Preference Erosion

The Case of Everything but Arms and Sugar

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Motivation

The European Union's Everything But Arms agreement was designed to make poor countries better off. But this noble goal might be overshadowed by some unwanted by-effects. In this work we are taking a close look at a phenomena called Preference Erosion!

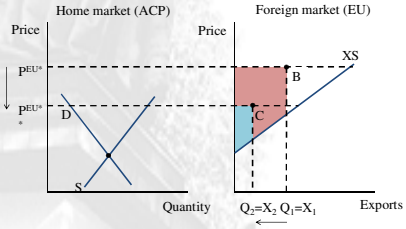
Policy

- Preference Erosion is a recent example for the truism that every policy creates winners and losers:
- The Everything But Arms (EBA) agreement grants unlimited access to the European sugar market for the Least Developed Countries (LDCs).
- There had been other preferential trade agreements in place before between the EU and the African, Caribbean Pacific (ACP) countries.
- The increased supply through EBA led to a decrease in the EU prices for sugar, as well as a reduction in the quotas for ACP countries.
- The existing preferences of the ACP countries had been of more value in the preceding, more rigorous trade regime.
- It follows that the ACP countries, which were already enjoying preferences before, were expected to lose from the consequences of the EBA.

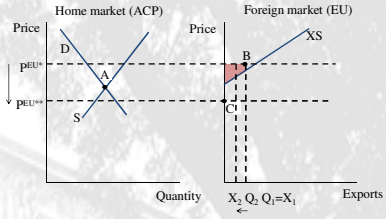
Consequences

In the following market diagrams, the impacts of the recent policies on four representative economies are depicted. The respective home markets are shown in the left part of each diagram, while the right part includes the export supply curve, as well as the changes of the prices and quotas the countries face due to the policy changes: a lower EU intervention price, newly duty free access for LDCs and an increase in their quotas.

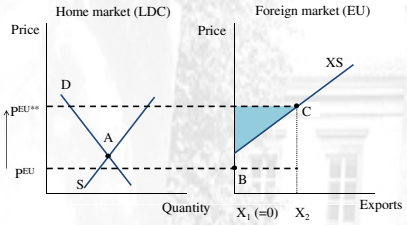
Case 1: An ACP country that faces a lower price and less quotas: it unambigously loses, but is still competitive.



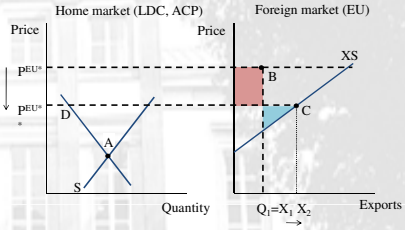
Case 2: An ACP country that faces a lower price and less quotas: it unambigously loses and is not competitive anymore.



Case 3: An LDC country that faces a higher price and no quantitative restrictions: it unambigously wins.



Case 4: An LDC and ACP country that faces a lower price and no quantitative restrictions: ambigous outcome.



Econometric Results

VARIABLES	*Fixed Effect OLS*	*Fixed Effect Poisson*
EBA	0.953*	0.642***
	(0.0807)	(0)
SP	-1.189***	-0.812***
	(0.00610)	(0)
SP_X_EBA	-0.235	
	(0.764)	
log_sug_production	0.884	9.48e-08***
	(0.383)	(0)
polity2	-0.137***	-0.0291***
	(7.12e-05)	(0)
log_PPP_conversion	-0.385	0.532***
	(0.760)	(0)
Constant	-1.161	
	(0.927)	
Observations	161	207
R-squared	0.746	
Number of sections	24	24

(Robust p-values in parentheses. Year and country fixed effects are not reported)

Gravity Model Specification

For the empirical analysis the gravity model is applied. Following the derivation of Anderson and van Wincoop (2003), the following model has been estimated:

$$\ln T_{ij}^{k} = EBA_i + SP_i + SP\_X\_EBA_i + D^i + \ln sugprd_i^k + polity_i^k + \ln exrate_i^k + \sum_k year^k$$

T_{ij}^{k} are the mono-directional trade flows of sugar from country i into the EU; EBA_i, SP_i and $SP\_X\_EBA_i$ are dummies that capture the policy change; D^i is a dummy that captures a fixed effect for every country; $sugprd_i^k$ stands for the size of the sugar sector in each country; $polity_i^k$ is an index for the sort of political regime in the exporting nation and $exrate_i^k$ controls for the exchange rate. $year^k$ captures common macroeconomic shocks.

Conclusions

- Did poorer countries profit from the EBA?
- Answer is ambiguous
- Increased sugar export of the LDCs
- But Preference Erosion did occur
- ACP countries are clearly worse off today than they had been before the introduction of the EBA.

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