International Trade Centre

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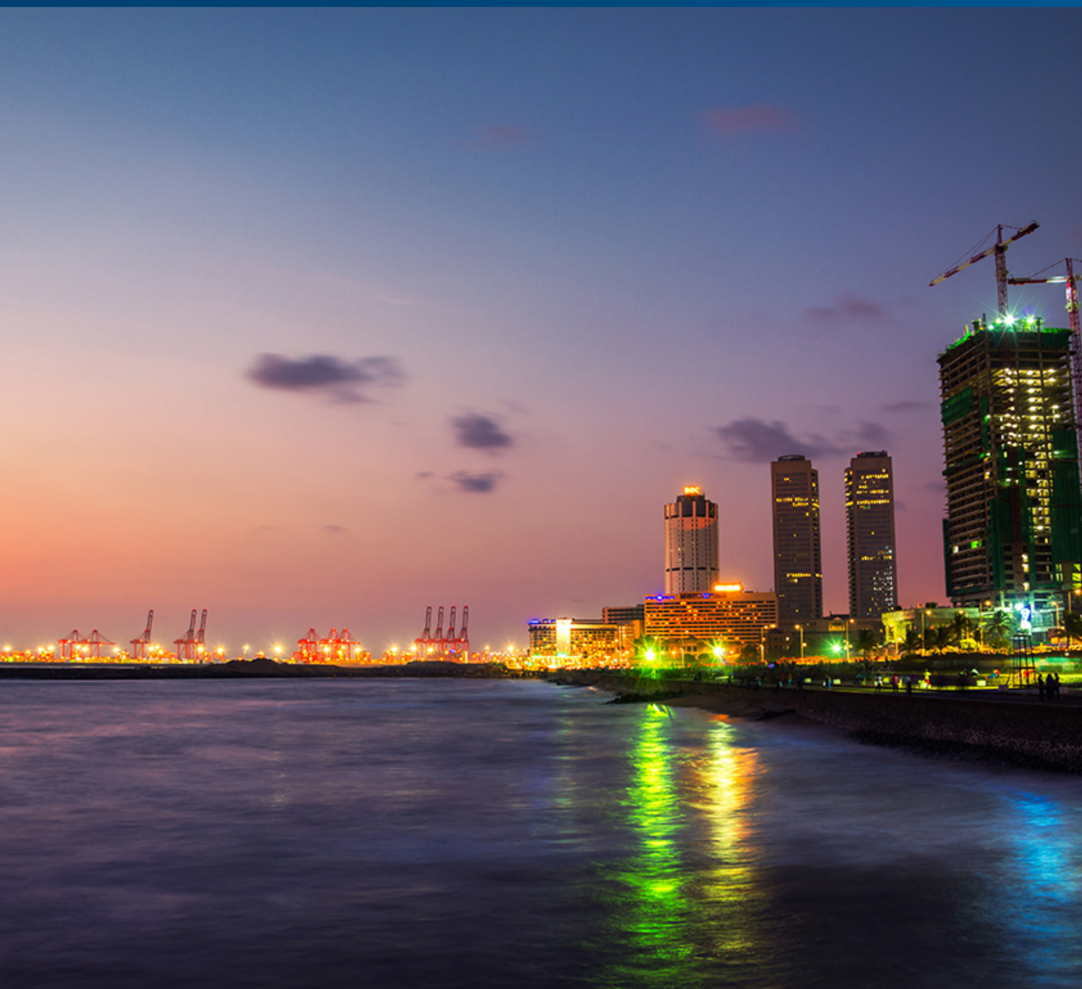
In collaboration with the Government of Sri Lanka

SRI LANKA'S ACCESS TO THE EU MARKET THROUGH GSP+

OPPORTUNITIES FOR INVESTORS



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Sri Lanka is an attractive investment destination for a number of reasons.[1,2] It is a strategic location, situated at the crossroads of major shipping routes to South Asia. It has become a global logistics hub, attuned to working with clients in several time zones. In addition, the country offers a range of investment incentives. Those who export products or services in excess of a certain percentage are entitled to various tax and duty reductions and exchange control exemptions.[3] Investors in specific sectors are also exempt from paying corporate tax or entitled to a reduced rate.

The country's infrastructure is developing quickly. Sri Lanka offers an extensive and expanding rail network, one of the busiest ports in South Asia and a well-connected international airport. Sri Lanka's telecommunications sector is also improving. The labour force is highly-skilled, productive, and cost-competitive, with experience in information technology, manufacturing, finance and accounting, fashion design and law.

When investing in Sri Lanka, investors are entitled to receive preferential market access to countries which have signed Free Trade Agreements (FTA). Specifically, Sri Lanka has signed bilateral FTAs with India, Pakistan and Singapore. Sri Lanka is also party to the Agreement on South Asian Free Trade Area (SAFTA) and the Asian Pacific Trade Agreement (APTA), under which it is entitled to receive duty-free access on a select number of products when trading with its members.[4,5] Furthermore, Sri Lanka is part of the South Asian Association for Regional Cooperation (SAARC), which aims to reduce trade barriers between Sri Lanka, Bangladesh, Bhutan, Nepal, India, Maldives and Pakistan. **Moreover, in 2017, Sri Lanka regained its status under the EU's Generalized Scheme of Preferences Plus (GSP+), which consists of duty-free access to the EU market on 66% of tariff lines.**

1. BOI (2021). *Why Sri Lanka?*. https://investsrilanka.com/
2. Dutch Ministry of Foreign Affairs (2018). Handbook of Doing Business in Sri Lanka. https://www.rvo.nl/sites/default/files/2018/06/Investment-Handbook-Sri-Lanka.pdf
3. *Ibid.*
4. A full list of duty free tariff lines under SAFTA can be accessed here: http://www.customs.gov.lk/classification/tarrif; a list of duty free tariff lines under APTAL can be accessed here: http://www.customs.gov.lk/classification/tarrif.
5. SAFTA Members are: Afghanistan, Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan and Sri Lanka; APTA Members are Bangladesh, China, India, Laos, South Korea and Sri Lanka.

Sri Lanka and the EU GSP+ scheme

In May 2017, Sri Lanka regained its Generalized Scheme of Preferences Plus (GSP+) status – following a temporary suspension in 2010 – which grants Sri Lanka duty-free access to the EU on 66% of tariff lines.

To be eligible to receive GSP+ benefits, countries must:

- Be categorized as a low or lower-middle income country in accordance with the World Bank's country classifications;
- Meet the vulnerability criteria;
- Meet sustainable development criteria which consist of ratifying and effectively implementing 27 international conventions on human rights, labour, environmental protection and good governance.

In 2019, Sri Lanka was, for the first time, listed as an upper-middle income country. However, in 2020, Sri Lanka reverted back to lower-middle income country status, enabling it to continue to receive GSP+ preferences. The EU has confirmed that Sri Lanka's GSP+ preferences will, at a minimum, apply until 2023 when the legal basis of the current EU GSP scheme will expire.[6]

GSP+ compared to Standard GSP and Everything But Arms (EBA)

GSP+ is one of three EU unilateral trade preferences arrangements that provides favourable market access conditions to products imported into the EU. The other two schemes are the Everything But Arms (EBA) arrangement for least developed countries (LDCs), and Standard GSP, for low and lower-middle income countries. In terms of tariff cuts, GSP+ provides for the full removal of duties on 66% of tariff lines — compared to the only partial removal on 66% of tariff lines under Standard GSP and the full removal of duties on all tariff lines – except arms – under the EBA scheme.

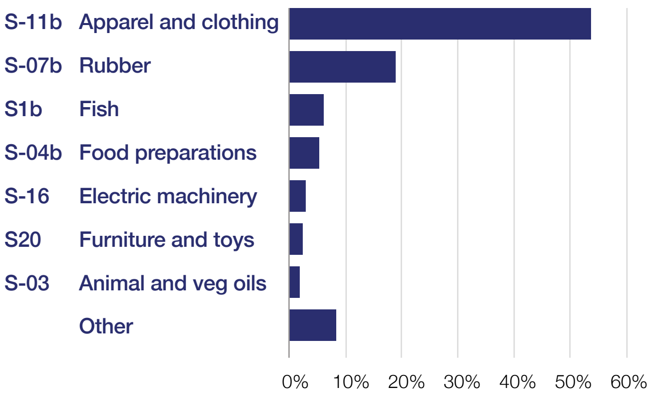
Table 1:

	Standard GSP	GSP+	EBA
Non-sensitive goods	0% duties	0% duties	0% duties
Sensitive goods	Duty reduction: - 30% (specific duty) - 3.5% points (ad valorem)	0% duties	0% duties
Coverage	66% of tariff lines	66% of tariff lines	100% of all tariff lines (except arms)

As a result of Sri Lanka's GSP+ status, the EU has become Sri Lanka's largest trading partner, ahead of India and China. In the months following the regaining of GSP+ in 2017, Sri Lanka's exports to the EU increased by more than 20%. This included a doubling of fisheries exports, in response to a removal of the import ban on fish, and significant export increases in apparel, tea, tires, gems, motor vehicle parts and footwear.[7] In terms of volume, as illustrated in Figure 1 on page 4, Sri Lanka's apparel industry has benefited the most, comprising 54% of Sri Lanka's GSP+ imports into the EU market, followed by rubber (19%), and fish, prepared food, electric machinery, furniture and toys, animal and animal and vegetable oil.[8]

6. De Silva, C. (2020, January 20). EU reassures continuity of GSP+ to Sl till 2023. Daily FT. http://www.ft.lk/front-page/EU-reassures-continuity-of-GSP-to-SL-till-2023/44-693934
7. EU GSP+ incentive drives spike in Sri Lankan exports by more than 20% (2019, November 8). Sri Lanka Brief. https://srilankabrief.org/2019/11/eu-gsp-incentive-drives-spike-in-sri-lankan-exports-by-more-than-20/
8. European Commission (2020, February 10). The EU Special Incentive Arrangement for Sustainable Development and Good Governance ('GSP+') assessment of Sri Lanka covering the period 2018–2019. https://ec.europa.eu/transparency/regdoc/rep/10102/2020/EN/SWD-2020-25-F1-EN-MAIN-PART-1.PDF

Figure 1: Sri Lanka's GSP imports to the EU[9]



However, despite the market opportunities presented by the GSP+ scheme, not all products that are eligible to receive preferential tariffs use them. Although there has been a gradual increase since 2017, the utilization rate in 2019 was only 62%. In other words, from the total Sri Lankan imports eligible to receive GSP+ preferences, only 62% of these imports actually benefited from the scheme. Utilization rates were especially low for the textile and electrical machinery sectors.

Low utilization rates are related to the rules of origin; that is, rules establishing the nationality of a product and thereby determining whether it is eligible to receive GSP preferences. For some products these rules can be very strict. For instance, whether clothing is considered to originate in a country depends on the number of 'transformation stages' carried out in the country. Since Sri Lanka imports most of its textiles, it has been challenging to meet the rules of origin requirements in the garment sector.

Cumulation rules allow Sri Lanka to claim originating status for components that do not originate in Sri Lanka but are used in the production process in Sri Lanka. Cumulation is possible with materials originating in countries that are part of Sri Lanka's regional group: Bangladesh, Bhutan, India, Maldives, Nepal and Pakistan.[10] It can also take place, under certain conditions, with materials originating in countries that have an FTA with the EU.[11] Finally, cumulation is possible with materials originating in the EU.

9. *Ibid.*
10. Sri Lanka and Indonesia have submitted a joint request to extent cross regional cumulation for raw material originating in Indonesia.
11. Sri Lanka is also expected to submit a request for extended cumulation with Vietnam, against the backdrop of Vietnam's recently signed free trade agreement with the EU.

GSP+ related benefits for EU businesses investing in Sri Lanka

Investing in currently traded products with the highest GSP+ tariff benefits

EU businesses benefit from Sri Lanka's market access opportunities available under GSP+ preferences, which enables them to access low-cost inputs. The benefits for EU businesses under the GSP+ scheme tend to be highest for products covered under the GSP+ preferential tariffs and which also have a large tariff differential compared to Most Favoured Nation (MFN)/Standard GSP tariff rates, are used as an input in the production process, or concern a situation whereby production is outsourced to a preference-receiving country.

In order to better understand the benefits provided under the GSP+ scheme, the GSP+ tariff rates can be compared to the tariff rates that Sri Lankan products would be subject to in its absence, either through the Standard GSP or the MFN tariff (which is applicable to all imports not subject to a preferential arrangement). This comparison is set out for key products in Table 2 below.[12]

GSP+ preferences have significant benefits for the European apparel industry. When apparel production is outsourced to Sri Lanka, European apparel companies can import the apparel products under the GSP+ scheme at zero duty – as opposed to the higher apparel tariff rates under the Standard GSP scheme (7.1–9.6%) or under MFN tariffs (8.9–12%).

The GSP+ scheme also benefits the EU tire industry, which is heavily reliant on the import of rubber, Sri Lanka's second-largest export under the GSP+ scheme. Under Sri Lanka's GSP+ scheme, the EU tire industry can import Sri Lankan rubber inputs at zero duty. However, the GSP+ benefits for the EU rubber industry are less pronounced compared to the garment industry, given that the tariff differential for rubber is less significant.

Table 2: Overview of tariff margins of top 10 exports from Sri Lanka under GSP+ in comparison to the Standard GSP and MFN tariff rates.[13,14]

HS Code	Product Description	MFN Tariff rates	Tariff rates under Standard GSP	Tariff rates under GSP +	% GSP Utilisation (2018)
61	Knitted and Crocheted Apparel	8.9-12%	7.1-9.6%	0%	47.1 %
62	Woven Apparel	8.9-12%	7.1-9.6%	0%	47.1 %
40	Rubber & Articles	0-4.5%	0%	0%	96.3 %
03	Seafood	7.5-18%	2.6-14.5%	0%	97.6 %
87	Vehicles other than railway	1.7-15%	0-10.5%	0%	88.1 %
85	Electronic machinery & equipment	2.1-3.7%	0%	0%	42.4 %
21	Miscellaneous edible preparations	0-14%	0-9.8%	0%	97.3 %
63	Other made-up textile articles	2-12%	1.6-9.6%	0%	47.1 %
95	Toys games and sports items	1.7-4.7%	0-1.2%	0%	87.9 %
64	Footwear	3.5%-17%	0-11.9%	0%	91.9 %

12. Cooray, P.T. (2017, May). Sri Lanka: Next Trade and Investment Destination in Asia. https://www.cc.lu/uploads/media/Mr_Cooray-Presentation_on_Trade___Investment.pdf.
13. *Ibid.*
14. Data on GSP utilisation rate can be accessed here: https://trade.ec.europa.eu/doclib/docs/2020/february/tradoc_158640.pdf

Investing in product and market diversification

EU businesses that are considering investing in Sri Lanka to reap the benefits of GSP+ are encouraged to target not only products and sectors that currently dominate EU–Sri Lanka trade, but also products covered under the GSP+ scheme but not currently included in EU–Sri Lanka's GSP+ trade. Table 3 provides potential products for sourcing and investment covering both currently traded and, in green, the not-yet traded.

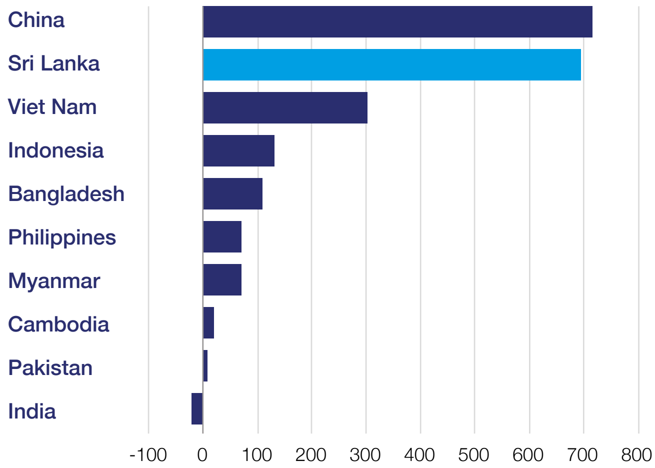
Table 3: Potential products for sourcing and foreign direct investment (FDI) in Sri Lanka.[15]

HS Code	Description	MFN tariff rate (approx.) (%)	GSP+ tariff rate (%)
61 & 62	Apparel and Clothing	11.6	0
9	Coffee, tea, mate and spices	7.1	0
24	Tobacco and manufactured tobacco substitutes	22.8	0
3	Fish and crustaceans	12.3	0
64	Footwear etc.	10.2	0
7	Edible vegetables	10.8	1.5
20	Preparation of vegetables, fruits	33.8	3.3
16	Preparation of meat or fish	17.7	
15	Animal or vegetable fats or oils	7.1	0.4
6	Live trees and other plants, bulbs, roots	6.3	0
69	Ceramic products	4.9	0
40	Rubber and articles	4.3	0
57	Carpets and other textile floor covering	7.6	0
44	Wood and articles of wood	4.3	0
71	Natural or cultured pearls, semi-precious stones	3.1	0

Impact of the pandemic

COVID-19 has significantly disrupted supply chains, creating serious challenges but also opening up new trading opportunities. Most notably, the pandemic increased demand for personal protective equipment (PPE), including test kits, protective garments, thermometers, disinfectants, medical consumables and other medical devices. Face mask imports from Sri Lanka to the EU, Japan and the United States (US) increased by 687% between January and June 2020. However, they represented only 6% of the total value of Sri Lankan textile, apparel and footwear exports. The pandemic has also accelerated the uptake of e-commerce, creating additional investment opportunities in this area.

Figure 2: Increase in face mask exports to the EU, Japan, and the US from Asian countries, Jan-June 2020 (%)[16]



EU investors exploring the Sri Lankan market are also invited to consider the benefits of GSP+ market access beyond the current geographic concentration, with most GSP+ exports going to the United Kingdom (29%), followed by Germany (19%), Italy (15%), Belgium (11%), and the Netherlands (10%). Indeed, GSP+ preferential market access covers all 27 EU Member States. EU investors in Sri Lanka could thus consider exploiting untapped market potential in Central and Eastern Europe.

Additional opportunities

Investing in Sri Lankan industries covered by GSP+ could also provide opportunities in the area of sustainability, a key component of the GSP+ regime. As noted above, to be eligible to the GSP+ tariff scheme, countries must ratify 27 conventions on human and labour rights, good governance and environmental standards. In response to rising consumer awareness, EU buyers are introducing new business models with higher environmental and labour standards, especially in the apparel industry.[17] Investing in Sri Lanka could facilitate the types of processes and oversight mechanisms to ensure compliance with high sustainability standards.

Depending on the specifics of the global value chain, EU investors into Sri Lanka could likewise facilitate compliance with rules of origin provisions. Indeed, as noted earlier, cumulation is possible with material originating in the EU.

15. Cooray, P.T. (2017, May). Sri Lanka: Next Trade and Investment Destination in Asia. https://www.cc.lu/uploads/media/Mr_Cooray-Presentation_on_Trade___Investment.pdf.
16. ILO Brief (October 2020) "The supply chain ripple effect: How COVID-19 is affecting garment workers and factories in Asia and the Pacific". Availabe at: https://www.ilo.org/wcmsp5/groups/public/---asia/---ro-bangkok/documents/briefingnote/wcms_758626.pdf
17. European Commission (2020, February 10) *Report on the Generalised Scheme of Preferences covering the period 2018-2019*. https://trade.ec.europa.eu/doclib/docs/2020/february/tradoc_158619.pdf

Future considerations

There are a number of ongoing developments relevant to Sri Lanka's GSP+ status which will have implications for investors. These include the COVID-19 pandemic, Brexit, and the expiry – and anticipated renewal – of the EU's GSP scheme in 2023.

Trade in Services

In addition to products, a number of investment opportunities in Sri Lanka, identified by the country's Board of Investment, relate to services such as knowledge industries, information technology, and tourism.[18] The COVID-19 pandemic has further accelerated the uptake of e-commerce and digital services. As services are not covered by the EU's GSP scheme, these developments suggest the need to explore the benefits of expanding the GSP+ scheme.

Brexit

Approximately 30% of all Sri Lanka's GSP+ exports are destined to the United Kingdom. Specifically, based on 2019 statistics, these exports include apparel, textile and footwear; rubber and plastic articles; machinery; and coffee, tea and spices.[19] As of 1 January 2021, exports destined for the UK are no longer covered by the EU GSP scheme; rather, they are covered by the UK's GSP scheme. Considering that the UK is a major trading partner for Sri Lanka, it would be important to closely monitor developments relevant to the UK's GSP scheme.

The UK's current GSP largely mirrors the EU's[20] GSP scheme: it contains three frameworks, which correspond to the three arrangements in the EU GSP system. Specifically, it includes the Least Developed Countries framework, which corresponds to the EU's EBA arrangement; the Enhanced Framework, which corresponds to the EU's GSP+ arrangement; and the General Framework, which corresponds to the EU's Standard GSP scheme. Countries that are GSP+ beneficiaries under the EU GSP+ framework automatically qualify to receive preferences under the enhanced framework. It must be noted, however, that differences apply with respect to the tariff lines subject to tariff reductions. The UK tariff lines can be accessed in the link in the footnote.[21]

2023 expiry of the EU's GSP scheme:

The regulation that governs the current GSP scheme expires on 31 December 2023. Currently, discussions are ongoing regarding the future of the GSP regulation, with a number of different options on the table: a continuation of the scheme as is; a discontinuation of any GSP arrangement; and fine-tuning the existing regulation. The European Commission is currently preparing a proposal for the review of the current GSP scheme which is expected to be adopted in 2021, after having been presented to and approved by the European Parliament and Council. It is most likely that a new GSP regulation will be adopted in 2023 incorporating various amendments, including updating the list of 27 conventions that must be complied with in order to receive GSP+ preferences, the product graduation threshold, the safeguards mechanism and an examination of the relationship between GSP and EU FTAs.

18. *Ibid.*
19. ITC (2021). *Trade Map, Bilateral trade between Sri Lanka and United Kingdom in 2019, Product: TOTAL All products.* https://www.trademap.org/Bilateral.aspx?nvpm=1%7c144%7c%7c826%7c%7cTOTAL%7c%7c%7c2%7c1%7c2%7c2%7c1%7c%7c1%7c1%7c1%7c1.
20. Please note that the analysis does not include rules of origin.
21. UK Department for International Trade. (2020). UK Generalised Scheme of Preferences. https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/947426/UK-Generalised-Scheme-of-Preferences.ods.

Recommendations

As EU businesses explore investment opportunities in Sri Lanka relevant to the GSP+ market access, there are several recommendations to keep in mind.

- **Explore market access opportunities** both with respect to the key products that are currently traded under Sri Lanka's GSP+ scheme, but also with respect to products that do not currently constitute a significant part of Sri Lanka's imports into the EU. Similarly, opportunities exist to go beyond the current geographic market concentration within the EU. Moreover, investment in various services sectors in Sri Lanka appears promising, even if this is not currently covered under GSP.
- **Leverage existing GSP+ preferences through meeting rules of origin.** Preference utilization rates under GSP+ are low for some products. This calls for exploring additional opportunities to meet the rules of origin, including through requesting extended cumulation with countries that have FTAs with the EU, or through widening opportunities for expanded regional cumulation as Sri Lanka and Indonesia have requested. Enhancing investment from the EU into Sri Lanka could also facilitate meeting rules of origin through EU cumulation.
- **Closely follow developments relevant to the COVID-19 pandemic, the 2023 expiry of the EU GSP Reform, and Brexit.** This will enable businesses interested to invest in Sri Lanka to address challenges and respond to new investment opportunities.
- **EU businesses, through their associations in Brussels, could ensure their voices are heard in the ongoing discussions on GSP reform.**
- **The EU has confirmed that Sri Lanka will continue to receive GSP+ tariffs at least until 2023,** when the GSP regulation will expire and is likely to be replaced. However, if Sri Lanka makes a strong post-COVID-19 recovery, then it may return to upper middle income status, in which case it could graduate from the GSP+ scheme. Therefore, it may be important for Sri Lankan and EU businesses to start exploring potential preferential trade arrangements beyond unilateral preferences.

Further information on GSP+ can be found:

- On the website of the Sri Lanka Department of Commerce: EU GSP (doc.gov.lk)
- In the EU GSP+ guide (available in Sinhala, Tamil and English), which provides exporters and traders with detailed insights into the requirements and regulations to be complied with in order to access the EU market under the GSP+ scheme: https://www.intracen.org/EU-SRI-LANKA/Resources-and-materials/

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