

PREFERENCE EROSION

Consequences of the completion of Doha and implications for the EPA
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<http://www.trade.gov.sb/>

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1 Background

Although the current round of World Trade Organisation (WTO) negotiations, the so-called Doha Development Agenda (DDA), has currently stalled, modalities for the further liberalisation of non-agricultural market access (NAMA) are close to completion. If the few countries locked in disagreement over agricultural subsidies were to settle their remaining differences then the round may conclude fairly quickly. Since the rough outline of a NAMA text is already complete, it is possible to analyse the consequences of this area of negotiations for Solomon Islands, should WTO members reach agreement on Doha.

2 Consequences of Doha

As a least developed country (LDC) with high binding coverage, Solomon Islands will not be required to improve its bound commitments to the WTO under the proposed NAMA modality. At first sight, it would seem that if Solomon Islands retains its current tariffs whilst other countries are forced to lower theirs, then the conclusion of Doha must necessarily be good for the country. However, the situation is more complex than that, and the net impact on Solomon Islands of Doha completing will probably be negative. The main reason for this is 'preference erosion'.

2.1 Preference Erosion

Under the Lomé conventions, the European Union (EU) secured cheap access to the natural resources of its former colonies in Africa, the Caribbean and the Pacific (ACP) in return for preferential market access for these countries into the European Union. The Economic Partnership Agreement (EPA) is a descendent of Lomé, with the new feature that, because of WTO rules, ACP countries must also pledge to grant duty-free market access to EU firms in most sectors.

This arrangement has divided developing countries into the ACP and non-ACP groups. ACP countries have received a substantial *tariff preference* over competitor developing countries from outside the ACP group. It is this *preference*, rather than low tariffs *per se*, which provide ACP exporters with an advantageous opportunity to export to the European Union.

For example, on tuna products of interest to Solomon Islands, the EU has a Generalised System of Preferences (GSP) duty rate of 24 per cent, which applies to non-ACP developing countries such as Thailand. In contrast, ACP states such as Solomon Islands have long enjoyed duty-free access to the EU for this product. Therefore, a European importer buying from Solomon Islands has a large cost advantage over one purchasing from Thailand — a cost advantage which, to some extent, can be passed on to the Solomon Islands exporter, and can cover the higher cost of doing business in Solomon Islands.

Under the currently proposed NAMA modality for tariff reduction, the EU would be forced to reduce its GSP duty rate from 24 per cent to approximately 6 per cent (depending on the exact

coefficient adopted during negotiations). Solomon Islands' duty advantage would fall by 18 per cent, over the course of only ten years.

The EU is not the only market to be affected. Quite apart from ACP preferences, as an LDC Solomon Islands enjoys duty-free access into the markets of a wide variety of different WTO members — one of the WTO aims declared in Hong Kong. This gives us a tariff preference relative to developing countries — one that will be substantially reduced if Doha concludes.

2.2 Ad Valorum Tariffs

Although Solomon Islands is not required to make any changes to its tariff bindings, it will be encouraged to convert those tariff lines which are listed at 'non-ad valorem' rates (that is, per unit, per unit weight or per unit volume as opposed to per unit of market value) to their ad valorem equivalents. The WTO has developed a systematic way of making this change. The intent would be to keep tariffs at essentially their current levels, but to convert to a uniformly ad valorem tariff schedule, to provide greater simplicity for importers and to reduce discrimination against low-cost products (which is argued to be a consequence of non-ad valorem rates).

3 Implications for the Economic Partnership Agreement

As of November 2008, Solomon Islands has declined to initial an EPA with the European Commission (EC). There are several reasons for this:

1. there are various unacceptable provisions in the text, such as
 - a. the lack of adequate protection for infant industries;
 - b. a ban on the use of export taxation for the purposes of economic development;
 - c. a 'most-favoured nation' clause that would prevent Solomon Islands from exchanging goods access for benefits such as labour mobility and development assistance in future; and
 - d. a standstill provision which would lock in our current applied tariff structure, even though various recommendations have been made for its review in forums such as the Integrated Framework Diagnostic Trade Integration Study;¹
2. compliance with many of the provisions will place a substantial administrative burden on Solomon Islands; and
3. there are very few tangible benefits compared to the alternative, which would be to use the EU's Everything But Arms (EBA) non-reciprocal tariff for LDCs.

It is important to note that the most important tangible benefit that has been offered is a modification to the rules of origin for canned and process fished products,² or so-called 'global sourcing' of canned tuna. This would potentially enable Solomon Islands exporters to send a greater quantity of canned tuna to the EU under the existing tariff preferences, since not all tuna landed in Solomon Islands qualifies under the old rules of origin.

However, it is vital to realise that the benefit of these improved rules of origin would begin to decline rapidly as soon as Doha completes. Within ten years of completion, the current 24 per cent tariff preference would have fallen to only 6 per cent, which may well make export to the EU market non-viable given strong competition from east Asian competitors. Any extension of the current rules of origin offer to chilled and frozen loins would suffer from the same rate of erosion.³ Given that these rules of origin are *the only tangible benefit* of signing an EPA with the EC (and given the significant costs), Solomon Islands must be certain that real use can be made of this preference in the short term if it is even to be considered an advantage of signing, and that short-term exploitation of the preference will be

¹ Draft of 7th November, 2008.

² Tariff headings 0604 and 0605.

³ Tariff headings 0304 and 0305.

beneficial (rather than merely disruptive, creating an unsustainable spike in production) for the industry.

It should further be noted that, at present, Soltai is able to source sufficient originating tuna to satisfy its current production for the EU market. Consequently, the improved rules of origin could only be of use if Soltai (or a potential new entrant) could expand production so much in the short term that its compliant supply would prove inadequate.