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EU´s preferential Trade with Sri Lanka: Waste of Tax Money or Modern Development Policy?

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- The EU preferential tariff regime (GSP+), existing since 2006, grants a 100% tax waiver on 7200 export products coming from 15 developing countries. The garment industry of Sri Lanka has particularly profited by this regulation. Approximately 50% of all Sri Lankan exports to the EU are garments. In return, the Sri Lankan Government ratified 27 UN and ILO conventions which are aimed at improving the status of human rights, labour rights and environmental standards.
- Unfortunately it is observed that the working and living conditions for workers in the Sri Lankan apparel sector didn’t improve under GPS+: Sweatshop conditions prevail.
- Therefore the question is justified whether the EU should extend the preference conditions for Sri Lanka. Sri Lanka is expected to submit its application for the renewal of this preferential tariff facility before the end of October 2008 and the EU has to make its decision on the GSP extension by the end of 2008. The benchmarks that were developed by the European and International Trade Union Confederations in consultation with the local unions should be considered in the evaluation of the GSP+ -Case Sri Lanka.

EU´s GSP System

The EU member states’ and EU´s experience on development policy strongly indicate that tariff exemptions for imports from developing countries will continue to be a counterproductive means of support to the developing world as long as it does not guarantee a fair distribution of the fruits of the increased trade. Its success has to be measured by its ability to engage respective ground situations in developing countries constructively.

Following this understanding in 1971 the EU was the first to implement a ‘Generalised System of Tariff Preferences’ as recommended by the United Nations Conference on Trade and Development (UNCTAD) in 1968. It is a preferential trading arrangement designed to extend privileged market access to developing countries. In its simplest meaning, the GSP is all about waiving off tariffs. In the economic context, it would cause EU nations to loose vital tax revenue generated by way of tariffs, which under normal circumstances would lead to swell state coffers. Therefore, GSP Plus will warrant imposing additional taxes on EU citizens to cover up the tax revenue that is waived off by way of GSP concessions.

The EU's GSP today, in place since 1995, grants dutiable products from 176 developing countries and beneficiary territories either duty-free access or a tariff reduction. The volume of EU’s imports under the GSP amounting to 57 billion Euros in 2007 is greater than the volume of imports under the US, Canadian and Japanese GSP systems combined. Similarly, the EU is the most open market in the developed world for the world’s poorest countries.

EU GSP “Plus”: More Trade and more development

With effect from January 2006, the EU introduced a unique zero duty preferential tariff regime named GSP "Plus". This regime grants additional preferences to vulnerable developing countries that pursue good governance and sustainable development policies. To benefit from GSP Plus, countries need to demonstrate that their economies are poorly diversified, and therefore dependent and vulnerable. They also have to ratify and effectively implement the 16 core conventions on human and labour rights and 11 conventions related to good governance and the protection of the environment before the beginning of 2006. Qualifying countries are eligible to export 7200 products duty free to the EU.

Sri Lanka is one of the 15 beneficiary countries that succeeded in gaining eligibility for GSP Plus. In the case of Sri Lanka, the benefits were fast tracked to be effective from July 2005. After effects of the December 2004 Tsunami catastrophe influenced the EU to consider the ratification of the human and labour rights conventions by Sri Lanka as the key criteria for eligibility. Many glaring lapses and inconsistencies prevailing in local laws and practices with relevant UN and ILO conventions were temporarily overlooked in the hope that necessary ground changes would be made by the government of Sri Lanka in the subsequent years.

The Sri Lankan economy

From the mid 1950s until 1977, Sri Lanka paralleled a global trend among post-colonial developing countries by implementing a policy known as Import Substitution Industrialization (ISI), whereby domestic production replaced imports from developed countries. With the rise of its East Asian neighbours such as Singapore, Malaysia, and South Korea, etc. Sri Lanka was convinced that it was time to look beyond ISI policies in search of faster economic growth and stronger favourable global integration.

The free market economic policies that it embraced in 1977 continue uninterrupted despite several volatile political regime changes. The liberalisation of the economy in the late 70s was characterised by a drive towards an export promotion economic policy. This has resulted in a significant growth in trade with the European Union states and the United States of America.

The 2008 records of World Bank classify Sri Lanka as a Lower Middle Income Country (LMC) with a total GDP standing at USD 26.9 billion and a population of 20 million.

**Sri Lankan Trade with EU:
Apparels on the hike**

Between 2002 and 2007, the share of apparels in the rapidly expanding exports of Sri Lanka was declining from 48% to 41 %. (Table one) However, the apparel exports to the EU maintained an ample 50% share of total exports to the EU during the whole period (ibid).

During the same period the value of total apparel exports climbed up by 40 % from USD 2.3billion to USD 3.2 billion (ibid). But the same figure for the apparel export to EU was climbing 100% from 0,7 to 1,4 billion USD (ibid) and the EU-share in total apparel exports climbed from 31% to 45% (ibid). The yearly growth rate of apparel exports to the EU since 2002 always was by far above average and reached in 2007 its all time record (Table 2).

Therefore, it is not surprising that the export of apparels formed the single largest source of foreign exchange earnings to Sri Lanka for more than a decade and within this apparel sent overseas the export to EU is of major and growing significance.

Productivity is increasing

According to Sri Lankan industry and government sources, the apparel sector offered in 2002 direct employment to around 380,000 workers and in 2007 to 270.000. 75% are women and most of them doing only basic work. Thanks to investments in factory improvement, management and increasing qualification of the workers, the productivity of each worker (the relation of export value to workers) has been growing from 2002 until 2007 about 110%. Because of the rapid and positive developments in the apparel sector, several recent media and industry reports indicate the existence of a shortage of 20.000 to 30.000 workers in the Sri Lankan apparel industry.

These statistics confirm that tariff concessions under the preceding GSP scheme (in 2004) and duty free access under the GSP Plus scheme (in 2006 and 2007) have led to a striking increase in Sri Lanka's apparel exports to EU countries and stimulated an equal striking increase of productivity in that sector. The EU GSP Plus has no doubt, served as an important and advantageous preferential tariff arrangement and has generated substantial economic benefits to the Indian Ocean island nation.

Trust is good - Control is better

GSP+ calls upon EU citizens to bear an additional tax burden in order to support some selected developing nations. Hence, it necessitates every EU citizen, policy maker and people's representative in the EU to ponder seriously, as to why the continuation of such a concessionary regime should be pursued. They hope for the effective implementation of the agreed upon UN and ILO conventions by the Sri Lankan Government and thus for human rights, core labour standards, good governance and environmental sustainability to be improved significantly. Only if such practically exercisable minimum standards are accepted and implemented in Sri Lanka this will result in the distribution of wealth in a more equitable manner and the conditions for freedom and social justice in Sri Lankan society will improve.

A lack of commitment on enforcement of its own requirements would serve the extreme opposite of what it seeks to achieve through the GSP+ regime. It can result in unequal distribution of economic benefits, undermining or deprivation of core labour standards, and soft-pedalling of human rights violations would become the norm. Therefore having in place an effective mechanism of monitoring and review of such rights based instruments should remain a *sine qua non* for the GSP+.

**Development Goals of GSP+:
Catch 22 in Sri Lanka?**

As explained earlier, apparel exports to the EU have doubled between 2002 and 2007. The EU GSP+ has remained a key contributory factor to this phenomenal growth. Despite the resulting boom in the apparel industry, the trickling down effect of economic benefits to workers and the society is appalling. In addition, the situation is clearly turning worse.

According to the Sri Lankan government's own study findings of June 2007 "*...in terms of Iron Deficiency Anaemia, female garment workers are the most affected occupation in the country and the status of iron store depletion is alarming. It is also shocking to note 57.2% of workers surveyed by the government did not take breakfast regularly and nearly 30% of workers have skipped either lunch or dinner regularly.*" "*...the Body Mass Index (BMI) of female factory workers, showed that 34.2% of the surveyed sample is suffering from some form of chronic malnutrition*"

The study further states "*…the Nutritional Status of female garment workers in the FTZ in Katunayake, Sri Lanka are poorer than their age-specific counterparts in the general population of the country and should be considered as an occupational health problem".*

The minimum wage in the apparel sector is among the lowest in the Asian region (USD 56 per month) for an eight hour working shift. In addition, the government for the current year has frozen the national minimum wage increases recommended by the State wage fixing body. These conditions compel workers to perform exhaustive overtime hours on a regular basis in order to earn even a meagre income. So overtime work, which is not voluntary in law, is often part and parcel of the mandatory working shift in garment factories.

These are clear evidences of "sweatshop conditions" continuing unabated under the GSP preference scheme in the Sri Lankan apparel sector.

Sri Lankan economic research sources estimate that around 70 per cent of the USD 3.1 billion apparel industry of the country is concentrated mostly among eight to ten family owned business groups. It appears that GSP Plus has somewhat effectively enriched the already rich in Sri Lanka while the wages did not even maintain the parity with the Euro in 2007 despite enormous progress in productivity and turnover.

These paradoxical evidences raise serious questions about the core objectives of the current GSP regime and its effectiveness as a modern development tool. That is why the question is justified whether the EU should extend the preference conditions for Sri Lanka.

More pressure is necessary

Although in terms of employment creation the apparel sector contributes substantially to society, the low value addition of the apparel sector contributes little to sustainable development in Sri Lanka.

Union activists estimate the share of the labour component in the cost of production of the apparel sector at an average of only 10%. Considering the structure of workforce and salaries in the apparel plants, it is a realistic assumption that less than the half of salary expenditure is spent to the majority, who are workers. The major part is salary for the few executives (approx. 10 executives within 500 employees).

This has obviously left enough money in the cash boxes of the Sri Lankan apparel industry to maintain their US-market share without any tariff waiver. Besides, for the current season they quoted the unit prices of their products to EU partner companies <u>excluding</u> the EU GSP+ tariff margin benefits as recently reported in the local media. A brake in competitiveness of Sri Lankan garment producers was not reported.

As the cost of labour is low in Sri Lanka and obviously, the demand for apparels Made in Sri Lanka is considered to be further increasing, the apparel industry announced a shortage of 20,000 to 30,000 workers. This is a significant evidence that the garment companies rather will care for their workforce than apply mass dismissals under the impact of termination of GSP+.

The answer to the success of the EU GSP Plus lies in the means set out to achieve its declared fundamental objectives. In view of the order of significance it would be prudent to take on the implementation of the core human rights and labour standards as the first and foremost step and then the environment sustainability provisions.

The new EU GSP Regulations for 2009-2011 set out to assess the implementation of labour and human rights standards based on available recommendations by relevant monitoring bodies of the ILO and the UN.

Unfortunately, Sri Lanka is yet to get its act together in demonstrating that it is sincerely committed towards complying with core labour standards. Many glaring inconsistencies in local laws and practices still exist. Systematic non-enforcement of labour laws, sweatshop conditions, and worker rights violations are widely prevalent.

Findings of ILO supervisory bodies, over the last few years have cited a chain of solid evidence pertaining to such lapses and violations. Making matters worse, the judiciary has brought to surface, that certain provisions of the International Covenant on Civil and Political Rights (ICCPR) and the Conventions of the ILO are inconsistent with the Constitution of Sri Lanka. These extremely negative developments actually give rise to serious questions on the applicability of ILO and UN instruments in general.

These events prove a systematic stifling of the application of ILO and UN Conventions in Sri Lanka so that continuation of GSP preference to Sri Lanka certainly stands to go against the WTO ruling on GSP systems and defeats the very purpose of the tariff concession.

Many analysts of the Sri Lankan situation, international rights bodies, Sri Lankan civil society groups as well as trade unions and others strongly believe that the effective implementation of core Conventions of the ILO will enable workers to stake a claim for a fair share of the gains. This would create a win-win situation for both the employers and employees and finally -by means of the additional taxes- for government and society.

The benchmarks proposals of the European Trade Union Confederation (ETUC) and the International Trade Union Confederation (ITUC) presented to the EU and the government of Sri Lanka is unique in this regard. It is primarily drawn from the supervisory body findings of the ILO with respect to Sri Lanka. The benchmarks enable the engaging of technical legal situations and practical social conditions at work place level. If implemented seriously as urged by the ETUC and the ITUC it can engage many of the unfortunate developments and sweatshop situations that exist in the Sri Lankan apparel sector. It forms a set of concrete and measurable standards and bases on the corresponding realistic and practical ground situations that can strategically guarantee the exercise of some core rights relating to freedom of association and collective bargaining. It specifically seeks to engage situations of forming and joining unions by workers, elimination of anti union discrimination, the right to engage in trade union actions and collective manifestations and finally achieving constitutional consistency for the wider and unrestricted implementation of ILO Conventions in general. The benchmarks proposal also sets out precise recommendations to the government of Sri Lanka to achieve compliance with each of the described areas.

With the help of the Benchmarks Sri Lanka should aim at a systematic and gradual improvement over a given period, followed by a process of close review and monitoring by the EU and relevant social stakeholders assisted by the expertise of the ILO.

It is only through such a carefully designed tool that the benefits of the EU GSP+ can go beyond a select few and reach the workers, society and the government as additional tax revenue. It is only then that it can give real meaning to the efforts of European taxpayers and serve its true development objectives.

The new EU GSP Plus Regulations for 2009-2011 clearly provide space for extended constructive practical engagements to make changes possible in beneficiary countries. If Sri Lanka fails to comply with the required standards it could be offered to meet the terms in a mid-term period (by 30 April 2010), in order to be considered for GSP Plus benefits for the second half of the 2009-2011 period. In the meantime, EU can take every step possible to convince the government of Sri Lanka to implement the most important parts of those ratified ILO and UN conventions until April 2009.

Table 1: Total Exports and Market share of Apparels in Sri Lanka, in Billion USD

Row	Destination	Category	2002	2003	2004	2005	2006	2007
1	EU	Total Exports	1,4	1,5	1,9	2,0	2,3	2,9
2		Apparel Exports	0,7	0,8	1,0	1,0	1,2	1,4
3		Apparel / Total Export	51	51	53	51	50	50
4	All Countries	Total Exports	4,7	5,1	5,8	6,4	6,9	7,7
5		Total Apparel Exports	2,3	2,4	2,7	2,8	2,9	3,2
6		Apparel to EU / Apparel Exports	31	32	37	36	40	45
7		Apparel / Total	48	47	46	43	42	41

Source: Central Bank of Sri Lanka, Annual Reports

Table 2: Annual Growth in Apparel Export Value (percentage)

Country / Region	2002	2003	2004	2005	2006	2007
EU	-1.2	11.7	26.7	0.8	16.2	23.5
All Countries	-3.8	8.6	8.8	3.5	6.2	7.8

Source: Central Bank of Sri Lanka, Annual Reports

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