Friday 19th of November 2021

BUSINESS

GSP+ withdrawal: How would it im Lanka's economy?

Published 2 months ago on 2021/10/1

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Sri Lanka's preferential access to the vital European Union (EU) market faces fresh after the European Parliament's special resolution adopted in June 2021. The reso for an assessment on "whether there is sufficient reason, as a last resort, to initiat procedure for the temporary withdrawal of Sri Lanka's GSP+ status.".

The GSP+ is a non-reciprocal trading arrangement whereby Sri Lanka does not ha tariffs in return but is required to implement certain non-trade related conventio from preferential access. The GSP+ arrangement slashes import duties to zero for low and lower-middle-income countries that implement 27 international convent to human rights, labour rights, environment protection, and good governance. Th assesses the impact of a hypothetical withdrawal of GSP+ on Sri Lanka's exports t largest single trading bloc, with the United Kingdom (UK), accounting for 30% of exports.

The Impact

A possible withdrawal of GSP+ will increase the tariffs for Sri Lankan products up Favoured Nation (MFN) tariffs. Consequently, products coming from Sri Lanka wil expensive in the EU market, directly reducing the export demand from Sri Lanka. Lanka's competitors that continue to benefit from the EU's GSP will face zero pref tariffs. Thus, in addition to the trade destruction effect, with the relative price of Sri Lanka being higher, the trade will be diverted to those competitors. Using a pa equilibrium analysis, one can ex-ante quantify these effects of GSP+ withdrawal. UK will follow the EU lead, and Sri Lanka will face the lower bound of relevant MF partial equilibrium estimates show that Sri Lanka's exports to the EU will fall by 6 million The simulations are done taking 2019 as the base year.

The worst-hit sectors are apparel (HS 61 and HS 62), tobacco (HS 24), seafood (HS rubber (HS 40) sectors. The combined loss for the apparel sector will be as much a million, and it is 79% of the total estimated trade loss. In addition, the seafood se deemed to lose 20 USD million or 17% of the sector's 2019 exports to the EU. Thus preference to a vital market will be hard for the recovering seafood industry

There are two caveats of an ex-ante impact assessment of this kind. The first is th analysis is based on assumed elasticities. However, the assumptions are not overly The second is that all the eligible exports from Sri Lanka do not utilise the GSP+ f the actual impact will be contingent upon the utilisation ratio. However, after Sri regained GSP+ preference in 2017, the utilisation ratio increased, reaching 61.8% improving from 55.1% in 2017. Therefore, the increasing utilisation ratio makes th impact still significant.

Notably, there is a variation of the utilisation rate within the HS chapters, .

The apparel sector will be relatively resilient to a loss of preference as its utilisatic 52% in 2019. However, a loss of preference will halt any industry drive that aims to the utilisation rate and then expand the market share in the EU. Further, the 2010 inflicted high costs to the industry. As seafood, rubber products, and footwear sec more than 90% of GSP+ preference, those sectors will be more vulnerable to the sl the difference between GSP+ preferential tariff and MFN tariff for seafood is highe versus 7.5% respectively aggravating the impact.

Future Steps

The losses from GSP+ preference will be significant and heterogeneous across sect GSP+ also opens the door for EU investments as outsourcing production to prefere receivers is beneficial to the EU. In addition, sectoral losses may spillover to the o economy exacerbating poverty and income inequality. Thus, avoiding such losses political priority for policymakers. Less dependence on the EU market is a widely s strategy. Diversification is indeed beneficial when it is done for economic reasons. ad-hoc moves to diversify to escape from unresolved political issues will not do m The EU market is a high-end export destination for Sri Lanka. The quality improve product standards, and consumer preferences positively challenge the Sri Lankan improve product quality and competitiveness.

Additionally, a non-reciprocal preference for various products incentivises produc diversification away from traditional exports into more complex products like elec equipment, including semiconductors (HS chapter 85). Therefore, while Sri Lanka to secure the GSP+ resolving the current political issues and focus on fully utilisin preference in the short run. In the long run, as GSP+ is contingent upon income le Lanka will lose it someday, and as such should enter into reciprocal trade agreeme EU and other high-end markets, including the US.

Link to blog: https://www.ips.lk/talkingeconomics/2021/09/28/gsp-withdrawal-hc impact-sri-lankas-economy/

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Published **4 hours ago** on **2021/11/19**