NAMA Negotiations in the WTO and Preference Erosion: Concerns of Bangladesh and Other Regional LDCs

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CSGR Working Paper No. 188/06

January 2006

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Acronyms and Abbreviations

ACP	: African, Caribbean and Pacific
AGOA	: Africa Growth Opportunity Act
APEC	: Asia Pacific Economic Cooperation
AP-LDC	: Asia Pacific Least Developed Country
BD	: Bangladesh
CBI	: Caribbean Basin Initiative
EBA	: Everything But Arms
EU	: European Union
GDP	: Gross Domestic Product
GSP	: Generalised System of Preferences
HS	: Harmonised System
IMF	: International Monetary Fund
LDC	: Least Developed Country
MFN	: Most Favoured nation
NAMA	: Non-Agricultural Market Access
RMG	: Ready Made Garments
RoO	: Rules of Origin
RTA	: Regional Trading Arrangements
SAFTA	: South Asian Free Trade Agreement
SAPTA	: South-Asia Preferential Trading Arrangements
S&DT	: Special and Differential Treatment
TIM	: Trade Integration Mechanism
TRADE Act	: Tariff Reduction Assistance for Developing Economies Act
WTO	: World Trade Organization

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Abstract: [The ongoing negotiations on non-agricultural market access (NAMA) in the WTO are expected to lead to substantive reductions in the tariff rates on industrial goods in both the developed and the developing countries. Although an agreement on the formula and coefficient(s) is yet to be reached, it is becoming increasingly clear that countries are moving towards a differentiated swiss-type formula with deeper cuts for higher tariffs. The July (2004) Framework Agreement stipulated that LDCs will not be required to undertake any tariff reduction commitments under the NAMA. However, LDCs are likely to suffer substantive tariff preference erosion as a consequence of NAMA negotiations since any tariff reduction by the developed countries will result in a fall in the preferential margins currently enjoyed by the LDCs under the various GSP schemes operated by the developed countries. Consequently, the competitive edge currently enjoyed by the LDCs by taking advantage of the preferential treatment under the various GSP schemes is set to suffer erosion. This is a major concern for Bangladesh and other LDCs in the Asia-Pacific region. This paper attempts to make an estimate about the range of *preferential erosion* for Bangladesh given her current trade pattern and preferential treatment enjoyed by her exports. The paper finds that for Bangladesh, the preferential erosion could be substantial (e.g. $42.1 million worth of net preference erosion in the EU alone for RMG products under one of the possible scenarios). Reduced preference margin will also undermine future competitiveness in the developed country markets. It is also to be noted that tariff reductions under NAMA will have positive implications for Bangladesh in the US market where most of Bangladesh's industrial goods do not enjoy GSP treatment. Thus, tariff reduction under NAMA is expected to have diverse implications for Bangladesh's export of industrial goods. NAMA, thus, may increase Bangladesh's competitive edge vis-à-vis Caribbean and Sub-Sahara African countries which are currently enjoying zero-tariff access for apparels under the AGOA and the CBI. The paper reviews some of the proposals that are being discussed to address the possible negative consequences of preference erosion for the LDCs.]

Keywords: Market Access, Preference Erosion, GSP, LDCs, NAMA, WTO, DDR

(Abbreviations)
GSP – Generalised System of Preferences
NAMA – Non-Agricultural Market Access
LDCs – Least Developed Countries
WTO – World Trade Organisation
DDR – Doha Development Round

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Introduction

The Doha Ministerial Declaration of the WTO stipulates that the negotiations on the Doha Round agenda "shall take fully into account the special needs and interests of developing and least developed country participants" (WTO Doha Declaration, 2001, Para 16). The Declaration further stipulates: "We recognise the particular vulnerability of the least-developed countries and special structural difficulties they face in the global economy…… We recognise that the integration of the LDCs into the multilateral trading system requires meaningful market access, support for the diversification of their production base, and trade-related technical assistance and capacity building". Although, under the *July Framework*, the LDCs are expected to bound at least some of their unbound tariff lines, they are not required to take any tariff reduction commitment. This is seen as a preferential treatment given to the LDCs as part of the special and differential treatment (S&DT) accorded to these countries in the WTO.

However, an issue of increasing importance and concern to the LDCs that is emerging in the context of the current WTO negotiations on non-agricultural market access (NAMA), which is likely to test the 'developmentness' of the Doha Development Round, is the issue of *preference erosion.*

The following sections analyse the implications of preference erosion for the LDCs in general and Bangladesh in particular. *Section I* deals with concerns of Bangladesh and other LDCs in the context of possible erosion of preferences under the current NAMA negotiations; *Section II* underscores the relevance and magnitude of preference erosion of LDCs in the Asia-Pacific region. *Section III* attempts to quantify the magnitude of preference erosion in the EU and US markets under various possible scenarios. *Section IV* puts forward a number of policy measures to offset negative consequences of possible preference erosion; *Section V* presents some concluding remarks.

Section I: Concerns as Regards Preference Erosion

As is known, the ongoing negotiations on NAMA aims at (a) reducing tariff on industrial products, including reduction or elimination of tariff peaks, high tariffs and tariff escalation, and (b) eliminating (or accelerated reduction of) all tariffs in particular

sectors (the so-called *sectoral*). The July 2004 Framework stipulates that (a) the product coverage would be comprehensive (without a-priori exclusions), (b) tariff reduction was to commence from bound rates, and (c) that all non-ad valorem duties are to be converted to *ad valorem* equivalents. Even if tariff reductions take place from bound rates, tariff reduction commitments are expected to lead to a lowering of Most Favoured Nation (MFN) tariffs on those goods, since the spread between bound rates and applied rates for most industrial products imported by the developed countries is not significant. There is also a possibility that tariff reductions (at least for some goods) may take place from the applied rate. The reduction of MFN tariffs under the current NAMA negotiations is likely to have important adverse implications for the LDCs in the form of *preference erosion.*

Preference erosion is defined as the decrease in the margin between a preferential tariff rate and the MFN tariff rate originating from multilateral tariff liberalisation. As is well known, the LDCs enjoy preferential market access in most of the developed countries under the various *Generalised System of Preferences* (GSP) Schemes operated by those countries. The GSPs have played an important role in providing LDC products a competitive edge in the developed country markets. This is not to deny that because of stringent rules of origin the utilisation of preferential treatment by LDCs under the GSP schemes have been less than satisfactory- in the EU and Japan these rates were only 54.0 percent and 53.0 percent respectively (UNCTAD, 2003). With the likely reduction of MFN tariffs in the developed countries under the ongoing negotiations on NAMA, the benefits enjoyed even under this limited use of the GSP facilities is likely to suffer significant erosion. As Hoekman and Prowse (2005) point out, compliance requirements reduce the value of preferences. Consequently, tariff reduction will further eat into the gains accrued to the LDCs. As Hoekman and Prowse (2005) point out, compliance requirements reduces value of preferences. Consequently, tariff reduction will further eat into the gains accrued to the LDCs.

As a matter of fact, any MFN reduction commitment in the WTO will also have negative implications for preferential margins enjoyed by LDCs that are members of various regional trading arrangements (RTAs) where they enjoy preferential treatment from developing or developed country partners on a non-reciprocal basis. For example, in the

South-Asia Preferential Trading Arrangement (SAPTA) the four South Asian LDCs (Bangladesh, Nepal, Bhutan and Maldives) enjoy preferential treatment (ranging from 10-100 percent of MFN tariffs) from the three developing countries (India, Pakistan and Sri Lanka). If the three developing countries reduce their MFN tariffs under the ongoing NAMA negotiations, the preferential margins currently enjoyed by the four LDCs will decline.

A number of tariff reduction proposals (the so-called *formulae*) are being considered in the context of the current NAMA negotiations. It appears that members are moving towards a non-linear, swiss or swiss type formula that would ensure deeper cuts for higher tariffs. There are also proposals as regards *sectorals* whereby tariffs on entire sectors may be eliminated. Though progress has been slow as regards arriving at a consensus-based modality for tariff reduction, there is enormous pressure on negotiators to come to an agreement on a formula. The Informal Ministerial Meeting in Dalian, China, held during 12-13 July, 2005 and also the APEC Trade Minister's Meeting held in Jeju, Korea during 2-3 June, 2005, have sent strong signals favouring speedy agreement on modality. It appears that some type of a swiss formula, with a couple of coefficients to accommodate specific concerns, would be the likely outcome of the current effort to reach a *First Approximation* in NAMA before the Hong Kong Ministerial. The extent of erosion in reality will depend on the level of ambition with respect to both overall tariff reduction as well as the *sectorals*. Nonetheless, there is no denying that whichever be the agreed formula, it will lead to reduction of MFN tariffs; resulting in the erosion of preferential margins for the LDCs. Thus the countries of the Asia-Pacific region should be seriously concerned about this likely prospect.

Section II: Relevance of Preference Erosion for the AP-LDCs

It is well known that in recent years the dependence of the Asia Pacific Least Developed Countries (AP-LDCs) on export earnings and export-oriented activities have been on the rise, particularly in view of the fact that many of these countries are, at present, pursuing export-led growth strategies. In 2003, AP-LDC export exceeded US$12.8 billion which was equivalent to about 16 percent of their GDP. The structure of their exports is heavily tilted towards such labour-intensive sectors as apparels, textiles, fisheries, agriculture and

tourism. Of particular importance is export of clothing and textile by these countries which together account for about two-thirds of the total commodity export of the AP-LDCs. Erosion of preferential margin is likely to undermine their competitive advantage with consequent adverse implications for their economic growth, foreign exchange reserves, livelihood for large number of people, and poverty alleviation.

In this context, it is also to be noted that the MFN tariff rates on items of export interest to the AP-LDCs tend to be relatively high. For example, average tariffs on apparels in the EU is about 12.0 percent, whilst in USA and Canada these vary between 10-30 percent (e.g. for Bangladesh the MFN tariffs on apparels in the US market is about 15 percent). The concern of the AP-LDCs in the context of NAMA originate from the fact that at present, under the various GSP schemes, these countries are enjoying duty-free access for most of their products in the markets of many developed countries (e.g. EU, Japan, Canada, Australia, New Zealand). For example, the *Everything But Arms Initiative* of the EU (EU-EBA) enables the AP-LDCs to export, among other items, apparels to the EU markets at zero-tariff, providing their exporters, vis-à-vis those not enjoying such benefit, a competitive edge equivalent to the MFN tariff.

TABLE 1
TARIFFS UNDER PREFERENTIAL SCHEMES

Preferential Agreement	Average Tariff Rate (all HS-6 products)	Average Tariff Rate (tariff peak products)
Canada		
GSP	4.3	28.2
LDCs 1/	4.4	22.8
MFN	8.3	30.5
European Union		
GSP	3.6	19.8
Non-ACP LDCs	0.9	12.4
MFN	7.4	40.3
Japan		
GSP	2.3	22.7
LDCs	1.7	19.0
MFN	4.3	27.8
United States		
GSP	2.4	16
Non-AGOA LDCs	1.8	14.4
MFN	5.0	20.8

1/ Does not reflect the recent Canadian initiative with regard to LDCs' exports; for example, under the revised GSP (2002) apparels exports enjoy zero-tariff access to the Canadian market under an LDC-friendly RoO criteria of 25 percent local value addition requirement.
Sources: Hoekman, Ng, and Olarreaga (2002) and IMF staff estimates as quoted in Subramanian, A (2004).

Table-1 provides information on the margin of preference enjoyed by the LDCs in developed country markets (the difference between the MFN tariff and the rate applicable to LDCs). The data justifies the apprehension as regards the erosion of preferences following MFN tariff reduction. As is known, many products of export interest to the LDCs also face high tariffs (tariff peaks) in these markets. These tariffs are particularly likely to be subjected to deeper cuts under the current negotiations. To that extent the erosion of preferences for the LDCs is also likely to be larger.

TABLE 2
LIKELY PREFERENCE MARGIN ENJOYED BY SELECTED AP-LDCS IN QUAD MARKETS

Country	Average Tariff (in percentages)				
	QUAD	US	EC-15	Japan	Canada
Bangladesh	12.4	12.1	12.3	7.3	21.7
Bhutan	12.4	12.1	12.3	7.3	21.7
Cambodia	13.4	4.4	4.4	4.4	4.4
Maldives	14.9	14.6	17.6	5.8	11.9
Myanmar	4.7	12.1	6.1	1.1	19.5
Nepal	9.5	11.1	7.4	7.7	18.7
Kiribati	5.7	0.1	14.7	7.1	4.4

Source: Subramanian, A, (2003).

Table-2 provides information as regards average tariffs facing exports from selected AP-LDCs in the Quad markets. The data indicates the range of preferential margin enjoyed by these countries if and when they get preferential treatment for their products in the Quad market.

Some of the developed country members including the US, EU and Japan have indicated strong interest favouring dramatic reduction in tariff levels, generally by way of non-linear formula. The US has submitted a proposal to the effect that tariff levels be brought down to no more than 8% by 2010, and subsequently to zero by 2015. New Zealand is also a supporter of speedy tariff reduction to zero. If such ambitious proposals are considered, and there is a decision to this effect under the current DDR negotiations or beyond, GSP preferential treatment will have a declining practical significance. Under such circumstances demand for global zero-tariff access for LDC products will have no relevance after a few years. This fact only reinforces the LDC concern about the fact of increasing preference erosion and strengthens their demand for according zero-tariff access on an immediate basis.

It is also to be noted that in recent years many developing countries have reduced their tariff on industrial goods quite significantly, on an autonomous basis, outside the ambit of the WTO. Thus, even if reduction commitments take the bound rates as reference point, for all practical purposes the operative tariff rates in these countries will remain at relatively low levels. For example, India has reduced her average industrial tariff from about 41% in 2000-01 to about 15% in 2005-06. This would imply that preferential margins under regional trading arrangement (RTAs), where both developing countries and LDCs are members, have suffered considerable erosion in recent years. The SAPTA (and envisaged SAFTA), where Bangladesh and India are both members, is a good example in this context. Because of the significant reduction in India's tariffs on industrial goods, actual benefits enjoyed by Bangladesh from preferential access to Indian market under the SAPTA (and also the SAFTA) have been on the decline over the past years. Indeed, it is in this context that the issue of zero-tariff access to markets of advanced developing countries (according to the July text version 'developing countries who are in a position to do so') acquires relevance and importance. There are three arguments in support of this: firstly, the preferential margins under RTAs are fast receding, so benefits to be had from preferential treatment are on the decline; secondly, competitive advantage of preference beneficiary countries vis-à-vis non-beneficiary countries is decreasing; thirdly, given the lower average operative tariffs, any possible loss of revenue on the part of developing countries originating on account of according such zero-tariff access to LDCs is not likely to be significant.

As was mentioned earlier, it is true that LDCs are not being able to take full advantage of the GSPs for a number of reasons including inability to comply with the rules of origin. However, even if this limitation is factored in, the erosion of tariff preference would be significant as far as the AP-LDCs are concerned. As a recent IMF Paper points out, the reduction in the margins could lead to a reduction in the utilisation rate of preferences as well. For example, utilisation could drop if the margin is small enough not to justify the administrative costs, including the cost of complying with RoO which has to be incurred to enjoy the preferences (Alexandraki, K and Lankes H.P, 2004).

Section III: Estimates of Erosion of Tariff Preference Margin under the NAMA: A Case Study of Bangladesh

In this section we present the results of an exercise to estimate the range of the erosion of tariff preferential margins for Bangladesh under various scenarios in the context of the on going NAMA negotiations.

To arrive at the estimates, a simulation exercise was carried, out based on *Swiss Formula,* with a set of hypothetical scenarios. Three coefficients, 0.3, 0.5 and 0.8, were used to estimate the possible range of Bangladesh's erosion of preference in the EU and the implications for the US markets. The *Swiss formula,* initially proposed during the Tokyo Round, is a tariff-dependent, non-linear formula which can be expressed mathematically as, $t_1 = \frac{a \times t_0}{a + t_0}$, where t_0 and t_1 are the initial and final tariff respectively and a is the coefficient which is to be negotiated. Rearranging the formula one gets the rate of tariff reduction, $R = \frac{t_0}{a + t_0}$. It implies that an increase in the value of a will reduce the rate of tariff reduction whilst a decrease will increase the rate of reduction. In other words, the lower (higher) the coefficient, the higher (lower) the reduction in tariff profile.

Data

The *Swiss formula* is applied on a line-by-line basis. Therefore, trade and tariff data are required at the level of HS-6 digit disaggregated tariff line to estimate the value of currently received preference, and to come at an estimation about the erosion of preference arising from the reduction of the tariff rate as a result of application of the *Swiss formula.* The EU import and tariff data at HS-6 digit level were taken from *Eurostat* and *UNCTAD TRAINS* database respectively, while import and tariff data for the USA were taken from USITC database.

3.1. Estimate of Bangladesh's Preference Erosion in the EU

In 2004, EU imported a total of 795 HS-6 digit items from Bangladesh. EU's total import from Bangladesh amounted to $5064.1 million in that year; more than 90 percent of this was accounted for by woven and knit RMG import from Bangladesh. Though Bangladesh enjoys duty and quota free access to the EU market through the EU-EBA programme, due to lack of adequate supply capacity and the stringent EU RoO (particularly the two-stage conversion in case of apparels) Bangladesh is not being able to realise the full potential benefit of the preferential treatment offered by the EU. For the purpose of our analysis, we have assumed that the GSP utilisation rates for woven RMG and Knit RMG are 25% and 90% respectively. This assumption is based on GSP ulilisation performance of Bangladesh in recent years. For other (non-RMG) products, it was assumed that Bangladesh is being able to take advantage of GSP facility to the fullest extent.

Based on the above assumptions, our estimates show that Bangladesh received duty free access for goods worth $3373.0 million in 2004. The remaining $1691.0 million of imports from Bangladesh were subject to MFN duties in the EU market. As a result, $206.3 million of import duties were imposed on Bangladesh's RMG exports in 2004 with the import-weighted average tariff being 12.2%. It is to be noted that about 84 percent of the import duties were imposed on the woven RMG which has a limited capacity to comply with the RoO.

In the absence of the EBA, preferential treatment, or any GSP facility for that matter, $599.6 million of import duty would have been imposed on Bangladesh's exports. This implies that Bangladesh was able to enjoy preference worth of ($599.6 million - $206.3 million) $393.3 million in 2004 in the EU thanks to the zero-tariff market access under the EBA programme.

Scenario 1 (Swiss Formula with coefficient of 0.3)

If the Swiss formula with coefficient of 0.3 is applied to the EU's current MFN tariff profile, the average tariff in the EU on items of import to Bangladesh will be considerably reduced (from 12.2% to 8.7%). Considering that EU's import from Bangladesh and Bangladesh's GSP utilisation rate remains same, $427.1 million of import duties would have been imposed on Bangladesh's exports in the absence of GSP facilities. Our estimates show that if the GSP utilisation rate remains the same, Bangladesh's actual preference utilisation would in this case be equivalent to $280.5 million. Thus the gross preference erosion would be ($339.3million-$280.5million) $112.8 million. On the other hand, as a result of reduction of MFN tariff, the average tariff on Bangladesh's exports would come down to 8.7 percent and the import duties on Bangladesh's exports would be $59.7 million less. Therefore, the net preference erosion would be to the tune of ($112.8 million-$59.7 million) $53.0 million.

It would be worthwhile looking at the net preference erosion for woven RMG and knit RMG separately. Because of Bangladesh's better GSP utilisation rate for knit RMG, the gross preference erosion would be $85.1 million and Bangladesh's gain in the form of tariff reduction would be $9.5 million, resulting in a net preference erosion of $75.6 million. On the other hand, the situation for woven RMG is quite opposite. In this case, gross preference erosion would be $16.7 million whereas gain from MFN tariff reduction would be $41.1 million. The net preference erosion would be negative ($41.1 million - $16.7 million) to the tune of (-)$33.5 million implying that Bangladesh would stand to gain if there is a tariff reduction in the EU (since it cannot utilize the GSP facility any way).

TABLE 3

NAMA & TARIFF REDUCTIONS UNDER VARIOUS SCENARIOS: IMPLICATIONS FOR BANGLADESH'S PREFERENCE EROSION IN EU

	All Products	Woven	Knit	RMG
Total Import from BD (Million US$)	5064.1	1894.8	2701.4	4596.2
- of which Under GSP (Million US$)	3372.9	473.7	2431.3	2905.0
Import duties on BD exports, if there was no GSP (Million US$)	599.6	231.4	328.0	559.4
Actual Import Duty Imposed on BD exports (Million US$)	**206.3**	**173.5**	**32.8**	**206.3**
Value of preference (foregone tariff) received by BD (Million US$)	393.3	57.8	295.2	353.1
Import weighted average tariff for Bangladesh (%)	*12.2*	*12.2*	*12.1*	*12.2*
Scenario 1 (Swiss Coefficient 0.3)				
Value of preference (foregone tariff) received by BD (Million US$)	280.5	41.1	210.1	251.2
Net Preference Erosion (Million US$)	**53.0**	**-33.5**	**75.6**	**42.1**
Import weighted average tariff for Bangladesh (%)	*8.7*	*8.7*	*8.6*	*8.7*
Scenario 2 (Swiss Coefficient 0.5)				
Value of preference (foregone tariff) received by BD (Million US$)	316.8	46.5	237.5	284.0
Net Preference Erosion (Million US$)	**36.0**	**-22.8**	**51.3**	**28.5**
Import weighted average tariff for Bangladesh(%)	*9.8*	*9.8*	*9.8*	*9.8*
Scenario 3 (Swiss Coefficient 0.8)				
Value of preference (foregone tariff) received by BD (Million US$)	341.7	50.2	256.3	306.5
Net Preference Erosion (Million US$)	**24.3**	**-15.4**	**34.6**	**19.2**
Import weighted average tariff for Bangladesh (%)	*10.6*	*10.6*	*10.5*	*10.6*

Note : Details in Annex Table -1
Source: Estimates based on Eurostat Data.

Scenario 2 (Swiss Formula with coefficient of 0.5)

If we use the Swiss formula with coefficient 0.5, Bangladesh's gross and net preference erosion for all products would be $76.5 and $36 million respectively. Under scenario 2, the average tariff on Bangladesh's exports would come down to 9.8 percent which is 1.1 percent higher compared to scenario 1; import duties on Bangladesh's exports would be $165.8 million.

Disaggregated analysis of woven and knit RMG gives the same direction of preference erosion, albeit to a lesser extent compared to scenario 1. For knit RMG, the gross preference erosion would be $57.7 million and Bangladesh's gain in the form of tariff reduction would be $6.4 million, resulting in a net preference erosion of $51.3 million. For woven RMG, Bangladesh's gain as a result of tariff reduction ($34.1 million) is higher than the gross preference erosion ($11.3 million) i.e. the net preference erosion

would be negative (-$22.8 million) implying that Bangladesh will stand to gain in case of woven-RMG.

Scenario 3 (Swiss Formula with coefficient of 0.8)

Under scenario 3, Swiss formula with a coefficient of 0.8 has been applied. The simulation result indicates that Bangladesh's gross and net preference erosion for all products would be $51.6 and $24.3 million respectively. In this case, the average tariff on Bangladesh's exports would come down to 10.6 percent which is 1.6 percent lower compared to current MFN tariff.

For knit RMG, the gross and net preference erosion would be $38.9 million and $34.6 million respectively. For woven RMG Bangladesh's gain as a result of tariff reduction, ($23 million) is higher than the gross preference erosion ($7.6 million) i.e. the net preference erosion would be negative (-$15.4 million) which indicates that Bangladesh will stand to gain in case of export if tariffs are reduced.

3.2. Estimate of Bangladesh's Preference Erosion in the USA

In 2004, US imported a total of 576 HS-8 digit items from Bangladesh the value of which amounted to $2302.5 million. Of these 576 items, 118 received GSP facility in the US market. In the same year, Bangladesh exported $1872.1 million worth of RMG products (247 HS 8 digit items). However, since RMG products are not eligible for GSP treatment in the US, these entered the US market on duty paid basis. For the purpose of our analysis, we have assumed that the GSP *utilisation rate* of Bangladesh is 100 per cent for the GSP eligible products in the US. Our estimates show that Bangladesh actually received duty free access for only $21.4 million in the US market (0.9 per cent of the total exports to US). The value of the GSP preference (in terms of foregone tariff) for Bangladesh was $1.1 million which is only 0.3 per cent of the import duty actually imposed on Bangladesh's exports. The remaining $2281.1 million of imports from Bangladesh were subject to MFN duties in the US market with an import weighted average tariff rate of 14.4 per cent. Value of import duties that were imposed on Bangladesh's export in 2004 by the US customs came to $327.7; of this $312.4 million was imposed as duty on the RMG products. It is to be noted here that the import weighted

average tariff rates for woven and knit RMG in the US market are 15.7 per cent and 19.4 per cent respectively.

Since preferential treatment received by Bangladesh in the US market is very negligible (and the main export RMG is not covered by the US-GSP scheme), erosion of preference in the US market due to tariff reduction under NAMA negotiations is expected to be insignificant and is not a major issue for Bangladesh. Rather, reduction of import duties in the US market under the NAMA negotiations (particularly for apparels products) is an issue that Bangladesh should follow very closely since it will reduce the import duty on Bangladesh's apparels in the US market and enhance her competitiveness vis-à-vis Caribbean and Sub-Saharan countries which enjoy zero-tariff access thanks to AGOA and CBI initiaves.

Scenario 1 (Swiss Formula with coefficient of 0.3)

Under scenario 1, the average tariff on Bangladesh's exports would come down to 8.9 percent, 9.9 percent and 11.1 percent for all products, woven RMG and knit RMG respectively. As a result, the value of import duty would come down to $204.8 million which is ($327.7 million – $204.8 million) $122.9 million less compared to the current import duties on Bangladesh's export to USA.

Scenario2 (Swiss Formula with coefficient of 0.5)

Under scenario 2, the average tariff on Bangladesh's exports would stand at 10.4 percent, 11.6 percent and 13.4 percent for all products, woven RMG and knit RMG respectively. As a result, the value of import duty would come down to $239.9 million which is ($327.7 million-$239.9 million) $87.8 million less than the current duties paid in the US market. This amount is $35.1 million higher compared to the duty paid under scenario 1.

TABLE 4

SUMMARY OF SIMULATION FOR US TARIFF REDUCTION UNDER NAMA AND ITS IMPACT ON BANGLADESH

Indicators	All Products	Woven	Knit	RMG
Total Import from BD (Million US$)	2302.5	1372.9	499.2	1872.1
- of which Under GSP (Million US$)	21.4	0.0	0.0	0.0
Total no. of HS 8 digit Items Imported by US from BD	576	159	88	247
- of which receiving GSP treatment	118	0	0	0
Import duties on BD exports, if there was no GSP (Million US$)	328.8	215.7	96.7	312.4
Actual Import Duty Imposed on BD exports (Million US$) (1)	**327.7**	**215.7**	**96.7**	**312.4**
Value of preference (foregone tariff) received by BD (Million US$)	1.1	0.0	0.0	0.0
Import weighted average tariff for Bangladesh (%)	*14.4*	*15.7*	*19.4*	*16.7*
Import Duties on BD exports, if Simple Swiss Formula (with coefficient 0.3) is applied to current MFN tariff profile (Million US$) (2)	**204.8**	**136.1**	**55.7**	**191.8**
Reduction in tariff considering that export value remains same (million US$) (1-2)	122.9	79.6	41.0	120.6
Import weighted average tariff for Bangladesh under Swiss coefficient 0.3 (%)	*8.9*	*9.9*	*11.1*	*10.2*
Import Duties on BD exports, if Simple Swiss Formula (with coefficient 0.5) is applied to current MFN tariff profile (Million US$) (3)	**239.9**	**159.1**	**66.7**	**225.8**
Reduction in tariff considering that export value remains same (Million US$) (1-3)	87.8	56.6	30.0	86.6
Import weighted average tariff for Bangladesh under Swiss coefficient 0.5 (%)	*10.4*	*11.6*	*13.4*	*12.1*
Import Duties on BD exports, if Simple Swiss Formula (with coefficient 0.8) is applied to current MFN tariff profile (Million US$) (4)	**266.3**	**176.2**	**75.2**	**251.4**
Reduction in tariff considering that export value remains same (Million US$) (1-4)	61.4	39.5	21.5	61.0
Import weighted average tariff for Bangladesh under Swiss coefficient 0.8 (%)	*11.6*	*12.8*	*15.1*	*13.4*

Source: Estimated from USITC database.

Scenario3 (Swiss Formula with coefficient of 0.8)

Under scenario 3, the average tariff on Bangladesh's exports would stand at 11.6 percent, 12.8 percent and 15.1 percent for all products, woven RMG and knit RMG respectively. The value of import duty would come down to $266.3 million which is ($327.7 million – $266.3 million) $61.4 million less than the current duties paid in the US market. This amount is $26.4 million higher as compared to the average duty under scenario 2.

Almost all of the aforesaid gains in terms of reduced import duties, under the various scenarios, will be enjoyed by the apparels sector of Bangladesh.

It is to be noted here that after Canada had provided zero-tariff access to all goods from the LDCs, under LDC-friendly rules of origin (25 percent value addition), Bangladesh's

export to Canada has gone up from $109.8 million in FY2002 to $335.4 million in FY2005; an average growth of 68.5 per cent per annum. As much as 92 per cent of these exports are those of apparels. If it is taken into cognisance that average tariff on apparels in Canada ranges between 15-25 per cent, the margin of preference will be easily understood. This also gives an idea about the possible range of erosion of preferences in case tariffs on apparels are reduced by Canada under NAMA negotiations.

Section IV: Suggested Policy Measures

The concern about tariff preference erosion was also echoed by G-90 Trade Ministers who, in their July 13, 2004 communication, stressed the need for resolution of the preference erosion issue within the WTO negotiations themselves. A number of proposals submitted by WTO members have tried to address the issue. The *Livingstone Declaration*, adopted at the Fourth LDC Trade Minister's Meeting during 25–26 June 2005, also called for "further strengthening of the existing preferential schemes and the incorporation of provisions in the modalities to address the erosion of preferences" (WTO, 2005d). Co-chair's summary of the recently held Informal Ministerial Meeting at Dalian, China (12-13 July 2005) noted that "while recognising that the concerns relating to preferences could not be tackled entirely under the WTO, we have already agreed that such concerns, among others, should be taken into consideration in the course of the agriculture and NAMA negotiations".

Estimates of losses originating from tariff erosion show that these are likely to be significant for a number of AP-LDCs. The study carried out by Subramanian, A. (2003) indicates that export losses to be incurred by Bangladesh on account of preference erosion originating from reduction in MFN tariffs would be in the range of US$222.4 million; for Cambodia this would be US$53.6 million, and for Nepal US$17.8 million. The estimates, however, also indicate that for most of the other AP-LDCs the erosion is not likely to be of significant magnitude; also, the impact is likely to be spread out over time owing to the phased nature of MFN reductions. However, the relatively low magnitude of the likely adverse impacts could, in part, be explained by two factors: *firstly*, the fact that limited supply side capacities of the LDCs do not enable these countries to take full advantage of the GSP facilities, and hence the lower impact; and *secondly*, as was mentioned, many AP-LDCs are not being able to enjoy preferential

treatment under the GSP schemes even when products are eligible because of inability to comply with the RoO which is yet another possible reason for lower estimates.

Two issues need be recognised: *firstly*, the issue of preference erosion should be addressed in a manner that does not jeopardise or undermine the liberalisation of global trade; *secondly*, from a long-term perspective countries which suffer readjustments in the market share originating from preference erosion, are also at the same time expected to benefit from new potential markets subsequent to multilateral liberalisation. In short, an offsetting of the potential losses could be expected.

However, as the proposal submitted by Benin on behalf of the ACP Group of States on March 2005 mentions, "trade liberalisation affects countries differently…… Small and weak developing countries that have managed to secure a market share due to preferential access are particularly at risk and vulnerable to MFN tariff liberalisation" (WTO, 2005). In its submission on NAMA, Mauritius has pointed out that preferences are linked to a narrow range of products since 'exports are concentrated in a limited number of products in very few export markets'. As the proposal submitted in March 2004 by Trinidad and Tobago also mentions, it is possible to 'identify specific tariff lines of products exported under preferences'. The proposal by Benin, on behalf of the ACP countries, proposes construction of a *Vulnerability Index* taking into cognisance three factors: (a) product concentration; (b) market concentration; and (c) global market share. Products would be identified on the basis of this index, and likely range of preference erosion would be assessed for these products. The proposal by Rwanda as regards non-reciprocal preferences, submitted on behalf of the African Group, in February 2005, also stresses that further multilateral liberalisation ought to take cognisance of preference erosion as a point of departure.

A number of proposals has been floated to enable the affected countries to address the adverse impact of preference erosion. Subramanian (opt. cit) rightly points out that the 'shocks from preference erosion are likely to be permanent', and goes on to say that these countries may need to be supported through adjustment financing and this should be an 'integral part of any response' to changes in MFN tariff levels. The author is of the view that in light of the distinguishing features of the losses from preference erosion (a

permanent shock, ability to anticipate beforehand, the potential losses being spread over time), any financing will be best done in the context of 'medium-term adjustment and programme financing facilities' and that creating a dedicated facility to address this particular issue 'would seem unnecessary and inefficient'. On the other hand, some others have suggested that the level of preference erosion could be set as a floor for a 'dedicated new assistance programme' (UNESCAP, 2004).

Another proposal (Sandrey, R, 2005) stipulates that rather than having tariff exemption privileges at the developed country border, an adjustment package be put in place based on the level of the baseline preferences, with a phase-out over time. As preferences erode as a result of tariff reduction, the difference between the baseline and current preferences would be compensated in the form of adjustment assistance. Page (2005) has argued that the issue of how the loss is to be assessed could be seen from two perspectives: whether the 'loss' should be the *total effect* of losses due to preference erosion or *net effect* (if negative) from all parts of any WTO settlement, i.e. offsetting the preference loss by any gains on other goods or services. As the author points out, addressing the issue from the perspective of the need for special and differential treatment of the poorest countries should be the right thing to do since these countries require non-repayable support in order to make the necessary adjustments.

Hoekman and Prowse (2005) point out that preference erosion is likely to happen gradually as MFN tariffs are expected to be reduced over time. They further argue that preference erosion will be offset by the compensatory effect of broad-based multilateral liberalisation and that LDCs will need to pursue their own complimentary reforms and public investments that enhance productivity of firms and farmers. Whilst one cannot contest this, there is hardly any doubt that there will be negative income effect of preference erosion. CGE estimates (by using GTAP data) carried out by Hoekman and Manchin (2005) shows a welfare (real income) loss of some $460 million for African LDCs and an additional loss of $100 million for Bangladesh, arising from complete preference erosion due to MFN reforms in the EU (including agriculture). According to Grynberg and Silva (2004), losses in terms of income transfers to producers in preference-dependent economies are estimated to be about $1.7 billion. According to

them, producers will require 14 to 20 years to adjust. This would imply a net present value of losses ranging from $6.0 billion to $13.8 billion.

One way to go around the problem would be to liberalise products of export interest to LDCs at a slower pace. However, as some have argued, this will entail substantial welfare loss globally. A proposal that has been floated recently relate to switching from *unilateral preferences to LDCs* to an *import subsidy scheme* (Limao, N &' Olarreaga, M, 2004). Instead of preferential access, the recipient country will receive a subsidy that will be subsequently revised depending on the reduction of MFN tariffs and its impact on the preference receiving economy. They estimate that total tariff revenue currently foregone due to preferences to LDCs is about $ 763 million. Here also Bangladesh is likely to be the largest loser ($202 million). The loss due to a 33 percent reduction in MFN tariffs is estimated to be about $624 million in the absence of a move towards a subsidy scheme (this is relatively high since MFN tariff reductions is expected to result in higher volume of imports to the Triad (EU, Canada, Japan) and increased world prices). The authors estimate that a move to a subsidy scheme would be welfare enhancing for all: global welfare gain would be $4354 million of which TRIAD welfare gain would be $2934 millions and LDC welfare gain would be $520 millions (Bangladesh's net welfare gain would be about $175 million). The European Commission has already come up with a proposal to establish a *financing facility* to support adjustment, in cases where 'real hardship' is likely in the face of preference erosion. Moreover, for the ACP countries, support was to be assured in advance to help the process of adjustment by these countries (European Commission 2005).

Proposals have also been floated that a fund should be established to provide support to the LDCs to offset the likely negative impacts of preference erosion. Page *(opt cit.)* has suggested that $500 million, equivalent to the total estimated amount of preference erosion, could be a reasonable size for this fund and that this fund may be created through transfers from developed countries as part of "their contribution to benefit both the gainers and the losers among developing countries". Page has argued that, countries which will reform agricultural systems will have 'both budgetary savings and national

income gains'. Such a 'public good' fund, to be administered by aid agencies, would remove (or reduce) distortions to trade, and would improve global welfare'.

As a matter of fact IMF's special lending programme, titled *Trade Integration Mechanism* (TIM) has been introduced recently to mitigate concerns about the prospect of balance of payments shortfalls as multilateral liberalisation changes the competitive position of developing countries. 'Chief among these concerns is that broad-based tariff liberalisation might erode the value of their preferential access to important export markets" and that "the erosion of tariff preference could lead to a reduction in the demand for a country's goods because other suppliers can now compete on more equal terms" (IMF, 2005). However the TIM is not a new facility that provides additional resources, although it makes support to compensate for tariff erosion more predictable.

What the policymakers in the AP-LDCs should argue most forcefully in the context of the envisaged preference erosion is that this possibility reinforces their argument for a global zero-tariff access for all products from the LDCs. Such market access could somewhat compensate for the likely losses. As is known, the *July Framework* of the WTO also urges 'the developed WTO members as well as advanced developing countries who are in a position to do so' to accord zero-tariff access to LDC products. As far as developed countries are concerned, this would essentially mean zero-tariff access to the US market which is the only remaining Quad country that is yet to allow such preferential treatment to major products of exports interest to the AP-LDCs including apparels. For example, tariff revenues on exports from Cambodia and Nepal in the US stood at US$195.9 million and US$21.4 million respectively (4.4 times and 0.65 times the respective ODA flow from USA). Preferential market access to USA is also justified by the fact that since 2000, most of the non-AP-LDCs have been enjoying preferential treatment for apparels under the *Africa Growth and Opportunity Act* (AGOA) and *Caribbean Basin Initiative* (CBI) of the USA. A study conducted by the Centre for Policy Dialogue (CPD) shows that export of apparels to USA could increase by $1.0 billion (or by 50 per cent) if such a zero-tariff access was provided by the US.

In case the *sectorals* go ahead and if these include items of export interest to AP-LDCs, the justification for such offsetting initiatives as global zero tariff access will be further

strengthened. In view of this, the proposal for zero-tariff market access for apparels in the US market under the *Tariff Reduction Assistance for Developing Economies Act* (TRADE Act 2005), which is now under consideration in the US Senate, is of such importance particularly because the countries that are being considered under this Act include most of the AP-LDCs (only Myanmar is left out).

Direct compensation for preference losses is one option. Grynberg and Silva (2004) have suggested creation of a special *Fund for Diversification* to offset the negative impact of preference erosion. Development partners could also think of allocating additional aid to countries that are likely to suffer most from preference erosion.

In the context of the ongoing WTO negotiations, the LDCs have also been calling for LDC-friendly rules of origin under the various GSP Schemes (lower value addition and flexible processing requirements). The justification for favourable consideration of this demand is also strengthened by the looming prospect of preference erosion.

Compensation mechanism to offset preference erosion could be sought on a bilateral basis, since it is obvious that the extent of preference erosion will vary from LDC to LDC. Some LDCs such as Bangladesh are likely to suffer most notably compared to other LDCs. However, it will not be easy to set up such bilateral mechanisms. Since preference erosion will take place as a consequence of MFN tariff reduction as part of multilateral negotiations, there is a strong argument favouring a search for seeking solutions within the trading agreements being negotiated in the WTO under the Doha Round.

However, there is no denying the fact that even if adequate measures are taken to address the issue of preference erosion, LDCs will need to do their homework to remain competitive in the global market. Reforms to enhance trade competitiveness and efficiency enhancement, and concrete steps to improve institutions and infrastructures related to trade facilitation are crucial in ensuring long-term competitive advantage of LDC products in the global market.

Section V: Concluding Remarks

Regrettably, the issue of preference erosion was not given due importance in the July (2004) text of the WTO. Paragraph 16 of *Annex B* to the text merely mentions: "We recognize the challenges that may be faced by non-reciprocal preference beneficiary Members and those Members that are at present highly dependent on tariff revenue as a result of these negotiations on non-agricultural products. We instruct the Negotiating Group to take into consideration, in the course of its work, the particular needs that may arise for the Members concerned". If the Doha Development Round is to have 'development' at the heart of its work, the concerns and interests of the AP-LDCs (and all LDCs for that matter) as regards preference erosion must be adequately addressed and dealt with. The WTO Ministerial in Hong Kong in December 2005 provides a good opportunity to the developed world (and also middle and high income developing countries, the so-called 'advanced developing countries') to accord zero-tariff access for all products from all the LDCs. In view of the erosion of the preferential margins that face the AP-LDCs in the context of the NAMA negotiations, and also the adverse impact that such erosion is likely to have on LDC exports in the long run, the rationale for zero-tariff market access is further strengthened. Policymakers of the least developed countries in the Asia-Pacific region must raise the issue of preference erosion to highlight their concerns in the context of the ongoing negotiations, and call upon other WTO member countries to favourably address their demand for global zero-tariff access, flexible RoO, technical assistance and implementation of various S&D provisions. The forthcoming Hong Kong Ministerial must address these concerns in order to advance the interests of the LDCs in the context of the multilateral trading system.

As our analysis bears out, tariff reductions under NAMA will have diverse impacts upon Bangladesh's export to the EU and the USA. In the EU, Bangladesh will suffer net preference erosion of varying degrees depending on the formula and the coefficient applied (e.g. under scenario one in our estimates, to the tune of $42.1 million). On the other hand, Bangladesh is expected to gain in the US market as a result of tariff reduction under NAMA. For example, as can be seen from our estimates, under scenario one, import duties on Bangladesh's RMG export to US is expected to be reduced by $120.6 million. This would also indicate that even if Bangladesh gets zero-tariff access to the US market, the comparative advantage arising from zero-tariff access would gradually decline. Bangladesh should call for granting of zero-tariff access to the US market, now

being considered in the US Senate under the TRADE Act, as a compensation for the possible preference erosion in the EU market.

The upshot of the above discussion is to argue that although LDCs have been demanding, and there is indeed a proposal under consideration in the WTO, granting of zero-tariff market access for LDC goods in developed country markets, under LDC friendly rules of origin, the real worth of the preferential margins originating from such market access is gradually on the decline as a consequence of MFN tariff reduction. The paper argues that if LDCs are to make real gains from such a global initiative, the time for this is now. The *window of opportunity* from global zero-tariff market access for LDCs is gradually vanishing.

It is from this perspective that a resolution of the issue of compensation for preference erosion is being suggested here though zero-tariff access for all LDC exports to the markets of developed countries subject to LDC-friendly rules of origin.

How the issue of preference erosion is treated could as well be a *litmus test* as to whether the Doha Development Round actually proves to be a *developmental round.*

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ANNEX TABLE 1
SUMMARY OF SIMULATION ON EU TARIFF REDUCTION IN NAMA AND ITS IMPACT ON BANGLADESH

		All Products	Woven	Knit	RMG
1	Total Import from BD (Million US$)	5064.1	1894.8	2701.4	4596.2
2	- of which Under GSP (Million US$)	3372.9	473.7	2431.3	2905.0
3	Total no. of HS 6 digit Items Imported by EU from BD	795.0	108.0	101.0	209.0
4	Import duties on BD exports, if there was no GSP (Million US$)	599.6	231.4	328.0	559.4
5	**Actual Import Duty Imposed on BD exports (Million US$)**	**206.3**	**173.5**	**32.8**	**206.3**
6=(4-5)	Value of preference (foregone tariff) received by BD (Million US$)	393.3	57.8	295.2	353.1
7	*Import weighted average tariff for Bangladesh (%)*	*12.2*	*12.2*	*12.1*	*12.2*
Scenario 1 (Swiss Coefficient 0.3)					
8	Import duties on BD exports, if there was no GSP (Million US$)	427.1	164.3	233.5	397.8
9	Actual Import Duties on BD exports, if Simple Swiss Formula (with coefficient 0.3) is applied to current MFN tariff profile (Million US$)	146.6	123.2	23.3	146.6
10=(5-9)	Reduction in tariff considering that export value remains same (million US$)	59.7	50.3	9.5	59.7
11=(8-9)	Value of preference (foregone tariff) received by BD (Million US$)	280.5	41.1	210.1	251.2
12=(6-11-10)	**Net Preference Erosion (Million US$)**	**53.0**	**-33.5**	**75.6**	**42.1**
13	*Import weighted average tariff for Bangladesh (%)*	*8.7*	*8.7*	*8.6*	*8.7*
Scenario 2 (Swiss Coefficient 0.5)					
14	Import duties on BD exports, if there was no GSP (Million US$)	482.6	185.8	263.9	449.7
15	Import Duties on BD exports, if Simple Swiss Formula (with coefficient 0.5) is applied to current MFN tariff profile (Million US$)	165.8	139.4	26.4	165.8
16= (5-15)	Reduction in tariff considering that export value remains same (Million US$)	40.6	34.1	6.4	40.6
17=(14-15)	Value of preference (foregone tariff) received by BD (Million US$)	316.8	46.5	237.5	284.0
18=(6-17-16)	**Net Preference Erosion (Million US$)**	**36.0**	**-22.8**	**51.3**	**28.5**
19	*Import weighted average tariff for Bangladesh(%)*	*9.8*	*9.8*	*9.8*	*9.8*
Scenario 3 (Swiss Coefficient 0.8)					
20	Import duties on BD exports, if there was no GSP (Million US$)	520.7	200.6	284.8	485.4
21	Import Duties on BD exports, if Simple Swiss Formula (with coefficient 0.8) applied to current MFN tariff profile (Million US$)	179.0	150.5	28.5	179.0
22=(5-21)	Reduction in tariff considering that export value remains same (Million US$)	27.4	23.0	4.3	27.4
23=(20-21)	Value of preference (foregone tariff) received by BD (Million US$)	341.7	50.2	256.3	306.5
24=(6-23-22)	**Net Preference Erosion (Million US$)**	**24.3**	**-15.4**	**34.6**	**19.2**
25	*Import weighted average tariff for Bangladesh (%)*	*10.6*	*10.6*	*10.5*	*10.6*

Note: While calculating GSP utilisation rate (or value of dutiable items) we considered the following scheme, Woven RMG = 25%, Knit RMG = 90% and other items 100%

Source: Estimated from EUROSTAT database (Import data for 2004) and UNCTAD-TRAINS database (Tariff Data at 6 digit level for 2002).

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