

6. Preferential and Other Special Arrangements

“ . . . the objectives of the generalized non-reciprocal, non-discriminatory system of preferences in favour of the developing countries, including special measures in favour of the least advanced among the developing countries, should be: to increase their export earnings; to promote their industrialization; and to accelerate their rates of economic growth”

Resolution 21(II) UNCTAD, New Delhi, 1968

6.1 No consideration of the extent and forms of protection would be complete without reference to the preferential and other special arrangements existing in individual markets, in favour of exports from developing countries. The most noteworthy of these are the various schemes introduced under the Generalized System of Preferences (GSP), which apply in principle to all developing countries, and the Lomé Convention which, with some exceptions and limitations, gives duty-free and quota-free trade access to the EEC for African, Caribbean and Pacific member countries (ACP). These arrangements replaced earlier preferences received by many countries from developed countries with which they had historical links; along with newer elements, they are applied to broader groups of both preference-giving and preference-receiving countries. Apart from the GSP and Lomé there are special provisions in the import tariffs of some developed countries which, while varying in detail, provide for partial remission of duty on imports of articles processed or assembled from components originating in the developed country.

The Generalized System of Preferences

6.2 At the second UNCTAD in 1968, a generalized system of non-reciprocal preferences for developing countries was agreed. The aim was to increase their export earnings, promote their industrialisation and accelerate the rate of their economic growth. Unlike the preferences

extended, on a reciprocal footing, by the United Kingdom, France, the Netherlands and others to countries with which they had historical links, all of which have now been superseded, the schemes introduced under the GSP extend preferential access on a non-reciprocal basis to nearly all the developing countries. However, they are greatly circumscribed by product exclusions, and by limitations on the preferences granted through tariff quotas, ceilings and maximum country amounts. Most schemes have a restricted coverage of agricultural products and either exclude or severely limit the preference granted to 'sensitive' products — those in which import penetration tends to be strong and in which therefore beneficiary countries have a substantial interest. All provide for unilateral termination or alteration by the implementing country without compensation for the affected parties; in GATT terminology none of the GSP concessions is 'bound'.

6.3 After detailed negotiations in OECD and UNCTAD, the GSP schemes of individual countries began to be implemented from 1971 and 1972, although the schemes of Canada and the United States had to wait until the middle of the 1970s. A pioneering scheme was introduced by Australia in the middle 1960s. The various schemes were not uniform and, for a number of reasons, the main products to benefit were manufactures and semi-manufactures. In 1976, by which time all GSP schemes were operational, GATT calculations show that, out of m.f.n. dutiable imports of agricultural products from GSP beneficiary countries amounting to \$20.3 billion, only \$4.6 billion qualified nominally for GSP treatment. With industrial products the proportion was very different, GSP eligible items accounting for \$22.5 billion out of m.f.n. dutiable imports valued at \$34.6 billion.

6.4 Among the agreed conclusions of the UNCTAD Special Committee on Preferences, that established the norms of the system, was the consideration that efforts for further improvements should be pursued in a dynamic context. What happened in practice, however, was a dilatory and defensive implementation of schemes which, because of their unilateral and temporary nature, lacked the incentive and certainty to evoke a significant increase in supplies. Also, being non-reciprocal, they were never seriously intended to involve structural adjustment in the preference-giving countries. They came replete with safeguards and prior limitations. Those products, like textiles and footwear, in which comparative advantage had already been demonstrated, were excluded from nearly all schemes at the outset. The EEC in principle included textiles in its scheme for countries that adhered to the Long-term Arrangements on International Trade in Cotton Textiles (and later the Multifibre Arrangement (MFA)), but severely restricted the benefits by a system of

maximum country amounts (tariff quotas). Thus the effect in this area was largely a revenue effect, with little trade volume impact at the margin, except insofar as the GSP and the MFA combined might have favoured exports from smaller producing countries or new entrants to the trade.

6.5 Data supplied to the UNCTAD secretariat by preference-giving countries, showing the extent of utilisation of their GSP schemes, indicate that the role of the GSP in improving market access for developing countries has been small but not insignificant. The latest available data, mostly for 1980, show imports under GSP by OECD and two centrally planned preference-giving countries valued at about \$27 billion, i.e. something under half the \$58 billion of imports into these countries nominally eligible for GSP treatment, out of the total of dutiable imports amounting to \$115 billion. Thus, roughly a quarter of m.f.n. dutiable imports are cleared under the GSP. This amounts to a little more than a tenth of total imports by these countries from GSP beneficiaries, when allowance is made for the portion of imports entering duty-free on an m.f.n. basis. In 1976, the first year when all schemes were being implemented, the comparable proportion was less than 7 per cent.

6.6 According to GATT, the trade-weighted average post-Tokyo Round preference margin for agricultural products included in the various schemes was about 8 per cent. For industrial products the margin would be about 7 per cent, or somewhat more at present as the staged m.f.n. cuts agreed to during the Tokyo Round are not yet fully implemented. Applying a factor of 8 per cent to the data presented above, which show imports cleared under the GSP amounting to \$27 billion in 1980, gives a rough estimate of about \$2.2 billion in terms of revenue foregone.

6.7 This is slightly less than the comparable figure in 1977, at current values, and demonstrates the declining importance of the GSP in real terms. This is particularly the case with schemes based on prior limitations. The annual increases in value ceilings in the scheme of the EEC have been less than the underlying rate of inflation, and in recent years there have been no increases in ceilings for 'sensitive' industrial products. With many tariff quotas falling short of current imports, large amounts of 'sensitive' eligible imports have failed to obtain preferential treatment under the GSP. This subjecting of incremental trade volumes to m.f.n. rates of duty must considerably detract from the effectiveness of the GSP in terms of its original objective of stimulating exports.

6.8 Various studies have been made in recent years of the dynamic effects of the GSP on trade in manufactures. While the results vary widely, depending on assumption, methodology and data sample, all show a

significant impact in trade terms. This is being eroded by the lack of an inflation factor, however, in those schemes based on prior limitations expressed in value terms, by the discriminatory way in which the more successful developing country exporters are being phased out of benefits in respect of 'sensitive' products, and by m.f.n. tariff reductions. This is not incompatible with the original conception of the system from the standpoint of developed countries, as a time-bound, non-contractual, non-reciprocal arrangement under which they would give what it cost them little to give, and would take it away when appropriate. But the consequence is that, as at present constituted, the GSP is too small and too uncertain an element in investment calculations to have any very significant effect on industrialisation.

6.9 Two aspects of the picture have attracted particular attention in the past. These are the low apparent rates of utilisation of the generalized preferences nominally on offer, and the fact that most use is made of them by a comparatively small number of developing countries. The greater use of the GSP by a small number of more advanced developing countries simply reflects their greater capabilities to take advantage of the schemes. The low levels of utilisation by the less advanced developing countries highlight the need for some beneficiary countries to improve their supply response, and for complementary measures to help them in doing so. More technical and other assistance, particularly to counter the greater proportionate burden that GSP documentation and international representation sometimes impose on smaller trading countries, could help them in this regard and such assistance could be provided. More careful attention might also be given by the licensing authorities in some preference-giving countries to assure equitable access to GSP tariff quotas by new entrants.

6.10 There is a feeling among a few developing countries with a competitive industrial base that the GSP has little value for them. In the light of the increasing tendency for them to be discriminated against, either by being 'graduated' out of the GSP benefits, or by being the target of other selective measures of protection, they see the maintenance of free markets as their main concern in the world's trading arrangements.

6.11 In view of the limited benefits conferred by the GSP, the question arises whether developing countries should not give greater emphasis to securing m.f.n. tariff reductions, although this would reduce the significance of the GSP. At present the fear of erosion of preferences can be used as an excuse against m.f.n. tariff reductions for products of interest to developing countries. Yet for some developing countries, and for others in the long-run, there are greater advantages in securing m.f.n.

reductions which are bound, and are not limited, and therefore provide greater certainty. Preferences tend to impair the principle of non-discrimination in international trade policy and, generally, developing countries have a strong interest in maintaining and strengthening this principle, subject to agreed exceptions in conformity with Part IV of GATT (Appendix 1).

6.12 The lack of uniformity among the various GSP schemes, and the administrative complexity of some of them, have long been a cause for concern. While the reasons for this complexity are understood, possibilities for standardisation and simplification in future should be pursued, especially taking into account progress in related fields such as the customs valuation code negotiated in the Tokyo Round, and the current work on tariff harmonisation in the Customs Cooperation Council. There is need to move towards a uniform coverage and depth of tariff cut within the GSP. However, it must be acknowledged that the major difference in the GSP schemes is more fundamental, separating the EEC-type schemes with their prior limitations, from the US-type, comparatively open-ended schemes with safeguards based on some sort of 'competitive need' formula, or a traditional safeguard clause. Without seeming to minimise the difficulties that would lie in the way of bridging this gap, it would be desirable to move towards the more open-ended and less complex features of a US-type scheme.

The Lomé Convention

6.13 The first Lomé Convention between the EEC and the ACP countries provided for contractual, institutionalised and time-bound preferences in the enlarged EEC to be shared by eligible Commonwealth developing countries and the francophone African states associated with the original members of the EEC under the Yaoundé Convention. The more populous and generally more industrially advanced Commonwealth countries in south and south-east Asia were excluded from eligibility on grounds of incompatibility, but a Declaration of Intent on the part of the EEC envisaged utilising the mechanisms of the GSP to provide some assurance against trade deflection, in the manner indicated in paragraph 6.27 below.

6.14 The second Convention, in the same way and with an enlarged membership, now covers four main areas: trade, aid, industrial cooperation and export earnings stabilization (Stabex). The trade provisions of the Convention provide for duty-free and quota-free entry for most imports of ACP origin into the EEC. In the case of a comparatively small number of agricultural products of ACP origin which face duties and levies on importation into the EEC, the import charges are

usually less than those applicable to non-ACP goods and, in some cases, they are almost entirely waived. For example, 90 per cent of the levy on beef originating in Botswana and certain other countries in Africa is remitted to the exporting countries. For a range of agricultural products that were of particular significance in the system of Commonwealth preferences, special arrangements have been made in a series of protocols to the Convention. The most important of these is for sugar. There are also protocols for rum and bananas.

6.15 However, while nearly all imports from the ACP into the EEC enter duty-free, the nominally generous access is not as substantial as it appears. For example, quantitative restrictions still apply to some imports, like beef, sugar and rum. Rules of origin remain restrictive and complex. More than three-quarters of ACP exports would enter the EEC duty-free and more than 90 per cent of their industrial exports would be eligible for GSP treatment in the absence of the Lomé Convention. The access provisions are also qualified by provisions for safeguard action.

6.16 Among the main differences between the Convention and the GSP are that the former, contractual relationship is more restricted in its membership but more beneficial in its terms, especially on the side of agriculture, as well as in providing preferences with greater time-bound certainty. On the whole, the advantages of Lomé to developing country members are potentially considerable.

6.17 Restrictive origin rules, safeguard clauses and the retention of barriers on some agricultural exports, do not alter the fact that significant preferences are provided to the ACP by the Convention. On the whole, however, the preferences do not seem to have had much beneficial effect on ACP exports. Between 1975 and 1980, when EEC imports of all products from the ACP fluctuated around 7 per cent of total EEC imports, the ACP share of EEC imports of semi-finished and finished manufactures, at just above 3 per cent, actually fell, while the share of other developing countries in the trade in these products rose from 12 to over 15 per cent. There is doubtless scope for improving the preferences, as is indicated below in the last section of this chapter, but it is obvious that supply problems are a great constraint on their effective utilisation.

Value-Added Tariffs

6.18 While not inherently preferential, other new developments in business practices and tariff structures have been of particular relevance to the prospects for manufactured exports from developing countries. Since the late 1960s there has been rapid growth in 'outward-processing' or 'offshore assembly'. These expressions refer to the assembly or processing

for re-export, under favourable tariff treatment at both ends of the trade, of components and parts originating in industrial countries. Exports arranged on this basis now average about 20 per cent of total developing country manufactured exports to the United States. The income (value-added) accruing to the developing country exporters from these activities is typically much less than the gross value of their exports, and usually less than that from an equal dollar value of traditional exports. Where traditional products like textiles, clothing and footwear face severe trade barriers in the developed countries, outward-processing offers an alternative or additional path along which developing countries seeking to initiate or accelerate industrial export growth may move. The establishment of export processing zones in developing countries, combined with the 'value-added' tariffs of developed countries, has greatly facilitated this movement.

6.19 While they have so far been concentrated in the clothing and electronics sectors, the variety of such outward-processing activities now being undertaken is extensive and growing. In general they are relatively unskilled labour-intensive activities, whether component manufacturing or processing, of a kind which can readily be segmented out of previously integrated production facilities. Transnational manufacturing and trading companies search out the cheapest sources for their requirements, either for direct purchasing from local firms or for location of their own establishments. In their quest to minimise costs, they now integrate developing countries into their global operations as suppliers not only of raw materials, as in the past, but also of particular manufactured products and processes.

6.20 The value-added tariff arrangements to be found in the tariff schedules of most industrial countries provide for duty-free re-entry or duty relief on domestically produced components which have been assembled or processed abroad. This frees the finished product of the full burden of import duties which would otherwise have to be paid on the sometimes substantial value of imported inputs, and thus encourages labour-abundant developing countries to conduct processing and assembly activities in which they possess comparative advantage. The value-added tariff reduces what would otherwise be the level of overall protection for the final product's manufacture in the industrial country. On the other hand, by lowering costs of components and assembly activities, and by providing a market for the original exported inputs, this tariff provision can enhance the profitability of the relevant industry and protect all of it other than those parts being relocated abroad. Where no import duties are to be levied on the relevant final product, whether because of GSP provisions, the Lomé Convention or zero m.f.n. rates,

there are no advantages offered by value-added tariffs; outward-processing already is encouraged by freedom from trade barriers.

6.21 While most developed countries operate their own version, the best known example of these tariff provisions is that of the United States. Item 807.00 of the US tariff schedule, which accounts for over 90 per cent of US imports under these provisions, allows duty-free re-entry only of components that do not lose their physical identity in the assembled article. Item 806.30 provides for offshore processing of certain metal products, but is limited to products that are returned for further processing in the United States. Under both headings the tariff relief attaches to the components of US origin, irrespective of the nationality of the firms involved.

6.22 In 1976 the EEC adopted a common outward-processing scheme, which differs from that of the United States in certain respects. For example, the EEC provisions apply to all kinds of products and to all forms of processing as well as to simple assembly. They also require that the exporting firm be resident in the EEC, and that the components be assembled and re-exported to that company on its own account. The extent of duty remission on EEC imports differs from that in the US scheme; it depends on the import duty applicable to the inputs in question had they been imported in unincorporated form. A similar provision forms part of the Japanese arrangements.

6.23 Outward-processing has also been favoured under the MFA which authorises special and differential treatment for re-imports into a participating country of textile products which that country has exported to another participating country.

6.24 Although a system of outward-processing is likely to provide significant opportunities for expanding exports of manufactures from developing countries, it is not without shortcomings. The processing activities usually consist of a few routine operations using low-cost labour. Limited industrialisation occurs through specialisation in labour-intensive technology of single components or assembly processes, with perhaps limited opportunity for the development of entrepreneurial and industrial skills. A manufacturing process which in this way tends to be dependent exclusively on foreign inputs, may severely restrict the development of economic linkages within the domestic economy. Tariff relief on outward-processing may be one means by which otherwise high effective rates of protection on manufacturing can be mitigated. But the structure of manufactured exports from developing countries which results from these differentiated trade barriers need not coincide with that which

comparative advantage or development aspirations, by themselves, would dictate.

6.25 Value-added tariffs and other provisions relating to outward-processing are not at present governed by agreed international conventions or guidelines. Some schemes are open to all; some are only available to locally-based firms. Some apply only to some sectors or types of activity; others are more universally applicable. Some such concessions are fully transparent, with public information as to their use being readily available; others are made available on a discretionary and secretive basis. The objectives of non-discrimination and transparency would be advanced by multilateral adoption of common procedures and policies regarding value-added tariffs and outward-processing. These would have maximum potential impact if their special provisions were available to all firms, within all industries. Regular reporting as to the dimensions and characteristics of their use, apart from the inherent advantages of transparency, would facilitate assessment of their overall role in the development of developing countries' industrial exports.

The Way Ahead

6.26 The apparently conflicting objectives of preferences and non-discrimination, and the trade arrangements reflecting these orientations, have been considered with a view to identifying areas for rationalization. The long-term objective must be non-discrimination. We do not start with a *tabula rasa*, but with historically determined regional preferences, and there exists a powerful rationale for the granting of general preferences to developing countries. Some countries are likely to gain more from a universal application of non-discrimination than they would lose from giving up their preferences: if, however, universal non-discrimination cannot be guaranteed, these countries cannot be expected to enjoy losing advantages which they now possess.

6.27 In spite of its limitations, to which attention has been drawn, and in the absence of a more extensive reduction of trade barriers, the GSP should be retained and improved, and consideration given to a more systematic application of its principles, by extending them to non-tariff measures, and in other ways. Apart from anything else, it has provided the mechanism, within the spirit of GATT, for some degree of 'compensation' to Asian Commonwealth countries that were excluded from eligibility in Lomé, by the opening of bilateral tariff quotas on certain products of export interest to them. Several of the GSP tariff preferences, which served to mitigate the adverse effects of the enlargement of the EEC on Asian countries, are still of considerable commercial importance in this context. Moreover, the formation of the EEC and its arrangements with EFTA has generated

discrimination against all non-members, including all non-ACP developing countries. Until the GATT proves more effective in reducing m.f.n. tariffs and other restraints on exports of interest to developing countries, the GSP has a role, albeit second best, in mitigating barriers against these exports. It should be made to respond more closely to the needs of the developing countries, especially the poorer ones.

6.28 The situation where GSP preferences could be and are withdrawn unilaterally, without reference to injury or trade disruption, should be ended. These withdrawals should take place on a multilaterally agreed and uniform basis. Any eventual phasing out of GSP arrangements, for those developing countries that can continue to achieve a buoyant expansion of exports without them, should also be subject to multilaterally agreed rules. In each case, when necessary, compensatory concessions for loss of preference should be negotiated.

6.29 The EEC and Japanese schemes have incorporated preferential access without limitation for the least developed countries. This principle should be adopted by other countries which have not yet done so.

6.30 The GSP should also be extended in the area of primary and processed agricultural products, without limitation, as these are the areas in which some of the low income developing countries could expect to find comparative advantage. Any resulting erosion of preferences in those countries having special preferential arrangements, such as are provided by the Lomé Convention, should be compensated by equivalent benefits in third markets.

6.31 The Lomé Convention has sought to preserve the most liberal features of former preferential trade regimes, while being made broader and less exclusive than the arrangements it replaced. In this respect it points the way ahead for preferences generally. Lomé has the advantage of tending to involve less industrially advanced developing countries and it provides them with more liberal access than is accorded by the GSP. It applies to some extent to the non-tariff area as well as to tariffs. It might thus serve as a model for wider preferential arrangements between developed and developing countries.

6.32 However, in spite of its unexceptionable intentions, the Lomé Convention has not always prevented, and may not do so in the future, the adoption of inward-looking policies by the Community. Although the free trade element is important for the ACP, the EEC, given its own economic difficulties, seems to be unprepared to encourage full advantage to be taken of the access provisions, particularly insofar as these relate to the

products of labour-intensive industries like textiles and clothing. Indeed, safeguard measures have already been threatened on the few ACP exporters that have made some headway in increasing exports of these products, although they are as yet responsible for an insignificant proportion of import penetration. And, instead of adjusting in such a way as to allow freer access to processed and manufactured goods from the emerging industrial sectors of the ACP, the EEC has sought to influence investment in the ACP along lines deemed to be complementary or harmonious with the structure of European industry. In particular, this implies more favourable treatment for ACP exports within EEC-based firms. The Lomé rules of origin are also intended to exert influence of this sort.

6.33 These rules of origin allow cumulation of origin involving more than one ACP state (i.e. the ACP states are considered as being, for origin purposes, one territory). They also allow cumulation of donor country content (i.e. they allow imports from the EEC to be considered as originating products). While these are positive elements, the high levels of value added required by the rules of origin, their proscription of 'simple mixing' and 'simple assembly', combined with the provision for cumulation of donor country content, make it difficult for indigenous (as well as non-EEC foreign) enterprises to grow, on the basis of trade with the EEC, in competition with offshoots of European enterprises. The origin rules should be liberalised to make them more appropriate to the stage of development reached by most ACP countries.

6.34 At the same time there is need for caution against the bilateral and inward-looking tendencies in some regional arrangements which, if left unchecked, may impede further progress in multilateral trade liberalisation. The provisions for cumulation of EEC origin in Lomé, the value-added tariffs of the developed country markets, and the recent Caribbean Basin Initiative may each, considered in isolation, encourage increased access for the exports of beneficiary developing countries. But unless efforts are made at some stage to standardise, 'untie' and multilateralise these arrangements in favour of the less industrially advanced developing countries, they may inhibit multilateral trade liberalisation on a non-discriminatory basis. Efforts should thus be made to secure a negotiated convergence of general and regional preferences for the less industrially advanced developing countries.