



Directorate-General External Policies

Policy Department

**ASSESSMENT OF THE PROPOSED REFORM
OF THE GENERALISED SYSTEM OF PREFERENCES**

POLICY PAPER

Abstract:

This policy paper reviews the draft Regulation for a new Generalised System of Preferences (GSP) in the light of the reform strategy prepared by the European Commission in July 2004. The reform of the GSP is of great potential significance both for the EU's overall trade policy and for its development policy. This policy paper identifies the key changes foreseen in the draft Regulation and assesses their potential impact, with a particular focus on graduation, the GSP+ scheme and the links with the Cotonou agreement. The paper looks at product coverage, WTO compatibility and identifies potential winners and losers of the new GSP system. The authors even address the difficulties encountered by policy-makers with regard to rules of origin, closely linked to the GSP scheme.

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Assessment of the Proposed Reform of the Generalised System of Preferences

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Paper prepared for the European Parliament
Directorate-General for External Policies of the Union

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Table of contents

Executive summary	v
Impact clouded by uncertainty	v
Main changes	v
Impact on utilisation	vi
Impact on countries	vi
1 The reform in context	1
1.1 GSP – a cornerstone of EU trade policy	1
1.2 The current GSP	1
1.2.1 What was new	2
1.2.2 What was retained	2
1.2.3 Is it used?	3
2 The new GSP	7
2.1 Broad features	7
2.2 Weighing up the changes	7
3 Graduation	9
3.1 Winners and losers to 2008	9
3.2 What happens in 2008?	10
4 GSP+ 13	
4.1 What it is – and who is eligible	13
4.2 Limitations on GSP+	13
4.3 The potential effects	14
5 Extension of product coverage	17
6 The GSP and Cotonou	19
References	21
Annex 1 The rules of origin	23
The issues ...	23
... and why they are difficult to resolve	23

Potential changes 24

Annex 2 Preference utilisation rates by country

26

Executive summary

This policy paper reviews the draft Regulation (CEC, 2004(b)) for a new Generalised System of Preferences (GSP) in the light of the reform strategy prepared by the European Commission in July 2004 (CEC, 2004(a), referred to hereafter as the ‘July Communication’). The EU was a pioneer of the GSPs now provided by most OECD states. It provides a ‘safety net’ for almost all developing countries, guaranteeing them that many of their exports to the EU will face lower tariffs than do many of their OECD competitors.

Reform of the GSP is therefore of great potential significance both for the EU’s overall trade policy and for its development policy. The July Communication described the Commission’s vision for the GSP over the next decade. The draft Regulation applies that vision in the initial period to 2008. This policy paper identifies the key changes foreseen in the draft Regulation and assesses their potential impact, particularly in the areas to which the terms of reference of the European Parliament direct the authors’ special attention.

Impact clouded by uncertainty

The proposed new GSP presents a paradox: its impact could be substantial, but equally it could be minor! The reason is that there are three points of uncertainty affecting the two significant innovations: the creation of a ‘GSP+’ (special incentive arrangements for sustainable development and good governance) to replace three existing regimes, and the replacement of the current graduation mechanism.

One uncertainty is whether the proposed GSP+ will be challenged successfully in the World Trade Organization (WTO). The Commission argues that it is based on the ‘objective standards’ required for WTO compatibility. But the *a priori* exclusion of some developing countries raises doubts.

The GSP+ offers the main avenue to increase trade – but only if it is widely used, and this is the second area of uncertainty. If few countries apply or are accepted, its net effect could be trade diversion. Developing countries have largely shunned the labour- and environment-protection regimes in the current GSP – but the margin of preference in GSP+ is much greater.

The third uncertainty is over the application of graduation from 2008. The picture for 2005–8 is clear: there will be fewer cases of new graduation than of reverse graduation (i.e. the restoration of GSP preferences to countries in sectors from which they are currently graduated). But the regime may be subject to ‘graduation creep’ from 2008. The application of the new formula (based solely on import share) is heavily dependent on the ‘base’ to which it applies. If countries are removed from the base (because they have been graduated or have agreements with the EU other than the GSP) then the arithmetic consequences are that the number of graduated countries will escalate. Until more is known about the way in which the formula will be applied from 2009, it is not possible to forecast the trade or development impact. Graduated countries are not eligible for GSP+.

Main changes

GSP+ and the revised graduation mechanism are the main changes. Some 243 items have been added to the list of products for which standard GSP⁽¹⁾ preferences are available. Just under two-thirds of these are fish and fisheries products, with the remainder being mainly fresh or processed fruits and vegetables. The new products account for about one percent of EU imports from the countries for which the extension will represent a change to the *status*

¹ The term ‘standard GSP’ is used throughout this paper for what is termed in the draft Regulation the ‘general arrangement’, i.e. the basic scheme excluding the two more favourable ‘special arrangements’ – see next section.

quo⁽¹⁾. The main beneficiaries seem likely to be Argentina, China, Ecuador, Russia and Thailand.

It appears that no products have been reclassified from sensitive to non-sensitive. And no changes are made in the Commission's draft Regulation to the rules of origin, the controversial role of which is described in Annex 1 to this policy paper.

Impact on utilisation

The utilisation rate of the GSP is low for at least six different reasons. The regime described in the draft Regulation will deal directly with only one of these, and indirectly with two others. Preference can only be claimed for products covered by the GSP. The product expansion will reduce directly, but modestly, the share of imports that are not GSP eligible.

The potential indirect effects are via GSP+. If this takes off it will increase the number of countries for which the GSP offers a commercial advantage, and the scale of this for some products. This will increase the incentive for exporting states to complete the GSP paperwork and for importers to claim the tariff reduction.

Impact on countries

Nothing in the draft Regulation will have a direct and systematic effect of altering the impact of the GSP in favour of poorer and vulnerable countries as opposed to richer ones. The incidence of graduation does not unambiguously favour the former over the latter across the board. Vietnam, for example, is graduated out of the GSP for footwear, but Brazil, Indonesia and Thailand are reintegrated.

The extent to which countries win or lose (to 2008) will be determined mainly by the uptake of GSP+. Countries that currently benefit only from the standard GSP but qualify for GSP+ will experience a major improvement. Only about 12 countries will be ineligible for GSP+ on all covered products even if they ratify all the conventions. These include a group of countries (estimated at seven) that are excluded for failing to meet the criteria for 'vulnerability' set out in the draft Regulation, plus other countries that are graduated out of specific sections.

Any country that benefits from the anti-narcotics regime in the current GSP but does not qualify for GSP+ will experience an equally sharp deterioration in its access to the EU market. And those countries that benefit from the Cotonou Agreement, 'Everything but Arms' (EBA) or a free trade agreement (FTA) are unlikely to be affected substantially one way or another.

The Cotonou Agreement, for example, still provides more favourable access even than GSP+. Hence, countries that fail to enter Economic Partnership Agreements (EPAs) with the EU post 2007 will suffer a deterioration in market access unless the GSP is subsequently improved.

¹ i.e. excluding imports from LDCs, countries that will be graduated, and those that may already be receiving a preference because they benefit from bilateral/regional FTAs with the EU.

1.1. The reform in context

1.1.1. GSP – a cornerstone of EU trade policy

The EU's GSP has a proud history. Europe was the first trading bloc to offer developing countries preferential access to its market in this way – a move that has been emulated since by most of the OECD states. Because it applies to almost all developing countries, the GSP provides a 'safety net': no developing country (other than the richest and most competitive) is offered less favourable access to the European market than that provided under the GSP.

Because of this, though, the GSP is not always the most favourable of the EU's import regimes. Lower tariffs are often paid by parties to the EU's older preferential trade accords (such as the Cotonou Agreement) and the more recent FTAs, such as those with Mediterranean countries, South Africa and Chile. Kenya, for example, would pay tariffs of up to 10.1 percent on its sales of fresh/chilled peas if they were imported into the EU under the GSP but it does not do so because they are imported instead under the Cotonou Agreement and enter duty free.

In broad terms the EU's trade partners fall into three categories:

1. **the most preferred** – that benefit from a trade agreement that is superior to the standard GSP;
2. **the middle group** – that are party to the standard GSP but to no other regime;
3. **the least preferred** (mainly industrialised countries) – that trade on the so-called 'most favoured nation' (MFN) terms⁽¹⁾.

Of the three groups, the middle one accounts for the smallest share of EU imports (see Figure 1). It is favoured by the EU in cases where a beneficiary country competes with members of the third group, but disfavoured when competition is with a member of the first. The term 'standard' is used in the description of the group's access to the EU because the GSP does not provide equal treatment to all developing countries. There are special, more favourable, tranches not only for the least developed countries (LDCs), but also for those fighting illicit narcotics and those with favourable social and environmental policies. These states fall into the 'most preferred' group.

It is this differentiated nature of EU trade policy towards developing countries that has underlain a number of disputes taken to the WTO over the past decade. The most recent of these, with India, has contributed directly to some of the reforms in the current Commission proposal (see Box 5, Section 4).

1.1.2. The current GSP

¹ The MFN is the highest tariff that the EU may levy on imports from WTO members. It applies to all of the exports of countries in the least-preferred group and to any items from other countries that do not receive a concession under their trade accords with the EU.

Figure 1. Share in total EU import value, 2002

1.1.1.1.1. What was new

Now over 30 years old, the GSP has been reviewed and adapted several times, most recently in 2001⁽¹⁾. Although described as a mid-term review of the ten-year regime 1994–2005, it made radical changes. It greatly simplified the old system under which covered items (see Box 1) fell into four categories according to their sensitivity and the applicable GSP tariff was 85, 70, 35 or zero percent respectively of the MFN tariff. There are now only two categories for covered items. Tariff duties on those classified as non-sensitive are entirely suspended⁽²⁾. For those classified as sensitive:

- the simple *ad valorem* GSP tariff is 3.5 percentage points lower than the MFN rate for all except clothing and textiles (Chapters 50 to 63) – for which the reduction is 20 percent.
- specific duties are reduced by 30 percent⁽³⁾ unless in combination with an *ad valorem* duty, in which case the specific duty is not reduced;
- duties are totally suspended where the application of the GSP reduction formula results in *ad valorem* duties of 1 percent or less or in specific duties of €2 or less.

Box 1. A GSP lexicon

1. The term **covered imports** includes imports of all items included in the GSP that originate in a beneficiary country, regardless of whether that country has been graduated out of the sector concerned. **Eligible imports** are limited to products for which the originating country has not been graduated. **Preferential imports** are products for which GSP treatment has been actually claimed.
1. The EU's **total imports** from a country include, in addition, all the products for which there are no GSP preferences. At present almost one tenth of dutiable products in the Common Customs Tariff are not covered by the GSP.

The new regime also incorporated the EBA scheme proposed in 2000. This extended a pre-existing special tranche of the GSP for LDCs that already offered duty-free access for all industrial goods but not for all agricultural ones.

1.1.1.1.2. What was retained

Three of the features of previous GSPs that were retained are:

- special, additional tariff cuts (most resulting in duty-free access) for states fighting narcotics (Andean and Central American states plus, for the first time, Pakistan);
- further tariff reductions, generally of 5 percentage points (in addition to the 3.5 percentage point standard GSP reduction) on some items for countries meeting the requirements for inclusion in special incentive regimes for the protection of labour rights and the environment;
- a graduation mechanism that made some states ineligible for GSP tariffs on specified products if they fell foul of criteria related to share of preferential imports, development index and export-specialisation index.

¹ The first European Community GSP was for an initial phase of ten years (1971–81), subsequently renewed for a second decade (1981–91). The third ten-year offer was delayed pending the outcome of the Uruguay Round, the 1991 scheme being extended with various amendments until 1994. The scheme for 1995–2004 was adopted on 1 January 1995, the legislative acts being Council Regulation 3281/94 in respect of industrial products and Council Regulation 1256/96 in respect of agricultural products. The scheme was revised for the period 1 July 1999–31 December 2001 on the basis of Council Regulation 2820/98. The basic structure of the offer was not substantially modified until the end of 2001, with the adoption of Council Regulation (EC) No 2501/2001 of 10 December 2001 (OJ L 346, 21.12.2001, p. 1), which covered the period 2002–4 and fully incorporated the EBA amendment. Council Regulation (EC) No 2211/2003 of 15 December 2003 (OJ L 332, 19.12.2003) subsequently extended this until 31 December 2005.

² Except for agricultural components.

³ 15 percent in the case of HS 2207 (ethyl alcohol).

Box 2. GSP utilisation

1. EU statistics on the proportion of imports for which GSP treatment is requested suggest quite low utilisation rates. In 2000 only 11 percent of EU imports from eligible countries claimed GSP treatment (Cerrex, 2002: Table 1); the rate for EBA in 2002 was higher, but at 39 percent it was still low (DG Trade, 2004).
1. There are six possible explanations for low utilisation, which require different responses.
 1. **Cause 1:** Countries are eligible for other, better trade regimes and so do not bother with GSP. Most ACP states, for example, use Cotonou – even the LDCs.
1. **Response:** Remove such cases from the GSP statistics to present a more realistic picture.
 1. **Cause 2:** Some products are excluded from the GSP. Only about half of the exports of countries covered by the GSP are eligible for preferences. Although only 11 percent of EU imports from GSP states claimed preferences in 2000, this represented 45 percent of the imports that were eligible for preferences (Cerrex, 2002: Table 1).
1. **Response:** Extend GSP product coverage.
 1. **Cause 3:** Countries' exports are concentrated on products facing low or zero MFN tariffs. This is particularly true for the poorest states dependent on traditional exports.
1. **Response:** Assist countries to diversify into new exports.
 1. **Cause 4:** The statistics are incomplete. All trade statistics contain errors, but these can be reduced by careful cross-checking. The GSP data are not presented in a form that allows such systematic analysis, but sufficient 'anomalies' exist to suggest that there are errors.
1. **Response:** Make the GSP data more usable and transparent.
 1. **Cause 5:** Exports do not meet the EU's rules of origin.
1. **Response:** Ease the rules.
 1. **Cause 6:** Traders fail to claim GSP preferences because of excessive bureaucracy, uncertainty, or lack of knowledge.
1. **Response:** Simplify the procedures and/or increase the margin of preference.

GSP utilisation more cost effective. Where the GSP preference is a tariff cut of only a few percentage points, it may not be worthwhile to fill out all the forms or, more seriously, for the importer to run the risk of being charged with tax evasion if customs subsequently decide that the goods do not, in fact, qualify for the GSP (perhaps because they fail to meet the origin rules).

For whatever reason, GSP utilisation appears to be heavily concentrated on a small group of countries. This is evident from a comparison of Figures 3 and 4: the former shows the geographical distribution of *eligible* imports, and the latter of *preferential* imports. Even the supply of eligible imports is geographically restricted, with the top six suppliers accounting for over half. But the share of the top six in preferential imports is two-thirds. One country (China) supplies one-third of the total, and a further five account for another third (Figure 4). Three of the countries identified Figure 3 are in the 'most preferred' group, but none of those identified in Figure 4 – lending weight to the idea that only states in the middle group find it worthwhile to use the standard GSP. Annex 2 shows the wide range of utilisation rates between countries.

Figure 3. Share in total eligible imports
(average 2001–3)

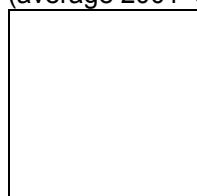
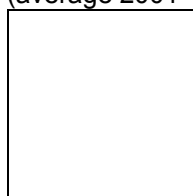


Figure 4. Share in total preferential imports
(average 2001–3)



Utilisation also varies widely according to the product group (Table 1). The rates for textiles, for example, are consistently low, suggesting that MFA quotas may be relevant. The utilisation rates for plastics are almost twice as high. It is likely that industry characteristics have an impact.

Table 1. GSP preference utilisation rates by section, 2001–3
(all suppliers, in ascending order of 2003 rate)

HS section	Description	Preference utilisation rate		
		2001	2002	2003
XI	Textiles and textile articles	37.3	40.9	39.1
IV	Prepared foodstuffs; beverages; tobacco	41.6	43.3	41.6
II	Vegetable products	45.1	46.0	43.2
XVIII	Precision instruments; clocks; musical instruments	40.0	42.5	43.6
V	Mineral products	47.4	50.2	45.8
VIII	Raw hides and skins, leather, furskins and articles thereof	68.6	61.2	46.3
I	Live animals; animal products	59.5	54.8	50.3
VI	Products of the chemical or allied industries	55.4	54.0	51.8
XVII	Vehicles, aircraft, vessels and associated equipment	58.5	63.8	53.1
IX	Wood and articles thereof	58.4	58.3	53.6
III	Animal or vegetable fats and oils and their cleavage products	36.4	56.5	53.7
XIV	Precious or semi-precious stones; precious metals and articles thereof	64.6	61.7	53.8
XVI	Machinery and mechanical appliances; electrical equipment	49.5	54.3	54.3
XX	Miscellaneous manufactured articles	68.1	65.2	58.5
XIII	Articles of stone, plaster, cement asbestos, mica or similar	63.7	65.9	63.0
XII	Footwear, headgear, umbrellas etc.	65.2	67.6	64.0
XV	Base metals and articles thereof	62.0	66.7	64.1
X	Pulp of wood or of other fibrous cellulosic material	76.7	75.8	65.8
VII	Plastics and rubber and articles thereof	78.8	80.3	70.1

Source: Commission GSP statistics.

1.2. The new GSP

1.2.1. Broad features

In its July Communication the Commission seeks to deal with the criticisms that have been levelled at the GSP and with the WTO ruling. Like its predecessor, the GSP regime it proposes will last for ten years (from 2006 to 2015) but with a mid-term review. The Commission's draft Regulation covers only the first period to 2008 – and it also brings forward by six months the proposed start date to July 2005 in order to comply with the WTO ruling.

Among the key reform objectives foreseen in the July Communication are to make the GSP:

- stable, predictable, objective and simple;
- targeted on the countries that most need it, such as the LDCs and the most vulnerable developing countries (small economies, land-locked countries, small island states, and low-income countries) as well as the countries that would need preferences most after the Multifibre Arrangement (MFA) textile-quota system comes to an end in December 2004;
- supportive of regional co-operation between developing countries.

Further, argues the July Communication, the GSP must strike the right balance between development through trade and through industrialisation via origin rules that reflect the balance but are less strict than at present. It should assist countries to attain a level of competitiveness that could make them self-supporting economically and full partners in international trade.

This can be done by maintaining and improving the Community offer. The accession to the Community of ten new Member States has already improved substantially the value of the GSP, but the July Communication also considers extending the GSP to cover new products and to reclassify others from the sensitive to the non-sensitive category. Preferential margins are to be at least maintained.

One way for the GSP to focus on the countries most in need is via graduation. The July Communication argues that certain beneficiaries should be graduated for the groups of products in which they are most competitive. Given the high level of competitiveness, there is no further justification for a continuation of preferential tariff treatment.

1.2.2. Weighing up the changes

The July Communication presented a balance of changes, such as limiting preferences to the most competitive states whilst extending and deepening preferences to the remainder. But it did not provide the details needed by observers to weigh up the partly offsetting reforms and to determine whether or not the 'balance' was to their liking.

The draft Regulation has provided these details for the first period of implementation, but not for the second. Table 2 lists the main areas of change proposed in the July Communication and summarises the relevant changes in the draft Regulation. The following three sections then review the details.

There are two areas of major uncertainty. These affect not only achievement of the objective of improved stability and predictability but also assessment of the new GSP's likely impact. One concerns the number of countries that will apply for the special incentives and meet the EU's criteria. Whilst Table 2 recognises the potential importance of GSP+ for the countries identified in the July Communication for targeting, most other developing countries would also be eligible. Wide usage of special incentives could transform the GSP's impact (see Section 4); modest take-up could reduce its trade effects. There is also a question mark over whether the regime would survive a WTO challenge.

Table 2. The objectives of GSP reform

Objective (as stated in July Communication ^(a))	Extent of change (in draft Regulation ^(b))
Improved stability and predictability	<ul style="list-style-type: none"> • Standard GSP is both stable and predictable to 2008 • Incidence of special incentives unclear • Substantial uncertainty post 2008
Improved objectivity	<ul style="list-style-type: none"> • The criteria for graduation have been changed, but are neither more nor less objective than the criteria replaced • Criteria for special incentives more objective than before
Simplification	Number of regimes reduced
Targeted on: LDCs Small economies Land-locked countries Small island states Low-income states MFA-affected	No change Potential availability of GSP+ ^(c) Potential availability of GSP+ ^(c) Potential availability of GSP+ ^(c) Potential availability of GSP+ ^(c) (but not for India, which is excluded <i>a priori</i>) Potential availability of GSP+ ^(c)
Rules of origin change: Form Substance Procedures	No change No change No change
Extending product coverage	243 new items (of which 151 fish/fisheries) ^(d)
Reclassification of sensitive items	None
Notes: (a) CEC, 2004(a). (b) CEC, 2004(b). (c) All countries have been eligible for the special labour and environmental incentives incorporated into the GSP in the 1990s, but the margin of preference under the proposed GSP+ is more substantial, and the product coverage broader. (d) General Secretariat of the Council, 2004. Four of the items on the list (two in HS 190420 and two in 210610) do not, however, appear in Annex II to the draft Regulation, and 27 are covered only under GSP+.	

The other uncertainty is over what will happen in the 2009–15 period. Neither the July Communication nor the draft Regulation specifies in sufficient detail, for example, how the graduation mechanism will be applied. As the 2001 reform demonstrates, ‘mid-term reviews’ can be substantial. Hence, while the outlook to 2008 is stable and predictable, any exporters requiring an investment pay-back period of over three years may view the regime as very unpredictable.

Since the trade provisions of the Cotonou Agreement also expire in 2007, African, Caribbean and Pacific (ACP) states will not find guidance in the draft Regulation on the likely impact of not joining EPAs. Section 6 returns to this issue.

1.3. Graduation

The graduation formula in the new GSP will replace that in the old (see Box 3). So there will be winners (countries that are reintegrated into the GSP) as well as losers (countries that are graduated anew). And, of course, for some countries there will be no major change: they are currently graduated and will remain graduated⁽¹⁾.

1.3.1. Winners and losers to 2008

The draft Regulation indicates which countries will be graduated for which sections on the first application of a new formula (Table 3). Graduation from a section applies to any country which accounts, on average over three consecutive years, for more than 15 percent (or 12.5 percent for Section XI, textiles and clothing) of the total value of covered imports within that section. Table 3 lists them and shows how the new regime will compare with the *status quo*.

The absolute ‘losers’ (countries not currently graduated that will be under the new regime) are listed in column 4. There are not very many of them. Only seven of the 19 Harmonised System (HS) sections⁽²⁾ would see any countries graduated out for the first time. China is graduated out of four sections which, between them, cover all wood and pulp, plus jewellery and vehicles. India is graduated out for jewellery, Vietnam for footwear, Algeria for mineral products and Russia for base metals. Four of the countries in the column are identified in Figure 4 as ‘major GSP suppliers’, but the other three are not.

The section that sees the greatest ‘first-time graduation’ is vehicles. No fewer than three significant sources of EU imports (Thailand, South Africa and China) are graduated out.

There are significantly more ‘winners’ (countries currently subject to old graduation that will not be caught by new graduation). Listed in column 5, they include Brazil and Thailand, which regain their rights to the GSP on the largest number of products – in six sections apiece. Mexico does so on four, Malaysia on three and Argentina, Chile, China, India, Pakistan, Russia and Ukraine on two apiece.

China remains graduated out for ten sectors, three of which do not overlap exactly with the product scope of its old graduation⁽³⁾. Brazil and Indonesia remain graduated on two sections (which correspond exactly with their old graduation), whilst Malaysia, and Thailand remain graduated out in just one.

Table 3. The effects of the new graduation formula

HS		Brief description	Change from <i>status quo</i>		Remain graduated ^(a)
Section	Chapter		Graduated for the first time	Reintegrated ^(b)	

¹ Since the old graduation applies to different product groups from the new graduation there could be some change even for this group (if the new graduation excludes a wider range of products than did the old).

² Although the HS is divided into 21 sections, two – Sections XIX (arms and armaments) and XXI (works of art) – contain no items covered by the GSP.

³ The HS chapters from which it is now newly graduated (because they were not covered by the old graduation) are 31 (fertilisers), 41 (leather, raw hides and skins) and 50–60 (textiles).

Box 3. Types of graduation

1. ‘**Old graduation**’ is what applies at present through the application of the formula in the current GSP Regulation linking market share, level of development and specialisation. Countries that fall foul are graduated out for a variable range of products: in some cases a single Harmonised System (HS) chapter; in others, two or more chapters. For example, Brazil is graduated out *inter alia* for GSP Sector VI, which is Chapter 9 of the HS (coffee, tea, etc.) while China is graduated out *inter alia* for Sector XXVII, which covers all of Chapters 74–83 plus eight 6- or 8-digit items within HS 7202 plus 7217, 7223, and 7323–7326.
1. The second is **exclusion**. A country which is otherwise eligible for the GSP is simply excluded for some products. Unlike ‘old graduation’ this is not related to any stated criterion and hence will not be reversed if the criterion no longer applies. South Africa, for example, is simply excluded from the GSP for iron and steel and Greenland is excluded for fisheries.
1. Third, there is ‘**new graduation**’. This is the application in future of the formula that has been proposed by the Commission

HS		Brief description	Change from <i>status quo</i>		Remain graduated ^(a)
Section	Chapter		Graduated for the first time	Reintegrated ^(b)	
1	2	3	4	5	6
I	1-5	Live animals; animal products	—	Argentina, Brazil, China, Thailand, Uruguay	—
II	6-14	Vegetable products	—	Brazil, Chile, China, Costa Rica, Ukraine	—
III	15	Animal or vegetable fats and oils and their cleavage products	—	Philippines	Indonesia, Malaysia
IV	16-24	Prepared foodstuffs; beverages; tobacco	—	Mexico, Thailand	Brazil
V	25-27	Mineral products	Algeria	Kuwait, Libya, Russia, Saudi Arabia	—
VI	28-38	Products of the chemical or allied industries	—	Belarus, Chile, Mexico, Russia, Ukraine	China (HS 28-38 excl. 31)
VII	39-40	Plastics and rubber and articles thereof	—	Malaysia, Thailand	China
VIII	41-43	Raw hides and skins, leather, furskins and articles thereof	—	Argentina, Brazil, India, Pakistan, Thailand	China (HS 42-3)
IX	44-46	Wood and articles thereof	China	Malaysia	Brazil, Indonesia
X	47-49	Pulp of wood or of other fibrous cellulosic material	China	Brazil	—
XI	50-63	Textiles and textile articles	—	India, Macao, Mauritius, Pakistan	China (HS 61-3)
XII	64-67	Footwear, headgear, umbrellas etc.	Vietnam	Brazil, Indonesia, Thailand	China
XIII	68-70	Articles of stone, plaster, cement asbestos, mica or similar	—	Mexico	China
XIV	71	Precious or semi-precious stones; precious metals and articles thereof	China, India	Brunei	Thailand
XV	72-83	Base metals and articles thereof	Russia	Brazil, Mexico	China
XVI	84-85	Machinery and mechanical appliances; electrical equipment	—	Malaysia, Thailand	China
XVII	86-89	Vehicles, aircraft, vessels and associated equipment	Thailand, South Africa, China	—	—
XVII I	90-92	Precision instruments; clocks; musical instruments	—	—	China
XX	94-96	Miscellaneous manufactured articles	—	—	China
<p><i>Note:</i></p> <p>(a) Countries shown in this column may not currently be graduated from as broad a range of items as they will be under the draft Regulation. This is because the 33 sectors from which countries may currently be graduated are reduced in the draft Regulation to the 21 HS sections. In most cases, therefore, the HS sections are broader than the current sectors. Where this is the case for countries in this column, the HS Chapters from which they are currently graduated are shown in brackets.</p> <p>(b) For the reason given in (a), countries shown in this column are not necessarily currently graduated for <i>all</i> items in the relevant HS section.</p> <p>Source: CEC, 2004(b).</p>					

1.3.2. What happens in 2008?

The draft Regulation lists all the graduation that will be implemented before 2008, but what about after? Presumably the graduation exercise will be repeated (or else countries will begin

to exceed the import share thresholds yet not be graduated). But against which imports will the share be calculated?

It would be logical to calculate each state's share of eligible imports for each section (i.e. to exclude from the denominator imports from countries that have been graduated this time). But doing this tends automatically to push some countries above the threshold (even if their exports have not grown relative to those of the others). Given sufficient time, eventually all countries could be graduated as a result of this simple arithmetic process!

If the graduation exercise were undertaken in 2008 on the basis of the current 15 and 12.5 percent thresholds and in relation to eligible imports, and if the eligible countries retained their 2003 relative trade shares, an additional 23 country/sector graduations would occur. This is over twice the number that will be graduated for the first time in 2005. The affected countries would be India (in four sections), Russia and South Africa (in three), Indonesia, Thailand and United Arab Emirates (in two), plus Argentina, Brazil, Malaysia, Mexico, Philippines, Saudi Arabia and Ukraine. In addition, of course, there would be 'genuine' graduations, i.e. the removal of countries whose exports had increased relative to their peers'. One way to avoid this would be to use covered rather than eligible imports in the exercise. This would be possible, and would avoid any 'graduation creep' from this source – but not from another. The other potential source arises from the Commission's intention to remove from the GSP countries with bilateral or regional trade agreements with the EU that provide equally or more favourable market access. Since these countries would no longer be listed in the GSP, they would not contribute to covered imports.

This reform is presented as a sensible 'tidying up' exercise that may, for example, remove the current confusion over whether or not preferences are well utilised (see Box 2, Cause 1). The draft Regulation does not remove any countries on this criterion for the period to 2008. This is presumably because even those agreements that foresee more favourable market access are still in their implementation period; they will be more favourable than the GSP only once fully implemented. This is the case, for example, with the Trade and Development Co-operation Agreement (TDCA) with South Africa. South African exports of roasted groundnuts to the EU under the TDCA enter duty free, whereas the GSP rate is 7.2 percent; some South African car bumpers, on the other hand, currently pay a tariff of 2.2 percent under the TDCA even though the GSP rate is zero.

Because no country has been removed this time, the draft Regulation provides no guidance on how it might be done. This gives rise to two queries: one concerning apparent inconsistencies between the July Communication and the draft Regulation (see Box 4) and the other on how the graduation formula will be applied from 2008.

Since countries that are no longer in the GSP cannot contribute, by definition, to covered imports, an unchanged graduation formula would apply the 15 and 12.5 percent thresholds to a smaller basket of imports. Evidently, some GSP beneficiaries that currently fall below the threshold will in 2008 be above, even if their exports have not increased relatively.

Any attempt to identify such effects must be speculative. Not only is it unclear which countries might be deemed to have 'GSP-equivalent' accords, but who knows which states' exports will

Box 4. Future exclusions from the GSP

1. Will countries be removed from the GSP only if their specific agreement has become as favourable as the GSP, or will their specific agreement be 'improved' up to GSP levels to facilitate their removal? The July Communication and the draft Regulation *appear* to say different things.
1. The draft Regulation would exclude an FTA member from the GSP 'if this agreement covers at least all the preferences provided by the present [GSP] scheme for this country' (preamble: para. 15). But the July Communication argues that, when making removals from the list, 'the Community *would of course ensure* that no country would lose as a result of this because GSP benefits for any particular product which formerly received GSP treatment should be consolidated into the FTA in question' (para. 6.3, emphasis added).
1. The difference could be critical to some current EU trade negotiations, such as those on EPAs. It might imply, for example, that EPAs including LDCs must

increase fastest. None the less, Table 4 provides an illustration of the possible implications. It shows the extra countries that would be graduated from the regime after 2008 if all the main countries which currently have a bilateral or regional trade agreement with the EU were removed from the GSP.

Table 4. Countries vulnerable to graduation from 2009 due to beneficiary removal^(a)

HS		Brief description	New graduation in 2009
Section	Chapters		
I	1-5	Live animals; animal products	Argentina
II	6-14	Vegetable products	—
III	15	Animal or vegetable fats and oils and their cleavage products	—
IV	16-24	Prepared foodstuffs; beverages; tobacco	—
V	25-27	Mineral products	Russia, United Arab Emirates
VI	28-38	Products of the chemical or allied industries	Russia
VII	39-40	Plastics and rubber and articles thereof	—
VIII	41-43	Raw hides and skins, leather, furskins and articles thereof	India
IX	44-46	Wood and articles thereof	—
X	47-49	Pulp of wood or of other fibrous cellulosic material	—
XI	50-63	Textiles and textile articles	India
XII	64-67	Footwear, headgear, umbrellas etc.	—
XIII	68-70	Articles of stone, plaster, cement asbestos, mica or similar	—
XIV	71	Precious or semi-precious stones; precious metals and articles thereof	—
XV	72-83	Base metals and articles thereof	—
XVI	84-85	Machinery and mechanical appliances; electrical equipment	—
XVII	86-89	Vehicles, aircraft, vessels and associated equipment	—
XVIII	90-92	Precision instruments; clocks; musical instruments	—
XX	94-96	Miscellaneous manufactured articles	—

Note:
(a) The table covers only 'main countries', i.e. those that are among the top 15 sources of GSP imports in any section. It is based on the values of covered imports in 2003 according to Commission figures with those for countries with bilateral/ regional agreements with the EU removed (the latter having been identified from UK Tariff).

Six new country/sector graduations occur (compared with ten first-time graduations in 2005). This is just as a result of this 'tidying up' exercise, since no other changes have been assumed.

As with the query over the use of covered or eligible imports as the denominator, it is perfectly possible for the EU to avoid this 'graduation creep'. It could decide simply to maintain the denominator as at present or to raise the 15 and 12.5 percent thresholds proportionately. But in the absence of any guidance, the effect of the draft Regulation must be to create uncertainty – not least in the minds of potential investors.

1.4. GSP+

1.4.1. What it is – and who is eligible

The proposed GSP+ (special incentive arrangements for sustainable development and good governance) replaces the current scheme's three types of special arrangement relating to labour rights, protection of the environment and illegal drug production and trafficking. It offers substantially improved preferences over the standard GSP, and covers a broader range of products. For those countries included in the special arrangements, simple *ad valorem* or specific duties will be suspended on all products covered by the GSP. For items subject to an *ad valorem* and a specific duty, the *ad valorem* element will be suspended. Duty suspensions will not apply to sections from which any given country has been graduated.

In order to benefit from these additional preferences, a country must:

- have ratified and effectively implemented:
 - 16 core human and labour rights UN/ILO Conventions; and
 - at least seven (of 11) conventions related to environment and governance principles;
- commit itself to ratify and effectively implement the remainder of the conventions;
- undertake to maintain the ratification of the conventions and their implementation, and to accept regular monitoring and review of its implementation record;
- be classified as 'vulnerable' (see below).

Beneficiaries must have ratified all 27 conventions by 31 December 2008.

1.4.2. Limitations on GSP+

GSP+ will not be available to every developing country that ratifies all the agreements. Countries must also satisfy additional criteria related to the value of their exports set out in Article 9.2(a) and (b) of the draft Regulation. These specify that a country is vulnerable only if it meets either of two criteria⁽¹⁾:

- **a diversification criterion** – the country is not classified as high income *and* the five largest HS sections account for over 75 percent of its covered imports (Article 9.2 (a)); or
- **a smallness criterion** – the country's covered imports represent less than 1 percent of the EU's total covered imports (Article 9.2 (b))⁽²⁾.

Two questions are whether the GSP+ criteria are 'development friendly' and whether they would sustain a WTO challenge. Table 5 lists the countries that would not be eligible for the special incentive arrangements – even if they ratified and implemented all the stipulated conventions – because they do not meet either of the two criteria.

Table 5. A priori exclusions from GSP+

Country ^(a)	GNI per capita 2003 (US\$) ^(b)
Argentina	4,220
Brazil	2,860
China	960
India	470
Indonesia	710
Philippines	1,030
Thailand	2,000

Sources: Data provided by the Commission; World Bank.

¹ The descriptive names have been coined by the authors of this paper.

² To be calculated using the data available on 1 September 2004 for an average over three consecutive years.

One excluded state, India, is classified by the World Bank as a low-income country; the July Communication identified low-income countries as one of the categories on which the GSP should focus. Five of the seven have *per capita* incomes of \$2,000 or less, which means that 36 richer developing countries will be eligible for GSP+ (if they sign up to the conventions). Indeed 14 GSP beneficiary countries are richer than all of the countries listed in Table 5. Such statistics might be relevant to any WTO challenge (see Box 5).

Box 5. The WTO dimension

1. The unfavourable WTO ruling on the special 'anti-narcotics' preferences in the current GSP has contributed to the design of the GSP+ (WTO 2004(a)). Importantly, the Appellate Body ruled against a claim by India that the GSP must offer 'identical' tariff preferences to all beneficiaries. It confirmed that different preferences may be given provided that the difference responds 'to a widely-recognized "development, financial [or] trade need" ...' (para. 164). But it also found that the justification given for the anti-narcotics regime failed to satisfy this criterion.

1. The Commission argues that the eligibility conditions for GSP+ do satisfy the criterion. But it remains to be seen whether the *a priori* exclusion of the countries listed in Table 5 would lay the scheme open to a further WTO challenge.

1. The Appellate Body gives an example of the 'objective standard' that could justify differential treatment for sub-groups within the GSP. The required '[b]road-based recognition of a particular need...' that would justify such differentiation is exemplified by recognition 'set out in the WTO Agreement or in multilateral instruments adopted by international organizations...' (para. 163). Whilst the conventions that eligible countries must apply appear plausibly to have such recognition, the same does not appear to apply to the diversification and smallness criteria.

1.4.3. The potential effects

The impact of GSP+ *could* be very substantial, but only if a high proportion of the countries not listed in Table 5 apply and are accepted. The new regime replaces two very different types of arrangement.

- **Deep but geographically restricted preferences** under the special anti-narcotics regime that provided substantial additional preferences to nominated countries. They have been well used by the beneficiaries.
- **Shallow but geographically unrestricted preferences** under the special regimes for protection of labour rights and the environment that provided modest additional preferences and have not been much used. Only two countries (Moldova and Sri Lanka) currently benefit under the former, and none under the latter. Two possible (linked) reasons for the low take-up are that: first, countries have been unwilling to accept the conditions (which are in areas considered contentious in the WTO), especially, second, when the gains from so doing are modest.

Will the applications for GSP+ be more substantial than for the labour/environment protection schemes? And will the applications succeed? If the answer is 'yes', the impact could be profound. GSP+ beneficiaries will be among the EU's 'most preferred' group. There could be three types of effect.

- **Trade creation.** The number of countries and products facing no tariff barriers in the EU would increase, resulting in more trade.
- **Trade diversion.** Countries elevated from the 'middle' to the 'most preferred' group would find that they have a competitive advantage over those that remain in the middle group and that they no longer face a competitive disadvantage compared with those that are already in the 'most preferred' group. They can expect to acquire some market share from both types of competitor. By the same

token, if some current beneficiaries of the anti-narcotics regimes fail to obtain GSP+ they will fall from the ‘most preferred’ to the ‘middle’ group – and lose markets.

- **Rules of origin.** If take-up were widespread, the origin rules would become a less important determinant of trade. The more countries that have identical access terms to the EU market, the less significant it is where the product ‘originated’. If, for example, a manufacturer in Pakistan uses inputs from Malaysia, the origin rules will determine whether or not the EU classifies the resulting good as Pakistani or Malaysian. But if the tariff for both Pakistan and Malaysia is 0 percent, the classification has no commercial importance.

The relative scale of these effects will be determined by the extent of GSP+ uptake. If many countries become eligible, the trade creation and rules of origin effects will predominate. If few countries become eligible, then trade diversion will be more marked, especially if beneficiaries of the anti-narcotics regime fail to obtain GSP+.

1.5. Extension of product coverage

Not all products are covered by the GSP – the full MFN tariff is charged on those that are excluded. It is proposed to add 243 new items to the GSP (General Secretariat of the Council, 2004)⁽¹⁾. Two-thirds of these are fish or fisheries products, and all the remainder are agricultural. The latter include some fresh horticulture and fruits, plus preserved and prepared meat, vegetables, fruits and juices (Table 6).

Table 6. Product groups in which coverage is extended^(a)

HS 4	# 8-digit items	Brief description	EU imports (€000) 2002
030 1	1	live fish	62
030 2	32	fish, fresh or chilled	208,765
030 3	50	frozen fish	595,399
030 4	26	fish fillets and other fish meat, whether or not minced, fresh, chilled or frozen	676,427
030 5	23	fish, dried, salted or in brine, smoked	58,626
030 6	4	crustaceans	7,834
030 7	2	molluscs	97,135
040 9	1 ^(b)	natural honey	169,016
070 7	1	cucumbers and gherkins, fresh or chilled	6,164
070 9	1	other vegetables, fresh or chilled	21,217
071 0	2 ^(b)	vegetables, uncooked or cooked by steaming or boiling in water, frozen	37,471
080 5	1	citrus fruit, fresh or dried	2,611
080 9	1	apricots, cherries, peaches incl. nectarines, plums and sloes, fresh	91
081 1	3 ^(b)	fruit and nuts, frozen	28,436
100 8	1	buckwheat, millet, canary seed and other cereals	2,188
130 2	1	vegetable saps and extracts	4,980
160 2	8 ^(b)	prepared or preserved meat, offal or blood	207,735
160 4	13	prepared or preserved fish	1,165,786
190 2	1	pasta	64
190 4	2 ^(c)	prepared foods obtained by the swelling or roasting of cereals or cereal products	307
200 2	8 ^(b)	tomatoes, prepared or preserved otherwise than by vinegar or acetic acid	79,208
200 7	10	jams, fruit jellies, marmalades, fruit or nut puree and fruit or nut pastes	3,474
200 8	30 ^(b)	fruits, nuts and other edible parts of plants, prepared or preserved	63,304
200 9	18	fruit juices and vegetable juices, unfermented	8,818

¹ These additional items are at the Combined Nomenclature (CN) 8-digit level. Four of them (two in HS 190420 and two in 210610) do not, however, appear in Annex II to the draft Regulation, and a further 27 are covered only by GSP+ (see Table 6).

210 6	2 ^(c)	food preparations n.e.s.	478
220 4	1	wine of fresh grapes, incl. fortified wines	2
Total			3,445,600
<p><i>Notes:</i></p> <p>(a) Coverage is extended only to the number of 8-digit items shown in the second column; this is not necessarily <i>all</i> the items within the respective HS4-digit heads shown in the first column.</p> <p>(b) For at least one of these items, the preference applies only to GSP+ beneficiaries.</p> <p>(c) These items do not appear in Annex II of the draft Regulation ('List of products included in the arrangements').</p> <p><i>Source:</i> General Secretariat of the Council, 2004.</p>			

Figures from the Commission indicate that EU imports in 2002 of the added items amounted to €3.4 billion. But it is necessary to deduct from this figure the value of imports from LDCs (already duty free) and also from countries that may already be receiving a preference on the added items because, in addition to the GSP, they benefit from trade agreements with the EU. Moreover, account must be taken that Brazil will be graduated out of the GSP for some of the additional items.

Taking account of all of this, the 'net' value of the trade covered by the new additions is in the region of €1.6 billion. The countries that are the main suppliers of the products concerned to the EU (and do not have trade agreements outside the GSP) are Russia, China, Argentina, Thailand and also Ecuador (which has access under the drugs-related GSP which is being phased out).

This €1.6 billion represents an increase of just 1 percent on the level of covered imports in 2002. By contrast, the value of EU imports of products that are still excluded from the GSP is almost seven times greater than the value of what has been added.

1.6. The GSP and Cotonou

The GSP is a ‘safety net’ for all developing countries. How adequate would it be for ACP states that do not enter into EPAs with the EU after 2007? One element of the answer is to be found by comparing the tariffs that the ACP states would pay on their exports to the EU if they were subject to the GSP rather than to Cotonou. It is not, though, the only element: Cotonou also provides special treatment under specific commodity protocols (especially for sugar), has particularly favourable provisions for cumulation under the rules of origin, and has a set of consultative and dispute resolution institutions. None of these would be replicated under the GSP.

On the narrow issue of whether or not EU tariffs would rise for non-EPA ACP states, the answer is clear:

- for LDCs they would not; EBA provides even more favourable access than does Cotonou;
- for non-LDCs, they would rise.

Table 7 shows that between 9.5 and 19.9 percent of the value of non-LDC ACP’s ‘significant’ exports would pay tariffs under the GSP, depending on whether or not states qualified for GSP+⁽¹⁾. Some €1.7 billion of EU significant imports from the ACP (9.5 percent) are for products that are covered neither by the standard GSP nor by GSP+. These are primarily sugar, bananas, aluminium, beef, long-grain brown rice and rum. A further €1.8 billion (10.4 percent) comprises items that are covered by the GSP but face positive (albeit preferential) tariffs under the standard regime, which can be as high as 20.5 percent (for tinned tuna) and 11.5 percent (for frozen hake and monkfish).

Table 7. Applying the GSP to the ACP

(tariff categories applicable to significant EU imports from ACP^(a))

Tariff category	€000 2002	Share of total trade
MFN zero	10,427,372	58.1
MFN not zero, but standard GSP zero	354,619	2.0
Positive standard GSP (GSP+ zero ^(b))	1,865,036	10.4
Not covered by either Standard GSP or GSP+	1,710,753	9.5
Total	14,357,780	80.1
<p><i>Notes:</i> (a) ‘Significant’ imports are those that accounted for 5 percent or more of any individual ACP country’s total in 2002. The table covers only imports from non-LDC ACP. (b) Except for two items (both frozen shrimps or prawns), for which the GSP+ tariff is 3.6 percent. <i>Sources:</i> Unctad; UK Tariff; CEC, 2004(b).</p>		

Hence, even if all non-LDC ACP states became eligible for GSP+ they would still face higher EU tariffs outside an EPA than they do at present. If the GSP is to be part of the ‘alternative arrangements’ that the EU is committed to consider for non EPA members, it will be necessary to consider further changes before 2008 for the ACP acquis to be maintained.

¹ No ACP state is excluded *a priori* from GSP+.

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Annex 1 The rules of origin

Since the draft Regulation proposes no changes to the GSP rules of origin the subject is not covered in the main body of the policy paper. But since it is an area of controversy, and given that the July Communication identified areas in which change is desirable, this annex reviews the key issues.

The issues ...

The Communication recognises that the rules of origin, which lay down the main criteria for access to preferences, were drawn up at a time when the international economy was very different from that of today and when goods were produced in a very different way. It argues that the need for change is widely recognised:

- in form (simplification);
- in substance (amendment of the origin criteria and cumulation rules); and
- in procedures (formalities and controls).

It identifies in particular the potential role of regional cumulation (Box 1) in promoting regional co-operation, seen by the Commission as a route to greater involvement in international trade. Regional cumulation was introduced into the GSP two decades ago. Members of four regional organisations are currently eligible for cumulation: the Association of South-East Asian Nations (ASEAN), the Andean Community, the Central American Common Market (CACM) and the South Asian Association for Regional Co-operation (SAARC). The Commission argues that '[f]urther consideration needs to be given to the possibility of *cross*-regional cumulation, based on requests coming from the different regional groupings' (para. 6.6).

The issue is to determine whether the current rules have the desired effect. Do they ensure that the countries benefiting from preferences are the ones the policy-makers intended? Or do they stifle exports from poorer countries by requiring unreasonably high levels of processing, thereby excluding from GSP benefits the type of goods that they can realistically expect to produce?

There is no *a priori* reason for supposing that a favourable or a critical view of origin rules is always (or even often) the more reasonable. The

'proof of the pudding is in the eating' – in terms of seeing whether or not a given set of rules does result in the emergence of a sustainable export trade that develops appropriate backward and forward linkages. A generalisation that a particular country's origin rules are 'unduly onerous across the board' (or the reverse) will usually go beyond the facts.

... and why they are difficult to resolve

The fundamental reason why it is hard to find such evidence is that if there were perfect information failures to meet origin rules would never occur! Investors would not develop production lines for export under a preference agreement if they knew the rules of origin

Box 1. What are the rules of origin?

1. Since preferences vary the import tax levied by the EU it is important that they accrue only to the intended beneficiary. If the product is wholly produced within a country there is no cause for uncertainty – but many processed and manufactured goods contain inputs from around the world. The rules of origin indicate what work has to be undertaken in a country for its exports to be classified as 'originating', and thus eligible for preference. They are usually expressed in terms of the allowable imported inputs, the processes that must be undertaken domestically or the value that must be added in a country.
1. In some cases, the required work may be 'shared' between two or more preference receiving states (or the EU). This is called 'cumulation'. The most extensive provision is in the Cotonou Agreement which has pan-ACP/EU cumulation, i.e. the required work can be shared between any EU or ACP state. The GSP has limited regional cumulation: so far only the countries of four regional groups can cumulate with other members of their agreement (but not with parties to

would not be met. Either the investment would not occur or the factory would be competitive even without the preference. In either case, there would be no evidence of a firm dispatching goods that would have been competitive at the preferential tariff but are not at MFN rates. And, indeed, it is alleged that unduly onerous rules of origin have deterred investment:

... the rules as presently enforced have substantially reduced the prospects for increased exports on the back of [foreign direct investment] into the industrial and processed foodstuffs sectors of many of the world's poorest countries (Cerrex, 2002: 40).

Since knowledge is not perfect, cases of frustrated investment and exporting do occur and can be catalogued, but there is usually plenty of scope for reasonable disagreements over whether or not the trade would have been sustainable had the preference been granted. Ideally there should be a clear counterfactual of what might have been – such as evidence that country X can export successfully to market Y under one set of rules of origin but not to Z under another set. 'Hard evidence' on the appropriateness of any given origin rule is likely to be in one of the following forms:

- a comparison of exports from the same (or analogous) countries to two or more markets in which different rules of origin apply;
- studies on the global distribution of production processes for relevant products to indicate technical and commercial 'norms' for the variables used in the rules of origin.

The first type of evidence is particularly helpful – but rarely available. In both cases the evidence is likely to be highly product specific. Fortunately data of the first type have been collated in an area that, whilst not directly concerned with the GSP, is sufficiently analogous to provide helpful lessons (see Box 2).

Potential changes

The many origin rule changes that have been floated fall into three main groups:

- a reduction in processing/value added required to obtain originating status;
- wider cumulation;
- simplification.

The experience described in Box 2 shows what can happen when the process/value-added criteria are relaxed. In the particular case described, the relaxation applied only to clothing, and the African gains may be reversed now that the Multifibre Arrangement has expired. But there is no reason to suppose that similar – and more sustainable – gains would not occur for other products if they were subject to a similar relaxation.

As explained in Section 4, wide cumulation may equally offset the commercial obstacles presented by excessive processing requirements. Global cumulation would solve all problems – but defeat the objective of the rules of origin. The issue is

Box 2. Relax the rules and exports boom!

A comparison of exports from sub-Saharan Africa of clothing to the EU under the Cotonou rules of origin and to the USA under the African Growth and Opportunity Act (AGOA) rules provides one rare opportunity to make direct comparisons (Stevens and Kennan, 2004). Since the EU's GSP origin rules for clothing are identical to those for Cotonou, the differences with AGOA apply with equal force. The EU's rules of origin have stifled clothing exports, especially from the poorer states. Whilst the more advanced African states (such as Mauritius) have been able to cope with them to some extent others have not, and clothing exports to the EU have been negligible despite 25 years of preferences. Yet 2–3 years of AGOA, with less onerous rules of origin, sparked vigorous exports to the USA. The goods are only modestly processed, but the evidence is that the economic effects on the exporting state are positive (*ibid.*).

The key difference between the Cotonou (and GSP) clothing rules and those for lesser developed countries under AGOA is that the latter allow the use of non-originating imported cloth. Save in the case of knitwear 'obtained directly to form' (e.g. knitted into clothing parts from yarn on a knitting machine), the Cotonou (and GSP) rules require either two or three industrial processes to be undertaken on any non-originating imported inputs; AGOA requires only one.

one of identifying from among the cumulation changes that might be politically feasible those likely to have the greatest impact.

A compromise widely canvassed is to allow cumulation between all LDCs. There is some *a priori* reason to suppose that small states may gain by having access to a wider range of raw materials than is to be found within their own borders. But the proposed change will open up new opportunities only if:

- the required inputs can be sourced cost effectively from a country with which cumulation is allowed; and
- it is not already possible to use them under the existing rules⁽¹⁾.

The problem with limiting cumulation to just least developed countries is that it reduces the likelihood of the first condition being met. A group of tiny, scattered economies is far less likely to be able to make good the supply deficiencies of a member than is a group that includes larger economies.

Simplification can be compatible with the other changes, but only if it does not result from harmonisation around the toughest standards. For example, the 'realistic' level of value added achievable in a poor country will vary from sector to sector: research suggests that in consumer electronics firms value added of under 10 percent is often the norm (Cerrex, 2002: 89). A 'simplification' that standardised on a 30 percent value-added requirement would represent a relaxation of the *status quo* for plastics but prejudice use of the GSP for consumer electronics.

¹ Such inputs can already be used without cumulation if either of two conditions is met. Either the materials are classified under a different HS heading and the rules of origin are based on the tariff-jump criterion, or the materials form a relatively small share of ex-works value and the rules of origin are based on value added.

Annex 2 Preference utilisation rates by country

Average 2001–3 (all items)

(in descending order of average utilisation rate)

Country	Average utilisation rate 2001-3	Average eligible import value (€000) 2001-3	Lowest and highest section utilisation rates 2001-3 ^(a)
Peru	92.2%	389,823	96 – 97.7%
Cuba	90.6%	193,658	89.2 – 90.4%
Nicaragua	87.5%	23,350	n/a
Ecuador	85.7%	307,636	76.3 – 86.3%
Colombia	84.8%	387,883	86.3 – 99.4%
Guatemala	83.0%	116,886	n/a
Tajikistan	81.7%	22,192	n/a
Costa Rica	80.5%	421,598	74.7 – 93.2%
India	80.5%	7,469,128	39.5 – 98.6%
Nepal	79.7%	97,620	n/a
Argentina	79.3%	1,474,337	35.1 – 98.5%
Libya	79.2%	220,547	77.8 – 88.3%
Venezuela	78.2%	580,238	68.8 – 96.3%
Pakistan	78.1%	1,949,770	2.3 – 94.4%
Honduras	76.4%	94,667	n/a
Uzbekistan	76.1%	88,271	n/a
Bolivia	76.0%	13,134	n/a
Kyrgyzstan	73.4%	2,736	n/a
Kuwait	73.3%	669,828	69.5 – 82.9%
Brazil	73.1%	3,370,136	20.6 – 99.5%
Turkmenistan	72.8%	53,702	n/a
Uruguay	72.5%	116,686	64.6 – 67.9%
Paraguay	72.1%	19,147	n/a
Yemen	70.5%	29,807	n/a
China	69.7%	24,682,243	0.5 – 92.9%
Iran	67.8%	614,725	92.5 – 94.6
Moldova	67.0%	113,799	n/a
Vietnam	67.0%	3,571,687	10.9 – 93.1%
Panama	65.6%	39,179	n/a
Chile	63.8%	540,698	4.9 – 96%
Laos	62.9%	126,535	n/a
Georgia	62.5%	38,834	n/a
Armenia	61.9%	25,232	n/a
Mongolia	61.8%	8,329	n/a
Thailand	61.6%	3,679,197	0 – 93.5%
Indonesia	61.5%	4,757,390	25.1 – 99.5%
Malaysia	60.9%	2,182,403	13.9 – 93.9%
Bahrain	59.0%	335,097	0 – 91.6%
Bangladesh	58.4%	3,302,877	51.4 – 98.7%
Lesotho	57.3%	2,757	n/a
Russia	55.9%	2,096,498	2.8 – 100%
Ukraine	55.2%	1,375,711	23.4 – 98.6%
Cambodia	50.9%	485,921	56.1 – 88.9%
Kazakhstan	50.3%	120,738	34.5 – 66.7%
Haiti	49.9%	4,211	n/a
Belarus	49.4%	397,534	76 – 87.8%
Saudi Arabia	49.3%	1,438,206	0 – 98.2%
South Africa	47.0%	4,652,021	5.5 – 93%
Azerbaijan	44.8%	56,171	40.1%
United Arab Emirates	44.5%	1,535,743	0 – 91.5%
Philippines	42.8%	1,365,713	10.9 – 90.3%
Br. Indian Ocean Terr.	41.8%	148	n/a

Country	Average utilisation rate 2001-3	Average eligible import value (€000) 2001-3	Lowest and highest section utilisation rates 2001-3 ^(a)
Sri Lanka	37.8%	1,082,668	18.1 – 89.7%
Seychelles	37.5%	17,655	n/a
Bouvet Island	31.2%	15	n/a
Qatar	31.1%	84,938	0%
Netherlands Antilles	29.3%	42,309	n/a
El Salvador	29.2%	34,973	0.7%
Nauru	25.6%	535	n/a
Oman	23.4%	122,833	0 – 14.4%
Aruba	21.8%	47,674	n/a
Kiribati	19.3%	537	n/a
Pitcairn	17.0%	378	n/a
Samoa	14.2%	1,833	n/a
Fiji	13.1%	4,419	n/a
US Virgin Islands	12.9%	5,705	n/a
Wallis and Futuna	12.0%	172	n/a
Algeria	11.8%	1,300,788	11.8 – 14.8%
Anguilla	11.7%	312	n/a
Ethiopia	11.7%	27,129	n/a
Guam	11.0%	420	n/a
Nigeria	10.4%	236,495	0 – 61.4%
Montserrat	9.4%	127	n/a
Syria	9.0%	247,435	87.1%
Egypt	8.5%	1,556,835	0 – 40.9%
Equatorial Guinea	8.1%	54,675	n/a
Macao	8.0%	196,830	0 – 14.3%
Mali	6.7%	4,528	n/a
Swaziland	6.5%	32,907	n/a
Bhutan	6.4%	220	n/a
East Timor	6.3%	740	n/a
Lebanon	6.2%	100,585	n/a
Cook Islands	6.0%	204	n/a
Eritrea	5.5%	1,229	n/a
Namibia	5.5%	191,288	0 – 1.2%
Maldives	5.4%	17,163	n/a
Djibouti	5.1%	2,413	n/a
American Samoa	4.6%	234	n/a
Mexico	4.6%	2,791,878	0.8 – 38.8%
Tokelau Islands	4.2%	4,599	n/a
British Virgin Islands	4.1%	4,707	n/a
Tuvalu	4.1%	731	n/a
Somalia	3.9%	458	n/a
Togo	3.9%	19,196	n/a
Botswana	3.3%	32,806	n/a
Surinam	3.3%	24,358	n/a
Tonga	3.2%	495	n/a
Grenada	3.1%	2,588	n/a
Sierra Leone	3.1%	16,079	n/a
Tanzania	3.1%	79,979	n/a
Belize	3.0%	9,673	n/a
Trinidad and Tobago	2.9%	341,338	0 – 7.2%
Uganda	2.8%	62,337	n/a
Afghanistan	2.7%	14,317	n/a
Niger	2.6%	2,839	n/a
Malawi	2.5%	126,882	0.5 – 1.7%
Burundi	2.4%	932	n/a
Dominican Republic	2.4%	133,821	n/a

Country	Average utilisation rate 2001-3	Average eligible import value (€000) 2001-3	Lowest and highest section utilisation rates 2001-3 ^(a)
Zambia	2.4%	53,390	n/a
French Polynesia	2.3%	7,248	n/a
Madagascar	2.1%	391,917	0 – 0.3%
Congo Republic	2.0%	29,998	n/a
Antigua and Barbuda	1.9%	27,121	0%
Jordan	1.9%	48,345	n/a
Liberia	1.9%	8,829	n/a
Congo DR	1.8%	4,476	n/a
Kenya	1.8%	500,054	0.1 – 5.5%
St Kitts and Nevis	1.7%	1,896	n/a
Guinea	1.6%	25,125	n/a
Cameroon	1.4%	106,412	0.1 – 1.7%
Barbados	1.3%	7,962	n/a
Benin	1.3%	6,447	n/a
Côte d'Ivoire	1.3%	613,903	0 – 13.7%
Zimbabwe	1.3%	408,460	0 – 5.8%
Brunei Darussalam	1.2%	13,549	n/a
Jamaica	1.2%	94,327	n/a
Micronesia	1.1%	27	n/a
Ghana	1.0%	193,304	0 – 1.3%
Burkina Faso	0.9%	8,452	n/a
Papua New Guinea	0.9%	160,263	0 – 1.5%
Cape Verde	0.8%	11,209	n/a
Gambia	0.8%	10,782	0%
Guyana	0.8%	8,456	n/a
Chad	0.7%	3,014	n/a
Mauritius	0.7%	728,020	0.2 – 1.3%
Morocco	0.7%	4,700,052	0 – 14.9%
Mozambique	0.7%	88,347	n/a
Rwanda	0.6%	1,809	n/a
Comoros	0.5%	16,413	n/a
Gabon	0.4%	89,613	0.1 – 0.7%
Tunisia	0.4%	5,107,611	0 – 31.6%
Turks and Caicos	0.4%	8,416	n/a
Bahamas	0.3%	75,842	n/a
New Caledonia	0.3%	13,699	n/a
Senegal	0.3%	248,307	0 – 1%
Central African Rep.	0.2%	1,367	n/a
Marshall Islands	0.2%	781	n/a
Mauritania	0.2%	106,941	0 – 0.2%
Myanmar	0.2%	107,162	n/a
St Lucia	0.2%	1,945	n/a
St Vincent/Grenadines	0.2%	11,944	n/a
Sudan	0.2%	9,814	0%
Vanuatu	0.2%	1,727	n/a
Angola	0.1%	43,999	n/a
Dominica	0.1%	9,817	n/a
Gibraltar	0.1%	45,429	0%
N. Mariana Islands	0.1%	997	n/a
Falklands	0.0%	73,826	n/a
Bermuda	0.0%	15,250	n/a
Cayman Islands	0.0%	12,354	n/a
Greenland	0.0%	6,155	0%
Guinea-Bissau	0.0%	3,580	n/a
Mayotte	0.0%	1,926	n/a
St Helena	0.0%	1,405	n/a

Country	Average utilisation rate 2001-3	Average eligible import value (€000) 2001-3	Lowest and highest section utilisation rates 2001-3 ^(a)
Sao Tome/Principe	0.0%	1,077	n/a
Iraq	0.0%	826	n/a
French southern lands	0.0%	606	n/a
Solomon Islands	0.0%	502	n/a
St Pierre et Miquelon	0.0%	490	n/a
Christmas Island	0.0%	112	n/a
Niue	0.0%	50	n/a
Antarctic	0.0%	45	n/a
S.Georgia/Sandwich Is.	0.0%	41	n/a
Coconuts Islands	0.0%	38	n/a
Minor US outlying is.	0.0%	36	n/a
Heard/McDonald Is.	0.0%	17	n/a
Palau	0.0%	5	n/a
Norfolk Island	0.0%	2	n/a
All countries	51.5%	99,388,550	
<i>Note:</i>			
(a) Refers only to countries which are among top 15 suppliers of at least one section, and the ranges shown apply only to the sections for which they are among the top 15 suppliers. The range shown is the lowest and highest utilisation rate in any section in any of the three years.			
<i>Source:</i> Commission GSP statistics			