

## **Preferential Programs Are Not Fully Used**

Being granted preferential market access does not mean countries can automatically export all products that are covered by programs, without any restrictions. According to Laird and Sapir, one of the major impediments that can reduce the potential usefulness of these programs for beneficiaries is their administrative complexity. Indeed, the U.S. General Accounting Office (GAO) found that the complexity of eligibility requirements, especially the level of accounting sophistication required for compliance can create disincentives for producers in recipient developing countries (U.S. General Accounting Office, 2001). (Note: GAO changed its name in 2004 to the Government Accountability Office. Sources cited herein are pre-2004.) Among donors' regulations, complex "rules of origin" are most often cited as the primary limiting factor restricting beneficiary countries' ability to fully utilize tariff preferences.

Rules of origin specify where and how goods can be produced in order to qualify for preferences. They are meant to ensure that the benefits of preferential tariff treatment are confined to products that are for the most part produced or manufactured in the beneficiary countries. Products that originate in third countries and merely pass in transit through, or undergo only minor or superficial processing in, a preference recipient country are not entitled to benefit from preferential tariff treatment. Producers in beneficiary countries may use imported materials to produce goods for export, provided the inputs comply with specific criteria outlined in the rules of origin for the preference program. For example, under U.S. programs the rules of origin require that the sum of the cost or value of the materials produced in the beneficiary country plus the direct costs of processing equals at least 35 percent of the appraised value at the time the product enters the United States.

In recent years, both the U.S. and EU have reformed their rules-of-origin requirements. To provide greater flexibility, certain regional groupings are considered as one area for the purpose of complying with the 35-percent local content requirement. For example, a manufacturer under the CBERA program can use imported materials from another regional beneficiary country (or from the U.S.) and the imported materials will be counted toward the minimum value-added threshold.

The cost of complying with program rules is another factor that could limit recipients' ability to use nonreciprocal preferences. In cases where the margin of preference is low, the potential price gains from utilizing preferences may be cancelled out by the costs of meeting eligibility criteria. This would seem to be more of a concern to small exporters. A good portion of these costs are fixed, which means the larger exporters can spread them out over greater quantities.

Numerous studies have reviewed preference program utilization rates, the ratio of the value of imports that received preferences to the value of imports that were eligible for preferences. Measuring utilization rates by program has proven to be very difficult since many countries qualify for preferences under more than one program. Overall utilization rates for U.S. and EU programs tend to be fairly high, although there can be considerable swings

by country and year. Despite overall utilization rates over 85 for both U.S. and EU programs, the main finding of every study we reviewed concluded that granting preferential market access to developing countries does not translate into full utilization of the programs nor does it result in increased exports for all countries. Among the reasons are weak institutional capacity and a lack of human and financial resources to effectively administer these programs. The lack of stability and predictability of these programs and tariff rates is one of the main reasons why utilization rates differ from one year to the next. A lack of knowledge about preferential programs on the part of program beneficiaries could be another reason for preferences going unutilized (U.S. General Accounting Office, 2001). To take advantage of preferential programs, potential program recipients need to understand the complicated tariff systems of the preference-giving countries and be able to keep abreast of periodic changes. In many cases tariffs for these agricultural products vary by season or there are timetables for imports under preferential programs. For countries with limited administrative capacity, the costs of monitoring that information could outweigh the benefits.