The Impact of Trade Preferences Removal

Hinnerk Gnutzmann[a], Arevik Gnutzmann-Mkrtchyan[a,b,c,*]

[a]*Institute for Macroeconomics, Leibniz Universität Hannover, Germany*
[b]*Belarusian Economic Research and Outreach Center*
[c]*CESifo*

Abstract

Under the Generalized System of Preferences (GSP), high-income countries grant unilateral trade preferences to developing countries. These preferences are subject to political conditionality, but little is known about the trade impact of loss of preferential access and the implications for political leverage implied by it. We study the EU's withdrawal of GSP preferences from Belarus in 2007 in response to labour rights violations to fill this void. The withdrawal caused a significant drop in trade for affected products (26% to 29% trade decline) and some trade reduction at the extensive margin. However, there is little evidence of a GSP effect on total trade. This is due to the fact that the main exports of Belarus were not eligible for the GSP program.

Keywords: GSP, generalized system of preferences, preference withdrawal, political leverage, Belarus
JEL: F13, F14, O19

*Corresponding author
Email addresses: gnutzmann@mak.uni-hannover.de (Hinnerk Gnutzmann), mkrtchyan@mak.uni-hannover.de (Arevik Gnutzmann-Mkrtchyan)

1. Introduction*

Under the *Generalized System of Preferences* (GSP), rich countries may unilaterally grant trade preferences to developing countries. The GSP is an exception to the Most Favoured Nation (MFN) principle of the World Trade Organization, thus providing considerable flexibility to the preference grantee. As a result, the GSP has become the most widespread and extensive program of special treatment for developing countries (see the surveys by Ornelas (2016), Hoekman and Özden (2005)).

At the same time, it is not clear how strongly the system actually promotes exports of developing countries. Exporters, for example, can face considerable bureaucratic barriers when seeking to use the preferences, leading to underutilization of these preferences. In some cases, the "discount" granted compared to MFN is small, and countries may see their preference revoked when they actually start exporting a product in large quantities (a process known as "graduation"). In this paper, we exploit the experience of Belarus to investigate how the EU's GSP program affects both exports overall and at the product level for "eligible" sectors. We are interested in the causal effect of GSP on the value of trade as well as the number of different products traded.

Belarus received market access benefits under the EU's GSP program until 2007, when the preferences were withdrawn. The withdrawal of preferences followed a report by the International Labour Organization (ILO) determining labour rights violations in Belarus. Hence, accordingly Belarus lost its GSP preference for all goods; but its neighbors, Ukraine and Russia, continued to enjoy GSP benefits afterwards. Thus, we can employ a triple difference-in-differences regression to understand how the Belarusian economy was affected by the loss of these preferences. In particular, we assess the export performance of Belarusian sectors eligible for GSP benefits after the loss of preferences relative to the period before, relative to those sectors that were never eligible, and relative to the export performance of Russia and Ukraine. Our main finding is that, although the total trade has not been significantly affected, the eligible exporters, particularly the smaller ones, experienced a significant drop in their exports.

GSP-granting countries at times intend to gain political leverage through GSP, but in

*Financial support from the Belarusian Economic Research and Outreach Center (BEROC) as well as the European Union's Horizon 2020 research and innovation programme under grant agreement No 770680 is gratefully acknowledged.

practice the effectiveness is in practice limited by the small trade effects of the program. For example, Carnegie (2015) studies the GSP as one tool of "coercive diplomacy", and policy conditionality is a common feature of GSP programs.[1] In particular, the European Union's GSP program foresees withdrawing the preferences when the beneficiary does not meet labour rights standards (UNCTAD, 2015); this clause was used in the case of Belarus. In practice, political considerations may also play a role: EU officials may have influenced the outcome of the ILO report on Belarus to justify the GSP withdrawal from the country.[2]

On the topic of conditionality, Zhou and Cuyvers (2011) study the two cases when the EU withdrew GSP preferences – besides Belarus, Myanmar was affected – and conclude that the sanction impact of GSP withdrawal has been very limited in each case: they argue that labour standards have not improved since. The EU appears to explicitly see GSP schemes as an instrument to have a political leverage to promote human rights (Oram and Gorska, 2012), so it is noteworthy that in the rare occasions of preference withdrawal the ensuing trade effect and political leverage were quite limited. Most recently, the threat of suspension of Everything but Arms (EBA) preferences appears to have had an impact in Cambodia due to the program's importance in the garment and footwear sectors (Vicheika, 2019). EBA provides duty-free access to almost all goods for the least developed countries.

We find that the GSP withdrawal strongly affected eligible products, although it had little impact on overall trade. For Belarusian exports which were initially covered by GSP, the withdrawal had a noticeable adverse effect on exports to the EU. Depending on the specification, the average export reduction is estimated between 26% and 29%. This effect is stronger for products where trade is small, and there is some evidence of trade reductions at the extensive margin after the GSP withdrawal. When limiting the sample to products with average EU exports of at least EUR 100 000, we estimate that GSP withdrawal caused a 20% export reduction. Moreover, the main Belarusian export goods were not covered by any GSP preference; as a result, the impact on *total* exports to

[1] Further, Gassebner and Gnutzmann-Mkrtchyan (2018) show that political alignment is rewarded in US decisions regarding suspension of GSP membership.

[2] According to Rettman (2007), "[a]n EU official said that close personal ties between senior ILO and EU officials have helped Brussels get the kind of ILO reports it wants, with other issues such as political prisoners also impacting the reading of ILO texts."

the EU appears to be limited. Therefore, our findings suggest that the EU GSP program was to some extent successful in raising export diversity, having rather localized impacts on a number of small industries.

These findings of modest trade impact due to limited coverage and preference margin are in line with previous empirical studies of preference programs. Trade preference programs like GSP have been found to be particularly important for the exports of the specific sectors that receive large tariff preferences. Frazer and Van Biesebroeck (2010) analyze the impact of the African Growth and Opportunity Act (AGOA), a preferences program that extends the standard US GSP, in particular for apparel and textile exports. Using the variation in the coverage of goods and countries, authors find that AGOA had a significant impact on the exports to the United States, most notably for the apparel goods where preference margins are large. Similarly, Hakobyan (forthcoming) finds that the loss of trade preferences granted by the US reduces the exports of beneficiaries, particularly for agricultural and textiles and clothing. Overall, Lederman and Özden (2007) and Thelle et al. (2015) find a larger export impact of trade preference programs that go beyond standard GSP for US and EU[3], respectively. These extended preference programs are typically provided to the least developed countries (LDCs). Consistent with this, Ornelas and Ritel (2018) show that LDCs benefit significantly from trade preferences.

2. Background

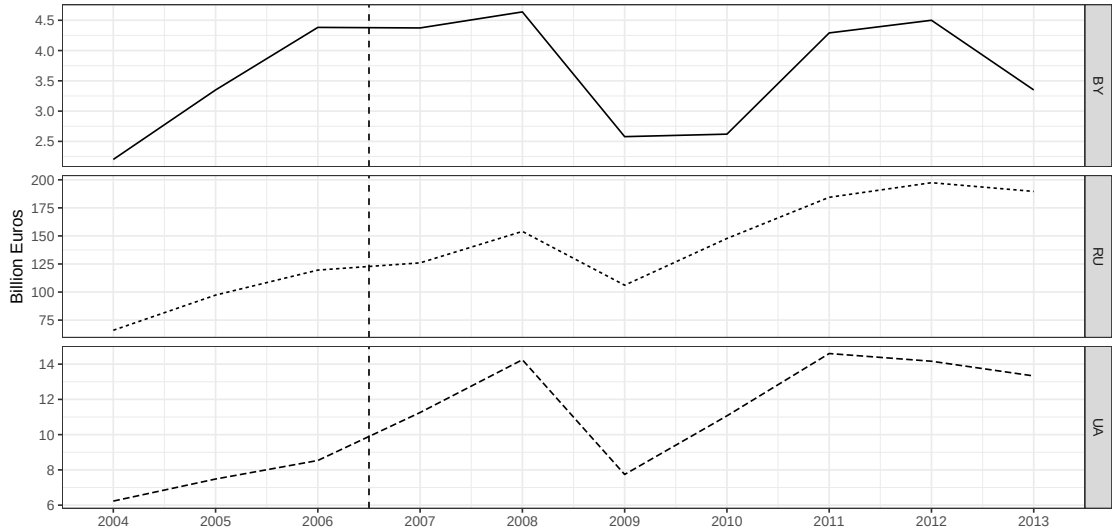
Belarus lost its EU GSP status in 2007. Hajduk and Silitski (2007) discuss the events that led to the removal of the GSP from Belarus. In particular, Belarus was accused in the ILO by the independent trade unions of limiting the ability of trade unions to register via legal and bureaucratic barriers as well as lack of the protections for members. Trade unions were reporting persecution and failure to extend the fixed-term contracts of members. This, in turn, would serve as a barrier for joining the independent trade unions. As respect for labour rights is a condition for receiving EU GSP, the EU Council removed Belarus' preferences in December 2006, effective from 21 June 2007.

The loss of GSP is not apparent in its aggregate exports to the EU. Figure 1(a) shows EU imports from Belarus, Ukraine and Russia. EU imports from these three countries

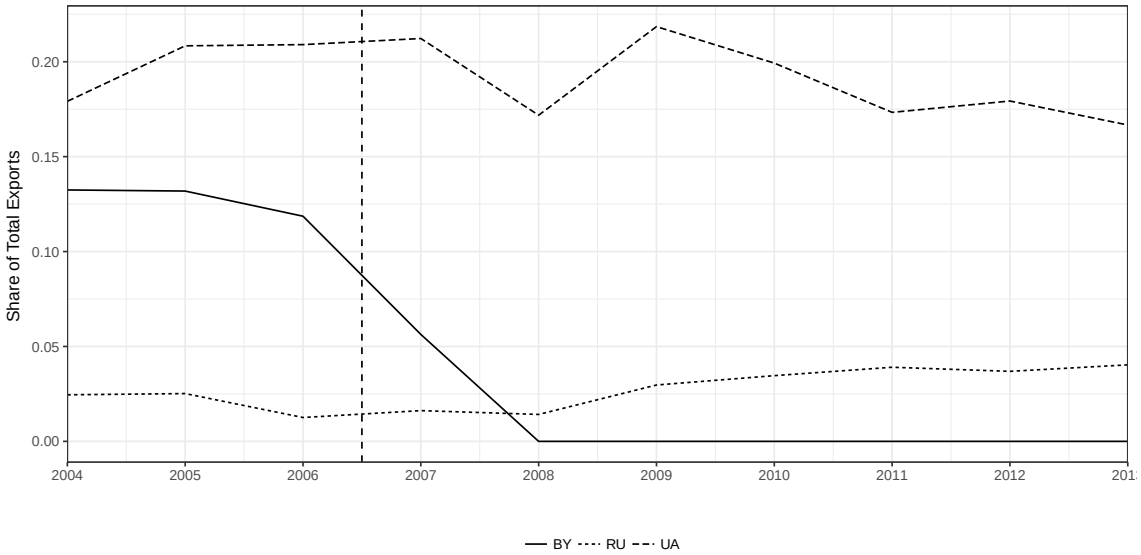
[3]Export impact of GSP/GSP+ are found to be, on average, only 4%

FIGURE 1
Total Exports and GSP Trade Share

(a) Total Exports to the European Union, by Country



(b) Share of Exports to the European Union traded under GSP, by Country



Source: Authors, based on COMEXT database

follow a similar pattern both before and after the loss of GSP by Belarus. Additionally, the exports of Belarus to the EU remained at a similar level: EUR 4.4 billion in 2006 (year before withdrawal) and 2007 (withdrawal year) and EUR 4.6 billion in 2008 (year after the withdrawal). For Belarus, the largest beneficary sectors in absolute terms were textiles, as well as mineral and chemical products. However, for chemicals and minerals, the share of eligible trade was small. The sectors with the highest share of trade covered by GSP are footwear, plastics and glass.

Figure 1(b) shows the share of exports that were exported using GSP. We see that only about $12 - 13\%$ of Belarusian exports to the EU used the GSP. Combining with the total export value, the GSP exports of Belarus were at about EUR 500 million in 2006, the year before the removal of the preferences. The small value of exports that utilized the GSP benefits explains why the impact of GSP removal is not visible in total trade. This helps us understand why the removal of GSP served only as a signal of disapproval rather than bearing a significant economic impact on the economy. Moreover, the negative effect would fall on the vulnerable exporters that were benefiting from the preferences.

Total trade values can hide significant variation for distinct sectors. First, few very large traded products (such as oil and fertilizers) can overshadow changes in trade of other products. Second, since not all products qualify for GSP, exports of those should not be affected by the loss of preferences and, again, can mask the impact on affected products. Finally, eligible sectors utilize preferences unevenly, depending on the expected tariff gains and administrative costs of claiming the benefits. Thus, the eligible products that did not use GSP should not be affected by the loss of preferences.

Figures 2 and 3 present the share of exports eligible for GSP and the utilization rate to address the issues discussed above and understand better how affected products were impacted by the GSP loss. Figure 2(a) shows that the share of Belarusian exports eligible for GSP was somewhat decreasing in the years before the removal of the GSP – from about 26% in 2004 to 20% in 2006. At the same time, the share of GSP eligible trade for Ukraine and Russia remained rather stable. This decrease suggests that Belarus experienced disproportional growth in sectors that were excluded from GSP or had duty-free imports on MFN basis. In particular, this can be caused by the unprecedented increase in oil exports by Belarus from negligible values in 2004 up to the largest export product in 2006 as EU imports oil duty-free on MFN basis, and so it is not a GSP product. Indeed, the Hajduk and Silitski (2007) report discusses the limited scope of EU GSP removal as a

policy tool is due to its marginal impact on oil exports and the lack of public communication. Figure 2(b) presents the share of GSP eligible products without mineral fuels to account for the oil export growth. GSP was more important for non-fuel exports, with a slight reduction from 45% of exports that could benefit from GSP in 2004 and to about 40% in 2006.

The declining share of GSP eligible Belarusian exports comes on a backdrop of increasing utilization rate by the eligible sectors. Figure 3 shows that Belarusian firms were learning to utilize the preferences as the utilization rate of eligible goods increased from slightly above 50% in 2004 to 60% in 2006. Ukrainian exporters similarly increased their utilization of preferences over time as exporters learn how to use the preferences. At the same time, Russian exporters did not manage to steadily increase their utilization rate.

Hence, from the one side GSP was becoming less important for Belarus as its exports were booming in sectors not covered by the GSP. However, from the other side, GSP was becoming more important for the eligible sectors as they were increasing the utilization of preferences.

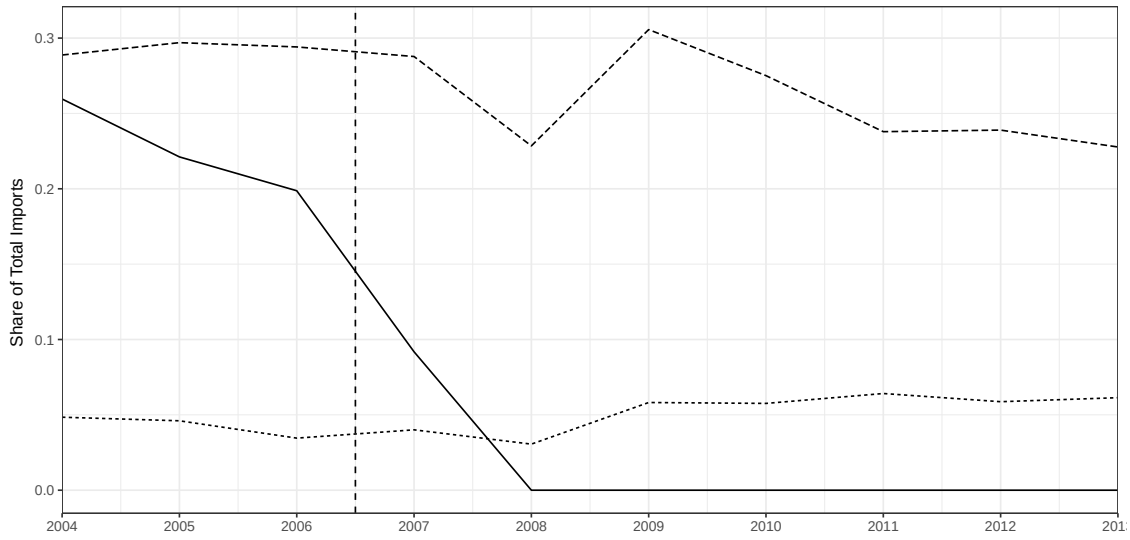
3. Data

We collected total imports, imports by trade regime of the European Union, as well as eligibility and utilization of the EU GSP from the COMEXT database provided by the European Commission. The data covers the period from 2004 to 2013 and includes imports of the European Union from Belarus, Ukraine and Russia at a 4-digit HS product classification. GSP eligibility and utilization data is reported as a total for all EU members. We omit the years before the EU enlargement to avoid differences due to the changing set of included countries.

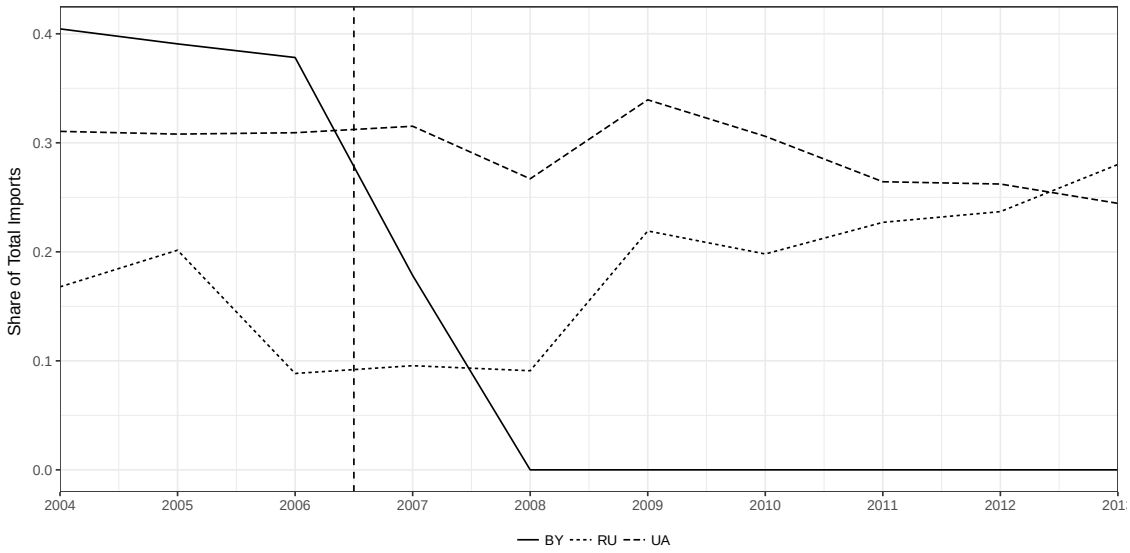
GSP eligibility is determined at the tariff line level; but in practice, there is little variation within a HS-4 group. Figure A1 shows a histogram of the share of products eligible for GSP within a HS-4 group. It is clear that the histogram peaks at zero and at full GSP coverage. This means that for most of the 4-digit product, either no or all 6-digit products were eligible for GSP. For the purpose of our analysis, we focus on HS-4 groups where the overwhelming majority of products is either eligible for GSP (thresholds: 95% and 80%), or not eligible for GSP (thresholds: 5% and 20%).

FIGURE 2
Share of Exports Eligible for GSP, by Country

(a) All Products

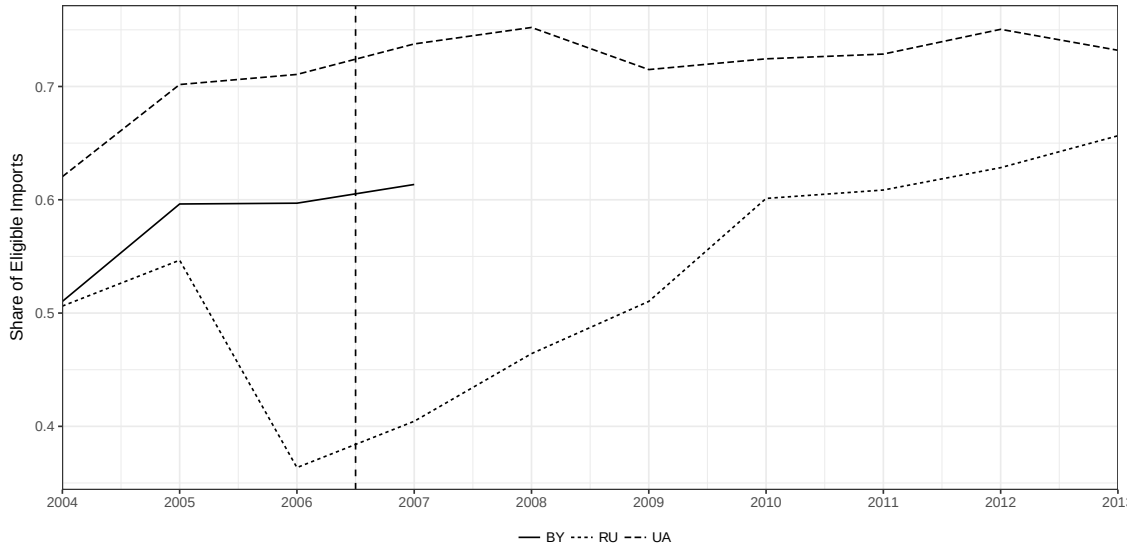


(b) Excluding Mineral Fuels



Source: Authors, based on COMEXT database

FIGURE 3
EU GSP Preference Utilization Rate, by Country



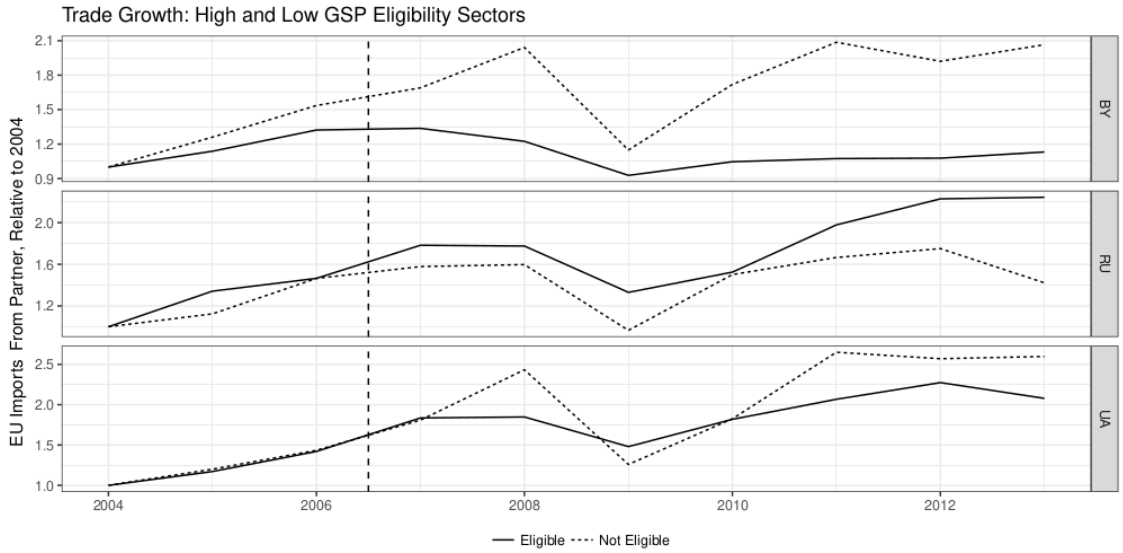
Source: Authors, based on COMEXT database

4. Empirical Analysis

This section conducts an empirical assessment of the impact of GSP removal on the exports of Belarus using product variation in GSP eligibility. Figure 4 shows the exports of GSP eligible products compared to non-eligible products for Belarus, Russia and Ukraine relative to 2004, excluding mineral fuels. The figure presents first evidence that Belarus' GSP eligible sectors have suffered from the loss of GSP preferences. All trends except the GSP eligible exports of Belarus show large growth over the sample period relative to 2004, bar the drop in the crisis year 2009. GSP eligible exports of Belarus show a similar pattern until 2007, the withdrawal year. However from 2008 growth turns negative until the exports of the goods that used to be eligible for GSP converge to values close to the 2004 level. Next, we proceed to the regression analysis to assess the impact of GSP withdrawal on the GSP eligible sectors of Belarus.

For our regression analysis we apply the triple differences in differences approach as in Frazer and Van Biesebroeck (2010), Hakobyan (forthcoming) as well as Thelle et al.

FIGURE 4
Exports of GSP eligible and non-eligible sectors, 2004=1, by Country



Source: Authors, based on COMEXT database. We define an HS-4 sector as GSP eligible if more than 95% of its trade is eligible for GSP, and not eligible if less than 5% of trade is covered by GSP preference. See also section 3.

(2015). The method explores the difference in trade flows over time between affected and non-affected countries, and between affected and non-affected products. In our case, we exploit the differences in the imports of EU GSP eligible products from Belarus relative to GSP non-eligible products before and after GSP removal and relative to the imports from Ukraine and Belarus that did not lose EU GSP (note, however, that Ukraine lost the US GSP preferences in 2001 and had them reinstated in 2006).

We estimate the following empirical specification:

$$ln\text{Imports}_{jpt} = \beta \left(\text{GSPremoval}_{jt} \times \text{GSPeligible}_{p}\right) + \gamma_{jp} + \delta_{jt} + \theta_{pt} + \epsilon_{jpt} \qquad (1)$$

where $\gamma_{jp}, \delta_{jt}, \theta_{pt}$ denote the exporter-product, exporter-time and product-time fixed effects, respectively. GSPremoval_{jt} is a dummy variable equal to 1 if the exporter is Belarus and years are up to 2007. GSPeligible_{p} is a dummy variable that equals to 1 if the 4-digit sector for which at least 95% (80% is used in some regressions) of exports

to the EU were eligible for GSP benefits. The dummy is equal to 0 (non-GSP product) if at most 5% (20% in some regressions) of the sector's exports were eligible for GSP. We exclude the sectors that could not be clearly classified as GSP or non-GSP product. Only a small minority of 4-digit sectors cannot be attributed to GSP or non-GSP products as it can be seen in Figure A1.

Next, we turn to estimating the effect of the removal of GSP on the probability to export a certain good. We follow Hakobyan (forthcoming) and apply a linear probability model to assess the effect of the loss of GSP benefits by Belarus at the extensive margin. The model estimates the probability of having positive exports to the EU. The dependent variable is a dummy that equals to one when there was a non-zero export of a product.

Table 1 presents the estimation results. Column (1) contains all products from sectors where GSP eligibility is less than 5% or greater than 95%, including those where either Belarus does not export to the EU or the exports are very small. For this sample, the estimated impact of the GSP removal is 29% ($e^{-0.34}$). This means that the Belarusian exports to the EU of GSP sectors were 29% lower due to GPS removal. Next, column (2) defines as a GSP product a sector with at least 80% of exports eligible for GSP benefits and as non-GSP product a sector with at most 20% of GSP eligible exports. The removal of GSP has a negative 26% ($e^{-0.30}$) effect on exports for affected Belarusian sectors. The results in columns (1) and (2) are very similar. Hence, the exact definition which 4-digit exports are GSP or non-GSP products has almost no impact.

Columns (3) and (4) restrict the sample to the products that have an export value from Belarus to the EU of at least EUR 100 000 in each year prior to the removal of GSP (2004-2006). We therefore limit the sample to the goods that are relevant for the exports of Belarus and remove the noise from products with very small export values. GSP sectors in this sample experienced smaller effect from the removal of Belarus' GSP benefits. The exports of GSP-eligible sectors were about $17 - 20\%$ lower due to the removal of GSP. Smaller export sectors were affected most by the removal of benefits suggested by the larger effect in the full sample.

Finally, columns (5) and (6) present the analysis for the extensive margin. In line with the expectations, the removal of benefits had a trade-stifling impact on the extensive margin as well. The removal of Belarusian benefits reduced the probability of exporting to the EU by $2 - 3\%$ for the GSP eligible products.

Our coefficient estimates suggest a larger impact of GSP than found in the prior

TABLE 1
Regression Results

	(1)	(2)	(3)	(4)	(5)	(6)
Dependent Variable	Log Trade Value				Extensive Margin	
GSP Eligibility	95/5%	80/20%	95/5%	80/20%	95/5%	80/20%
Trade Value Restriction			≥EUR 100 000	≥EUR 100 000		
GSPremoval×GSPeligible	-0.34^{***}	-0.30^{***}	-0.22^{*}	$-0.18^{\dagger}$	-0.02	-0.03^{*}
	(0.10)	(0.09)	(0.11)	(0.10)	(0.01)	(0.01)
Fixed Effects	exporter-product, exporter-time and product-time fixed effects					
Observations	19900	26207	5325	6781	29610	37230

$^{***}p < 0.001$, $^{**}p < 0.01$, $^{*}p < 0.05$, $^{\dagger}p < 0.1$

Source: Authors

literature. Hakobyan (forthcoming) studies the trade impact of a temporary suspension in the US GSP program, which affected *all* countries. She finds that the interruption in GSP was associated with a 3% fall in exports, even though the exporters could have reasonably expected to receive reimbursement for preferences later. One reason why our estimate is larger, differences between US and EU GSP programs aside, is that the withdrawal of preferences *for an individual country* may encourage more trade diversion than wholesale suspension of the program. Thelle et al. (2015) find that the removal of EU GSP preferences leads to a 5% fall in exports on average; their main source of variation is the graduation of countries due to high export growth and becoming "too competitive". Presumably, sectors that graduate have developed a comparative advantage and thus one should not be surprised that the trade impact of preference withdrawal is smaller; in contrast, the largest beneficiaries of GSP in Belarus (by GSP export share) were industries where Belarus had no comparative advantage, such as footwear. Such industries may no longer be viable once the trade preference has been withdrawn.

5. Conclusion

After Belarus lost its GSP preference, total exports to the EU did not decline. However, there is a statistically significant and economically important adverse trade impact

on those industries that benefited from the program. Among the beneficiary sectors, exports fell by more than a quarter due to the withdrawal. The effect is especially strong for products where the exports to the EU were small. When considering only sectors with more EUR 100 000 trade value per year, the GSP withdrawal effect shrinks to $17 - 20\%$. However, the overall impact on the economy was limited, because the most important export products – fuels and fertilizers – were not covered by the GSP.

These findings suggest that any political leverage deriving from the EU GSP program cannot rely on aggregate economic effects. Limited tariff sectoral coverage and low preference margins are the key obstacles. This leaves only sectoral impacts as an alternative leverage channel – if politically connected industries stand to lose from GSP withdrawal, they may lobby national governments to satisfy GSP requirements. This channel would be similar to political "smart sanctions" (Drezner, 2011), such as travel bans, which target narrow groups of politically influential individuals. However, since GSP industries are not chosen based on political considerations, this channel is likely to have limited impact.

In future research, it would be interesting to address the trade impact of the EU EBA and GSP+ programs. The latter includes more broad tariff elimination in return for more substantial political commitments by the recipient state. To the extent that EBA and GSP+ programs have stronger trade impacts, they may also generate more political leverage.

6. References

Carnegie, A. (2015). *Power plays: how international institutions reshape coercive diplomacy*. Cambridge University Press.

Drezner, D. W. (2011). Sanctions sometimes smart: targeted sanctions in theory and practice. *International Studies Review*, 13(1):96–108.

Frazer, G. and Van Biesebroeck, J. (2010). Trade growth under the african growth and opportunity act. *The Review of Economics and Statistics*, 92(1):128–144.

Gassebner, M. and Gnutzmann-Mkrtchyan, A. (2018). Politicized trade: What drives withdrawal of trade preferences? *Economics Letters*, 167:10–13.

Hajduk, K. and Silitski, V. (2007). After the gsp withdrawal: the case for the revision of the eu policy towards belarus. *Belarusian Institute for Strategic Studies, http://pdc. ceu. hu/archive/00003465*, 12(09).

Hakobyan, S. (forthcoming). GSP Expiration and Declining Exports from Developing Countries. *Canadian Journal of Economics*.

Hoekman, B. M. and Özden, Ç. (2005). *Trade Preferences and Differential Treatment of Developing Countries: A Selective Survey*, volume 3566. World Bank Publications.

Lederman, D. and Özden, Ç. (2007). Geopolitical interests and preferential access to us markets. *Economics & Politics*, 19(2):235–258.

Oram, A. and Gorska, G. (2012). EU trade policy and Human Rights. Online; accessed on 12.06.2019, http://trade.ec.europa.eu/doclib/docs/2012/february/tradoc_149077.pdf.

Ornelas, E. (2016). Special and differential treatment for developing countries. *Handbook of Commercial Policy*, 1:369–432.

Ornelas, E. and Ritel, M. (2018). The not-so-generalized effects of the generalized system of preferences.

Rettman, A. (2007). Belarus joins Burma as EU trade outcast. Online; posted 21-June-2007.

Thelle, M., Jeppesen, T., Gjødesen-Lund, C., and Biesebroeck, J. V. (2015). Assessment of economic benefits generated by the E.U. Trade Regimes towards the developing countries. *European Commission, DEVCO*.

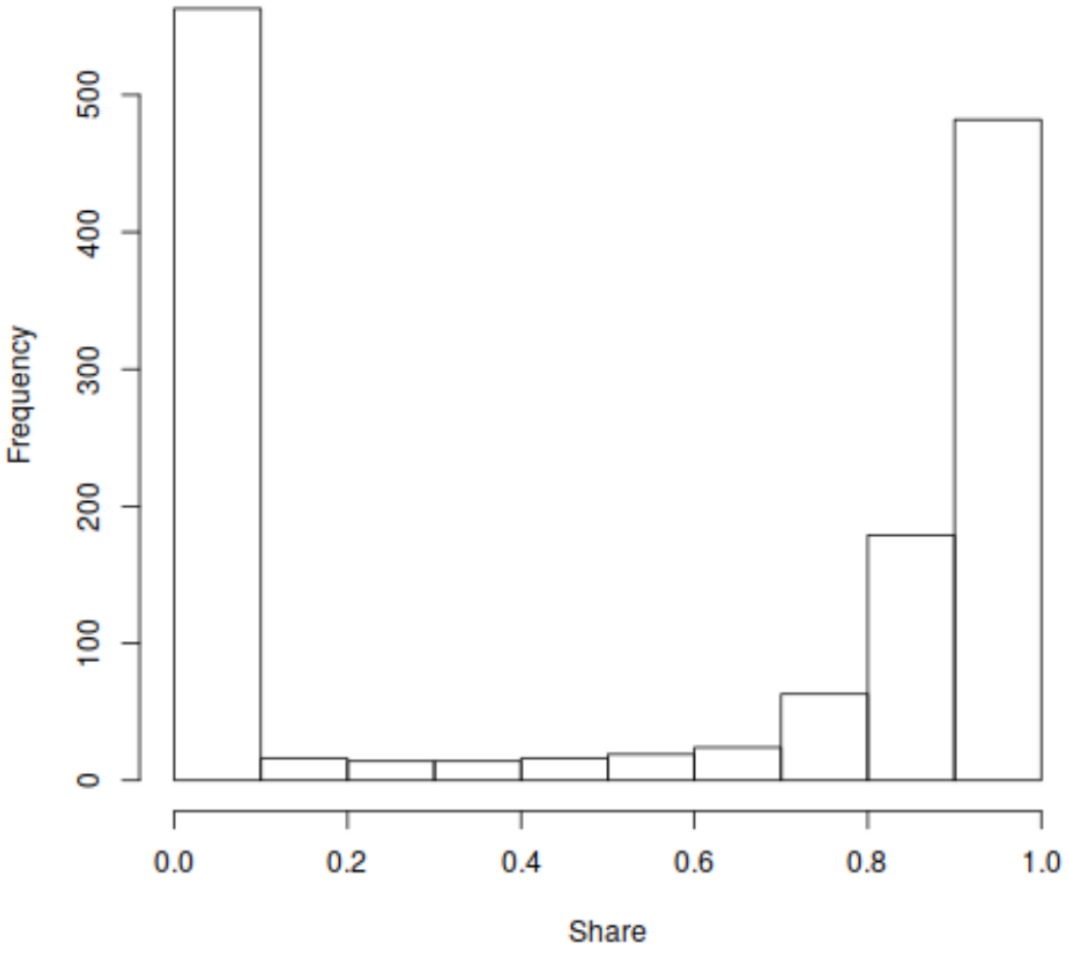
UNCTAD (2015). GSP – Handbook on the scheme of the European Union.

Vicheika, K. (2019). EU Commissions Completes Preliminary EBA Report, Sam Rainsy Says Pressure on EBA Working . Online; accessed on 15.11.2019, https://www.voacambodia.com/a/eu-commissions-completes-preliminary-eba-report-sam-rainsy-says-pressure-on-eba-working/5163852.html.

Zhou, W. and Cuyvers, L. (2011). Linking international trade and labour standards: the effectiveness of sanctions under the european union's gsp. *J. World Trade*, 45:63.

Appendix

FIGURE A1
EU GSP Preference Utilization Rate, by Country



Source: Authors, based on COMEXT database