FAO TRADE POLICY BRIEFS
on issues related to the WTO negotiations on agriculture

No. 7 NON-RECIPROCAL AGRICULTURAL TRADE PREFERENCES

SUMMARY

- *Non-reciprocal trade preferences are important for many of the poorest and most vulnerable developing countries. In agriculture, such schemes are of particular importance to few countries in a limited number of products.*
- *As Most Favoured Nations (MFN) tariffs are reduced, the relative benefit of trade preferences to the beneficiary countries will erode. A tension exists between countries that will be negatively affected by the erosion of preferences and other countries whose exports are constrained by MFN tariffs.*
- *Limited product coverage and constraints on preference utilization, together with supply side problems, have prevented the full use of trade preferences by the majority of preference-receiving countries. More effective utilisation of remaining preferences could offset some of the losses expected from preference erosion.*
- *To cope with significant erosion of trade preferences, the current beneficiary countries will need adjustment assistance to enhance the productivity and competitiveness of their preference-dependent agriculture commodity sectors, or to facilitate the diversification and exit from such sectors.*

Preferential trade programmes are either reciprocal or non-reciprocal. Reciprocal preferences occur when two countries offer each other trade concessions not offered to other countries. Non-reciprocal trade preferences are trade arrangements where a country unilaterally offers concessions to one or more other countries. This note focuses only on non-reciprocal preferences.

About 80 least developed and small island developing states benefit from non-reciprocal preferences. However, they account collectively for less than 2 percent of world agricultural exports. Moreover, their relative share in global agricultural exports has been declining over the past decade, suggesting that preferences have not significantly curtailed the market opportunities of third countries.

There is concern among those seeking greater trade liberalization that the continued existence of preferences could result in less than hoped for liberalization being attained because preference-receiving countries will not press for ambitious cuts in MFN tariffs, and preference-granting countries could use the provision of preferences as an argument for the maintenance of support and protection to their own agriculture.

To achieve consensus on further reductions in MFN tariffs within the WTO, the impact of the potential losses which will fall on small preference-receiving countries needs to be determined and if necessary, alleviated.

In this context, a number of questions about the importance and usefulness of non-reciprocal trade preferences to countries receiving them require clarification:

- What is the legal status of, and how important are, non-reciprocal preferences?
- How effectively are they used?
- What factors could affect the continued existence of preferences?
- How can any potential losses that preference-receiving countries might face be alleviated?

Drawing on a more detailed explanation[1] of the insights that recent research offers, this Policy Brief addresses these questions in turn.

[1] See FAO Trade Policy Technical Note No.7 for further details on the arguments reviewed in this brief. http://www.fao.org/trade/policy_en.asp.

1 What is the legal status of, and how important are, non-reciprocal preferences?

Within the WTO, an "Enabling Clause" is the legal basis which permits deviation from the principle of non-discrimination among WTO members for the granting of trade preferences to developing countries.[2] The Clause requires, however, that there be no discrimination among developing countries in the granting of trade preferences, except for special treatment in favour of the least developed among them (LDCs). Individual developed countries sometimes grant specific preferences for limited groups of developing countries which include non-LDCs, such as those the EU extends to ACP countries under the Cotonou Agreement. This agreement has in the past been deemed not compatible with the Enabling Clause and it has required a waiver by WTO members of the existing rules for its continuation during a defined period. However, a recent WTO appellate ruling suggests that schemes which discriminate in favour of some non-LDC developing countries may be consistent with the Enabling Clause provided they meet conditions related to that clause and extend the same preferences to all developing countries of the same status.

Developing countries which benefit from non-reciprocal preferential trade account for a very small proportion of global trade, and such trade is limited and concentrated on a few countries and products, notably bananas and sugar. It is no coincidence that policies in support of these products in preference-granting countries have been amongst the most restrictive and have been challenged in the WTO.

Empirical studies indicate that the trade diversion impact on third countries has been small, and that trade creation from preferences outweighs the diversion effects.[3]

But these preferences are very important for the receiving countries. Table 1 illustrates the particularly large contribution to foreign exchange earnings and GDP that can arise from the export and preferences of a single commodity.

Table 1: Importance of banana and sugar exports and preference value from selected countries in 2000-2002

	Exports as a percentage of agricultural exports	Exports as a percentage of total merchandise exports	Exports as a percentage of GDP	Value of preferences as a percentage of GDP
Sugar				
Fiji	55	20	6.3	3.5
Guyana	41	20	14	9.3
Jamaica	26	4	0.9	0.7
Mauritius	74	6	5.7	4.6
Bananas				
St. Lucia	68	65	4.3	0.71
St. Vincent	50	38.6	4.6	0.94
Dominica	63	26	4.7	0.71

Source: Small island developing states. Agricultural production and trade, preferences and policy*. FAO Commodities and Trade Technical Paper No. 7, 2004.*

[2] *Decision on differential and more favourable treatment, reciprocity and fuller participation of developing countries*. GATT Document L/4903. 28 November 1979, BISD 26S/203.

[3] Trade diversion involves the reduction of imports by an importing preference-giving country, from an alternate supplier who is more competitive than the one receiving preferences. Trade creation involves the increase in imports by an importing preference-giving country from a competitive supplier, who, prior to the preferences, could not provide the relevant market because of protection of higher cost suppliers.

Enhanced market access and higher prices in preference-granting markets have contributed to higher export earnings in several small commodity-producing developing countries. These countries have not only small domestic markets with limited ability to exploit economies of scale and diversification opportunities, but also a limited resource base in terms of natural resources, skilled labour and domestic capital stock. These constraints make it difficult to achieve and maintain competitiveness. By providing a stable investment environment, preferences have contributed to the diversification already taking place in many preference-receiving countries. This has happened, through the attraction of local and international investments associated with the industry receiving a preference.

2 How effectively are preferential schemes used?

Limited product coverage, administrative constraints on preference utilization and domestic supply-side problems in some countries have limited the ability of many beneficiaries to take full advantage of trade preferences.

Product coverage in preferential schemes is often limited and has tended to be biased toward imports of non-sensitive products in the preference giving countries, and raw materials. With a few important exceptions, preferential tariff lines tend to have low tariffs, and cover few lines in areas of real export opportunity for preference recipients.

Utilization of these schemes is often costly. The high costs are related to meeting technical, sanitary and phytosanitary regulations and adherence especially to complicated import rules of origin. The former require investment in infrastructure and inspection systems. The latter often limit the amount of raw materials sourced externally and as a result the unit production and shipping costs may consequently be high. The greater these costs are, the less the benefit of any given preference margin.

Further, incentives provided to the producers of preference-receiving products as a result of these schemes, where they have been effective, may have reduced the incentives to invest in other competitive sectors. However, the provision of these schemes partly results from the recognition that many preference-receiving countries have a low domestic supply capacity to exploit trade opportunities.

3 What factors could affect the continued relevance of preferences?

The recent proliferation of bilateral free trade areas and regional trade agreements, as well as reductions in MFN tariffs foreseen in the current Doha Round of WTO negotiations, has diminished and will continue to diminish the extent to which meaningful trade preferences can be offered. Furthermore, declining domestic prices due to unilateral policy reforms in preference-granting countries and custom areas reduce the value of preferences to those markets.

For example:

- Bilateral and regional agreements that have extended lower-duty and duty-free arrangements to some groups of countries can erode the benefits of preferences to countries that enjoyed certain preference levels in these markets before the regional free trade agreements were created. The relative loss of preferences by the Caribbean Basin Initiative beneficiaries when NAFTA was created is a case in point.
- Unilateral reform within the preference giving countries without any direct changes in the preference regime itself can lead to the erosion of preference benefits. The EU proposal to modify its internal agricultural arrangements on for example, sugar, under the CAP is evidence in this regard Current EU CAP reforms could lead to reductions in the internal EU prices for products receiving preferences and the EU preference tariff margins for ACP countries could fall as a result. The resulting net income loss is likely to be significant for countries which depend on a few export products sold to this market.

4 How can potential losses that preference-receiving countries might face be alleviated?

Several studies suggest that a number of preference-receiving countries have already experienced losses due to preference erosion. Moreover, it is likely that until many preference-receiving developing countries improve their supply capacity and competitiveness, they will stand to lose from further MFN tariff reductions or participation in reciprocal preferential arrangements with developed countries.

Increased access for preference-receiving countries from further liberalization is also likely to be limited because beneficiary countries already enjoy low tariffs.

In view of these realities, several approaches are under consideration for dealing with preference erosion:

- Maintenance of preference schemes on the basis of a small number of country/product pairs[4] where signifi-cant net benefits are realized. Therefore, emphasis could be on maintaining “deep” preferences that provide significant market access concessions for a limited number of countries that need preferences, as opposed to "shallow" preferences for all developing countries. The difficult issue here is reaching agreement on the criteria determining how country/product pairs are identified and what the preference concession should be.

- *Stability of access and value of the agreed preference schemes*. This is recognized as perhaps the most critical issue for preference-receiving countries. Hence, the binding of preferences, their definition in terms of margins, expanded tariff rate quotas and simpler rules of origin to allow greater use of tariff preferences, need consideration in redefining preference schemes.
- *Re-evaluation and graduation based on need and competitiveness.* In the context of a continuation of some preference schemes, some WTO members seek graduation for middle income countries which receive preferences and others which are competitive on the world market but continue to receive preferences. The counter-argument has been that some middle income countries are small and vulnerable and the continued existence of their agricultural sectors depends to some extent on preferential market access. In some preference schemes, the threshold level of per capita GNP and criteria such as exceeding "competitive needs limits" determine graduation. This criterion, which could be adopted as a yardstick, refers to the country in question surpassing its ceiling of allowable imports under the preference scheme, which could be a value amount or a percentage of the importer's market. When a country achieves the prescribed level of export value or import percentage, then eligibility for preferences is re-evaluated.
- *Adjustment assistance for loss of market opportunities due to preference erosion.* This should be considered in addition to, not in place of, an improved preferential regime for specific countries. In other words, adjustment assistance may not be a substitute for preferences in all cases but can hasten the transition to adoption of alternative economic activities where this is possible.

[4] See FAO Trade Policy Technical Note No.7 for further details. However, there is a need for further analysis at a more disaggregated level to better identify these countries and products.

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