



FONDATION POUR LES ÉTUDES  
ET RECHERCHES  
SUR LE DÉVELOPPEMENT  
INTERNATIONAL

# Vignettes on the utilization of preferences

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OMC Webinar

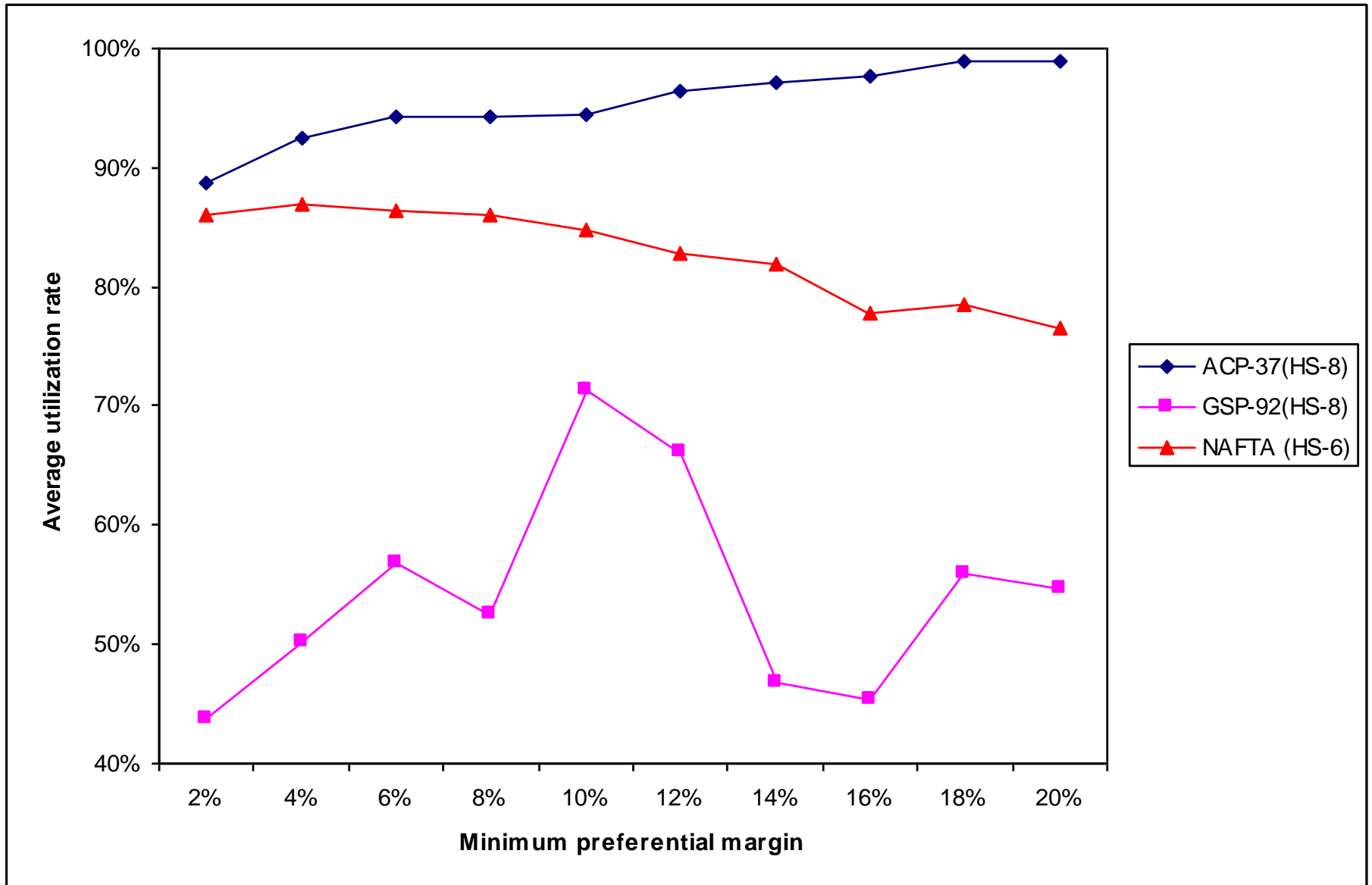
"What drives the utilization of trade preferences?"

19 May 2021 – 10:45 – 14:30 CET

# OUTLINE

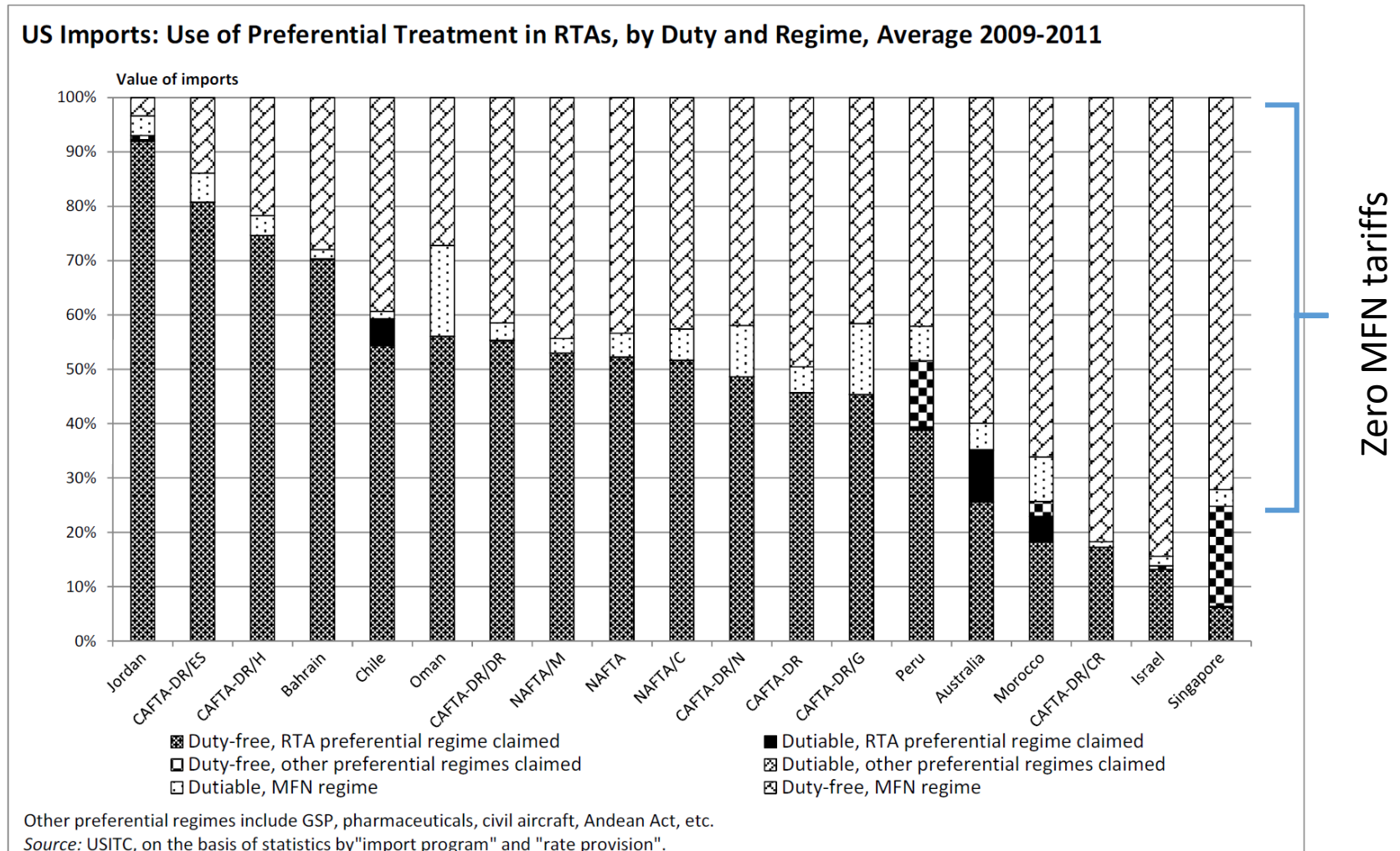
- Selected Preference Utilization Rates (PURs) patterns
- Balance sheet of Rules Of Origin (ROO) for an exporter
- Sample of evidence on Effects of ROO
- Evidence PURs across 114 PTAs involving LA countries
- T&A: Quasi-experimental evidence: move to single transformation under AGOA and EBA
- AFCFTA negotiations on harmonization
- Time to take seriously the unnecessary complexity of Rules of Origin

# Preferences & utilization rates (circa 2000)



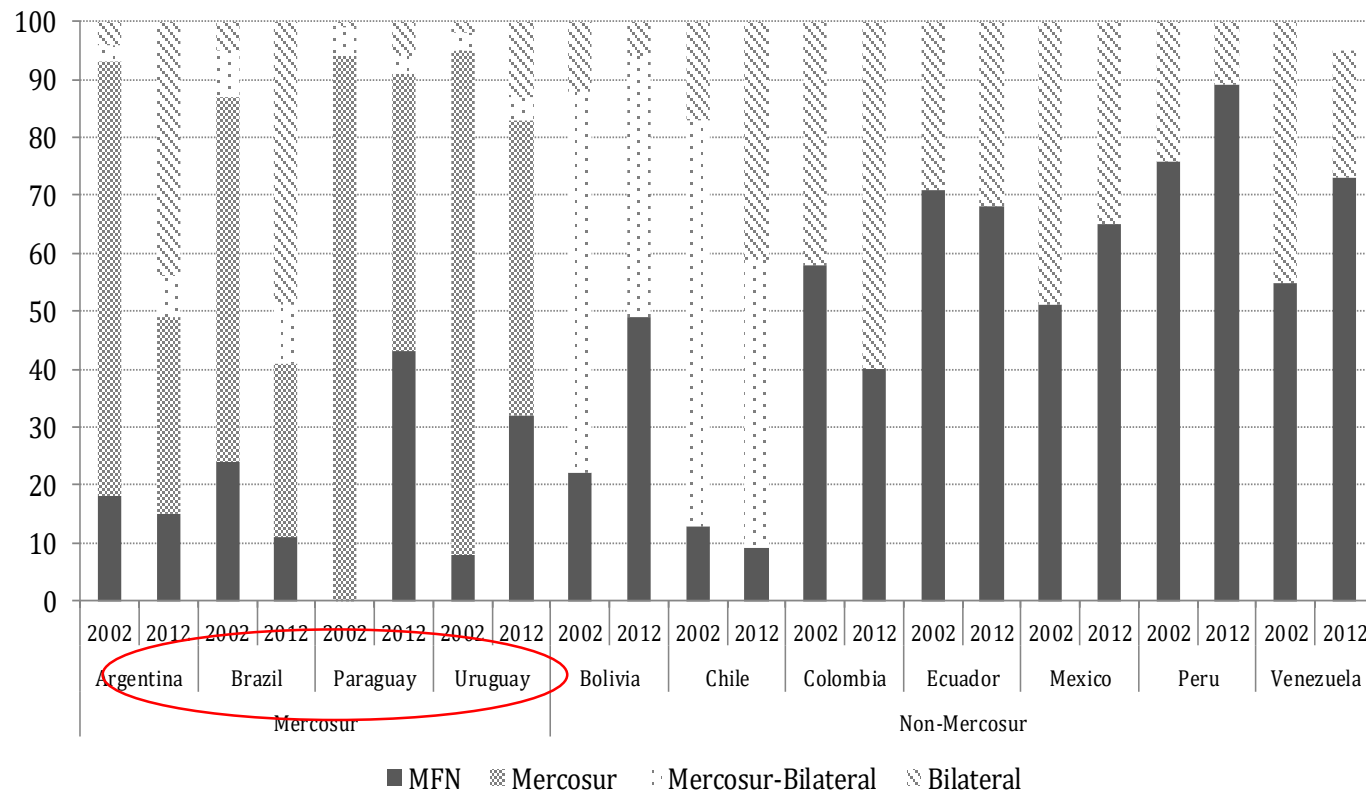
Source: Cadot et al. (2006)

# US PURs across FTAs



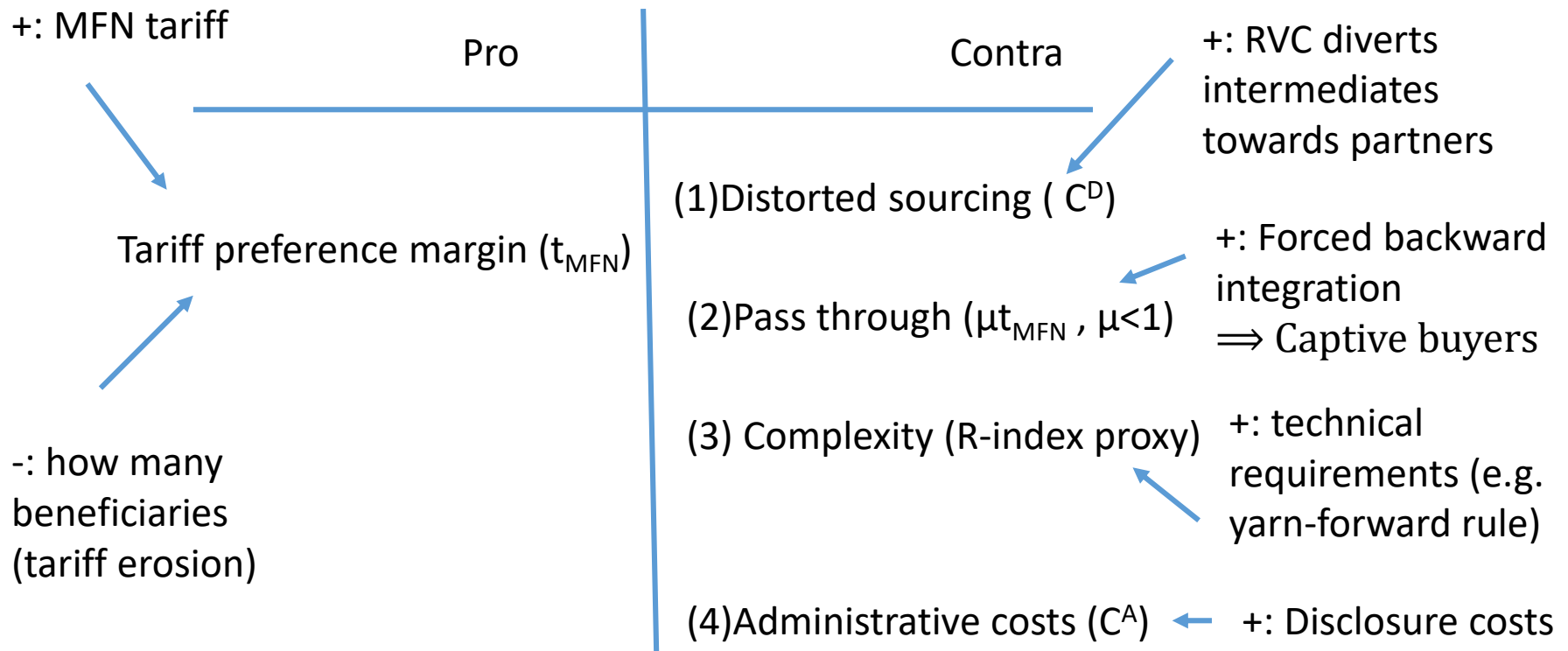
Similar heterogenous PURs are observed across PTAs for EU, China. Moreover, one cannot conclude that PURs are systematicall higher for margins above 5%...

# Tariff preference utilization across LAIA PTAs



- Use of preferences differs widely across LAIA (Latin American integration association) countries : in 2021 90 percent of Chile's export toward other LAIA countries use preferential tariff while this was only 60 percent in Colombia and 45 percent in Mexico
- Mercosur has bilateral agreements with other LAIA countries, MERCOUR-Mexico for instance

# Balance sheet of Rules of Origin for exporter



$PD = PW(1 + t_{MFN})$ ;  $marg = t_{MFN}$ ;  $C^0$  = unit cost cif; PUR = preference utilization rate

$[C^C]$  = compliance costs to meet substantial transformation criterion for preferential access

$$c_i = c_i^0 + c_i^c = c_i^0 + c_i^D + c_i^A + \mu_i \leq p_i^*(1 + \text{tar}_i) \rightarrow \text{pur}_i = 1$$

$$c_i = c_i^0 + c_i^c \geq p_i^*(1 + \text{tar}_i) \rightarrow \text{pur}_i = 0$$

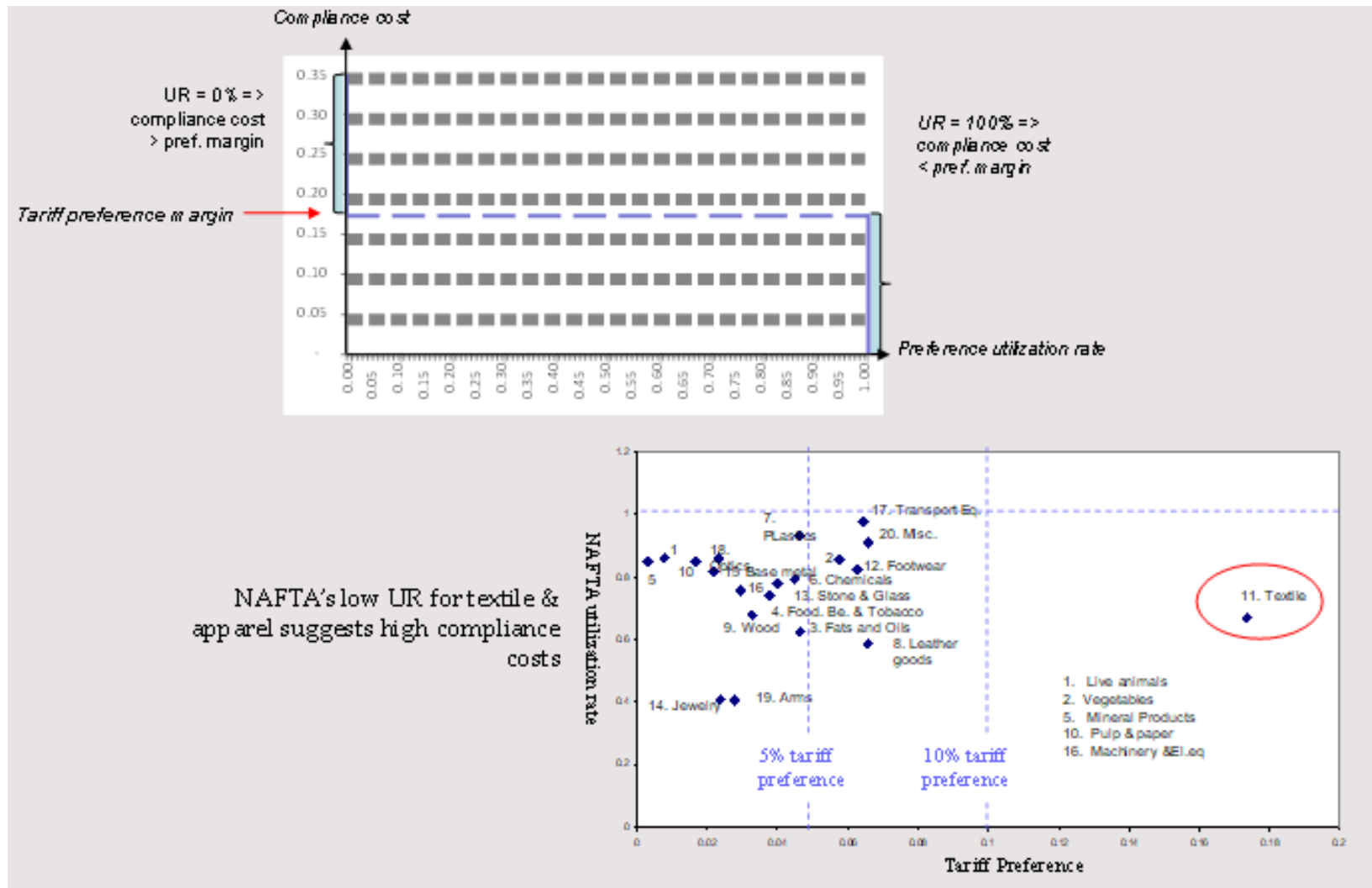
...but a high PUR only means that compliance costs are less than preference margin and high preferential margins are often **not** associated with high purs (next slides on evidence)

# Summary of selected evidence on effects of ROO

(numbers refer to contra items on previous slide)

- (1) Trade flows. Much evidence on distortionary effects. Mexico under NAFTA: Reduction of 22% of intermediates relative to counterfactual with no ROO (Conconi et al. (2018))
- (2) Captive effect. Price of intermediates (at HS6 level) sold by US to NAFTA 11.9% above that sold to non-captive buyers (Cadot al. (2005))
- (3) Ordinal R-index (Estevadeordal (2000)). PURs systematically estimated to be lower for sectors (HS4) with higher R-index values after controlling for preferential margins In many studies (Carrère-Melo (2006), Cadestin al. (2016)). Higher R-index values also associated with PSRs yet to be agreed on AFCFTA negotiations
- (3) Cumulation. PURs positively associated with more liberal cumulation rules (Augier al. 2005). Switching to diagonal cumulation leads to sourcing decisions away from ROW reinforcing value chain connections in the cumulation zone (Bombarda and Gamberoni, 2019)
- (4) Fixed vs. Variable costs. Transaction-level data (Iceland): fixed costs per shipment in range (€20-€260) (Albert-Nilsson (2016))

# Weak association between PURs and tariff preference (NAFTA 1998-2000)

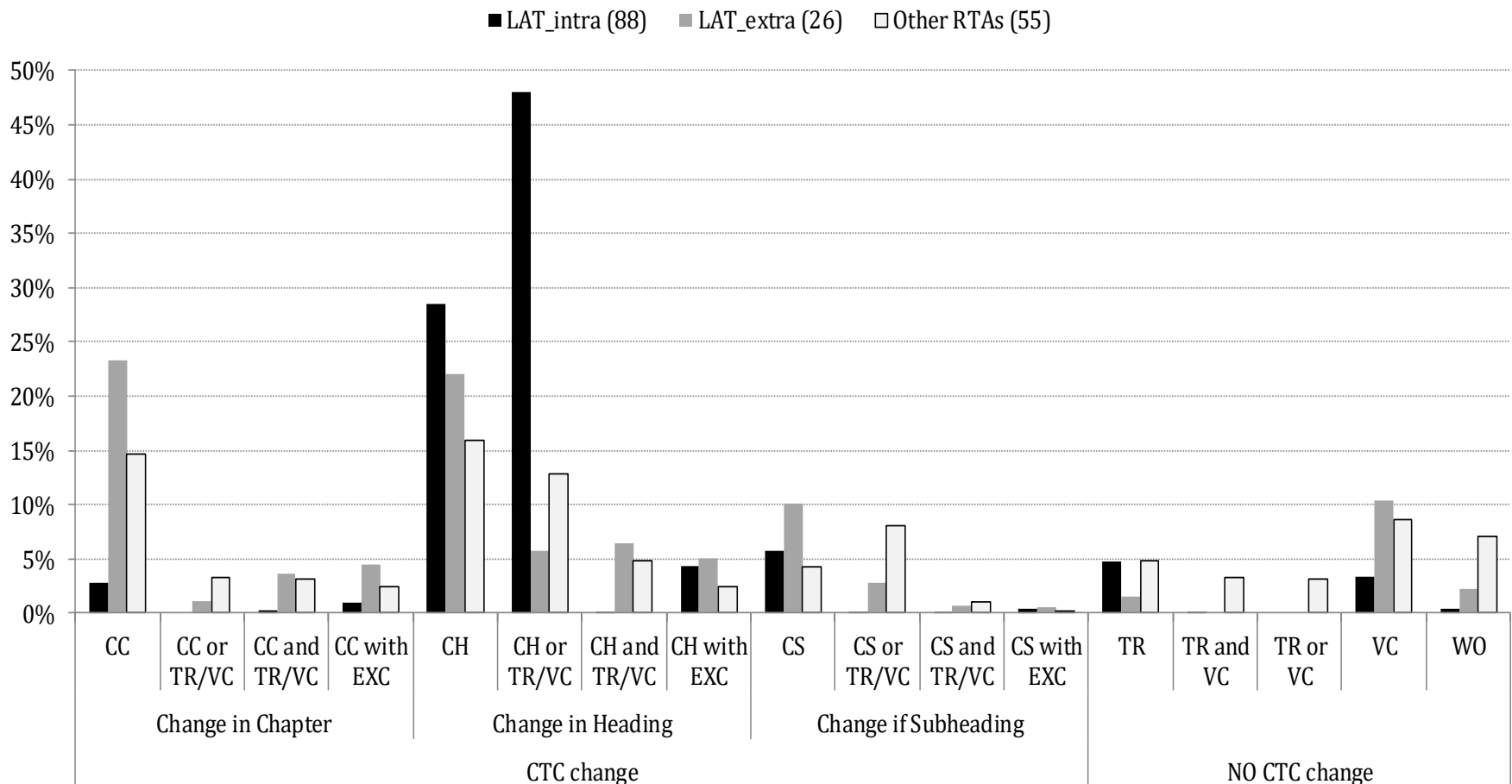




# Patterns of RoO and PURs across LAC PTAs (114)

Dataset: 114 PTAs covering 27 categories of PSRs: CTC (CC, CH, CS), VC, TR, EXC (and any combinations of those).

- CH or (CH or VC) account for 75% of intra-LAC PTAs and 30% for other PTAs.
- Intra-LAC PTAs more « and » and less EXC rules than with non-LAC



# ROO and Preference utilization in LAC PTAs (1)

- Results from structural gravity model estimated over 2002-2012 at HS-4 level
- Estimated AVEs of different types of ROO by category of goods

	All Goods	Intermediate Goods	Final Goods
RoO	4.0%	8.6%	0.0%
CTC	0.0%	0.0%	0.0%
CTC/VCTR	5%	11.4%	6.3%
VCTR	13.4%	12.2%	19.4%
WO	15.5%	44.3%	0.0%

Sample...How do you go from 6 to 3 and is ROO the average, no RoO is a dummy is there is an RoO, whatever it is.

Cadestin et al. (2016)

# ROO and Preference utilization in LAC PTAs (2)

VARIABLES	1 Utilization rate	2 Utilization rate	3 Utilization rate
Products	ALL	INT	FIN
GDP_reporter	1.799*** (0.026)	1.702*** (0.035)	1.886*** (0.037)
GDP_partner	-0.363*** (0.022)	-0.398*** (0.028)	-0.307*** (0.035)
Distance	-0.508*** (0.014)	-0.475*** (0.019)	-0.574*** (0.021)
Common border	0.203*** (0.020)	0.191*** (0.027)	0.214*** (0.030)
Tariff	-0.149*** (0.010)	-0.128*** (0.014)	-0.155*** (0.014)
RTA*Tariff	0.117*** (0.012)	0.166*** (0.018)	0.085*** (0.016)
RTA	1.337*** (0.036)	1.163*** (0.051)	1.375*** (0.048)
RoO	-0.247*** (0.027)	-0.119*** (0.036)	-0.293*** (0.039)
Year Fixed Effects	Yes	Yes	Yes
Exporter Fixed Effects	Yes	Yes	Yes
Importer Fixed Effects	Yes	Yes	Yes
Secto HS3 Fixed Effects	Yes	Yes	Yes
Observations	1,099,014	648,561	450,453
R-squared	0.19	0.17	0.24

Controlling for preference margins and a host of other co-variates:

- PUR lowered by 24% (all goods)
- PUR lowered by 29% (intermediates)

□ RoOs undo a relatively significant portion of the positive trade effect of agreements, especially for trade in intermediate products.

□ RoOs are estimated to have tariff equivalents of around 11 and 9 percent, respectively, for intra- and extra-trade agreement imports of intermediate products

# Textiles and Apparel

Dissecting effects of move to single transformation under AGOA and EBA, a  
« quasi-experimental » situation

# Textiles and Apparel

**Table 2** Utilisation rates for apparel, 2016

## Knitted (HS61) and non-knitted (HS62)

	EU		US	
	HS61	HS62	HS61	HS62
Algeria	0.02	0.60	N.A.	N.A.
Egypt	0.93	0.89	0.99	0.98
Israel	0.60	0.39	0.97	0.97
Jordan*	0.01	0.07	1.00	1.00
Lebanon	0.91	0.80	0.00	0.51
Morocco	0.89	0.90	0.23	0.05
Syria	0.95	0.86		
Tunisia	0.93	0.90	0.00	0.00
Turkey	0.95	0.97	0.75	0.48

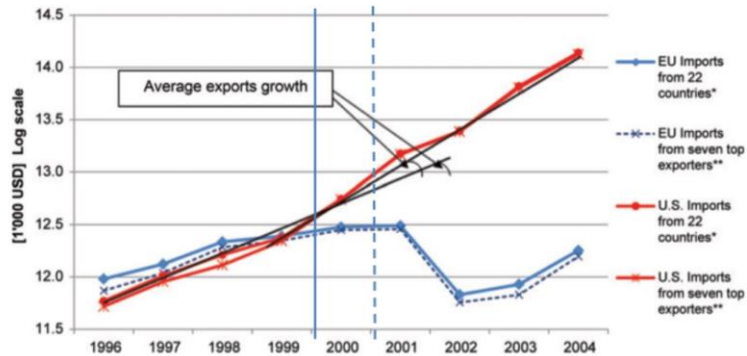
Notes: N.A. No trade flow. \* For the USA, utilisation rates include FTA+GSP+ QIZ

Brunelin et al. (2018)

Large differences in PURs across partners in reciprocal FTAs, especially US. Here preference margin is above 10% for both EU and US

# Quasi experimental evidence: Moving to the single transformation rule in T&A for AGOA and EBA

**Figure 1a** The move to the single transformation rule under AGOA: Exports of apparel by 22 African countries to the US under AGOA and to EU under EBA



Note: Solid line indicates entry into effect of AGOA and dashed line indicates entry into effect of single rule (for most beneficiaries).

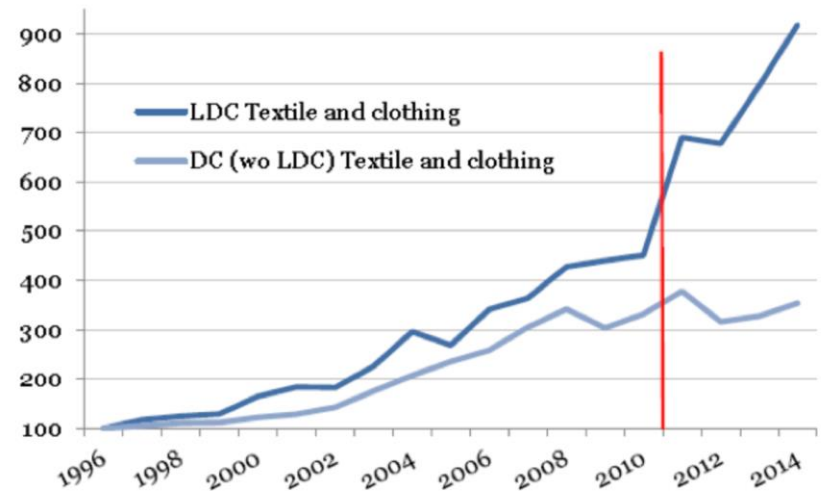
## AGOA

AGOA, EBA  $\approx$  preferential margin (12-15%)  
But AGOA : triple  $\rightarrow$  single transformation in 2003

## EBA

EBA: double  $\rightarrow$  single transformation in 2011  
See next slide for evolution of PURs under single transformation rule for EBA beneficiaries (LDCs)

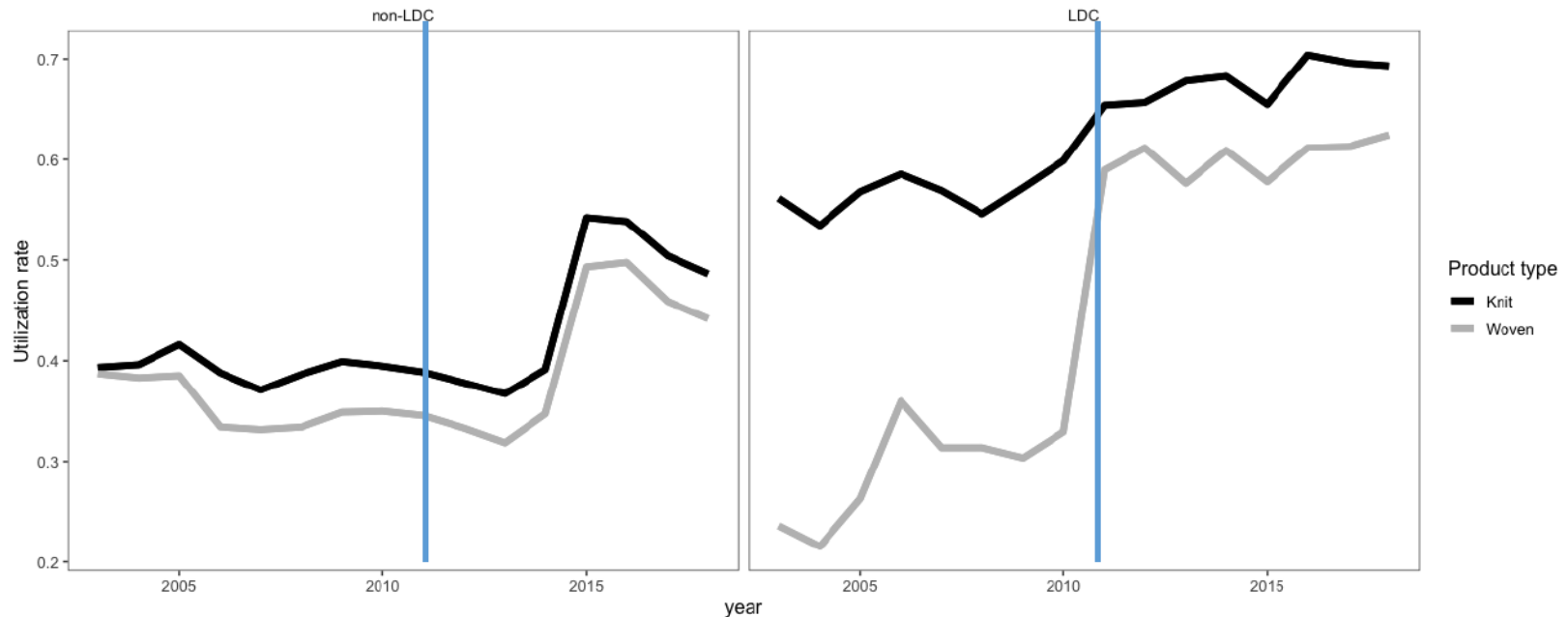
**Figure 1b** The move to the single transformation rule under EBA: EU textile and clothing imports, LDCs vs other developing countries



Note: Base: 1996=100. Vertical line indicates entry into effect of single transformation rule

# Preference Utilization Rates (PURs)

Figure 3: Utilization Rates



Notes: This figure displays the average utilization rate of the EU's Everything But Arms agreement for apparel products by year. The data are broken down by product type (woven versus knitted apparel) and exporter type (LDCs versus non-LDCs).

Passage to single transformation rule for EBA (i.e. for LDCs) in January 2011 (vertical bar)  $\Rightarrow$  Controlling for other factors, EBA PUR up by 50% at pre-baseline level with PUR increase higher for products with higher non-preferential tariff rates

Sytsma, 2021

# AFCFTA negotiations on harmonization

Objective: harmonize both the Regime-wide rules (RWRs) and Product-specific Rules (PSRs) across 8 African Regional Economic Communities (RECs). Still ongoing (like those on TFTA)

RWRs: Agreement has been reached (see details on the 30 RWRs in extra slides)

- Bottom line: For most RWRs (and on simple average across RWRs)
- Differences for flexibility are greater than for transparency, probably a reflection of the greater difficulty in reaching agreement on flexibility than on transparency.

Third, there is less uniformity on both types of provisions for certification than for process.

On positive side, following agreements have contributed towards reducing compliance costs:

- All PTAs have the same set of provisions on transparency for process, but not on transparency provisions for certification.
- For both types of provisions, there is greater uniformity on transparency than on flexibility.

On the negative side, following RWR provisions that would have reduced compliance costs but have not been included in AfCFTA

Provision for duty-drawback

Provision for self-certification

Third-party invoicing, arguably an important missed opportunity

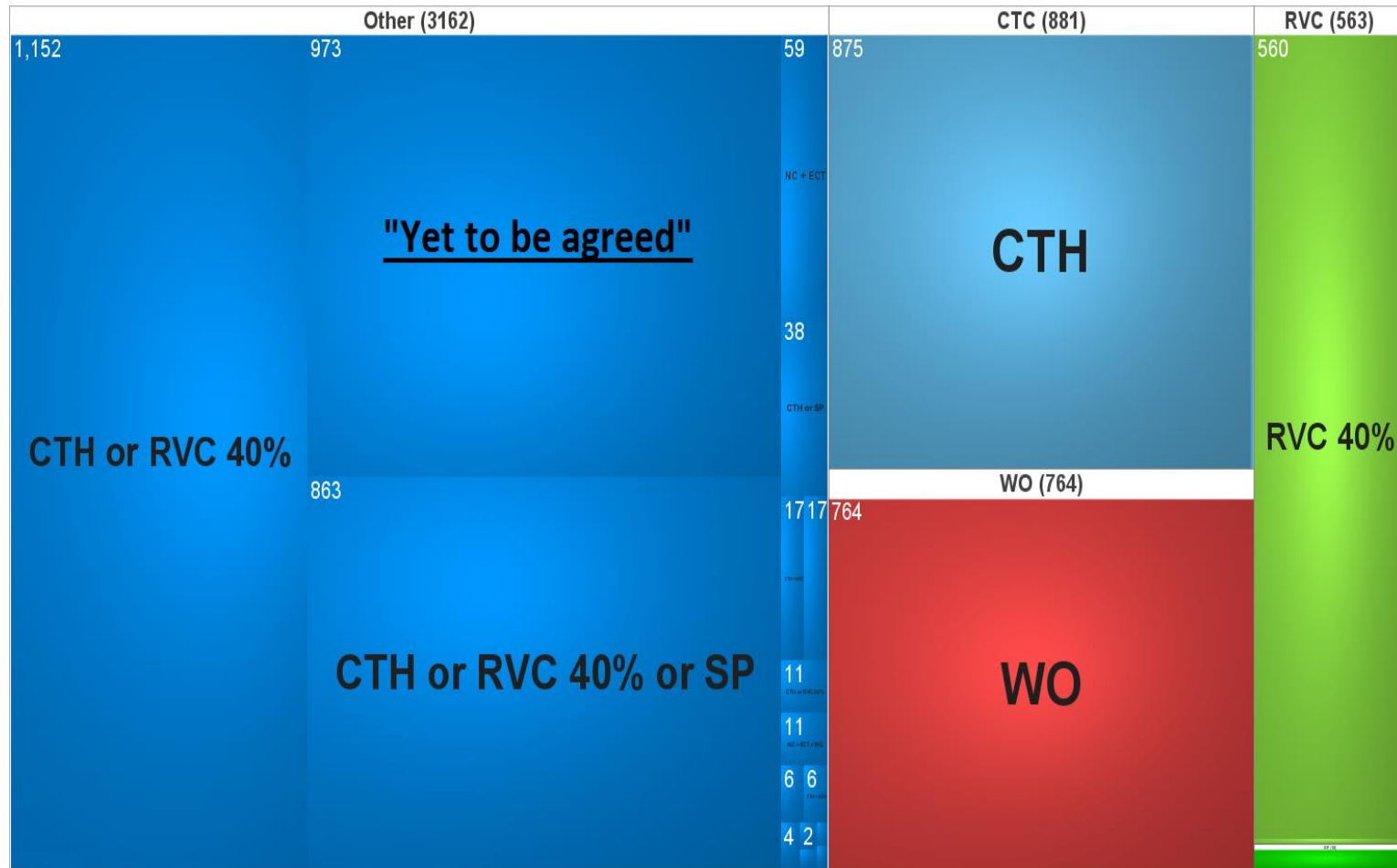
Allow for non-direct transport (allowed under TFTA and ECO)

Not imposing principle of territoriality (allowed under SADC, ECO and COM)

Next slide on PSRs



# Distribution of most common PSRs in AfCFTA across 6 African RECs over 5387 HS6 codes: (18%) of codes yet to be agreed as of January 2021

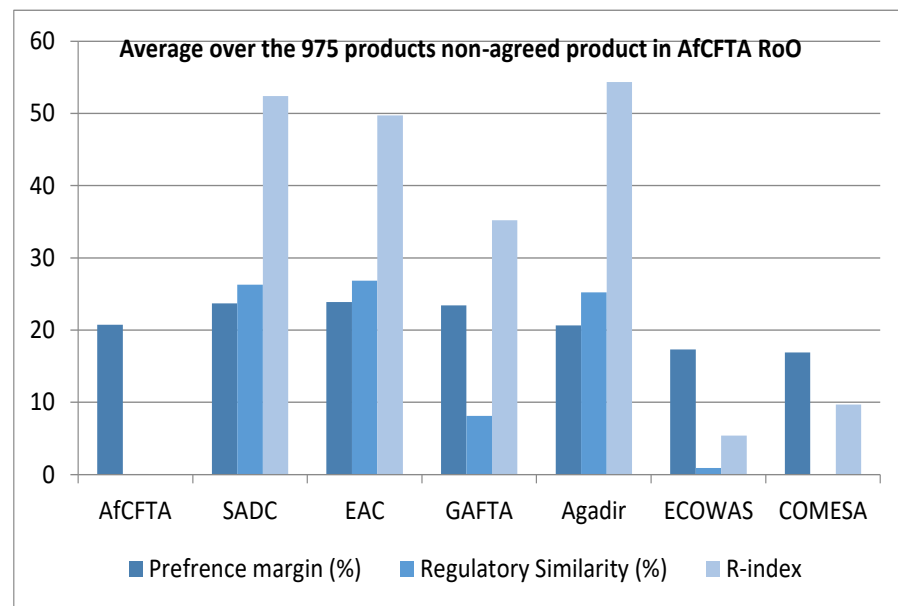
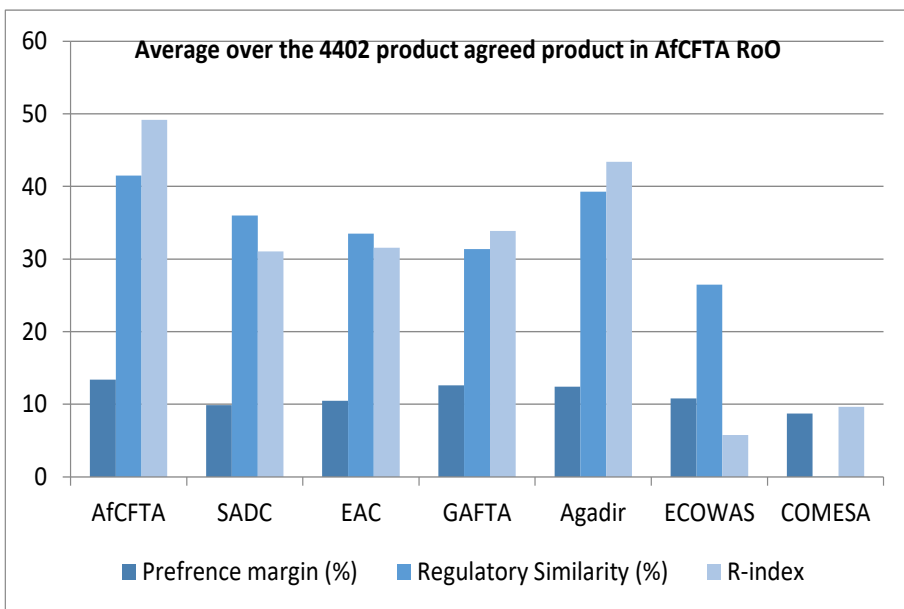


Source: Gourdon et al. (2021)

- Agreement has been reached with single criteria PSR for 41% of HS6 codes (WO, RVC at 40%, CTH) and on another 37% agreement has been reached for a choice criterion account (CTH or RVC 40%), and (CTH or RVC 40% or SP).
- Note that the yet to be agreed category is for infrequent ROOs like “EXC” or “TEC” (exceptions or technical ROO)

# Agreed PSRs have lower preferential margins, higher regulatory similarity and lower index values of restrictiveness

PSRs in AfCFTA	Average Pref margin	Average Regulatory similarity	R-index
YES (87% of tariff lines)	11%	28	25
NO	21%	14	35



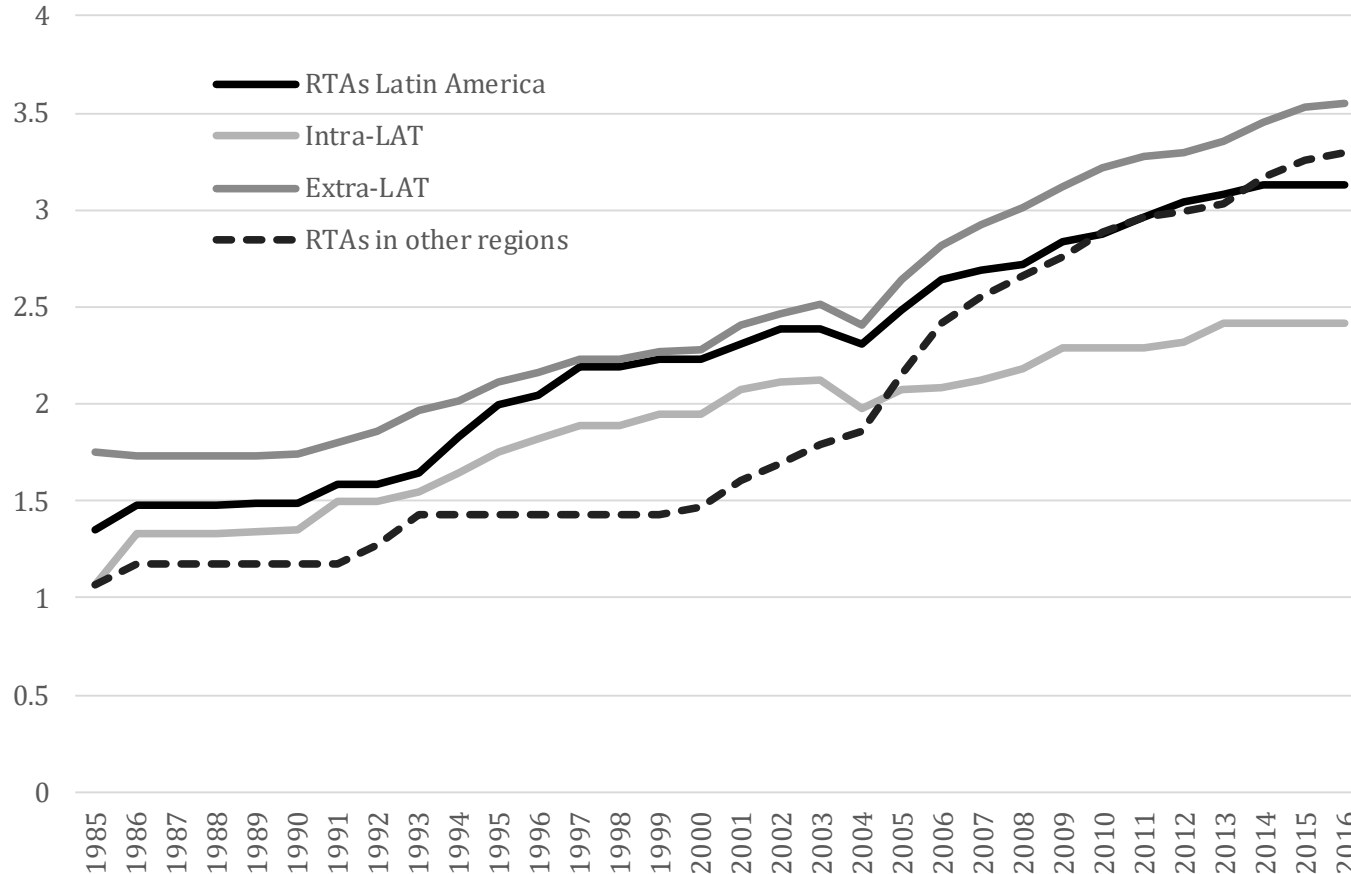
# Time to take seriously the unnecessary complexity of Rules of Origin

REMINDER: Excerpt from the conclusion of an evaluation of EU and US PTAs in the World Trade Review (2006) where we mention our hope that a report we had just submitted to the EC commission would lead to such simplification.....

Second, this paper – together with several other recent ones – substantiates the hypothesis that the complexity and restrictiveness of RoOs has something to do with special-interest pressure. It follows that the argument in favor of simplification, possibly going as far as the uniform rule currently considered by the EU Commission, is desirable not just for the direct reduction of compliance costs, but also, and perhaps more importantly, to take RoOs out of the reach of special-interest pressures. The argument here is essentially the same as that in favor of uniform tariffs: departures from uniformity being very salient, the hurdle for special-interest groups to distort the instrument is bigger.

# A rising tide

Average number of different PSRs at the HS6 product level (5387 products\*) is rising because PTAs adopt 'tailor-made' PSRs.



Cadestin et al. (2016)

\*After elimination of 'similar' PSRs, ITC's Rule of Origin Facilitator lists over 54,000 distinct PSRs in a data base of 370 (?) PTAs, 10 times more than HS6 codes

# Results of ITC firm surveys on NTMs(1)

(20,000 interviews in 38 countries 2000-2018)

- Perceptions collected from interviews with firms
- 20% of burdensome NTMs are related to ROO (for both developed and developing countries) and are much higher for manufacturing.

Distribution of reported RoO-related cases by major sectors



Source: ITC NTM surveys, 2010-2018.

Note: The pie chart presents the share of cases linked to RoO in the total number of all NTM related trade obstacles reported by exporters in 38 developing countries. This includes both measures applied by home and partner countries. The charts reveal that 8% of NTM cases reported by agricultural exporters are linked to RoO, whereas in the manufacturing sector, this share makes up 23%.

■ Technical requirements  
■ Pre-shipment inspection and other entry formalities  
■ Finance Measures  
■ Rules of origin  
■ Other

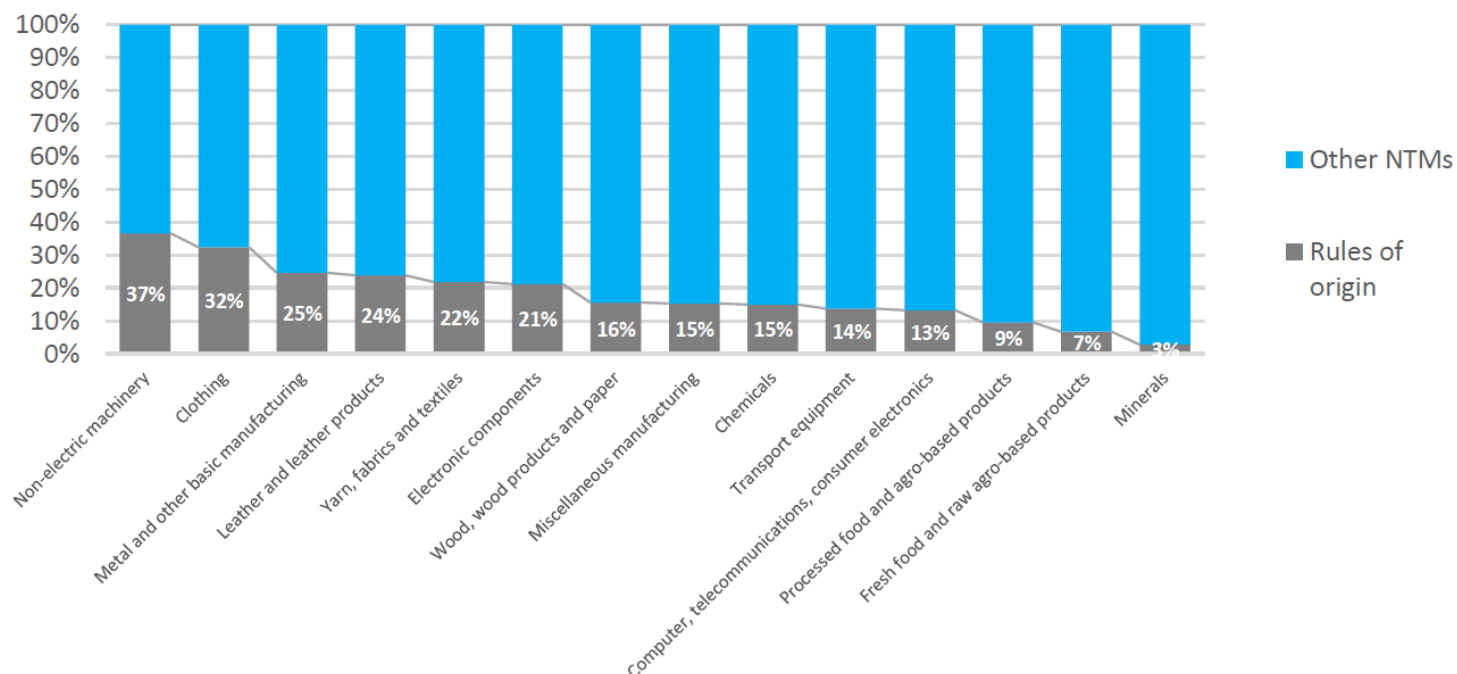
■ Conformity assessment  
■ Quantity control measures  
■ Price control measures  
■ Export related measures

# Results of ITC firm surveys on NTMs(2)

(20,000 interviews in 38 countries 2010-2018)

- Highest shares of ROO –related NTMs are for non-electrical machinery, clothing, metal
- Procedural hurdles perceived as the main NTM obstacle for ROO (see extra slides)

Figure X. Share of NTM cases related to Rules of Origin, by sector



Source: ITC NTM surveys, 2010-2018.

Note: The bar chart presents the relative importance of RoO-related cases across various sectors, as a share of the total number of NTM cases reported by exporters when trading goods according to their sector. The figure shows that some sectors, including non-electric machinery, clothing and leather products are among the sectors with the highest percentage of NTM incidences linked to RoO.

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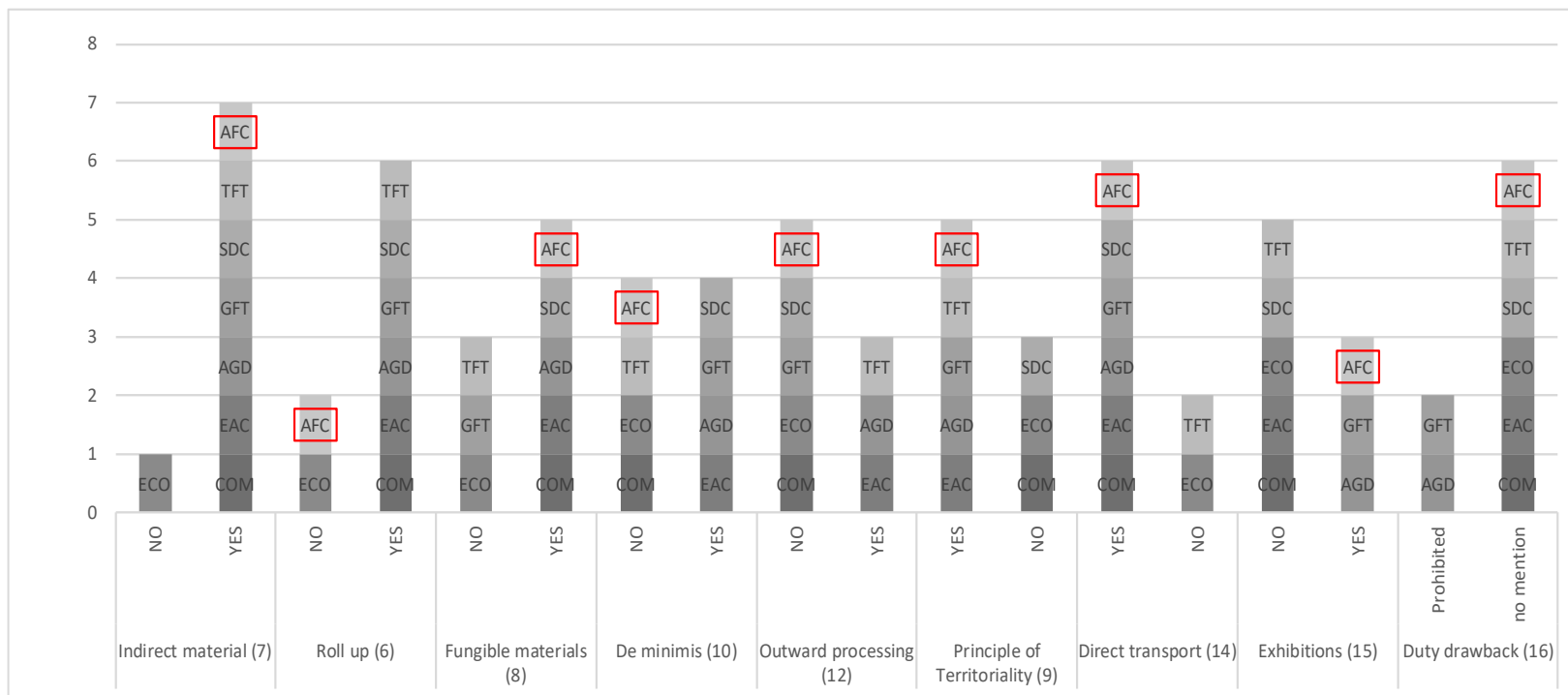
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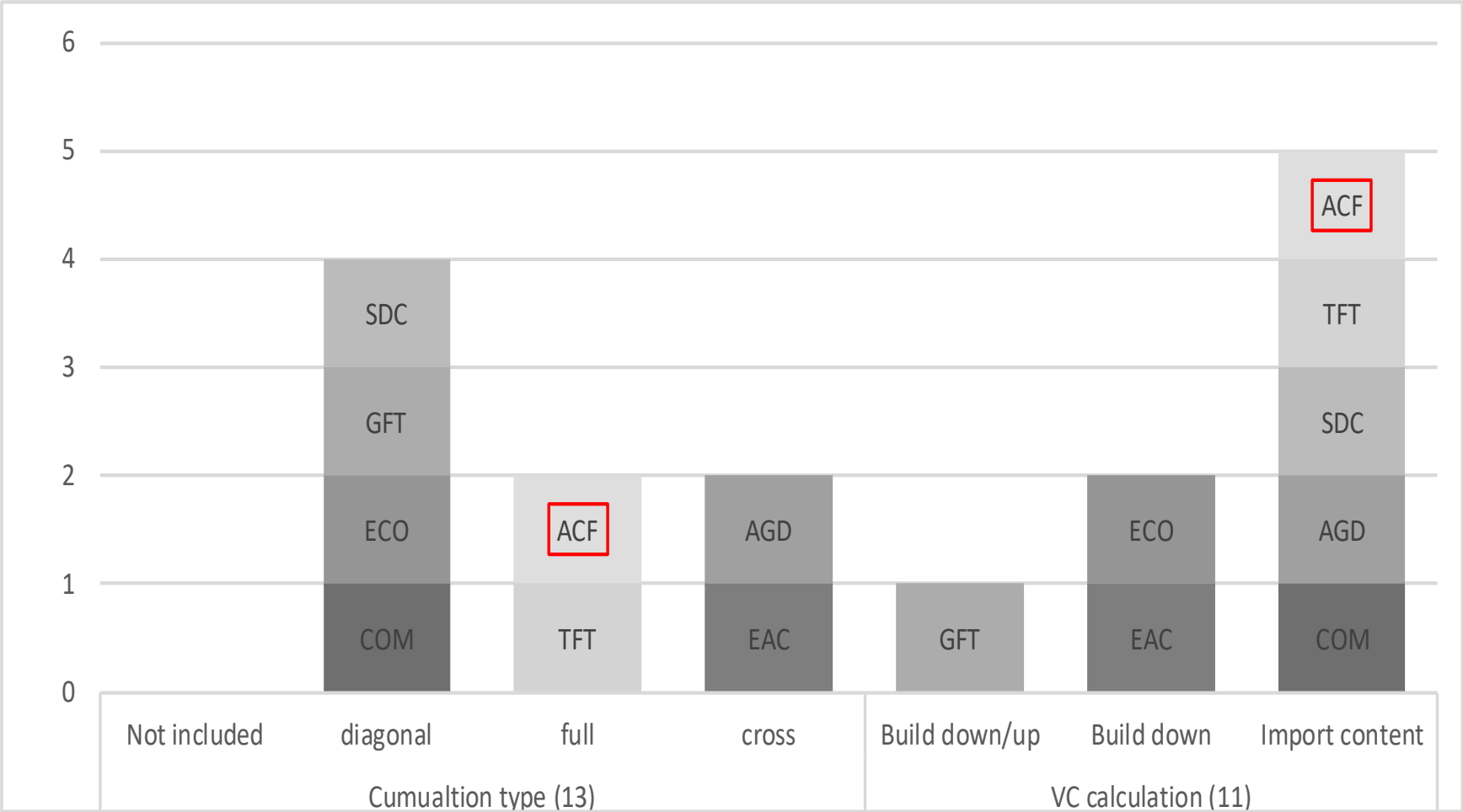


# EXTRA SLIDES

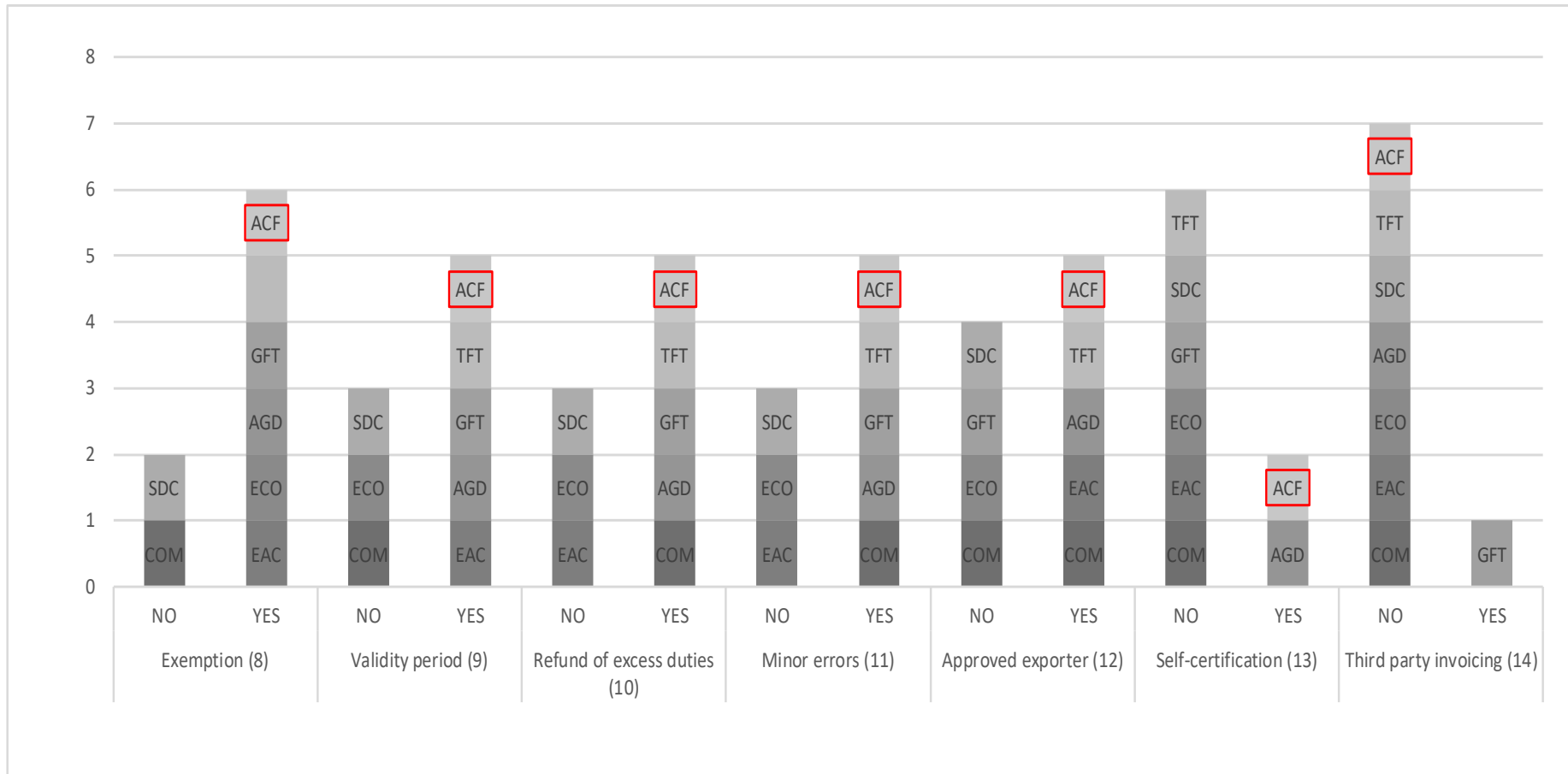
## Provisions on origin process are more flexible for AFCFTA



# Cumulation and Value Content (VC) calculation more flexible for AFCFTA



# Provisions on certification are generally more flexible under AFCFTA

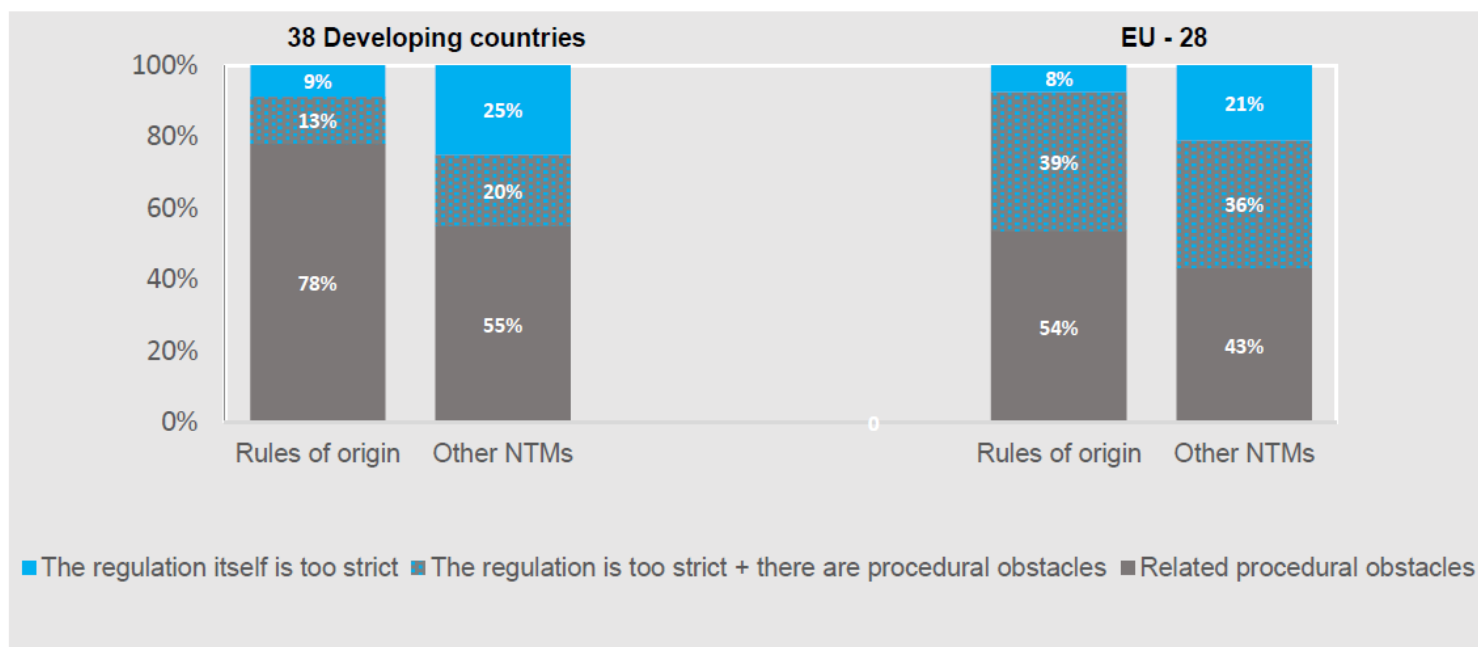


# Results of ITC firm surveys on NTMs(3)

(20,000 interviews in 38 countries 2010-2018)

- Procedural hurdles perceived as the main NTM obstacle for ROO

2. Figure X. Procedural obstacles related to RoO applied to exports (38 countries)



Source: ITC NTM surveys, 2010-2018.

Note: The bar charts present the types of RoO related trade obstacles faced by exporters in two groups of surveyed countries. They show that in more than 90% of cases in both developing and developed countries, exporters perceive RoO as cumbersome because of procedural obstacles. Especially in developing countries, procedural hurdles are considered by companies as the main challenge linked to RoO.