



**THE IMPACT OF GSP GRADUATION ON LDCS AND CUMULATION-THE CASE OF CAMBODIA**

SUBMISSION BY CAMBODIA

The following submission, dated 15 May 2023, is being circulated at the request of the delegation of Cambodia.

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## ACRONYMS AND ABBREVIATIONS

<b>ACP</b>	African, Caribbean and Pacific
<b>ASEAN</b>	Association of Southeast Asian Nations
<b>CRO</b>	Committee on Rules of Origin
<b>DFQF</b>	Duty-Free and Quota-Free
<b>EBA</b>	Everything But Arms
<b>EPA</b>	Economic Partnership Agreement
<b>ESA</b>	Eastern and Southern Africa
<b>EU</b>	European Union
<b>FTA</b>	Free trade Agreement
<b>GPT</b>	General Preferential Tariff
<b>GSP</b>	Generalized System of Preferences
<b>GSP Regulation</b>	Regulation (EU) No. 978/2012 of the European Parliament and of the Council of 25 October 2012 applying a scheme of generalized tariff preferences and repealing Council Regulation (EC) No. 732/2008, OJ [2012] L 303/1
<b>HS</b>	Harmonized System
<b>LDCs</b>	Least Developed Countries
<b>PSRO</b>	Product-specific rules of origin
<b>TAXUD</b>	Directorate-General for Taxation and Customs Union
<b>WTO</b>	World Trade Organization

## 1 INTRODUCTION

1.1. As noted by the Least Developed Countries (LDCs) Group in previous submissions, almost eight years have passed since the adoption of the Nairobi Ministerial Decision on Preferential Rules of Origin for LDCs. Since then, the creation of a notification template and the calculation of utilization rates of the Duty-Free and Quota-Free (DFQF) schemes, as well as related discussions on utilization rates, helped to achieve better transparency. However, there has been no parallel progress in implementing the substantive part of the Nairobi Decision. Specifically, the paragraphs concerning substantial transformation, cumulation, and certification requirements have not been implemented yet.

1.2. We are now well past the 5<sup>th</sup> anniversary of the Nairobi Decision, and on 14 April 2022, the Committee on Rules of Origin (CRO) adopted a Decision on Preferential Rules of Origin and the Implementation of the Nairobi Ministerial Decision (G/RO/95). In particular, the CRO's Decision provides:

*"The work of the CRO could include identifying and agreeing upon best practices by all Members on preferential rules of origin and related administrative requirements and further analyzing existing origin requirements and the utilization of trade preferences."*

1.3. The Ministers who attended the 12<sup>th</sup> Ministerial Conference of the World Trade Organization (WTO) welcomed this Decision and mandated the CRO to report its work to the General Council ahead of the 13<sup>th</sup> Ministerial Conference.

1.4. In line with this mandate, the Cambodian delegation hereby wishes to provide its input on the application of Paragraph 2 of the Nairobi Decision, which concerns the topic of cumulation.

1.5. The present submission examines the challenges and opportunities faced by the Cambodian private sector arising from the "Everything But Arms" (EBA) initiative of the European Union (EU). This examination focuses particularly on the experience reported by Cambodian bicycle producers.

This submission then shares lessons learned and best practices that preference-giving countries could adopt to (i) facilitate compliance with origin requirements, (ii) mitigate the adverse effects that may arise from graduation of beneficiary status from LDCs trade preferences by facilitating cumulation procedures, and (iii) maintain regional value chains, as implicitly recommended by Paragraph 2 of the Nairobi Decision on cumulation.

## 2 THE POSITIVE EFFECTS OF THE EU REFORM CONCERNING RULES OF ORIGIN ON CAMBODIAN EXPORTS TO THE EU

2.1. As acknowledged by the LDCs Group in previous submissions, the tangible and concrete trade effects of the EU reform concerning rules of origin have been dramatic for many LDCs, especially Cambodia.

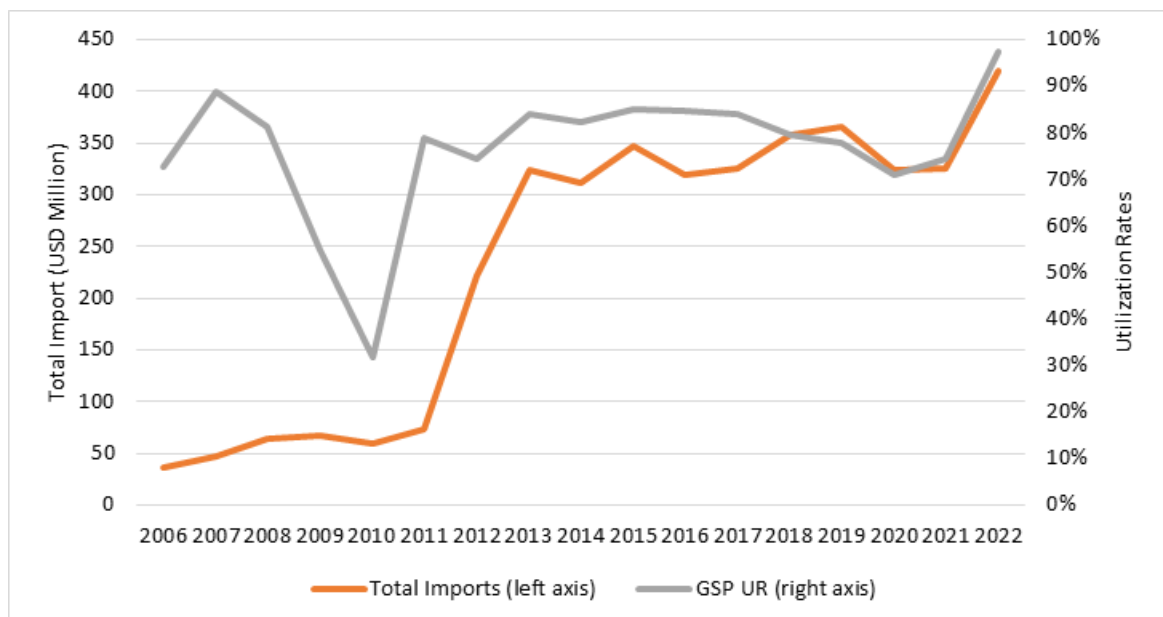
2.2. In the context of the EU initiative to reform the rules of origin for LDCs, Cambodia is often branded as a success story, as it managed to substantially increase its exports to the EU, showing high utilization rates under the EBA. Following the EU reform of rules of origin of 2011, Cambodia was also able to diversify its export composition to the EU thanks to the success of its bicycle industry. Moreover, Cambodia benefitted from using regional value chains and cumulation with the Association of Southeast Asian Nations (ASEAN) countries, this being one of the stated goals of the EBA's provisions on cumulation.

2.3. The EU reform introduced lenient rules of origin for clothing products falling under Chapter 62 of the Harmonized System (HS) that allowed garments assembled in the EU and sewn from fabric produced anywhere to obtain originating status. This reform had an immediate effect on the Cambodian garment sector: in 2011, garment exports from Cambodia to the EU almost doubled, and continued to increase over the subsequent years. The utilization rate of Cambodian exports to the EU increased from 57% to 90%, with a significant surge in the volume of exports of clothing products.

2.4. The impact of the EU reform, however, went well beyond the traditional garment sector, as it relaxed the rules of origin in entire HS Chapters, such as Chapter 87 *Vehicles, other than railway or tramway rolling stock and parts and accessories thereof*. This allowed the use of up to 70% of non-originating materials for bicycles and the easing of ASEAN cumulation rules.

2.5. Figure 1 below shows that, in 2011, the utilization rate of bicycles exported from Cambodia to the EU increased to around 80% from the rate of 33% of the previous year. Moreover, between 2010 and 2013, import values multiplied by a factor of 5.4, increasing from US\$60 million to US\$325 million (+442%).

Graph 1- EU imports from Cambodia and GSP utilization rates: Bicycles



2.6. Between 2014 and 2020, the utilization rates decreased slightly, *i.e.*, from over 80% in 2014-2018 to 78% in 2019 and 72% in 2020. This decrease in utilization rates may be due to the difficulties arising from the loss of cumulation with Malaysia and the challenges in using the derogation, as discussed in Section 4.1 below. The subsequent increase in imports and utilization rates after the COVID-19 epidemic in 2021 and 2022 represents a recovery bubble that is overshadowed by the declining orders for 2023 that are not yet reported in official data.

2.7. A critical liberalizing factor of the reformed EU rules of origin was the change in cumulation rules. The new cumulation relaxed the value-added principle in the allocation of origin when two or more ASEAN countries are involved in manufacturing.

2.8. This new cumulation rule allowed bicycle manufacturers based in Cambodia to use ASEAN parts, such as bicycle frames made in Vietnam and Shimano gears made in Malaysia, without these inputs being counted against the 70% threshold of non-originating materials. In such cases, the finished bicycle would have Cambodian origin and be entitled to duty-free treatment in the EU, provided that the working or processing operations carried out in Cambodia went beyond the simple assembly of the bicycles. The higher allowance threshold of 70% on the use of non-originating material combined with the new rules on cumulation created significant investment opportunities that were exploited by a number of companies producing bicycles in Cambodia. Examples of producers that were able to benefit from these reforms are AJ bikes,<sup>1</sup> Speedtech and Smartech.<sup>2</sup>

2.9. To adequately and collectively represent their interests, these companies formed the "Cambodia Bicycles Coalition" (CBC).

### **3 THE COMBINED CHALLENGES TO THE CAMBODIAN BICYCLE INDUSTRY ARISING FROM THE LOSS OF CUMULATION DUE TO GRADUATION AND EROSION OF MARKET ACCESS**

3.1. The positive impact of the abovementioned EU reform began to fade in 2014, with the amendment to the EU's Generalized System of Preferences (GSP) rules, which resulted in countries being excluded from the EU GSP if they either (a) graduated from beneficiary status under the EU GSP or (b) concluded Free Trade Agreements (FTAs) with the EU.

3.2. EU Regulation No. 978/2012 (EU GSP Regulation),<sup>3</sup> which came into effect in 2014,<sup>4</sup> provides (in Article 4) that a beneficiary country shall be removed from the list of GSP beneficiaries if (a) the World Bank has classified it as a high-income or an upper-middle income<sup>5</sup> country during three consecutive years immediately preceding the update of the list of beneficiary countries; or (b) it benefits from a preferential market access arrangement which provides the same tariff preferences as the GSP, or better, for substantially all trade.

3.3. The first challenge arose from the graduation of Malaysia from GSP beneficiary status in 2014. As a result, Cambodia's bicycle sector could not use any more gears originating in Malaysia under ASEAN cumulation. This seriously affected the supply chain of Cambodia's bicycle producers since the gears originating from Malaysia that national or regional alternatives could not replace. This challenge was addressed through the request for a specific derogation to the EU, as discussed in Section 4.1 below.

3.4. The second challenge emerged from the entry into force of the EU-Vietnam FTA on 1 August 2020.<sup>6</sup> This is because, according to Article 4(b) of the EU GSP Regulation, countries that

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<sup>1</sup> See <https://www.ajsibikes.com/>

<sup>2</sup> See <https://panjiva.com/Smart-Tech-Cambodia-Co-Ltd/5476217>.

<sup>3</sup> Regulation (EU) No. 978/2012 of the European Parliament and of the Council of 25 October 2012 applying a scheme of generalized tariff preferences and repealing Council Regulation (EC) No. 732/2008, OJ [2012] L 303/1.

<sup>4</sup> *Ibid*, Article 41.

<sup>5</sup> Compare to Article 3 of Council Regulation (EC) No. 732/2008 of 22 July 2008 applying a scheme of generalized tariff preferences for the period from 1 January 2009 to 31 December 2011 and amending Regulations (EC) No. 552/97, (EC) No 1933/2006 and Commission Regulations (EC) No. 1100/2006 and (EC) No 964/2007, OJ [2008] L 211/1, which provided a higher threshold for graduation from the GSP.

<sup>6</sup> Free Trade Agreement between the European Union and the Socialist Republic of Viet Nam, OJ [2020] L 186/3. See *also* [https://ec.europa.eu/commission/presscorner/detail/en/IP\\_20\\_1412](https://ec.europa.eu/commission/presscorner/detail/en/IP_20_1412).

"[benefit] from a preferential market access arrangement (FTA) that provides the same tariff preferences as the scheme, or better, for substantially all trade" lose GSP beneficiary status after a transitional period of two years.<sup>7</sup> Therefore, Vietnam lost its GSP beneficiary status as of 1 January 2023.

3.5. The direct effect of this development is that Cambodian bicycle manufacturers can no longer use Vietnamese-origin materials under the ASEAN cumulation provision to meet the 70% of the non-originating material threshold for preferential access to the EU. Overall, most of the bicycles manufactured in Cambodia are made mainly with Vietnamese-origin materials. Without the cumulation of Vietnamese-origin materials, the applicable product-specific rule of origin (PSRO), which requires not exceeding 70% of non-originating materials out of the ex-works price, cannot be met.

3.6. As further detailed in the Sections below, the loss of cumulation with originating parts of bicycles from Malaysia and subsequently Vietnam created significant difficulties for the Cambodian bicycle producers, causing delays and disruptions to the supply chains.

3.7. The EU has embarked on a process of revising the EU GSP scheme for the next decade, *i.e.*, 2024-2034. Such a process may provide opportunities to review and redress the evident imbalances arising from disallowing the use of inputs originating in GSP-graduated beneficiary countries. However, despite Cambodia's attempts to bring the issue to European Commission's attention, the current developments show little willingness to better understand the implications of the EU combined policy actions on Cambodia and ASEAN LDC.

3.8. The combined trade policy actions of (i) excluding inputs of graduated ASEAN countries from cumulation and (ii) embarking on concurrent FTA negotiations with individual ASEAN countries are creating collateral damage to Cambodia and ASEAN LDCs, disrupting ASEAN regional value chains, and affecting the market access condition of the ASEAN LDCs by eroding their preferential margins. The EU could legitimately pursue its trade and economic interests while also maintaining the necessary measure to safeguard ASEAN LDC achievement and regional value chains.

3.9. The current EU GSP Proposal<sup>8</sup> does not seem to contain any provision to remedy the existing imbalance. In fact, Article 4 of the EU GSP Proposal, which deals with the eligibility criteria for the standard EU GSP, does not provide any solution. It basically reproduces Article 4 of the EU GSP Regulation. Likewise, Paragraph 3 of Article 33 of the EU GSP Proposal, which regulates the procedures for cumulation, does not introduce corrective measures to redress the existing imbalance and is not clear as to the procedures to be followed for requesting extended cumulation, as discussed in Section 4.2 below.

## **4 THE CHALLENGES RESULTING FROM THE GRADUATION OF ASEAN COUNTRIES FOR CAMBODIA BICYCLE PRODUCERS: THE LOSS OF CUMULATION WITH MALAYSIA AND VIETNAM**

### **4.1 The loss of cumulation with Malaysia**

4.1. As pointed out in the previous Section, following the amendments to the EU GSP Regulation, Cambodia's bicycle producers could no longer use Malaysian inputs (mainly gears produced by the Shimano factory in Malaysia) for ASEAN cumulation purposes. At that time, similar changes to the Canadian GSP rules of origin raised concerns and caused significant difficulties for the Cambodian bicycle industry. As discussed in Section 6, the Canadian Government addressed such concerns

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<sup>7</sup> See Paragraph 2(b) of Article 5 of Regulation No. 978/2012: "The decision to remove a beneficiary country from the list of GSP beneficiary countries, per Paragraph 3 of this Article and based on point (b) of Article 4(1), shall apply as from two years after the date of application of a preferential market access arrangement."

<sup>8</sup> Proposal for a Regulation of the European Parliament and of the Council on applying a generalized scheme of tariff preferences and repealing Regulation (EU) No. 978/2012 of the European Parliament and of the Council Brussels, 22.9.2021 COM (2021) 579 final 2021/0297 (COD).

through the adoption of new rules in the Canadian graduation policy which allowed the use of inputs from graduated countries.<sup>9</sup>

4.2. Faced with a difficult situation in the EU market, the Cambodian bicycle manufacturers contacted the Ministry of Commerce of Cambodia to request a derogation from the European Commission to continue using inputs originating in Malaysia as eligible under ASEAN cumulation during a transitional period. This request was granted with a quota on the number of bicycles that can use cumulation,<sup>10</sup> and for a period of three years, *i.e.*, from 29 July 2014 until 31 December 2016.

4.3. This derogation, however, did not address the production cycles. As reported by bicycle manufacturers located in Cambodia:

*"The derogation for Malaysia took much too long to [be] put in place, we missed a whole model year with no Shimano as local content. Then when it was granted, it took a long time for the Malaysia[n] government to start to issue Form A<sup>11</sup>. Frankly, we will only start [benefitting] from this model year production, which starts in May, and we just have until the end of 2016 before [the derogation from the EU GSP Regulation] expires. Brands [will not] want to change specifications halfway through a model year in 2016. So, for us, it's almost all over from May 2016."*<sup>12</sup>

4.4. During the derogation period (*i.e.*, 29 July 2014 until 31 December 2016), several consultations and exchanges of letters took place between the Cambodian Minister of Commerce and Commissioner Malmstrom. On those occasions, the Cambodian Minister reiterated the need to find a permanent solution to the issues faced by the Cambodian private sector, which the temporary nature of a derogation could not address. However, the European Commission did not provide any substantive reply.<sup>13</sup> It simply outlined the procedure to request a new derogation and the modalities to request extended cumulation, which is discussed further in Section 4.2 below.

4.5. Building up the necessary information to apply for a second derogation took some time.<sup>14</sup> Moreover, once it was granted, the difficulties of taking advantage of the second derogation remained. As explained by the Cambodian bicycle manufacturers:

*"As with the last derogation, the long lead times in our industry create a problem, which I suppose the [European] Commission [does not] really understand. [Now] that we have the confirmation of form A, we can go to the customers and try to get them to change the specification of models already in production elsewhere and move that production to Cambodia. Assuming [that] they agree, the lead time from order to production is four months. [Therefore,] after the technical checks, we can start [exporting] these additional models in February 2019. [This means that, for a long period, Cambodian bicycle producers could make no use of the derogation extension granted by the EU]. Furthermore, customers also face losing it again through expiry (for EU arrivals) In December 2019, "In" means shipments [made] in November, so orders placed in July should again be without derogation. Therefore, the [...] production [that benefitted] from the derogation is [the production which took place*

<sup>9</sup> See, Canadian circular available at <http://www.cbsa-asfc.gc.ca/publications/dm-md/d11/d11-4-4-eng.html>.

<sup>10</sup> Commission Implementing Regulation (EU) No. 822/2014 of 28 July 2014 on a derogation from Regulation (EEC) No. 2454/93 as regards the rules of origin under the scheme of generalized tariff preferences in respect of bicycles produced in Cambodia regarding the use under cumulation of bicycle parts originating in Malaysia, OJ L 223, 29 July 2014, p. 19.

<sup>11</sup> Form A was adopted in 1970 by UNCTAD's Working Group on Rules of Origin as a common certificate of origin for the purposes of the GSP (TD/B/AC.5/38).

<sup>12</sup> Inputs from AJ Company, September 2018.

<sup>13</sup> See the letter of Commissioner Malmstrom of 9 November 2016 addressed to the Minister of Commerce of Cambodia, available at: [http://ec.europa.eu/carol/?fuseaction=download&documentId=090166e5ae183eb7&title=CM\\_signed%20-%20ASEAN%20letter%20to%20Sorasak.pdf](http://ec.europa.eu/carol/?fuseaction=download&documentId=090166e5ae183eb7&title=CM_signed%20-%20ASEAN%20letter%20to%20Sorasak.pdf)

<sup>14</sup> Commission Implementing Regulation (EU) No. 2018/348 of 8 March 2018 on a temporary derogation from the rules of preferential origin laid down in Delegated Regulation (EU) No. 2015/2446 in respect of bicycles and other cycles produced in Cambodia regarding the use under cumulation, of parts originating in Malaysia, OJ L67/24,09.3.2018, p. 1.

between] January [and] July 2019 (6 months), whereas the derogation was granted for 18 months."<sup>15</sup>

#### **4.2 The loss of cumulation with Vietnam and the Cambodian bicycle producers' experience in requesting extended cumulation**

4.6. The loss of cumulation with Vietnam from 1 January 2023, *i.e.*, two years after the entry into force of the EU-Vietnam FTA, is another formidable challenge to achieving an established regional value chain.

4.7. In fact, while the amount and value of Vietnamese-origin materials used may vary from one bicycle model to another, not a single bicycle eligible for EBA duty-free can be manufactured by Cambodian producers without using Vietnamese-origin materials.

4.8. The materials imported from Vietnam to Cambodia for bicycle production include alloy and carbon frames, forks, saddles, tubes, tires, rims, decals, handlebars, stems, seat posts, kickstands, fenders, chains, brakes, rear carriers, and high-quality packaging materials. The materials of Vietnamese origin used by Cambodian producers constitute the most important parts of the bicycles.

4.9. In 2020, on a weighted average basis, the Vietnamese-origin materials used by the CBC members accounted for 20% of the total value of the materials used. On a model-specific basis, the Vietnamese-origin materials' value can be much higher.

4.10. Cambodian bicycle producers had no option but to request extended cumulation. Such a possibility is provided under the EU GSP Regulation as outlined below:

##### Box 1 - Paragraph 7 of Article 86 of the EU regulation

At the request of any beneficiary country's authorities, extended cumulation between a beneficiary country and a country with which the European Union has a free-trade agreement per Article XXIV of the General Agreement on Tariffs and Trade (GATT) in force may be granted by the Commission, provided that each of the following conditions is met:

- (a) the countries involved in the cumulation have undertaken to comply or ensure compliance with this Section and to provide the administrative cooperation necessary to ensure the correct implementation of this Section both with regard to the European Union and between themselves.
- (b) the undertaking referred to in point (a) has been notified to the Commission by the beneficiary country concerned.

The request referred to in the first subparagraph shall contain a list of the materials involved in the cumulation and be supported with evidence that the conditions laid down in points (a) and (b) of the first subparagraph are met. It shall be addressed to the Commission. Where the materials concerned change, another request shall be submitted. Materials falling within HS chapters 1-24 shall be excluded from extended cumulation.

4.11. As is clear from the wording of Paragraph 7 of Article 86 of the GSP Regulation,<sup>16</sup> "extended cumulation" can only be granted upon request and where several conditions are met.

4.12. These conditions can be summarized as follows:

- a) The request for extended cumulation must be motivated and supported by evidence;
- b) If granted, extended cumulation applies only to specific products (although it is unclear how the products subject to the request should be defined and how specific their definition should be, *i.e.*, whether at HS chapter level, heading level, etc.);
- c) Extended cumulation may not be granted in relation to agricultural products; and
- d) The countries involved in the cumulation (*i.e.*, Cambodia and Vietnam) must have undertaken to provide the administrative cooperation necessary to comply with the rules of origin both with regard to the EU and among themselves.

<sup>15</sup> Statement by a Cambodian bicycle producer.

<sup>16</sup> Now in Article 56 of the Union Code as contained in Commission Delegated Regulation (EU) No. 2015/2446 of 28 July 2015.

4.13. It is also noted that there is no procedure regulating the period that may lapse between the submission of the request and a reply from the European Commission.

4.14. Officials of the Cambodian Ministry of Commerce and of the Directorate Generals for TRADE and for Taxation and Customs Union (TAXUD) of the European Commission held consultations on the exact procedures to be followed, including possible formats and required information to apply for extended cumulation. However, the initial phase of these consultations was not particularly fruitful.<sup>17</sup> It was only after a formal communication through the lawyer of the Cambodian bicycle producers with TAXUD that the procedural steps were finally clarified. In order to be considered, TAXUD required requests for extended cumulation to be accompanied by a joint undertaking of the Governments of Cambodia and Vietnam about administrative cooperation on rules of origin. However, no sample or direction as to the content of the joint undertaking was provided.

4.15. Due to the complexity of the issue and the necessity to enter into a bilateral agreement, it took two years (2021-2022) and a series of bilateral consultations and exchanges of letters between the Government of Cambodia and the Vietnamese Government to finalize and sign a joint undertaking.

4.16. The formal request for extended cumulation was lodged in December 2022. At present, while informal discussions have taken place, the European Commission has not provided a definitive response yet.

4.17. During such informal discussions, the Commission officials informed the Government of Cambodia that, due to the entry into force of the new EU GSP scheduled for 2024 and some related changes in the EU rules of origin, the joint undertaking signed by Cambodia and Vietnam must be updated to identify the correct legal basis for granting the request. This, in turn, will entail a new round of consultations between Cambodia and Vietnam to sign the updated undertaking.

4.18. Article 33 of the EU GSP Proposal<sup>18</sup> for the 2024-2034 decade provides in relevant part:

*3. Without prejudice to the rules referred to in Paragraph 2 and upon request from a beneficiary country, the Commission shall grant regional cumulation between beneficiary countries of different regional groups or extended cumulation where and as long as the following conditions are met:*

- a) the request from the beneficiary country provides sufficient evidence that such cumulation is necessary in view of the specific trade, development, and financing needs of that country;*
- b) the cumulation does not create undue trade difficulties for other eligible countries, in particular beneficiaries under the EBA arrangement, in view of possible diversion of trade flows;*
- c) The beneficiary country provides evidence that it cannot comply with the rules of origin applicable to the goods in question, without such cumulation being granted.*

*4. When assessing if the request is justified in view of the specific trade, development and financing needs of the beneficiary country, in particular, based on information provided by that country, the Commission shall take into account the level of dependency of the beneficiary country on integrated production with the third countries concerned by request, the impact of such dependence for the beneficiary country, the relevance of sectors with such integrated production for the economy of the beneficiary country and future development perspectives with regard to the products in question.*

*5. Before the Commission reaches its decision on a request, it shall give the beneficiary country the opportunity to present its views.*

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<sup>17</sup> Meetings among Cambodia delegation and Taxud and Trade Directorates' officials of 2016 and 2017.

<sup>18</sup> Proposal for a regulation of the European Parliament and of the Council on applying a generalized scheme of tariff preferences and repealing Regulation (EU) No. 978/2012 of the European Parliament and of the Council; Brussels, 22.9.2021 COM (2021) 579 final 2021/0297 (COD).



4.19. The above text does not clarify the procedure for submitting a request, it does not specify the format to be used for the joint undertaking and does not provide a timeline for the European Commission to assess and respond to the request for extended cumulation.

4.20. The text of the provision does nevertheless provide guidance as to the factors that should motivate a request for extended cumulation. The pending request submitted by the Cambodian bicycle manufacturers provided details on such factors, including:

- a) the level of dependency of the beneficiary country on integrated production with the third countries concerned by the request;
- b) the relevance of sectors with such integrated production for the economy of the beneficiary country; and
- c) future development perspectives with regard to the products in question.

4.21. The combined effects of the loss of cumulation of parts originating in Malaysia first and of parts originating in Vietnam in 2023 are affecting regional value chains of the Cambodian bicycle industry.

4.22. As discussed in Section 7, the loss of cumulation – and the procedures being tied up to its re-establishment – is not an isolated Cambodian issue, as it is affecting other African LDCs that have entered an Economic Partnership Agreement (EPA) with the EU.

4.23. In addition to being unable to use parts originating in Malaysia and Vietnam, the Cambodian bicycle industry is also facing competition arising from the erosion of trade preferences. The preferential margin that bicycle producers enjoy by being based in Cambodia is eroding gradually, as the tariff cuts under the EU-Vietnam FTA are implemented. In the same vein, those ASEAN countries that entered into FTAs with the EU may be able to cumulate among themselves progressively.<sup>19</sup> Cambodia, on the other hand, may face important limitations in terms of the cumulation scope since most ASEAN countries will have either graduated from the GSP or concluded FTAs with the EU.

4.24. As a bicycle producer, an important advantage of being located in Cambodia, is that there exist more lenient PSRO, which allow the use of up to 70% of non-originating materials under the EBA. By contrast, under the EU-Vietnam FTA only 45% of non-originating materials may be used. Yet, as Cambodia may graduate from LDC status in 2026, *i.e.*, after the review of the criteria for graduation by the UN Committee on Development Policies, Cambodian bicycle producers may lose these benefits in 2029, *i.e.*, after the grace period of three years provided under the EBA.

## **5 THE ALLEGED RATIONALE FOR EXCLUDING MATERIALS ORIGINATING IN GRADUATED COUNTRIES THAT ALSO BENEFIT FROM REGIONAL CUMULATION.**

5.1. The most significant challenges for the Cambodian bicycle producers originate from the graduation policy introduced by the EU in its GSP scheme. It is important to clarify that the matter under discussion is not the EU graduation policy *per se*, which may be legitimately pursued by a preference granting country. Rather, the issue which the present submission aims to highlight is *how*, since the entry into force of the EU GSP Regulation, the EU GSP graduation policy has been applied to inputs originating in graduated countries that are also members of a regional grouping.

5.2. The graduation of a country from EU GSP beneficiary status results in the exclusion of inputs and materials originating in that country from regional cumulation. Regional cumulation is granted under the EU GSP scheme to various regional groupings.<sup>20</sup> Under this arrangement, beneficiaries

<sup>19</sup> The provisions of the EU-Singapore FTA expressly provide for ASEAN cumulation, and similar provisions in the EU-Vietnam FTA are also providing scope for cumulation with ASEAN countries and cumulation with South Korea for a number of textile inputs for clothing products.

<sup>20</sup> The EU grants regional cumulation to the following groupings:

- Group I: Brunei; Cambodia; Indonesia; Laos; Malaysia; Myanmar/Burma; Philippines; Thailand; Vietnam; (ASEAN)
- Group II: Bolivia; Colombia; Costa Rica; Ecuador; El Salvador; Guatemala; Honduras; Nicaragua; Panama; Peru; Venezuela;
- Group III: Bangladesh; Bhutan; India; Maldives; Nepal; Pakistan; Sri Lanka; (SAARC)
- Group IV: Argentina; Brazil; Paraguay; Uruguay (MERCOSUR).

that are members of the same regional trade grouping may consider inputs originating from other members as originating in their own country. This substantially facilitates compliance with rules of origin requirements.<sup>21</sup>

5.3. The EU GSP Regulation, however, changed the treatment of inputs and materials originating in graduated countries. These changes have significant and concrete implications, especially for the countries that still benefit from GSP preferences. The previous EU GSP Regulation (EU Regulation No. 732/2008) contained an express provision that maintained the 'acquis' of regional cumulation even when one of the members of a regional group graduated from the GSP. This provision used to read as follows:

Box 2 - Paragraph 3, Article 5 of the EU GSP Regulation No. 732/2008

Regional cumulation within the meaning and provisions of Regulation (EEC) No. 2454/93 shall also apply where a product used in further manufacture in a country belonging to a regional group originates in another country of the group, which does not benefit from the arrangements applying to the final product, provided that both countries benefit from regional cumulation for that group.

5.4. Neither the current EU GSP Regulation nor the EU GSP Proposal that will revise the EU GSP scheme for the next decade 2023-2033 contain a provision equivalent to Article 5(3) of the EU GSP Regulation No. 732/2008. The absence of such a provision means that the inputs originating in graduated countries can no longer be used for cumulation purposes under the regional cumulation provisions.

5.5. According to officials of the European Commission, the absence of such a provision in the EU GSP Regulation is motivated by the fact that the continued use of inputs from graduated countries runs against the reasons underlying graduation. According to this reasoning, the products and/or materials originating in graduated countries no longer need preferential treatment to be competitive and allowing the use of such materials for the manufacturing of products in other countries may frustrate the objective of graduation.

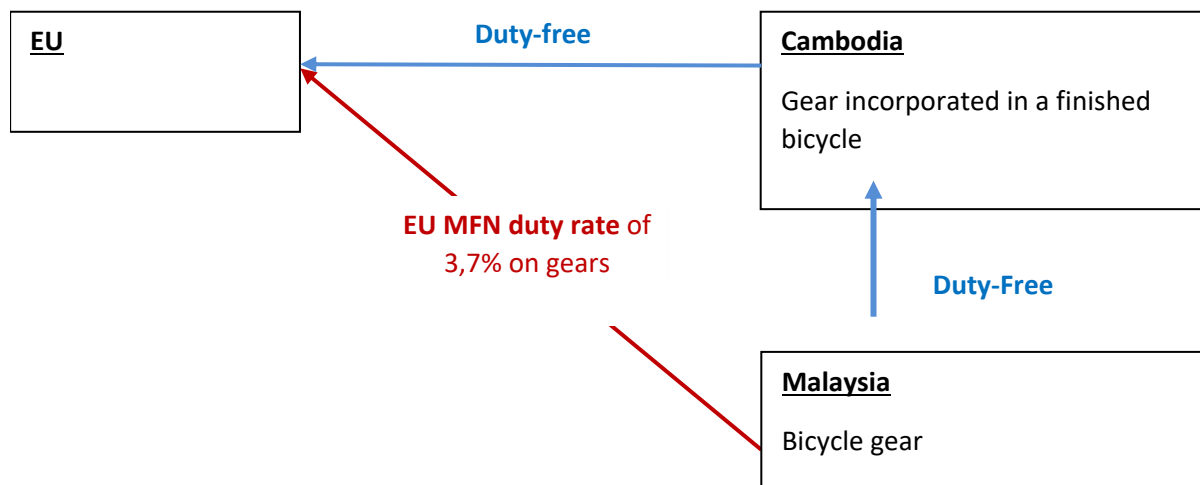
5.6. Above all, the European Commission argues that the use of inputs originating in graduated countries is inconsistent with Article I of the GATT 1994, as graduated countries may not have equivalent preferential access to the EU market.<sup>22</sup>

5.7. Figure 1 below illustrates the inconsistencies that would supposedly arise in cases where gears with Malaysian origin are exported to the EU market. After the graduation of Malaysia from the EU GSP Regulation, a bicycle gear (HS sub-heading 87141020) exported from Malaysia to the EU is subject to an MFN customs duty of 3.7% *ad valorem*. However, under ASEAN regional cumulation, if the same gear is incorporated into a bicycle with Cambodian origin, it would enter the EU market duty-free thanks to the EBA.

<sup>21</sup> See Stefano Inama, Rules of origin in international trade, Cambridge University Press, 2009 and 2022.

<sup>22</sup> At least, this is the argument used by the Commission to justify the absence of the provision contained in Paragraph 3 of Article 5 of EU GSP Regulation 2008 in the GSP regulation of 2014.

**Figure 1 - Potential WTO inconsistency of regional cumulation of inputs and materials originating in graduated countries in the absence of equivalent market access between the EU and the graduated countries**



5.8. According to the European Commission, the different treatment of inputs originating in graduated countries under, on the one hand, the EU GSP Regulation No. 732/2008 and, on the other hand, the current EU GSP Regulation would be justified in that the situation illustrated in Figure 1 above would be equivalent to tariff circumvention and would constitute a breach of Article I of the GATT 1994.<sup>23</sup>

5.9. This argument, however, is not entirely convincing, as it is unclear why such an argument was not raised before when the EU GSP Regulation No. 732/2008 was in force. Moreover, it can be argued that, when the inputs originating in graduated countries are incorporated into a finished product, they are substantially transformed into a new product, as indicated in the Union Customs Code<sup>24</sup> (see Box 3).

Box 3 - Paragraph 4 of Article 55 of the Union Customs Code

Regional cumulation between beneficiary countries in the same regional group shall apply only under the condition that the working or processing carried out in the beneficiary country where the materials are further processed or incorporated goes beyond the operations described in Article 47(1) and, in the case of textile products, also beyond the operations set out in Annex 22-05.

<sup>23</sup> Article I of GATT 1994 provides as follows: "...any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties..."

<sup>24</sup> Available at <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:02015R2446-20160501&from=EN>.

5.10. Article 47(1) of the Union Customs Code lists a series of working or processing operations that are considered to be insufficient to confer origin.<sup>25</sup> Hence, as long as the working and processing operation carried out in a country are not among those listed in Article 47(1), the materials that have been worked and processed should be conferred a new origin.

## **6 COMPARABLE SITUATIONS AND BEST PRACTICES ADOPTED BY OTHER PREFERENCE-GIVING COUNTRIES.**

6.1. Canada, another major preference-giving country, has adopted a very different approach in applying its graduation policy. Such an approach should serve as an example of best practices and could be adopted by the European Commission in implementing the EU GSP Proposal, which is expected to enter into force next year.

6.2. As part of its 2013 "Economic Action", Canada reformed its General Preferential Tariff (GPT) regime. Under the reformed Canadian GPT regime, countries meeting one of the two criteria below ceased to be eligible for the Canadian GSP scheme. The two criteria are:

- a) whether, according to the latest World Bank income classifications, the country is classified for two consecutive years as a high-income or upper-middle-income economy; or
- b) whether, according to the latest WTO statistics, the country has had a 1% or greater share of the world's exports for two consecutive years.

6.3. Under the new Canadian regime, the eligibility of each country to benefit from GSP status shall be reviewed every two years.

6.4. The reform led to the graduation from GPT treatment of 72 trading partners in 2015. The graduation of these 72 countries was projected to have a series of negative implications for the remaining beneficiaries. However, the potential negative impact of this reform was acknowledged by Canadian importers during the review process carried out by the Canadian Government on the

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<sup>25</sup> Article 47 of the Union Code provides as follows.

1. Without prejudice to Paragraph 3, the following operations shall be considered as insufficient working or processing to confer the status of originating products, whether or not the requirements of Article 45 are satisfied:
  - (a) preserving operations to ensure that the products remain in good condition during transport and storage;
  - (b) breaking up and assembly of packages;
  - (c) washing, cleaning; removal of dust, oxide, oil, paint, or other coverings;
  - (d) ironing or pressing of textiles and textiles articles;
  - (e) simple painting and polishing operations;
  - (f) husking and partial or total milling of rice; polishing and glazing of cereals and rice;
  - (g) operations to colour or flavour sugar or form sugar lumps; partial or total milling of crystal sugar;
  - (h) peeling, stoning, and shelling of fruits, nuts, and vegetables;
  - (i) sharpening, simple grinding or simple cutting;
  - (j) sifting, screening, sorting, classifying, grading, matching (including the making-up of sets of articles);
  - (k) simple placing in bottles, cans, flasks, bags, cases, boxes, fixing on cards or boards and all other simple packaging operations;
  - (l) affixing or printing marks, labels, logos and other like distinguishing signs on products or their packaging;
  - (m) simple mixing of products, whether or not of different kinds; mixing of sugar with any material;
  - (n) the simple addition of water or dilution or dehydration or denaturation of products;
  - (o) simple assembly of parts of articles to constitute a complete article or disassembly of products into parts;
  - (p) a combination of two or more operations specified in points (a) to (o);
  - (q) slaughter of animals.
2. For the purposes of Paragraph 1, operations shall be considered simple when neither special skills nor machines, apparatus or tools especially produced or installed for those operations are required for their performance.
3. All the operations carried out in a beneficiary country on a given product shall be taken into account when determining whether the working or processing undergone by that product is to be regarded as insufficient within the meaning of Paragraph 1.

impact of the proposed changes to the Canadian GPT scheme. In fact, as reported in the outcome of the impact exercise, out of the 105 submissions "*approximately half of the submissions received during consultations expressed concern that changes to GPT country eligibility would reduce the benefits of Canada's LDCT and outward processing regimes. Grandfathering the pre-1 January 2015, list of GPT beneficiaries for these regimes responds to these concerns.*"<sup>26</sup>

6.5. Accordingly, modifications to the rules of origin under Canada's LDCs trade regime were made to ensure that LDCs' exports would continue to be eligible for duty-free treatment when imported to Canada, even when they incorporated inputs originating in countries that would no longer be eligible for the GPT.

6.6. Unfortunately, neither the mid-term evaluation of the EU's GSP 2017<sup>27</sup> nor the impact assessment study carried out in 2021<sup>28</sup> mention, let alone address, the negative effects that graduation of the inputs originating in graduated countries will have on the countries that should remain GSP beneficiaries.

## **7 THE SYSTEMIC NATURE OF THE ISSUE RAISED BY CAMBODIA: LACK OF PROCEDURES FOR REQUESTING CUMULATION UNDER THE EU GSP REGULATION AND ECONOMIC PARTNERSHIP AGREEMENTS.**

7.1. The situation faced by the Cambodian bicycle industry in applying for regional or extended cumulation is neither unique nor an isolated case.

7.2. Under the trade arrangement provided by the Cotonou Agreement between the EU and the African, Caribbean and Pacific (ACP) countries (the Cotonou Agreement), the ACP countries were granted full regional cumulation by the EU. The Cotonou Agreement, including its provisions on cumulation, has gradually been replaced by different Economic Partnership Agreements (EPAs) between the individual ACP countries and the EU. Similarly, the EU-Vietnam FTA as well as other FTAs concluded by the EU contain detailed rules on the implementation of cumulation with other ASEAN countries.

7.3. A closer look at the cumulation provisions contained in the EPAs between the EU and the ACP countries and the EU-Vietnam FTA shows a number of similarities. In fact, the implementation of these provisions on cumulation is subject to a number of conditions. Such conditions echo those for extended cumulation analysed above.

7.4. An example is provided by Paragraph 5 of Article 3 of the Protocol on rules of origin of the EU-Vietnam FTA, which reads:

Box 4 - Paragraph 5 of article 3 of the Protocol on rules of origin of the EU-Vietnam FTA

The cumulation provided for in Paragraphs 2 to 4 shall only apply provided that:

- (a) the ASEAN countries involved in the acquisition of the originating status have undertaken to:
  - (i) comply or ensure compliance with this Protocol; and
  - (ii) provide the administrative cooperation necessary to ensure the correct implementation of this Protocol both with regard to the Union and among themselves;
- (b) the undertakings referred to in subparagraph (a) have been notified to the Union;
- (c) the tariff duty applicable by the Union to the products in Annex IV obtained in Vietnam by use of such cumulation is higher or the same than the duty applicable by the Union to the same product originating in the ASEAN country involved in the cumulation.

<sup>26</sup> See <http://canadagazette.gc.ca/rp-pr/p2/2013/2013-10-09/html/sor-dors161-eng.html>.

<sup>27</sup> Final Interim Report 21 September 2017 available at: <https://circabc.europa.eu/ui/group/f243659e-26f5-44d9-8213-81efa3d92dc7/library/fef4662d-6e95-4242-8e5a-d0ec5bde782f/details>

<sup>28</sup> Available at <https://op.europa.eu/en/publication-detail/-/publication/be174994-f337-11eb-aeb9-01aa75ed71a1/language-en>.

7.5. A mirror provision is contained in Paragraph 6 of Article 4 in the EPA between the EU and the Eastern and Southern Africa (ESA) countries containing similar conditionalities for implementing regional cumulation.

Box 5 - Paragraph 6 of Article 4 in the EU-ESA EPAs

The cumulation provided in this Article may only be applied provided that:

- (a) the countries involved in the acquisition of the originating status and the country of destination have concluded an agreement on administrative cooperation, which ensures the correct implementation of this Article;
- (b) materials and products have acquired originating status by the application of the same rules of origin as provided in this Protocol; and
- (c) the ESA States will provide the Community, through the European Commission, with details of agreements on administrative cooperation with the other countries or territories referred to in this Article. The European Commission shall publish in the Official Journal of the European Union (C series), and the ESA States shall publish, according to their procedures, the date on which the cumulation provided for in this Article may be applied with those countries or territories listed in this Article which have fulfilled the necessary requirement.

7.6. The two examples provided above show that the cumulation provisions were respectively (a) included under the GSP provisions prior to 2014, *i.e.*, ASEAN cumulation for Vietnam, and (b) Cotonou and later Market Access Regulation for ACP countries and other countries that have entered or will be entering an FTA with the EU, have not been automatically transferred to new trade arrangements.

7.7. Put simply, graduation out of the GSP schemes or conclusion of an EPA with the EU means that the cumulation provisions granted under the former GSP or EBA are subject to conditions for the entry into force of the cumulation under the new trade arrangements. These conditions may be summarized as follows:

- a) the conclusion of an agreement on administrative cooperation;
- b) notification of the details of the agreements to the EU; and
- c) official publication of the date on which cumulation will enter into force.

7.8. Therefore, countries that have entered into FTAs with the EU and that used to benefit from cumulation under the EU GSP Regulation or Market Access regulation or EBA (*e.g.*, Vietnam and the ACP countries members of the Cotonou Agreement) have to re-apply for regional cumulation according to the provisions in their respective FTAs.

## 8 MAIN CONCLUSIONS AND RECOMMENDATIONS

8.1. In conclusion, the EU reform concerning rules of origin has brought considerable benefits to Cambodia. However, with the introduction of the exclusion from the cumulation of the inputs originating in graduated countries, the EU has significantly backtracked the outstanding results of its reform for no apparent and valid reason.

8.2. The issue of graduation from the EU GSP and the exclusion from the cumulation of graduated countries under Article 4(b) of the EU GSP Regulation is not limited to ASEAN LDCs but is also a systemic issue affecting ACP countries. In fact, as a result of this provision, ACP countries entitled to benefit from cumulation under past arrangements with the EU, *i.e.*, the Cotonou Agreement, can no longer cumulate with ACP countries that have entered into an EPA with the EU, unless a specific procedure is undertaken as discussed in Section 7.

8.3. The Cambodian delegation thus recommends redressing the collateral damage that resulted from graduation, which has profoundly affected Cambodia's private sector as well as the private sectors of other ASEAN and ACP countries.

8.4. In the GSP Proposal, the European Commission and the European Parliament should re-introduce the possibility for a country that is part of a regional trade grouping to cumulate inputs

originating in a graduated country that is part of the same regional grouping. The GSP Proposal should also impart predictability and transparency as regards the procedures for submitting a request for extended cumulation. Most importantly, the EU GSP Proposal should include a provision imposing a deadline of 90 working days on the European Commission to decide on a request for extended cumulation. Once the deadline is passed, the request should be deemed to be accepted for a minimum period of five years.

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