Study in support of an impact assessment to prepare the review of GSP Regulation No 978/2012

Final Report

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EXECUTIVE SUMMARY

The European Commission has commissioned an assessment of options for the upcoming review of the the EU generalised scheme of tariff preferences (GSP Regulation No 978/2012), which will expire at the end of 2023. This report sets out the results of the research concerning the potential economic, social, human rights and environmental impacts of the alternative policy options, including continuing the status quo, both in GSP beneficiary countries and in the EU, while also considering legal, institutional and procedural issues, and provides the conclusions and policy recommendations that flow therefrom.

The GSP framework consists of three arrangements: **Standard GSP** for low and lower-middle income countries (currently 15 in total), which partially or fully removes customs duties on about two-thirds of EU tariff lines; **GSP+**, which reduces the same tariffs to 0% for vulnerable low and lower-middle income countries (8 in total covered by the study but 9 as of 9 April 2021 after Uzbekistan joined the scheme) that have implemented specified international conventions on human rights, labour, the environment and good governance; and **Everything But Arms (EBA)**, which provides least developed countries (LDCs; currently 48 in total) duty-free, quota-free market access for all products except arms and ammunition.

The policy options take into account the recency of the major reform of the GSP in 2012, the positive assessment of the functioning of the revised scheme in the 2018 Mid-Term Evaluation (MTE), and the European Parliament's non-legislative resolution of March 2019, which gave a favourable assessment while recommending enhancements to encourage export diversification, improve environmental outcomes, and strengthen institutional arrangements for stakeholder engagement and monitoring of implementation.

The **review of performance** of the scheme since the MTE reconfirms the overall positive impact of the scheme on the beneficiaries, with the highest marks going to the EBA arrangement in supporting growth and trade diversification, and measurably better performance observed in GSP+ countries compared to the Standard GSP countries, which is consistent with the expectation that stronger governance commitments support stronger economic performance. At the same time, external vulnerability of the beneficiaries has increased with current account deficits tending to widen for most countries, including six of the countries expected to graduate from EBA status into the Standard GSP arrangement.

In **consultations**, the vast majority of respondents supported maintaining GSP preferences, including the three arrangements, on grounds the scheme helps to eradicate poverty, create jobs (notably for women), and support economic growth (including economic recovery of beneficiary countries severely impacted by COVID-19), while contributing to sustainability of development and possibly serving as a stepping-stone to reciprocal trade agreements as countries graduate. At the same time, some respondents observed that the scheme had not worked as well as hoped in terms of distributional outcomes in the beneficiary countries and in terms of supporting their economic diversification. Concerns also were raised about the EU continuing to grant GSP preferences, at some expense to certain of its own import-competing sectors, to countries not respecting human and labour rights or environmental standards.

Country Graduation Scenarios

Regarding **country coverage** of the overall scheme, four scenarios are evaluated: the *status quo* (which takes into account scheduled transitions across the three arrangements); discontinuation of the GSP+ and Standard GSP (the legal default scenario with expiry of the GSP Regulation at end-2023); discontinuation of the Standard GSP only; and graduation of only the largest Standard GSP countries, India and Indonesia.

Some of the three policy change scenarios for country coverage raise **legal questions about consistency with non-discrimination obligations** under the World Trade Organization (WTO) enabling clause, which provides the legal basis for GSP preferences. The incumbent GSP makes distinctions in treatment across developing countries based on differing economic (in the case of the EBA arrangement) and non-economic (in the case of the GSP+ arrangement) needs of the beneficiaries. To preserve non-discrimination, the exclusion of certain beneficiary countries would have to be characterised as "comprehensive product graduation", with the possibility of "ungraduating" product sectors – that is, restoring sector preferences – if the economic situation *vis-à-vis* those sectors changes while GSP preferences continue to be granted in those sectors to other developing countries with the same development needs. Arguably, therefore the GSP must continue to be available to all developing countries, even if no countries qualify for specific parts of the scheme. Further, to graduate all the countries in the Standard GSP and GSP+ arrangements, it would need to be demonstrated, on development grounds seen in economic terms, that all product sectors for non-LDC developing countries can be graduated. Moreover, preserving preferences for the GSP+ but not the Standard GSP countries would leave the GSP+ preferences resting solely on development needs defined in non-economic terms. While the latter claim is probably legally tenable, it would be novel and would likely require explanation.

As regards the economic implications of the alternative scenarios, each policy change scenario involves some increase in EU tariff protection. For the EU, this implies higher tariff revenues and a reduction in overall imports under the GSP. The impacts are strongest in a scenario where both the Standard GSP and GSP+ lapse (scenario 2b) and least strong when only India and Indonesia exit the GSP (scenario 2d). The macroeconomic impacts on the EU27 scale accordingly. The higher level of protection results in negative impacts on economic efficiency (real GDP tends to be lower by about -0.01% across the three scenarios). However, terms of trade gains lead to higher nominal GDP (about 0.03% in Scenario 2b falling to 0.02% in Scenario 2d) and ambiguous, near-zero welfare impacts. Some EU sectors gain from added protection, in particular leather (real value added gain of 0.6% in each scenario), apparel (0.6% in scenario 2b falling to 0.4% in scenario 2d) and textiles (0.9% in scenario 2b falling to 0.1% in scenario 2d).

For GSP beneficiaries losing preferences, the implications are lower exports to the EU with negative impacts on real economic growth. Negative terms of trade effects compound the welfare loss. Countries that remain GSP beneficiaries (and third parties) benefit from positive trade diversion effects as they gain market share in the EU at the expense of those losing preferences. The quantitative modelling suggests there is considerable variation in the scale of impacts within each group of beneficiary countries – EBA, GSP+ and Standard GSP. The main negative impacts are experienced by the following economies:

- India and Indonesia lose preferences in all three scenarios, with palpable negative impacts on real GDP (-0.07% for India and -0.08% for Indonesia), negative terms of trade effects, and consequently larger negative welfare impacts. Sectoral impacts are concentrated in leather (India sees a decline in real value-added of close to 4% and Indonesia a little over 3%), driven by steep declines in exports to the EU (about 17% and 22% respectively). Apparel and to a lesser extent, textiles also see relatively steep decline in exports to the EU and consequently relatively severe output declines.

- The most severe negative impacts are experienced by Bangladesh (scenarios 2b and 2c) and Pakistan (scenario 2b). These economies experience a hit to real GDP on the order of -0.3%, with welfare effects (over -0.4%) amplified by steep terms of trade declines. The sectoral impacts are concentrated in the leather (especially for Bangladesh) and textiles and apparel (especially for Pakistan) sectors.

Other Standard GSP and GSP+ beneficiaries losing preferences experience smaller negative macroeconomic impacts but suffer often palpable impacts in sectors facing relatively high EU MFN tariffs (leather, textiles and apparel, and agri-food). EBA economies are favourably impacted, with the scale depending on their capacity to benefit from trade diversion effects.

The consequential environmental, labour, gender and human rights impacts depend on the sectoral impacts in each economy. Given the concentration of sectoral impacts on the leather, textiles and apparel group and various agri-food areas, the labour market and in some cases gender impacts as well as human rights issues that flow from labour market impacts, such as right to work and a living wage, are concentrated in these areas in the GSP+ and Standard GSP economies, depending on the scenario. Environmental impacts, in particular greenhouse gas emissions, also follow the sectoral impacts with emissions shifting from economies losing preferences to those benefiting from trade diversion. The overall non-economic impacts are, however, modest and in many cases too small to detect on the basis of available modelling.

Product Graduation Scenarios

Several scenarios for **product graduation** were examined: **maintaining current** product coverage and graduation mechanism; **expanding** product coverage for Standard GSP and GSP+ to include environmental goods; and **limiting** product coverage for certain products by lowering the threshold for graduation of certain products – rice and sugar in one scenario and a broad range of agricultural products in another. Another assumption tested was to base product graduation criteria on total EU imports from the world in the respective product sections, rather than imports from GSP beneficiaries as currently is the case.

As regards the impact of the **status quo** GSP on export diversification, there is little evidence that it has supported such diversification which points to broadening the Standard GSP in terms of product coverage to strengthen the impetus that exporting to the EU under this arrangement provides for industrial development and diversification, rather than narrowing the scope of the scheme by tightening the rules for product graduation.

As regards **expanding coverage** by bringing more **environmental goods** into the scheme, the analysis suggests that the benefits would be limited and flow to the largest and most diversified economies within the GSP+ and Standard GSP arrangements, with minimal advancement of the diversification objective for the less-diversified Central Asian and African economies. More generally, to minimize economic distortions generated by selective preferences, **a sunset clause for all excluded and sensitive products** could be considered, together with an industry-driven mechanism to establish (or continue) a country-product exclusion/sensitivity. This would systematically prune the system of unnecessary reservations, flatten the EU GSP tariff profile, contribute to diversification in the beneficiary countries and systematically re-tailor the scheme to meet the needs of a rapidly evolving EU industrial structure.

As regards **tightening product graduation rules,** extending graduation rules for **rice and sugar** to all GSP beneficiary countries would not lead to any graduations from any GSP countries, regardless of whether graduation criteria were applied at the GSP product section level or at the narrower HS 4-digit heading level. Extending current graduation rules to **all agricultural products** would lead to only one instance of a product graduation, cut flowers from Ethiopia (section S-2a). This might lead to significant impacts on this sector in Ethiopia.

As regards the issue of changing the threshold from a percentage based on total imports from GSP countries to total EU imports from the world, the specific threshold that would be optimal would not be chosen independently of a range of other provisions as discussed above. As all options considered for adjusting the thresholds when changing the base for the threshold calculation have drawbacks, we recommend not changing the current basis.

Impacts of Expected LDC Graduation from the EBA Arrangement

Up to 12 countries are expected to graduate from LDC status over the next ten years and thus move from the EBA into the Standard GSP or GSP+ arrangements.[1] Of these, only six (Bangladesh, Lao PDR, Myanmar, Nepal, Sao Tomé and Príncipe, and the Solomon Islands) face non-negligible impacts from reduced trade preferences. Apart from Bangladesh, the impacts are assessed to be manageable with existing transition provisions. Bangladesh, however, does not meet the current vulnerability conditions for GSP+ and faces a very significant fall in exports under Standard GSP arrangement with a consequential large decline in real GDP (-1.66%) and economic welfare (including a 5% decline in nominal GDP), and potentially disruptive industrial adjustment in the most affected sectors (textiles and apparel and leather/footwear), with consequential negative impacts for employment, wages, gender, and human rights.

Access to the GSP+ arrangement would limit the negative impacts of the transition. At present, no graduating economy meets all the sustainable development criteria for the GSP+. **Mitigating actions** supporting graduating EBA beneficiaries to meet these criteria – i.e. to ratify and implement international conventions – should be considered. Options for allowing access for all graduating LDCs to the GSP+ in terms of the vulnerability criteria include (a) raising the threshold for vulnerability based on the country’s share of EU GSP imports from the current 7.4% to about 16% (to accommodate Bangladesh); (b) dropping this criterion

[1] Note that assumptions made about the graduation of countries from the GSP due to reaching upper middle-income country status or graduating from LDC status were based on growth forecasts made before the covid-19 pandemic and now have to be considered overoptimistic; accordingly, the number of graduations in the coming years is now expected to be smaller.

and assessing vulnerability based on limited export diversification; or (c) adding a third criterion, namely whether the weighted tariff the country would face with transition is above the GSP simple average (this criterion would clearly single out Bangladesh as vulnerable).

In addition, the **transition period could be extended to five years** to give more time for countries to implement reforms (including to qualify for GSP+) and for firms to take investment decisions (a recommendation from business in the consultations).

International Conventions for GSP+

As regards the ratification and implementation of **international conventions required for GSP+**, the current list remains relevant with one update recommended, namely replacing the Kyoto Protocol with the 2015 Paris Agreement. In addition, consideration should be given to **adding several conventions** (all of which have been ratified by all EU Member States as well as a large majority of GSP countries, contribute to GSP objectives, are relevant for international trade, and have been recommended for inclusion by a number of stakeholders): the Convention on the Rights of Persons with Disabilities (CRPD); The Optional Protocol to the Convention on the Rights of the Child on the Involvement of Children in Armed Conflict (OP-CRC-AC); ILO Convention No. 81 on Labour Inspection; ILO Convention No. 144 on Tripartite Consultation; and the UN Convention against Transnational Organized Crime. Other possible conventions should be deferred for later consideration. Suitable **transition periods** and any needed **technical assistance** would be recommended for beneficiary countries to ratify and implement the additional conventions.

Conditionalities for Access to GSP Preferences, Monitoring and Disciplines

The study considers expanded use of conditionality of access to GSP benefits to promote observance of international standards, including possible enhancement of transparency mechanisms to improve monitoring, and how to make conditionalities effective and usable.

It finds that the **positive conditionalities** that gatekeep access to GSP+ do in fact incentivise ratification and implementation of international conventions and should be retained, albeit with improved administration, and extended to Standard GSP and EBA beneficiaries on a staged approach, with suitable transition periods and financial implementation support as necessary, so as not to drive exit from the scheme altogether. However, the study finds that the **negative conditionality** for withdrawal of GSP benefits fails to deter violations of conventions. Nonetheless, solely for policy coherence reasons, negative conditionality is recommended to be extended to cover the conventions listed in Part B of Annex VIII (including any that would be added to this list), with reforms to address concerns.

Transparency and monitoring could be enhanced, including by: making publicly available lists of issues; establishing a publicly-funded Civil Society Organization (CSO)-based monitoring body or (less advisedly given resource demands) forming a Domestic Advisory Group; and/or expanding the monitoring cycle to three years with the option to perform prioritised (out of cycle) monitoring for specific issues and/or countries.

Notwithstanding recent steps to improve transparency of the **procedures for withdrawal of preferences**, and a finding in the present review that these procedures are generally effective, maintaining the current practice without enhancements could raise further concerns about the lack of consistency and transparency of the process. Accordingly, the **preparatory process** should be retained, while maintaining a **dialogue with the beneficiary country government** and **involving beneficiary country stakeholders** to the extent possible, including, inter alia, business, parliament, employer and worker organisations, other civil society actors, and enforcement agencies to build public support for any measures taken. **Reporting on the steps taken by the Commission** could be made more regular (including through social media) while the involvement of the international stakeholder community could be enhanced by establishment of a **complaint mechanism,** hosted by the Chief Trade Enforcement Officer, with provision for public hearings and the possibility of triggering a formal investigation by the Commission.

Following the launch of formal procedures, certain additional steps are recommended, in particular to develop an **impact analysis**; and to **actively engage EU, beneficiary country and international stakeholders**.

As regards the possibility of targeting **measures against specific actors**, experience confirms the difficulty of isolating fault given that certain actions originate in government or state institutions; are enabled by domestic legislation non-compliant with international norms; or reflect weak enforcement. Similarly, **exemption for specific actors** following international due diligence practice could shift compliance burden to the private sector.

Amending the Automatic GSP Safeguard Mechanism

As regards the possible **extension** of the automatic GSP safeguard **to all agricultural goods and to EBA beneficiaries**, this would not trigger new applications with current thresholds. Nonetheless, reforms could more effectively shield EU industry from harm, including by lowering the tolerance threshold for rising import competition, especially for surges (e.g., if imports of a given section were growing faster than total EU imports, and if imports from a GSP beneficiary were growing faster than total EU imports in that section and thus leading the growth, which would be prima facie evidence of competitiveness). Transparency could be improved by codifying the procedure more fully or making publicly available a manual of procedures. Safeguard administration would be facilitated by evaluating surges on the basis of import values rather than volumes. Finally, the *de minimis* threshold could be abolished.