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The EEC Preferences: A Critical Evaluation

by Professor Richard N. Cooper, New Haven *

On July 1, 1971, the European Community introduced a system of generalized tariff preferences for less developed countries. This followed nearly five years of intensive discussion among the major industrial countries about how best to respond to an appeal by the UNCTAD to help improve the trading opportunities of LDCs.

The EEC hailed the introduction of its scheme as a "generous response" to the needs of developing countries, and urged other industrial countries to follow its lead. It was soon followed by Japan with a similar plan and the United Kingdom with a quite different one.

It is the purpose of this paper to explore tentatively just how generous the European tariff preference scheme is, and how likely it is to provide the stimulus to new exports and new investment in developing countries that is the ultimate objective of generalized tariff preferences.

Nature of the European Scheme

The Community's scheme offers duty-free entry for all manufactures from developing countries (except Taiwan) defined in terms of roughly 1000 4-digit Brussels Tariff Nomenclature (BTN) categories, up to a certain quota or ceiling. Beyond that ceiling, imports will pay the full most-favored-nation (MFN) duty. In practice, quotas have been established administratively for only a selected list of "sensitive" commodities, with others merely subject to surveillance and later decisions.

The formula for the duty-free quota comprises two parts: the basic quota, equal to exports of all developing countries of a particular 4-digit product group to the Community in a base year, initially 1968, but subject to later change; and a supplementary quota, equal to 5 p.c. of imports of that product group from other developed countries (including Communist countries, but excluding intra-Community trade) in the most recent year for which data are available. Moreover, no single developing

country is entitled to more than half the total quota for each commodity, and in some cases no more than 20 or 30 p.c., but this secondary limitation will not influence the analysis that follows.

It should be noted that the tariff quota in any year depends on observations for past years, and that delays in data collection mean that the supplementary quota will be based on data covering a period about two years earlier than the year to which the quota applies. This reliance on past data, in combination with the very rapid growth in exports of manufactures that the developing countries have in fact achieved in recent years — without the help of tariff preferences — means that the Community's tariff preference scheme will offer little additional incentive to developing countries, either to export or to invest. The normal growth in exports will rapidly overtake, and in many cases has already overtaken, the duty-free quota, so additional exports must pay the full duty¹.

Discrimination of Competitive Goods

Some idea of how the scheme may be expected to operate can be had by supposing that it was actually in effect in 1969 and 1970. This exploration will represent only an approximation, however, for several reasons. The scheme itself will define about 1,000 commodity groups, whereas published trade data for the EEC are most readily available for under 80 categories of imports of manufactures under the Standard International Trade Classification (SITC). Use of the latter data will thus lead to

¹ For example, with imports from developing countries growing at 15 p.c. a year and other imports growing at 10 p.c. a year, the quota for a product for which the base year (1968) share coming from developing countries is 10 p.c. will be exhausted in less than three years, i.e. by 1971!

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both errors of approximation and to errors of aggregation. Second, in order to explore the data for two years it will be assumed that the supplementary quota is determined with only a one year lag, rather than the prevailing two year lag. This assumption exaggerates the generosity of the scheme in a period of rapidly growing imports.

The results are summarized by the major commodity category in the table². There it can be seen that developing countries would have been able to increase their exports of chemicals by \$ 50 mn in 1969 under duty-free treatment, but that this scope for expansion was reduced to only \$ 39 mn in 1970. Moreover, four of the SITC categories of chemicals for which data were available had already exhausted their quotas in 1969, the first year of assumed operation, and by 1970 six categories had exceeded their quotas, leaving most of the room for expansion in organic chemicals and plastics. A similar situation exists for the other major categories of imports with the exception of machinery and transport equipment, where the tariff quotas are large compared with the low level of exports by developing countries.

The results for the machinery and transport category indicate an essential feature of the scheme: it is most generous for those products in which the developing countries are least competitive, and the most generous quotas of all are for those products, such as jet aircraft and advanced com-

puters, which the developing countries have little hope of exporting for many years, duties or not. In contrast, it offers little incentive, or none at all, to expand exports of those products which are currently of greatest interest to the developing countries, for such exports must pay, or expect soon to pay, the full tariff duty. Total estimated unused quotas would have amounted to well under 10 p.c. of total developing country exports to the EEC in the important areas of miscellaneous manufactures (SITC 6 + 8), where their trade interest is greatest. Moreover, only 22 p.c. of their total exports of manufactures to the Community would not have been subject to the quota ceiling in the second year of operation.³

Quota Allocation Problems

In practice, the scheme is not as simple as implied above. First, special and somewhat more restrictive treatment is accorded to textiles and footwear.⁴

³ It might be noted that the quotas listed in the table for 1970 are comparable to the duty-free ceilings applicable to 1971, since the scheme that actually went into effect was based on 1968 and 1969 trade data. Imports of developing countries continued to grow rapidly in 1971, so the unused quotas would be even lower than those shown here for 1970. However, the individual country limitations—50 p.c. of quota on most products and as low as 20 p.c. on some textiles—provide some mitigation for the restrictive character of the scheme sketched above. To the extent that some countries—e.g. Yugoslavia, Hong Kong—hit these ceilings, unused quotas may be available to other, less competitive countries. But the scheme remains highly restrictive even with this qualification.

⁴ Estimates are even more difficult for textiles than for other products because the quota formula varies from product to product—no supplementary quotas for some, a shortened list of eligible countries for others—and the readily available published trade statistics do not permit such a fine division.

² Details may be found in a longer version of this paper to be published in the Journal of Development Studies.

Summary of Imports of Manufactures Into EEC from Developing Countries, Quotas and Unused Quotas

(In \$ mn)

SITC		Total Imports (excluding intra-EEC)	Imports from Developing countries	Tariff Free Quotas	Unused Quotas	Percentage of 3-digit categories over quota
Chemicals (5)	1968	1,754.9	104.1			
	1969	2,083.9	145.1	186.3	49.5	33
	1970	2,589.9	202.1	200.3	39.0	50
Semi-finished (6 excl. 65 & 68) ^a	1968	2,728.5	302.3			
	1969	3,549.8	418.6	423.6	60.1	27
	1970	4,620.8	579.7	513.2	47.5	41
Machinery and Transportation (7)	1968	4,588.9	70.6			
	1969	5,616.0	97.4	296.6	201.4	14
	1970	6,874.7	134.4	349.5	217.6	0
Other finished Manufactures (8)	1968	1,557.9	211.7			
	1969	2,021.8	339.1	279.0	39.8	33
	1970	2,646.5	543.1	295.7	34.7	67

^a Excluding textiles and non-ferrous metals.

Note: These "quotas" represent aggregation from calculations based on SITC 3-digit trade data found in the OECD, Trade Statistics, Series B. 1970 data were partly estimated.

Second, any binding quota system must allocate the quotas in some way, and this allocation is likely to limit still further the gains to developing countries. Since the EEC has no administrative machinery for applying quotas throughout the Community, implementation has been delegated to the national authorities, on the basis of a formula allotting 37 p.c. of the quotas to Germany, 27 p.c. to France, and smaller amounts to other member countries. These quotas in turn must be allocated in some way. In 1971 Germany, for instance, allotted its quotas to traditional importers, product by product, while the Netherlands allocated the quotas largely on a "first come, first served" basis. Under either system, or any other that eschews allocation on the basis of exporting countries (which would violate the "generalized" character of the scheme), there is considerable chance that the developing countries will not even benefit from the tariff revenue foregone by the Community. Where imports exceed the quotas, developing countries are able to sell in the Community despite the tariff; and where this is so, producers in developing countries may compete with one another so strongly that they bid down the sales price even on duty-free imports to the price prevailing on dutiable products. Under these not unlikely circumstances, the real beneficiaries of the Community's generalized tariff preference scheme will be the European importers lucky enough to get the duty-free quotas.

Negligible Stimulant to Development

The ultimate purpose of tariff preferences for developing countries is to stimulate their development by encouraging the exportation of manufactured goods. New encouragement to exports will stimulate investment, both by local entrepreneurs and by foreigners.⁵ But if actual exports exceed the quota ceilings, so that MFN. duties must be paid on the excess, then there will be no new incentive where it counts, at the margin. Neither exports nor investment will be stimulated.

The only issue raised by the introduction of such quotas is the distribution of that part of the revenue that corresponds to the duty-free quota. With luck or collusion among the exporting countries, it will represent a transfer to them in the form of higher prices; with quotas allocated to European importers or on a first-come, first-served basis, however, competition among the exporters will keep the c.i.f. price excluding tariff at what it was before introduction of the scheme, and all the gains will accrue to the European importers holding the

quotas. But even if developing countries do receive some of this foregone revenue, they will still have no incentive to expand exports and investment. The stimulus to development will be negligible.

Conclusions

This rather pessimistic appraisal must perhaps be qualified by the claim of Community officials that the scheme will be administered in a liberal way. The tariff quota in principle applies to all manufactures. But in fact the Community has distinguished a list of "sensitive" manufactures from all others, and initially machinery for administering the quotas was established only for these sensitive products, which include certain textiles, footwear, plywood, crockery, and assembled transistors. A much longer list of quasi-sensitive products has been placed under close surveillance (implying special efforts to gather and cumulate import information more quickly than is normally done) "to prevent undue damage to Community products", and still others are not even under special surveillance.⁶ Thus it is possible that for some products duty-free treatment will extend beyond the amounts allowed by the quota ceilings.

But this apparent laxity hardly provides the basis for long-term investment and export promotion. The possibility that the quotas may be imposed, indeed the likelihood if imports grow rapidly and domestic producers complain, is bound to make any prospective investor think twice about it. In view of these facts, it is difficult to take seriously the contention of the Community that "the Community's decision (to introduce the scheme) will give immediate and significant benefit to developing countries . . . and . . . gives further proof, if any were needed, that far from being protectionist, . . . it is both liberal-minded and outward looking."⁷

It may nonetheless be true, however, despite the restrictiveness of the scheme, that it stimulates exports from developing countries. This stimulation may arise, first, by drawing attention in a world of imperfect information to the possibility of exporting to Europe, and thereby inducing exports that could take place profitably even over the tariff walls, but did not because of market ignorance; and second, by providing an "entering wedge" to the further liberalization of European import practices. The principle of preferential treatment has been established, and developing countries may be expected to press hard for its realization once the restrictive character of the present scheme is recognized.

⁵ H. G. Johnson has placed special emphasis on the attraction of foreign investors arising from new preference-induced export opportunities. See his "Economic Policies Toward Less Developed Countries", Washington, The Brookings Institution, 1967, pp. 194-195.

⁶ Community press release of April 22, 1971.

⁷ Community press release of April 22, 1971.