Multilateralizing regionalism: lessons from the EU experience in relaxing rules of origin

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Theory of economic integration
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Outline

- Introduction
- Aim
- Why do we need ROOs?
- Impact of ROOs on patterns of trade
- When are ROOs likely to matter more?
- Cumulation and ROOs in a multilateral world
- Why diagonal cumulation matters?
- Evidence on the constraining impact of ROOs
- Conclusions
Rules of origin (ROOs);
- Have all preferential trading agreement (PTA) except customs unions
- Imply constraints on firm’s choices concerning their sourcing of intermediates,
- Two important issues with regarding intermediates are;
  a. Protectionist and
  b. strengthening spaghetti bowl effect
Aims

- Explaining why ROOs undermine the process of regional integration and the relationship to the multilateral process of trade liberalization.
Why do we need ROOs?

- To establish whether a given good is exemption from customs duties
- To prevent trade deflection
- To determine the geographical source of imports
- To identify the criteria confer originate status on the export good.
Impact of ROOs on patterns of trade

- ROOs intended to support a processes of trade liberalization;
  i. administrative and bureaucratic cost
  ii. Trade diverting or suppressing properties of rules of origin.

- Trade creation and trade diversion
Figure 4.1 ROOs and trade deflection

Rules of origin need to be in place to prevent trade deflection as given by the solid arrow.
Figure 4.2 The impact of constraining ROOs – supply switching
When are ROOs likely to matter more?

- ROOs influence the sourcing on intermediate goods and final goods trade;
- The higher the intermediate share in production;
- The higher the export share in the final good production;
- The lower the import tariffs among non-cumulating countries;
- The higher the share of exports of the final good destined for a FTA;
- The greater the possibilities of sourcing substitute intermediates from within FTA.
Cumulation and ROOs in a multilateral world

- For a firm to export a product into different PTA partner country markets, and wishing to take the advantage of preferences granted, needs to ensure that it has satisfied ROOs applicable to each markets.

- Lack of compatibility among the ROOs across different PTAs make organization of production and international supply chains complicated for firms.

- Pan-European ROOs which in principle apply in all its PTAs with CEECs and EU-Southern Mediterranean trade.
Why diagonal cumulation matters?

- Trade among three or more trading partners normally linked by FTAs with identical ROOs;
- The participating countries bilaterally agree that material originating in one country can be considered to be materials originating in all the other countries.
- For example suppose the intermediate good imported by country B was deemed to originate in country C. Country B could cumulate its own value added with the intermediate input from country C in determining originating status on the export of the final product to the EU.
Impact of diagonal cumulation:

- trade creation (TC) – as imports replace less efficient domestic production
- trade reorientation (TR) – as imports switch to more efficient external supplier
- trade diversion (TD) – as imports switch from ROW to less efficient ‘partner’

Figure 4.3 The impact of diagonal cumulation
Evidence on the constraining impact of ROOs

- ROOs are likely to impact materially on trade flows and allowing for diagonal cumulation;

- Brenton and Manchin (2002) explain that the Baltic States’ exports to the EU tariffs on supposed tariff-free General System of Preferences (GSP) imports. They argue that the explanation for this derives from the restrictive ROOs applied by the EU.

- In the context of US – Mexico trade, Cadot et al. (2004) also show that ROOs have a negative impact on the volume of preferential trade.
Conclusions

- ROOs can constrain firms’ choices and serve to distort trade.

- ROOs materially impact on trade flows.

- ROOs are key components of the spaghetti bowl effect, and it’s less likely for countries not party to the same trade agreement to trade with one another.
THANK YOU FOR YOUR ATTENTION.