K4D | Knowledge, evidence and learning for development

The Diplomatic Impacts of Most Favoured Nation Tariff Changes by Major Economies

Kelbesa Megersa
Institute of Development Studies
10 June 2020

Question

What evidence tells on the diplomatic impacts of Most Favoured Nation tariff changes by major economies for their relations with other nation states or customs unions with particular reference to the developing world and 'preference erosion'?

Contents

1. Overview

Developed countries have long given non-reciprocal (unilateral) trade preferences to the various developing countries (see Heron, 2019; Hoekman and Prowse, 2005). In 1968, the United Nations Conference on Trade and Development (UNCTAD) suggested a Generalised Scheme of Preferences (GSP) in which developed countries could offer non-reciprocal trade concessions to 'all' developing countries, not only to the 'former colonies'. Ever since, the member countries of the Organisation for Economic Co-operation and Development (OECD) have adopted a number of non-reciprocal preferential access schemes, in addition to an ever-expanding set of bilateral and regional (non-reciprocal) trade liberalisation schemes. Such arrangements include national GSP programmes; GSP-plus programmes for the least developed countries (LDCs) – such as the European Union's (EU's) Everything but Arms (EBA) initiative; and special provisions for subsets of developing countries like the United States African Growth and Opportunities Act (AGOA) (Hoekman and Prowse, 2005; Heron, 2019).

Preference erosion (i.e. the trade losses arising from liberalisation in other countries) is a major problem for many developing countries, often leading to appeals by their diplomats and trade negotiators. For instance, most African nations have benefited from trade preference systems such as AGOA and EBA. Nevertheless, the elimination of tariffs, which is a key goal of international trade negotiations, would reduce the advantages of these preferences (Alpert, 2005; Kopp et al., 2016; Vickers, 2019).

Before setting new international trade arrangements and eliminating tariffs on imported goods (i.e. following Brexit), the UK should assess the impact on developing countries. Most developing countries typically enjoy preferential access to the UK market through GSP or EBA schemes. The UK Government has indicated that it wishes, in principle, to preserve such schemes, although they may differ from those of the EU. Eliminating the most-favoured-nation (MFN) tariffs on products would undermine the preferences that developing countries currently enjoy, which could be detrimental to these countries and to key sectors within those countries. This possible unintended impact on developing countries further demonstrates that trade policy should be consistent with other policy/diplomatic objectives of the UK, e.g. UK's overall foreign policy priorities and obligations to developing countries (UKTPO, 2020; Vickers, 2019).

Many developing countries (particularly non-LDCs)[1] covered by current trade agreements will find that market access to the UK will be restricted after Brexit (i.e. leading to possible complaints and diplomatic disputes). In this regard, there are several historical examples that may offer some illustration on tariff/quota disputes, particularly linked to preference erosion and the most-favoured-nation treatment (see Annex for more details):

[1] The UK has been a member of free trade agreements (FTAs) with developing countries, including Vietnam, Central America and the Economic Partnership Agreements (EPAs) with some African, Caribbean and Pacific countries (i.e. while being part of the EU). Some of these countries, in particular some EPA members, have the UK as their main destination for exports of goods (e.g. Kenya) or services (e.g. the Caribbean). They are expected to have duty-free and quota-free (DFQF) market access under the preferential regime for the LDCs (Mendez-Parra, 2016). On the basis of the territoriality clause of the EPAs, these FTAs apply exclusively to the territory of the EU (Mendez-Parra, 2016).

- Complaint by Ecuador, Guatemala, Honduras, Mexico, and the United States against European Communities regarding bananas imports from third countries – particularly about a more favourable quota level for African, Caribbean and Pacific Group of States (ACP).
- Complaint by India against European Communities regarding products imported from Bolivia, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Nicaragua, Pakistan, Panama, Peru and Venezuela benefiting from the 'Drug Arrangements' through the EC GSP scheme – thus, putting India at a disadvantage.
- Complaint by European Communities, Japan, and the United States against Indonesia regarding the automotive industry. It was noted that Indonesia violated the MFN treatment since the duty and sales tax exemptions given to Korean imported motor vehicles (and vehicle parts) were not given unconditionally to other WTO members.

Although the UK may have (diplomatic and economic) interest in re-negotiating current free trade agreements (FTAs), many developing countries will not be on the priority list of partners to be negotiated with, particularly at a time when the UK's trade negotiators and diplomats are going to be busy (Lydgate et al, 2016). This suggests that a kind of transitional arrangement may be needed to avoid disruption (Rollo, 2016). Mendez-Parra (2016) notes that the **UK's post-Brexit transitional provisions will need to depend more on diplomacy to avoid challenges for other World Trade Organisation (WTO) members.**

Nevertheless, it is worth noting that there is a limited evidence base (e.g. academic studies) around the diplomatic impacts of (MFN related) tariff changes. Much of the evidence in the area focuses on the economic effects of tariff changes and preference erosion – rather than on diplomatic or political impacts. The evidence base narrows further when limited to the effect on developing countries. Thus, this rapid evidence review relies on a limited number of key literatures – especially taking advantage of the growth in the literature around Doha Development Round (or Doha Development Agenda (DDA)) in the 2000s. It must be noted that specific trade figures (e.g. estimates of preference margins) reported in older sources may be less accurate now. However, they convey still relevant dynamics around trade politics and diplomacy between countries. To complement the key (older) sources, the review also looks at different types of recent relevant literature – including reports issued by different international development agencies, commentaries by scholars and some academic publications.

The report is structured as follows. Section 2 briefly discusses the Most Favoured Nation (MFN) clause and the diplomatic frictions linked to it. Specifically, it first discusses the diplomatic/political concerns of developing countries linked to MFN tariff changes and then how preference erosion affects developing countries. Section 3 briefly discusses how post-Brexit UK's MFN tariff structure could potentially impact developing countries. In this regard, the section first assesses UK's potential MFN policy (post-Brexit) towards developing countries and then about the resulting preference erosion and its likely diplomatic impacts. Section 4 draws lessons on historical MFN policies of Australia, the EU and the US – and how the changes in tariff policy led to preference erosion in developing countries, at times resulting in some complaints and diplomatic rows. However, it must be noted again that much of the analysis of the impacts of tariff changes in these countries is also economic. Diplomatic impacts are often briefly mentioned or simply implied (i.e. to settle the complaints of countries). Finally, the Annexe section provides some useful examples of notable MFN tariff disputes handled by the WTO's Appellate Body and the WTO Panel since the 1990s.

2. Most-favoured-nation (MFN) and Diplomatic Frictions

Diplomatic (or Political) Concerns of Developing Countries Linked to MFN Tariff Changes

The multilateral trade system depends on the principle of non-discrimination. The **most-favoured-nation clause**[2] (symbolised in article I of the General Agreement on Tariffs and Trade (GATT)) was the vital principle for a system that emerged in the post–World War II era, largely in reaction to the folly of protectionism and managed trade, which exacerbated the global economic depression of the 1930s. However, from its origins, the GATT has allowed exemptions from the MFN rule in the case of reciprocal preferential trade agreements. It also enables the giving of unilateral (non-reciprocal) preferences to developing countries (Hoekman et al., 2008; Heron, 2019; Vickers, 2019).

Unilateral preferences given by member countries of the Organisation for Economic Co-operation and Development (OECD) create an unavoidable (diplomatic/political) pressure between "more preferred" developing economies (e.g. typically beneficiaries from pre-existing colonial regimes) and other developing countries concerning the impacts of MFN liberalisation by preference-granting countries. Worries about preference erosion were one of the key points of dispute in the negotiations of the Doha Development Agenda (Hoekman et al., 2008; Efstathopoulos, 2012; Trommer, 2017; Mahrenbach and Shaw, 2019). When the Doha Round was launched, ministers placed development at the centre of the discussion. They stressed that they "seek to place developing countries' needs and interests at the heart of the Work Programme adopted in this Declaration." They also added that they "shall continue to make positive efforts designed to ensure that developing countries, and especially the least-developed among them, secure a share in the growth of world trade commensurate with the needs of their economic development. In this context, enhanced market access, balanced rules, and well-targeted, sustainably financed technical assistance and capacity-building programmes have important roles to play." (WTO, 2020)

However, concerns of preference erosion had been an issue long before the Doha Round (i.e. the latest round of trade negotiations between the WTO members).[3] In the 1970s, for example, the effect of the Tokyo Round of liberalisation on the benefits derived by developing countries from the Generalised System of Preferences (GSP) was widely discussed (e.g. Ahmad, 1977). Although preference erosion is a long-standing concern for many developing countries, the scope and coverage of unilateral preferential regimes have increased considerably over the years, particularly for the least developed countries (LDCs). In the past, concerns about erosion

[2] The 'UK in a Changing Europe' has defines the 'most-favoured nation' principle of the World Trade Organisation (WTO) as implying that "WTO members cannot discriminate between their trading partners and must, with a few exceptions, offer access to their market on the same terms for all WTO members. It means that a favour offered to one country must be offered to all. However, members can go further and offer better trading terms to some countries if, for example, they agree a free trade agreement or they give developing countries better terms." (UK and EU, 2020)

[3] https://www.wto.org/english/tratop_e/dda_e/dda_e.htm

have not been a strong constraint on the MFN-based reforms of the GATT (now the WTO) as GSP programs typically gave some tariff reductions and preferential quotas but did not provide duty-free or quota-free access. Thus, even if the MFN rates were lowered, it was possible to retain a given preference margin by reducing the preferential tariff or by widening the coverage of the scheme. But contemporary programs like the EU's EBA or the U.S. AGOA include duty-free and quota-free access for almost all products and, thus, any reductions in MFN tariffs lower the preference margin. It is, hence, not startling that preference erosion has garnered considerable diplomatic attention in the WTO multilateral negotiations (Hoekman et al., 2008; see also Shaw et al., 2019).

As discussed in Hoekman and Özden (2005), **early assessments of preferential regimes raised doubts as to whether preferences were an effective way to help developing countries**. It was noted that producers in the beneficiary countries had to be able to compete with domestic producers in the donor country as well as other exporters. Subject to this discussion was the extent to which the 5 to 7% preference margin would make a significant difference.[4] In addition, diplomats and trade experts noted that even in sectors where preferences would make a difference, they could lead to specialisation in sectors where the beneficiary country did not have an inherent comparative advantage; this outcome, in turn, would lead to socially wasteful investment (Hoekman et al., 2008).

Other concerns included the potential diplomatic or political tension between the beneficiary and excluded countries, administrative costs such as rules of origin, and the possibility that preferences would reduce incentives for global MFN liberalisation as beneficiary countries became concerned about the deterioration of preference margins. A more general concern was the politicisation (i.e. the addition of diplomatic objectives) of trade policy in so far as donor countries used preferences 'to reward and punish' recipients for their 'behaviour and performance' in other non-economic areas (Hoekman et al., 2008; Vickers, 2019; WTO, 2018; WTO, 2013).

GSP and other unilateral preferences made available by the United States and the EU often attached side conditions (e.g. certain diplomatic, political, economic, social, and/or environmental objectives) that, although aimed at improving conditions in those countries, are potentially costly to the recipient developing country. As such, these unilateral preferences are not free to developing countries. Furthermore, Jackson (1997) notes that the GSP experience in the GATT system has been that, for a number of reasons, the preference giving states (i.e. industrialised economies) often fall victim to the temptation of using preferential systems as part of **'diplomatic bargaining chips**' (Jackson, 1997). This was possible partly because the GSP-extended preferences are privileges rather than enforceable rights (UNCTAD, 2016; Heron, 2019).

Preference giving countries, thus, may suspend preferences in a GATT-legal manner, which is without GATT-sanctioned retribution. The USA and the E.U. In exchange for cooperation on various non-trade issues such as labour, the environment, drug trafficking and intellectual property, offer explicit reductions in trade barriers. Instances of these include the

[4] The GSP included preferences, not duty-free and quota-free access of the type currently granted to the LDCs by many OECD countries

Eastern European and Mediterranean agreements signed by the E.U.; US agreements with Jordan, Mexico and other Latin American and Caribbean countries; and preferential treatment that the E.U. and the United States extends over GSP to most developing countries (Limao and Olarreaga, 2006; Heron, 2019).

The legitimacy of some of the extra preferences granted just to sub-groups of developing countries has been contested in the WTO. For example, India has questioned the preferences of the EU. grants for cooperation on drugs to Pakistan and other countries. The preference practice is still common, nevertheless. Besides that, even if unilateral schemes are substituted by preferential trade agreements (PTAs) requiring a reduction in the protection of the small country, compliance with the side conditions will continue to play a vital role in the desire of the developed country to pursue such agreements (Limao and Olarreaga, 2006; see also WTO, 2018; and Annex section in this report).

Trade preferences are essential to continued efforts to negotiate further multilateral trade liberalisation in the context of the WTO Doha Round of negotiations. Middle-income countries are greatly worried about the discrimination they face in OECD markets as a result of better access to these markets, both for other industrialised nations – as a result of free trade agreements – and for poorer or "more preferred" developing countries. LDCs and non-LDC African, Caribbean and Pacific countries are worried that the liberalisation of trade based on broad MFN tariffs and the elimination of trade-distorting policies in agriculture by OECD countries will undermine the value of their current preferential access (Hoekman and Prowse, 2005; Mendez-Parra, 2017; Heron, 2019).

Preference Erosion and Developing Countries

Trade preferences entail a blend of benefits for preferential exporters but may end up costing third-country exporters and potential losses for the importing country. Only when the (more) preferred nation is small, in the sense that it does not impact the internal price of the importing country, will there be no negative impact on third-country competitors. In such cases, preferences only generate trade (i.e. expands imports) to the disadvantage of local suppliers in the preference-giving nation, but not of other foreign suppliers, who continue to see the same price (Hoekman and Prowse, 2005; Mendez-Parra, 2017; WTO, 2018).

Preference erosion entails the reallocation of benefits from those with the greatest preferences to those facing punitive tariffs. Those faced with greater tariffs will obtain an export surplus, while the preferential suppliers will encounter a decline in demand for their exports, resulting in a partial, albeit generally incomplete, loss of benefits from the initial preference scheme. The loss is not complete since the preferences include, in part, the advantages of the original tariff-ridden balance resulting from a non-discriminatory tariff cuts by the importer. Consequently, preference erosion usually results in a partial, and not full, loss of the initial benefits of the preference scheme (Hoekman and Prowse, 2005; see also WTO, 2018).

Trade reforms by recipient nations and emerging market countries that do not give preferential access have the potential to greatly mitigate the negative effects of preference erosion. When assessing the magnitude of the erosion effects, much will rely not only on the depth of liberalisation by preference giving countries (e.g. the extent to which sectors

such as sugar, beef and rice are opened up in OECD economies) but also on what other countries are doing. Much also depends on whether developing countries profiting from preferential access utilise schemes to strengthen the competitiveness and productivity of their enterprises and farmers. Development assistance can play a significant role in this area (Hoekman and Prowse, 2005; Mendez-Parra, 2017; WTO, 2020).

A clear focus on tackling erosion concerns will help to eliminate an instrument that is costly to the international trading system. Preferences manipulate international trade and have been the causes for the multiplication of regional trade agreements. This is because excluded (i.e. less preferred) nations are compelled to negotiate equivalent access on a reciprocal basis with major preference-granting countries. In the long term, the continued deepening of preferential trade arrangements (e.g. the EU Economic Partnership Agreements) may further exacerbate the status quo bias, implying that concerns of preference erosion by diplomats and trade negotiators may become even more of a constraint in concluding a multilateral trade rounds (Hoekman and Prowse, 2005; WTO, 2013).

For tariff preferences to have significance, beneficiaries must have the ability to export products that enjoy preferential access. However, major preference granting schemes (e.g. GSP) may exclude products in which developing countries have a good comparative advantage. Even where countries get duty-free access on all goods, several low-income countries just don't have the capacity to utilise preferences, either without productive facilities or the capacity to compete with the price advantage that preference confers on them, due to internal transactions and operating costs.[5] Thus, preferences have little value for countries with no such capacity, and the benefits of preferential access may be concentrated in certain sectors where low income countries are able to produce at a level at, or nearing (and therefore aided by the tariff preference), international competitiveness (Hoekman and Prowse, 2005; Bureau et al., 2019; UNCTAD, 2018).

3. Change in UK’s MFN tariff structure: Potential Impact

In accordance with the UK's exit from the EU at the end of January 2020, procedures are underway to chart the country's independent trade policy. These policies will apply once the transitional period (i.e. where the UK remains bound by the EU's trade policy) comes to an end. **The UK must also aim to balance strategic trade objectives (i.e. future free trade agreements) with the dedication to developing nations to lower the prevalence of poverty through trade.** Among the list of suggestions is an assessment of the impact on developing countries prior to the elimination of tariffs on goods not produced within the UK (UKTPO, 2020). In view of the historical diplomatic and economic links between the UK and many developing nations, one of their big concern is the change in their trading arrangements after Brexit. However, this period of change may also offer an opportunity to reorganise and improve existing policies hampering their trade with the UK (Mendez-Parra, 2016 and 2017; Vickers, 2019).

[5] Also, as long as either importers and distributors or the transport and logistics sector have considerable market power, the terms of trade benefits of preferential tariff cuts will be collected (at least in part) by those intermediaries instead of by exporter countries, i.e. developing countries to whom the preferences were intended (see Hoekman and Prowse, 2005; Francois and Wooton, 2001; UNCTAD, 2018).

UK: MFN Policy (post- Brexit) Towards Developing Countries

The characteristics of the post-Brexit relationship between the UK and the EU will influence the UK's trade policy towards developing countries. Typical provisions, such as the harmonisation of standards and regulatory procedures that may or may not form part of the agreement between the UK and the EU, may have an impact on the operation of value chains involving the UK, the EU and developing countries. Nevertheless, **very little has been said in recent debates among diplomats, trade negotiators and scholars about how the UK's new trade policy tools can be designed to help developing countries trade more and contribute to their development**. Some principles and specific tools ought to be clearly stated in the definition of trade policy, especially for developing countries (Mendez-Parra, 2016).

Regarding the definition of its MFN tariff (i.e. the default tariff applied to any WTO member), the UK could aim to eliminate the existing tariff peaks. A uniform, ad-valorem and low tariff implemented across all products, for instance, allows some revenue to be collected and offers some negotiating power in the bargaining of future FTAs. Nevertheless, presuming that the UK inherits the EU WTO timetables, this type of tariff structure will be impossible to implement (Bartels, 2016). In order to change this, the UK will have to start negotiating the inherited timetable with all WTO members. As a result, the new MFN tariff will have to be defined in the short term within the limits of the current schedules. Conversely, this does not deter the decrease of existing tariff peaks in agriculture, food and textile products (Mendez-Parra, 2016 and 2017).

UK: Tariff Changes, Preference Erosion and Diplomatic Impacts

In its contribution to the 'GREAT Insights Magazine', Mendez-Parra (2016) argued that **preferences for developing countries should be based on a simple two-tier system: i) for LDCs and ii) some non-LDCs.**[6] For the LDCs, it is probable that the UK will apply an analogous regime to the existing EU EBA (i.e. **duty-free and quota-free (DFQF) access for all LDCs in all products**). Nevertheless, he notes that the UK should not skip the chance to improve up on the EBA. Common rules of origin with low domestic content thresholds and versatile rules on cumulation with other developing countries and UK FTA partners ought to be part of the system. Under the GSP, the UK, via the EU, gives preferences to many non-LDCs. The UK should replace the current two-tier system (GSP and GSP+) with a singular option of preferences. **However, the preference system for non-LDC will be much less cordial than that for the LDCs (and this could likely lead to diplomatic complaints by some non-LDCs).** Several key products for the least developed countries, such as sugar, cotton, tropical fruits and processed

[6] Mendez-Parra (2016) argues that there are a number of guiding principles that should characterize the UK's trade policy, in particular towards developing countries. Trade policy should be simple, with its results tilted towards the least developed countries. The principle of preferences for all means that preferences should not apply to anyone, even though this may involve some cost to other developing countries. The UK may need to use Aid for Trade to offset the adverse effects to those countries affected by these policy changes. Complete coverage and simplicity also should apply to the definition of service preferences. Main products of the LDCs ought to be excluded from FTAs with certain emerging economies and extra LDC-friendly provisions should be implemented (Mendez-Parra, 2016).

products, must not be included in the offer for non-LDCs. Other labour-intensive items, such as some textiles, could also be omitted. In addition, a simple and transparent overall criterion (i.e. not based on products) must be applied to the benefit of both LDCs and small non-LDCs in order to exclude big and competitive developing countries.

After Brexit, one of the primary objectives of the UK includes negotiating FTAs with non-LDC countries (i.e. other developed and emerging economies such as China, India and Brazil). Trade talks with these countries are expected to be negotiated on the basis of more reciprocal principles. However, they could have an impact on trade from the LDCs (and other developing countries) because of extra competition (i.e. preference erosion) in the UK market on products that are also exported by the LDCs (Mendez-Parra, 2016 and 2017; Vickers, 2019). **The magnitude of the economic effect (and the consequent diplomatic disputes involving the affected countries) depends on how similar the export structure of the LDCs and emerging economies to the UK is and on the UK's preference margin (Rollo et al, 2013).** For example, the FTA with India may have significant effects on Bangladesh and Cambodia, as their exports to the UK are comparable to around 20% of the products (Mendez-Parra, 2016).

Products that are in conflict with imports from the LDCs and where the margin of preference offered is high may need to be excluded from UK's forthcoming liberalisation of FTAs with emerging countries. In addition, the rules of origin of these FTAs ought to favour the integration of inputs from LDCs. Besides, if the mutual recognition of certification bodies is agreed, it should be extended to products originating in the LDCs. This may favour the creation of value chains involving the UK, its FTA partners and the LDCs (Mendez-Parra, 2016).

4. Other Case Studies (Australia, EU, and the US) on Impact of MFN Tariff Changes

Australia: MFN Policy Towards Developing Countries

Australia is a much smaller player in world trade than major/bigger developed economies (such as the European Union, the United States and Japan). However, Australia is a key market for certain developing countries. Its preferential programs are particularly of regional importance (Lippoldt, 2006; Morgan, 2018; Rai, 2018).

It is possible to categorize the non-reciprocal preferential tariff schemes of Australia in terms of trade flows, by order of their size (Lippoldt, 2006).

- **Among Australia's non-reciprocal preferential tariff measures, the tariff for developing countries is the widest preference with regards to the number of eligible economies and the total preferential imports into the country.**
- The next biggest non-reciprocal preference category by Australia consists of special rates for Asia's special economies. This category includes Hong Kong, China, the Republic of Korea, Singapore and Taiwan. However, Australia has signed ‘new’ reciprocal arrangements with some of these countries that used to export to the Australian market under “special rates”. For instance, an FTA with Singapore (which was

effective since 2003) offered exporters in Singapore an enhanced or duty-free access to the Australian market.

- The third-largest category involves the preference scheme for the Forum Island Countries (FICs). **These preferences cover imports from a number of Pacific island economies and were implemented under the South Pacific Regional Trade and Economic Cooperation Agreement** (Lippoldt, 2006; Kautoke-Holani, 2018). Papua New Guinea is a special case covered by the Agreement on Trade and Commercial Relations between Papua New Guinea and Australia. Papua New Guinea was eventually included among the beneficiaries of the FIC. even though total trade volumes are comparatively small under these preferences, they are very crucial to some of these economies. Imports under the scheme accounted for less than 1% of total Australian imports from developing countries over the 1996 to 2004 period (Lippoldt, 2006).

Sugar and bananas are sensitive tropical items and source of many diplomatic disputes (e.g. the so called "banana wars") between countries. For some examples of such disputes, see WTO (2018; 2013) and Annex section in this report. **These items are, understandably, the most impacted by preference erosion** (Lippoldt, 2006; Mercado, 2017; Rai, 2018; WTO, 2013)**.** Alexandraki and Lankes (2004) identify middle-income developing countries that are highly susceptible to export losses due to preference erosion (likely leading to diplomatic frictions). Alexandraki and Lankes (2004) estimate the effects of changes in the trade-weighted preference margins between developing countries concerned and the developed economies. They find that the vulnerability of developing countries to preference erosion is especially seen on sugar and banana exports (particularly to the European Union and U.S. markets). In several such cases, producers are small island economies (e.g. many small Pacific island states to whom Australia is a major export market) that may have significant challenges in adjusting to the erosion of preferences. They also find vulnerability to the preference erosion of textiles and clothing among middle-income countries, but to a far lesser degree than for sugar and bananas. Likewise, the Commonwealth Secretariat (2004) found that many preference-dependent economies (i.e. recipients of preferences for sugar, bananas, and textiles and clothing as well as beef) would suffer numerous economic woes in adjusting to a more liberalised trading environment (Lippoldt, 2006).

Despite the availability of preferences for imports of sugar and bananas, the relative openness of the Australian MFN regime and the small import volumes imply that the negative impacts of erosion of Australian preferences in these areas are rather small. This reduces the potential for major diplomatic friction between the "preferred" and other countries. Australia seems to have a competitive domestic sugar and banana industry. It has a considerable production of bananas and is a major exporter of sugar. Though Australia has a relatively open trading regime for these products, the country's import volumes for both goods (as opposed to other developed countries) remains relatively low, both in terms of absolute volumes and export shares for exporters from developing countries. Imports are insignificant in the case of bananas. The effective preference margins of the developing countries are moderate, despite the availability of duty-free treatment for imports from the LDCs (Lippoldt, 2006).

Australia: Tariff Changes, Preference Erosion and Diplomatic Impacts

Australia (like many other developed countries) has strengthened its trade preferences for LDCs over the years. Hoekman, Ng, and Olarreaga (2001) underline the diplomatic disputes liked to the deepening of preferences for the LDCs and the MFN-based liberalisation, with the benefit of the former being subverted by the latter. Preferential schemes may have significant direct impacts on specific beneficiaries, but much tends to depend on their supply-side capability, their ability to reinvest rents in a meaningful way, and the nature of administrative requirements (such as rules of origin). all in all, such limitations have restricted the actual benefit of preferences for many LDCs, leading Hoekman, Ng, and Olarreaga to imply that the erosion of current preferences should be of limited concern as a consequence of the liberalisation of the MFN. They note that one explanation as to why it has been possible to expand duty-free access for the LDCs is that they contribute to less than 0.5% of world trade (Lippoldt, 2006).

Following the statement at the Asia-Pacific Economic Cooperation (APEC) Summit on 25 October 2002 by Australia's foremost diplomat of the time (i.e. Prime Minister John Howard), the Australian Government revised the Customs Tariff to provide the LDCs with duty-free and quota-free access to the Australian market. The rules of origin for LDCs allow the use of materials from all developing countries, the FICs and Australia, to be counted as local content, except that the portion of non-LDC developing countries is limited to no more than 25% of the total manufacturing cost of the goods. The Australian Productivity Commission assessed the potential effects of this action in a report around the same time. The Commission referred to the generally limited flow of imports from the LDCs and noted that much of this flow had already been covered by the developing country and FIC preferences. In view of the pattern of trade and tariffs, the Commission concluded that the main impact on the LDCs was likely to come from Australian clothing imports, but that the ability of the LDCs to benefit would depend on their ability to offer an enabling environment for an efficient supply response. In a related paper, Zhang and Verikios (2003) assessed the possible effects of duty-free access on LDCs. They found that the LDCs would (on average) benefit from the policy change, particularly the major exporters of clothing (for example, Bangladesh and Cambodia). It has been estimated that the effects on suppliers from non-LDCs developing countries are moderate. They noted that some countries competing with LDCs (such as China) may not lose out in the policy change since they could increase their exports of intermediate inputs to LDCs (Lippoldt, 2006).

Exports from developing countries to Australia are consistently treated, with relatively high preferential margins granted to developing countries in South and East Asia, Latin America, and Africa. Other exceptions include Brazil, South Africa, Thailand, and Vietnam. On average, these countries face hurdles higher than those faced by other trading partners, partly due to the composition of their exports to Australia. In some cases, such as in the case of the FICs, the benefits from enhanced market access under unilateral liberalisation appear to be more than offsetting the losses resulting from the erosion of preferences (Lippoldt, 2006).

EU: MFN Policy Towards Developing Countries

The EU is by far the biggest contributor to the spread of trade agreements worldwide. The origins of this proliferation of trade agreements in the political economy lie in three factors: the heterogeneity of the EU; the particular role played by its trade policy; and the fierce (diplomatic and economic) demands from its trading partners (Candau and Jean, 2009; Mahrenbach and Shaw, 2019).

There are two main types of trade agreements: free trade agreements and non-reciprocal schemes.[7] Free trade agreements are bilaterally negotiated on reciprocal obligations between the parties, while non-reciprocal schemes are unilaterally given by the EU to developing countries (Heron, 2019; WTO, 2018). Free trade agreements are designed as a tool for regional economic integration, with a legal basis in the multilateral domain under Article XXIV of the GATT (Bartels, 2016; VanGrasstek, 2013). Non-reciprocal agreements give more favourable treatment to developing countries (under the enabling clause or via specific WTO waivers). The non-contractual character of a number of non-reciprocal schemes (and the GSP in particular) also involves uncertainty regarding their future (with the exception of the EBA initiative) since they can be unilaterally modified (Candau and Jean 2009).

The most inclusive of EU's trade agreements with developing countries is the GSP, which gives non-reciprocal, preferential access to a wide range of products, albeit with a restricted preferential margin for so-called (politically and economically) 'sensitive' products. The GSP is also transitory and subject to periodic updates. Graduation measures (i.e. the exclusion of some or all goods from the system) are taken where beneficiary states may have achieved a level of competitiveness in particular sectors that guarantees further growth even in the absence of preferential access to the EU market (EC, 2020; Candau and Jean, 2009). The GSP is linked to fairly strict rules of origin. In the past, drug-fighting countries have been given a special and more advantageous regime. In 2001, this regime concerned only the countries of the Central American and Andean Pact. The updated GSP amended this approach and gave very gracious preferences to countries that prove a commitment to sustainable development by ratifying crucial international treaties and conventions (Candau and Jean, 2009).

Furthermore, as from March 2001, **EU's EBA initiative gave duty-free, quota-free access to LDCs for all products except arms, with delayed implementation for sugar, rice and bananas**. even though it is part of the GSP scheme (and therefore associated with the same general rules), the EBA is not limited by any restriction on duration, coverage, or protection measures. (2009, Candau and Jean; Mendez-Parra, 2017)

The other types of trade agreements of the EU involve a number of bilateral and regional agreements (such as those with Chile, South Africa and the Mediterranean countries) that give deeper preferences than those to which the GSP countries would have been entitled. The Cotonou Partnership Agreement, that built on from the former Lomé Conventions, and later led to the Economic Partnership Agreements (EPAs) between the EU and ACP countries is especially

[7] EU's numerous trade agreements can be classed into a few categories. The first set includes close, neighbourhood, reciprocal agreements within Europe, which include agreements with the European Free Trade Association, bilateral free trade agreements with Central and Eastern European countries, and a few additional bilateral agreements (Candau and Jean, 2009). The rest of the trade agreements are for developing countries.

remarkable. EPAs aim to promote the 'smooth and gradual' inclusion of ACP countries into the world economy and eventually realize sustainable development and poverty reduction via trade and investment (EC, 2018).[8] These non-reciprocal agreements give the majority of ACP products duty-free access to the EU market (and also crucial preferential tariff quotas) and is highly pertinent to the benefit of developing countries (Candau and Jean 2009; Van Biesebroeck and Zaurino, 2019; Mendez-Parra et al., 2016). The Cotonou Agreement allows for full cumulation, taking all operations carried out in the participating countries at the time of origin into consideration. This provision is much more liberal than the GSP rules of origin, which only allow for bilateral or diagonal cumulation (Candau and Jean 2009).

As compared to other developed markets (e.g. Canada, Japan, and the United States), the EU seems to provide a fairly high preferential margin to developing countries. This benefit is particularly clear to LDCs who face nearly zero ad valorem equivalent (AVE) protection, as a result of the EBA initiative. For non-LDCs, the average preferential margin on the EU market is limited but still better than that accessible on other markets (i.e. Canada, Japan and the United States). In manufacturing, protection is generally low. However, for developing countries, it is practically zero for products other than textiles and clothing. In such cases, there is no significant preferential margin for non-LDCs (Candau and Jean 2009).

The case of agricultural products (exported by developing countries to the European market) is particularly relevant, given both the high level of trade barriers in this sector and the immense significance of these products to exports from developing countries (Candau and Jean, 2009; Bureau et al, 2019; WTO, 2013). Developing countries (especially the LDCs) accounted for a much larger share of agricultural imports into the EU than they do in other major developed markets (Candau and Jean, 2009).

EU: Tariff Changes, Preference Erosion and Diplomatic Impacts

The EU is by far the biggest market for agricultural exports in developing countries – and it is particularly important for most former colonies of European states. **The EU's trade preferences are, therefore, important from the perspective of development. Diplomats and trade ministers of the African Union Member States had long recognised this.** The diplomats and trade negotiators have **repeatedly expressed their concern about the erosion of preferences**. These worries were, for instance, reflected in the specific provisions of the draft modalities for market access liberalisation in the Doha Round (WTO, 2008; Candau and Jean, 2009).

[8] "…EPAs have sustainable development as a key objective. In that regard, an explicit reference is made in EPAs to the commitments set out in the Cotonou Agreement, especially the general commitment to economic development and reducing poverty in a way that is consistent with the objectives of sustainable development. EPAs are explicitly based on the "essential and fundamental" elements set out in the Cotonou Agreement, i.e. human rights, democratic principles, the rule of law, and good governance…." (EC, 2018. p 2)

Preferential trade arrangements, whether they are reciprocal or not, play an important role in shaping trade opportunities for many developing countries, particularly the poorest.[9] They are **particularly important for sub-Saharan African countries, given the non-reciprocal preferences given, especially through the Cotonou Partnership Agreement** (Candau and Jean 2009; Mendez-Parra et al., 2016; Van Biesebroeck and Zaurino, 2019). The prospect of multilateral liberalisation, therefore, raises major concerns about the erosion of these preferences and the potential ramifications of such erosion (Bouët, Fontagné and Jean 2006; Candau and Jean 2009).

By combining deep preferences, broad coverage and relatively flexible rules, the Cotonou Partnership Agreement had been instrumental for African exporters. The end of this agreement in 2008 was, therefore, a landmark in the trade relationship between sub-Saharan African countries and the EU and finding an acceptable transition from this regime was a major issue. The negotiations among diplomats and the partnership agreements signed or bargained with the EU were a way out for most countries, even if their reciprocity required widespread liberalisation of imports from the EU in return by these countries. In this context, the EBA initiative was a good alternative for the sub-Saharan African LDCs. Given the specialisation of those countries in raw agricultural products, most of which are manufactured using only a few traded intermediates and therefore do not interfere with the rules of origin. For other developing countries, the EU GSP appears to be a very poor substitute (Candau and Jean, 2009).

USA: MFN Policy Towards Developing Countries

The GSP in the U.S., which is provided to many developing countries, is duty-free and covers most dutiable and semi-processed products and selected agricultural, fishery and primary industrial goods that are not otherwise duty-free. However, compared to other U.S. preferential programs, the GSP covers fewer products. Products deemed to be sensitive to importation are excluded by law. Agricultural products which are subject to a tariff-rate quota are not eligible for duty-free access in any quantity which exceeds that quota. Other ineligible products include most textiles, clothing, watches, footwear, handbags, luggage, work gloves and other clothing made of leather in whole or in part. The GSP has additional limitations, including periodic expiry, loss of GSP eligibility due to automatic graduation to the World Bank's high-income country category, and loss of GSP eligibility for a particular product once the competitive requirements have been exceeded (Dean and Wainio, 2006; Mendez-Parra, 2017; Blanchard and Hakobyan, 2015).

The U.S. African Growth and Opportunity Act (AGOA) provided duty-free status to more than 6,400 imported goods from sub-Saharan African countries as part of the Trade Act 2000 (USITC, 2004a; Van Biesebroeck and Zaurino, 2019). This is a much larger set of goods than that covered by the GSP. In the case of non-LDC countries, products are eligible for preferences under AGOA or GSP, but not under both. Nevertheless, some products are eligible

[9] The EU plays a key role in the export of developing countries, not only because of the size of its market but also because of its various reciprocal and non-reciprocal preferential agreements. Dependence on EU preferences is particularly important for some African and Caribbean countries. On average, the use of these tariff preferences has been shown to be strong (Candau and Jean 2009).

for both programs for the LDC beneficiaries. AGOA exempts beneficiaries from the limits of competitive needs. The program also provides duty-free and quota-free access to clothing made from U.S. fabric, yarn and thread in eligible sub-Saharan African countries. Imports of apparel made from regional fabrics were subject to a cap, which was intended to grow over a period of eight years. Furthermore, the Special Apparel Rule (SRA) permitted the LDCs to have duty-free access to apparel made from fabrics originating in third countries. AGOA II (part of the 2002 Trade Act) widened preferential access and increased the regional clothing cap, while AGOA III (2004) extended the program until 2015 (Dean and Wainio, 2006; Van Biesebroeck and Zaurino, 2019).

The Caribbean Basin Economic Recovery Act (CBERA) is a program that eliminates or reduces tariffs on eligible imported goods from designated Caribbean and Central American countries and territories (USITC, 2005; Dean and Wainio, 2006; VanGrasstek, 2013). Further, the Caribbean Basin Trade Partnership Act (CBTPA), an extension of CBERA. Under the CBTPA, a number of import-sensitive products have become eligible for preferential duty treatment, including apparel, petroleum and petroleum products. CBTPA grants unrestricted duty-free entry for imports of garments manufactured in CBERA countries from fabrics made and cut in the United States of American yarns. CBTPA also offers some preferential access to clothing made from regional fabric, however, unlike AGOA, it does not have a third-country fabric provision (Dean and Wainio, 2006; UNCTAD, 2016).

The Andean Trade Preference Act (ATPA) granted duty-free access to a large number of import items from Bolivia, Colombia, Ecuador and Peru since the early 1990s (USITC, 2004b). ATPA covers more products than GSP, and eligibility is not limited to the limits of the GSP's competitive needs or the possibility of graduation. ATPA preferential treatment was extended in 2002 to include previously excluded import-sensitive products such as petroleum and petroleum derivatives, clothing and textiles, footwear, and tuna in foil packages. ATPA allows unlimited duty-free and quota-free treatment for imports of textiles and clothing made in ATPA countries using yarn, fabric or fabric components made entirely in the United States. Like the CBTPA, ATPA also provides some preferential access for clothing made from regional fabric, but no provision for third-country fabric (Dean and Wainio, 2006; UNCTAD, 2016).

USA: Tariff Changes, Preference Erosion and Diplomatic Impacts

There has been a great deal of diplomatic friction and debate over the value of preferential trade programs offered by the US (i.e. like other major industrial countries), giving duty-free or reduced-duty access to many exports from developing countries. Some diplomats from developing countries and non-governmental organisations asserted that the erosion of preferences would have dire implications for development and would require compensation (e.g. Alpert, 2005). Similarly, other diplomats and trade experts asserted that the vulnerability to preferential erosion is limited to only a few countries and products and therefore requires more targeted assistance (WTO 2004; Dean and Wainio 2006; WTO, 2018).

Compensation for the erosion of preferences, higher food import costs, and adjustments to implementation have been promised by US diplomats (as well as other preference-giving countries) in various trade negotiations/rounds (FAO, 2020; Alpert, 2005; Heron, 2019)**.** The LDCs were often promised substantially increased financial and technical assistance

necessary to enable them to respond appropriately to any new measures. Nevertheless, the delivery of these promises has been historically negligible. Conversely, the Doha Round was dubbed 'the Development Round' by the diplomats of the US and other rich countries (i.e. to reflect the commitments of all members to integrate poor countries into the multilateral trading system). Members agreed that the new round would address the development dimension of trade. The Round also focused on the different array of concerns raised by the diplomats and trade negotiators of developing countries – e.g. special and differential treatment, trade facilitation assistance, challenges faced by net food imports from developing countries, and loss of preference erosion (Alpert, 2005; FAO, 2020; Heron, 2019).

Many diplomats of developing countries stress that they will not be able to benefit from new trade rules, even with special and differential treatment, without additional trade-related support. Statements by the LDC Trade Ministers at the Doha Round recall the commitments made by the international community (e.g. at negotiations in Marrakech, Singapore, Geneva and Brussels) to help the LDCs, and call on all WTO members to offer trade assistance (Alpert, 2005; UNCTAD, 2018; Heron, 2019). However, despite the insistence of LDCs diplomats (i.e. on the need for special consideration and extra support), their proposals have been (historically) firmly challenged. Rich countries have been questioning the need for specific solutions to the erosion, implementation and other development interests outlined by the LDC diplomats – even during the Doha (or “Development”) Round. While the framework agreement of July 2004 tried to address these issues, it merely states that 'development issues should be taken into consideration.' Unless these claims are taken seriously, many developing country diplomats see little value in trade rounds and negotiations. For instance, of the 80 proposals put forward by diplomats of developing countries for special and differential treatment in the Doha Round, more than half requested assistance to address adjustment costs, capacity building needs, and the impact of preferential erosion and liberalisation. Nevertheless, promises made by developed members amounted to little more than a ‘positive diplomatic language’, as rich countries continue to raise different objections to the demands of LDC diplomats (Alpert, 2005).

5. References

Ahmad, J. (1977). Tokyo Rounds of Trade Negotiations and the Generalised System of Preferences. Economic Journal 88 (350): 285–95.

Alexandraki, K. and Lankes, H. (2006). “Estimating the Impact of Preference Erosion on Middle-Income Countries.” in Trade Preferences and Differential Treatment of Developing Countries, ed. Bernard Hoekman and Çaglar Özden, 397–431. Cheltenham, U.K.: Edward Elgar

Alpert, E. (2005). Scaling Up Aid for Trade: How to support poor countries to trade their way out of poverty. Oxfam International. https://oxfamilibrary.openrepository.com/bitstream/handle/10546/114589/bn-scaling-up-aid-for-trade-151105-en.pdf?sequence=1&isAllowed=y

Bartels, L. (2016). The UK's Status in the WTO after Brexit. SSRN 2841747. http://dx.doi.org/10.2139/ssrn.2841747

Blanchard, E., and Hakobyan, S. (2015). The US Generalised System of Preferences in principle and practice. *The World Economy*, *38*(3), 399-424. http://faculty.tuck.dartmouth.edu/images/uploads/faculty/emily-blanchard/Principle_v_Practice_Paper.v13.pdf

Bouët, A., Fontagné, L. and Jean, S. (2006). “Is Erosion of Tariff Preferences a Serious Concern?” In Agricultural Trade Reform and the Doha Development Agenda, ed. Kym Anderson and Will Martin, 161–92. Basingstoke, U.K.: Palgrave Macmillan.

Brenton, P. (2003). Integrating the Least Developed Countries into the World Trading System: The Current Impact of EU Preferences under Everything but Arms. Policy Research Working Paper 3018, World Bank, Washington, DC.

Bureau, J. C., Guimbard, H., and Jean, S. (2019). Agricultural Trade Liberalisation in the 21st Century: Has It Done the Business?. *Journal of agricultural economics*, *70*(1), 3-25. http://dx.doi.org/10.1111/1477-9552.12281

Candau, F. and Jean, S. (2009). What Are European Union Trade Preferences Worth for Sub-Saharan African and Other Developing Countries? The World Bank. http://documents.worldbank.org/curated/en/866991468163170618/pdf/483390PUB0Trad101OFFICIAL0USE0ONLY1.pdf#page=83

Commonwealth Secretariat (2004). Preference-Dependent Economies and Multilateral Liberalisation: Impacts and Options. Commonwealth Secretariat, Canberra.

Dean, J. and Wainio, J. (2006). Quantifying the Value of US Tariff Preferences for Developing Countries. The World Bank. http://documents.worldbank.org/curated/en/152951468130479034/pdf/wps3977.pdf

EC (2018). Economic Partnership Agreements (EPAs). European Commission. https://trade.ec.europa.eu/doclib/docs/2017/february/tradoc_155300.pdf

EC (2020). Generalised Scheme of Preferences (GSP). European Commission. https://ec.europa.eu/trade/policy/countries-and-regions/development/generalised-scheme-of-preferences/

Efstathopoulos, C. (2012). Leadership in the WTO: Brazil, India and the Doha Development Agenda. Cambridge Review of International Affairs 25 (2): 269–293. https://doi.org/10.1080/09557571.2012.678294

FAO (2020). Erosion of Preference Margins: is there a Case for Compensation? Food and Agriculture Organisation of the United Nations. http://www.fao.org/3/y2732E/y2732e0a.htm

Francois, J., and Wooton, I. (2001). Trade in International Transport Services: The Role of Competition. Review of International Economics 9 (2): 249–61.

Heron, T. (2019). Small and Least-Developed Countries. In *The Palgrave Handbook of Contemporary International Political Economy* (pp. 155-167). Palgrave Macmillan, London. https://doi.org/10.1057/978-1-137-45443-0

Hoekman, B. & Prowse, S. (2005). Economic Policy Responses to Preference Erosion: From Trade as Aid to Aid for Trade. World Bank Working Paper, 3721. http://documents.worldbank.org/curated/en/557831468329460368/pdf/wps3721.pdf

Hoekman, B., & Ozden, C. (2005). Trade preferences and differential treatment of developing countries: a selective survey. The World Bank. http://documents.worldbank.org/curated/en/591041468166772176/pdf/wps3566.pdf

Hoekman, B., Martin, W. and Primo-Braga, C. (2008). Quantifying the Value of Preferences and Potential Erosion Losses. The World Bank. https://www.researchgate.net/publication/254304825_Quantifying_the_Value_of_Preferences_and_Potential_Erosion_Losses/citation/download

Hoekman, Bernard, Francis Ng, and Marcelo Olarreaga. 2001. “Eliminating Excessive Tariffs on Exports of Least Developed Countries.” Policy Research Working Paper 2604, World Bank, Washington, DC.

Jackson, J. (1997). The world trading system: law and policy of international economic relations, 2nd ed. Cambridge, MA: MIT Press.

Kautoke-Holani, A. (2018). Labour mobility in the PACER Plus. *Asia & the Pacific Policy Studies*, *5*(1), 90-101. https://onlinelibrary.wiley.com/doi/pdf/10.1002/app5.221

Kopp, T., Prehn, S., & Brümmer, B. (2016). Preference Erosion–The Case of Everything But Arms and Sugar. *The World Economy*, *39*(9), 1339-1359. https://doi.org/10.1111/twec.12374

Lamy, P. (2002). Steppingstone or Stumbling Blocks? The EU’s Approach towards the Problem of Multilateralism vs. Regionalism in Trade Policy. World Economy 25 (10): 1399–413.

Limao, N., & Olarreaga, M. (2006). Trade Preferences to Small Developing Countries and the Welfare Costs of Lost Multilateral Liberalisation. *The World Bank Economic Review, 20*(2), 217-240. Retrieved May 1, 2020, from www.jstor.org/stable/40282328

Lippoldt, D. (2006). The Australian Preferential Tariff Regime. OECD Trade Policy Working Paper No. 33. Organisation for Economic Co-operation and Development. https://www.gtap.agecon.purdue.edu/resources/download/2806.pdf

Lydgate, E., J. Rollo, and R. Wilkinson (2016). *The UK trade landscape after Brexit*. UKTPO Briefing paper No. 2. https://www.chathamhouse.org/sites/default/files/publications/research/2016-10-06-uktpo-uk-trade-landscape-lydgate-rollo-wilkinson.pdf

Mahrenbach, L. C., & Shaw, T. M. (2019). Continuities and Change in IPE at the Start of the Twenty-first Century. In *The Palgrave Handbook of Contemporary International Political Economy* (pp. 1-23). Palgrave Macmillan, London. https://doi.org/10.1057/978-1-137-45443-0

Mendez-Parra, M. (2016). A simple and targeted trade policy for developing countries after Brexit. GREAT Insights Magazine - Volume 5, Issue 6. December 2016/January 2017. https://ecdpm.org/great-insights/shifts-trade-development/simple-targeted-trade-policy-developing-countries-brexit/

Mendez-Parra, M., P. Papadavid, and D.W. te Velde. 2016. *Brexit and development: How will developing countries be affected*. ODI brief. https://www.odi.org/sites/odi.org.uk/files/resource-documents/10685.pdf

Mercado, C. A. C. (2017). Erring on the Side of Precaution: An Assessment of the Application of the Precautionary Principle in International Trade Law. *Ateneo LJ*, *62*, 987. http://ateneolawjournal.com/Media/uploads/85cab4c777fc375981510f273aab1ea1.pdf

Morgan, W. (2018). Much lost, little gained? Contemporary trade agreements in the Pacific Islands. *The Journal of Pacific History*, *53*(3), 268-286. https://doi.org/10.1080/00223344.2018.1475832

Rai, K. (2018). The development of trade arrangements in the Caribbean Island Nations and the Pacific Island Countries. *Journal of Pacific Studies*, *38*(1), 99-120. https://pdfs.semanticscholar.org/0d56/f413ee50fe1bc562c888e7d839d5d082d807.pdf

Rollo, J. (2016). 'A new UK trade policy towards developing countries: what sort of transition' in The Impact of the UK's post-Brexit trade policy on development, Mendez-Parra, M., D.W. te Velde and L.A. Winters (eds), ODI-UKTPO. https://www.odi.org/sites/odi.org.uk/files/resource-documents/10852.pdf

Sapir, André. 1998. "The Political Economy of EC Regionalism." European Economic Review 42 (3–5): 717–32.

Shaw, T.M., Mahrenbach, L.C., Modi, R., Yi-Chong, X. (Eds.) (2019) *The Palgrave Handbook of Contemporary International Political Economy* (pp. 1-23). Palgrave Macmillan, London. https://doi.org/10.1057/978-1-137-45443-0

Trommer, S. (2017). The WTO in an Era of Preferential Trade Agreements: Thick and Thin Institutions in Global Trade Governance. World Trade Review 16 (3): 501–526. https://doi.org/10.1017/S1474745616000628

UK and EU (2020). What does ‘most-favoured nation’ (MFN) mean? UK in a Changing Europe. https://ukandeu.ac.uk/fact-figures/what-does-most-favoured-nation-mfn-mean/

UKTPO (2020) Recommendations on the UK Government’s Global Tariff proposals. UK Trade Policy Observatory. https://blogs.sussex.ac.uk/uktpo/publications/recommendations-on-the-uk-governments-global-tariff-proposals/#bp39mfn

UNCTAD (2016). Generalised System of Preferences Handbook on The Scheme Of United States of America. United Nations Conference on Trade and Development. https://unctad.org/en/PublicationsLibrary/itcdtsbmisc58rev3_en.pdf

UNCTAD (2018). Trade policy frameworks for developing countries: a manual of best practices. United Nations Conference on Trade and Development. https://unctad.org/en/PublicationsLibrary/ditctncd2017d5_en.pdf

USITC (2004a). U.S. Trade and Investment with Sub-Saharan Africa. 5th annual report. USITC Publication 3741. Washington, DC: U.S. International Trade Commission.

USITC (2004b). The Impact of the Andean Trade Preference Act. 10th report. USITC Publication 3725. Washington, DC: U.S. International Trade Commission.

USITC (2005). The Impact of the Caribbean Basin Economic Recovery Act. 17th report. USITC Publication 3804. Washington, DC: U.S. International Trade Commission.

Van Biesebroeck, J., & Zaurino, E. (2019). *Effects of Trade Liberalisation on Textile and Apparel Exports from Sub-Sahara Africa*. The World Bank. https://openknowledge.worldbank.org/bitstream/handle/10986/32056/WPS8936.pdf?sequence=4

VanGrasstek, C. (2013). *The history and future of the World Trade Organisation* (p. 201). Geneva: World Trade Organisation. https://www.wto.org/english/res_e/booksp_e/historywto_e.pdf

Vickers, B. (2019). Implications of Brexit. In *The Palgrave Handbook of Contemporary International Political Economy*(pp. 283-299). Palgrave Macmillan, London. https://doi.org/10.1057/978-1-137-45443-0

WTO (2004). “Statement by the IMF Managing Director,” WTO News, October. World Trade Organisation. http://www.wto.org/english/news_e/news04_e/gc_stat_imf_22oct04_e.htm

WTO (2008). Draft Modalities for Nonagricultural Market Access. TN/MA/W/103/Rev.2. World Trade Organisation. Geneva.

WTO (2013). WTO Dispute Settlement: One-Page Case Summaries 1995 – 2012. World Trade Organisation. Geneva. https://www.wto.org/english/res_e/booksp_e/dispu_settl_1995_2018_e.pdf

WTO (2018). WTO Dispute Settlement: One-Page Case Summaries 1995–2018. World Trade Organisation. Geneva. https://www.wto.org/english/res_e/booksp_e/dispu_settl_1995_2018_e.pdf

WTO (2020). The Doha Round. World Trade Organization. https://www.wto.org/english/tratop_e/dda_e/dda_e.htm#development

Zhang, X. and Verikios, G. (2003). A General Equilibrium Analysis of Australia Providing Duty-Free Access on Goods Imported from Least Developed Countries. Paper prepared for the Sixth Annual Conference on Global Economic Analysis, The Hague, Netherlands, June 12–14.

6. Annexe: Historical Examples of MFN tariff Disputes

1. Ecuador, Guatemala, Honduras, Mexico, and United States vs. EC (Bananas)

	PARTIES	AGREEMENTS	TIMELINE OF THE DISPUTE	
Complainants	*Ecuador, Guatemala, Honduras, Mexico, United States*	*GATT Arts. I, III, X, XIII* *GATS Arts. II, XVII* *Licensing Ag Art. 1.3* *Lomé Waiver*	Establishment of Panel	*8 May 1996*
			Circulation of Panel Report	*22 May 1997*
Respondent	*European Communities*		Circulation of AB Report	*9 September 1997*
			Adoption	*25 September 1997*

Source: WTO (2018, 2013)

- **Measure at issue:** The European Communities' regime for the import, distribution and sale of bananas was introduced on 1 July 1993 and created by EEC Council Regulation 404/93 (WTO, 2018; 2013).

- **Product at issue:** Bananas that are imported from third countries. Third countries are those countries other than (i) 12 African, Caribbean and Pacific ("ACP") countries who have traditionally exported bananas to the European Communities and (ii) ACP countries that were not traditional suppliers of the EC market (WTO, 2018; 2013).

- **Summary of key findings:**
  - **GATT Art. I (most-favoured-nation treatment):** WTO's Appellate Body[10] endorsed the WTO Panel's finding that the activity function rules, which was valid only to licence allocation rules for imports from other than traditional ACP countries, were not consistent with MFN treatment (WTO, 2018; 2013).
  - WTO's Appellate Body also agreed with the WTO Panel that the EC export certificate requirement afforded a benefit to some Members only, i.e. the Framework Agreement on Bananas (BFA) countries, in violation of MFN treatment. In an issue not appealed to WTO's Appellate Body, the WTO Panel discovered that tariff preferences for ACP countries were not consistent with MFN treatment, but that they were warranted by the Lomé Waiver (WTO, 2018; 2013).

2. Ecuador vs. EC (*Bananas*)

	PARTIES	AGREEMENTS	TIMELINE OF THE DISPUTE	
Complainant	*Ecuador*	*GATT Arts. I and XIII* *GATS Arts. II and XVII*	Referred to the Original Panel	*12 January 1999*
			Circulation of Panel Report	*12 April 1999*

[10] WTO's Appellate Body "is composed of seven Members who are appointed by the Dispute Settlement Body (DSB). Each Member of the Appellate Body is required to be a person of recognized authority, with demonstrated expertise in law, international trade and the subject-matter of the covered agreements generally. They are also required to be unaffiliated with any government and are to be broadly representative of the Membership of the WTO." https://www.wto.org/english/tratop_e/dispu_e/ab_members_bio_e.htm

Respondent	*European Communities*		Circulation of AB Report	*NA*
			Adoption	*6 May 1999*

Source: WTO (2018, 2013)

- **Measure taken to comply with the DSB recommendations and rulings:** EC Regulation No. 1637/98 which was implemented to modify Regulation (EEC) No. 404/93 – the measure at issue in the original dispute – together with EC Regulation No. 2362/98, which set forth implementing rules for the revised Regulation. The Regulation related to the imports of bananas into the European Communities and access to the EC market for three types of bananas (WTO, 2018; 2013).

- **Summary of key findings:**
  - **GATT Art. I:1 (most-favoured-nation treatment):** The WTO panel found that a more favourable quota level for ACP countries was a prerequisite under the Lomé Convention. Nevertheless, it found that there was a breach of MFN treatment in the collective distribution of quotas to ACP countries, calculated on the basis of the best-ever export volume of individual countries prior to 1991, which could have resulted in some countries exporting more than their best-ever export volume prior to 1991, which would not have been justified under the Lomé Waiver. As regards the preferential zero tariff for imports from non-traditional ACP countries, the WTO panel found no infringement as the Lomé Convention allows the European Communities to grant preferential treatment to ACP countries as well as discretion as to the form of such preferential treatment (WTO, 2018; 2013).

3. Ecuador *and the United States vs. EC* (*Bananas*)[11]

PARTIES		AGREEMENT	TIMELINE OF THE DISPUTE	
Complainants	*Ecuador, United States*	*GATT Arts. I, II 2 and XIII DSU Art. 21.5*	Referred to the Original Panels	*20 March 2007 (Ecuador) 12 July 2007 (United States)*
			Circulation of Panel Reports	*7 April 2008 (Ecuador) 19 May 2008 (United States)*
Respondent	*European Communities*		Circulation of AB Reports	*26 November 2008*
			Adoption	*11 December 2008 (Ecuador) 22 December 2008 (United States)*

Source: WTO (2018, 2013)

- **MEASURE TAKEN TO COMPLY WITH THE DSB RECOMMENDATIONS AND RULINGS:** Import regime for bananas from the European Communities, as provided by EC Regulation No 1964/2005 of 24 November 2005. The constitutes a duty-free quota of 775,000 mt for bananas from ACP countries and a tariff rate of 176/mt for all other bananas imported (WTO, 2018; 2013).

- **Summary of key findings:**

[11] European Communities – Regime for the Importation, Sale and Distribution of Bananas – Second Recourse to Article 21.5 of the DSU by Ecuador; and European Communities – Regime for the Importation, Sale and Distribution of Bananas – Recourse to Article 21.5 of the DSU by the United States 2 Art. II was invoked only by Ecuador.

- **GATT Art I (most-favoured-nation treatment):** In an issue not referred to the WTO Appellate Body, both panels found that the preference given by the European Communities to an annual duty-free tariff quota of 775,000 mt of imported bananas originating in ACP countries constituted a benefit not granted to bananas originating in non-ACP WTO members and thus was inconsistent with MFN treatment. The WTO Panel also found that the European Communities had not demonstrated the existence of an exemption from MFN treatment for the period following the expiration of the Doha Waiver to cover the preference granted by the European Communities to ACP banana duty-free tariff quotas (WTO, 2018; 2013).

4. India vs. EC (tariff preferences on imports from India)[12]

	PARTIES	AGREEMENT	TIMELINE OF THE DISPUTE	
Complainant	*India*	*GATT Art. I.1 Enabling Clause para. 2(a)*	Establishment of Panel	*27 January 2003*
			Circulation of Panel Report	*1 December 2003*
Respondent	*European Communities*		Circulation of AB Report	*7 April 2004*
			Adoption	*20 April 2004*

Source: WTO (2018, 2013)

- **Measure at issue:** European Communities' generalised tariff preferences ("GSP") system for developing countries and economies in transition. Specifically, special arrangement under the scheme to combat drug production and trafficking (the "Drug Arrangements"), the benefits of which apply only to the listed 12 countries experiencing a certain gravity of drug problems.[13]
- **Product at issue:** Products imported from India vs products imported from the 12 countries benefiting from the Drug Arrangements through the EC GSP scheme (WTO, 2018; 2013).

- **Summary of key findings:**
  - **GATT Art. I:1 (most-favoured-nation treatment):** The WTO panel noted that the tariff advantages under the Drug Arrangements were not consistent with the treatment of MFN, as the tariff advantages were granted only to products originating in the 12 beneficiary countries and not to similar products originating in all other Member States, including those originating in India (WTO, 2018).
  - **Enabling Clause, para. 2(a):** WTO's Appellate Body reached an agreement with the WTO Panel that the Enabling Clause is an "exception" to GATT MFN treatment, and concluded that the Drug Arrangements were not justified under para. 2(a) of the Enabling Clause, as the measure, *inter alia*, did not set forth any objective criteria, that, if met, would permit for other developing countries "that are similarly affected by the drug problem" to be incorporated as beneficiaries under the measure. In this respect, even if upholding the WTO Panel's conclusion, WTO's Appellate Body conflicted with the WTO Panel's logic and found that not every difference in tariff treatment of GSP beneficiaries inevitably constituted discriminatory treatment. Awarding different tariff preferences to products originating in different GSP beneficiaries is permitted under

[12] European Communities – Conditions for the Granting of Tariff Preferences to Developing Countries

[13] The 12 countries benefiting from the Drug Arrangements are the following: Bolivia, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Nicaragua, Pakistan, Panama, Peru and Venezuela.

the term 'non-discriminatory' in footnote 3 to para. 2, given that the relevant tariff preferences react positively to a particular “development, financial or trade need” and have been made available on the basis of an objective standard to “all beneficiaries that share that need” (WTO, 2018).

- **Burden of proof (Enabling Clause):** WTO’s Appellate Body stated that, as a general principle, the responsibility of proof for an “exception” falls on the respondent. Given “the vital role played by the Enabling Clause in the WTO system as means of stimulating economic growth and development”, nevertheless, when a measure taken pursuant to the Enabling Clause is contested, a complaining party must claim more than mere inconsistency with MFN treatment and must point to specific provisions of the Enabling Clause with which the scheme is supposedly inconsistent so as to define the parameters within which the responding party must prepare its response under the requirements of the Enabling Clause. WTO’s Appellate Body discovered that India in this case sufficiently raised para. 2(a) of the Enabling Clause in making its claim of inconsistency with GATT MFN treatment (WTO, 2018).

5. *Costa Rica, El Salvador, Guatemala, Honduras* vs. the DOMINICAN REPUBLIC (Polypropylene bags and tubular fabric)[14]

	PARTIES	AGREEMENT	TIMELINE OF THE DISPUTE	
Complainants	*Costa Rica, El Salvador, Guatemala, Honduras*	*GATT Arts. I:1, II:1(b), XIX:1(a), XIX:2 and XIX SA Arts. 2.1, 2.2, 3.1, 4.1(a), 4.1(c), 4.2(a), 4.2(c), 4.2, 6, 9.1 and 11.1(a)*	Establishment of Panel	*7 February 2011*
			Circulation of Panel Report	*31 January 2012*
Respondent	*Dominican Republic*		Circulation of AB Report	*NA*
			Adoption	*22 February 2012*

Source: WTO (2018, 2013)

- **Measure at issue:** The provisional and final protection measures enforced by the Dominican Republic on imports, and the investigation that led to the imposition of those measures.
- **Product at issue:** Polypropylene bags and tubular fabric (WTO, 2018; 2013).
- **Summary of key findings:**
  - **GATT Arts. I:1 (most-favoured-nation treatment) and II:1(b) (schedules of concessions – other duties or charges):** The WTO Panel decided that the measures at issue had the consequence of suspending the Dominican Republic’s most-favoured-nation treatment responsibility in MFN treatment, as well as the exclusion on other duties or charges in connection with importation within the meaning of Art. II:1(b) (WTO, 2018; 2013).

[14] Dominican Republic – Safeguard Measures on Imports of Polypropylene Bags and Tubular Fabric

6. *Philippines* vs. Brazil (Desiccated Coconut)[15]

	PARTIES	AGREEMENTS	TIMELINE OF THE DISPUTE	
Complainant	*Philippines*	*GATT Arts. I, II and VI AA Art. 13*	Establishment of Panel	*5 March 1996*
			Circulation of Panel Report	*17 October 1996*
Respondent	*Brazil*		Circulation of AB Report	*21 February 1997*
			Adoption	*20 March 1997*

Source: WTO (2018, 2013)

- **Measure at issue:** A countervailing duty Brazil imposed on 18 August 1995 on the basis of an investigation started on 21 June 1994.
- **Product at issue:** Desiccated coconut and coconut milk imported from the Philippines.
- **Summary of key panel/ab findings:**
    - **GATT Arts. I (most-favoured-nation treatment), II (schedules of concessions) and VI (anti-dumping and countervailing duties):** WTO's Appellate Body upheld the WTO Panel's finding that GATT Arts. I, II and VI did not apply to the Brazilian countervailing duty measure at issue for the reason that it was centred on an investigation initiated prior to 1 January 1995, the date that the WTO Agreement came into effect for Brazil. In particular, the WTO Panel found: (i) the subsidy rules in the GATT cannot apply separately of the Agreement on Subsidies and Countervailing Measures (ASCM); and (ii) non-application of the ASCM makes the subsidy rules in the GATT non-applicable. As for GATT Arts. I and II, they did not apply to this disagreement since the claims under these provisions derived from the claims of inconsistency with Art. VI (WTO, 2018; 2013).

7. Indonesia vs. *European Communities, Japan, United States* (Autos)[16]

	PARTIES	AGREEMENTS	TIMELINE OF THE DISPUTE	
Complainants	*European Communities, Japan, United States*	*TRIMs Art. 2.1 GATT Arts. I:1 and III:2 ASCM Arts. 5(c), 6, 27.9 and 28*	Establishment of Panel	*12 June 1997*
			Circulation of Panel Report	*2 July 1998*
Respondent	*Indonesia*		Circulation of AB Report	*NA*
			Adoption	*23 July 1998*

Source: WTO (2018, 2013)

- **Measure at issue:** (i) "The 1993 Programme" that delivered import duty reductions or exemptions on imports of automotive parts on the basis of the local content percent; and (ii) "The 1996 National Car Programme" that delivered various benefits such as luxury tax

[15] Brazil – Measures Affecting Desiccated Coconut

[16] Indonesia – Certain Measures Affecting the Automotive Industry

exemption or import duty exemption to qualifying (local content and etc.) cars or Indonesian car companies (WTO, 2018; 2013).

- **Product at issue:** Imported motor vehicles and parts.
- **Summary of key panel findings**
  - **GATT Art I (most-favoured-nation treatment):** The WTO Panel agreed that the measures violated MFN treatment since the "advantages" (duty and sales tax exemptions) given to Korean imports were not afforded "unconditionally" to "like" products from other Members (WTO, 2018; 2013).

8. Chile vs. Argentina (Price Band System)[17]

PARTIES		AGREEMENTS	TIMELINE OF THE DISPUTE	
Complainant	*Argentina*	*AA Art. 4.2* *GATT Art. II:1(b), second sentence* *WTO Agreement Art. XVI:4*	Referred to the Original Panel	*20 January 2006*
			Circulation of Panel Report	*8 December 2006*
Respondent	*Chile*		Circulation of AB Report	*7 May 2007*
			Adoption	*22 May 2007*

Source: WTO (2018, 2013)

- **Measure taken to comply with the DSB recommendations and rulings:** The revised price band system applied by Chile, through which the total amount of duties applied on imports of wheat, wheat flour and sugar would fluctuate, through the imposition of extra specific duties or through the concession of rebates on the amounts payable. When the reference price established by the Chilean authorities dropped below the lower threshold of a price band, a specific duty was included to the *ad valorem* **most-favoured-nation tariff**. On the other hand, when the reference price was greater than the upper threshold of the price band, imports would benefit from a duty rebate (WTO, 2018; 2013).

9. Turkey vs. United States (Rice)[18]

	PARTIES	AGREEMENTS	TIMELINE OF THE DISPUTE	
Complainant	*United States*	*GATT Arts. III:4, X:1, X:2, XI:1* *AA Art. 4.2* *Licensing Ag Arts. 1.4(a), 1.4(b), 1.6, 3.5(a), 3.5(e), 3.5(f), 3.5(h), 5.1,* *5.2(a), 5.2(b), 5.2(c), 5.2(d), 5.2(e),* *5.2(g), 5.2(h), 5.41* *TRIMs Art. 2.1 and para1(a) of the Annex*	Establishment of Panel	*17 March 2006*
			Circulation of Panel Report	*21 September 2007*
Respondent	*Turkey*		Circulation of AB Report	*NA*
			Adoption	*22 October 2007*

Source: WTO (2018, 2013)

[17] Chile – Price Band System and Safeguard Measures Relating to Certain Agricultural Products – Recourse to Article 21.5 of the DSU by Argentina

[18] Turkey – Measures Affecting the Importation of Rice

- **Measure at issue:** Turkey's limits on the importation of rice, specifically: (i) the decision, during particular periods of time commencing September 2003 to refuse or fail to grant Certificates of Control to import rice at the **most-favoured-nation tariff rates**; (ii) the domestic buying condition incorporated in Turkey's TRQ regime (until July 2006), to import rice at lesser tariff rates; (iii) the discouragement of the full use of tariff-rate quotas via their administration; (iv) the collective effect of measures (i) and (iii); and (v) Turkey's administration of its import regime for rice, more broadly (WTO, 2018; 2013).
- **Product at issue:** Rice, including paddy, husked and white rice, imported by Turkey.
- **Summary of key findings:**
  - **AA Art. 4.2 (quantitative restrictions):** The WTO Panel noted that Turkey had refused or failed to grant licences to import rice **at the most-favoured-nation tariff rates**, i.e. beyond the tariff rate quotas. The WTO Panel found this practice to be a quantitative import restriction and discretionary import licensing, within the meaning of footnote 1 to Art. 4.2 (WTO, 2018).[19]

10. Panama vs. Colombia (textile, apparel and footwear imports)[20]

	PARTIES	AGREEMENT	TIMELINE OF THE DISPUTE	
Complainant	*Panama*	*GATT Arts. XI:1, XIII:1, V:2 V:6 and I:1 CVA Arts. 1, 2, 3, 5, 6 and 7*	Establishment of Panel	*22 October 2007*
			Circulation of Panel Report	*27 April 2009*
Respondent	*Colombia*		Circulation of AB Report	*NA*
			Adoption	*20 May 2009*

Source: WTO (2018, 2013)

- **Measure at issue:** Colombian customs rule about the use of indicative prices and restrictions on ports of entry.
- **Product at issue:** some textiles, apparel and footwear classifiable under HS Chapters 50-64 of Colombia's Tariff Schedule, which were re-exported and re-exported from the Colon Free Zone ("CFZ") and Panama to Colombia (WTO, 2018).
- **Summary of key findings:**
  - **GATT Art. I:1 (most-favoured-nation treatment):** The WTO Panel noted that, by requiring textile, apparel and footwear imports coming from Panama and the CFZ to an advance import declaration obligation, which thus involves payment of customs duties and sales tax beforehand and thwarts importers from examining goods on-site upon arrival so as to verify the accuracy of the declaration, Colombia conferred advantages to like products from all other WTO Members that were not given immediately and unconditionally to textile, apparel and footwear imports from Panama and the CFZ in violation of Art. I.1 (WTO, 2018).

[19] In making this finding, the WTO Panel did not consider it necessary to assess whether the relevant Turkish documents constituted import licences as argued by the United States.

[20] Colombia – Indicative Prices and Restrictions on Ports of Entry

Suggested citation

Megersa, K. (2020). *The Diplomatic Impacts of Most Favoured Nation Tariff Changes by Major Economies*. K4D Helpdesk Report 794. Brighton, UK: Institute of Development Studies.

About this report

This report is based on six days of desk-based research. The K4D research helpdesk provides rapid syntheses of a selection of recent relevant literature and international expert thinking in response to specific questions relating to international development. For any enquiries, contact helpdesk@k4d.info.

K4D services are provided by a consortium of leading organisations working in international development, led by the Institute of Development Studies (IDS), with Education Development Trust, Itad, University of Leeds Nuffield Centre for International Health and Development, Liverpool School of Tropical Medicine (LSTM), University of Birmingham International Development Department (IDD) and the University of Manchester Humanitarian and Conflict Response Institute (HCRI).