# 2

# Arrangements for Preferential Access: Experience and Potential

The initial review of trade and global poverty in chapter 1 suggests a two-track strategy for using trade policy as an instrument for reducing poverty. One track, oriented toward about one-fourth of the world's poor, would grant early and deep preferential market access to imports from at-risk countries where the share of the poor in national income is relatively high, including in particular the least developed countries (LDCs), heavily indebted poor countries (HIPCs), and sub-Saharan Africa (SSA). The optic of the "poverty intensity of trade" developed in chapter 1 leads naturally to the inclusion of this approach in any overall strategy seeking to mobilize trade to help reduce global poverty.

The other track would address the other three-fourths of the world's poor by increasing opportunities for trade and growth in developing countries more generally. This would be done through the phased reduction and elimination of trade barriers, on a multilateral basis through World Trade Organization (WTO) negotiations. It will be argued in chapter 6 that the two tracks are complementary even in terms of building coalitions for multilateral liberalization, because without the positive inducement of prompt deepening of free access for poorer countries, some of them may be tempted to block the general consensus needed in the new "single-undertaking" structure of WTO negotiations. At the same time, the commitment to global free trade on a phased-in multilateral basis would ensure that the enhanced free entry for poor "at-risk" countries would be only a temporary preference, by virtue of eventual free market access for all countries.

The international trading system already has considerable experience with a two-track approach in the form of past preferential regimes for developing countries alongside steady progress toward multilateral liberalization. It thus behooves policymakers to take stock of what has already been accomplished under preferential arrangements in the past, in order to have a more informed view of the potentialities and pitfalls of deeper preferential access in the future. This chapter seeks to review the experience of preferential regimes and to draw relevant lessons for future policy. The subsequent chapters of this study then turn to the potential effects of multilateral liberalization for the reduction of global poverty.

There has been an important evolution in the emphasis in regimes of special market access for developing countries during the past four decades. The initial framework was one of a Generalized System of Preferences (GSP) granting duty-free entry for imports from developing countries, which were considered appropriately eligible for "special and differential" treatment that did not require reciprocal free entry on their part. The objective was to permit infant-industry protection in developing countries while addressing their seemingly weak prospects for earnings from traditional raw materials exports by encouraging the development of new export industries. The underpinnings of this framework increasingly eroded, however, as the implementation of the GSP in practice tended to be relatively restrictive.

At the same time, import-substituting industrialization increasingly fell out of favor as a development strategy, as the distortions and inefficiencies it encountered as some developing countries moved further into heavy industries unsuited for their comparative advantage began to become more apparent. The idea gained favor that unilateral liberalization of at least highly protected sectors, and especially by middle-income countries, was more likely to contribute to their development than was continued protection. There was a parallel growing sense that developing countries' emphasis on special and differential treatment in past trade negotiations had in the end been a bad bargain because it induced negotiating partners to leave off the table the products of particular importance to developing-country exporters given that the protection of the latter countries was off the table.

Within the past two decades or so, however, a second track of preferential access began to emerge even as the GSP approach increasingly seemed outdated. In part because of growing concern about the severe lag and often retrogression of economic conditions in low-income countries, and in part because of political motivations from former colonial ties or considerations of the Cold War or the drug war, the European Union and United States developed regimes much closer to free entry for goods from low-income countries. The EU's Lomé Convention and Everything But

Arms initiative and the United States' Caribbean Basin Initiative, Andean Trade Preference Act, and African Growth and Opportunity Act are the principal efforts in this second track. For middle-income countries, in contrast, the new trend was toward the negotiation of free trade arrangements based on at least phased reciprocity, as best illustrated by the North American Free Trade Agreement (NAFTA).

Economists have tended to view special-access regimes skeptically, some because the regimes do not work and others because they might work. The former can legitimately cite the restrictive application of the GSP in practice, while the latter worry that special regimes cause trade diversion. However, to the extent that the trade policy instrument is to be used as a vehicle to address global poverty, regimes of special access for poor countries would appear to hold considerable promise. Not only do they follow naturally from a focus on the "poverty intensity of trade," but they also tend to involve minimal trade diversion because the economic base of the beneficiaries is too small in the aggregate to have much impact in distorting global trading patterns.

This chapter begins with a review of the oldest of the special-access regimes, the GSP, and then turns to the evolving programs for enhanced special access for poor countries in EU and US trade policy. After an attempt to identify statistical evidence for the impact of these regimes on beneficiary-country export performance, the chapter concludes with an outline of directions for policy to make the regimes for poor-country market access more effective.

## The Generalized System of Preferences

The oldest preferential regime, the GSP, was designed to include all developing countries. The rapid rise of strong competitive pressures from some middle-income economies, most recently and notably China, helps explain why in practice the regime has been applied in a restrictive manner, and why the more recent preferential initiatives have increasingly focused on the poorer and weaker economies.

### Origins and Status

A Generalized System of Preferences for imports from developing countries was first proposed in 1964 by Raul Prebisch, then secretary general of the UN Conference on Trade and Development (UNCTAD). The proposal reflected the then-popular notion that the commodity exports of developing countries faced unfavorable demand elasticities, condemning

their economies to falling terms of trade and slower growth than in industrial countries unless they industrialized themselves. Duty-free entry for exports from developing countries (particularly manufactured goods) was seen as one partial remedy (import-substituting industrialization behind high protective barriers was seen as another). Even though preferences were to be "generalized," from the outset there was a recognition of "graduation," in that less advanced developing countries should be granted special preferences, and that preferences for more advanced developing countries would "gradually have to disappear" after permitting a period of use "to prevent or rectify the structural imbalance in their trade" (UNCTAD 1964, Laird and Safadi 2001).

By 1968, the second UNCTAD adopted the principle of a "generalized, non-reciprocal, non-discriminatory system of preferences in favour of developing countries." In 1971, the General Agreement on Tariffs and Trade (GATT) granted a 10-year waiver to the most-favored nation (MFN) provisions to allow preferences, and in 1979 the Tokyo Round negotiations adopted an "Enabling Clause" providing a formal legal basis for preferences (Laird and Safadi 2001). All the major industrial countries, along with a handful of middle-income countries, currently have GSP regimes.[1]

Despite the prevalence of these regimes, few would disagree that the GSP has fallen short of the original hope that it could be a major vehicle for development. As will be shown, its benefits have been meager. In part, this has reflected restrictions (e.g., on sensitive products); in part, it has been a consequence of inherently diminishing scope as multilateral liberalization has reduced MFN tariffs, making the preferences less valuable. Many would also argue that developing countries have directed too much negotiating effort toward seeking preferences and too little to offering reciprocal liberalization in return for reductions in industrial-country protection of goods of special interest to them. Moreover, the true restraints on trade increasingly have not been tariffs, against which preferences could be of help, but nontariff barriers, including not only quotas in agriculture and textiles and apparel but also such "process-protection" mechanisms as antidumping and countervailing duty (antisubsidy) measures.

UNCTAD (1999) nonetheless argues that the GSP remains relevant today and for the future. It judges the scope of the program as significant, noting that in 1997 GSP programs granted preferential entry to about $100 billion in imports, or 18 percent of imports, from beneficiary nations into preference-granting countries. Moreover, it points out that the tariffication of agricultural quotas in the Uruguay Round has increased the potential benefit from tariff preferences in agriculture.

1. GSP programs are offered by Australia, Canada, the European Union, Japan, New Zealand, Norway, Switzerland, and the United States, as well as Belarus, Bulgaria, the Czech Republic, Hungary, Poland, Russia, and the Slovak Republic (Laird and Safadi 2001).

## The European Union

The European Union's GSP program is by far the most substantial.[2] Its product coverage is wide, and includes food and agricultural products, metal products and machinery, wood and paper, textiles and apparel, and leather goods. In 1997, the European Union (EU) granted tariff preferences covering $65 billion in imports and according $1.6 billion in forgone revenue.[3] These imports represented 56 percent of imports covered by the GSP, and 23 percent of total imports from 106 developing countries. In 1995, the European Union eliminated quota restrictions in the program and introduced "tariff modulation." The preference margin (i.e., the percent cut from MFN tariff) under this approach is 15 percent for "very sensitive" products, 30 percent for "sensitive" goods, 65 percent for "semi-sensitive" goods, and 100 percent (duty-free) for "nonsensitive" goods.[4] The resulting average duty in 1997 for GSP beneficiaries (excluding LDCs) was 3.4 percent, compared with the average MFN tariff of 6.0 percent.

For the 49 LDCs, the European Union's GSP prior to 2001 provided for duty- and quota-free entry of all but about 900 agricultural tariff-line items, out of the European Community's 10,500-line tariff nomenclature (Bora, Cernat, and Turrini 2002, 18; European Commission 2000, 3). As a result, in 1997 the overall average tariff on (MFN-dutiable) imports from LDCs was a minimal 0.2 percent (see table 2.1). Beginning in 2001, the European Union pushed free entry for LDCs further with its Everything But Arms initiative, which is discussed below.

The European Union has set $6,000 per capita (in 1991) as the income level for graduation from its GSP program, and in 1996 South Korea, Hong Kong, Singapore, Saudi Arabia, and a number of smaller oil-producing economies became ineligible on this basis.[5] The program also graduates a supplier to ineligibility in a particular product when its supply exceeds 25 percent of total EU imports of the good from GSP beneficiaries. Despite the provisions for product graduation, benefits under the program have been concentrated, with approximately 50 percent of preference-receiving imports provided by the top three countries (China, 31.8 percent; India, 10.3 percent; and Thailand, 6.5 percent). Product coverage

2. These descriptions of the EU, US, and Japanese GSP programs are primarily from UNCTAD (1999).

3. Note, however, that Laird and Safadi (2001) place the amount at only $38.2 billion in 1999, using WTO data.

4. From the resulting preferential tariffs, there are further cuts ranging from 10 to 35 percent for the first three categories respectively if the country meets labor and environmental standards.

5. Despite this, UNCTAD (1999) shows small remaining GSP-benefiting imports from these countries in 1997, and total imports from them are included in the base mentioned above.

**Table 2.1 Generalized System of Preferences (GSP) imports of the European Union, United States, and Japan, 1997**
(billions of dollars, percent)

| | Measure | European Union | United States | Japan | Total or average |
|---|---|---|---|---|---|
| A | Countries covered (number) | 106 | 123 | 170 | 133 |
| B | Total imports from GSP countries | 279.6 | 101.3 | 173.1 | 554 |
| C | Imports from all developing countries | 431.5 | 420.8 | 185.5 | 1,037.8 |
| D | GSP country imports/total (B/C percent) | 64.8 | 24.1 | 93.3 | 53.4 |
| E | Dutiable imports from GSP countries | 179.2 | 66.0 | 93.5 | 338.7 |
| F | Of which: covered by GSP | 115.9 | 25.1 | 40.0 | 181.0 |
| G | Imports receiving GSP | 64.8 | 15.3 | 17.0 | 97.1 |
| H | Potential coverage ratio (F/E percent) | 64.7 | 38.0 | 42.8 | 53.4 |
| I | Utilization rate (G/F percent) | 55.9 | 61.0 | 42.5 | 53.6 |
| J | Utility rate (G/E percent) | 36.2 | 23.2 | 18.2 | 28.7 |
| K | Tariff revenue forgone | 1.6 | 0.24 | 0.35 | 2.19 |
| L | Percent GSP-receiving imports (K/G percent) | 2.5 | 1.6 | 2.1 | 2.3 |
| M | Percent total imports from GSP countries (K/B percent) | 0.57 | 0.24 | 0.20 | 0.40 |
| | Share of top 5 in GSP country Imports (percent) | 30.6 | 48.2 | 50.0 | 39.9 |
| | Imports receiving GSP benefits (percent) | 64.4 | 62.5 | 74.0 | 65.8 |
| | Share of LDCs in GSP country Imports receiving GSP benefits (percent) | 1.0 | 5.2 | n.a. | n.a. |
| | Revenue forgone (percent) | n.a. | 10.0 | n.a. | n.a. |
| | Tariff averages on GSP countries MFN rates (percent) | 6.0 | 6.7 | 5.9 | 6.1 |
| | Incorporating preferences All but LDCs (percent) | 3.4 | 4.8 | 3.4 | n.a. |
| | LDCs (percent) | 0.2 | 3.3 | 2.3 | n.a. |
| | Tariff peak products, average tariff MFN (percent) | 40.3 | 20.8 | 27.8 | n.a. |
| | GSP (percent) | 19.8 | 16.0 | 22.7 | n.a. |

LDCs = least developed countries
MFN = most-favored nation
n.a. = not available

*Sources:* UNCTAD (1999); IMF (2002a); IMF-World Bank (2001).

remains high at 70 percent for China. In contrast, LDCs have consistently accounted for only about 1 percent of preference-receiving imports from GSP beneficiaries.

Although the EU program is relatively large, the "utilization rate" is somewhat lower than might be expected: Imports receiving preferences were 56 percent of GSP-covered imports in 1997. The latter, in turn, were a

relatively high 64.7 percent of total imports from the GSP countries, but the combination of nonuse and noncoverage reduced preference-receiving imports to only 36 percent of total imports from these countries. This, in turn, suggests that in a number of products for many GSP countries, even the relatively generous EU program provides too modest an incremental advantage to warrant utilization, reflecting low MFN tariffs and implying significant informational and administrative costs. Indeed, in the aggregate, the forgone tariff revenue amounts to only 0.9 percent of the value of total dutiable imports and 0.6 percent of total imports from GSP countries, suggesting only a marginal overall potential impact.

## The United States

The United States' GSP program has been considerably smaller than that of the European Union. In 1997, imports granted GSP preferences amounted to $15.3 billion, and the corresponding tariff revenue forgone was only $242 million (UNCTAD 1999).[6] The most conspicuous country absent from the US plan is China, in contrast to the EU scheme. Otherwise, the profile of concentration among principal beneficiaries is not unlike that of the European Union. Thus, countries that bulk large in the US program (Brazil, with 14.4 percent of US imports benefiting from GSP preferences; Thailand, 16.5 percent; Indonesia, 12.7 percent; the Philippines, 10.8 percent; and India, 8.2 percent) also tend to do so in the EU program (6.8, 6.5, 8.8, 1.5, and 10.3 percent, respectively).

The general list of products eligible for duty-free entry in the US program comprises 4,650 product categories out of the total of approximately 10,500 at the 8-digit level in the Harmonized Tariff System of the United States (HTSUS). In addition, beginning in 1997, another 1,770 categories were made eligible for 40 LDCs (USTR 1999). The US program has relatively greater participation by LDCs, which accounted for 5.2 percent of imports receiving preferences in 1997, than other industrial countries.[7] In contrast to the EU approach of conferring alternative depths of preferential cuts from MFN tariffs depending on the product and the country, the US program grants duty-free entry.

The US program excludes from eligibility countries that exceed competitive-need thresholds for the product in question. These are triggered by either of the following: (1) a country accounts for more than half of total US imports of the product category; or (2) the amount in question ex-

6. According to Laird and Safadi (2001), by 1999 the amount of imports receiving GSP was $16.7 billion.

7. For the LDCs, moreover, the average revenue forgone was 3.1 percent of import value benefiting from GSP, compared with 1.6 percent for the program as a whole. This conveyed 10 percent of total forgone revenue to the LDCs (calculated from UNCTAD 1999).

ceeds $100 million.[8] A list of 28 countries currently has such product ineligibilities, ranging from Belize, with a single restricted good, to numerous restrictions for Brazil (64 products), Argentina (158), and especially India (775) (USITC 2002). In addition to restrictions, the US GSP program has been marked by uncertainty, because it has been subject to periodic expirations and reinstatements only after a hiatus.

The overall effect of the program has been relatively restrictive. Thus, in 1997, out of a total of $66 billion in imports from GSP-eligible developing countries dutiable at the MFN level, only $25 billion were GSP-eligible (38 percent potential coverage ratio). As a result, despite a utilization rate (61 percent) approximately the same as in the European Union, the overall ratio of imports receiving GSP treatment to GSP-eligible imports ("utility rate") was only 23.2 percent, or about two-thirds that of the EU program (UNCTAD 1999). Total revenue forgone was a modest 1.6 percent of value even on imports actually benefiting, a slimmer 1.0 percent for potentially eligible imports, a still smaller 0.36 percent of the total value of dutiable imports from GSP countries, and a thin 0.24 percent of the value of all imports from these countries.

### Japan

In 1997, the total value of imports benefiting from the GSP in Japan was $17 billion, and tariff revenue forgone was $353 million (UNCTAD 1999). These amounts were modestly larger than those for the United States. A key difference is that China is eligible for the GSP in Japan's program, and in 1997 it accounted for 33 percent of total GSP benefits granted. Somewhat surprisingly, the total value of Japan's imports from GSP countries ($173 billion) was larger than that of the United States ($101 billion), though smaller than that for the European Union ($280 billion). The smaller total for the United States reflects the absence not only of China but also of Mexico from the US program, because Mexico has duty-free entry under its alternative NAFTA membership.

### Other Industrial Countries

The GSP schemes of other industrial countries add modestly to those of the big three. Total GSP imports in 1997 (with the corresponding "utility rates" to gauge against total imports) were $2.9 billion (40 percent) for Canada, $1.5 billion (26 percent) for Switzerland, and $0.7 billion (47.6 percent) for Norway, placing the Canadian and Norwegian programs above those of the big three in terms of generosity.

8. The value threshold was set at $75 million for 1996, with a scheduled increment of $5 million annually thereafter.

## Overview of the GSP Experience

Table 2.1 provides a summary of the relevant economic magnitudes for the GSP programs of the European Union, United States, and Japan in 1997 (the most recent year for which UNCTAD has compiled comparative data). The table shows the following patterns:

- Approximately $100 billion in imports entered the industrial-country markets with the benefit of GSP preferences in 1997, or 17.5 percent of total imports from GSP countries.[9]
- The countries included under the GSP account for only 24 percent of imports from all developing countries in the United States, and only 65 percent for the European Union. This reflects US coverage of Mexico under NAFTA rather than the GSP, as well as a number of exclusions of countries not deemed to need preferential treatment.[10]
- Revenue forgone under the GSP amounts to about 2 percent of the value of imports receiving GSP treatment, but only 0.4 percent of the value of total imports from GSP-eligible countries.
- The benefits of the program are concentrated in the largest suppliers, with the top five beneficiaries receiving two-thirds of benefits in the EU and US programs and three-fourths in Japan's. These shares significantly exceed the corresponding shares of total imports from the same top five countries under each program, suggesting that the largest and more sophisticated economies still eligible secure the lion's share of benefits (most notably China's 32 percent share in GSP-benefiting imports in the European Union).
- LDCs have accounted for very low shares in total imports receiving GSP benefits (about 5 percent for the United States and only 1 percent for the European Union), although the deeper cuts make their share in tariff revenue forgone somewhat higher (10 percent for the United States).
- The fraction of otherwise dutiable imports receiving GSP benefits (UNCTAD's "utility rate") is low, at 36 percent for the European Union and only 23 percent for the United States and 18 percent for Japan.
- This is partly due to product exclusion, because the products covered make up about two-thirds of the total for the European Union and

9. For the big three, the amount was $97 billion; including Canada, Switzerland, and Norway, it was $102 billion.

10. Major exclusions include the following. For the European Union: the Czech Republic, Hungary, Nigeria, Poland, Taiwan, and Turkey. For the United States: China, Hong Kong, Mexico, Singapore, and Taiwan.

only about 40 percent for the United States and Japan. It is also due to additional threshold screens (especially in the US program), as well in all likelihood as informational and administrative costs, which can be high relative to the size of the potential tariff preference.

- The overall effect is to cut average tariffs from about 6 to 3.4 percent in both the European Union and Japan, and somewhat less generously from 6.7 to 4.8 percent in the United States, according to UNCTAD estimates. The cuts are much steeper for LDCs for the European Union (to 0.2 percent), and moderately steeper for the United States and Japan (to 3.3 and 2.3 percent, respectively).

A study by the staffs of the IMF and World Bank (IMF and World Bank 2001, 34) notes that the often generous tariff preference margins under the GSP typically apply to products that already face low tariffs, in the range of 4 to 8 percent. It emphasizes that, in contrast, for tariff-peak products, the preferential margins tend to be lower. As a result, despite preferential treatment, GSP countries face after-preference tariffs averaging about 20 percent in the European Union, 16 percent in the United States, and 23 percent in Japan in the peak-tariff categories (table 2.1).

Overall, it is difficult to escape the conclusion that the GSP is a mechanism whose impact is close to negligible, and far smaller than might be expected given the long history of the instrument and the intense negotiating battles that have been fought on its behalf. Certainly in the aggregate, it would be hard to argue that the incentive it provides is meaningful. The best overall measure of this incentive is the amount of the tariff revenue forgone relative to the import base. When the full import base (for just the GSP countries) is considered, this incentive amounts to a mere 0.4 percent for the big three, ranging from a high of 0.57 percent for the European Union to about 0.2 percent for the United States and Japan. It is difficult to envision any investment decision being influenced by the promise that the export will benefit from a special price advantage amounting to half a percent or less of the product price. The impact of the GSP is to some extent inherently limited because the MFN tariffs are already modest at about 6 percent, and because on the most burdensome (peak) tariffs the preferences are insufficient to avoid still-high after-preference tariffs.

The key exception to this diagnosis would seem to be for the LDCs. Their deeper tariff preferences and lesser incidence of exclusions generate a much more generous outcome for the European Union, as well as a somewhat more generous result for the United States and Japan, than is the case for the other developing countries that account for the bulk of imports under the programs. This diagnosis suggests, however, that addressing the LDCs may be more effective using special regimes than under the GSP.

## Special Regimes of the European Union

Both the European Union and the United States have increasingly turned to special regimes for certain developing-country trading partners that go beyond the GSP. For most of the past three decades, these arrangements have stemmed from special cultural ties and cold war geopolitical considerations (the Lomé Convention for the European Union, and the Caribbean Basin Initiative for the United States) as well as antidrug considerations (the US Andean Trade Preference Act). More recently, both the European Union and the United States have moved toward special arrangements for the poorest countries (in the Everything But Arms initiative and African Growth and Opportunity Act, respectively). At the same time, there has been a shift from the GSP concept of temporary nonreciprocal preferences toward free trade arrangements incorporating reciprocity, albeit with a delayed phase-in of liberalization for the developing-country partner (most conspicuously in NAFTA but also in the EU's Cotonou Agreement).

### The Lomé Convention and Cotonou Agreement

The Lomé Convention comprised a series of agreements made between the European Union and 70 LDCs in Africa, the Caribbean, and the Pacific (the "ACP" states) covering trade preferences as well as development aid relationships and a commodity stabilization program.[11] All ACP industrial exports and 80 percent of agricultural exports are free from import duties and quota restrictions (UNCTAD 2001, 18). The convention was inaugurated in 1975 for 46 countries and was successively renewed and expanded every five years to encompass 70 countries by 1995.

By the late 1990s, the Lomé Convention came under increasing doubt because of the rising profile of its incompatibility with GATT rules. The European Community's single market for bananas set up in 1994 in particular precipitated confrontations with the United States and nonmember banana producers. A GATT panel found the Lomé Convention inconsistent with the GATT because being nonreciprocal, it was not a free trade arrangement, and being confined to a specific set of developing countries, it was discriminatory and thus ineligible for the Enabling Clause permitting departure from MFN treatment. Although the European Union secured a waiver through the end of Lomé IV (2000), it became necessary to rethink the arrangement (European Commission 1996). A prevailing sense that the arrangement had "not been sufficient to enhance export growth and increase diversification" (European Commission 1996, 17), and that the donor-recipient dynamics in the development assistance dimensions of

11. In the tradition of trade agreements, the name derives from the location of the negotiations (Lomé, Togo, and Cotonou, Benin).

the arrangement had yielded "patchy results," contributed to the decision to revamp the mechanism.

In 2000, the European Union replaced the arrangement with the ACP-EU Partnership Agreement, known as the Cotonou Agreement, with 77 countries for a period of 20 years.[12] Whereas under the Lomé Convention the European Union had granted nonreciprocal trade preferences to ACP exports, the Cotonou accord has shifted emphasis to economic integration agreements that progressively remove barriers and enhance cooperation in all areas related to trade. To this end, Regional Economic Partnership Agreements (REPAs) are to be negotiated on a regional basis by 2008, likely within the framework of existing regional organizations. Until then, the existing provisions of the Lomé Convention continue in force. The change in name is thus a signal of a new strategy rather than of any immediate change in the preferential arrangement.

### Structure

The Lomé Convention sought "stability and contractuality" through the granting of preferences for long periods, whereas GSP preferences are continually subject to modification. It provided that products originating in the ACP states were eligible to enter the European Union tariff free and exempt from quantitative restrictions. The major exceptions were for products covered under the Common Agricultural Policy, which faced tariffs and restrictions but received concessions of various sorts.

ACP countries have thus been exempted in the EU market from the textile and apparel quota regime under the Multi-Fiber Arrangement (MFA). They have benefited from "generous prices and guaranteed access for specific quantities" (European Commission 1996, 16) under commodity protocols for bananas, sugar, beef and veal, and rum.[13] Special rules of origin allow the ACP states to "cumulate origin" among themselves and count imports of intermediate goods from the European Union as having domestic origin. The agreement also includes safeguard clauses and surge protections that are less restrictive than the corresponding clauses for the EU's GSP preferences.

### Impact

Studies of the Lomé Convention have tended to conclude that it had little effect in fostering export growth. ACP countries lost rather than gained market share. Of total European Community imports, the ACP share fell

12. Of the 77 ACP states, 48 are in Africa (including all of SSA), 15 in the Caribbean, and 14 in the Pacific region. Out of the 49 LDCs (also covered by the EU's Everything But Arms initiative of February 2001), 40 are ACP.

13. The banana, sugar, and beef and veal protocols are discussed below. Note that in 1997 the European Union agreed with the United States to phase out the rum protocol.

from 8.5 percent in 1974 to 4 percent in 1989, whereas the share of other developing countries rose from 9.5 to 17.1 percent, with rising shares especially for the East Asian economies but also for Latin America (Grilli 1994).

Moreover, there was no apparent difference in outcomes between the original Lomé countries and those that joined later. As noted, the European Commission shares in the view that Lomé did not succeed in spurring export growth or diversification, although it cites individual success cases (Botswana, Côte d'Ivoire, Jamaica, Mauritius, and Zimbabwe; European Commission 1996). Thus, 37 of the ACP countries rely on one commodity to provide more than 50 percent of their exports to the European Union (Bjørnskov and Krivonos 2001). For Nigeria, which in 2001 accounted for 20 percent of EU imports from ACP countries, oil accounted for 81 percent of exports to the European Union (European Commission 2002b).

Grilli (1994) identifies a number of reasons for the lack of impact. First, only about 35 to 45 percent of EC imports from the ACP countries benefited from preferences, because about 5 to 10 percent were subject to Common Agricultural Policy restrictions and about 50 to 60 percent were in goods not subject to a duty (including key raw materials, e.g., oil, phosphates, and cotton, as well as copper). Second, the depth of the preferences declined over time as a consequence of multilateral trade liberalization. Third, the size of ACP preferences vis-à-vis other developing countries was small in manufactures, because of the GSP (despite Lomé's conscious attempt to maintain some preference by retaining some tariffs, unlike the zero-tariff US treatment). Fourth, an "ACP line" monitoring ceiling in practice restrained textile and apparel imports despite exemption from MFA quotas. Fifth, rules of origin were restrictive, requiring 50 to 60 percent local content, despite the allowance for cumulation.

More broadly, disincentives to exports that outweighed the potential benefit of preferences were common. These included overvalued exchange rates, export taxes, government-controlled producer prices, and high domestic protection on manufactures. In addition, falling real prices for a range of commodities, and the preponderance of commodities in the exports of ACP countries, have acted as a drag on their export performance relative to other, especially Asian, exporters.[14]

Although a simple comparison of trade shares suggests little if any export stimulus from the Lomé Convention, ideally numerous other economic influences should be taken into account to detect the Lomé impact at the margin. One of the few econometric attempts to do so is that of Nilsson (2002). He applies a gravity trade model, regressing the dollar value of EU imports from countries belonging to the Organization for Economic

14. However, Grilli (1994) points out that even within commodity classes, e.g., tropical beverages, vegetable oils, and minerals, the share of African countries in world production and exports fell rapidly after the early 1970s.

Cooperation and Development (OECD) and from developing countries (deflated by the US GDP deflator) against variables meant to capture demand (EU GDP and GDP per capita) and supply (partner GNP and GNP per capita) and including distance as the "gravity" variable. Dummy variables are included for GSP and Lomé.

Nilsson's results show that in the five out of eight three-year periods from 1973 to 1992 for which both dummies are statistically significant, the GSP raised developing countries' exports by 34 to 59 percent above levels that otherwise would have been expected; and Lomé, by 45 to 69 percent. The impacts started large but fell to near zero by 1980 (for Lomé, and below zero for the GSP), before rebounding to the range of a 40 percent export impact by the period 1990–92. Nilsson attributes the earlier decline to the diminishing margin of preference as multilateral liberalization proceeded as well as the European Union's increasing use of nontariff barriers, and the rebound after the early 1980s to the reversal of the latter as well as increasing developing country export orientation.

Nilsson's results suggest that after two decades of preferential treatment under Lomé, ACP exports to the European Union stood about 50 percent above the levels they would otherwise have reached without preferences. In principle, this could be a plausible diagnosis arising from a regression technique that attributes the lagging of Lomé exports behind those from East Asia (for example) to the more rapid growth of supply in the latter (the GNP variable for exporting countries has an elasticity of about unity) rather than a negligible preference impact for the former. Even so, one wonders whether the result is not too large to be fully credible, especially considering that the corresponding GSP effect by 1990–92 is about a 30 percent increment. The latter would seem implausibly high for a preferential price impact of only 0.6 percent (measured by revenue forgone relative to total EU imports from GSP countries; see table 2.1).

More troublesome, the highest measured Lomé trade impact (an increment of 70 percent) is for the first period considered, 1973–74, yet this predates the Lomé Convention. This problem cannot be explained away by invoking the preferences already existing in the 1963 Yaoundé Convention, because that arrangement was only for the Association of African States and Madagascar (18 former French colonies), whereas the purpose of Lomé was to extend special treatment to 20 countries of the British Commonwealth following the United Kingdom's joining the European Economic Community in 1973 (Bjørnskov and Krivonos 2001). If the Lomé dummy is overestimated immediately before the arrangement, it is likely to be so for the following periods as well.

## The Cotonou Process

The shift from nonreciprocal preferences to regional free trade arrangements (FTAs) has two major implications. First, the Lomé countries will

increasingly be expected to liberalize their own trade, not only with the European Union but also with regional partners. Second, the new agreements should make it possible to achieve further liberalization of the EU market for these exporters, especially in agricultural products.

The Cotonou Agreement has already revised the banana protocol after agreement by the European Union, United States, and Ecuador in 2001 (Bjørnskov and Krivonos 2001). The tariff-rate quota regime is to be converted to a tariff only by 2006. During a transition, part of the existing quota is to be shifted from ACP countries (which were only filling about three-fourths of their total quotas) to other developing-country exporters. Because of the high level of protection (EU banana imports average twice the price of those entering the United States), liberalizing the regime should provide the potential for important gains for outside suppliers and new entrants among Lomé countries, albeit at the cost of a loss in rents for the largest existing suppliers (Côte d'Ivoire and Cameroon, which account for about 5 percent each).

In sugar, where EU imports from ACP countries are at the EU-internal price—about 160 percent above world price—future trade will be governed by the REPAs to be negotiated. This seems likely to boost EU imports from such LDCs as Sudan and Zambia, probably at the expense of the current leading exporters (including especially Mauritius, with 30 percent of EU sugar imports, and Fiji and Guyana, each with about 13 percent; Bjørnskov and Krivonos 2001).

The future REPAs will also govern EU imports of beef and veal. Current imports are relatively low (only $123 million in 1999), in part because above-quota tariff rates in the tariff-rate quotas are high (22 to 56 percent). The potential for increased exports is thus high if REPA negotiations are liberalizing, although sanitary and phytosanitary standards could be an important constraint. Other agricultural goods in which REPA negotiations will be important include citrus fruit, where ACP countries face above-quota tariffs as high as about 14 percent, coffee (8 percent), fruits (7 percent), vegetables (11 percent), and tobacco (32 percent) (Bjørnskov and Krivonos 2001).

An important risk is that the REPA process will amount to a reshuffling of existing EU quotas for ACP countries, rather than a broad liberalization. At the same time, the nature of the eventual agreements will presumably be affected by the success or failure of multilateral agricultural liberalization agreed within the Doha Round, as well as more liberalized access that may arise from EU agreements with Mercosur and Mediterranean countries. The more successful the increased multilateral and other-regional access to goods from US, Latin American, and other non-ACP suppliers, the less scope will remain for dividing rents among ACP suppliers in a protected EU market.

Finally, the FTA reached between the European Union and South Africa in October 1999 (the Trade, Development and Cooperation Agreement, or

TDCA) warrants review as EU trade policymakers consider it a potential model for the REPAs.[15] South Africa did not enjoy Lomé preferential access, because the European Union had rejected its 1994 accession request on grounds of erosion of ACP preferences. The European Union instead granted qualified membership in 1998 and admission to the Cotonou Agreement in 2000, subject to negotiation of the FTA.

The TDCA provides for the elimination of tariffs on about 95 percent of South African exports (compared with 75 percent now) and 85 percent of EU exports (compared with about 55 percent now). South Africa is given 12 years to phase in the liberalization; the European Union, 10 years.[16] However, South Africa begins from considerably higher protection (10 percent average tariff, to be cut to 4.3 percent) than does the European Union (2.7 percent, to be cut to 1.5 percent). Liberalization is to be faster in industrial products on the EU side and agricultural goods on the South African side, reflecting their corresponding areas of comparative advantage. Free access will be granted to only 61 percent of South African agricultural exports by the end of the decade, and some important exports are to be excluded from liberalization (wine, citrus fruits, and apples). In contrast, EU barriers will be removed within 3 years for a range of industrial products (but more slowly for textiles, footwear, iron, and steel). The TDCA is not expected to pose major problems of trade diversion from ACP countries, because South Africa's exports are more heavily oriented toward industrial goods than is the case for most of the others.

Although the TDCA may be a model in terms of its lengthy phase-in, and perhaps as well in terms of its relatively ambitious goals for the extent of opening, it is unclear how fully it can exemplify future REPAs, for two reasons. The first is simply that South Africa is much more developed than the majority of Lomé countries. The second is that the agreement does not involve liberalization vis-à-vis third countries in the region, whereas the REPAs will do so.

### The Everything But Arms Initiative

In October 2000, the European Commission adopted an initiative, within the GSP, to admit free of duties and quotas Everything But Arms (EBA) from 48 LDCs, of which 39 were ACP.[17] This initiative, which was imple-

15. The description here is drawn from Bjørnskov and Krivonos (2001).

16. Note that one study, applying a computable general equilibrium (CGE) model incorporating dynamic effects, estimates that the long and back-loaded phase-in of liberalization reduces the impact of the agreement to 2 percent of South Africa's total growth during 2000–18, from a potential of 6.8 percent (Andriamananjara and Hillberry 2001).

17. The non-ACP LDCs are Afghanistan, Bangladesh, Bhutan, Cambodia, Laos, Maldives, Myanmar, Nepal, and Yemen.

mented in March 2001, removes protection on 919 agricultural line items (8-digit Harmonized System), leaving only 25 armaments tariff line items out of the total 10,500 product categories subject to restrictions. For three key products, liberalization is to be phased in gradually (2002–06 for bananas, and 2006–09 for sugar and rice; Page and Hewitt 2002).

It is less than obvious whether EBA is likely to have sizable or de minimis effects. The case for the latter includes the following:

- the LDCs account for only 1 percent of EU imports;
- 99 percent of imports from LDCs already pay no duty (Resal 1999), reflecting in part the fact that four-fifths of the LDCs already enjoy free entry for industrial and most agricultural goods as ACP countries;
- the safeguard clause in EBA allows withdrawal of LDC preferences if imports rise much above "usual levels";
- the amount of tariff revenue collected on imports from the LDCs in 1998 was a de minimis €7 million (Stevens and Kennan 2001), consistent with the de minimis 0.2 percent average after-preference tariff noted in table 2.1; and
- regulatory, sanitary, and phytosanitary standards will remain and could constrain increased trade.

The alternative case for a significant impact derives from

- the large gap between internal EU prices on key agricultural goods and the world price;
- the removal of quota limits for LDCs in these products;
- the fact that LDCs can engage in triangular trade to ship exports of their own goods to take advantage of the high EU price while filling the resulting gap in domestic demand by importing from elsewhere at the world price; and
- the availability of "cumulation" from other LDCs, EU, ASEAN, and SAARC suppliers in meeting rules-of-origin requirements (European Commission 2000).[18] LDCs need provide only 50 percent local content beyond inputs from these sources to qualify for EBA free entry.

The case for a substantial impact rests, moreover, either on sizable triangular trade or investment to develop production and export capacity beyond current levels.

18. The members of ASEAN, the Association of Southeast Asian Nations, are Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam. The members of SAARC, the South Asian Association for Regional Cooperation, are Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan, and Sri Lanka.

The large gaps between domestic EU price and world price, combined with potential supply capacity, create the most plausible substantial gains in bananas (where EU prices are 83 percent above world levels), rice (100 percent), and sugar (160 percent; European Commission 2000, 4). There is, however, a trade-off for the ACP LDCs. Under their current quota access in the banana, sugar, and rice protocols, they receive a windfall rent equal to the difference between the world and EU price on the amount of the quota. If there were major export expansion, the result would be to drive down the internal EU price, reducing the unit rent, so the net effect would depend on the proportion of export expansion compared with the proportionate reduction in the rent.

The European Commission (2000) estimates that EBA could increase LDC rice exports to the European Union by 450,000 tons annually, representing €135 million at the world price and $270 million at the EU internal price. The new regime could boost LDC exports of sugar to the EU by 900,000 to 2.7 million tons, representing a corresponding range of €225 million to €540 million at the lower end and €675 million to €1.62 billion at the upper end. The EC study does not estimate the impact for bananas, given the changes already on track in that protocol and the "low competitive position" of LDCs in this category.

For other affected agricultural products (cereals, fruits, vegetables, potatoes, meat, milk, butter, and cheese), the study hypothesizes that LDC exports to the European Union could rise by 3 to 10 percent of their existing domestic production. Applying the average of the European Union and world prices reported for these products, this could add €780 million to €2.6 billion to the export impact.[19] The lower of these two estimates seems far more relevant considering that as a group the LDCs consume more than domestic production in almost all these products (European Commission 2000, 7). Applying the midpoint of the estimates for rice and sugar, EBA could thus increase LDC exports to the European Union by somewhere in the range of €1.75 billion annually. This represents about 20 percent of the base LDC exports to the European Union.[20]

An impact of this size would indeed be major from the standpoint of the LDCs, though minimal relative to total EU imports of about $430 billion from all developing countries (table 2.1). Although these magnitudes would correspondingly require investment and increases in production, the figures do suggest that the potential effect is not de minimis.

Other similar analyses tend to identify the same key product sectors, but express more doubts about the likely supply response capacity of the LDCs. A study prepared for Oxfam argues that LDCs would be unlikely

19. About 40 percent of this total would be in vegetables, especially tomatoes, and another 15 percent in fruits.

20. This was reported as €8.1 billion in 1997 by Resal (1999).

to boost their sugar exports to the European Union by more than about 100,000 metric tons annually, far below the EC estimate of 900,000 to 2.7 million tons noted above, considering that LDC total exports in 1997 were only 191,000 metric tons (Stevens and Kennan 2001, 14). The European Food Security Network similarly emphasizes that except for "isolated cases such as Sudan, Zambia, or Malawi," the LDCs are sugar importers rather than exporters (Resal 1999, 4).

More generally, Stevens and Kennan note that there is only a limited number of product categories in which LDCs not only currently pay import duty in the EU market but also have supply capacity. Of about 500 narrowly defined product categories in which EU imports from LDCs amount to €0.5 million or more, only 11 did not already enjoy duty- and quota-free access before EBA, concentrated in beef, cheese, maize, bananas, rice, and sugar (p. 4). They also emphasize that among LDCs, those not within the ACP will benefit more, because the ACP states already had more favorable treatment in these relevant products.

A more formal analysis of EBA is provided by Bora, Cernat, and Turrini (2002). Using a computable general equilibrium (CGE) model, they calculate that upon full implementation EBA should generate static welfare gains totaling $400 million annually for SSA (excluding southern Africa[21]) and Bangladesh, with two-thirds of the gain coming from improved terms of trade. This estimate is in the right order of magnitude for consistency with the gross export expansion effect suggested above (€1.75 billion annually). Two-thirds of the welfare gains stem from improved terms of trade, which reflects the opportunity to obtain greater access to the EU market, where key agricultural prices are far above world levels. The rest stems from increased allocative efficiency, given the opportunity for LDCs to shift further toward agricultural goods in which they have comparative advantage. For a few economies, the welfare gains are as large as 0.8 to 1.1 percent of GDP (Malawi, Tanzania, and Zambia). The global welfare effect of the EBA is calculated to be slightly positive. Welfare losses are concentrated in the European Union ($250 million). These come wholly from a terms-of-trade loss, reflecting the rising unit cost of imports from LDCs as their exports move outward along an upward-sloping supply curve.[22] Trade diversion imposes welfare losses on other areas (the United States,

21. Southern Africa includes Angola, Botswana, Lesotho, Mauritius, Namibia, South Africa, Swaziland, and Zimbabwe.

22. This somewhat counterintuitive result is in contrast to typical CGE results for multilateral liberalization, which tend to show that the elimination of relatively high agricultural protection in industrial countries provides major welfare gains (IMF and World Bank 2001, 45–46). It would appear that the differing results stem from the fact that because the LDCs are such a small fraction of global supply, the primary effect of EBA is to drive up their supply prices to the European Union rather than drive down EU consumer prices. Note also that the model indicates a shift of resources away from LDC production and exports of textiles, apparel, and other industrial goods as a consequence of the shift into agriculture.

Japan, the rest of Asia, Latin America, North Africa, southern Africa, and China, for a combined total of $123 million).

Although not quantitative, another study (Page and Hewitt 2002) raises important questions about EBA, focusing on its potential adverse effects on other developing countries. LDC-designated countries in SSA could gain at the expense of non-LDC ACP countries (Malawi and Zambia vs. neighboring Zimbabwe; Uganda and Tanzania vs. Kenya).[23] Because countries with large populations are excluded from the LDCs (excepting Bangladesh), populous poor countries (especially India, Pakistan, and Indonesia) could lose from trade diversion under EBA. Their concern about trade diversion may be exaggerated, however, because the LDCs account for such a small fraction of EU imports from developing countries (only 2.4 percent in 2000; see table 1.4 in the present study).

At the same time, the arrangement could appear to many of the Cotonou countries to undermine that agreement. The authors also make the point that in evaluating EBA it is necessary to project overall EU trade policy. The potential benefits for sugar exporters will be quite different from a baseline calculation if the European Union instead phases out the sugar protocol. Finally, the authors stress that economic impact estimates based on existing trade and production (as in European Commission 2000) can fail to capture the introduction of entirely new production. They cite the surge of apparel from 0.01 percent of Bangladesh's exports in 1977 to 51 percent in 1991 in response to its exemption as an LDC from EU textile and apparel controls (Page and Hewitt 2002, 96).

Overall, the thrust of the various estimates is that there may be scope for significant albeit not particularly large benefits to the LDCs from EBA, while all effects are likely to be extremely small in relative terms for the European Union and the rest of the world.[24] This outcome reflects the asymmetry between the very small economic and export base of the LDCs and the large EU (and rest of world) markets. The paradox of significant impact despite nearly free LDC access already stems from the opportunity to exploit further the large rents stemming from high EU protection in a few agricultural sectors. Finally, however, the caveats of Page and Hewitt (2002) suggest some possible policy costs of EBA and also serve as a reminder that if the Doha Round successfully liberalizes agricultural goods of interest to the broader range of developing countries, the LDC preference will erode over time.

23. The calculation of their model at more aggregated regional levels means that Bora, Cernat, and Turrini (2001) do not capture such effects.

24. Thus, in Bora, Cernat, and Turrini's (2001, 56) results, whereas the welfare effect of EBA is in the range of +0.2 to +1.1 percent of GDP for SSA (excluding South Africa), it amounts to a vanishing –0.004 percent of GDP for the European Union.

## Special Regimes of the United States

Just as in the GSP, for most of the past three decades, the United States has had much more limited special regime preferences for developing countries than the European Union. The reason is mainly that whereas the European Community had special trade ties with former colonies and associated states dating back to its formation in the Treaty of Rome in 1957, the United States had no comparably intense historical ties. In Latin America, the natural partner area for the United States, trade shares in Argentina and Brazil have actually been higher with Europe than with the United States. Mexico, with its long US border, was the one exception, and in a sense proves the rule because it is now a free trade partner with the United States in NAFTA.

Gradually, however, the US special regimes have grown to rival or surpass those of the European Union. The guerrilla warfare in El Salvador and elsewhere in Central America at the height of the cold war helped foster the Caribbean Basin Initiative (CBI) in the early 1980s; the war on drugs had a similar effect in prompting the Andean Trade Preference Act (ATPA) in the early 1990s; and the African Growth and Opportunity Act (AGOA) for SSA beginning in 2001 further extended US special regimes.

As a result, by now the special preference trade regimes of the United States (even excluding NAFTA) encompass 76 countries (24 in CBI, 4 in ATPA, and 35 AGOA-approved and 13 additional AGOA-eligible), almost the same as the EU's 77 Cotonou partners. Using 2000 trade data, the US programs aggregate to somewhat more than those of the European Union (at least using total imports as opposed to those actually using preferences), representing $50.4 billion, or 11.6 percent of US imports from developing countries, in comparison with the EU's $30.8 billion in imports from Cotonou countries, or 7.4 percent of its imports from developing countries.[25]

### The Caribbean Basin Initiative

In 1983, the Caribbean Basin Economic Recovery Act (CBERA) launched the CBI. The arrangement gives zero- or preferential-duty treatment to 24 Caribbean and Central American countries. Although inclusion is contingent on such factors as respect for worker and intellectual property rights, and benefits can be revoked by the president, only Honduras has had its CBI preferences suspended (and only briefly, in 1998, over intellectual property issues).

25. The US breakdown is $19.9 billion, CBI; $10.9 billion, ATPA; $15.5 billion, 35 AGOA-approved countries; and $4.1 billion, 13 other AGOA-eligible countries. Calculated from IMF (2002a).

CBERA provides more generous treatment than the US GSP. Its rules of origin are less stringent: Whereas the GSP requires 35 percent value added in the country, CBERA allows for the cumulation of inputs from other CBERA countries, and up to 20 percent from the United States, in calculating value added. Similarly, there is no phaseout after a country passes a threshold of competitive need or on a basis of per capita income. Nonetheless, important products have been excluded from, or received only limited, preferences under CBERA, including most textiles and apparel, leather goods, petroleum products, and some footwear.[26] Many agricultural products are also subject to quotas and restrictions under sanitary standards. At the same time, other preferences are also available, either under the GSP or production-sharing arrangements.[27] As a consequence, of total US imports of $22 billion in 2000 from the CBERA countries, only $6 billion were eligible for CBERA preferences, while only $2.8 billion received preferences, and of these only $1.5 billion received preferences exclusively available under CBERA (USITC 2001, 18).[28]

In part to compensate for erosion of preferences following multilateral trade negotiations and the inception of NAFTA, and in part as a response to economic damage from Hurricanes Mitch and Georges, in May 2000 preferential access was expanded under the Caribbean Basin Trade Partnership Act (CBTPA). To remain in force through 2008—when it is to be superseded by another regional agreement or by the Free Trade Area of the Americas (FTAA)—CBTPA extends NAFTA-equivalent treatment to certain sectors previously excluded from full CBERA preferences, most importantly apparel but also footwear, watches, petroleum and petroleum products, tuna, and leather goods. Although President Bill Clinton declared all 24 CBERA countries eligible, as of late 2001 only 14 had applied and qualified by meeting customs-related requirements (USTR 2001a).

The arrangements under CBTPA would appear to reflect a key strategic decision by the textile industry in particular that the best strategy for confronting the termination of MFA quotas by 2005, as negotiated in the Agreement on Textiles and Clothing in the Uruguay Round, is to enter into partnership with low-cost apparel producers in the region on a basis of exports of US fabric as inputs. This reflects a shift away from traditional outright protectionism toward emphasis on obtaining access to foreign markets for US exports of textile fabric, which tends to be amenable to

26. The constrained sectors are the same as those exempted from GSP, and received only a 20 percent cut from the MFN tariff, subject to a maximum 2.5-percentage-point cut.

27. Under the production-sharing arrangements of the former tariff schedule article "807" (new Harmonized Tariff Schedule 9802.00.80), tariffs on inputs assembled from US-produced components have been levied only against value added abroad.

28. About half of the $16 billion imports from the region in 2002 ineligible for CBERA preferential treatment were in just 3 oil and gas categories ($1.9 billion) and 10 apparel items ($6.1 billion; USITC 2001, 16, 19). Other key products already were duty free under MFN tariff treatment.

mechanization and can be capital intensive, in return for opening the US market to imports of apparel (including that outsourced by US firms), which tends to be labor intensive and more suited to production by developing countries. CBTPA provides that to be eligible for duty-free entry into the US market, apparel produced in CBERA countries must use fabric made and cut in the United States. If the fabric is cut in the Caribbean Basin, it must be sewn with thread produced in the United States.[29] Apparel is already the most important industry in the region, and it accounts for the largest share of US imports, displacing oil and oil products, which have fallen from about half in the early 1980s to about 10 percent now.[30]

At first glance, CBERA might not seem to have had much of an impact. The grouping's share of total US imports has actually fallen over time, from 3.1 percent in 1983–84 to 1.8 percent in 2000 (USITC 2001, 15). However, the aggregate import data disguise a more dynamic performance of nonoil goods. Whereas US imports of oil[31] actually fell from $4.2 billion in 1984 to $3.1 billion in 2000, imports of all other goods from CBERA rose from $4.5 billion to $19.0 billion. This increase by a factor of 4.2 was somewhat greater than the corresponding growth of total US merchandise imports (by a factor of 3.7; IMF 2001b). Considering that total US imports of oil rose by a factor of 2.5 during this period (US Census 2002), it would appear that the weak aggregate performance of imports from the region has much more to do with market-organization factors sharply reducing the Caribbean share in the sourcing of US oil imports than with any inefficacy of the preferential regime.[32]

At the same time, there are reasons for expecting that the impact of CBERA could have been modest. Most eligible goods were also eligible for duty-free entry either in MFN categories with zero duty or under the GSP; some important goods with a potential comparative advantage, such as textiles, were omitted; the value of the preference was limited in many covered goods where tariffs were already low; and the arrangement did not cover nontariff restrictions. The differential impact of CBERA is further difficult to evaluate in view of other influences, including unilateral trade liberalization beginning in the late 1980s by a number of the countries, and foreign exchange reforms.[33]

29. Similar provisions apply for NAFTA but for North American inputs.

30. Other product composition changes have included a decline in tobacco and sugar, and an increase in fruits, chemicals, and plastics (USITC 2001, 16–23).

31. This is defined as mineral fuels, HTS chapter 27.

32. In particular, crude oil production capacity fell by 28 percent from 1984 to 2000 in the only major producing country, Trinidad and Tobago (2002 data from US Energy Information Agency, www.eia.doe.gov).

33. Unweighted average nominal tariffs fell from 22 percent in 1987 to 7 percent in 1998 in the Central American Common Market (CACM), and from 14.5 percent to 9.5 percent for nine Caribbean economies excluding the Bahamas and Dominican Republic (USITC 2001, 108).

Nonetheless, CBERA appears to have played a role in accelerating both foreign direct investment and export growth in the region. Thus, for the six Central American economies, median inward foreign direct investment rose from 0.8 percent of GDP in 1970–83 to 1.7 percent in 1984–98; for 13 Caribbean economies, the median rose from 1.0 percent of GDP to 5.0 percent.[34] Median annual real export growth rose from 2.75 percent in the first period to 4.4 percent for the Central American economies, and from 3.25 to 7.0 percent for the Caribbean economies.[35]

The US International Trade Commission has implemented an econometric model to evaluate the impact of CBERA (USITC 2001). For a pool of six Caribbean and six Central American economies during the period 1970–98, the model estimates an equation for economic growth as a function of capital, labor, technical change, and terms of trade. It also estimates an equation for investment, as a function of the expected growth of income. The analysis includes alternative measures of CBERA in the equations (coverage and utilization of CBERA-specific preferences). The results show a small positive influence of CBERA on growth in the region, but this appears to be limited to years when the countries were undertaking unilateral trade and foreign exchange liberalization measures themselves, and decreased over time as US trade became more open. They show a strong positive impact of production-sharing agreements on both growth and investment, although this impact was significantly eroded by the advent of NAFTA. The authors emphasize that the generally strong impact of production sharing underscores the importance of the CBTPA, which extends duty-free treatment to apparel produced using US fabric.

## The Andean Trade Preference Act

In 1991, as part of the war on drugs, the United States adopted the Andean Trade Preference Act, a regime of special trade preferences for four of the five Andean Pact countries: Bolivia, Colombia, Ecuador, and Peru. These four countries are the origin of "virtually all cocaine sold in the United States" (USTR 2001b, 3). In contrast, the excluded Andean Pact member, Venezuela, has not featured prominently in coca production, and as an oil-based economy with 81 percent of its exports in petroleum (IMF 2001b) was less germane for the strategy of providing economic incentives for diversification away from coca.

34. Nonetheless, any acceleration of direct investment appears to have been considerably more modest than in the case of Mexico under NAFTA. Thus, in the decade 1985–95 the stock of inward direct foreign investment in the CBI economies rose 137 percent, whereas in the first decade of NAFTA the corresponding stock rose 221 percent. Calculated from United Nations (2000, 296).

35. Calculated from USITC (2001, 101).

ATPA provides duty-free treatment for imports of all goods except those on an excluded or limited-preference list. Like the CBI, it required 35 percent value added but allowed cumulation from CBERA and ATPA countries as well as 15 percent from US inputs. Also like CBERA, it exempted from duty-free treatment textile and apparel products, crude and refined petroleum, canned tuna, certain footwear, watches, sugar, and rum products. Similarly, it granted only a 20 percent reduction (or 2.5 percentage points, whichever is smaller) in duties on other sensitive items, including handbags, luggage, gloves, and leather apparel (Hornbeck 2001, 9).

The potential export incentive from ATPA is limited by the fact that (in 1999) 40 percent of US imports from the grouping are in categories that were already duty free under MFN tariffs. Zero-tariff products include several traditional exports from the region, such as coffee, bananas, shrimp, and precious metals and stones. Another 1.6 percent entered duty free under production-sharing arrangements, and 1.3 percent, under the GSP. A major share of petroleum products in the region's exports also constrains the overall potential of ATPA preferences, which exclude oil and oil products. Nonetheless, a substantial 17.8 percent of imports entered under ATPA preferences (down somewhat from 19.7 percent in 1998, as a consequence of a rebound in oil prices). Products benefiting from ATPA preferences account for about 30 percent of US imports from the region for Bolivia, 40 percent for Peru, and 12 percent for Colombia and Ecuador (USTR 2001b, 11–12).[36]

Total imports from the four ATPA countries held relatively constant at 1 percent of overall US imports from 1991 through 1999. In view of the very rapid rise in imports from some other suppliers (e.g., China and Mexico), however, this outcome is not inconsistent with some trade stimulus from the arrangement. Moreover, in the second half of the 1990s, products actually granted ATPA preferences were the leading sectors for exports to the United States, showing export growth twice that of total exports from the region. Principal ATPA-beneficiary products have included cut flowers, copper cathodes, pigments, processed tuna, and zinc plates (USTR 2001b, 11).

In terms of the objective of offering product alternatives for diversification out of coca, the evidence does show major changes in coca production, although not necessarily or even likely because of ATPA itself. From 1991 to 1999, coca production fell 55 percent in Bolivia and 68 percent in Peru. In Colombia, however, it rose 227 percent. The most suggestive in-

36. A study by the Congressional Research Service (Hornbeck 2001) chooses instead to emphasize that only 10 percent of US imports enter under ATPA-unique preferences. This calculation, which is premised on the fact that much of ATPA-preference trade could have entered instead under GSP, tends to understate the impact of the regional program. Unlike the frequently expiring GSP, ATPA had a secure 10-year initial horizon, providing greater certainty, and its rules-of-origin treatment was more generous.

stance of a link to ATPA was the increase in Peruvian exports of asparagus, a cash crop grown near traditional coca areas (USTR 2001b, 2, 6). In contrast, Colombian cut flowers were already established as a major export prior to ATPA and have lost share in ATPA-preference imports (though cut flowers from Colombia and Ecuador still accounted for 25 percent in 1999, down from 40 percent in 1995; p. 5).

Overall, it would appear that ATPA has had at least a mild positive effect on its member countries' exports to the United States, which has been accompanied (if not necessarily spurred) by progress in coca eradication in at least Bolivia and Peru.[37] Some positive trade impact is consistent with the findings of Hufbauer and Kotschwar (1998, 81) that in 1995 US imports from the four members in 1995 were substantially higher than predicted with a gravity trade model.[38] The arrangement also appears generally to have avoided precipitating domestic US producer calls for restrictions.[39] The combination of at least a modest contribution to the antidrug war and an absence of major domestic opposition meant that upon expiration at the end of 2001, renewal of ATPA through 2006 was approved by July 2002. The delay arose from the attachment of the Trade Promotion Authority legislation to the ATPA renewal legislation, another indication that the US administration judged the regional arrangement politically attractive.

The reauthorization of ATPA as the Andean Trade Promotion and Drug Eradication Act in August 2002, through the end of 2006, liberalizes the arrangement by granting duty-free entry to footwear, petroleum, watches, handbags, luggage, work gloves, and leather apparel, subject to presidential determination that the article is "not import sensitive." Rum remains ineligible for duty-free treatment, and sugar remains subject to the general tariff-rate quotas. Duty-free entry is granted to apparel made from US fabric. Apparel from llama, alpaca, and vicuña fabrics is also duty free, as are hand-loomed products. Apparel produced with regional fabric is duty free, subject to a cap of 2 percent (rising to 5 percent over four years) of all US apparel imports. Finally, in a provision designed to mollify competing

37. Note that the USTR report emphasized that even in Colombia, in 1999 there had been "record levels of coca eradication" (USTR 2001b, 3).

38. Imports were about 30 percent higher than predicted for Peru, 90 percent for Bolivia, 160 percent for Colombia, and 540 percent for Ecuador. However, the model details are not reported. Nor is it clear whether the same model would have already underpredicted US imports on the eve of ATPA, a methodological issue raised above regarding gravity-model tests for the Lomé Convention.

39. Of the leading ATPA-member exports to the United States, only cut flowers have been large enough to constitute a major share of the US market (75 percent), although at about 7 percent each, copper cathodes and gold compounds have also been significant. Nonetheless, by 1999 US producers of cut flowers had desisted from seeking antidumping and countervailing remedies, an indication that they were no longer seriously concerned by the import competition (Hornbeck 2001, 7).

Philippine producers of canned tuna (subject to a 35 percent tariff), the reauthorization permits duty-free imports of tuna in pouches ("foil or other airtight containers") but not cans.[40]

## The African Growth and Opportunity Act

The US African Growth and Opportunity Act passed Congress in May 2000. The law extended preferential market access for qualified countries in SSA within the framework of the GSP effective January 1, 2001. To be eligible for AGOA preferences, countries must be making progress toward market-based economies, strengthening the rule of law, eliminating barriers to US trade and investment, protecting intellectual property, combating corruption, protecting human rights, and eliminating certain child labor practices. As of January 2003, President George W. Bush had designated 38 of the 48 SSA countries as AGOA beneficiaries (USITC 2002; *International Trade Reporter*, January 9, 2003, 80).

AGOA adds 1,800 tariff line items to the 4,600 more generally eligible for duty-free treatment under the US GSP (out of a total of 11,800 tariff line items). The additional products include footwear, luggage, handbags, watches, and flatware. The AGOA regime of market access is assured through 2008, whereas the GSP is subject to annual review. The qualifying SSA countries are also exempt from the competitive need limitations of the GSP.

Much trade from sub-Saharan Africa is already enjoying the benefits of the regime's special treatment, although the data on utilization can be somewhat deceptive. Goods enjoying duty- and quota-free benefits specific to AGOA account for only 43 percent of US imports from countries designated as AGOA beneficiaries. However, another 29 percent enters duty free under zero MFN rates applicable to all suppliers, and a further 3 percent enters free under the GSP. Fully three-fourths of imports from AGOA beneficiaries thus enter duty free.

The full potential has not yet been met, however. In the important sector of apparel, only 38 percent of imports are duty free, and the fraction is even lower for sugar, tobacco, iron, and steel—all traditionally protected sectors in the United States. Features of eligibility approval and time horizon also unduly limit investor certainty and thus AGOA's impact on exports and job creation.

The AGOA legislation removed all existing quotas on textiles and apparel from sub-Saharan Africa (USTR 2003). In effect, for AGOA countries, this moved up by five years the date scheduled for the international elimination of textile and apparel quotas under the MFA negotiated in the

40. The Philippine authorities took sharp exception anyway, it turns out (*New York Times*, August 1, 2002).

Uruguay Round of multilateral trade negotiations. The apparel provisions of AGOA grant unlimited duty-free and quota-free access to SSA apparel made from US fabric, yarn, and thread. Apparel made from SSA fabric is also granted free access up to a cap set at 3 percent of overall US apparel imports, rising to 7 percent by 2008.[41]

The 2002 US Trade Promotion Act provided a modest liberalization of treatment in the sector by doubling the duty-free access for knit apparel. Countries with a per capita gross national product below $1,500 in 1998 further have duty-free access for apparel made from fabric of any origin through September 2004.[42] The use of the apparel provisions, however, is contingent on establishing effective visa systems to monitor against transshipment and counterfeiting.

In 2001, the 36 countries that qualified for AGOA benefits accounted for $17.6 billion in US imports, of which $11.0 billion (62.5 percent) was in oil (USITC 2002).[43] AGOA countries accounted for 96.4 percent of total US nonoil imports from sub-Saharan Africa, and 83.4 percent of US imports of all goods from the region (reflecting the fact that a major oil exporter, Angola, has not yet been declared eligible).

Because oil accounts for the bulk of US imports from sub-Saharan Africa, and because the MFN tariff on oil is already low at only 1.0 percent (USITC 2003), the potential impact of AGOA preferences on African growth lies primarily in the possibility of developing nonoil imports in the future.[44] Imports of apparel and textiles from AGOA countries have already shown considerable dynamism, rising from $651 million in 1999 to $789 million in 2000, $1.02 billion in 2001, and $1.18 billion in 2002 (USITC 2003). Imports of vehicles and parts have risen even more rapidly, from $121 million in 1999 to $573 million in 2002. Aggregate nonoil imports have risen from an average of $5.3 billion in 1998–99 to an average of $6.6 billion in 2000–02. For the seven quarters following passage of the AGOA legislation compared with the seven quarters before, the ratio of

41. This is under the limits adopted in the August 2002 revision of the law. The cap had originally been set at 1.5 percent of total US apparel imports, rising to 3.5 percent over eight years.

42. Although this Special Rule applied in 2002 to 30 of the 36 AGOA countries, it excludes South Africa as well as Gabon, Mauritius, and Seychelles. Botswana and Namibia were granted exceptional access to the Special Rule in AGOA II adopted in August 2002.

43. Oil trade is measured by Standard International Trade Classification (SITC) category 3.

44. In 2000, US imports from sub-Saharan Africa in HTS 2709.00.20 (crude oil 25° API or more) amounted to $8.6 billion, and in HTS 2710 (refined oil not elsewhere specified), $4.1 billion, comprising virtually all fuel imports. The MFN duty on the first category is 10.5 cents per barrel. The highest duty in the second category is 52.5 cents per barrel. The SSA data for this category are not broken down, so the calculation here applies the highest rate. For both categories, the rates are taken as a percent of the 1999–2001 average price per barrel for Brent oil ($23.5; IMF 2003).

**Table 2.2 US imports from AGOA countries by product and duty treatment, 2001** (thousands of dollars)

| Product category (HTS2) | | Total | Zero-duty MFN | Noneligible AGOA | Eligible AGOA | Utilized AGOA | GSP |
|---|---|---|---|---|---|---|---|
| 3 | Fish | 80,284 | 80,276 | 8 | 0 | 0 | 8 |
| 9 | Coffee, tea | 157,000 | 155,386 | 1,614 | 0 | 0 | 1,517 |
| 17 | Sugar | 38,525 | 0 | 38,525 | 0 | 0 | 29,236 |
| 18 | Cocoa | 276,109 | 264,940 | 11,168 | 0 | 0 | 21,404 |
| 24 | Tobacco | 42,135 | 2,449 | 176 | 39,509 | 8,199 | 15,769 |
| 1–23 | Other agricultural | 174,620 | 77,104 | 22,018 | 75,498 | 50,421 | 11,845 |
| 25 | Cement, etc. | 44,481 | 42,166 | 2,314 | 0 | 0 | 574 |
| 26 | Ores | 351,649 | 351,380 | 190 | 79 | 0 | 33 |
| 27 | Oil | 11,022,039 | 846,008 | 0 | 10,176,031 | 6,827,422 | 0 |
| 28 | Inorganic chemicals | 129,194 | 50,535 | 78,659 | 0 | 0 | 67,874 |
| 29 | Organic chemicals | 349,768 | 321,656 | 24,596 | 3,517 | 0 | 20,130 |
| 30–43 | Miscellaneous A | 117,798 | 41,311 | 63,701 | 12,786 | 4,564 | 52,228 |
| 44 | Wood products | 81,626 | 60,728 | 20,870 | 28 | 0 | 19,703 |
| 45–49 | Cork, straw, pulp, books | 33,155 | 30,684 | 2,006 | 464 | 66 | 1,479 |
| 50–56 | Yarns, fibers | 22,490 | 1,520 | 20,971 | 0 | 0 | 570 |
| 57–60 | Fabrics | 14,015 | 53 | 13,962 | 0 | 0 | 743 |
| 61–62 | Apparel | 938,795 | 0 | 938,795 | 0 | 355,771 | 31 |
| 63–70 | Miscellaneous B | 35,783 | 6,544 | 27,643 | 1,596 | 318 | 21,595 |
| 71 | Precious stones and metals | 2,105,331 | 2,077,584 | 27,743 | 4 | 0 | 26,822 |
| 72–73 | Iron and steel | 327,610 | 15,574 | 171,837 | 140,200 | 91,166 | 122,707 |
| 74–75 | Copper, nickel | 28,535 | 19,413 | 9,122 | 0 | 0 | 8,923 |
| 76 | Aluminum, products | 119,144 | 53,632 | 65,201 | 312 | 0 | 64,066 |
| 77–83 | Miscellaneous C | 62,557 | 28,959 | 33,415 | 183 | 2 | 13,394 |
| 84–86 | Machinery and equipment | 327,003 | 283,172 | 42,217 | 1,614 | 44 | 32,176 |
| 87 | Vehicles | 359,485 | 30,854 | 58,791 | 269,840 | 241,169 | 47,750 |
| 88–97 | Miscellaneous D | 83,833 | 58,966 | 23,365 | 1,502 | 16 | 19,611 |
| 98–99 | Special | 250,523 | 250,030 | 493 | 0 | 0 | 0 |
| | **Total** | 17,573,488 | 5,150,926 | 1,699,400 | 10,723,161 | 7,579,158 | 600,189 |

AGOA = US African Growth and Opportunity Act
GSP = Generalized System of Preferences
HTS2 = 2-digit Harmonized Tariff System
MFN = most-favored nation

*Source:* Calculated from USITC (2003).

US imports of nonoil goods from AGOA countries to those from other non-OECD countries rose by 3.8 percent (USITC 2003).[45] All these trends suggest a meaningful initial impact of the regime.

Table 2.2 provides the details of the duty treatment and product composition of US imports under AGOA in 2001. Clearly, there has been major

45. The ratio of course remains small, at 2.06 percent in the second period versus 1.99 percent in the first.

movement toward the objective of granting free access to the US market for AGOA countries, because three-fourths of US imports from them enter duty free. Imports granted duty-free entry by preferences specific to AGOA amount to 43 percent of US imports from the group.[46] In addition, 29 percent of imports enter duty free because they are in product categories that already had zero MFN tariff rates applicable to all suppliers. This relatively large share of MFN duty-free goods in the product mix (mainly precious stones and metals, but also large amounts in oil, chemicals, ores, machinery and equipment, and cocoa) is the major explanation for why fewer than half of total imports from AGOA use its specific duty-free provisions. If the imports entering with GSP rather than AGOA special treatment are also included ($600 million), total imports entering effectively at zero-duty treatment amounted to $13.3 billion, or 75.9 percent of the total. Three-fourths of imports from AGOA countries thus entered duty free one way or another.

The table also indicates that about $3 billion in imports was eligible for AGOA benefits but did not utilize them. This amount, however, was almost entirely in oil products. Considering the very low oil tariff, the implication seems to be that for about 30 percent of oil imports, the firms involved consider the potential tariff savings from AGOA too small to warrant the administrative procedures required to obtain them.

In contrast, the most conspicuous area in which the effective use of AGOA benefits would have had the greatest additional impact but where usage has been limited is apparel imports, where MFN tariffs are high. Only 38 percent of these imports entered with duty-free AGOA benefits in 2001, reflecting the rules of origin and ceilings discussed above. There are also significant gaps between total imports and the amounts receiving AGOA benefits (or enjoying zero MFN duties) in sugar, tobacco, inorganic chemicals, and iron and steel. It is likely no coincidence that these sectors include ones that in the past have been subject to protectionist pressures. These and other sectors included a total of $1.34 billion (7.6 percent of total imports) in goods ineligible for AGOA benefits.

## Testing for the Trade Impact of Preferential Regimes

As discussed in the previous sections, it can be difficult to detect the impact of special trade regimes for developing countries. One reason is

46. Thus, of total imports of $17.6 billion from AGOA members, the amount reported by the USITC as utilizing AGOA-specific duty-free entry benefits was $7.6 billion. Note that both the amount utilized and broader amount listed in the table as AGOA-eligible include $356 million in apparel imports, even though apparel as a whole (HTS categories 61–62) is recorded as ineligible in the summary USITC statistics, presumably because of the special rules-of-origin requirements and ceilings.

likely that these regimes tend to be established on behalf of countries whose economies and export sectors are relatively weak, so it becomes particularly important to consider the counterfactual (how exports would have performed without the arrangement) rather than merely the observed outcome. Otherwise, lackluster export growth in comparison with that of stronger developing economies may falsely be attributed to the inefficacy of the special regime.

It is useful to consider a "metatest" to determine whether there is evidence of an impact of special trade regimes on the export performance of the eligible countries. For a pool of 100 developing countries, annual real export growth in the period 1981–2001 can be related to a series of macroeconomic variables as well as to dummy variables capturing whether the country is a member of a special trade regime. Real exports are estimated as nominal dollar exports deflated by the unit value of world imports (IMF 2002a, 2002b). The first macroeconomic variable is global growth (using market rather than purchasing parity exchange rates, because it is the former that matter for effective demand) as estimated by the International Monetary Fund (IMF 1990, 2002c). Next are two variables designed to capture the country's export growth capacity. The first is the lagged average rate of growth of real GDP for the country in the previous three years. This measure separates out those countries that chronically achieve high economic performance from those that chronically fail to achieve satisfactory growth. It is to be expected that the pace of building export capacity, like that of other areas of the economy, will be greater in the former than in the latter.

The second capacity variable is purchasing power parity GDP per capita. To the extent that poor countries have a lesser capacity for export expansion than richer countries, this variable will be positively related to export growth. If instead the dominant influence is the general "convergence" trend (as found in chapter 1 for GDP per capita in 1960–2000), the sign for this variable will be negative because trade will tend to grow faster for poorer countries. The next macroeconomic variable is the real effective exchange rate. A more rapid pace of export growth can be expected from a country that has a relatively depreciated real exchange rate that provides a relative price incentive to shift resources into the production of exports and import substitutes rather than into nontradable goods. Another economic variable determining export performance is the share of exports in manufactures. In broad terms, there has tended to be a falling relative price for raw materials after the 1970s, deterring expansion of production and exports.

The impact of special trade arrangements is tested through the inclusion of a binary (1–0) dummy variable for countries (and years) in which special access was available through the Lomé or Cotonou arrangement ($D_L$), Caribbean Basin Initiative ($D_C$), or Andean Trade Preference Act

($D_A$).[47] Finally, in part because of the strong pattern of below-norm economic performance in SSA identified in the convergence analysis of chapter 1, a dummy variable is included for SSA countries ($D_S$). Otherwise, given the substantial overlap between SSA and Lomé countries, the weak export performance associated with weak economies in the region could spuriously be attributed to Lomé membership.

Equation 2.1 reports the results of an ordinary-least-squares regression for pooled cross-section and time-series observations for 100 developing countries during the period 1981–2001 (*t*-statistics are in parentheses):

$$GX^*_{i,t} = \underset{(-1.53)}{-6.93} + \underset{(2.48)}{1.93}GW_t + \underset{(1.61)}{0.41}GYLAG_{i,t} + \underset{(1.97)}{0.079}\,MFSHR_{i,t-1} + \underset{(2.36)}{7.76}\,REER_{i,t-1}$$

$$\underset{(-1.00)}{-0.00040}\,yppp_{i,t\text{-}1} + \underset{(2.36)}{8.83}D_L + \underset{(2.39)}{7.23}D_C + \underset{(0.29)}{1.66}D_A \underset{(-2.36)}{-10.75}D_S;$$

$$\text{Adj. } R^2 = 0.0163; \text{ no. obs.} = 1{,}412. \qquad (2.1)$$

The variables are as follows: $GX^*_{i,t}$ = percentage growth rate of real exports for country *i* in year *t*; $GW_t$ = percentage real growth rate in world GDP (at market exchange rates); $GYLAG_{i,t}$ = average real percentage growth rate of country *i* for the three years preceding *t*; $MFSHR_{i,t-1}$ = percent of exports in manufactures for country *i* in year prior to *t*; $REER_{i,t-1}$ = index of real effective exchange rate for country *i* in year *t* (1981–2002 average = 1.00); and $yppp_{i,t-1}$ = purchasing power parity GDP per capita in the year prior to *t* (dollars).[48]

The estimated coefficients generally have the correct signs, reasonable statistical significance, and are of plausible orders of magnitude. The elasticity of developing-country real export growth with respect to growth of global GDP is about 2, and is strongly significant. The "export capacity" variable (significant at almost the 10 percent level) states that an extra percentage point in recent average growth tends to be associated with 0.4 percentage point in extra export growth, a reasonable capacity-boosting effect. As for the level of per capita income, apparently the convergence influence dominates rather than the economic capacity influence, because the coefficient is negative. Nonetheless, this variable is not statistically significant.

47. For four Caribbean economies—the Dominican Republic, Haiti, Jamaica, and Trinidad and Tobago—the regional preferential area is limited to the CBI rather than also attributed to the Lomé Convention in which they also participated, because their trade with the United States far exceeded that with the European Union.

48. The real effective exchange rate is calculated in terms of units of local currency per dollar, against the six major industrial countries, deflating by consumer prices and weighting by bilateral trade shares. It has a base of unity set at the 1981–2001 average for the country in question.

The manufacturing share coefficient at 0.079 (which is significant at the 5 percent level) means, for example, that a country with manufactures at 50 percent of GDP typically will have experienced 0.79 percent higher annual real export growth than a country with manufactures at 40 percent of GDP, again reasonable. The coefficient on the real exchange rate index means that, for example, if a country depreciated by 20 percent (raising the index from 1.0 to 1.25), the pace of real annual export growth would rise by 1.94 percentage point and remain at this new higher level as long as the new level of the real exchange rate remained in place.[49] The coefficient is statistically significant at the 2 percent level.

The overall degree of statistical explanation is extremely low, with an adjusted $R^2$ of only 1.6 percent. However, this is not unusual for such a large data set, especially when the dependent variable is stated in percentage change terms rather than in levels.[50]

The key variables of interest are the special regime dummies. The dummy variables for the CBI and Lomé are both large and are statistically significant at the 2 and 7 percent levels respectively. They indicate that, other things being equal, preferential regime membership has boosted real export growth by 7.2 percent annually for CBI countries and 8.8 percent for Lomé countries. The coefficient for ATPA shows a corresponding boost of 1.7 percent annually, but it is statistically insignificant (reflecting perhaps the relatively small number of observations as only four countries are in this regime). As expected, the dummy for SSA is negative; it is also large and highly significant, and it indicates that an SSA country typically had 10.7 percent lower real export growth annually than would otherwise be expected.

The CBI and Lomé dummy variables are so large that they suggest taking a second look. When the regression is run screening out the highest and lowest 1 percent of export growth observations, the result is to shrink the CBI coefficient from 7.2 to 2.2, and the Lomé coefficient, from 8.8 to 5.2. The screening also removes statistical significance.[51] The strong results from the full sample thus appear to be driven by extreme observations. On this basis, a balanced assessment would probably place the special regime effect on export growth at about 5 percent annually for Lomé and 2 percent for the CBI rather than the larger impact coefficients estimated from the full sample. The corresponding ATPA arguably could be placed at about 1.5 percent.

49. The more normal formulation of the exchange rate effect, a lagged percent change, was investigated (using a distributed lag of 0.25 on current year, 0.5 on previous year, and 0.25 on two years prior) but found statistically insignificant.

50. Using percentage changes avoids any question of nonstationarity.

51. The ATPA coefficient rises marginally to 1.76. The *t*-statistic for CBI falls to 1.00 (insignificant), and for Lomé, to 1.48 (significant only at the 15 percent level). In the screened test, the SSA dummy also falls, to –6.28.

This metatest, then, suggests an important favorable effect of the special regimes on export performance of their members, even after some downscaling to adjust for extreme observations. The results suggest the importance of taking into account the counterfactual of export performance given general macroeconomic variables. The more typical analyses that simply examine the export growth of preferential regime countries against nonmember countries fail to do so, and hence can attribute to regime inefficacy a weak performance that instead reflects more important macroeconomic differences between, for example, such members as Haiti, for Lomé, and nonmembers such as South Korea. Indeed, if we consider that the very reason for the existence of the special regimes is to compensate for the economic weakness of the members, the direction of bias we should expect is toward understatement (or even negative-impact estimate) in a simple (as opposed to econometric or other counterfactual) comparison between members and nonmembers.[52]

## Policy Implications

Regimes of special preferential trade access for developing countries are often considered to have provided little developmental impact and to pose distortions that make them inadvisable as a developmental strategy. The review of the GSP presented at the outset of this chapter suggests that the effects of that regime have indeed been limited, in part because of graduation provisions and product exclusions. However, closer examination of the Lomé, CBI, and ATPA arrangements suggests that these more focused programs have had greater impact, and AGOA might also do so once it has time to take effect. In the context of the relationship between trade policy and global poverty, these findings suggest that enhanced regimes of truly unencumbered market access for poor countries with a high incidence of poverty (and a high share of the poor in national income) could make an important difference to export and growth prospects. Before considering what such regimes might look like, it is important to address three related policy issues—the relationship between investment and trade, the trade diversion problem, and the relationship of deeper preferential access to multilateral and FTA liberalization.

### The Investment Connection

There is every reason to believe that the synergism between more dynamic direct foreign investment and enhanced market access opportuni-

52. Note also that the result here for Lomé is in the same spirit as that obtained by Nilsson (2002), cited above, but does not suffer from the inconsistency in that result whereby there was already a positive Lomé effect before the regime existed.

ties can substantially enhance the export and growth opportunities arising from special regimes for poor countries. As was noted above, direct investment in Mexico has soared under NAFTA, facilitating the expansion of production facilities to accomplish rapidly growing exports to the US market. The review of the CBI above also emphasizes the acceleration of direct investment under this regime.

The importance of the synergism between trade and investment suggests that if efforts are to be undertaken to enhance further market access as a means of reducing global poverty, these should be accompanied by measures that help spur direct investment in the countries in question. One measure especially warrants consideration: the exemption from corporate taxation of earnings on direct investment in specified poor countries or groupings (e.g., AGOA) for new investments undertaken during the next 10 to 15 years. For the United States in particular, the "residential" basis for corporate taxes means that corporate income is taxed at US rates even if it is earned in, for example, South Africa. Most other countries apply some combination of the residential principle and the "territorial" principle, whereby the tax obligation is solely to the host country. Existing US investment tax treaties do tend to provide for allowance of the host-country's taxation against US taxes otherwise due, but if the host tax is low, this still leaves the total tax obligation at the US rate. With outright exemption, the developing host country could enjoy either the tax revenue or, perhaps more relevant, the growth benefits of a stimulus to direct foreign investment through the granting of a partial or full tax holiday of a given duration (e.g., 10 years).[53]

A second instrument for spurring direct foreign investment is the use of political risk insurance (in the United States, through the Overseas Private Investment Corporation, or OPIC). For countries selected for special trade and investment treatment for purposes of alleviating global poverty, it would be possible to make particular efforts to ensure that such insurance is available, perhaps by allocating some portion of official assistance toward paying the higher risk premiums that might be required. In the specific case of OPIC, Moran (2003) argues that the agency is unduly constrained by legislative restrictions against providing insurance where there will be any loss in US jobs whatsoever, rather than taking account of US export jobs. This and other restrictions against activity in "sensitive" sectors such as textiles and apparel would need to be eliminated or suspended for investment in specified poor countries or regional groupings for perhaps 10 to 15 years to enable OPIC to play an active part in an overall trade and investment package for these countries.

53. CCFA (2003, 6) similarly calls for exemption from US taxation for any US company doing manufacturing or service business in any African country. Hufbauer and Wong (2002) outline possible terms for such an exemption.

## How Serious Is the Trade Diversion Problem?

A second issue that must be considered is whether preferential trade regimes are adverse in their effect because they create trade diversion. Overwhelmingly, the practical question here is simply whether the magnitudes are large enough to worry about. If special regimes for poor countries are the focus of the question, the answer is almost certainly no.

Chapter 1 observes that the three most prominent special groupings of poor countries—HIPCs, LDCs, and SSA—comprise approximately 64 countries with a combined population of 1.0 billion people, of whom 715 million are living in poverty (at the $2 per day threshold; table 1.3). Moreover, this set of countries has the highest "poverty intensity" in the imports of industrial countries, simply because the poor in these countries receive a much higher fraction of total income than they do in middle-income countries, which nevertheless also have large absolute numbers of poor people (e.g., Brazil and China).

If an enhanced special regime were to be limited to this threefold set of poor countries, on a basis of trade data for 2000 only 6.4 percent of total US imports from developing countries would be involved, only 8.5 percent for the European Union, and only 3.8 percent for Japan (calculated from IMF 2002a and from table 1.4 in this volume).[54] Moreover, as much as half or more of these imports is in oil, where protection is already extremely low. The normal concern that exports would be diverted from the other developing countries to those included in the special-access program would thus be minimized, because even a large proportionate increase in the exports of the poor countries, and even the assumption that a large fraction of this increase came out of the potential exports of other developing countries, would mean only a minor loss of export opportunities for the other, more advanced developing countries.[55]

## The Relationship to Multilateral and FTA Liberalization

Another issue that must be considered is whether preferential regimes make any sense in a world moving toward more completely free trade multilaterally and free trade in a growing number of increasingly important FTAs. These liberalizations erode the potential impact of preferen-

54. In absolute terms: $27.8 billion, $35.3 billion, and $5.4 billion, respectively.

55. As for the traditional static welfare effects of trade diversion, and whether there would be enough trade creation to offset them, these considerations would seem of secondary importance given the magnitudes involved, and in any event would be an inadequate basis for policy evaluation in a context in which the main objective is to address global poverty. In principle, some dollar valuation—e.g., the amount of grant development assistance that could equivalently be forgone (for the same poverty reduction impact—would be necessary to obtain more meaningful welfare estimates of trade diversion in such a regime.

tially free access. However, it will be some considerable time before global trade is truly free as a consequence of multilateral and/or FTA liberalization. The Doha Round was inaugurated in 2001. In the most recent round of multilateral negotiations, the Uruguay Round, the time lapse from the launching of the round (1986) to its full implementation (2005, for dismantling textile quotas) was 19 years. This suggests that a time horizon of some two decades remains ahead in which special market access for poor countries could retain a meaningful economic content, even if the Doha Round and the constellation of new FTAs (including a possible Free Trade Area of the Americas) were eventually to yield totally free global trade—an outcome unfortunately unlikely to be attained. Moreover, as outlined in chapter 6 below, providing a positive incentive through an immediate deepening of preferential access as part of an overall Doha Round agreement could help ensure that "at-risk" low-income countries are not tempted to block multilateral liberalization for fear of the erosion of existing preferences, a risk heightened by the new "single-undertaking" structure of WTO negotiations requiring general consensus.

## A Policy Strategy for Free Market Access for Poor Countries

Chapter 1 pointed out that the poverty intensity of industrial-country imports from HIPCs, LDCs, and SSA countries is in the range of 40 to 50 percent on a basis of the share of the poor in supplying-country income, and 60 to 70 percent on a basis of the headcount share of the poor in the populations of these countries. This chapter has broadly concluded that the preferential access regimes constructed under the EU's Lomé Convention and the United States' CBI and ATPA have had a meaningful, positive effect on the export performance of the countries in question, and there are initial signs of a positive effect even for trade under the new AGOA arrangement. Similarly, experience with the CBI (and even more so with NAFTA) suggests that the foreign direct investment effects of such regimes can be important as well.

If these strands are gathered together in pursuit of a strategy for using the trade policy instrument to combat global poverty, the following type of regime begins to suggest itself as applicable to all industrial countries and especially the United States, European Union, and Japan:

- completely duty- and quota-free entry to imports from all HIPCs, LDCs, and SSA countries (collectively, the "HLS" countries);
- exemption from corporate taxation on earnings from foreign direct investment in this set of countries for a specified period of time, such as 10 to 15 years, making it feasible for the host developing countries to adopt tax incentive regimes to spur investment to complement the new trade opportunities;

- commitment to refrain from all contingent protection, including antidumping and safeguard measures;
- sweeping simplification of rules of origin, with inputs purchased either from the importing country (e.g., textile fabric purchased from the United States) or from any poor (HLS) country counting toward local value-added measures;
- availability of trade adjustment assistance for workers deemed to have been displaced by increases in imports from HLS countries under the special-access regime;
- guaranteed continuation of the free access for a decade even if internal political conditions change.

Because the trade base of the HLS countries is small, a comprehensive free access program along these lines could make possible a large proportionate increase in their exports without breaching magnitudes of trade change that would be likely to impose significant worker displacements; even so, provision for trade adjustment assistance (e.g., along the lines of the new US Trade Promotion Act) could help provide assurance to domestic labor organizations that helping reduce global poverty would not seriously jeopardize their own prosperity.

The guarantee of continued eligibility despite possible setbacks on, for example, domestic governance, would be necessary to ensure that the regime provides investment incentives even in countries facing periodic domestic instability. The industrial-country governments could rest assured that in countries where there were sharp deteriorations in such dimensions as corruption and human rights, it would be highly unlikely that there would be robust investment and expansion of exports, so there would be little prospect that the regime could somehow "reward" governments pursuing adverse paths. Conceivably, the initial membership of eligible HLS countries could exclude the most egregious offenders under such criteria, however.

Finally, for the case of the US regime for AGOA, several major enhancements would seem desirable (Cline 2003a). Special regimes such as AGOA work only if they induce investment in productive capacity. The current structure of AGOA has three major limitations that inhibit this result. First, each country's eligibility must be reviewed annually. Second, the regime expires in 2008. Third, duty-free entry for apparel remains subject to the restrictions on source of fabric, as described.

Regarding the first of these, the desire for review is understandable, because the problem of governance has been perhaps the foremost source of disappointing growth in SSA in the past. At the same time, an annual review seems an unduly "short leash" that unnecessarily adds uncertainty

to any potential investor's decisions. A useful reform would be to assure *eligibility for a period of five years* once a country has qualified. (There could be a qualification allowing the president to revoke eligibility in extreme circumstances, e.g., when a government has been deposed by force.)

Second, the *term of AGOA could be extended to 10 years* (through 2013) prior to full review of the regime (rather than through 2008, as presently provided). Moreover, the revised term could provide for indefinite continuation unless Congress passes legislation to the contrary, rather than calling for automatic expiration unless Congress acts to extend (as presently provided).

Third, the *regime for apparel could be substantially liberalized*. The general AGOA requirement for duty-free access for apparel is that it be made using fabric and yarn imported into Africa from the United States. The two exceptions to the US-fabric rule are duty-free entry up to a ceiling of 3 percent of US apparel imports, rising to 7 percent by 2008, for AGOA apparel made from fabric produced within the region itself; and, for 30 poorer SSA countries, duty-free entry for all apparel (regardless of fabric origin) but within this same volume cap and only through 2004. The presence of the volume cap and the imminent expiration date for special treatment of the 30 poorer countries act as a source of uncertainty for investors, while the actual volume of imports remains very low—only about 1.5 percent of US apparel imports in 2002 (table 2.2; USITC 2003).

An appropriate reform would be to remove altogether the volume ceiling for duty-free entry of apparel made from SSA-regional fabric. Similarly, for the poorer countries, the cap could be removed for apparel made from fabric of any source, and this provision could apply for the full 10-year horizon of an enhanced AGOA rather than expiring in 2004. This liberalization could be accompanied by provision for an automatic triggering of a review of whether injury has occurred warranting safeguard protection if total apparel imports from AGOA exceed, for example, 15 percent of total US apparel imports. Certainly over the longer term, it would be desirable for a major share of apparel imports to come from the poorest region in the world, in light of the underlying objective of using AGOA to reduce global poverty.

Fourth, AGOA could be amended to grant the same *exemption from safeguards protection* that applies to Canada and Mexico under NAFTA, which prohibits application of such protection unless the Canadian or Mexican share in US imports of the good is "substantial" and "contributes importantly" to the US industry's difficulties.[56] Although the existing WTO provisions already give some shelter to developing countries from safeguard

56. Imports from Canada or Mexico are considered "substantial" in the agreement if the country is among the top five suppliers of the product to the United States.

restrictions,[57] NAFTA-type treatment would provide a higher degree of assurance that safeguards would rarely be imposed on AGOA suppliers.

The overall effect of this policy approach would be to adopt an aggressive program of immediate free market access for goods from "at-risk" poor countries, combined with a complementary policy of tax exemption on direct investment in these countries. This track of trade policy would most directly address the concentration of about one-fourth of the global poor in countries where the share of the poor in national income is high (because the vast bulk of the population is poor). A parallel track of more generalized trade liberalization for other developing countries would be pursued to address the other three-fourths of global poverty. Chapters 3 through 5 turn to the potential poverty reduction effects of multilateral trade liberalization.

57. The Uruguay Round agreement provided that an industrial country could not impose safeguard protection on an import from a developing country if the amount imported did not exceed 3 percent of the industrial country's total imports of the good, and imports from developing countries collectively did not exceed 9 percent.