

# Preference erosion and the developing countries exports to the EU: A dynamic panel gravity approach<sup>1</sup>

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**Abstract:** The erosion of preferences due to multilateral tariff reductions is a long-standing concern for many developing countries. Since 2004 there has been a sharp decrease in border protection for the EU rice industry. Because the EU grants trade preferences to a considerable number of rice exporting developing countries, the reform implied preference erosion as well. Rice is among the most sensitive products for many developing countries exporting to the EU. The objective of the paper is to assess the magnitude of preference erosion and its impact on rice exports to the EU of developing countries benefiting from preferences. By addressing this issue, this paper contributes two original insights to the literature: first, by proposing a new empirical approach to compute the preference margin when tariff rate quotas are in force, which is based on the assumption of the existence of fixed costs and economies of scale in international trade; second, by estimating the trade elasticities of preferences by means of a dynamic panel gravity equation to deal with the issues of endogeneity of preferences and persistency in bilateral trade flows. The results show that the way preference margins are calculated matters significantly when assessing the existence and extent of their erosion and the values of trade elasticities. Finally, the estimations highlight the fact that the impact of preferences is still very strong for some of the countries concerned.

**Keywords:** Trade Preferences, Gravity Equation, Tariff Rate Quotas, EU Rice Policy, GMM,

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