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Do nonreciprocal preferential trade agreements increase beneficiaries' exports?

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ABSTRACT

This paper investigates whether and to what extent nonreciprocal preferential trade agreements (NRPTAs) have increased developing countries' exports to richer countries. Using recent developments in the econometric analysis of the gravity equation over the period 1960–2008, we find robust evidence that, on the whole, NRPTAs and the Generalized System of Preferences have had an economically significant effect on exports from developing countries. However, the estimation of catch-all dummies masks heterogeneous results for the individual programs.

1. Introduction

The increase of exports from developing countries to industrialized nations' markets has long been considered an essential element to reduce poverty, promote sustainable development and reap the potential benefits of globalization for the developing world. While there has been an intense debate in policy-making circles on how best to accomplish these aims, the prevailing approach has implied that developed countries give support to the integration of developing countries into the world economy through a "special and differential treatment" (in the form of nonreciprocal preferences) for imports from the developing world. The leading instrument for such trade preferences has been the Generalized System of Preferences, but there exist other nonreciprocal preferential trade agreements (NRPTA) that are part of this approach.

The Generalized System of Preferences (GSP) is an exception to the GATT principles of reciprocity and nondiscrimination emerged in the second half of the 1960s, through which developed countries provide preferential access to their markets to a large number of developing countries and territories. The European Community was the first to establish a GSP for developing countries and since the early 1970s other developed countries followed its footsteps (Japan, Norway, New Zealand, etc.).[1]

In addition to the standard GSP programs, the EU and the US have signed other NRPTAs with poor countries. On the one hand, the Cotonou Agreement (also known as ACP-EC Partnership Agreement) is the most comprehensive partnership agreement between developing countries from Africa, the Caribbean and the Pacific (ACP) and the European Union (EU). The basic principle of Cotonou Agreement (henceforth ACP-EU) is that, with some exceptions, the ACP countries' industrial exports have duty- and quota-free access to the EU market. Another NRPTA, that forms part of the system of preferences of the EU, is the Everything But Arms (EBA) arrangement, which provides unilateral trade preferences to the EU market for products from the Least Developed Countries. On the other hand, besides the United States' GSP, the US administration also grants other, more recent, nonreciprocal trade preferences including the Caribbean Basin Initiative (CBI), the Andean Trade Preference Act (ATPA) and the African Growth and Opportunity Act (AGOA).

This paper investigates whether and to what extent NRPTAs have increased developing countries' exports. This paper fits within a larger literature that attempts to measure the effect of policies on bilateral

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[1] The date of entry into force of the GSP programs and other nonreciprocal trade preferential agreements considered in this paper are reported in Appendix A (Table A1).

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trade using gravity equations.[2] To the best of our knowledge, there are no studies that estimate the effect on the developing countries' exports of all nonreciprocal preference agreements. In particular, we estimate the effect of NRPTAs on exports with several estimation techniques taking into account lagged effects on trade flows and controlling for multilateral resistance terms, time-invariant and time-variant unobserved bilateral heterogeneity, individual preferential trade agreements (PTA) and currency unions (CU) effects and zero trade flows. The sample covers 177 countries over the period 1960–2008. To preview our results, we find robust evidence that, on the whole, nonreciprocal preferential trade agreements and, in particular, the GSP have had an economically significant effect on exports. However, the estimation of catch-all dummies masks heterogeneous results for the individual programs.

The paper is structured as follows. Section 2 provides a background of GSP and other NRPTAs. Section 3 presents the methodology. Section 4 describes the data. Section 5 discusses the estimation results. Section 6 offers an extensive robustness analysis. Finally, Section 7 concludes the paper.

2. Background: nonreciprocal preferential trade policy

Since the early 1970s the EU, the US and other developed countries have provided developing countries with preferential market access via trade policies in the form of nonreciprocal trade preference programs. The Generalized System of Preferences (GSP) was the first one-way preferential agreement implemented by developed countries in order to promote developing countries' exports. The GSP is a system of individual national programs based on common goals and principles. However, due to the existence of important differences in developed countries' economic structures and tariff programs there is not a unified system of tariff concessions. Each preference-granting country establishes particular criteria and conditions for defining and identifying developing countries' beneficiaries.

The basic principle behind the GSP is to provide a wide range of goods originating in developing countries with preferential market access (usually in the form of lower tariff rates or duty-free status) to developed country markets in order to spur on economic growth. The GSP programs were established on the basis that preferential tariff rates in developed country markets could promote export-driven industry growth in developing countries. The argument was that only the market sizes of industrialized trading partners were large enough to provide enough economic motivation to attain these goals. But the GSP were also established, in part, because lesser-developed countries called during the early negotiations on the General Agreement of Tariffs and Trade (GATT) for "special and differential treatment".

Since they were nonreciprocal and discriminatory preference programs, the GSP posed some problems under the GATT norms. They were inconsistent with the principle of reciprocity and, most importantly, with the principle placed on GATT Parties in GATT Article I:1 to grant most-favored-nation (MFN) tariff treatment to the products of all other GATT Parties. In 1965, GATT Parties made an amendment recognizing the special economic needs of developing countries and allowing for non-reciprocity. With respect to the issue of MFN, in 1971, GATT Parties adopted a waiver of Article I for GSP programs, which allowed developed contracting parties to accord more favorable tariff treatment to the products of developing countries for ten years. At the end of the Tokyo Round of Multilateral Trade Negotiations in 1979, developing countries secured adoption of the Enabling Clause, a permanent deviation from MFN by joint decision of the GATT Contracting Parties. The Enabling Clause was incorporated into the GATT 1994 upon the entry into force of the Uruguay Round agreements.

As noted in the introduction, EU and US trade policies towards developing countries go beyond their standard GSP. In the case of the EU one of these additional nonreciprocal preferential agreements is the ACP–EC Partnership Agreement. The notion of "ACP States" goes back to the "ACP Group of States", formally established in 1975 by the Georgetown Agreement.[3] From 1975 until 2000 the ACP–EU relations were governed by the regularly adapted and updated Lomé Conventions. The fourth Lomé Convention expired on 29 February, 2000, and it was succeeded by the Cotonou Agreement. The ACP States counts 79 countries and most products originating in this group of countries are exempted from EU custom duties. Another preferential arrangement that forms part of the EU's system of preferences is the so-called Everything But Arms initiative, which provide duty-free and quota-free access to the EU market for all products coming from the about 50 Least Developed Countries, with the exception of arms, ammunition and some agricultural products (bananas, sugar and rice for a limited period). In terms of product coverage EBA is currently the most inclusive program.

The US administration also offers countries in the Caribbean and in Latin America special preferences under its Caribbean Basin Initiative (CBI) and Andean Trade Preference Act (ATPA), respectively. On the one hand, the CBI was initially launched in 1983, through the Caribbean Basin Economic Recovery Act (CBERA). In 2000, it was substantially expanded through the US–Caribbean Basin Trade Partnership Act (CBTPA). Currently, the CBI provides beneficiary countries with duty-free access to the US market for most goods. On the other hand, the ATPA was enacted in December 1991, to help four Andean countries (Bolivia, Colombia, Ecuador and Peru) in their fight against drug production and trafficking by expanding their economic alternatives. This initiative provides duty-free access to the US market for most of the products coming from these four countries, without requiring reciprocal liberalization in turn. The ATPA was renewed and amended in 2002 under a new denomination: the Andean Trade Promotion and Drug Eradication Act. The main change was the extension of the duty-free access to apparel and footwear.

Finally, the African Growth and Opportunity Act (AGOA) is the most recent and ambitious one-way preferential arrangement of the US administration. Introduced in 2000, as part of the US "trade, not aid" economic philosophy towards Africa, AGOA has extended the product coverage of the US GSP program in the field of textiles and apparel products (in which beneficiary countries have the greatest comparative advantage) to around 40 countries of sub-Saharan Africa.

Before presenting the methodology, it is worth noting that there are large differences in the relative importance that developed countries' markets represent in total exports from beneficiary countries. In 2008, both the EU and the US represent a quite relevant market share for the developing countries' beneficiaries of the corresponding nonreciprocal trade preferences. In the cases of the GSP of EU and US as well as in the rest of nonreciprocal preferences granted for these countries (ACP–EU, EBA and AGOA) this market share ranges from 21 to 26%. It is even larger for the cases of ATPA (33%) and CBI (67%). For the remaining GSP programs, market shares are lower: Japan (7%), Australia (3%), Canada and Turkey (around 1.5%) and Switzerland, Russia, Norway and New Zealand less than 0.5%.

3. Methodology

Over the last four decades, the gravity equation has emerged as the empirical workhorse in international trade for examining the *ex-post*

[2] The main branch of that literature examines the effect of preferential trade agreements (see, for example, Baier and Bergstrand, 2007; Baier et al., 2007; Carrère, 2006; Gil-Pareja et al., 2008a or Lee et al., 2008). But the gravity model has also been regularly used to estimate the trade effects of currency unions (Glick and Rose, 2002; Micco et al., 2003 or Rose, 2000), exchange rate regimes (Gil-Pareja et al., 2007 or Klein and Shambaugh, 2006) GATT/WTO membership (Rose, 2004; Subramanian and Wei, 2007 or Tomz et al., 2007), and even of the physical presence of government officials in the destination markets or the existence of state visits (Gil-Pareja et al., 2008b; Nitsch, 2007; Rose, 2007 or Volpe-Martincus and Carballo, 2008).

[3] The European Community (EC) support to Sub-Saharan Africa received a structured approach since the Yaoundé Conventions (1963–1975). The accession of the United Kingdom to the EC broadened the geographic scope of this partnership to African, Caribbean and Pacific countries of the Commonwealth.