



INTERNATIONAL TRADE: EU UPDATE

The EU proposes a radical overhaul of its GSP

1. Executive Summary

The European Commission has issued a proposal to radically change the EU's General System of Preferences ("GSP"). The most controversial point is to cut the number of GSP beneficiary countries by more than half. The Commission is also proposing to exclude countries that sign an FTA with the EU.

The Commission aims to have the proposed new GSP effective as of January 1, 2014. Both the date and the actual outcome will largely depend on the EU decision-making process, which requires input and approval by the European Parliament and the European Council.

This newsletter outlines the three main GSP schemes; explains the key proposed changes to the GSP; sheds light on the interplay between GSP and the GSP rules of origin, which have recently undergone important changes; and provides examples of what GSP users and beneficiaries should now consider, both in practice and in contacts with decision-makers.

2. Overview of the EU's GSP

Like the current GSP, the new GSP will cover three separate regimes:

- **General GSP:** The EU continues to offer GSP beneficiary countries (i) a zero duty upon import of all non-sensitive products, and (ii) a duty reduction of 3.5% for sensitive products.

Under the Commission's proposal, around 96 of the current 176 countries will be removed from the general GSP, with only 80 countries remaining. The threshold for removal is World Bank classification as a high or upper middle income economy during the past three years. Some argue that the World Bank listing is arbitrary. During the decision-making process other criteria may therefore be examined.
- **GSP+:** Under this regime, the EU offers products of so-called "vulnerable" countries a zero duty upon import for all goods covered by the GSP. The GSP+ will be subject to some major changes, by which it may become easier to obtain GSP+ status but harder to maintain it.
- **EBA:** The Everything But Arms continues to offer all goods except arms originating in least developed countries ("LDCs") duty free access to the EU market.

3. Key characteristics of the new GSP

The following five changes to the GSP are examined below: (1) the GSP will become open-ended; (2) the criteria for the new GSP+; (3) the introduction of “unfair trade practice”; (4) changes to the graduation mechanism; and, (5) exclusion of countries that conclude an FTA with the EU.

3.1. Open-ended GSP

To enhance predictability, the Commission has proposed removing the expiration date for a particular GSP scheme, thereby making it “open-ended.” Historically, GSP schemes have lasted three years with the possibility of extension. By removing the end-date, the Commission wishes to make the GSP scheme, and therefore also sourcing from GSP countries, more predictable. However, predictability may be undercut by other factors, such as the threat of graduation and GSP+ exclusion procedures, which are loosely defined in the Commission’s proposal.

3.2. GSP+: “relaxation” of rules but tougher monitoring

The new scheme will make it easier for countries to join GSP+:

- The import threshold of the “vulnerability” criteria for GSP+ beneficiaries to join will be increased from 1% to 2% of EU GSP imports. This means that a country will be eligible for the GSP+ benefits if its GSP-covered imports into the EU represent less than 2% of the value of the total imports into the EU of GSP products originating in GSP countries. However, as the number of GSP beneficiaries will drop substantially, so will the total value of GSP imports into the EU. It is therefore unclear whether, even with the increase from 1% to 2%, there will be a true relaxation of the vulnerability threshold.
- GSP+ countries will no longer be subject to product *graduation* (exclusion of benefits for certain product sections), making it more predictable to source their products (see discussion on graduation below). Either a country enjoys GSP+ or it doesn’t.
- Applications to join GSP+ will be considered at any time, rather than once every 1.5 years.

However, current GSP+ beneficiaries will not automatically re-qualify for the new GSP+; they will need to reapply. All applications will be examined before the introduction of the new scheme. It is therefore impossible to determine which countries will benefit from GSP+ as of January 1, 2014. Moreover, because data on GSP imports is not made publicly available, it is difficult for stakeholders to predict which countries may eventually be granted GSP+. We expect that this point will be debated during the remainder of the decision-making process.

Even if joining is made easier, the Commission will monitor compliance with GSP+ conditions more strictly:

- The Commission will continuously monitor beneficiaries’ compliance record. Every two years, the Commission will present a report to the Council and the European Parliament on the beneficiary countries’ ratification, reporting obligations and effective implementation. As of this writing, the standard of the review is not yet known. Only the first reports will provide an indication of what the Commission considers “effective implementation.” Again, this may become a point of controversy in the decision-making process.
- In addition, the Commission will be able to start so-called exclusion procedures. These new powers have not been further defined and the proposal contains neither criteria for initiating exclusion procedures nor details on the type of scrutiny the Commission might perform. The risk of exclusion procedures will likely give rise to discussions in the decision-making process and given the more frequent reviews mentioned above, this new power for the Commission may even be considered superfluous.

- Beneficiaries will have a reporting obligation and need to prove that they are abiding by their commitments. Under the current scheme, the Commission must prove that countries are in breach before removing GSP+ benefits.

Stricter monitoring of compliance, plus the threat of exclusion, will tend to favor countries and stakeholders who are already comfortable with international conventions and savvy about dealing with the Commission.

3.3. Inclusion of (an unclear definition of) “unfair trade practices”

GSP beneficiary countries will also face a risk of exclusion in case of serious and systematic “unfair trading practices” that have an adverse effect on EU industry. The proposal tries to give hand and feet to the EU’s Global Europe and Raw Materials Initiative by explicitly listing practices that may affect the supply of raw materials. Besides a nexus to a practice being WTO “prohibited or actionable”, the lack of definition of “unfair practices” leaves uncertainty and it is likely to raise discussions in the decision-making process. It remains to be seen how the EU will use this tool, but some stakeholders may try to raise the possible exclusion as leverage in case of trade problems.

3.4. Graduation – removing preferences for GSP product sections

The proposal modifies the current product graduation mechanism.

- The threshold for goods being graduated will increase from 15% to 17.5 % (and from 12.5 to 14.5% for textiles). Thus, if the GSP imports in a product section from a certain country become 17.5% or more of the total GSP imports into the EU in that section the country will lose its preferential treatment for all products falling under that section.
- The product sections used for graduation have been expanded from 21 to 32 sections. As a result, some products may graduate more quickly out of GSP because lower import volumes in other product sections cannot offset high volume in the products that face graduation.
- The number of GSP beneficiaries and thus also the total value of GSP imports into the EU will drop. This makes for a higher risk of graduation for any product section. It is unclear whether the increase in the thresholds offsets that risk.

3.5. Excluding countries with FTAs – not having the best of both worlds

The new GSP both incents countries to and deters them from signing an FTA with the EU. In general, countries that enjoy some kind of an FTA with the EU will no longer benefit from the GSP scheme. (This has implications for *regional cumulation* (see below), for graduation, and for GSP+ vulnerability criteria since the total value of GSP imports into the EU will become smaller.) Therefore, the new GSP may make countries less inclined to sign an FTA since they would lose GSP or GSP+. On the other hand, this change may stimulate the countries that are losing their GSP status to start FTA negotiations with the EU. Also, under the new provisions of *extended cumulation* (see below), GSP countries may apply to use specific materials from a country if the EU has an FTA with that country.

4. GSP and the new rules of origin

The devil is in the detail, and for GSP the detail is in the GSP rules of origin. These determine whether a product from a GSP country actually “originates” there. These rules have recently been remodeled (as of January 1, 2011) and are part of the EU’s customs rules. To understand the full impact of the proposed new GSP, it is important to examine the new rules of origin.

4.1. Relaxed list rules for LDCs (those benefiting from EBA)

The rules of origin spell out how much non-originating materials a producer in a GSP country may use in products to still claim GSP preferences. These maximum content thresholds, contained in Annex 13a of the rules, vary from product to product. Historically, the rules have applied alike to all beneficiary countries (i.e. LDCs, GSP beneficiaries and GSP+ beneficiaries). The remodeled GSP rules of origin have however introduced separate thresholds for LDCs, which make it easier for LDCs to obtain GSP origin for certain goods. Two telling examples are:

- making clothes (apparel) by “single transformation” from imported fabric instead of from fabric that is woven in the LDC, and
- making TVs with imported materials up to a value of 70% of the ex-works price of the TV, instead of the 50% threshold that applies for other GSP beneficiaries.

In view of these new rules, production and investment in LDCs may become more attractive.

4.2. New cumulation rules

Cumulation is a form of relaxation of the rules of origin and means that material imported from certain countries is considered to be sourced locally and therefore originating in the beneficiary country. There are several types of cumulation. *Regional cumulation* allows the use of materials from other GSP countries in the same region as *if* they were sourced locally and not imported (i.e. considered as originating materials). The new GSP rules of origin have relaxed the regional cumulation rules and introduced the concept of *extended cumulation*. Stakeholders should review the new rules, to see if their operations could benefit.

Regional cumulation

The rules concerning regional cumulation will no longer require fulfillment of a minimum value-added criterion in the country that last processed and exported a product to the EU. This allows goods to originate in the country from which they are dispatched. Further, because separate rules of origin sometimes exist for LDCs, cumulation has now been made possible between countries with different origin rules (i.e. a LDC and a GSP+ country). Also, the Commission can grant regional cumulation between two specific regional groups.

Not surprisingly, the new rules have been introduced with precautions, including a special list of goods for which regional cumulation does not apply (Annex 13b). Another restriction is that a country in a given region who eventually decides to sign an FTA with the EU will no longer be part of the GSP system. As a result, the other countries of the same group will no longer be able to benefit from regional cumulation with that country. It may however be possible to apply for extended cumulation.

Bilateral cumulation

Bilateral cumulation means being able to use materials from the EU and considering it as being sources locally. It remains possible. It can also apply to materials from Norway, Switzerland and now also Turkey.

New extended cumulation – with EU FTA countries

The remodeled rules have introduced the concept of extended cumulation, under which the Commission may grant a GSP country permission to use specific materials from a country outside the GSP as long as it has an FTA with the EU. This new concept can have a very important impact on trade with GSP countries for two reasons.

First, because of the slow pace of multilateral trade negotiations (the Doha Round), the EU is moving ahead with negotiating and signing FTAs with larger trading partners (not only GSP countries). Thus, extended cumulation potentially allows GSP countries to use materials from highly developed countries like South Korea. As the EU

proceeds with FTAs with other countries, this could open up investments and trade between countries in and outside the GSP.

Second, the Commission is proposing to remove from the GSP system countries that sign an FTA with the EU. This means that if regional cumulation falls away because a country in the group concludes an FTA with the EU, by applying for extended cumulation, the remaining GSP countries could continue to use materials from this country. On its face however, this alternative appears more restrictive for the remaining GSP countries than being able to rely on regional cumulation.

4.3. Self - certification of origin

Currently, government authorities in GSP countries issue a Form A certificate to prove the origin of a product. This procedure will be replaced by new self-certification system as of January 1, 2017. From that date, in order to obtain the GSP preference, exporters will need to register in the exporting country and provide a “statement on origin” on the invoice or other commercial document to their EU customer (the EU importer).

The self-certification system will place the burden on the EU importers to prove that the origin was correct at the time of importation, removing their ability to rely in good faith on origin certificates issued by the exporting authority. This requires at a minimum a review of contracts with suppliers.

5. Implications and opportunities

- **Involving decision-makers**

Public sector and private stakeholders that currently rely on GSP should evaluate the practical implications of the proposed new GSP and engage in the decision-making process. Many issues will be discussed in the decision-making process and it is likely that the European Parliament will try to propose changes. To influence the outcome, it is now time to engage both European Parliament and the EU Member States.

- **Contracting ability**

Multinationals dealing with GSP countries should now consider tailoring long-term contracts with GSP suppliers to guarantee origin, allow audits and incorporate a right to recourse in case of incorrect origin statements.

- **Review risks**

EU importers or distributors relying on GSP should proactively review the effects of the proposed new GSP regime (including its origin rules) on their operations and consider action if required.

- **Access to data - predictability**

Stakeholders should engage the EU institutions 1) to make data available as a basis for the current decision-making process and 2) to introduce provisions obliging the Commission to publish data on GSP imports on a regular basis. Transparency would enhance predictability by helping both GSP countries and companies to assess risks of product graduation and a country’s ability to qualify as a vulnerable country for GSP+.

If you have any questions regarding this update, please contact the Sidley lawyer with whom you usually work.

The International Trade and Arbitration Practice of Sidley Austin LLP

From our offices throughout the United States, Europe and Asia, the International Trade and Arbitration group assists companies, governments and trade associations worldwide on transactional, regulatory, dispute settlement and policy matters. Success in the global marketplace requires an understanding of the rules that today govern every aspect of the international economy. Our team of seasoned negotiators, dealmakers, litigators and policy advisers draws on extensive private sector and government experience to help companies and governments shape these rules and resolve disputes arising under them. Combined with our broad-based transactional practice, our practice is a critical component to offering seamless global solutions to our clients.

To receive future copies of this and other Sidley updates via email, please sign up at www.sidley.com/subscribe

BEIJING BRUSSELS CHICAGO DALLAS FRANKFURT GENEVA HONG KONG LONDON LOS ANGELES NEW YORK
PALO ALTO SAN FRANCISCO SHANGHAI SINGAPORE SYDNEY TOKYO WASHINGTON, D.C.

www.sidley.com

Sidley Austin LLP, a Delaware limited liability partnership which operates at the firm's offices other than Chicago, London, Hong Kong, Singapore and Sydney, is affiliated with other partnerships, including Sidley Austin LLP, an Illinois limited liability partnership (Chicago); Sidley Austin LLP, a separate Delaware limited liability partnership (London); Sidley Austin LLP, a separate Delaware limited liability partnership (Singapore); Sidley Austin, a New York general partnership (Hong Kong); Sidley Austin, a Delaware general partnership of registered foreign lawyers restricted to practicing foreign law (Sydney); and Sidley Austin Nishikawa Foreign Law Joint Enterprise (Tokyo). The affiliated partnerships are referred to herein collectively as Sidley Austin, Sidley or the firm.

SIDLEY AUSTIN LLP
SIDLEY