Regaining GSP Plus for Sri Lankan Exports to EU: Industry Perspectives

By Anushka Wijesinha and Jayani Ratnayake

In one day from today Sri Lankan exporters would once again be able to export over 6,000 products duty free to European Union countries, giving a much needed boost to the export sector. Seven years since losing the preferential trade scheme, Sri Lanka has regained it following two votes; first at the EU Parliament and then at the EU Council of Ministers. This is an important victory for the country at a time when overall exports have been performing poorly. During 2015 and 2016, exports declined year-on-year for 17 months straight (March 2015 to July 2016) except for a modest bump in September, August and November 2016.

Quick Overview of GSP Plus

GSP Plus offers incentives in the form of duty reductions on exports as a reward to developing countries for their commitment to upholding the 27 core international conventions on human and labour rights, sustainable development and good governance. Then the country must also be considered 'vulnerable' under two conditions; the country is not competitive in the EU market (the import-share ratio is less than 6.5% of EU's total GSP imports) and the country does not have a diversified export base (seven products account for over 75% of that country's total GSP imports to EU). There are currently eight other GSP Plus beneficiaries - Armenia, Bolivia, Cape Verde, Kyrgyzstan, Mongolia, Pakistan, Paraguay and the Philippines.

Another important aspect of the current GSP Plus scheme that gets less attention is the ability of countries to make use of 'regional cumulation' to gain advantage of Rules of Origin (ROOs) in instances where product input cannot be sourced locally. Regional cumulation encourages regional co-operation amongst those countries that are both GSP beneficiaries and members of a regional grouping recognized by the EU. There are two main types of regional cumulation that can benefit Sri Lanka - SAARC Regional Cumulation and Cross Regional Cumulation – e.g. between SAARC and ASEAN. Sri Lankan exporters should study the possibilities of regional cumulation in their supply chains in order to maximize what GSP Plus can offer.

Sri Lanka will continue to be eligible for GSP Plus as long as the periodic reviews (the first one coming in two years) by the EU do not raise any red flags with regard to implementation of agreed human rights and governance reforms. Yet, once the country graduates to an 'upper-middle income economy' status (as classified by the World Bank) and remains at that classification for three years, then Sri Lanka becomes no longer eligible for GSP Plus (with a grace period of around two years). Moreover, at that stage, Sri Lanka would no longer be eligible even for the regular GSP scheme. Sri Lanka's graduation will of course depend on our growth rates over the next few years (slower growth would mean longer time to graduation), the value of the currency (sharper depreciation against the USD would mean longer time to graduation), and the country classifications of the World Bank (which are revised annually under the World Bank Atlas Method, in line with global Purchasing Power Parity levels).

Potential Gains from GSP Plus

The primary way in which Sri Lanka will gain from GSP Plus is by our exporters having duty free access to the EU market on a whole range of products, which were previously only under a preferential tariff through the GSP scheme. The additional tariff advantage will greatly strengthen Sri Lankan exports' relative competitive position in the EU. Sectors like apparels, processed food products, seafood, toys products, porcelain and ceramic ware, are some of the main sectors that will benefit under GSP Plus. The additional tariff concession gained by these sectors will vary; in many apparels categories duties are cut from 9.6% to zero, in the seafood sector from 18.5% to zero, in the fresh and processed fruits and vegetable sector from 12.5% to zero, in the porcelain and ceramic ware sector from 8.4% to zero, and in the toy products sector from 1.2% to zero.

Regaining of the GSP Plus facility is expected to give a major boost to Sri Lanka's top export product, apparel, which claims the lion share of total exports to the EU (61%). Our calculations on 2016 exports in nine HS categories in the apparel sector (covering around 40% of total apparel exports to EU) estimate that this additional reduction of tariffs under GSP Plus is valued at around USD 60 Million. Our discussions with apparel exporters over the last two weeks indicate that more EU customers would now change their sourcing strategy (which currently is tilted towards duty free countries like Bangladesh and Cambodia) in favour of Sri Lanka. Given that ROO under GSP Plus requires fabric to be sourced from Sri Lanka (or from an area that qualifies for regional cumulation) in order to qualify for GSP Plus, there will be an increase in demand for fabric sourced from Sri Lankan fabric mills, rather than from countries such as China.

While it is difficult to provide a full analysis of what was lost, looking at how Sri Lanka's competitors fared in the EU market, give some sense of how Sri Lanka lost out to Asian apparel exporters. According to the International Trade Centre, Vietnam, Pakistan and Cambodia all trailed Sri Lanka in 2009, with EU exports at USD 2.1 billion, USD 1.5 billion and USD 1.09 billion respectively, against Sri Lanka's USD 2.3 billion. By 2015, however, Vietnam's apparel exports to the EU had risen to USD 3.9 billion, Pakistan's to USD 2.9 billion and Cambodia's to USD 3.7 billion, with Sri Lanka trailing at USD 2.4 billion.

GSP Plus Amidst EU Growth Recovery

The regaining of GSP Plus is especially timely as EU economies are beginning to show signs of economic recovery, which will hopefully improve demand conditions for Sri Lanka's exports to the EU. As the Economic Intelligence Unit's Monthly Economic Update for March 2017 observed, headline data is showing positive momentum in the Eurozone's economic recovery – for instance, fifteen consecutive quarters of GDP growth. The latest Spring Economic Outlook of the EU projects 1.9% growth in 2017 and 2018, up by 0.2% and 0.1% respectively.

Following the economic crisis, high unemployment rates in the EU had been a severe dampener on economic activity and consumer demand. The fact that this is now declining is certainly a positive sign. Unemployment in the EU has been trending downward and is expected to fall to 8.0% in 2017 and 7.7% in 2018; the lowest since late 2008. This has been a result of rising domestic demand, structural reforms and other government policies in certain countries that encourage robust job creation. Private sector investment was at a six year high in February, although political uncertainty continues to weighs heavily on economic prospects. A good signal of the region's economic recovery will be the European Central Bank (ECB) decision on renewing, or not, its stimulus lending program set to expire shortly.

Industry Perspectives

In order to get a quick sense of how the GSP Plus is likely to boost key export sectors, we conducted in-depth interviews with industry leaders in these sectors and asked specific questions, for instance on how their order books would change as a result of GSP Plus; how much of the additional tariff advantage would be retained at home; and what challenges they may face in meeting new demand. Leading apparel exporters have reported to us they anticipate a 10-15% boost in export earnings in the 12 months following the regaining of GSP Plus, and will particularly accrue to smaller players in the sector. One large exporter was confident that the apparel industry would be able to achieve over a 25% increase in export volumes over 18 months. Given that most contracts have already been finalized for the year 2017, real benefits will be seen in 2018. Yet, some expect a 4-5% bump in 2017 itself.

It is not just the apparel industry; there are big gains likely to be made in other export categories such as fresh and processed vegetables and fruits. One agro products exporter noted that their company "could expand their export volume to EU by more than 50% within a short period". Industry leaders in this sector observed that the benefit of the 12.5% tariff reduction would be a three way split among the customer, exporter and the farmer with as much as 50% of it going to farmers (at least 10,000 -12,000 registered farmers they work with) as they believe in strengthening the supply is key to ensuring sustained supply for EU exports. This demonstrates the possible impacts on rural livelihoods from regaining GSP Plus.

Several companies noted that they are already in contact with EU buyers who have shown positive signals on placing new orders as soon as the GSP Plus is reinstated. One exporter mentioned that their current export volume of processed vegetables could be increased from current level of 5 to 6 containers to about 30 containers per month. They are confident on overcoming production capacity constraints by doubling the work shifts and automating the production process. Sri Lankan exporters in these sectors can exploit the potential for agro-based processed food exports in collaboration with European companies through joint ventures and transfer of technology.

Meanwhile, seafood exporters were upbeat about regaining GSP Plus as it will bring an 18%-23% reduction in tariffs and the current export volume of USD 230 Mn could be doubled within this year. Yet, they cautioned that the noticeable decrease in live fish in the Sri Lankan deep waters is posing a threat to the medium to long-term ability of the sector to meet new demand.

Exporters of bicycles to the EU market noted a likely 50% boost in orders; but will be only experienced in 2018, given the 3-6 month order cycle, and exporters of porcelain and ceramic ware expect GSP Plus to boost exports by 5% - 10% over next 18 months.

Challenges to Overcome

Some exporters anticipate capacity constraints by way of labour shortages, particularly for SME-level exporters. This issue was raised by sectors ranging from apparels to ceramics. Rather alarmingly, several exports we spoke with have not taken initiatives to expand their production to prepare for new demand. The government has a role to play in helping SME exporters boost production quickly and leverage on the GSP Plus opportunity, than be held back by capacity constraints.

Exporters who had shifted their export focus away from the EU market over the last 7 years since the loss of GSP Plus acknowledge that regaining their presence in the EU and restoring market share cannot be achieved overnight, and it will take time. Once again, this is where government authorities like the EDB and our diplomatic missions in EU countries can help prospective exporters with finding new partners and help to quickly break back in to the EU market.

Many apparel and ceramics exporters also observed that the looming 'Brexit' could have a negative impact on realizing GSP Plus benefits fully. In apparels, for instance, the UK accounts for more than 40% of total exports to EU. The government would need to move early to forge a deal with the UK; if a bilateral FTA would take time, Sri Lanka can lobby for the UK to grant GSP Plus type access to the UK market for Sri Lanka exports.

Concession Shouldn't Breed Complacency

It is important that the Sri Lankan exports sector use the GSP Plus period as 'breathing space' rather than 'comfort zone'. The government can consider launching a targeted, accelerated, and cost-effective programme to support export sectors capable of expanding their exports to the EU. This can range from loans for technology upgrading and innovation; targeted support for market development, skill training and labour attraction schemes; support for quality and standards improvement; and fast-tracking approvals and certifications. Sri Lanka must use this window to boost competitiveness of our exports to the EU and not be complacent. As the country fast approaches 'Upper Middle Income' status and will thereafter not be eligible for GSP Plus or GSP, building export success beyond the concessionary scheme is crucial.

Anushka Wijesinha and Jayani Ratnayake are economists with the Economic Intelligence Unit of the Ceylon Chamber of Commerce. This article is part of the Chamber's 'Trade Intelligence for the Private Sector' (TIPS) initiative. Write to eiu@chamber.lk to engage.

EIU

Prepared by Economic Intelligence Unit (EIU), The Ceylon Chamber of Commerce.
For queries, contact EIU on eiu@chamber.lk