

CGD Global Trade Preference Reform - Washington Consultation Meeting

September 25, 2009 - 10:00am – 2:00pm

Randall Soderquist opened the meeting with a quick description of the origin, purpose, composition, timeline, and goals of the Global Trade Preference Reform Working group. It was emphasized that Chatham House rules applied to the discussion.

Kim Elliott followed with a quick description of how the deliberations of the Working Group has proceeded on substantive issues, with an emphasis that 100% duty-free, quota-free (DFQF) market access to developed countries for the least developed countries (LDCs) will almost certainly be the core recommendation. She stated that the key questions she would like to discuss during the meeting were: 1) whether to expand eligibility for trade preference programs beyond LDCs and, if so, for which countries and using what criteria for classification; 2) how to improve actual versus “nominal” access for developing countries through improvements in rules of origin and cumulation schemes; 3) what methods of graduation should be used in preference schemes; 4) what complementary measures can be used to overcome ongoing obstacles related to utilization, a specific example being sanitary/phyto-sanitary (SPS) standards, and; 5) what can be done to address in an effective and sustained way the issues related to supply-side constraints. Randall added that he would like to discuss the issue of conditionalities.

On the issue of 100% DFQF market access to developed countries by the LDCs, one participant stated that while 100% DFQF for all LDC is not politically realistic, she feels that the Working Group should push for 100% DFQF and then be prepared to discuss the issue with Congress and domestic constituencies. The participant felt that because the 97% figure was established prior to this Administration, they did not necessarily agree to it. Another participant said the Working Group should do what needs to be done for development, not what is politically feasible, and should pursue the 100% DFQF proposal. There seemed to be general agreement among participants on this issue.

A question was raised concerning what should be expected from emerging economies on the 100% DFQF issue. One participant stated that emerging economies that do not provide DFQF to LDCs should not be included in the cumulation system or allowed to provide inputs. Another participant stated we had not determined what an emerging economy was, and that answer should come first. A participant responded that since there was not a clear definition, we should simply examine which countries are currently implementing or plan to implement a trade preference program as that would be a sufficient guideline.

Another participant stated that one way to encourage emerging economies to provide preferences would be to allow countries to provide inputs to LDCs through the rules of origin. If we looked at the global trading system in regions, identify what the regional trade centers are and then determine who is and is not fully participating, we can then get an indication of who the free-riders are. We can examine who the major suppliers are in the region, and simply state that they need to provide increased access for the LDCs. Another participant agreed and went further, stating that it might be possible for these countries to then be graduated from trade preference programs, i.e. the US should take into account developing countries’ policies towards the poor to decide whether or not they should be eligible for GSP. There was a recognition among participants of the risks involved in such an approach.

Significant discussion on this issue continued, with no agreement from participants. Some argued that there is no reason that emerging economies should provide DFQF access to poor countries on all

products as some may be import sensitive and these countries are focused on their own development. Others argued that the United States should not force emerging economies to provide access to LDCs when it had yet to provide access on products critical for development. One participant stated that if the Working Group is already recommending that developed countries provide 100% DFQF to LDCs, it should definitely create a formula for emerging economies, perhaps some form of “escape clause”. A participant stated opposition to this idea as this “escape clause” might be used inappropriately. One participant stated that requesting that emerging economies provide preferences to LDCs requires a more comprehensive understanding of the developmental level of the country, including comprehensive indicators of social development. Quantitative indicators related to income level are insufficient.

A participant responded by stating that by and large any incentives for emerging economies to provide preferences are directly linked to the role they want to play in the global economy and their desire to sit at the table at the WTO. They should be required to play a role consistent with their increased status. Countries like Brazil, India, and China are providing preferences but should eliminate trade barriers for the LDCs. Another participant stated that this is consistent with the current discussions on the Hill related to “parallel compensation”, that is what is offered to emerging economies and what they are required to offer now that they have reached a certain level of development.

As a general observation, the participants recognized that this was a critical issue and Congress would be looking for guidance on the topic.

On the issue of expanded eligibility, one participant raised concerns about the use of revised country classification groups described in previous CGD documents as it would lead to tension at the World Trade Organization (WTO). As the LDCs are the only group recognized as qualified to receive preferential treatment at the WTO, would this step provoke significant problems related to legal waivers and other WTO requirements? Would it also cause problems between countries who have preferential access and those who would like to have preferential access? This was reinforced by a comment made by another participant that while there is a compelling humanitarian argument for the LDCs, the expansion of eligibility beyond the LDCs would create significant new and avoidable problems related to preference erosion. From the participant’s perspective, the best way to expand eligibility was to complete the Doha Round, thus providing tariff reductions for all developing countries.

Another participant stated that determining eligibility for trade preference programs based only on national income levels was a flawed approach as it does not capture the heterogeneity of production, competitiveness and development within individual countries. The described benchmark was misleading. Most participants agreed.

Two participants emphasized that as expanded eligibility is considered by the Working Group it should recognize the importance of regional integration or regional markets, and specifically how to attract investment and encourage intra-region trade. This is considered self-evident when officials discuss Africa, but it should be discussed more intensively when it comes to South Asia. This has become very obvious when officials examine on a global way the issue of food security. It was emphasized that any trade preference program reform facilitates an increase in intra-regional trade and lessens a region’s reliance on developed country markets would be considered a major step forward.

Another participant stated that the discussion of the expansion eligibility was premature as we still do not understand why preferences are not working for LDCs, and how they might be made to work.

In general, there was agreement among the group that eligibility should not be expanded.

On the issue of graduation, the question was raised that competitive need limits (CNL) do not currently apply to LDCs under the US GSP program, and should they be considered for specific products or sectors under expanded duty-free, quota-free access?

One participant stated that graduation should not be used as trade simply goes to China when a country graduates. Another participant stated that if a country is totally dependent on trade preferences in a single sector, then it is not actually competitive and the country should not be forced to graduate. At present, there is no way to determine how long it takes for a country to become competitive nor how to determine when it is ready to graduate. A participant responded by stating the United States already determines graduation through tariff line assessments of competitive sectors, so this would not be anything new.

Another participant stated that if you fixed the rules of origin problem you would not have to worry about CNLs.

There was no clear agreement among participants on this issue.

On the issue of rules of origin, it was stated that there was a strong recognition among Working Group members that rules of origin need to be reformed so that beneficiaries can more fully utilize preferences in practices. Extended (or global) cumulation, which allows beneficiaries to source inputs from a defined group without losing eligibility for the exported product, is a potential approach. A key question is how "global" should be defined: Should all LDCs be included? All GSP beneficiaries? All developing countries? And should FTA partners be included as well? Two approaches were presented, one which emphasized mutual recognition and one which emphasized extended cumulation. Reference to the US, Canadian, and EU systems were provided.

One participant stated agreement with the idea of the extended cumulation among LDCs, including FTA partners as well. However there were concerns about the implementation process, especially in that products under existing FTAs are not fully included because of agreed-upon phase-ins, on example being textiles from Colombia. One participant suggested that LDC countries should be responsible for meeting rules of origin requirements and then be able to source from any preference-receiving country. This would also mitigate problems related to supply limitations developing countries currently confront.

Significant discussion occurred on this issue among participants, in particular the kind of rules of origin and cumulation – including value added and transformation provisions – that would increase and sustain investment and competitiveness.

One participant stated that there were contradictions in the discussion. Politically speaking, there should be a simply formula: anything that benefits China is bad, anything that increases South-South trade is good, and rules of origin are there because domestic constituencies believe they should be there. As such, changes in rules of origin are not possible.

There was a reminder that the Working Group was not working at the national level focusing on reform of rules of origin in the United States alone, but rather looking for broader reforms that would include all countries with trade preference programs. The goal is to make this work more effectively for developing countries.

One participant stated that the Working Group should make every effort to avoid transshipment from China through LDCs, and that it should focus on schemes that mitigate investments that are only cut and sew and do not lead to increased investment in value-added products. A participant responded by saying that it is difficult to use rules of origin to establish the direction of trade. Others disagreed, stating that rules of origin were a significant factor in establishing the direction of trade. One participant said the Working Group should identify a scheme with the most reasonable and simplest rules of origin and establish that is the common denominator. A participant replied that some studies showed that simpler does not always mean better for LDCs and this is another reason to establish a recommendation of mutual recognition or extended cumulation.

One participant added that there were concerns about the entire concept of “reform” as preference programs were established for certain regions and reform might necessarily put regions at risk.

There was no clear agreement among participants on this issue.

On the issues of complementary measures and supply side constraints, two questions were then asked.

- 1) What complementary or facilitating measures can be used to overcome obstacles (SPS as a specific example) created by preference-giving countries to increase the utilization rate for trade preference programs? Are there innovative and/or proven approaches that have been used previously to increase exports by either governments or the private sector?
- 2) Are there proposals that could address, in an effective and sustained way, the supply-side constraints that now limit the efficacy of trade preference programs? Are there innovative and/or proven approaches that have been used to increase investment, production, and exports? Given the current budget constraints in many preference-giving countries, are there effective ways to prioritize or "sequence" funding that would provide greater impact on economic development strategies in preference-receiving countries?

One participant stated that studies of beneficiary countries that assessed their preference utilization verified that it was much below the expected level, and that one solution would be to ask developing countries to describe the reasons for that low utilization, identifying the most relevant barriers and how to address them. This would force developing countries to maximize investments. Another participant agreed, stating there should be a more cooperative dialogue on this issue. A participant responded that this moves dangerously close to Millennium Challenge Corporation (MCC) model and should be avoided.

One participant stated that the creation of a new pipeline to address supply-side constraints is completely unrealistic. The best way to address supply side constraints is to link trade preference programs to initiatives that have political support, such as food security. There should also be a recognition by officials in all countries that trade-related funding lacks any policy coherence. Reference was made to the fact that trade ministries do not talk to finance ministries and none of them talk to donors. One participant added that NGOs should also play a more effective role in development assistance.

One participant stressed the need for a “transformation program for Africa” that consists of three parts: 1) recognition that there are multiple donors to Africa; 2) recognition that there should be cooperation

among donors, and; 3) recognition that trade preference programs should connect to these donors and work in a regional capacity.

A participant asked if the current European Union (EU) Economic Partnership Agreements (EPAs) are working in this regard.

There was significant debate among participants on the approach currently being implemented by the EU, although there was strong recognition that an approach that emphasized a dialogue between preference-giving and preference-receiving countries on what projects or sectors would provide the most benefit in increasing competitiveness or facilitating diversification is something that should be emulated.

The discussion then moved to the issue of complementary measures related to standards and trade preference program utilization.

One participant stated that the critical issue that had to be addressed was the capacity of producers in LDCs to export to multiple markets, the current problem being that these producers – in Africa especially – usually had to choose between the United States and Europe. Participants were in strong agreement on this issue. There were no obvious suggestions concerning measures that have worked, although some did reference work that was currently underway in the private sector in cooperation with NGOs.

On the issue of conditionalities, the question was raised as to whether and how the Working Group should approach recommendations.

One participant stated that the Working Group should absolutely address the issue of conditionalities as the entire purpose of trade preference programs is transformational change. If you do not provide incentives for good governance, or rule of law, it doesn't matter what the program does. Why should we reward countries that are doing bad and not incentivize those that are doing good? It is of the country's interest to have some form of conditionality. Another participant disagreed, emphasizing that if the level of conditionality is set too high, there is a risk that countries will lose preferences. Another participant stated that conditionalities are helpful for companies as a benchmark, but that they should be part of the trade capacity building process and not part of trade preference programs.

Another participant stated it that it was impossible to separate conditionality from trade, but that they should not be defined unilaterally but in cooperation with the beneficiary country through discussion. Another participant agreed, and stated trade preference programs should move in concert with US foreign policy goals for developing countries and encourage improvements in areas as IPRs, SPS and labor rights.

One participant stated there is always going to be conditionality. The debate is how far you should go in prescribing conditionality. Effective arguments for conditionalities emphasize that it should be used as a carrot and not a stick. In the case of Cambodia, the textile program never succeeded to the extent that it might have because it was hindered by conditionalities. Rigid rules limited market access. That was a "wrong" conditionality. Developed countries should give flexibility. They should recognize that they are dealing with developing countries and there must have some flexibility. On the other hand, if a country is being a "bad actor" and because of that it receives half of the preference now and the other half when the standards are met, the reality shows that in practice, the country will never get the full preference.

There was no clear agreement among participants on this issue, although sufficient funding for provisions related to conditions was considered essential.

The meeting then concluded.