

Why are EU Generalized System of Preferential tariffs not being fully utilized by eligible importers?

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Abstract

International trade had over recent years become more efficient and importers have looked for ways to keep costs down while maintaining quality. The European Union provides incentives to importers to trade internationally with lesser developed countries by reducing the entrance tariff to the EU. It provides a preferential trade agreement in the form of generalised system of preferences. However, there are many imports into the EU that qualify for the preference but importers are not registering these goods for preference so that there is under-utilization of the preferences available.

While there are many studies of the generalised system of preference and the benefits that the preference provides to the exporter, along with its effects on the exporter's economy, there are few studies of the effect on importers and how they apply the preferences.

This paper explores the issues that importers face when wanting to import from Lesser Developed economies. It establishes why importers are not using preferences to the full potential. Senior management in ten European Companies were interviewed to understand the problems they face when importing from non-EU countries.

1. Introduction

The European Union has encouraged trade with developing countries since 1971, (Brenton and Machin, 2002). The main mechanism used to facilitate trade is to lower importation tariffs at the point of entry into the EU. The discount system is called the Generalised System of Preferences (GSP). Its application makes goods supplied by lesser developed countries (LDCs), cheaper and hence more attractive to EU importers.

GSP was first implemented by the EU in 1971. It is a nonreciprocal trade programme. It is reviewed and renewed every ten years, (McQueen, 2007) The EU has the ability of withdrawing preferences when the recipient's exports have increased, (Özden and Reinhardt, 2005).

Benton and Manchin (2002) highlighted that in 1999 only one third of EU imports eligible for GSP actually entered the EU with reduced tariffs. At the time 99 per cent of imports from LDC were eligible for preferences. A comparable US GSP scheme achieved 76 per cent in 1998, (Benton and Machin, 2002). Candau, Fontagne and Jean (2004) argue further that the EU is the contributor to world trade which has the most trade agreements, however, they highlight the utilisation rate as low. Brenton (2003) found that as much as 50 percent of recorded exports eligible for zero duty access to the EU from non-ACP LDCs are not applying for the preferential duty rate.

There can be many factors why importers do not utilise the GSP. Administration costs can have an effect on the preferential trade program. In particular compliance with the rules of origin can be costly. (Hoekman, et al. 2008). Brenton (2003) recognised that costs of complying with the Rule of Origin (RoO) is an area of concern. Manchin (2006) highlighted that production costs, quality of products, competitiveness gains and the benefit from the preferences obtained, all had to be taken into account to determine whether a preference should be required.

The European Commission during 2005 claimed that the EU received a higher volume of imports under GSP than equivalent systems used by Canada, Japan and US combined, (Townsend, 2008). With this level of GSP activity the EU are forgoing income from the reduced duty arising from the preference. GSP is a growing area of trade within the EU market. Imports into the EU under the standard GSP scheme were over €57 billion in 2007, an increase by 12% from 2006 (€51 billion) and an increase of 10% between 2005 and 2006. The duty foregone was €1.5 billion to the EU, (Townsend, 2008). Therefore GSP has a substantial financial impact not only on individual businesses, but also it has a cost penalty to the EU through lost duty.

With the globalisation of trade there is more opportunity for EU importers to expand their supply chain across the globe. The availability of the GSP scheme should in principle enhance this trade further. A number of manufacturers have factories overseas and import completed components to the EU for further processing or for the retail market. Brenton (2003), found that the greater fragmentations of the supply chain has made it more difficult to comply with 'rules of origin'. This constrains LDCs manufactured from engaging in the global production networks.

This paper investigates the utilisation of GSP from the importer's perspective. Highlighting the issues facing importers when complying with the GSP scheme and the emphasis placed on importers that it is their responsibility to ensure compliance with the various regulations when undertaking the GSP scheme. This paper presents a preliminary study of the importers perspective. Senior management of ten companies were interviewed. The results provide an assessment of issues important to importers when using Generalised System of Preference.

The next section of this paper provides a literature review of previous research on preference trade. The third section describes the method of the research. The fourth section analyses the results and discusses the findings. The fifth section concludes research and the sixth section summarises the implications of the findings.

2 Literature Review

The literature review covers three areas in relation to the issue of utilization of preference.

2.1 Utilization of Preference

Preferences are a set of import duty reductions used to encourage trade between the EU and LDC. The GSP utilization rate is the proportion of goods eligible for GSP that actually apply for GSP. According to the commission of European communities (2004), GSP utilisation rates have fluctuated. Over the period 1994 to 2002, it was at its highest at 57.5% in 1996 and a low of 42.6% in 1999/2002, increasing to 52.5% in 2002.

There is an argument that the Rules of Origin (RoO) have a direct impact on the utilization of GSP. Rather than helping LDC's to increase the RoO imposes costs on the beneficiaries. Rather than helping developing countries they instead suppress trade, especially where fractionalization of production is a major part of the country's economy, in particular AFTA countries, (Cadot, et al. 2006).

Not only is there a cost to the LDC, but there is also an effect on the EU importer. The proposed 2017 EU Generalised System of Preferences reforms place the responsibility on the EU importer to make contractual agreements between the importer and exporter, the importer is penalised for non-compliance. If country of origin is found to be an issue then the importation duties can still be levied against the EU importer up to three years after importation. Penalties can be issued if false origin claims are made and if the importer has any doubt then they should not claim preference, (Naumann, 2012).

The Country of Origin rule could be deemed to be a trade barrier as the under-utilisation of preference will have a direct impact on exports from the LDCs, Brenton, (2003). Brenton and Machin (2002) and Candau, Fontagne and Jean (2004) find evidence that the Country of Origin Rules set by the EU have resulted in tariffs still being paid on a large proportion of tariff-free GSP imports. Benton and Machin (2002) appear to suggest there is that the Country of Origin status could be an issue, due to the emphasis on the importer to ensure that all rules have been complied with when importing preference goods.

2.2 Graduation

If an LDC economy grows and the GSP provides an unfair advantage then the GSP can be taken away gradually over a period of time, so the LDC trades on the global market without the advantage of GSP. (Hoekman and Ozden, 2006). Once a country has reached a level of development and is able to compete in the global market, the GSP can be withdrawn. The preference is withdrawn in stages. The EU's view on graduation from a GSP scheme is that graduation ensures that GSP is provided to countries most in need of help and the GSP has been successful in its function. (Townsend, 2008). Ozden and Reinhardt (2005) suggested that as GSP is not included within the GATT legal system, preferences can be modified or even cancelled at any time. The GSP committee alter the GSP allocation. The GATT membership approved GSP with an "enabling clause". This prevents normal legal constraints applying to GSP implementation. Countries can provide and adjust their schemes "as they see fit" (Hudec, 1987; Jackson, 1997). The EU GSP scheme has safeguards against any threat or serious difficulty to an EU producer by allowing the preference to be suspended or graduated. However, the United Nations Conference on Trade and Development (UNCTAD), have raised this as an issue and the argument that this type of graduation protects producers in the importing countries. (Irish, 2007).

2.3 Administration of GSP and Country of Origin

To be able to apply for GSP status the shipments from the LDC have to comply with the EU Country of Origin rule. The supplier has to have changed the goods when imported from another country by a large percentage to be allowed to have the country of origin of the new product to be originating from the country of manufacture. This can be a complex rule especially as compliance lies with the importer. Brenton and Machin, (2002) questioned why importers are not utilising fully the incentives of GSP. They highlight the difficulties of adhering to the rules of origin. Augier, Gasiorek, and Lai-Tong, (2005), highlighted that the final goods producers may not change their sources of supply and if they do not meet with the origin requirement they will still continue to pay tariffs on exports to the EU and hence reducing the utilisation of the preference. Brenton and Machin (2002) suggested that the burden of administrative costs on companies proving origin is an issue, mainly due to the cost in relation to proving the origin and to maintain the administrative systems to ensure consistency.

3 Methodology

A preliminary study was carried out to identify issues affecting the under-utilisation of GSP upon importation.

Primary data was collected through interviews with senior managers from ten companies. Six of the ten are registered Plc's. The sample covers small, medium and large organisations. The turnover of the companies ranged from £12 million to £10 billion. Three of the ten companies do not currently use preference. Reasons provided by the three companies are:-

- i) one had only recently started trading and were still sourcing parts,

- ii) another produced goods that were exempt from duty
- iii) the third had become aware of GSP and were undertaking consultation to claim GSP.

There are two automotive companies that are combined as they share the same preference department. They have been treated as a single entity within the study. There were four companies with a turnover of over £2 billion. The sample was made up of nine British companies and one German company.

Of the entities using GSP; two were automotive manufacturers; two were within fashion and retail, one manufactured packaging and one manufactured agricultural machinery.

4 Findings/ discussion

The results were tabulated. Questions are shown in full on Appendix 1. Appendix 2 Table 1 shows the results of all the companies interviewed. Three companies were found not to be compatible see section 3. Discussion and analysis undertaken in relation to the remaining six companies shown in Table 1, (the Automotive company shown in column four combines two related companies together). Similar questions are grouped together to provide an analysis of similar issues and how these issues relate to the companies questioned. The findings of each section are analysed in Appendix 3.

4.1 Discussion.

Analysing the overall results has provided some interesting patterns between the companies taking part in the sample. The two automotive companies show the same results, (see Table 1), despite manufacturing within different fields. When comparing the business and their different sectors, the similarity of the answers between the two automotive companies, the retail and the agricultural companies provide gravitas to the overall results as it highlights that companies are processing the preference in similar ways and they are adhering to the same legislation.

4.2 Quality against Cost

Quality against Cost was questioned and four of the companies stated that they had issues with gaining supply from a LDC and the main factor is quality of parts, the remaining two companies suggested that they are able to manage the quality of production due to they either have a more hands on approach with their suppliers or they rely on the competition of the market place to ensure the quality is high. There is a suggestion that all the companies take into consideration quality of the goods and the cost is just an advantage element. This is interesting as it has not really been addressed as a main issue within the academic argument as to why there is under-utilisation of GSP. However, Manchin (2006) highlighted that consideration to production costs, quality of products and competitiveness gained and the benefit from the preferences made available by the EU to ascertain the need to request for a preference.

4.3 Country of Origin Rule

The application of the country of origin rule has been cited many times in academic journals as one of the determinants of under-utilisation of GSP. Hoekman, et al. (2008) suggested that administration costs can have an impact on the preferential trade program, particularly compliance with the rules of origin. Brenton (2003) highlights costs of complying the Rule of Origin as an area of concern. Three companies had issues with adhering to the country of origin rule. There were strong correlation between the question of country of origin rule and finding the overall administration cumbersome, and the companies not having the confidence to include the preference within their main business strategy. This highlights that there is an issue for importers. Interestingly all six companies found that the administration was

very cumbersome. However, no companies experienced delays in shipment due to the lack of the country of origin certificate.

4.4 Graduation of Generalised System of Preference

Three of the interviewees stated that they had been affected by the withdrawal of GSP at some time. The same three companies would consider lobbying the EU GSP committee if their company was going to be affected by a withdrawal of GSP. Two of the three companies stated that they treat the GSP refunds as a bonus while one stated that they include the GSP as part of their overall business strategy. This is mainly due to this company having a dedicated department to oversee importation. These companies are large and have the resources to be able to consider lobbying. English (2013) stated that this is a way companies try and govern the risk by not placing too much reliance on the duty saved. However, this could be a concern for smaller and medium size companies who are more reliant on cashflow and are unable to mitigate the risk of the removal of GSP. (English, 2013). Another aspect of the graduation process is that if preference is removed from a LDC then there is no governance from the EU to stop the larger companies moving their supply of goods to another LDC whose preference has not been removed

4.5 Other Issues

Companies feel remote from the EU GSP commission decision making process when it determines whether the GSP is to be withdrawn or reduced. All six companies stated they feel remote from the EU policy making process. This could be an issue when companies are trying to build a reliable supply chain, as the withdrawal of preference can be very costly.

The larger companies in the sample feel more able to utilize the preference. Smaller and medium size companies, with less than 250 employees make 99 % of the total EU company base. One may question if the preferences provided to LDC's effective as they could be, (Morsing and Perrini, 2009)?

Conclusion

This preliminary research identified some of the issues importers are faced with when applying for the Generalised System of Preference. Most interviewees found administration to be cumbersome and a cost to their business.

The graduation of the GSP also has an influence how companies utilize the preference, for example to use it within their decision making process or provide for it as a bonus. It appears that some companies are prepared to lobby the EU commission to ensure that GSP is secured. However, this is a costly process and is not affordable for all companies. There is an issue of the lack of governance from the EU with regards to the larger companies' simply moving supplier to another LDC which still has preference when graduation is undertaken. This may question as to if the preference is achieving the policy of increasing trade for the LDC's to merely take the trade away again if the LDC is not compliant or has achieved economic growth. The trade enjoyed while having the preference could contract and leave the LDC with an even poorer economy.

The quality of goods produced in LDC's, was a concern throughout the interviewees. All company's stated that quality is the main factor they considered, even before cost. This implies investment is required by the LDC's suppliers to ensure that goods are of a sufficient standard for importers to want to trade with them.

Implications

The preliminary study has highlighted a number of issues relating to importers who are currently using the GSP system. The main areas being:-

Administration and Compliance

RoO highlighted by Brenton(2003) and Hoekman, et al. (2008), as a possible area of concern. The importers have an issue with complying with RoO and all of those questioned that the administration is very cumbersome, this could lead to many companies not wanting to utilize GSP as they would feel that it is too costly to implement and easier to pay the duty in full on entry into the EU.

Graduation

The use of the graduation system and the ability to withdraw the GSP scheme by the EU GSP committee has shown that GSP is successful in its overall function. (Townsend, 2008). However, the importers have stated that they feel remote from the overall process and for some they do not incorporate the GSP within their overall business strategy. Therefore it could be said that GSP is treated as bonus and therefore utilization of the scheme is not the main priority.

If GSP is graduated from a LDC the importers will simply move to another to another GSP country. The findings however, have found that it is quality that is the main priority of the business strategy, with the cost factor as the second factor of concern and therefore companies do not in the first instance move countries because of the GSP being withdrawn

Other Issues

Other issues highlighted by the importers interviewed that there are many companies, large, medium and small will not apply resources to implement GSP and therefore they are losing out on vital income stream. The implication of this is that many larger companies are able to allocate financial resources to ensure the maximum benefit is achieved from the GSP. It is these companies that will have the capability of lobbying the EU GSP committee and this in turn may have an impact on the political decision making process.

Underutilization

The underutilization of preference when trading to LDC's is an area of concern, as it has many implications affecting the LDC's economic growth. Also there are many importers who are failing to benefit from the preference scheme and losing out on vital income. However, there is an argument that although the GSP system is not being fully utilized the importation into the EU using GSP is increasing and the EU is forgoing considerable income because of this. There is a implication that if more importers became aware of the preferences available and utilized it more on the current importation trade the EU would lose further revenue and this in turn could have an impact on the EU economy.

Further Research

The preliminary research undertaken has highlighted many areas which require further research some of which are listed as follows:-

- Investigate the communication between EU GSP policy makers and the importers.
- Establish how much trade imported into the EU eligible for GSP, is not applied for.
- Establish if the lesser developed countries economies actually improve with GSP or without.
- Investigate the impact of a LDC losing GSP status.

As stated at the beginning of the paper there have been many academic arguments made as to why the GSP system is underutilised, but, little research has been undertaken from the importers angle and how they see the system of GSP. This is an area where further research could be undertaken to establish the effect of trade preferences.

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Appendix 1

Questions asked at the interview.

Key

- Q1 Are preferential tariffs used?
- Q2 Do you import? (supplied by RE)
- Q3 If no preferential tariffs are currently being applied for, what is the reason for this?
- Q4 If the receipt of imported goods from Non-EU countries increase, would you consider applying for preference?
- Q5 Are there any problems in importing in principle from a LDC? i.e. in relation to quality/logistics
- Q6 Would quality of parts be the main consideration and cost saving an advantage?
- Q7 Do preference tariffs influence your choice of suppliers?

Administration of Generalised System of Preference

- Q8 Are preferences cumbersome regarding the administration?
- Q9 Do you feel remote from the GSP decision making process?
- Q10 Do you treat GSP duty reductions as a bonus?
- Q11 Do suppliers have issues with complying with the Country of origin rules/GSP certificates?
- Q12 Do you treat GSP duty reductions as part of the business?
- Q13 Are preferential tariffs applied for retrospectively?
- Q14 Are shipments delayed due to the raising the Country of Origin certificates.

Graduation of Generalised System of Preference

- Q15 Has the withdrawal of GSP status affected you?
- Q16 Would you lobby the EU to stop the withdrawal of GSP?

Other preferential reliefs

- Q17 Are any other reliefs used? i.e. IPR and OPR.
- Q18 If so do the benefits cover Import/export.
- Q19 Are these reliefs easy to administer?

Appendix 2: Table 1:- Results of Questions

Column1	Automobile	Aerospace	Hygiene Clothing		2 x Automobile Companies	Automobile	Fashion Warehouse	Retail Clothing	Packaging	Agricultural Machinery
Q1	Q	B	M		B	B	B	B	L	B
Q2	Y	B	U		B	B	B	B	Y	B
Q3	N	N	Y		N	N	Y	Y	Y	Y
Q4	B	B	Y		Y	Y	N	Y	B	Y
Q5	B	B	B		N	N	N	N	N	N
Q6	B	B	B		Y	Y	Y	N	Y	N
Q7	B	N	N		Y	Y	Y	B	B	N
Q8	N	N	N		Y	Y	Y	Y	Y	Y
Q9	N	U	Y		Y	Y	Y	Y	Y	Y
Q10	B	B	Y		Y	Y	Y	N	N	Y
Q11	Y	Y	N		Y	Y	Y	D	N	Y
Q12	Y	B	Y		Y	Y	Y	N	Y	N
Q13	B	B	M		Y	Y	Y	N	Y	N
Q14	B	B	B		Y	Y	L	N	Y	N
Q15	B	B	M		N	N	N	Y	N	Y
Q16	B	B	B		Y	Y	N	Y	N	N
Q17	Y	B	N		Y	Y	N	Y	D	N
Q18	B	Y	Y		Y	Y	Y	N	Y	Y
Q19	B	Y	N		Y	Y	Y	N	Y	Y

Key:- Question Answers

N	No
Y	Yes
B	Not applicable
D	Depends
Q	Quality of parts
L	Lack of knowledge
M	Not monitored
U	Non GSP

Appendix 3

Written analysis of the findings

Clarification of use of GSP

Are preferential tariffs used?

Do you import from outside the EU

These two questions are providing the same results as all the main companies have stated Yes to both these questions. This is what is expected as companies need to import to be able to use preferential tariffs.

If no preferential tariffs are currently being applied for, what is the reason for this?

If the receipt of imported goods from Non-EU countries increase, would you consider applying for preference?

Both of these questions were answered as not applicable blank with the exception of the packing company which answered Lack of Knowledge and Yes. This is valid as the company only has finished goods under GSP and is looking to expand the preference to its raw materials. Therefore the lack of knowledge is due to the company currently looking into the new area of raw materials and the Yes relates to the fact that the raw material purchases is increasing and therefore they are considering applying for preference on this section of the business.

Supply of Goods

Are there any problems in importing in principle from a LDC? i.e. in relation to quality/logistics

Would quality of parts be the main consideration and cost saving an advantage?

The first three companies and the sixth company provided said Yes to both questions, the retail company stated No and Depends and the packing company stated no to both. Therefore we can assume that this is good correlation between both answers. Leading on from this the retail and packing companies that stated no, both considered quality but felt that they are able to manage the supplier to ensure that the quality would not be an issue.

Do preference tariffs influence your choice of suppliers?

The result was the first two companies stated No and the remaining four provided the answer of Yes. The four Yes's appear to be more cost conscious, however, the automotive manufacturers stated Yes in relation to the quality of the parts being the main consideration. Therefore, rather than cost driven they appear to be quality driven. The answers to this question do not appear to correlate to answers provided by other questions. Except that there are overall two Yes's and four No's.

Administration of Generalised System of Preference

Are preferences cumbersome regarding the administration?

Do you feel remote from the GSP decision making process?

Do you treat GSP duty reductions as a bonus?

There was a 100% correlation between these three questions. The first three and fifth companies stated Yes's and the retail and agricultural companies stated No. This suggests the companies that are finding the administration an issue feel that they are remote from the GSP decision making process and because of this they do not have the confidence to include the preference saving as part of their main business strategy and treat the reductions in tariff as a bonus. However, the retail and agricultural company are able to cope with the overall administration of claiming preference. Overall however there are 4 Yes's and 2 No's.

Do suppliers have issues with complying with the Country of origin rules/GSP certificates?

The first, second and fifth companies stated Yes and the fourth and sixth companies stated No, the third company provided an answer of Lack of Knowledge, as they rely on the suppliers providing the country of origin certificates and are unaware of any issues. With the exception of the third company's answer the overall combination of answers correlate to the previous three questions.

Do you treat GSP duty reductions as part of the business?

The first three companies along with the fifth company stated No and the fourth and sixth company stated Yes. This is directly opposite to the previous questions and therefore is the reverse in correlation to

the previous three questions. The fourth and sixth companies answered the previous question that they do not have an issue with the administration of applying for preference and this is highlighted again here as they are confident with the preference process that they choose to include it as part of their business strategy.

Are preferential tariffs applied for retrospectively?

The first, second, fourth and sixth company stated Yes with the third stating No and the fifth stating not applicable. To apply retrospectively the administration is more involved and the companies have up to three years to claim. The third company felt that the cost of applying for the duty refund outweighed the overall benefit and the fifth company always claimed duty at point of entry.

Are shipments delayed due to the raising the Country of Origin certificates.

All companies stated No to this question. Therefore shipping delays is not an issue when utilising the preference.

Graduation of Generalised System of Preference

Has the withdrawal of GSP status affected you?

Would you lobby the EU to stop the withdrawal of GSP?

First, second and fourth companies stated Yes and the third and sixth companies stated No to both with the fifth company stating No to the first question and Depends to the second question, the answer is dependent on the amount of money involved. Overall there is a strong correlation between the two questions.

Other Reliefs

Are any other reliefs used? i.e. Inward Processing Relief and Outward Processing Relief.

If so do the benefits cover Import/export.

The first three, fifth and sixth company stated Yes's and the Retail company stated No. This is due to the retail company is not moving goods out of the EC or sending goods to their suppliers for further manufacture.

Are these reliefs easy to administer? IPR and OPR

Companies first, second and third all stated Yes and companies fourth fifth felt it was not applicable and the sixth company stated No. There is some correlation to the three questions as only two companies put not applicable. However, the first three companies did not find issues in administering these reliefs as they are more automated within their accounting systems but did find the GSP administration cumbersome due to the lack of automation. The sixth company also found the reverse, it is easier for them to administer GSP due to the automation of their system but difficult with regards to IPR and OPR in locating the level of detail required.