and stability around the globe. Extending full duty-free, quota-free market access to all least developed countries would have trivial effects on preference-giving nations while providing a critical boost to the world's poorest people. The Center for Global Development's Global Trade Preference Reform Working Group calls upon G-20 leaders to take advantage of the opportunities this year—at the Toronto summit in June and at the United Nations in September—to implement these recommendations and realize the Millennium Development Goal of using trade as a tool for development.

Figure 1. Exports from Least Developed Countries Will Increase as More Countries Move to 100 Percent Market Access



* This graph excludes Malawi, whose exports would increase from 12.97 to 13.91 percent.

Source: Bouet, Antoine, et al., "The Costs and Benefits of Duty-Free, Quota-Free Market Access for Poor Countries: Who and What Matters," CGD Working Paper, Center for Global Development (2010).