

# Project Briefing

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## GSP graduation: will it reduce poverty?

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### Key points

- Proposed changes to EU trade policy are supposed to help less competitive developing countries, but richer countries will be the main beneficiaries
- Any positive impact on the poorest beneficiary states may be outweighed by the negative impact on poverty
- Alternative reforms are likely to produce greater gains for poor states

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Europe is reviewing the Generalised System of Preferences (GSP), its broadest-based trade policy to support developing country exports (Box 1). The European Commission has proposed the most radical changes in the scheme's three-decade history, arguing that this will 'focus the GSP preferences on the countries most in need' (EC, 2011a: 2). But will it? This Project Briefing summarises ODI research, including case studies on Bangladesh, China, India, Kenya, Madagascar and Viet Nam to identify the potential impact of the proposals on key exports. The research finds that only a very small part of any gains will accrue to poor countries and that workers in the graduates may be just as poor and vulnerable as those in beneficiary states.

### The big picture

The keystone in the Commission's proposals is a cut in the number of countries eligible for the GSP from 175 states to about 80 (see Box 2 overleaf). Exact figures are not yet known: the Commission has only proposed the eligibility criteria and their definitive application shortly before implementation (expected to be in 2014) and periodically thereafter. But the proposal does include an illustrative list of the countries eligible when it was written, and it is this list that ODI has applied, primarily, in its research, as shown in our full report (Stevens et al., 2011).

Although the cut will be achieved partly by tidying up, it will also involve increasing EU tariffs on imports from two groups of countries:

1. all imports from upper-middle income countries (UMICs) that do not have a free trade agreement (FTA) with the EU — 'income graduation'
2. some imports from those lower-middle and low-income countries (LMICs and LICs) not covered by the GSP+ regime — 'product graduation'.

### Box 1: The Generalised System of Preferences

The EU, like other OECD states, levies lower tariffs on some goods imported from a developing country than from an industrialised country with which it has no Free Trade Agreement (FTA). The current GSP regime should have expired at the end of 2011 but will now continue until a new one is in place, probably in 2014. It covers three areas:

- the basic or 'Standard' GSP for which all 175 developing countries and territories are eligible and which provides reduced or zero tariffs on many but not all goods
- the GSP+ programme, which covers more goods and offers tariff reductions on top of the general GSP to 15 developing countries that are vulnerable and that are implementing core international human, labour and environmental standards and with respect to good governance
- the Everything But Arms (EBA) programme, which offers duty-free and quota-free market access for virtually all goods to the 50 least developed countries (LDCs).

An independent mid-term review has indicated that the GSP is a modest success which has increased LDC exports and welfare (CARIS, 2010). But because many EU imports face no tariff even outside the scheme and not all goods are covered, the Standard GSP regime actually provides lower tariffs on only 8% of the beneficiaries' exports, with GSP+ covering only 25%.

Applying the proposed new criteria to current data indicates that:

- eight countries will face product graduation: China, India, Indonesia, Iraq, Nigeria, Thailand, Ukraine and Viet Nam, but the share of key products affected ranges widely from highs for Viet Nam and India to negligi-

## Box 2: The proposed graduation regime

All the EU's GSPs have included some provision for graduation. Income graduation has been relatively rare, but both the Standard GSP and GSP+ are subject to product graduation. This applies if a country's covered exports in a broad product group exceed 15% (or 12.5% in the case of textiles and clothing) of total EU GSP imports of that group over the last three years for which data are available. Product graduation also operates in reverse, with countries being reintegrated into the GSP when their share of imports falls.

The proposals envisage more extensive income graduation in the next GSP. Current beneficiaries will lose their eligibility entirely if they have 'been classified by the World Bank as a high-income country or UMIC during three consecutive years immediately preceding the update of the list of beneficiary countries' (Article 4.1.a). They will also be removed from the GSP if they have an equally good or better trade regime with the EU as a dependent territory or party to an EU FTA.

This will have a knock-on effect on product graduation by reducing the value of imports in the calculations. The thresholds for product graduation will be increased to 17.5% (and 14.5% for textiles/clothing) of imports from only about 80 states, rather than the current 175. The product groups for which the calculations are made have also been changed. Instead of using the 21 large 'sections' into which the Harmonised System (HS) of trade classification is divided by international agreement, the calculations will relate to one of 32 sub-groups ('GSP Sections') created for this purpose from the HS by the EC.

Note: Product groups are defined in the current GSP at section level of the HS. And 'covered exports' include all goods within a section that are listed in the GSP regulation.

ble for Iraq, Nigeria and Ukraine.

- 17 states are excluded from the GSP solely because they are UMICs (i.e. not also because they have an FTA with the EU); the share of their key products is very low in most cases but Cuba, Argentina and Gabon are exceptions.

Will these increased tariffs on imports create space in the European market for poorer and less competitive exporters, as the Commission hopes? ODI research suggests that they may, but not on any great scale. The arithmetic simply does not add up: it is high-, upper-middle and (non-graduated) lower-middle-income countries that are best placed to take up any slack. This finding is consistent with the Commission's own impact assessment of alternative reforms (EC, 2011b: section 5.4.1), as well as with complementary research by the University of Sussex (Caris, Trade Sift, 2011).

Graduation will have an impact only on the 40% of EU imports that are covered by the GSP and on which the tariff will increase under the best available non-GSP regime. Over 40% of these are imported from rich states that are ineligible for the GSP. The share of these goods imported from LICs (2%) and LDCs (2%) is low, limiting the scope for a large absolute increase in their exports as a result of graduation.

## Focusing on key products

Poor countries might see export increases that are relatively important for them because they help to build a broader, more diversified export base. ODI's research has focused on goods that may generate the greatest gains for a poor country, how widespread this gain might be, the products and countries that might be affected, and the poverty characteristics of the affected industries in the graduate and potential beneficiary states.

There are four possible scenarios when gradua-

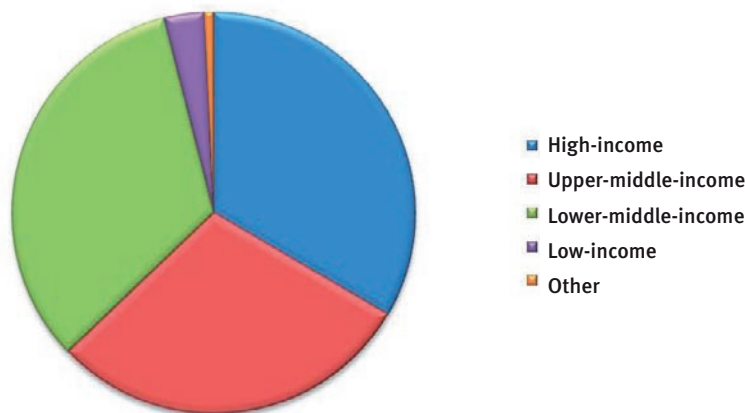
tion increases the tariff payable on imports from the graduate:

- Margin trimming: no effect on the volume of imports from the graduated state (which remains competitive even when paying MFN tariffs).
- European protection: a fall in EU imports as domestic suppliers become more competitive with imports from the graduated state.
- Increased rich country exports: a decline in imports from the graduated state and an equivalent increase in imports from rich states and trade with the EU on Most Favoured Nation (MFN) or FTA terms.
- Increased poor country exports: a decline in imports from the graduated states and an equivalent increase in imports from other GSP beneficiaries.

But in only the fourth of these is there any possibility of poor country gains offsetting the adverse impact on the graduate. In the others either money is simply taken out of the export supply chain and transferred to the European budget or any fall in imports from the graduates is offset by increased supply from countries that are not poor.

Which imports might fall into which category? As margin trimming may be the most plausible response when the tariff increase is very small, the research has focused on goods for which the tariff increase is large (5% or more). Adding other filters to focus attention on the goods where poor country gains might be most substantial – 'key products' – produces a similar 'big picture' to the analysis of all GSP imports: poor countries are a small minority of suppliers (Figure 1). HICs and UMICs are the most frequent significant sources of EU supply for these goods. LICs are suppliers for only a small share, and LDCs (which are not classified solely on income grounds and are spread between four of these groups) are suppliers for even fewer.

**Figure 1: Most important sources of EU imports of key graduated products**



Note: Income groups based on World Bank classifications at January 2011. 'Other' = countries not listed by the World Bank (other than Taiwan, which is included in HICs), and countries not specified in the trade statistics.

One reason is that over two-thirds of the 'key products' subject to product graduation covered in Figure 1 are agricultural or fisheries products, with organic chemicals accounting for most of the remainder. Clearly, natural resources will be a determining factor in which countries gain import share.

### Products on which LDCs might gain

If some poor states can produce some of the goods, graduation might help. A longlist of goods for which poor country gains could be most substantial (at least €0.1 million in aggregate for LDCs or for a non-LDC LIC) was subjected to value chain and economic analysis to identify those with the greatest potential. Three products were selected from this shortlist for desk-based case study analysis.

### The case studies

The ODI case studies examined key poverty indicators for:

- the shrimp industry in Viet Nam (the graduate), India, Bangladesh and Madagascar (potential beneficiaries)
- the leather industry in India (the graduate) and Bangladesh (the potential beneficiary)
- the vegetable sector in China (the graduate) and Kenya (the potential beneficiary).

There is strong evidence that even a transitory shock can result in declines in consumption and well-being with a substantial and long-term impact. Lessons for the possible impact of GSP graduation can be learned from recent global financial crises.

The effects of the GSP changes on poor households depend on how they are transmitted through the economy, which is influenced by the social and economic structure. The main transmission channels are prices, employment, taxes and transfers,

access to goods and services, authority and assets (OECD, 2007). The impact will also depend on the capacity of those affected, which is in turn affected by current levels of poverty and vulnerability.

The case studies investigate and compare these key channels and poverty characteristics to identify the potential development and environmental effects in both graduates and potential beneficiaries.

One finding common to our case studies is that the GSP changes are relatively insignificant, even at this micro level. This is not surprising for the graduates, given that they are graduated on product-share grounds and are likely to be globally competitive. But it was also true of most beneficiaries.

Beneficiaries' potential gains are small in terms of absolute value and in most cases even as a share of their total exports of the goods. Only in the case of Madagascar's shrimps did the potential estimated gains compared to the counterfactual reach around 5% of total exports of the product. As Madagascar's share of the EU market has been falling, the effect may be to slow a decline rather than support an increase. Madagascar's exporters will gain a price advantage over the graduates but not over competitors such as Bangladesh (which could also have smaller but not trivial relative gains).

Small though the change is, it could have adverse poverty effects in the graduate country that are greater than any gains for the beneficiaries studied. For two of the three products a significant part of any gain would accrue to richer states: Ecuador and Thailand for shrimp, Norway and Turkey (plus Pakistan and Egypt) for leather. So, whilst the estimated loss to Viet Nam's shrimp farmers is €24 million, the combined gain for Bangladesh, India and Madagascar is only €18.8 million. For leather the estimated losses for India are €0.6 million but the gains for Bangladesh are only €0.3 million.

The net effect is only likely to be positive if the producing communities in the beneficiaries are



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significantly poorer or more vulnerable than those in the graduates and this may not always be the case. The shrimp industry in Viet Nam (a graduate) is dominated by small-scale producers with few or no assets, leaving them vulnerable to irreversible declines in well-being. In Madagascar, by contrast, roughly two-thirds of shrimp production in coastal fisheries is conducted by industrial freezer trawlers.

It would be wrong to exaggerate — the characteristics of shrimp producers in India and Bangladesh are similar to those in Viet Nam. But no clear pattern emerges of better-off producers in buoyant industries being graduated in favour of poorer producers in fledgling or struggling industries. India, a potential beneficiary in this case, is the world's second-largest shrimp exporter, and shrimp plays a central role in the Bangladesh fisheries sector which is one of the country's highest earning and fastest growing exporters.

In leather, India (the graduate) is one of the three largest world producers but Bangladesh (the beneficiary) is not a new entrant. After two decades of double-digit growth its exports are nearly 15% of India's, a handful of large enterprises dominate its exports and tannery working conditions are some of the worst in the world. In India any effect of graduation might be felt by the low caste and women workers found in high concentrations in the leather sector. They may lack the job mobility enjoyed by

others, leaving them more vulnerable to the consequences of job losses.

## Conclusion

The Commission proposals now being discussed have some good features: they give the GSP more permanence and the tidying-up removes a source of confusion. But the graduation formula will mainly benefit richer states. Although most effects will be small, the adverse poverty impact in some graduates may exceed the gains of the poorest states.

There are alternative reforms that could benefit poor countries. Although the report does not analyse them in detail, it does show the level at which graduation sets 'the bar' for assessing their relative effectiveness in reducing poverty. It is low.

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### Project Information:

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