

The utilisation rate of preferences in the EU

Fabien CANDAU (U. de Pau, U. College Dublin, and CEPII)

Lionel FONTAGNE (CEPII)

Sébastien JEAN[#] (CEPII)¹

Preliminary and incomplete draft

To be presented at the 7th Global Economic Analysis Conference, Washington D.C., 17-19
June 2004

Abstract:

The objective of this work is to study how effective are EU's preferential agreements in granting their partners improved market access. In particular we assess how far preferences are indeed utilised by exporters, when entering the EU's market. The complexity of EU's protection renders the exercise uneasy. In particular, many EU's partners are eligible to several different preferential regimes, and the competition between regimes needsto be taken into account. Our results suggest that underutilisation of preferences does not have a large average impact on the protection faced by exporters when acceding the European market. Still, the utilisation of preferences is lower when the preferential margin is small, suggesting that compliance costs are not negligible. Most of all, the utilisation appears weak under the GSP for textile and apparels, and most of all for EBA for the same products. Restrictive rules of origin are here the main suspects.

Key words: Preferential trade agreements; Underutilisation of preferences; European Union; Sub-Saharan Africa.

[#] Corresponding author: s.jean@cepii.fr.

¹ The authors are grateful for financial support from the World Bank. We are grateful to the European Commission services for giving us access to the customs data. We would like to thank especially Reinhard Binder, Xavier Pichot, David Laborde, Will Martin and Jacques Gallezot for their useful help and comments. The remaining errors are the authors' sole responsibility.

In the Grand-Baie declaration (June 20th, 2003), the Ministers of Trade of the Member States of the African Union (AU) recognised "the vital importance of long standing preferences for African countries", and subsequently expressed in three occasions their concerns about the erosion of preferences. As a matter of fact, preferential trade arrangements (PTAs) are an important aspect of protection patterns across the world. Either granted through unilateral preferences or through regional trade arrangements (RTAs), they play a central role in shaping trade opportunities for numerous developing countries, especially for the poorest ones. This is especially the case for Sub-Saharan African countries, due to the preferences they are granted under arrangements such as the Cotonou agreement, Europe's Everything but Arms (EBA) initiative, and the US Africa Growth and Opportunity Act (AGOA). Against this background, it should not come as a surprise that the prospect for multilateral liberalisation raises concerns about the erosion of preferences.

Whether these concerns are justified, and how they might be addressed can only be determined with knowledge of the details of these arrangements. The objective of this work is precisely to study how effective are EU's preferential agreements in granting their partners improved market access. How far are preferences indeed utilised by exporters, when entering the EU's market? How does this underutilisation vary across agreements and partners? Can we characterise the corresponding variations, and help explaining their source?

At best, analysts are used to assessing the consequences of these trade preferences on the basis of statutory protection, i.e. of the preferential access exporters are eligible to. This is certainly more realistic than not taking account at all of preferences. However, this does not necessarily reflect the actual level of duties they face in practice. Indeed, recent studies suggest that preferences are systematically underutilised by exporters. Brenton and Manchin (2001) found that only 35% of CEECs' exports enter the EU using the lowest tariff for which they would be eligible to. Brenton (2003) reports that the EBA initiative was very poorly utilised by LDC exporters to the EU in 2001. Gallezot (2003), in contrast, find that a large proportion of the EU's agricultural imports use a preferential rate, although approximately a third of eligible imports enters under the MFN rate. These results might seem contradictory at first glance. However, they do not deal exactly with the same problem. While Brenton focuses on the utilisation of the EBA initiative (in addition, during the year it has been enforced), Gallezot takes a broader measure, by studying the utilisation of at least one of the preferential agreements the exporter is eligible to. Indeed, EU's trade policy is fairly complex, and numerous trade partners benefit from various preferential agreements, as it is the case for sub-Saharan Africa countries with the EBA initiative and the Cotonou agreement. The analysis of the utilisation of preference must therefore be adapted to this specific context, where in addition the administrative requirements and the rules of origin vary from one agreement to the other, included for a given partner.

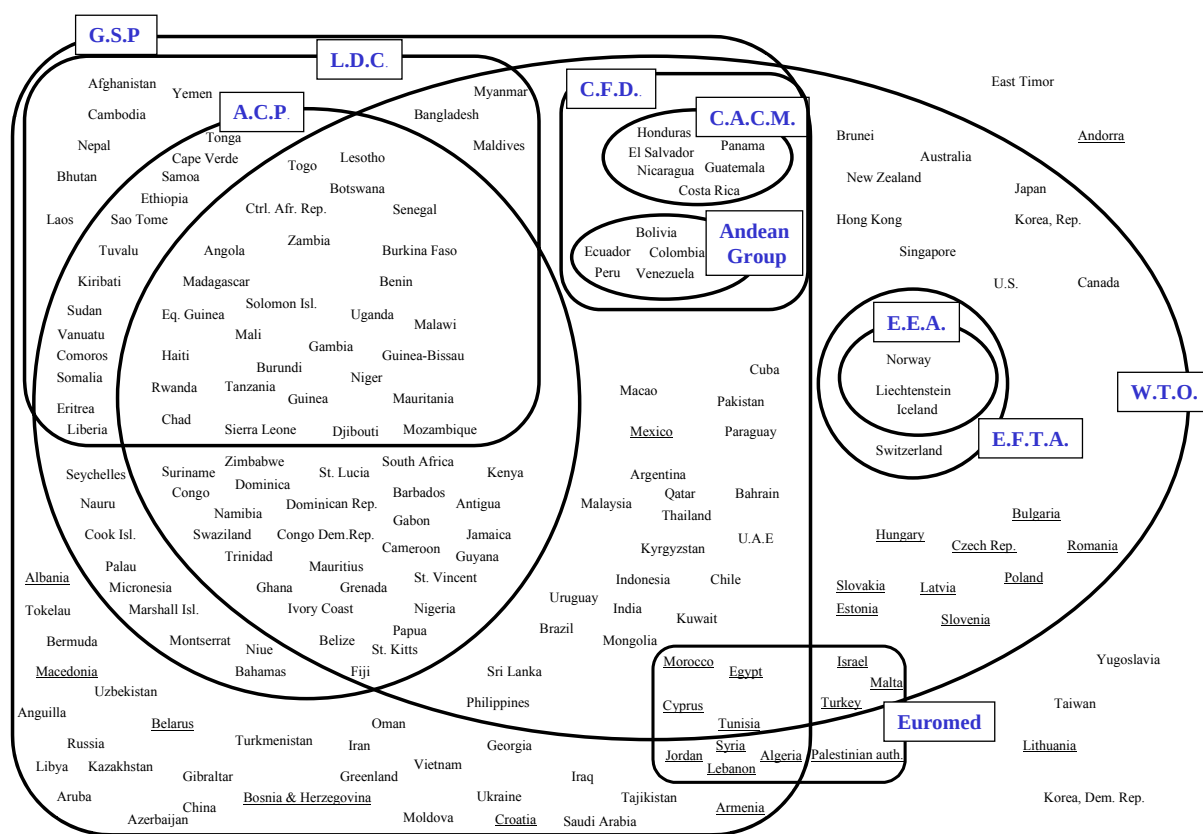
By re-examining EU customs declarations, this paper attempts to shed more light on this topic. In doing so, it aims at making different contributions to the debate. Firstly, it takes a broad view of the utilisation of preferences, by considering jointly the various preferential arrangements available to each exporter, and by making clear to what extent the most beneficial regime is used, to what extent a "second-best" regime is used, and how often the exporter does not request for any preferential regime. Secondly, it attempts to link systematically the utilisation rate with statutory protection, in order to investigate how underutilisation might be linked to the magnitude of the preferential margin. Thirdly, throughout the analysis, emphasis is put on proposing and applying methodologies adapted

for subsequent utilisation in a CGE analysis. Finally, a simple econometric analysis of the determinants of the utilisation rate of preferences is proposed.

European trade policy: the scope and depth of preferential agreements

Up to December 2002, some 250 RTAs had been notified to the GATT/WTO up to December 2002, of which 170 are currently in force. And the WTO estimates that, by the end of 2005, if RTAs reportedly planned or already under negotiation are concluded, the total number of RTAs in force might well approach 300. The EU is by far the first contributor to this profusion of agreements, with more than 50 RTAs notified to the WTO. As illustrated by Figure 1, even a simplified overview of the EU's trade policy remains quite intricate.

Figure 1: EU's trade policy in 2001



Source: authors' revision, based on Bouët et al., 2002.

Note: An underlined country's name signals a bilateral agreement with the EU. This figure is a simplified representation of EU's trade agreements in 2001. It does not pretend to be exhaustive, and it does not show the variation across country of the product coverage of agreements.

Not only are those preferences extensive, many of them also grant substantial preferential margins. Compared to other Quad market, the preferential market offered to developing countries appears relatively high in the EU (Table 1). This is especially clear for LDCs, for

which the AVE protection faced appears to be close to 0, as a result of the EBA initiative. For non-LDC developing countries, the average preferential margin in the EU market is thin (0.7 percentage points), but still superior than in other Quad markets. At the broad sector level, the picture appears rather contrasted. In manufacturing, protection is low in any case, but it is virtually zero for developing countries, outside textile-clothing. In textile and clothing, non-LDC developing countries do not benefit from any significant preferential margin. In agriculture, the margin is almost 4 points for non-LDCs, and as much as 15.7 percentage points for LDCs. Note however that the average preferential margin offered to developing countries (either LDC or not) for agricultural products is higher in Canada and in Japan, while it is almost inexistent in the US, except for non-LDCs.²

Table 1: Protection faced in Quad markets in 2001, by partner and sector

Panel A. Average AVE protection by sector and by partner (%)

Importer:	By sector			By partner			Total
	<i>Agric.</i>	<i>Manuf.</i>	<i>Textile</i>	<i>Rich</i>	<i>DCs</i>	<i>LDCs</i>	
Canada	14.4	1.6	12.6	3.7	3.1	6.3	3.5
European Union (15)	16.2	1.8	6.4	3.6	2.9	0.8	3.2
Japan	28.7	0.6	9.9	3.9	3.4	1.9	3.7
United States	5.2	1.4	10.4	2.4	2.6	5.9	2.4

Panel B. Average AVE protection by sector, for each partner (%)

Partner:	Developed Countries			Non-LDC developing coun.			LDCs		
Importer:	<i>Agric.</i>	<i>Manuf.</i>	<i>Textile</i>	<i>Agric.</i>	<i>Manuf.</i>	<i>Textile</i>	<i>Agric.</i>	<i>Manuf.</i>	<i>Textile</i>
Canada	18.1	2.0	11.5	5.8	0.7	13.4	0.4	0.0	16.2
European Union (15)	18.5	2.5	6.6	14.7	0.8	6.5	2.8	0.0	1.0
Japan	33.0	0.7	10.2	18.1	0.4	10.1	11.6	0.2	0.1
United States	5.8	1.6	9.7	3.7	0.8	10.9	5.2	0.1	13.0

Source: Bouet et al. (2004), based on MAcMap.

Note: "Agric." refers to agriculture and agrofood. "Textile" refers to textile, clothing, leather and leather products.

² How far is that due to the partial enforcement of AGOA in 2001 remains an open question.

The utilisation of preferences: previous studies and prima facie evidence

Related literature

First, there is a direct cost associated with the completion of such rules. Herin (1986), Cadot *et al* (2003), Inama (2003) and Anson *et al.* (2004) and all point out to sizeable costs (up to 3% to 5%) undermining exports under preferential schemes. Second, rules of origin (RoOs) are making it more difficult to achieve economies of scale, since input requirements may vary according to destination markets of the final products. Third RoOs are an incentive to purchase intermediates in the country conceding the preference, and this can be the source of a trade diversion if there is a more efficient producer of intermediates elsewhere. This trade diversion can be the source of welfare losses (Brenton and Manchin, 2002). With no-cumulation, this detrimental impact on trade in final products is magnified, while intermediate imports from the conceding country can be enhanced (Augier *et al*, 2004; Estevadeordal and Suominen, 2004). Lastly, RoOs have sometimes been interpreted directly as hidden protectionism (Krishna and Krueger, 1995). These issues are well documented in the existing literature, of which Brenton (2003-a) is a good synthesis.

Building an index of restrictiveness of RoOs, Estevadeordal (2000) shows that these rules are a mean to limit trade deflection: the larger the difference in tariffs between Mexico and the USA, the more restrictive the associated RoOs. More interestingly, it was also shown that the sectors associated with a limited liberalisation are also those where RoOs are the more restrictive. Cadot *et al.* (2002) interpret RoOs as an instrument which neutralises an important part of the cut in tariffs associated with the NAFTA. So, what about the UE ?

Recent studies suggest that preferences are systematically under-utilised by exporters. Brenton and Manchin (2001) found that only 35% of CEECs' exports enter the EU using the lowest tariff for which they would be eligible. Brenton (2003) is raising doubts regarding the potential impact of the EBA initiative, despite the permanent exemption of tariffs and quotas that makes a difference with any GSP scheme. Inama (2003), found that 62% of imports of Quad countries from all beneficiaries of GSP schemes were actually covered by preferences. But only 39% of the eligible imports were effectively shipped under such schemes. Turning to LDCs only, 64% of imports were covered and 43% of eligible imports were effectively benefiting from these schemes (more precisely, one get the information concerning the requested regime, the one that will be ultimately granted by custom authorities). Regarding the EU, the utilisation rate was 40% for LDCs, to be compared with 30% for Japan, in 2001. Under the AGOA scheme, the utilisation rate was varying 36% only for textile and textile articles, but 67% for mineral products accounting for 90% of total imports receiving in the US the preferential scheme. Gallezot (2003), in contrast, found that a large proportion of the EU's agricultural imports use a preferential rate, although approximately a third of eligible imports enters under the MFN rate.

In the case of the EU, the problem is rendered by the fact that many exporters face not one but several alternatives to the MFN rate, as already emphasised. Hence, the full set of possibilities has to be tackled at the same time. Second, it makes sense considering that this choice can be impacted by the preference margin conceded under each preferential scheme.

The data

In order to study the utilisation of preferences in the EU's market, the main source we are aware of is the Single administration declarations (SAD), collected by National customs, and put together by Eurostat. This database makes it possible to know, for each tariff line, the value and volume of imports by requested preference regime. Seasonal tariffs are treated using several lines (one for each period of time), additional information is available about the use of a quota, or for tariff suspension. The analysis is carried out here based on summer 2003's release.³ The EU notifications concerning the use of their GSP is used as an additional source. It allows GSP imports to be disentangled from other preferential imports.

It should be emphasised at the outset that the preference regime notified in the data is the regime *requested* by the exporter, not the regime finally used. In other words, no information is available about the treatment carried out by custom officers, and the answer they have given to this request. This explains why a significant proportion of the declarations is inconsistent: this occurs for instance when an exporter requests a regime he is not eligible to. While nothing prevents him from making such a request, custom officers should deny him benefiting from this regime. Obvious inconsistencies need to be corrected during the statistical treatment.

In order to judge of the consistency of custom declarations, it is necessary to have a detailed information about the regime the exporters are eligible to. This includes the countries covered by each agreement, but also the product coverage of each agreement, given that this product coverage varies in some instances from one partner to the other, due to product exclusions. An important example is the GSP, for which graduation measures are taken when "beneficiary countries may have reached, in certain sectors, a level of competitiveness which ensures further growth even without preferential access to the EU market" (European Commission). In practice, graduation means exclusion. The decision about the countries and sectors concerned is taken each year.

In the present dataset, the frequency of inconsistent declarations is about 15%. These declarations are not taken into account while computing utilisation rates.

Should such declarations be corrected, one way or the other? In this work, we chose to exclude these declarations to the calculations of utilisation rates of preferences (and of AVE request duty, see below). However, the corresponding trade flows are taken into account in the measurement of trade flows, and in the trade-based weighting procedures.

Still, working on requested instead of effectively used regime clearly remains a limitation, and should be borne in mind when interpreting the results. Beyond already-mentioned inconsistent declaration, indeed, this means that it cannot be guaranteed that exporters do indeed benefit from the regime they are requesting.

³ Noteworthy, a previous version of this database has been circulated before. Compared to previous releases, the quality of the database has been strongly improved in this new version, both in terms of consistency for countries covered, and through the inclusion of the Netherlands, which were previously missing. The number of inconsistencies in the database is approximately halved in the new release.

The coverage and utilisation rates of preferences

Based on the above described data, the coverage and utilisation of preferences can be studied. This is usually made by calculating first the coverage ratio, i.e. the ratio of imports eligible to the preference regime to dutiable imports, for the (group of) partner and the (group of) sector considered:

$$\text{cov}_{\text{partner, sector}}(\text{regime}) = \frac{\sum_{\substack{p \in \text{partner} \\ s \in \text{sector}}} (M_{p,s} \text{ such as } p,s \text{ is eligible to regime})}{M_{\text{partner, sector}} (\text{such as MFN} > 0)}$$

Where $\text{cov}_{\text{partner, sector}}(\text{regime})$ is the coverage rate of "regime", for the (group of) partner(s) "partner", for the (group of) sector(s) "sector". $M_{\text{partner, sector}}$ denotes EU's imports from "partner", in "sector".

Now the utilisation rate of a given preference regime will be calculated as the share of imports eligible to this regime, that indeed (request to) use it:

$$\text{util}_{\text{partner, sector}}(\text{regime}) = \frac{\sum_{\substack{p \in \text{partner} \\ s \in \text{sector}}} (M_{p,s} \text{ entering under regime})}{\sum_{\substack{p \in \text{partner} \\ s \in \text{sector}}} (M_{p,s} \text{ such as } p,s \text{ is eligible to regime})}$$

Inama (2003) also calculates the utility ratio of a preference regime, referring to the share of imports that do use a given preference regime. The utility ratio is thus the product of the coverage ratio by the utilisation ratio.

Now, this simple arithmetic might be misleading when various preference regime are available to the exporter. And this is the case for numerous EU's partners, as should be clear from Figure 1. From the comparison of the results obtained respectively by Brenton (2003) and Gallezot (2003), in particular, it follows that while EBA is very poorly utilised in sub-Saharan Africa, the Cotonou agreements is strongly used. This suggests that many LDC African countries continue to use the Cotonou regime, even though EBA would grant them a highest preferential margin. In this case, it is useful to understand why this is the case, but it is also necessary to take stock of the fact that these countries still benefit from a preferential regime.

In analytical terms, this implies that measuring the utilisation rate of a preference regime that is not the most favourable does not make sense: this regime ought not be largely utilised if a better one exists. For LDCs in sub-Saharan Africa, for instance, the utilisation rate of the Cotonou regime is meaningless, as is the utilisation of the GSP for a country that also benefits from a preferential agreement, as for instance Morocco or Tunisia.

In general terms, a preferential agreement provides with an additional preference, with respect to GSP. Nonetheless, the reverse is true for LDCs: since EBA is embedded in the GSP scheme, GSP is the best regime available to them, even when they benefit in addition from a preferential agreement, as is the case with ACP, LDC countries. Note however that, although EBA offers equal or lower tariff duties compared to the Cotonou agreement, it is associated with tighter administrative requirements and RoOs, since the Cotonou agreement is especially

favourable in this respect. Note, finally, that a preferential regime never covers all products, and that product coverage varies widely across agreements.

In order to overcome these problems, we calculate two kinds of utilisation and coverage rates, for each type of partners: the rates corresponding to the most favourable preference regime (GSP for LDCs, other preferential agreements for non-LDCs eligible to the GSP); and the rates of coverage and utilisation of "at least one" preference regime, with the corresponding obvious definitions. By definition, the coverage rate is superior for at least one preference than for any single preference regime, but this is not necessarily the case for the utilisation rate.

In order to deal consistently with these methodological difficulties, the utilisation and coverage rates are computed by grouping partners according to the preference regime they are eligible to, and treating separately LDCs. In addition, sub-Saharan African (SSA) countries are treated separately.

Table 2: Average coverage and utilisation rates of preferences in the EU, by group of partners, 2001 (%)

Partner	Total imports (M euros)	Dutiable imports (M euros)	Coverage rate (%)			Utilisation rate (%)			Utility rate (%)		
			GSP	Pref	At least one	GSP	Pref	At least one	GSP	Pref	At least one
SSA_LDC	7,386	2,046	95.4	98.7	99.7	1.3	-	92.2	1.2	-	91.8
SSA_nonLDC	14,312	3,963	67.2	99.6	99.7	-	92.8	94.2	-	92.5	93.9
Other_LDC	4,452	4,289	99.4	0.1	99.4	49.6	-	49.6	49.3	-	49.4
GSP_PRE	58,285	24,139	83.7	84.2	90.5	-	72.7	86.4	-	61.2	78.2
GSP_nonPRE	168,203	57,996	91.1	0.0	91.1	69.6	-	69.6	63.4	-	63.4
nonGSP_PRE	236,836	150,257	0.0	90.6	90.6	-	85.4	85.4	-	77.4	77.4
nonGSP_nonPRE	241,056	105,709	0.0	0.0	0.0	-	-	-	-	-	-
All partners	730,530	348,400	23.5	46.6	63.4	52.5	84.1	81.2	12.4	39.2	51.5

Source: Authors' calculations based on Custom declarations.

Results for 2001 are shown in Table 2. The distribution of dutiable imports among groups of importers, classified by regime of conceded preferences, is the first striking empirical evidence. Not surprisingly preferences are concerning a limited amount of imports, and LDC or SSA countries a very limited part of the latter. This does not come out as a surprise since SSA LDCs account for only 1% of EU imports as a whole. We record 105 billion euros of EU imports entering in Europe on a non-preferential basis. Another 150 billion enter under a preferential scheme that is not the GSP. The GSP corresponds to 81 million, SSA and LDCs shipping only 10 million euros of dutiable imports. All these figures have to be compared with 730 billion euros of total imports.

Regarding the coverage rate, 63% of EU imports are covered by at least one preference, out of which 23% are covered by the GSP. The percentages shown in the table are consistent with the clustering of imports by preferential regime. For the line "nonGSP_nonPRE", corresponding to imports that are not subject to any preference, the coverage rate is of course 0. The same observation is made for the GSP coverage of "nonGSP_PRE" imports. 90% to 99% of dutiable imports from countries benefiting from a preference are effectively covered by a preference. The coverage rate of a given preferential scheme depends on the situation of the exporter: for instance, the "GSP_nonPRE" group is of course relying only on the GSP to obtain a 99% coverage rate. This is also the case for the group "other LDC". More interestingly, "SSA_nonLDC" exports are covered for 99% by basically the Cotonou scheme,

and only up to 67% by the GSP scheme, since these countries are not eligible to the EBA initiative.

Table 3: Average coverage and utilisation rates of preferences in the EU, by group of products, 2001 (%)

Products	Total imports (M euros)	Dutiable imports (M euros)	Coverage rate (%)			Utilisation rate (%)			Utility rate (%)		
			GSP	Pref	At least one	GSP	Pref	At least one	GSP	Pref	At least one
Raw agric.	26,104	10,582	32.9	43.0	53.9	39.1	74.6	83.5	12.9	32.1	45.0
Food prod.	28,625	20,899	30.9	40.8	56.6	55.0	83.1	89.9	17.0	33.9	50.9
Oth. primary	116,853	3,259	34.7	57.3	64.7	28.6	87.7	93.1	9.9	50.3	60.2
Text-wearing	57,101	55,968	46.0	54.0	85.7	42.5	90.2	79.6	19.6	48.7	68.2
Oth. manuf	501,847	257,693	17.5	45.5	59.6	59.6	82.9	80.8	10.4	37.7	48.1
All products	730,530	348,400	23.5	46.6	63.4	52.5	84.1	81.2	12.4	39.2	51.5

Source: Authors' calculations based on Custom declarations.

How each set of preferences is actually utilised is tightly associated to the sequence of their implementation, and to the associated level of preference and administrative constraints. This is why Cotonou countries, that were already benefiting from a very favourable treatment are only utilising the GSP up to 1%, whereas they use in total 92% of their preferences (column "at least one"). Hence, it is difficult to compare this figure with the rate of utilisation of the GSP of 49% for the "other LDCs", or the 69% for the "GSP_nonPRE". In total, affirming that only 52% of the GSP is used would be misleading: potential beneficiaries prefer relying on other preferences. In total, the rate of utilisation of at least one preference is 81%: it ranges from 49% for the non-SSA LDCs, to 69% for the GSP_nonPRE (essentially the non-LDC developing countries that are not "preferred" by the EU), to more than 90% for the SSA countries.

Table 4: Coverage and utilisation rates of preferences in the EU, by group of partners and group of products, 2001 (%)

Products	Partner	Total imports (M euros)	Dutiable imports (M euros)	Coverage rate (%)			Utilisation rate (%)			Utility rate (%)		
				GSP	Pref	At least one	GSP	Pref	At least one	GSP	Pref	At least one
Raw agric.	SSA_LDC	1,078	399	96.8	99.9	100.0	1.5	-	94.2	1.5	-	94.2
Raw agric.	SSA_nonLDC	2,920	1,075	75.6	99.9	100.0	-	94.9	95.3	-	94.8	95.3
Raw agric.	Other_LDC	58	11	99.1	1.6	99.1	92.3	-	93.0	91.4	-	92.2
Raw agric.	GSP_PRE	5,447	3,584	39.3	43.9	51.5	-	53.8	85.0	-	23.6	43.8
Raw agric.	GSP_nonPRE	8,596	1,605	53.7	0.0	53.7	71.6	-	71.6	38.5	-	38.5
Raw agric.	nonGSP_PRE	2,595	1,870	0.0	80.6	80.6	-	77.1	77.1	-	62.2	62.2
Raw agric.	nonGSP_nonPRE	5,411	2,037	0.0	0.0	0.0	-	-	-	-	-	-
Food prod.	SSA_LDC	892	849	99.1	96.9	99.2	0.4	-	91.8	0.4	-	91.0
Food prod.	SSA_nonLDC	1,514	1,459	52.9	99.1	99.1	-	96.6	97.0	-	95.8	96.2
Food prod.	Other_LDC	241	238	98.5	1.3	98.7	89.9	-	90.2	88.6	-	89.0
Food prod.	GSP_PRE	3,182	2,707	63.5	78.0	83.8	-	64.2	93.6	-	50.1	78.5
Food prod.	GSP_nonPRE	10,714	5,798	49.9	0.0	49.9	88.6	-	88.6	44.2	-	44.2
Food prod.	nonGSP_PRE	5,906	5,155	0.0	80.3	80.3	-	86.0	86.0	-	69.1	69.1
Food prod.	nonGSP_nonPRE	6,176	4,694	0.0	0.0	0.0	-	-	-	-	-	-
Oth. primary	SSA_LDC	3,666	17	98.9	100.0	100.0	0.3	-	98.6	0.3	-	98.6
Oth. primary	SSA_nonLDC	7,402	75	60.4	100.0	100.0	-	51.2	88.7	-	51.2	88.7
Oth. primary	Other_LDC	6	3	95.9	6.9	97.4	93.2	-	94.5	89.4	-	92.0
Oth. primary	GSP_PRE	23,319	1,059	89.1	83.6	94.4	-	86.2	96.2	-	72.1	90.8
Oth. primary	GSP_nonPRE	49,702	178	68.8	0.0	68.8	76.5	-	76.5	52.6	-	52.6
Oth. primary	nonGSP_PRE	24,771	1,586	0.0	56.2	56.2	-	92.1	92.1	-	51.7	51.7
Oth. primary	nonGSP_nonPRE	7,987	341	0.0	0.0	0.0	-	-	-	-	-	-
Text-wearing	SSA_LDC	254	252	97.5	100.0	100.0	3.0	-	95.4	3.0	-	95.4
Text-wearing	SSA_nonLDC	704	701	99.9	100.0	100.0	-	90.9	92.5	-	90.9	92.5
Text-wearing	Other_LDC	4,017	3,975	99.9	0.0	99.9	46.6	-	46.6	46.6	-	46.6
Text-wearing	GSP_PRE	7,201	7,162	99.3	99.3	100.0	-	91.5	94.0	-	90.9	94.0
Text-wearing	GSP_nonPRE	14,163	13,843	99.1	0.0	99.1	64.5	-	64.5	63.9	-	63.9
Text-wearing	nonGSP_PRE	25,981	25,830	0.0	85.7	85.7	-	89.7	89.7	-	76.9	76.9
Text-wearing	nonGSP_nonPRE	4,780	4,205	0.0	0.0	0.0	-	-	-	-	-	-
Oth. manuf	SSA_LDC	1,496	529	87.2	99.9	99.9	1.6	-	89.6	1.4	-	89.5
Oth. manuf	SSA_nonLDC	1,771	654	51.1	100.0	100.0	-	87.7	88.5	-	87.7	88.5
Oth. manuf	Other_LDC	131	62	71.3	1.8	72.9	90.3	-	89.3	64.4	-	65.1
Oth. manuf	GSP_PRE	19,136	9,627	93.7	89.8	99.5	-	61.3	78.2	-	55.0	77.8
Oth. manuf	GSP_nonPRE	85,027	36,572	96.3	0.0	96.3	69.9	-	69.9	67.3	-	67.3
Oth. manuf	nonGSP_PRE	177,584	115,816	0.0	92.8	92.8	-	84.6	84.6	-	78.4	78.4
Oth. manuf	nonGSP_nonPRE	216,702	94,432	0.0	0.0	0.0	-	-	-	-	-	-

Source: Authors' calculations based on Custom declarations.

Utilisation and level of preference margin

The economic significance of the underutilisation of preferences is difficult to gauge without additional information. In particular, the link between the magnitude of the preference margin and the degree of underutilisation of the preferential regime is a key problem. It should not come as a surprise that exporters do not find it profitable to comply with administrative requirements, when the preference margin it would provide them is very tiny. In contrast, a low utilisation of a preference regime granting a large preferential margin is a clear sign that some obstacles exist, that prevent exporters from taking advantage of the preference.

In order to be able to illustrate this dimension of the utilisation of preference, it is necessary to match statutory protection with custom duties. Indeed, custom declarations do not provide any information about the level of duties, but only about the preference regime used. This information is thus taken from the official information about the EU's statutory protection, as

given in the TARIC. Here again, the data used is broken down at the level of EU's notifications to the WTO, *i.e.* at the 8-digit level.

Computing the preference margin requires calculating ad-valorem equivalents of specific tariffs. At the tariff line level, the only information available to us is the unit value of imports, by partner. This information presents two shortcomings: it lacks robustness, and it is likely to present endogeneity. Endogeneity might in particular arise when preferential imports represent a substantial part of imports, and benefit from a significant preference margin: given the often-limited degree of competition observed in exporting countries, this is likely to create rents, materialising in above-world average prices (see e.g. Olarraega and Ozden, 2003). The presence of specific tariffs may also, by itself, bias prices upward. For the sake of robustness, ad-valorem equivalents are thus calculated based on the weighted median world price, for each HS-6 product. This price is thus such that half the value of world trade in the product concerned is sold at a superior unit value, the other half being sold at a lower unit value.

Based on these AVE duties, it is possible to compute, for each product and each preferential regime, the AVE preferential margin. In Table 5, the utilisation rate of preference is related to the preferential margin, calculated for the most favourable regime. Two kinds of situations may give rise to a relationship between the preferential margin and the utilisation rate of preferences. Firstly, the existence of a significant compliance cost for a given preferential regime should lead exporters not to request for the benefit of this regime, as long as the preferential margin is lower than the compliance cost. Such a situation should be reflected in a poor utilisation for low preferential margins, since compliance costs are generally assumed to be limited to a few percentage points of total cost. Secondly, preferential access may be associated with restrictive RoOs. When these rules are indeed a binding constraint for exporters, they should lead to an incomplete utilisation of preference. And there is no reason to assume a priori that this underutilisation should be restricted to low preferential margins: if the local content requirement and the rules of cumulation associated with a regime prevent exporters from sourcing their intermediate inputs from the best providers, this might entail a significant cost increase.

The results shown in Table 5 are consistent with the existence of significant compliance costs, since the utilisation of at least one preference tends to be lower for margins below 3%, and to a lesser extent between 3 and 6%. Still, the utilisation remains substantial for these “moderate” preferential margins, generally above two-thirds. Noteworthy, this is not consistent with estimates of compliance costs accounting for 3 to 5% of total cost: why, if this were the case, should exporters bear this cost, in order to benefit from only a few percentage points of preferential margin?

Table 5: Coverage and utilisation rates of preferences in the EU, by group of partners and by magnitude of preferential margin, 2001 (%)

Partner	Pref. margin	Dutiable imports (M euros)	Total imports (M euros)	Utilisation rate (%)		
				GSP	Pref	At least one
SSA_LDC	0	24	2,360	-	-	-
SSA_LDC	]0 ; 3]	48	366	0.0	-	74.5
SSA_LDC	]3 ; 6]	75	78	1.8	-	81.8
SSA_LDC	]6 ; 9]	382	395	1.7	-	94.1
SSA_LDC	> 9	494	494	1.0	-	93.9
SSA_LDC	All products	1,023	3,693	1.3	-	92.2
SSA_nonLDC	0	62	5,165	-	-	-
SSA_nonLDC	]0 ; 3]	69	127	-	48.7	70.5
SSA_nonLDC	]3 ; 6]	145	147	-	88.8	91.2
SSA_nonLDC	]6 ; 9]	397	399	-	96.6	97.4
SSA_nonLDC	> 9	1,307	1,315	-	94.7	95.1
SSA_nonLDC	All products	1,980	7,154	-	92.9	94.3
Other_LDC	0	13	86	-	-	-
Other_LDC	]0 ; 3]	1	7	4.1	-	34.4
Other_LDC	]3 ; 6]	15	15	90.3	-	89.9
Other_LDC	]6 ; 9]	101	101	65.4	-	65.6
Other_LDC	> 9	2,015	2,016	48.5	-	48.5
Other_LDC	All products	2,145	2,226	49.6	-	49.6
GSP_PRE	0	618	16,985	-	-	-
GSP_PRE	]0 ; 3]	2,395	2,893	-	56.1	81.5
GSP_PRE	]3 ; 6]	2,411	2,534	-	75.1	81.7
GSP_PRE	]6 ; 9]	2,260	2,293	-	72.8	90.0
GSP_PRE	> 9	4,383	4,435	-	82.2	91.3
GSP_PRE	All products	12,068	29,141	-	72.7	86.4
GSP_nonPRE	0	3,481	56,878	-	-	-
GSP_nonPRE	]0 ; 3]	11,951	12,655	68.2	-	68.2
GSP_nonPRE	]3 ; 6]	10,509	11,363	68.6	-	68.6
GSP_nonPRE	]6 ; 9]	2,306	2,342	88.8	-	88.8
GSP_nonPRE	> 9	447	559	68.0	-	68.0
GSP_nonPRE	All products	28,694	83,797	70.0	-	70.0
nonGSP_PRE	0	9,846	51,280	-	-	-
nonGSP_PRE	]0 ; 3]	22,108	23,224	-	83.8	83.8
nonGSP_PRE	]3 ; 6]	14,976	15,534	-	81.1	81.1
nonGSP_PRE	]6 ; 9]	11,388	11,503	-	91.5	91.5
nonGSP_PRE	> 9	15,433	15,498	-	86.9	86.9
nonGSP_PRE	All products	73,750	117,040	-	85.2	85.2
nonGSP_nonPRE	0	52,750	120,423	-	-	-
nonGSP_nonPRE	All products	52,750	120,423	-	-	-
All partners	0	66,794	253,178	-	-	-
All partners	]0 ; 3]	36,572	39,272	62.5	81.2	78.5
All partners	]3 ; 6]	28,131	29,671	59.7	80.5	76.6
All partners	]6 ; 9]	16,834	17,034	48.9	88.8	91.0
All partners	> 9	24,078	24,318	22.9	86.7	84.5
All partners	All products	172,409	363,474	52.7	83.9	81.2

Source: Authors' calculations based on Custom declarations and TARIC.

Note: The preference margin is calculated as the difference between the AVE MFN rate and the best preferential rate available. The calculation is made at the tariff line level. The AVE of specific tariffs are computed based on worldwide weighted median unit values.

For higher margins, the utilisation is generally high, in most cases above 85%. The two remarkable exceptions are the low utilisation, for large margins, of the GSP for those partners not benefiting from any other preferential agreement, and of EBA for non-ACP countries. In the latter case, the utilisation of margins above 9 percentage points is as low as 48%. Clearly, these results points to the existence of constraining rules of origin, under the GSP regime (recall that EBA is embedded in the GSP), for textile and wearing.

The link between the level of preference margin and their degree of underutilisation can also be summarised through the computation of various average AVE duties. Every exporter has at least access to the MFN regime, without any additional requirement. If he complies with administrative requirements, he can at best use the most favourable preferential regime he is eligible to. Hereafter, this is referred to as the best preferential regime. Somewhere between these two bounds is the average protection faced by the exporter is thus a priori. We then calculate the average AVE duty actually faced by the exporter, i.e. the ratio of duties paid to the value of imports. This is what is called hereafter the average "requested duty".

Table 6 shows this average duty, in comparison to the MFN and the best duty, by group of partners and group of products. In order to check for the sensitivity of the result, averages across tariff lines are computed using two alternative methods: a simple average, and then an average weighted by the imports of the reference group the EU belongs to, from the exporter considered), and a trade-weighted average. For more details on MAcMap methodology, see Bouët et al. (2003-a).

As is well-known, calculating equivalent, aggregate rate of protection raises two kinds of problem. Firstly, trade flows are endogenous, since a higher protection rate leads, other things being equal, to lower imports. This is likely to give rise to an endogeneity bias, inducing an understatement of protection. Secondly, tariff lines are not equivalent, because of the product specialisation of the exporter, because of the specialisation of domestic production (and hence of the level of competition by domestic products), and because of the level of domestic demands. These supply and demand specificities ought be taken into account in aggregating the data.

The two methods used here are opposite in this respect: a simple average does not suffer from any endogeneity bias, but does not take into account at all demand and supply specificities. An import-weighted average suffers from a maximal endogeneity bias, but fully accounts for the respective importance of products.

In computing these calculations, we are chiefly interested here in the difference between the rate exporters do request in practice and the best preferential rate they are eligible to. This difference illustrates how much the imperfect utilisation of preference matters, in terms of the protection actually faced by exporters.

The results confirm that, broadly speaking, underutilisation of preferences does not have a large impact on the protection faced by exporters. In average, the difference is only a few tenths of percentage points. These results also confirm that underutilisation does indeed matter in one specific case: textile and wearing under the GSP, and more specifically under the EBA initiative. In the latter case, while exporters are supposed to benefit from duty-free access, they actually request import regime under which the average AVE tariff duty is as high as 6.5% in simple average.

Table 6: AVE of MFN, requested and best preferential rates in the EU, by group of partners and group of products, 2001 (%)

Products	Partner	Simple average			Import-weighted average		
		MFN	Req	Best	MFN	Req	Best
Raw agric.	SSA_LDC	12,6	2,1	1,9	3,2	0,2	0,0
Raw agric.	SSA_nonLDC	12,6	7,7	7,4	13,6	6,6	6,1
Raw agric.	Other_LDC	12,6	2,2	2,1	3,5	1,2	0,0
Raw agric.	GSP_PRE	12,5	9,5	9,3	46,0	42,6	41,5
Raw agric.	GSP_nonPRE	12,4	10,4	10,3	6,3	5,9	5,6
Raw agric.	nonGSP_PRE	12,3	10,0	9,7	7,2	4,6	4,0
Raw agric.	nonGSP_nonPRE	12,5	12,5	12,5	2,9	2,9	2,9
Raw agric.	All partners	12,5	8,1	7,9	14,5	12,5	12,0
Food prod.	SSA_LDC	23,8	0,9	0,8	11,1	1,4	0,6
Food prod.	SSA_nonLDC	23,8	14,0	13,9	21,1	7,3	6,8
Food prod.	Other_LDC	23,8	0,9	0,9	13,2	2,0	0,9
Food prod.	GSP_PRE	23,8	18,4	18,3	9,7	4,7	3,2
Food prod.	GSP_nonPRE	23,7	21,8	21,7	12,0	10,7	10,5
Food prod.	nonGSP_PRE	23,6	17,9	17,7	13,3	5,4	4,0
Food prod.	nonGSP_nonPRE	23,7	23,7	23,7	18,8	18,8	18,8
Food prod.	All partners	23,7	15,0	14,9	13,8	10,1	9,5
Oth. primary	SSA_LDC	4,4	0,0	0,0	0,1	0,0	0,0
Oth. primary	SSA_nonLDC	4,4	0,1	0,0	0,1	0,0	0,0
Oth. primary	Other_LDC	4,4	0,1	0,1	10,4	0,5	0,1
Oth. primary	GSP_PRE	4,4	1,8	1,7	0,1	0,0	0,0
Oth. primary	GSP_nonPRE	4,4	3,5	3,5	0,0	0,0	0,0
Oth. primary	nonGSP_PRE	4,3	2,5	2,4	0,2	0,1	0,1
Oth. primary	nonGSP_nonPRE	4,4	4,4	4,4	0,3	0,3	0,3
Oth. primary	All partners	4,4	1,9	1,8	0,1	0,1	0,1
Text-wearing	SSA_LDC	8,2	0,1	0,0	10,3	0,5	0,0
Text-wearing	SSA_nonLDC	8,2	0,2	0,0	11,4	1,0	0,0
Text-wearing	Other_LDC	8,2	0,6	0,1	12,0	6,5	0,0
Text-wearing	GSP_PRE	8,2	3,0	2,6	10,8	0,9	0,1
Text-wearing	GSP_nonPRE	8,2	6,6	6,4	9,9	9,2	8,8
Text-wearing	nonGSP_PRE	8,3	2,4	0,9	10,0	2,4	1,5
Text-wearing	nonGSP_nonPRE	8,2	8,2	8,2	7,1	7,1	7,1
Text-wearing	All partners	8,2	3,1	2,7	10,0	5,7	4,8
Oth. manuf	SSA_LDC	3,0	0,0	0,0	2,0	0,2	0,0
Oth. manuf	SSA_nonLDC	3,0	0,1	0,0	1,9	0,2	0,0
Oth. manuf	Other_LDC	3,0	1,1	1,1	4,3	0,7	0,4
Oth. manuf	GSP_PRE	3,0	0,4	0,3	2,6	0,9	0,4
Oth. manuf	GSP_nonPRE	3,0	0,9	0,6	2,6	1,7	1,3
Oth. manuf	nonGSP_PRE	3,0	1,1	0,7	3,2	0,9	0,5
Oth. manuf	nonGSP_nonPRE	2,9	2,9	2,9	2,1	2,1	2,1
Oth. manuf	All partners	3,0	0,7	0,5	2,6	1,6	1,3
All products	SSA_LDC	8,2	0,3	0,2	2,6	0,2	0,1
All products	SSA_nonLDC	8,2	3,1	3,0	5,8	2,2	2,0
All products	Other_LDC	8,2	1,0	0,9	11,8	6,0	0,1
All products	GSP_PRE	8,2	4,7	4,5	7,0	4,7	4,2
All products	GSP_nonPRE	8,1	6,1	6,0	3,9	3,2	2,9
All products	nonGSP_PRE	7,8	4,7	4,1	4,0	1,1	0,7
All products	nonGSP_nonPRE	8,1	8,1	8,1	2,6	2,6	2,6
All products	All partners	8,1	4,1	3,9	3,8	2,5	2,2

Source: Authors' calculations based on Custom declarations and TARIC.

Note: The preference margin is calculated as the difference between the AVE MFN rate and the best preferential rate available. The calculation is made at the tariff line level. The AVE of specific tariffs are computed based on worldwide weighted median unit values. For details on MacMap weighting, see Appendix. Import-weighted and simple average are computed at the tariff line level.

Conclusion

The preliminary results presented in this article propose new evidence about the utilisation of trade preference in the EU. The complexity of EU's protection renders the exercise uneasy. In particular, many EU's partners are eligible to several different preferential regimes.

This "competition" between regimes makes it difficult to assess one regime separately from others. This is why the analysis presented here adds the calculation of the utilisation of at least one preference.

This approach suggests that underutilisation of preferences does not have a large average impact on the protection faced by exporters when acceding the European market. Still, the utilisation of preferences is lower when the preferential margin is small, suggesting that compliance costs are not negligible. Most of all, the utilisation appears weak under the GSP for textile and apparels, and most of all for EBA for the same products. Restrictive rules of origin are here the main suspects.

References

- ANSON J., CADOT O., ESTEVADEORDAL A., DE MELO J., SUWA-EISENMANN A., and B. TUMURCHUDUR (2004), Rules of Origin in North-South Preferential Trading Arrangements with an Application to NAFTA, *mimeo*.
- BOUËT A., DECREUX Y., FONTAGNÉ L., JEAN S., LABORDE D. (2003-a), "Computing an exhaustive and consistent, ad-valorem equivalent measure of applied protection: a detailed description of MAcMap-HS6 methodology", *mimeo*, CEPII, available on <http://www.cepii.fr/anglaisgraph/bdd/macmap.htm>.
- BOUËT A., FONTAGNÉ L., MIMOUNI M. (2003-b), "Direct measure of protection: a rehabilitation", GTAP conference.
- BRENTON P. (2003-a), "Notes on Rules of Origin with Implications for Regional Integration in South East Asia", *mimeo*, World Bank, Washington D.C.
- BRENTON P. (2003-b), "The Value of trade Preferences: The Economic Impact of Everything but Arms", *mimeo*, World Bank, Washington D.C.
- BRENTON, P., MANCHIN M. (2003), "Making EU Trade Agreements Work: The Role of Rules of Origin", *World Economy*.
- CADOT, O., A. ESTEVADEORDAL, J. DE MELO, A. SUWA-EISENMANN and B. TUMURCHUDUR , (2002), "Assessing the Effect of NAFTA's Rules of Origin", *mimeo*, University of Lausanne.
- ESTEVADEORDAL, A. (2000), "Negotiating Preferential Market Access: The Case of the North American Free Trade Agreement", *Journal of World Trade*, 34, 141-66.
- ESTEVADEORDAL, A., and K. SUOMINEN (2003), "Measuring Rules of Origin in the World Trading System and Proposals for Multilateral Harmonization", *mimeo* IDB, Washington, D.C.
- ESTEVADEORDAL, A., and K. SUOMINEN (2004), "Rules of Origin: A World Map and Trade Effects", *mimeo* IDB, Washington, D.C.
- GALLEZOT J. (2003) "Real access to the EU's agricultural market", *mimeo*, INRA, Paris.
- HERIN, J. (1986), "Rules of Origin and Differences Between Tariff Levels in EFTA and in the EC", *EFTA Occasional Paper* 13.
- INAMA S. (2003), "Trade Preferences for LDCs: An Early Assessment of Benefits and Possible Improvements", UNCTAD, ITCD/TSB/2003
- Olarreaga M. and Ozden C. (2003), " Who Captures the Tariff Rent in the Presence of Preferential Market Access?", The World Bank