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March 2017

Trade Preferences Removal – The Case of Belarus

How does the removal of trade preferences influence the exports of the affected country? We study this question on the example of Belarus' loss of trade preferences granted by the EU to developing countries. Our brief argues that trade preferences are most important for simple non-manufactured goods. As a result, removal of trade preferences should increase the manufactured goods in the export structure. Indeed, the overall complexity of Belarusian exports was not harmed by the removal of EU preferences and the manufactured exports increased relative to non-manufactured exports.



Belarus losing trade preferences

As a developing country, Belarus used to receive trade preferences from the US and EU. These preferences grant duty-free imports or provide a discount on the import tariff under the so-called Generalized System of Preferences (GSP). The preferences are provided on a unilateral basis to developing countries and can also be removed on a unilateral basis for various reasons. Their stated objective is to support the economic development of poorer countries (Ornelas 2016). In particular, the US removed Belarus' preferences in 2000 for worker rights violations. Later, the EU removed the preferences in 2007 for similar reasons. It is a relevant question for policy to understand how the removal of trade preferences affected exports.

This brief discusses the effect of trade preferences removal on the value of Belarus' exports to the EU and on the structure of exports. Utilization of trade preferences might not be uniform across sectors. In fact, a preference-receiving country should satisfy the Rules of Origin (ROO) requirements and demonstrate that a large enough share of the exported product was produced in the country. This requirement might be more difficult to satisfy for complex manufactured goods with many components from several countries (Hakobyan 2015). Exporters of such products might find satisfying the ROO more costly than what they could gain from receiving an import tariff preference. Exporters of simple or raw products, on the other hand, face a lower cost of demonstrating the origin.

The remainder of the brief develops the hypothesis of a differential impact of trade preferences removal on manufactured and non-manufactured goods; and makes an event study of Belarus' loss of EU trade preferences in 2007. Our findings suggest that GSP withdrawal affected disproportionately non-manufactured exports, leading to an increase in the

manufacturing exports share. This means that harm caused by losing trade preferences was, to some extent, reduced by higher incentives to export more complex manufactured exports.

The complexity of Belarusian exports

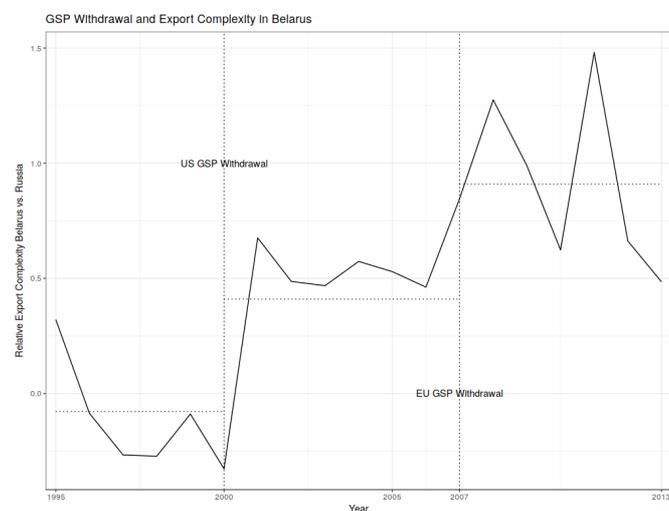
To understand the overall structure of Belarusian exports, we first look at the complexity of Belarusian exports over time. Figure 1 presents the economic complexity index (ECI), developed by Hausmann et al. (2014), of exports of Belarus relative to Russia from 1995 to 2014. The ECI measures the diversity and ubiquity of a country's exports. It considers the number of products a country exports with revealed comparative advantages and how complex these products are. In turn, the complexity of the products is accessed by a so-called product complexity index, PCI. It is determined in an analogous fashion: if few countries are able to export a good and these countries have diversified exports, this product is complex. For example, fertilizers and oil (important exports of Belarus) have low complexity scores, as countries that export these products tend to not have diversified exports.

Figure 1 shows that the difference between the economic complexity of Belarus and Russia increased following the two incidents of Belarus losing trade preferences; first from the US and then from the EU. The incidents of removal of trade preferences are associated with an increase in economic complexity of Belarusian exports relative to Russia. That is, the export of more complex manufactured goods became more important in the export basket of Belarus when it lost the trade preferences. This is consistent with the hypothesis that trade preferences are more important for simpler goods, and following a preference removal their share will go down. Russia is chosen for comparison due to its similarity in economic perspective (economies in transition, similar complexity, GDP trends, dependence on oil and fertilizer prices) and because it also received trade preferences from



both the US and EU throughout the considered period.

Figure 1. GSP withdrawal and Export Complexity in Belarus relative to Russia



Note: the figure presents the ECI of Belarus over ECI of Russia in logarithmic form. Source: Authors' calculations using the ECI data from the Observatory of Economic Complexity.

Export structure of Belarus

To make a first pass at understanding how GSP withdrawal affects the composition of exports, we conduct an event study centered on the year of 2007, when the EU withdrew its GSP preferences for Belarus. We consider the three years before and after the revocation, and benchmark the share of manufacturing exports from Belarus to the EU with its share of manufacturing exports to the US. Since the US had already withdrawn its preferences earlier, its trade regime with Belarus stayed unchanged throughout the period. This makes the US a natural point of comparison to understand the effect of GSP withdrawal.

Findings

As Figure 2 shows, the average share of manufactured products in Belarusian exports to the EU increased slightly after the GSP withdrawal, increasing to 40.4% from its earlier level of 37.9%. At the same time, mineral and fuel exports, though falling slightly, remain the

backbone of Belarusian exports accounting for 50% of total exports to Europe. Interestingly, the share of non-fuel exports to the EU remained approximately unchanged at 9%. In other words, the composition of exports to Europe did not drastically change after the GSP withdrawal, as had been anticipated by some ex-ante studies (e.g. BISS 2007).

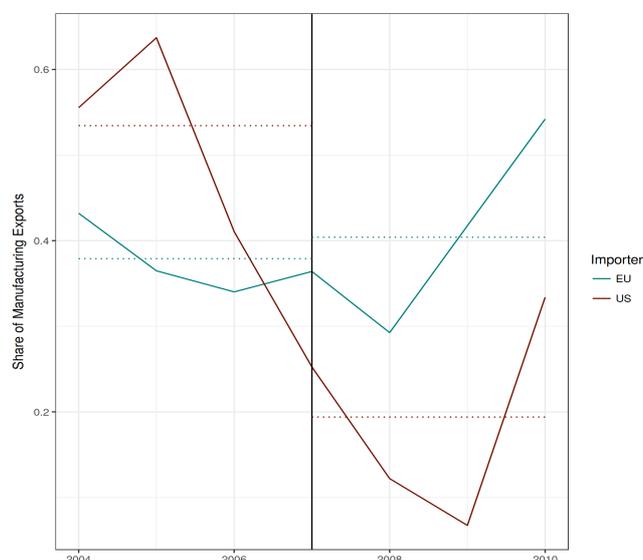
This comparison alone does not address the question of what might have happened to Belarusian manufacturing exports had the GSP preference not been removed. One possible counterfactual is that the trends in the European export market would have been the same as in the US, where Belarusian manufacturing exports massively lost ground. Their share decreased from 53.4% to 19.3%. Hence, a difference-in-difference estimator would suggest that perhaps the withdrawal of the GSP reduced non-manufacturing export growth to Europe. In turn, the Belarusian manufacturing export share is estimated to be 36.5% higher than it might have been if the GSP had not been withdrawn (statistically significant at the 1% level). This estimate may be a result of trade diversion of non-manufactured goods from the EU to the US. To the extent that non-manufacturing products benefit more from the GSP preferences, these should be stronger affected by trade diversion and would therefore reduce the manufacturing share of Belarus' exports to the US.

Alternatively, one could consider the Belarusian manufacturing export share in relation to Russia, within the European market. For Russia, there is a pattern of declining manufacturing shares. Before 2007, manufacturing accounted for 17.7% of exports to the EU, but afterwards it declined to 14.2%, a 2.5% fall. If Belarus had experienced the same trend, its manufacturing share would have fallen from 37.9% to 34.4%. Instead, Belarusian manufacturing share grew from 37.9 to 40.4%, which suggests that due to the GSP removal, the Belarusian manufacturing export increased by 6%. Given the smaller effect size and the short sample period, this increase is not statistically



significant. However, in economic terms, it would still be an important shift.

Figure 2. Share of Manufacturing Exports



Note: Manufacturing includes sectors 5, 6, 7 and 8 according to the SITC classification. Source: Authors' calculations using data from the UN COMTRADE.

Conclusion

Although development is one of the main goals of the GSP, there is little evidence that the EU's Generalized Scheme of Preferences supported the development of advanced industries in Belarus. To the contrary, after the GSP withdrawal the export complexity of Belarus increased relative to that of Russia. There is also some suggestive evidence that the GSP may have encouraged an export profile more focused on non-manufactured products, for which rules of origin are easier to satisfy in practice. More research is

clearly needed, not least to analyze other cases of GSP withdrawal for external validity.

Our preliminary findings suggest that GSP in its current form might have created incentives for exporting relatively simple goods, thus creating a risk of "middle-income trap". Policy implications are twofold: First, the goal of preference programmes like the GSP is development, i.e. more advanced economy with more complex production, and if the preferences in fact foster simple exports, it could create a barrier to development; Second, removal of preferences might have a large negative impact overall but the observation that it removes the previous incentive of producing simple non-manufacturing goods can be seen as positive and thus cushion the negative impact.

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