TRADE HOT TOPICS
Commonwealth

Issue No.23

India-European Union Dispute on Generalised System of Preference Conditionalities

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Introduction

At its meeting on 27 January 2003, the Dispute Settlement Body (DSB) of the World Trade Organization (WTO) established a Panel, at the request of India. The Director General, WTO, composed the Panel on 6 March 2003. The Panel has to examine whether:

- the provisions of the EU GSP Scheme granting Tariff Preferences under the Special Arrangements for Combating Drug Production and Trafficking and the Special Incentive Arrangements for the Protection of Labour Rights and the Environment;
- any implementing rules and regulations;
- any amendments to any of the foregoing; and,
- their applications are consistent with Article I:1 of the GATT 1994 and the requirements set out in paragraphs 2(a), 3(a) and 3(c) of the Enabling Clause.

Background

The origin of the dispute was the EU's granting of additional market access in textiles in 2001 under the Special Arrangements to Combat Drug Production and Trafficking in its Scheme of Tariff Preferences. The trade package for Pakistan had two elements. First, a fifteen per cent quota hike in the textiles sector, and a zero duty market access for products as allowed under the Drug Window.

India was seeking increased market access in the EU at par with Pakistan on the strength of its own record in drug control. Bilateral discussions between the EU and India began in March 2002 where India sought compensation for an estimated loss of around $225 - $250 million worth of textiles exports on account of preferential treatment to exports from preferential origin countries.[2] The broad thrust of India's negotiating stance was to seek either enhanced access to the EU through the Generalised System of Preferences (GSP) Scheme or negate the adverse impact of the EU's GSP Regime through other means. During the consultations, the EU was not agreeable to accept India's request. As a consequence, India asked the WTO for the setting up of a Panel.

India stands to lose in terms of price competitiveness to Pakistan because of its special status under the Drug Window, as the two countries compete in several products in the world market, the competition being most severe in the clothing sector where Pakistan is a major player. Pakistan exported Euro 2.66 billion in 2000 to the

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[2] Rediff. Com. April 2002.

EU of which trade worth Euro 1.4 billion (including Euro 642 million for textiles and clothing) have graduated out of the Generalised System of Preferences.

The value of trade covered by the GSP was estimated at Euro 1.45 billion of which clothing accounted for Euro 1.06 billion. Therefore, it is expected that Pakistan may dramatically improve its utilisation of GSP coverage following the concessions given by the EU under the Drug Control Window of GSP. "It is apprehended that India would stand to lose trade substantially in the clothing sector where the applicable duty for our items is 10 per cent", according to the Additional Secretary from the Department of Commerce, Government of India.[3]

India's challenge has evoked wide interests in the WTO with Brazil, Colombia, Costa Rica, Colombia, Cuba, Ecuador, EL Salvador, Guatemala, Honduras, Paraguay, Peru, Sri Lanka, USA and Venezuela requesting third party rights.

India has challenged the conditionalities of the EU's GSP Scheme on several grounds.[4] First, the Special Incentive Arrangements for the Protection of Labour Rights, for the Protection of Environment and Special Arrangements to Combat Drug Production and Trafficking under the GSP Scheme are discriminatory. Thus, it violates Art. 1:1 of GATT which provides for Most-Favoured Nation (MFN) treatment. Since the GSP Scheme was introduced under a waiver from the GATT with respect to Article 1 and was to be generalised, non-reciprocal and non-discriminatory; it allows discrimination in favour of developing countries but not inter-se. Second, the GSP was introduced with the objective to facilitate and promote the trade of developing countries and respond positively to the economic needs of the developing countries. India has argued that the conditions under which the EC accords Tariff Preferences under the Special Arrangement cannot be reconciled with those two requirements. India has also cited para 2(a) of what is commonly known as the Enabling Clause which has a reference to the GSP.

In response, the EU said that its GSP Scheme was an autonomous programme granted on a non-reciprocal, generalized and non-discriminatory basis. The incentives it provides for combating drug trafficking and for labour and environmental protections are fully in line with internationally recognised objectives aimed at promoting sustainable development. The EU also warned that India's Challenge would hamper all developed countries efforts to help developing countries. But the Indian official noted that its challenge was strictly limited to the conditions the EU imposed and not to its GSP Programme as a whole.[5]

Analysis of the Legal Regime

To analyse the issues under dispute, it is necessary to consider how the GSP was negotiated, the GATT waiver, the history of the so-called Enabling Clause, the way trade policy objectives have evolved since then in the developed countries and the EU Scheme of GSP.

Generalised Tariff Preferences

The GATT is based on the principle of reciprocity and non-discrimination. Part IV of the GATT, introduced in 1966, legitimized the 'principle' of non-reciprocity without changing the legal framework. The concept of preferential and differential treatment was formalized in the second UNCTAD Conference (1968) held in New Delhi when it adopted the Generalized System of Preferences.

GSP was the first multilateral agreement which provided for non-reciprocal tariff preferences on an MFN basis. Resolution No. 21 (II) of UNCTAD II, entitled Preferential or Free Entry of Exports of Manufactures and Semi-manufactures of Developing Countries to the Developed Countries, reads as follows:

> "The United Nations Conference on Trade and Development,
> Having examined the problems relating to the application of a generalized non-reciprocal, non-discriminatory system of preferences in favour of developing countries,
> …………………
> Recognising the unanimous agreement in favour of the early establishment of a mutually acceptable system of generalized non-reciprocal and non-discriminatory preferences which would be beneficial to the developing countries,
> …………………

[3] The hindubusinessline.com. 2002/06/07
[4] WTO, WT/DS 246/1 12 March 2002
[5] Inside US Trade, 31 January 2003.

1. Agrees that 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 developed among the developing countries, should be:
   (a) to increase their export earnings;
   (b) to promote their industrialization;
   (c) to accelerate their rates of economic growth;[6]
   ………………"

The GATT Waiver

The UNCTAD resolution on GSP was to be legalized in the GATT Framework to make it operational. It was done by a waiver (Decision of 25 June 1971). The relevant paras, one from preamble and one from decisions, are reproduced below:

> "Recalling that at the Second UNCTAD, unanimous agreement was reached in favour of the early establishment of a mutually acceptable system of generalized, non-reciprocal and non-discriminatory preferences beneficial to the developing countries in order to increase the export earnings, to promote the industrialisation, and to accelerate the rates of economic growth of these countries;"
>
> ***Decide:***
>
> (a) "That without prejudice to any other Article of the General Agreement, the provisions of Article 1 shall be waived for a period of ten years to the extent necessary to permit developed contracting parties, subject to the procedures set out hereunder, to accord preferential tariff treatment to products originating in developing countries and territories with a view to extending to such countries and territories generally the preferential tariff treatment referred to in the Preamble to this Decision, without according such treatment to like products of other contracting parties;"[7]

The 1971 waiver was a non-permanent waiver from the MFN obligation of GATT Article 1. To make the derogation permanent, it was necessary to incorporate into the GATT legal structure of the concept of non-reciprocity as a component of the broader concept of Special and Differential Treatment. The Framework Group during the Tokyo Round was seized of this issue. Out of the deliberations of the Framework Group emerged the so-called Enabling Clause whose proper nomenclature is 'Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries (Decision of 28 November 1979).[8]

The Enabling Clause provides the legal basis for derogation from the MFN obligation to extend differential and more favourable treatment to developing countries. It is necessary to go into the details of the Enabling Clause as India's challenge specifically seeks to review the consistency of some of the special features of the EU's GSP Scheme with the provisions of the Enabling Clause. The relevant provisions of the Enabling Clause are:

1. Notwithstanding the provision of Article 1 of the General Agreement, contracting parties may accord differential and more favourable treatment to developing countries, without according to other contracting parties.
2. The provisions of paragraph 1 apply to the following:
   (a) Preferential tariff treatment accorded by developed contracting parties to products originating in developing countries in accordance with the Generalised System of Preferences.

   . . . . . .

   . . . . . .
3. Any differential and more favourable treatment provided under this clause:
   a) shall be designed to facilitate and promote the trade of developing countries and not to raise barriers to or create undue difficulties for the trade of any other contracting parties;

   . . . . . .

   . . . . . .

   c) shall in the case of such treatment accorded by developed contracting parties to developing countries be designed and if necessary, modified, to respond positively to the development, financial and trade needs of developing countries.

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[6] Indian Institute of Foreign Trade (1968), UNCTAD : A Step Forward, New Delhi.
[7] GATT, BISD. 18/S, P.25
[8] WTO, www.wto.org

Foot note 3. As described in the Decision of the Contracting Parties of 25 June 1971 relating to the establishment of generalised non-reciprocal and non-discriminatory preferences to the developing countries (BISD 18S/24)

The GSP Scheme of the European Communities

The GSP Scheme of the EC was first introduced in 1971 and has evolved over the years. The one under challenge is the Generalized Tariff Preferences for the period from 1 January 2002 to 31 December 2004.[9]

The Scheme provides for preferential market access to the designated beneficiary countries. The Scheme has four Special Incentives Arrangements, relating to least developed countries:

- for combating drug production;
- for combating drug trafficking;
- for the protection of labour rights; and,
- for the protection of the environment.

The list of beneficiary countries differs according to each of these special arrangements.

The Preamble of the Scheme for 2002-04 provides inter alia:

"(2) The community's Common Commercial Policy must be consistent with and consolidate the objectives of development policy, in particular the eradication of poverty and the promotion of sustainable development in the developing countries."

"(6) The Special Arrangements to Combat Drug Production and Trafficking should be closely monitored."

. . . . . .

. . . . . .

"(18) The special incentive arrangements for the protection of labour rights should require effective application of all standards referred to in the International Labour Organisation (ILO) Declaration on Fundamental Principles and Rights at Work."

. . . . . .

. . . . . .

"(21) The Special Incentive Arrangements for the Promotion of the Environment should take into account new developments concerning internationally agreed standards and certification schemes."

The Special Incentives Arrangements provide greater market access to the designated beneficiary countries compared to those which are eligible under the General Scheme. There is, however, one basic difference as to the eligibility criterion for these incentives arrangements. For the Special Arrangements for the least developed countries, the benefit of this arrangement should be granted to all countries recognised and classified by the United Nations as least developed countries. Likewise, for the special arrangements (a) for the protection of labour rights and (b) for the protection of the environment, the eligibility is on the basis of application by a prospective beneficiary and its acceptance by the EC on the basis of criteria indicated in the GSP document. However, for the Special Arrangement to Combat Drug Production and Trafficking, the document is silent as to on what basis a country is considered and designated as a beneficiary.

The extent of preferences under each Special Incentive Scheme is also substantially higher compared to what is available under the General Scheme. Countries which are eligible only under the General Scheme will have duty-free access for the non-sensitive products while all other products, with the exception of textiles and clothing, will face a uniform reduction of 3.5 percentage points.

The countries which apply and receive the Special Incentives for labour and environment protection will receive an additional reduction in duties to the extent of 5 percentage points. (3.5 + 5 = 8 percentage points in total). However, this additional 5 percentage points reduction, under the environment window, is available only for products of tropical forest. Under the labour window, this incentive will not be applicable to products not included in the general arrangement for the country concerned. The incentive system for drug provides for zero duty market access for almost all products, with a few exceptions.

The Special Incentive Schemes have so far not found much favour with the developing countries except the one for drug. The current list of countries which have been made eligible for this incentive scheme are principally the Central and South American countries. The only other country which has been accorded this facility from other regions is Pakistan.

[9] Council Regulation (EC) No. 2501/2001 of 10 December 2001. Official Journal of the European Commission 31.12.2001

Analysis of the Dispute

India has noted that the EC's Special Arrangements for Drug Production and Trafficking as well as the Special Incentive Schemes for the Protection of Labour and Environment are not available to all countries otherwise eligible to the Tariff Preferences under the General Scheme. The Panel has to determine whether these provisions and their application are consistent with Article 1:1 of the GATT 1994 and the requirements as set out in the paragraphs 2(a), 3(a) and 3(c) of the Enabling Clause.

India's position has so far been on two tracks: Economic and Legal. On the economic side, India has observed that its record in combating drug production and trafficking is no less credible than that of Pakistan and, therefore, it should also receive also receive similar treatment. Just as for Pakistan, textiles and clothing sector is crucial, this sector is also very important for India, in terms of its contribution to exports and employment.

On the legal side, India has noted that:

- Selective application of the special arrangement and incentive scheme is discriminatory and thus violates the Most-Favoured-Nation obligation of Article 1:1; and,
- The Enabling Clause Paragraph 2(a) specifically refers to the GSP. Since the GSP, at the time of negotiations, had specific trade objectives, introduction of new non-trade objectives such as labour, environment and drug trafficking is not permissible.

To summarise, India's position is that the GSP under the Enabling Clause allows a derogation from the MFN obligation only to the extent it allows discrimination in favour of developing countries in a generalized way. Imposition of any additional conditionalities outside the developmental objectives of GSP, as referred to in Para 2(a) of the Enabling Clause violates the MFN obligation under Article 1:1 of the GATT. Further, the developmental objectives of GSP are reinforced by Paragraphs 3(a) and 3(c) which allowed differential and more favourable treatment only "to facilitate and promote the trade of the developing countries …" and … "to respond positively to the development, financial and trade needs of developing countries."

The initial response of the EC has been to assert that:

- Its GSP Programme was an autonomous regime granted on a non-reciprocal, generalized and non-discriminatory basis; and,
- The Special Incentives provided for in the GSP programme are fully in line with internationally recognised objectives aimed at sustainable development.
- Neither party has made any written submissions so far to the Panel.

The Legal Basis of India's Position

The basic principle of GATT/WTO is the MFN obligation, as enshrined in Article 1.1 of GATT 1994. Any derogation from this obligation will have to be under a specific waiver. The initial derogation required for the introduction of the GSP scheme was allowed under the GATT Decision of 25 June 1971 for a period of ten years. The Decision was made on the basis of a Communication (C/W/178) from the prospective preference-giving contracting parties applying for a waiver in accordance with Article XXV:5. The 1971 waiver was not renewed in the light of the Decision of 28 November 1979 on "Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries" (Enabling Clause) which authorises Preferential Tariff Treatment accorded by developed contracting parties to products originating in developing countries in accordance with Generalised System of Preferences'.[10] Thus, GSP Programme has to be consistent with the Enabling Clause.

GSP has been conceptualized as a system of generalised, non-reciprocal and non-discriminatory preferences. The 'non-discriminatory' and 'generalised' refer to the system being uniformly applicable to all beneficiary countries under the GSP. Therefore, the EU's Special Arrangements which provide differential scales of incentives introduce a discriminatory treatment. It thus violates a basic premise of GSP, and by inference, the Enabling Clause.

The issue of non-discriminatory treatment has another dimension in the context of the EU GSP Programme. The Programme allows prospective beneficiary countries to apply to be eligible to the Special Incentives under the Labour and Environment Windows. But this facility is not available for the Drug Window. While in the case of

[10] WTO (1995) Guide to GATT Law and Practice: Analytical Index, Vol. 1, P.49.

the former two, the EC programme provides guidelines on eligibility, it is silent on the drug window. There is, therefore, lack of transparency.

The waiver, whether under the GATT Decision of 25 June 1971 or the Enabling Clause, is conditional upon the fact that the derogation is only to achieve specified objectives. The objectives in the UNCTAD 1968 resolution were only three. These are: (a) to increase their (developing countries) export earnings; (b) to promote their industrialization; and, (c) to accelerate their rates of economic growth.

The Enabling Clause addresses the issue in a more generalized way in para 3 (a) and 3(c) which reads as: 3(a) "to facilitate and promote the trade of developing countries" and (3c) "to respond positively to the development, financial and trade needs of the developing countries". The Special Incentives Programmes for Drug Production and Trafficking under the Labour and Environment windows cannot thus be covered either under the GSP (1968) or Enabling Clause provisions.

Possible Response of the EC

EC position may indicate that the GSP is a non-reciprocal, preferential arrangement. The non-reciprocity means that no violation of GATT contractual right is involved. Enabling Clause only enables a derogation of MFN obligation but as such does not confer any contractual right on the beneficiary countries.

It can argue that discrimination in the sense of non-uniformity of treatment to all the beneficiaries is allowed under the so-called 'Graduation Principle' which is used by many GSP-granting (donor) countries. This can be interpreted as allowing derogation of the MFN obligation.
EC can also draw attention to the Council discussions on the Decision 25 of 25 June 1971:

> "The waiver did not specify the determination of the beneficiary countries and covered general guidelines for a decision on beneficiary countries presented by the preference-giving countries in the UNCTAD, 'according to which donor countries would in general base themselves on the principle of self-election."[11]
>
> On the issue of objectives (Enabling Clause Para 3(a) and 3(b), UNCTAD Resolution 21 (II)), EC can point out the preamble of the WTO which aims at 'sustainable development'."

The relevant part of the Preamble is:

> "Recognizing that their relations in the field of trade and economic endeavour should be conducted with a view to raising standards of living, ensuring full employment and a large and steadily growing volume of real income and effective demand, and expanding the production of and trade in goods and services, while allowing for the optimal use of the world's resources in accordance with the objective of sustainable development, seeking both to protect and preserve the environment and to enhance the means for doing so in a manner consistent with their respective needs and concerns at different levels of economic development."[12]

To the extent, the objectives as modified under the GSP Scheme are consistent with the objective as in the WTO Preamble, it can seek to justify its conformity with those in the Enabling Clause.

EC may also observe that the Special Incentives Programmes for Labour and Environment are designed with transparent rules, both with respect to eligibility as well as temporary suspension.

Task Before the Panel

The issues raised in this dispute, especially the use of trade policy instruments to achieve primarily non-trade objectives, such as protection of human rights, improvement in labour standards and environment protection, are currently at the forefront of global debate on rule-making in international trade. The debate on the so-called 'social clauses' in the WTO is well-known and is no where near where any convergence of views either exists or is even expected.

However, the linkage between trade policy instruments and other non-trade objectives is already established in some bilateral or regional trade agreements. This linkage was in fact introduced by the United States in its GSP Scheme in mid 1980s. Under the GSP Amendment of 1984, USA can suspend concessions granted under the

[11] WTO (1995), op.cit., P. 49
[12] WTO (1994), The Results of the Uruguay Round of Multilateral Trade Negotiations : The Legal Texts, P.6.

GSP to countries where labour standards are not considered to be in conformity with 'internationally recognised' standards. Several countries were already suspended.[13] The EU linked its GSP concessions to core ILO labour standards effective 1997.[14] The Panel may also look at the earlier GATT discussions on this and related issues. On the issue of MFN treatment, the 1972 Working Party Report on the Danish Temporary Import Surcharge noted that:

"Without prejudice to the legal issues involved, the Working Party noted that as from the introduction of the Danish General Preference scheme on 1 January 1972, products included in that scheme would be exempted from the surcharge when imported from Members of the group of seventy seven. Several members of the Working Party welcomed this decision of the Danish Government noting that this had been one of the recommendations of the Group of Three. Other members expressed concern that the exemption did not extend to all developing countries. Some other members said that discrimination caused by these discriminations gave their delegations cause for concern."[15]

On the GSP Scheme, the Committee on Trade and Development in its 1980 report referred to a statement from a representative of a developing country that the preferential treatment of certain textiles imports under the EC's GSP scheme for 1980 had not been extended to all beneficiaries of the Community's GSP scheme and amounted to discrimination inconsistent with the spirit of the GSP. The representative of the European Communities replied that in view of the increasingly serious difficulties in the textiles sector, the communities had to limit their zero duty treatment for textiles imports under the GSP to countries which were either a signatory of the MFA or had entered into a commitment to abide by obligations similar to those under that Arrangement.[16]

On the question of the compatibility of 'graduation' with the Enabling Clause, at 58th session of the Committee on Trade and Development, one representative stated:

> "The Enabling Clause provided the legal basis for GSP programmes and the GSP had offered an opportunity for developing countries to expand and diversity their exports to the developed countries .... She said that the guidelines provided in paragraph 3 of the Enabling Clause were important, and particularly paragraph 3 (c) which indicated that special and differential treatment should be provided on a dynamic basis, taking into account changes in the development levels and the development, financial and trade needs of developing countries. ...... She noted that paragraph 7 required differentiations between developing countries beyond that envisaged for the least developed countries."[17]
>
> "During the review of the implementation of Part IV and of the operation of the Enabling Clause at the 63rd Meeting of the Committee on Trade and Development, the representative of Brazil stated: although preferential concessions constituted an unilateral act of the donor country the exclusion of countries from GSP was *per se* a discrimination which was not based on the agreed principles ..... some countries were clearly moving away from the observance of the basic principles set out in the Decision of the Contracting Parties of 25 June 1971 and of 28 November 1979 concerning the granting of preferential treatment to products originating in developing countries .... Developed contracting parties acting individually had been authorized to grant such a preferential treatment provided that the corresponding schemes were of a generalized, non-discriminatory and non-reciprocal nature. The fact that such schemes were of a voluntary character and did not constitute a binding obligation for the preference-giving countries did not in his view give them the right to ignore the legal framework under which they have been authorised to implement such schemes."[18]

Implications

Considering the arguments and evidences cited above and many more which would come out during the submissions before the Panel, it is quite clear that this is a complicated dispute. However, the Panel decision will have more of a policy impact than a trade impact. This is so because of the following reasons:

[13] De Castor (1995)
[14] Gavin (2001)
[15] GATT, L/3648 adopted on 12 January 1972.
[16] GATT, L/5074, adopted 26 November 1980. 27S/48.
[17] WTO (1995), op. cit., P. 58.
[18] WTO (1995), op.cit., P.58-59.

- The only country which has so far opted for the special incentives under the labour window is Moldova;
- Not a single country has opted for the special incentives under the environment window; and,
- The drugs programme has been extended to 12 countries all of which except Pakistan are in Central and South America. These are: Bolivia, Colombia, Costa Rica, Ecuador, Guatemala, Honduras, Nicaragua, Panama, Peru, Pakistan, El Salvador and Venezuela. Of these, the only Commonwealth country is Pakistan.

Therefore, the major trade impact in case the Panel finds the drug window to be incompatible with either the MFN obligation or Enabling Clause or both, India becomes the obvious beneficiary, though not the sole beneficiary, because all the other GSP receiving countries, at least in theory, can benefit from the non-extension of the special market access to Pakistan.

The more important impact would be felt on the trade policy formulation whichever way the Panel decision might go. In the recent years, there has been an increasing trend in many developed countries where trade policy instruments are being linked to attaining non-trade objectives. The discussions on the desirability and legality of such a linkage in the multilateral framework is currently a matter of acrimonious debate in the WTO. GSP is a special case because it is a non-reciprocal arrangement. But despite this, a Panel decision either way may provide some light on the legality of such linkages. To what extent transparency in trade policy formulation and in implementing preferential market access programmes are legally required may also get addressed in the Panel decision. That will also be of great value for future.

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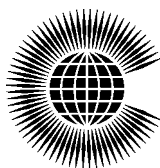

Produced by the Economic Affairs Division of the Commonwealth Secretariat. For further information electronic version or hard copies, please contact: Economic Affairs Division, Commonwealth Secretariat, Quadrant House, 3rd Floor, 55-58 Pall Mall, London SW1Y 5JH, UK
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