



**Preferential RoO:  
Past, Present,  
and Future**

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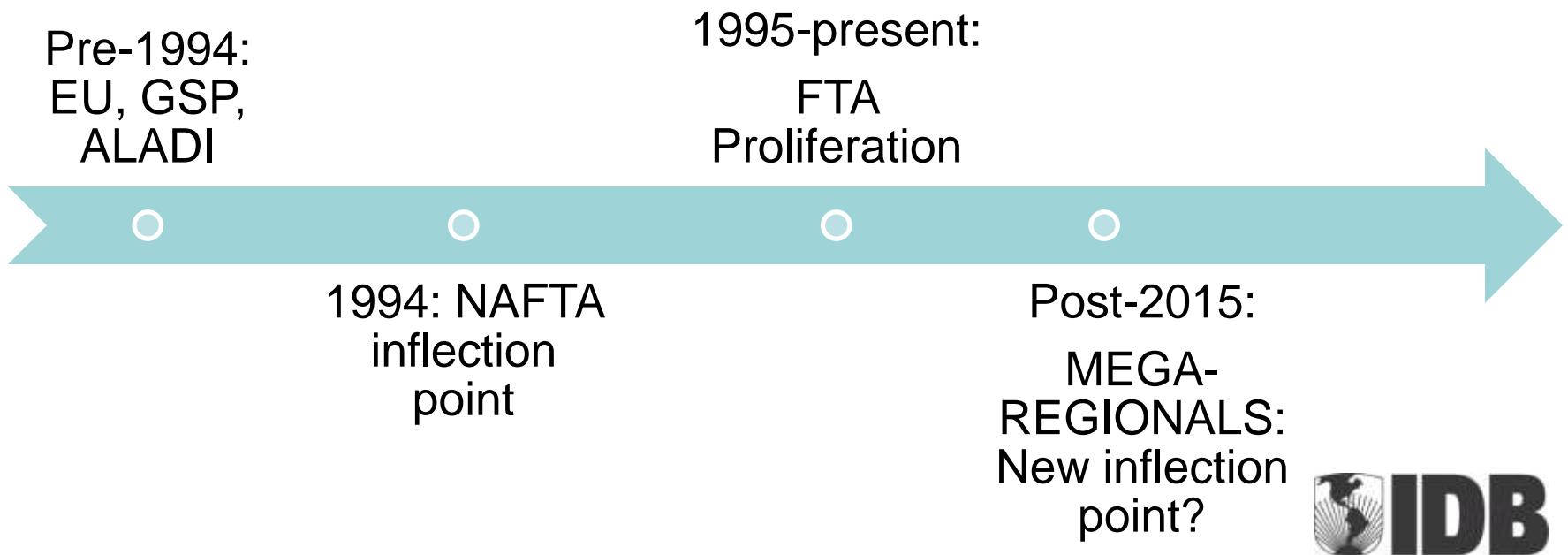
- Some Context on Preferential RoO
- Drivers of Change
- State of Knowledge
- Coming Challenges and Opportunities

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- **Some Context on Preferential RoO**
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# Some Context on Preferential RoO

“...any quick-witted Dutchman could find ways around the Navigation Acts. Whereas the Act forbade any foreign vessels to bring to England goods that were not manufactured in the shipper’s own country, it was agreed in 1667 that certain goods from the Dutch hinterland should be regarded as Dutch ... including German linens – provided they were bleached at Haarlem.” (Braudel, 1984)



# Some Context on Preferential RoO

- Pre-NAFTA RoO were rarely tailored for use as a trade policy instrument (across-the-board rules are arbitrary, like across the board tariffs)
- NAFTA innovated with extensive use of RoO to lock in sourcing patterns and becomes a powerful trade policy instrument in FTA design (extension of the NAFTA model)
- Economists generally ignored RoO until the mid-late 1990s (IDB early work in the development of methodologies that enabled measurement of RoO)

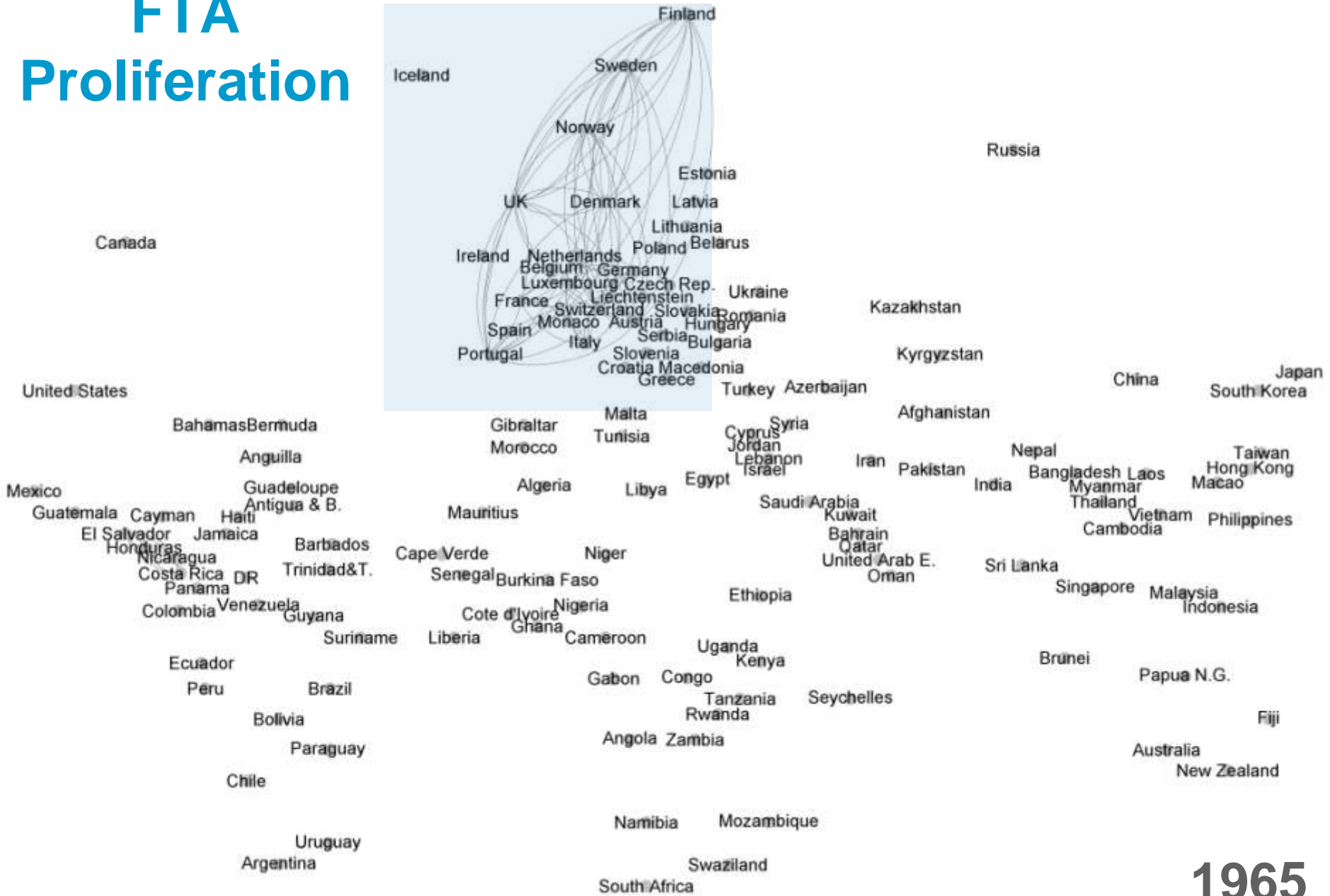
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# Drivers of the importance of RoO

- FTA Proliferation
- Fragmentation of Production in GVCs
- Falling MFN tariffs and increasing importance of transport and logistics costs
- Growing private sector's role in the design of trade policy

# FTA Proliferation



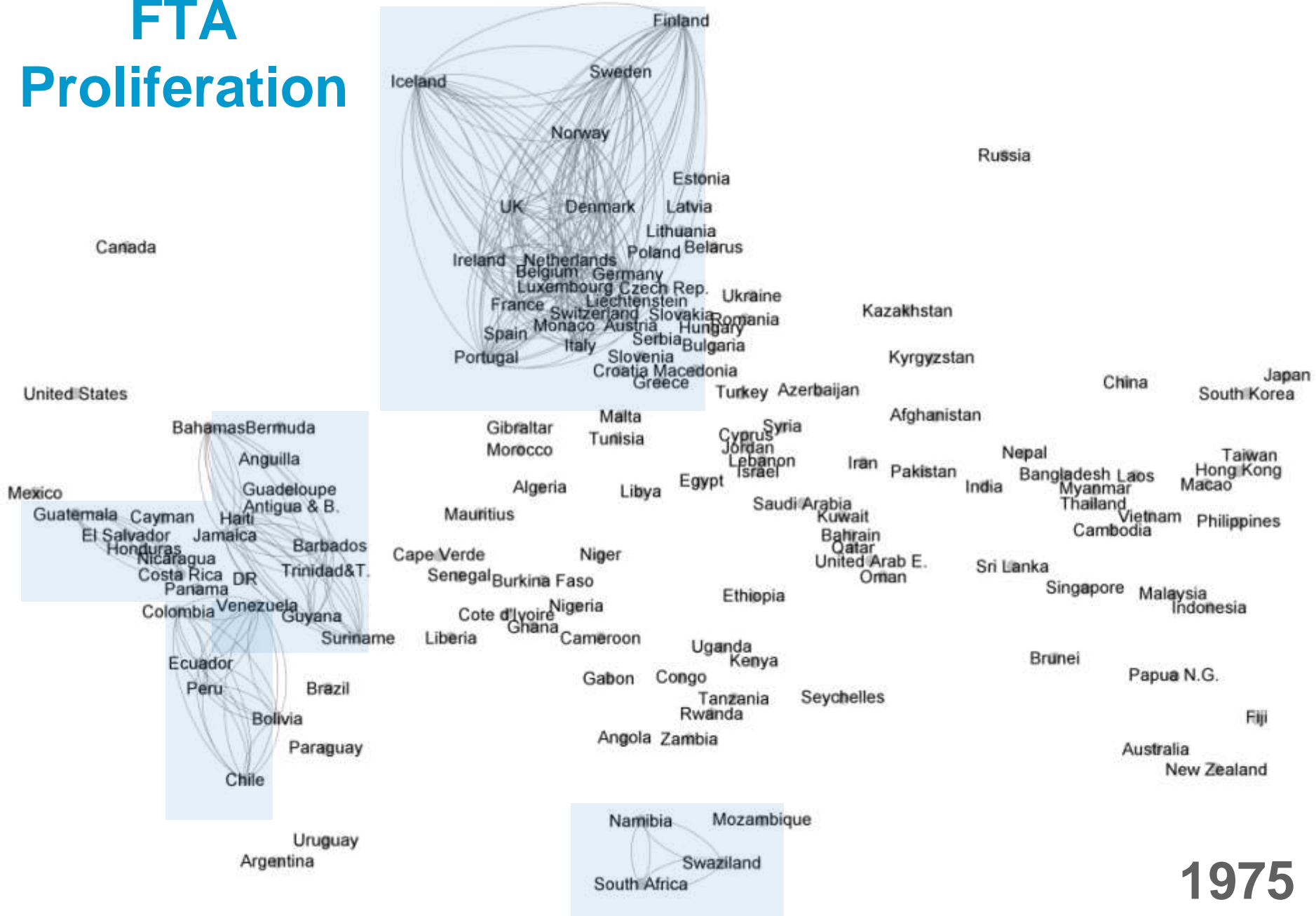
1965

Source: IDB Integration and Trade Sector based on INTrade.



# FTA

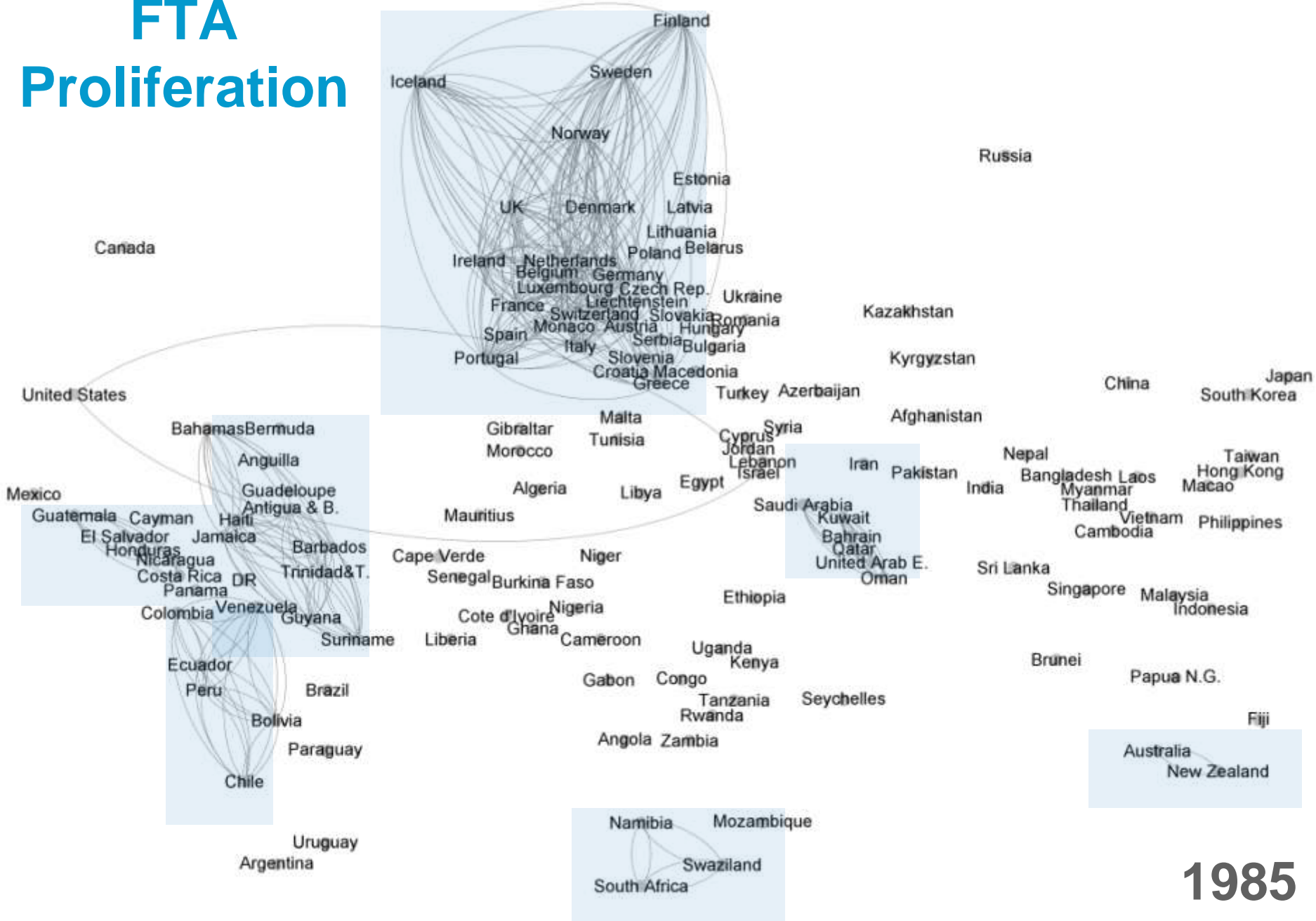
## Proliferation



1975

# FTA

## Proliferation

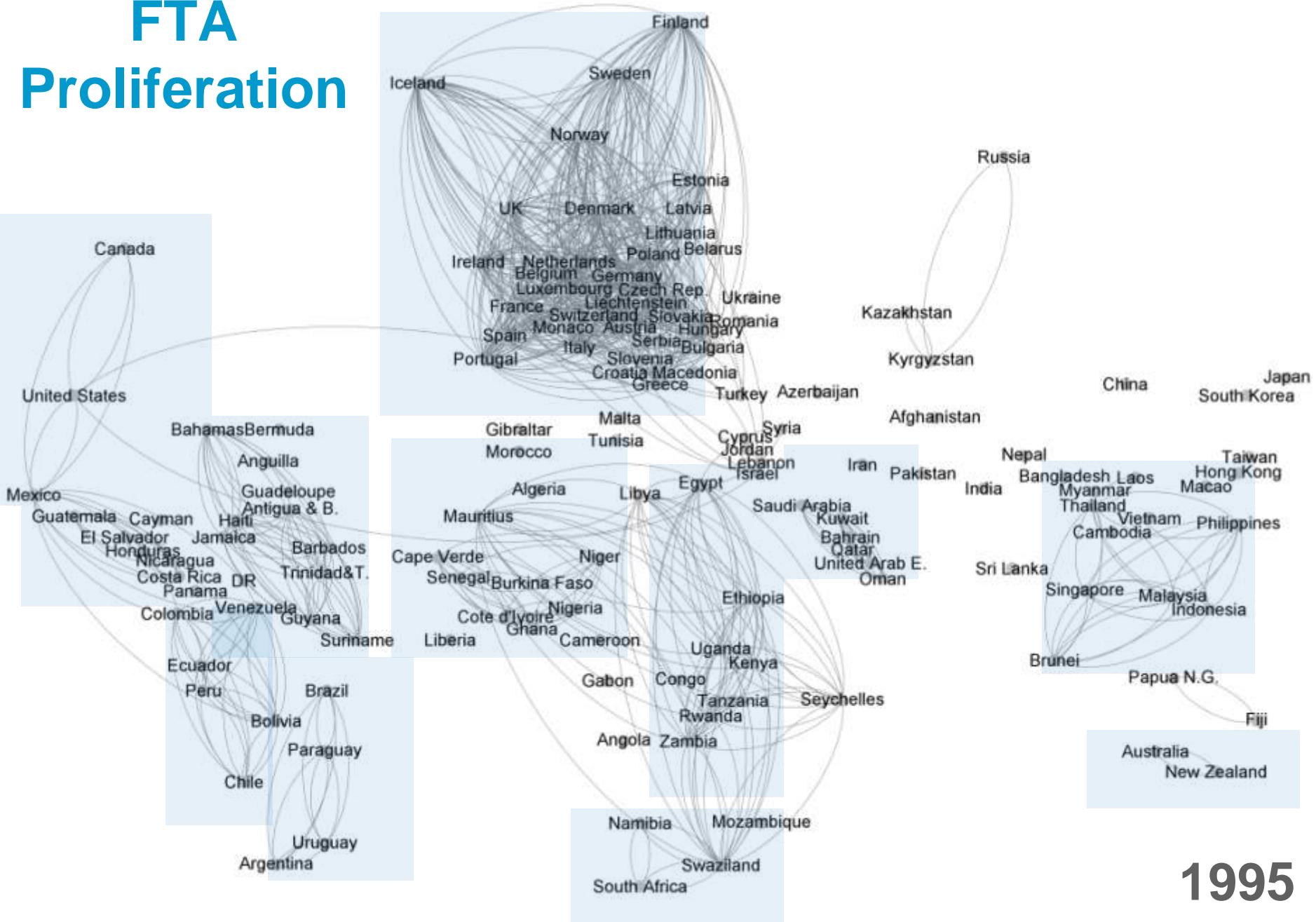


1985

Source: IDB Integration and Trade Sector based on INTrade.

# FTA

## Proliferation

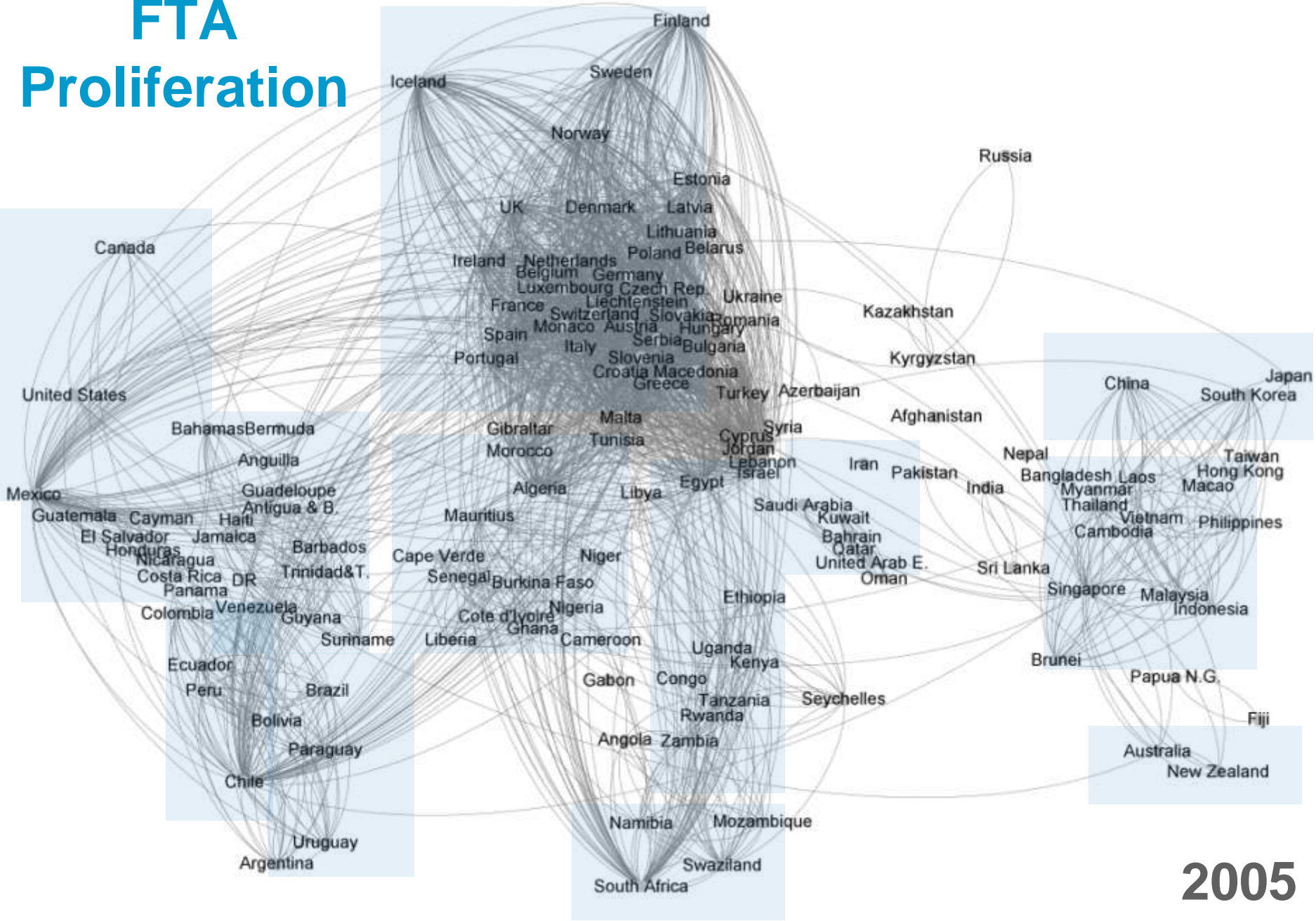


1995

Source: IDB Integration and Trade Sector based on INTrade.

# FTA

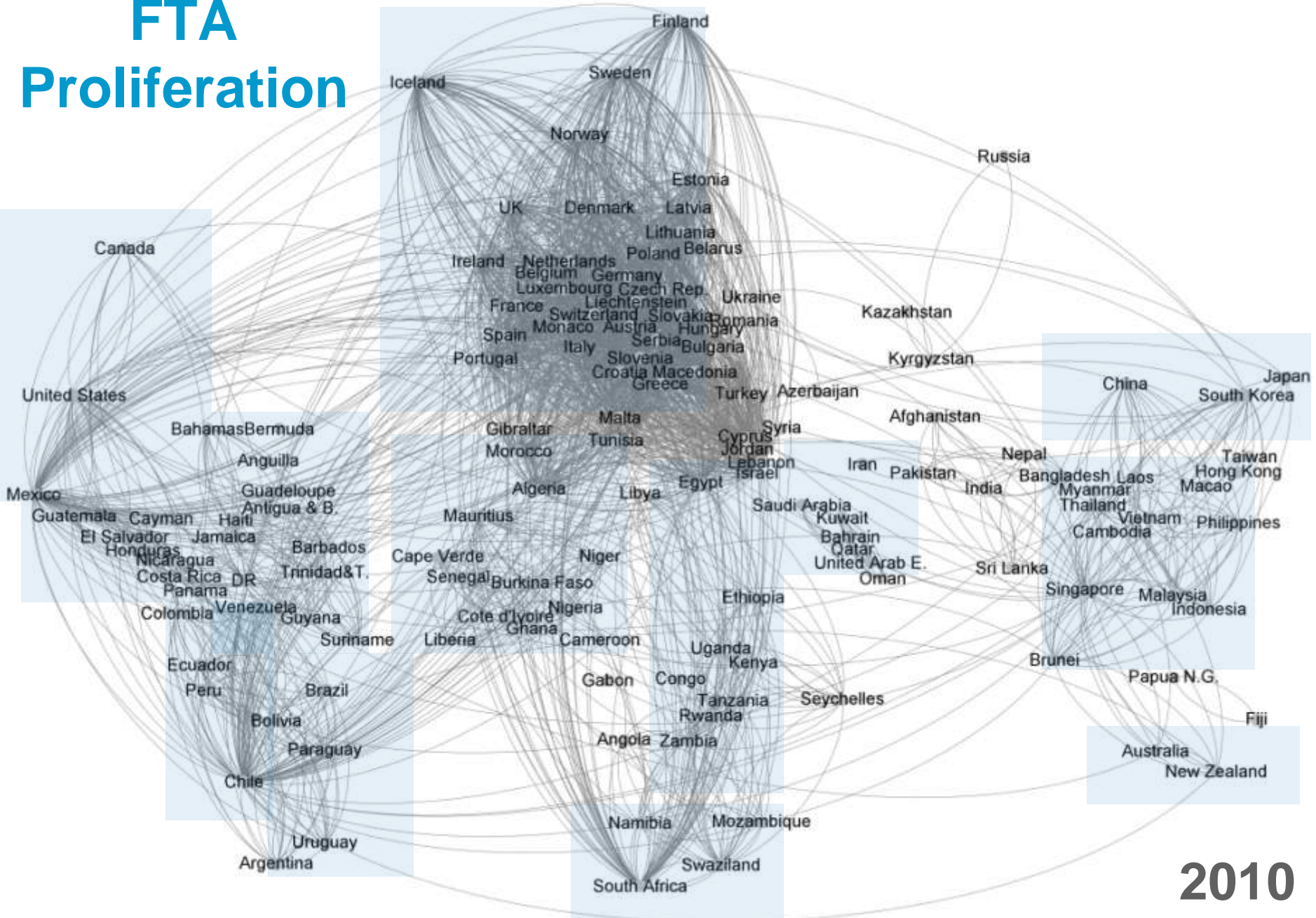
## Proliferation



Source: IDB Integration and Trade Sector based on INTrade.

# FTA

## Proliferation

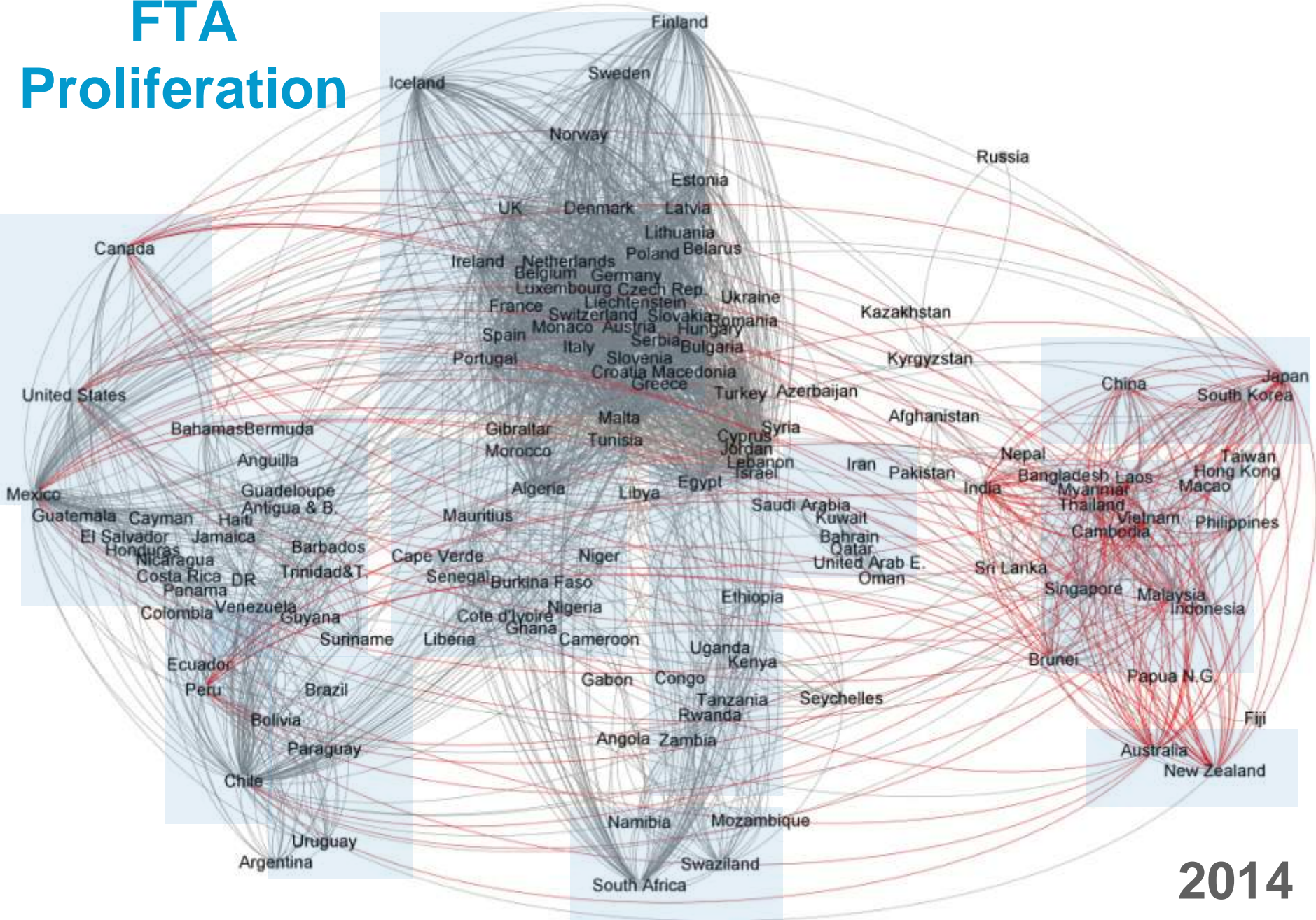


2010

Source: IDB Integration and Trade Sector based on INTrade.

# FTA

## Proliferation



2014

Source: IDB Integration and Trade Sector based on INTrade.

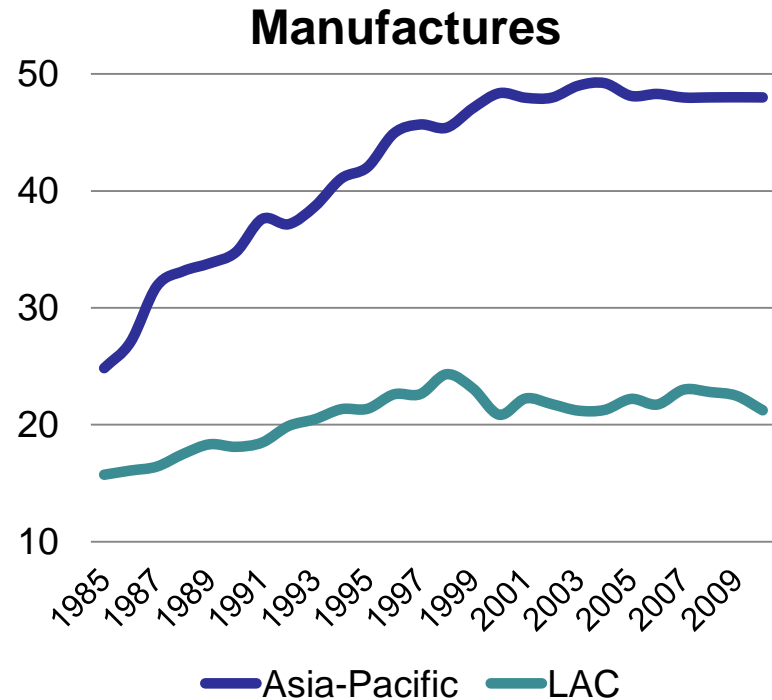
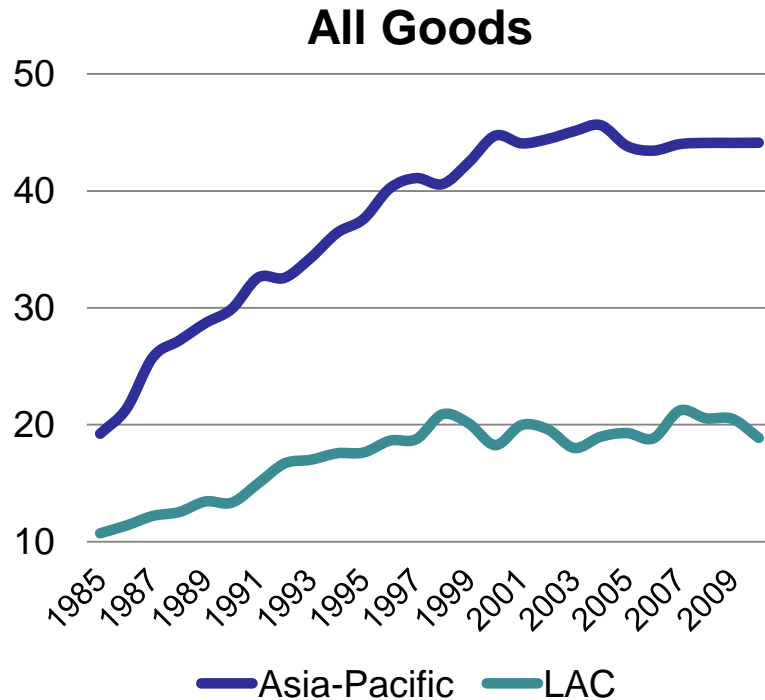
# FTA Proliferation

→ Multiple overlapping FTAs, each with different Product Specific Preferential RoO and cumulation zones, exponentially complicate firms' ability to serve all preferential markets.

# Global Fragmentation of Production in GVCs

## Intra-Industry Trade Indices

Regional averages, (1985-2010)



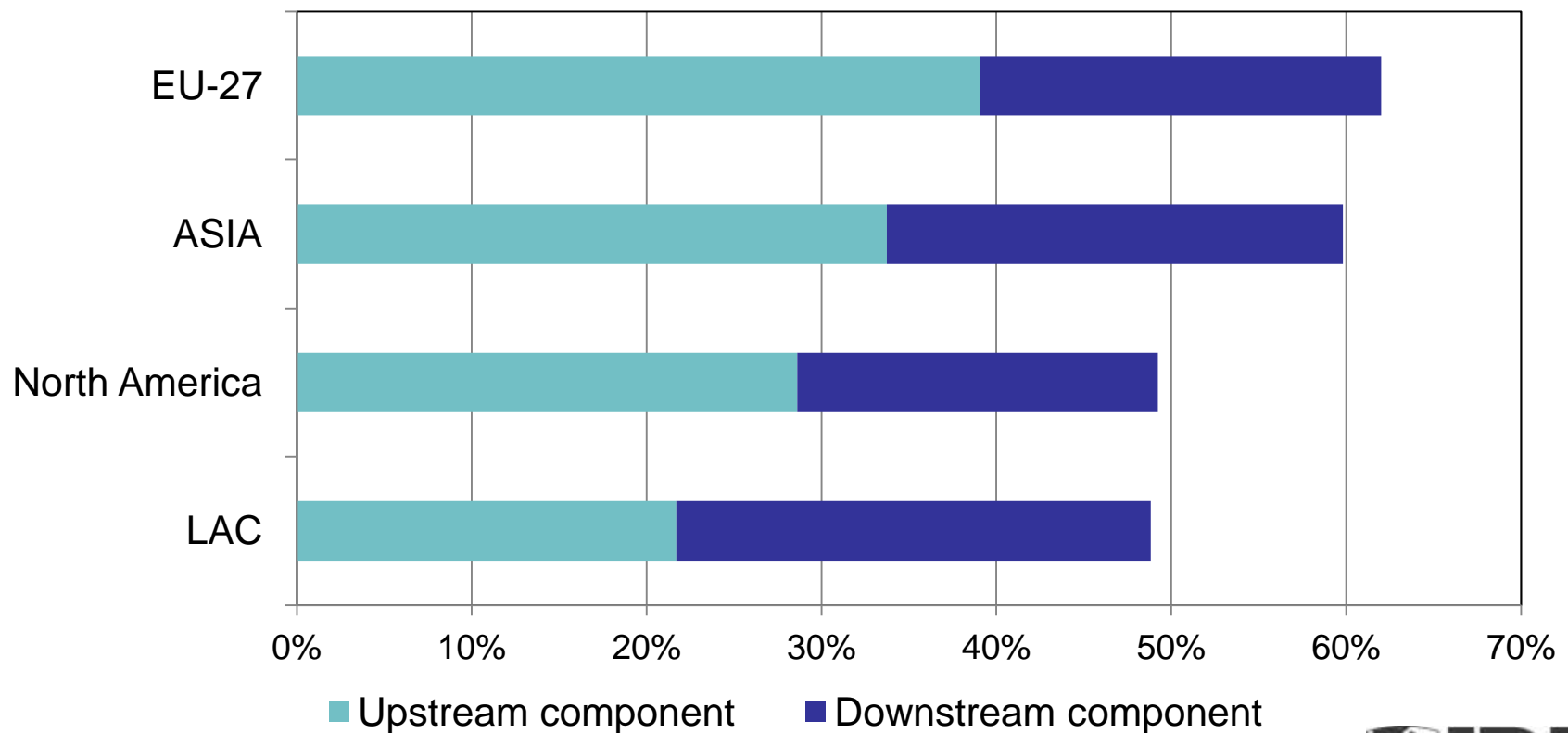
Intra-Industry trade has doubled in the past 30 years as firms increasingly export goods produced from imported materials, parts, and components.





# Global Fragmentation of Production in GVCs

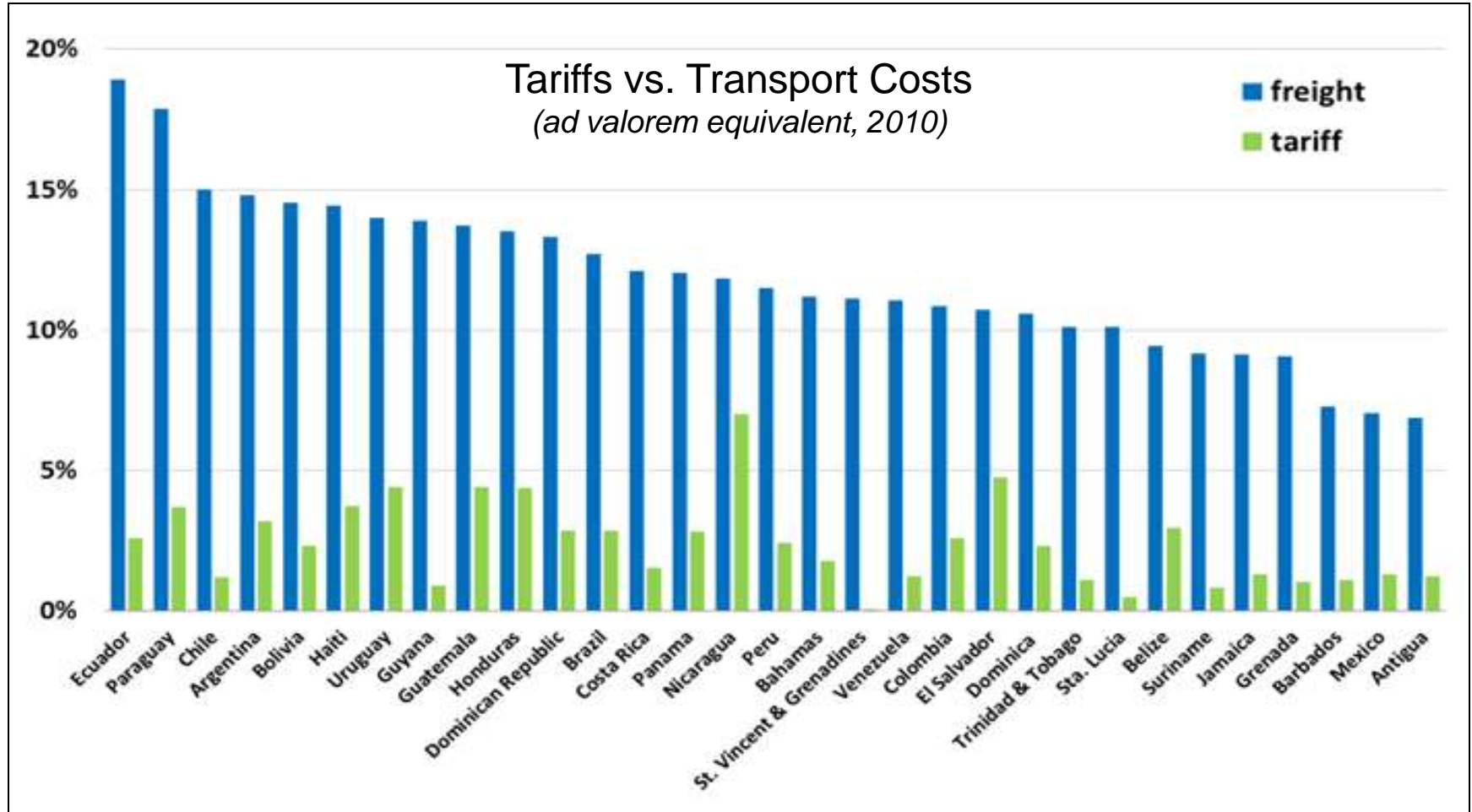
## Percentage of Exports in Multistage International Production Processes (average 2003-2010)



# Global Fragmentation of Production in GVCs

→ Dividing production across borders increases the difficulty of complying with RoO, and of documenting and verifying compliance. Greater need for cumulation and/or outward processing provisions.

# Decreasing relative importance of MFN tariffs



# Decreasing relative importance of MFN tariffs

→ Preferential tariff reduction provides less competitive edge as compared to better logistics – strict rules or ponderous administrative procedures making preference utilization more costly than it is worth.



# Private Sector and Trade Policy Design

- Rise of Global MNCs' dependence on suppliers of parts and components (often SMEs) has led to a growing sophistication of the private sector, and more efficient impact on the design of trade policy.
- The private sector is increasingly able to provide sophisticated input to policymakers to the design of tailored trade policies.

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# What we know and what we don't know...

## RoO as a relatively new research field

- Political Economy of RoO
  - Impact of RoO on Trade
  - Impact of RoO on Investment
- 

- Design of RoO
- Administration of RoO
- RoO and Preference Utilization

# The Political Economy of RoO

- What we know
  - Stricter RoO compensate for faster liberalization
  - North/South asymmetric bargaining power regarding participation constraints, templates and flexibility
- What we don't know
  - Are greater fragmentation of production, lower MFN tariffs and / or increasing linkages between global firms and SMEs resulting in less strict RoO?



# Impact of RoO on Trade

- What we know
  - Stricter RoO limit trade expansion from FTAs
  - Stricter RoO associated with greater upstream trade
- What we don't know
  - Do firms actually change suppliers to qualify for preferences?
  - Is the impact of RoO changing over time?
  - How does trade respond to changes in rules?

# Impact of RoO on Investment

- What we know
  - Some evidence that greater flexibility of RoO is associated with greater investment – both in that sector and upstream.
- What we don't know
  - Do firms invest in rule-jumping production?
  - How does investment respond to stricter rules?

# Design of RoO

- What we know
  - Facilitative measures matter (*de minimis*, etc.)
  - Expanding cumulation increases trade
- What we don't know
  - Differential impacts of tariff shift, value added, process rules methods: what criteria impose the lowest costs on trade? Under which criteria is it easiest to demonstrate compliance? Which are easiest for customs to verify ex post?

# Administration of RoO

- What we know
  - There is practically no research on questions related to administration RoO, which are essential to the functioning of trade agreements, from transparency, to border controls, to ex-post verification.
- What we don't know
  - Does 3<sup>rd</sup>-party certification help or hinder trade?
  - Is self-certification more prone to fraud?
    - Does fear of origin liability depress utilization?
    - Does more frequent ex-post verification improve compliance or suppress utilization?

# RoO and Preference Utilization

- What we know
  - Regions show different patterns in preference utilization (LAC/Asia)
  - Compliance costs range from zero to over 15% AVE
- What we don't know
  - Very few countries publish detailed utilization rates, so most studies rely on U.S. NAFTA data.
  - Are the challenges greater for smaller or larger firms?
  - Is utilization the right metric of “success”?

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# Coming Challenges and Opportunities

The structure of global preferential trade is still evolving. This will change the impact of RoO and most likely will require reforms of RoO.

- Optimal design of policies and procedures
- Macro trends
- Open questions
- A role for International Institutions

# Optimal Design of Policies and Procedures

- Are Customs fully prepared for more FTAs and greater preference utilization? Are there specialized units for monitoring and administering RoO?
- Is Private Sector fully prepared? Do they understand the requirements and procedures? Do they expect customs to have the same interpretations of the rules?
- Convergence will bring implementation challenges
- Implications of Bali agreement for RoO (LDCs)



# Looking forward: Macro Trends

- The impact of Mega-regional FTAs
  - Changes similar to the NAFTA inflection point?
  - Will they set new templates or standards for RoO?
- The potential for Multilateralization
  - Can an international agreement impose order on RoO?
  - Bali calls for simplicity, flexibility, and transparency. If this is good for LDCs, why not for all FTAs?
  - Perils of RoO harmonization (one size does not fit all). Cumulation zones are different, and a common rule could have very different effects across FTAs.

# Looking forward: Open questions

- Traceability agenda and RoO:
  - RoO and climate change/border carbon taxes.
  - Other environmental and/or social standards.
- Certification agenda and RoO:
  - Self-certification vs. 3<sup>rd</sup> parties (gov't or chambers).
  - Cost/efficiency vs. information value added.
- Preferential Trade in Services and RoO:
  - Role of services in GVC plus ICT enabled services trade are increasing.
- IT in supply chain and RoO

# International Institutional support for RoO

- Inter-Institutional Collaboration
  - WCO, WTO, IDB, ADB, UN, ICC, etc.
- Data
  - Data collection and online access
- Research
  - Focus on preference utilization and design impacts
- Dialogues
  - Public-Private dialogue
- Capacity Building



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