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**The 2011 Commission Proposal
for a Revision of the Generalised
System of Preferences:
Articulating Trade, Development
and Foreign Policy Objectives**

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The 2011 Commission Proposal for a Revision of the Generalised System of Preferences: Articulating Trade, Development and Foreign Policy Objectives

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Abstract

Since the early 1970s, the EU pictures itself as a pioneer of trade measures specifically adapted to the need of developing countries. The Generalised System of Preferences (GSP) is a flagship instrument of EU trade policy and of its commitment to the realization of development objectives. In 2010, the European Commission undertook a major revision exercise, which led to the adoption in October 2012 of an EU regulation on a revised GSP. If the review of the past system was rather positive – the contribution of the GSP to development and poverty eradication being recognised – it was not as far-reaching as one would have hoped. The revision process reflects EU efforts not only to adapt its scheme of import preferences to rapidly changing global trade patterns, but above all to better match the trade, economic and financial needs of developing countries and to target its efforts on those developing countries most in need. The role of the Commission was instrumental given its expertise and competence in trade policy. This paper focuses on the drafting of the Commission proposal for a regulation on a revised GSP. To what extent does the Commission proposal provide for a consistent action of the EU on trade preferences?

Key Words: European Commission, trade policy, import preferences, developing countries, development, conditionality

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The preferential import scheme for developing countries (DCs) is often presented as a flagship instrument of EU external action, its trade policy and its commitment to the realization of development objectives. First introduced in 1971, the Generalised System of Preferences (GSP) has since then remained a major element of EU relationship with DCs.¹ The Commission considers import preferences as an effective trade instrument tailored to the needs of DCs (Commission 2011c:3).

The EU revised GSP was published on 31 October 2012. On the basis of a Commission proposal, the new GSP regulation (regulation (EU) 978/2012) entered into force in November 2012 but preferences will be applied as of 1 January 2014 only. First and foremost a trade instrument, the GSP also articulates other objectives: the revision process reflects EU objectives to better match the trade, economic and financial needs of DCs, to target efforts on the DCs most in need and to adapt to changing global trade patterns. Accounting for these different objectives – trade, development and foreign policy – is challenging. Because the Commission was the lead institution on the revision, with DG Trade the *chef de file* in the drafting of the proposal, this paper focuses on the Commission legislative proposal COM(2011)241 for a regulation of the European Parliament and of the Council applying a scheme of generalised tariff preferences (Commission 2011b). The assessment of the previous scheme raised a tri-dimensional challenge to the consistency of the scheme: the revision shall ensure that the Commission proposal for a revised GSP is

1. Consistent with development objectives,
2. Consistent with foreign policy objectives and
3. Consistent with trade objectives.

Consequently, the paper aims to answer the following question: to what extent is the Commission proposal consistent?

The paper builds on a PhD research focusing on the consistency of EU external policies. Overall, the research has identified 3 approaches developed by the EU to ensure the consistency of its action: first the treaty framework, second the policy framework and third the decision-making. These approaches will not be discussed hereunder but the empirical evidence gathered supports the developments below. The paper evaluates the internal consistency of the proposal – defined as the absence of contradictions within the proposal – along the three challenges raised above.

¹The GSP consists of 3 arrangements, each characterised by its country- and product-coverage. First, the general arrangement is the largest program. Second, the GSP+ arrangement is the special arrangement for sustainable development and good governance. Third, the Everything But Arms initiative provides non-reciprocal quota-free and duty-free access for all products except arms from Least Developed Countries. The 2012 revision that is the focus of the paper does not cover the EBA initiative as it is subject to periodic reviews on its own.

Refocusing on those Countries most in need: Enhancing the Consistency of Trade and Development

Formally a trade instrument, the *raison d'être* of the GSP is yet to serve development purpose. Despite a positive assessment of the overall effectiveness of the instrument (CARIS 2010, Commission 2011c), the consistency of import preferences under the previous GSP regulations with development was questioned.

The scheme is assessed to be a valid trade instrument for developing countries but preparatory work reveals the necessity to refocus its preferences on the countries most in need (CARIS 2010:12, Commission 2011c:3) and the political opportunity of refocusing import preferences to improve the “consistency (of the scheme) at country level” (Commission 2010:10, Commission 2011d:1). If the role of preferences in the expansion and diversification of DCs’ trade sector is acknowledged (Commission 2011c:4, Commission 2011d:1), not all DCs have performed the same. The GSP is particularly key an instrument for the poorer countries – especially the Least Developed Countries (LDCs) and the GSP+ beneficiaries – that suffer from competitive pressure from GSP beneficiaries because of the economic size of some beneficiaries and their import shares in total imports (Commission 2011c:11, Commission 2012:8).

This challenge to the consistency with development objectives comes from several drivers, which shall be addressed by the revision in order “to better address the growth and development objectives through encouraging the trade of developing countries, especially those most in need” (CARIS 2010:12).

The first driver of competitive pressure within the GSP is the suboptimal targeting of beneficiaries. However, excluding countries is a delicate exercise for the EU, which has to find non-arbitrary criteria. Under the previous GSP regulation, high-income countries (HICs) continued to benefit from GSP preferences if their economies were not sufficiently diversified (income and diversification are cumulative eligibility criteria; article 3.1 Regulation (EC) 732/2008). However, these countries have the necessary resources to attain higher diversification without the help of EU preferences (Commission 2011c:11). Besides, Upper Middle Income Countries (UMIs) also remained within the scheme under the previous regulation, while their income levels were sometimes the same as some EU member states. Further competitive pressure is also due to the coexistence of multiple preference tracks. As a response, the new GSP introduces income-based criteria. These criteria are defined by the World Bank, what limits the margin for political discretion. The regulation excludes countries that were classified as HICs and UMIs during three consecutive years before the update of the list of beneficiaries (article 4.1(a) of COM(2011)421). It also reiterates the exclusion of countries benefiting from a preferential market access arrangement (whereas 9 and article 4.1(b) of COM(2011)421). Countries falling under either of these categories remain eligible but are no longer beneficiaries of the GSP (it means

that if their situation changes, they can become beneficiaries of the scheme again). The new GSP also excludes Overseas Countries and Territories (OCTs), which have an alternative market access arrangement for developed markets (whereas 10 of COM(2011)421). As a result, the number of beneficiaries will drop from 176 to 89 (Commission 2012:6, Commission 2011a:2). Removing countries from the list of beneficiaries might be seen as disruptive. However, OCTs and beneficiaries from other preferential arrangements have alternative market access arrangements with the EU: consequently, their exclusion is not expected to have a negative impact on their trade with the EU. Besides, transition periods have been foreseen (article 5.2(a) and (b) of the new GSP regulation). In addition, even if these criteria exclude countries from the benefit of GSP, the countries remain eligible to GSP and as such are in a position to benefit again from GSP in the future should they meet again the criteria.

The second driver of the lack of focus of preferences is a suboptimal graduation mechanism. Graduation is a mechanism by which certain products do not benefit from preferences anymore because they are competitive on the world market. Before the revision, the graduation mechanism was based on sections (category of products from a country) of the Common Customs Tariff. The logic behind the graduation mechanism is that a sector does not need preferences to penetrate the market once it has become competitive at the global level “(i)n order to ensure that (the) scheme benefits only those countries it is intended to benefit” (whereas 20 of COM(2011)421). Global competitiveness is a consequence of successful development strategies: some DCs have export-oriented sectors, which are in a relatively strong position on world markets as they exploit advantages such as low labour costs and economies of scale (Commission 2011c:12). If a sector that has become competitive still benefits from preferences, it puts competitive pressure on the same sector of countries at a less advanced development stage – what relates to the criticism of the inconsistencies of preferences with development objectives. At the same time, the graduation mechanism also responds to concerns to protect EU industry against products that have too strong a comparative advantage when entering the European market (Commission 2011c:13). Graduation was considered to be a suboptimal mechanism for several reasons, addressed by the revision. Before the revision, graduation applied when the average imports of a section from a country exceeded 15% of Community imports of the same products from all beneficiaries during three years. The threshold was lower for textiles (12,5%) as this sector was considered sensitive (article 13.1 of regulation (EC) 732/2008). The new regulation increases the thresholds: they are of 17,5% in general and of 14,5% for textiles in particular, what means that graduation will happen sooner as the number of beneficiaries drop (article 8 and annex VI of COM(2011)421). The graduation mechanism was also based on sections of the EU customs tariff: these categories were too large and covered heterogeneous products. It is now based on a section or subsection (whereas 21 of COM(2011)241) and the number of sections used for graduation is expanded from 21 to 32 (Commission 2011a:3) in order to

provide for more homogeneous categories of products. Lastly, under the previous GSP regulation, graduation did not apply to EBA countries but did apply to GSP+ countries. This was introducing another distortion and competitive pressure among DCs as EBA and GSP+ countries are often in the same economic situation (Commission 2011c:13). The revision evens out the treatment of EBA and GSP+ countries: it specifies that graduation shall neither apply to GSP+ nor to EBA beneficiaries (whereas 21 of COM(2011)241). Overall, the revision provides for a mechanism, more responsive to the protection of export interests of fragile DCs.

The third driver of the inconsistency of the preference focus is an insufficient product coverage (Commission 2011c:14). GSP product coverage is not complete. Under the previous regulation, GSP and GSP+ countries benefited from preferences on 66% of the EU's 9,443 tariff lines and EBA countries for 75% of the lines (*ibidem*). Besides, the coverage is also limited by the distinction between sensitive and non-sensitive products: non-sensitive products enjoy duty-free access while sensitive products enjoy a tariff reduction (before the revision, 61% of the lines were sensitive for GSP beneficiaries, accounting for 63% of covered imports; *ibidem*). However, the room for improving the coverage was limited as only 9% of tariff lines were outside GSP. The new GSP expands the product coverage and preference margins to a limited extent: 15 new duty-free tariff lines are added to GSP as non-sensitive; 4 tariff lines under GSP are turned from sensitive into non-sensitive; and 4 new duty-free lines are added to GSP+ (Commission 2012:7). The Commission defends its choice not to put further pressure on LDCs: "increasing the products or preferences which enjoy GSP will then make LDC exports relatively less attractive" (Commission 2012:8).

The last driver of inconsistency is the suboptimal entry mechanism to GSP+. The GSP+ arrangement was initially designed to meet the specific needs of vulnerable economies. However, eligibility and entry criteria (such as the prerequisite for countries to be defined as vulnerable economies and to effectively implement the 27 international conventions, article 9.1 of COM(2011)421) are considered to be restrictive. The specifics of this arrangement will be discussed under section 2. With the 2012 revision, the vulnerability criterion is relaxed, as is the entry window.

Overall, the consistency issue of the GSP with development objectives weakens the support that the scheme actually provides to development strategies through the expansion and the diversification of exports of the countries most in need. Each dimension has been addressed, to a more or lesser extent in the 2011 proposal for a revision in order to enhance the consistency of GSP with development objectives.

Making Political Elements more effective: Enhancing the Consistency of Trade and Foreign Policy Objectives

The foreign policy dimension of GSP is present in several mechanisms. First, it is the foundation of the special incentive arrangement for sustainable development and good governance (GSP+), which makes the granting of additional preferences to vulnerable economies conditional upon the ratification and implementation of a number of international conventions. Second, EU attempts to influence political developments in partner countries are also visible in the reasons listed for the temporary withdrawal of preferences. Enhancing the consistency of the scheme with foreign policy objectives led to rethinking both aspects.

Evaluation of the effectiveness of the GSP in the promotion of sustainable development and good governance is not straightforward. The special incentive (GSP+) constitutes an attempt by the EU to steer and shape political developments in DCs in favour of sustainable development and good governance as defined by a list of international conventions (annex VIII of regulation (EC) 732/2008 under the previous scheme, annex VIII of COM(2011)421). If it seems that GSP+ has had a positive effect on the ratification of the conventions listed in the regulation, the impact is less clear-cut as to the actual implementation of these conventions (CARIS 2010:151-188, Commission 2011c:5). Nevertheless, GSP+ remains a meaningful instrument, as illustrated by the withdrawal of preferences for Sri Lanka in 2010 (CARIS 2010:155). Beyond this uncertainty, 2 weaknesses were identified in the impact assessment prepared ahead of the drafting of the Commission proposal.

First, the entry to GSP+ is suboptimal because of a combination of restrictive criteria (Commission 2011c:16). To be eligible to GSP+, DCs need to qualify as vulnerable economies. Under the previous GSP regulation, the vulnerability of a country was defined in terms of its income, diversification of exports and share in GSP imports (Article 8.2 of regulation (EC) 732/2008). This criterion was leaving some vulnerable countries out (CARIS 2010:174). Its redefinition opened up a strong debate. The 2011 Commission proposal redefines the vulnerability criterion as follow: the threshold of diversification of exports remains the same (75%) but the threshold of the share in GSP imports is relaxed from 1 to 2% (article 9 and annex VII of COM(2011)241). The relaxation of the vulnerability threshold was agreed but this step must be read together with the strengthening of the safeguard mechanism to protect certain sensitive EU interests (interview 3). In addition, the existence of entry windows open every 18 months only (article 9.1(a) of regulation (EC) 732/2008) also prevented DCs from entering GSP+ at any time whenever they fulfilled entry requirements (Commission 2011c:16). The revision introduced instead the possibility to apply to GSP+ at any time (article 10 of COM(2011)421).

Second, the workability of GSP+ was also at stake in the debate over the exact list of conventions of the arrangement. Numerous new additions to the list were put forward by different DGs (for instance multilateral environmental agreement or the UN framework convention on climate change), on the basis of the normative power of the EU and their individual international agendas (interviews 3, 4, 5). A list of 50 conventions would have been unrealistic in terms of the operationalisation and of the monitoring of the arrangement. The lead DG and cabinet identified strict criteria to the inflation of the number of conventions included under the GSP+ arrangement: the potential effect on the GSP+ beneficiaries under the previous regulation (to catch out any do-good intent hiding a protectionist interest), all EU member states shall have ratified the suggested additional convention(s) and shall actually implement them and any suggestion addition should respond to specific trade, development and financial needs to satisfy WTO conditionality (interview 3). Overall, these criteria led to the addition of only one new convention (the UNFCCC) to GSP+.

The second potential inconsistency risk is the temporary withdrawal mechanism common to all arrangements. For instance, preferences were withdrawn in Burma/Myanmar and Belarus because of their internal political situations. During the drafting, some DGs suggested to introduce additional reasons on the basis of which to withdraw preferences, (Commission 2011d, interviews 2, 3, 4, 5). If the Commission proposal did not initially include new basis for withdrawal, the inter-service consultation led to the introduction of a reference to the supply of raw materials to the list of reasons to withdraw preferences in the 2012 regulation (article 19.1).

In conclusion, the long discussion on the vulnerability threshold and the list of GSP+ conventions illustrates the divergence between 2 approaches to the preferential scheme. The foreign policy dimension of the GSP overlaps with certain MS' national interests (for instance southern MS concerned for their textile industry by the possible entry of export-competitive countries if the vulnerability threshold had been too relaxed) and the international agenda of some DGs. Trade objectives in relation to GSP+ were different: it meant to enhance the incentive, to simplify the application procedure, while making the monitoring more effective and transferring the body of proof on to the beneficiaries of GSP+. Eventually, the 1st issue (the list of conventions) was resolved by DG Trade taking a firm stance on the conditions to add conventions to the list. The 2nd issue (the vulnerability threshold) was resolved in 2 steps. First, the policy objective was clear, to strengthen GSP+ and support states that were serious about implementing conventions. Second, operationalizing this objective required to find the balance between opening GSP+ to the countries most in need while leaving open the possibility to protect EU industrial interests, a concern in terms of consistency within trade policy, a discussion to which the next section turns (interview 2). But beyond the technicalities of political conditionality under the scheme, the revision of the GSP also raised questions as to the foreign policy impact of the revision on GSP beneficiaries overall. The answer cannot be straightforward but the

revision is likely to have consequences on production and employment. In certain countries, these potential consequences are key elements to take into account in the revision. For instance, after the Arab spring in the North African rim, the EU has an interest in promoting stabilisation, for which social conditions (i.a. production and employment) are central (Commission 2011d). Overall, the European External Action Service (EEAS), the foreign policy actor by excellence, welcomed the revision. Unilaterally granting trade preferences was important for the (self)-perception of the EU as a major development actor at the international level. Beyond checking the mere consistency of the new scheme (the absence of contradictions within the scheme), EU actors had an interest in creating synergies between the different elements of the GSP.

Different Trade Objectives to Account for: Enhancing the Consistency of Trade Policy

During the revision, concerns of inconsistency between the GSP and overall trade objectives were raised. The insufficient focus on countries most in need is a first sign of inconsistency with trade objectives because the GSP is a trade instrument specifically designed to provide a framework for trade into the EU from the countries most in need. Overall consistency between trade objectives raises internal and external challenges. The articulation between different preferential arrangements, the impact on on-going negotiations but also internal sectoral interests were concerns that the revision had to address at the same time.

The revision aimed to clarify the articulation between different arrangements of import preferences. The previous regulation was already excluding the possibility for a country benefiting “from a preferential trade agreement with the Community which (was) cover(ing) all the preferences provided for by the present scheme” to benefit from the GSP at the same time (article 3.2 regulation (EC) 732/2008). Yet, this prohibition was ever hardly enforced because of legal uncertainty. Indeed, it was particularly difficult to determine whether all preferences were covered when rules of origin differed under the GSP and under the preferential agreement (Commission 2011c:12). It followed that certain partners of the EU could opt in or out of the GSP depending on the generosity of the preferences. The revision specifies the articulation between the different preferential regimes by providing that no country might benefit from GSP preferences if it already “benefits from a preferential market access arrangement” under the condition that this arrangement “provides the same tariff preferences as the scheme, or better, for substantially all trade” (article 4.1.b regulation (EU) 978/2012).

Beyond the provisions of the GSP regulation, the scheme might constitute a challenge to EU position in certain international negotiations. For instance, the existence of import preferences was weakening the EU in the Non-Agricultural Market Access (NAMA) negotiations (interview 1). For the first

time in these negotiations, emerging economies were asked to contribute to tariff reduction. The existence of preferences (such as those under the GSP) deprives the EU of bargaining chips in the negotiations: if emerging economies could benefit from GSP preferences, why would they agree on tariff reduction? The revision of the GSP had to take into consideration the risk it constituted not to further jeopardise EU position in the negotiations (interview 1). Besides, the revision of GSP also has an impact on the network of EU trade agreements (interview 3). As an overall trade objective, the EU is committed to the conclusion of bilateral and multilateral negotiations. However, the revision might have an impact on the on-going negotiations and the design of trade relationships with some partners. Fears resulted from the exclusion of certain beneficiaries (GSP or GSP+ arrangements) and the continuation of benefits for other countries. However, reactions against the revision have not been as dramatic as expected because Trade had carefully planned the announcement of critical elements thereof. For instance, an important conference was organised in Brussels in 2010 to announce the main lines, gathering together beneficiaries and ex-beneficiaries of the GSP. Sitting in the same room made politically impossible for emerging economies to complain about the loss of preferences in comparison with the situation of LDCs (interview 3). Late November 2011, the EU-Mercosur summit discussed the effect of the removal of GSP preferences to most Mercosur countries but without any animosity (interview 3). Until now, the revision does not seem to have had any particular impact on the negotiations of the strategic partnership with Brazil. It will also be interesting to see what effect the revision will have on India. The country is not out of the GSP but it has graduated from most sectors: the more competitive it becomes, the more likely it will be to lose its GSP preferences. In turn, this might affect EU-India relationship (interview 3). At the same time, some Commission services were also concerned that countries that would still be beneficiaries of the GSP would have a disincentive to conclude bilateral negotiations with the EU (Commission 2011c:15), a risk that has not materialised yet.

Lastly, the consistency of trade objectives is also an internal issue and illustrates the intersection between an external policy and internal sectoral interests. The revision of the GSP needed to take into consideration the effect that the revised scheme would have on European industry. Under the scheme, European interests are protected by the safeguard mechanism. The previous regulation provided that the safeguard mechanism could be activated (and thus preferences temporarily withdrawn) as soon as imports from one beneficiary country exceeded 15% of the value of Community imports of products from all countries and territories over three consecutive years (article 13 of regulation (EC) 732/2008). Among the objectives of the revision (to better safeguard EU interests and to enhance the legal certainty of the mechanism), the modalities of the safeguard mechanism were clarified. The revision expands special safeguards (previously only for agriculture and fisheries sectors) to cover textiles and ethanol (2 sectors for which the ISC had signalled political

sensitivity). For sensitive sectors, the revision also specifies stricter thresholds than under the previous GSP regulation:

- for the special safeguard (but textile products), a surge of 13,5% in quantity as compared to the previous calendar year (article 29.1(a) of regulation (EU) 978/2012) – this threshold is even stricter than in the Commission proposal, 15% (article 29.1(a) of COM(2011)421);
- for the textile sector under the special safeguard, if the imports exceed 14,5% of the value of Union imports of the same products during any period of 12 months (article 29.1(b) and annex VI of COM(2011)421 and of regulation (EU) 978/2012) – a threshold that was, for specific textile products (products from section XI(b)) either defined by a 20%-increase in quantity as compared with the previous calendar year or a 12,5%-increase of the value of Community imports of products from all countries and territories during any period of 12 months under the previous GSP regulation (article 20 of regulation (EC) 732/2008);

Under the general safeguard provisions, preferences might be temporarily withdrawn when the average value of Union imports from a section originating in a GSP beneficiary country over three consecutive years exceeds 17,5% of the value of Union imports of the same products from all GSP beneficiary countries (article 8 and annex VI of COM(2011)421).

In conclusion, the risk of inconsistency with trade objectives is manifold. The revision aims to find a balance between external and internal objectives, controlling to some extent the effect of the new regulation on the general architecture of trade agreements and the protection of European interests.

Conclusion

The revision of the GSP regulation was an important political exercise for the Commission. The interests (both external and internal) and actors (within the Commission and the EEAS) concerned by the GSP were plentiful. The potential inconsistencies between the three major dimensions of this instrument – trade, development and foreign policy – made coordination a requirement from the outset of the decision making to bring actors together and to articulate their different positions.

Evidently, Trade was in charge of developing the proposal, within the limits of a specific policy frame and on the basis of clear objectives for the preferential scheme and for the revision. The revision was not only an exercise important politically for the Commissioner but a key decision-making for Trade in general. In a favourable position given the exclusive nature of the trade competence, the lead DG used external expertise to inform the drafting. Despite the limited staff number of the unit in charge within DG Trade, the

proposal was carefully prepared as a result of a theoretically inclusive inter-service consultation. However, the sheer existence of coordination instruments does not guarantee the quality of coordination. For instance, DG Devco issued a negative opinion on the proposal, which was overcome by the mere absence of the Commissioner responsible for development at the College meeting. Besides, the EEAS did not play a coordinating role during the revision, as it did not have the mandate to do so because the trade portfolio falls outside of the remit of the EEAS. To that extent, the new service created by the Lisbon Treaty did not have a major impact on the decision-making.

Overall, the proposal for a revised scheme did meet the objectives set and was only amended to a limited extent during the later stage of co-decision. It was not characterised by internal contradictions. However, this assessment does not prejudge of the consistency of the scheme as it remains to be seen how the provisions will be interpreted and actually implemented under the leadership of DG Trade. The revision of the GSP reveals the coordinated and integrated nature of the decision-making, framed in a long-term strategy and whose balance is protected at several levels. First, the system builds on checks and balances (impact assessment and impact assessment board, the inter-service consultation, the lead cabinet and the President's cabinet) throughout the decision-making to ensure consistency (interview 2). Second, the sequence of Commission, Council and European Parliament constitutes a 3-filter system that share the consistency objective (interview 2). Member states' interests and the potential role of the European Parliament were always in the shadow of the decision taken by the Commission. Co-decision left the Commission proposal largely unchanged, all the more a victory for DG Trade since it constituted an important piece of legislation relating to a key trade instrument (interview 3). In turn, the systemic characteristics enhanced the credibility of the revised GSP instrument, of the Commission and the consistency of its proposal.

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