

New Preferential Arrangements for Developing Countries: The EU GSP in 2006

By Carol C. George¹

1. Overview

On 7 July 2004, the European Commission issued a Communication setting out its plans to overhaul its Generalised System of Preferences (GSP), the basis upon which the EU extends tariff preferences to developing countries². The Communication, which sets out the main objectives for the 10-year period 2006-2015, will be followed by a formal proposal in autumn 2004. The new system, which will enter into force on 1 January 2006, will be implemented through Council Regulations, the first of which will be in effect for 3 years.

Although the amendment of the GSP was due to be carried out anyway, in anticipation of the expiry of the current 10-year cycle at the end of 2005, the proposed changes are also, in part, a response to an adverse WTO panel decision issued in April 2004. The case involved a complaint by India against the EU's so-called 'drug regime', one of 5 arrangements the EU currently extends to beneficiary countries. Although the WTO decision relates to only one aspect of the GSP currently used by the EU, it will inform the evolution of the system generally, and influence proposals put forward by the Commission to modify the GSP for the next 10 year period. In a nutshell, the EC has identified the following 7 objectives for the new GSP:

1. maintain generous tariff rates, extend product coverage;
2. target the countries that most need help;
3. make the arrangements simpler and more accessible;
4. simplify the 'graduation' mechanism for withdrawal of GSP benefits;
5. provide new incentives to encourage sustainable development and governance;
6. improve the applicable rules of origin; and,
7. reinforce safeguard and anti-fraud measures.

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² Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee. Developing countries, international trade and sustainable development: the function of the Community's generalised system of preferences (GSP) for the ten-year period from 2006 - 2015, COMMISSION OF THE EUROPEAN COMMUNITIES, Brussels, 7.7.2004, COM(2004) 461 final.

The primary change to the existing GSP will be the combination and simplification of the 'arrangements' under the GSP into three programs. The 'general arrangements' and the arrangement in favour of LDCs will remain largely unchanged, while the three special incentive packages for drug prevention and the protection of labour rights and the environment will be combined and restructured. The details have yet to be fleshed out, but presumably the terms of the new arrangement to promote a broader concept of 'sustainable development' will prove more attractive to developing countries than the evaluative process imposed by its predecessors in relation to labour standards, the treatment of tropical forests and the battle against drugs. It should also ensure that the EU conducts the determination of additional preferences on the basis of criteria that are more transparent and objective than were previously applied, thus avoiding the criticism recently received from the WTO Appellate Body in relation to the anti-drug regime.

2. Origins

In 1968, the UNCTAD formulated a recommendation to states in favour of a Generalised System of Preferences (GSP). The idea was that, under a GSP system, industrialised countries would autonomously grant developing countries special trade preferences, which would exempt their export goods from normal customs duties, thus creating an incentive for traders to import them and increase their competitiveness on international markets. In turn, this would increase the trade of developing countries, enhance their export earnings, promote industrialisation and encourage diversification of their economies.

The legal foundation for implementing such a system, which violates the GATT principle of 'non-discrimination', was a waiver from the terms of Article I of the GATT. The Contracting Parties granted this waiver in 1971, creating the legal framework under which developed countries were authorised to establish individual 'Generalised Schemes of Tariff Preferences'. The acronym 'GSP' sometimes refers to the system as a whole and sometimes to one of the individual schemes. This 'Enabling Clause' was adopted for an initial 10-year period, then renewed indefinitely in 1979.

According to the clause, preferential treatment provided under the GSP must be non-discriminatory, non-reciprocal and autonomous. While discrimination in favour of developing countries is allowed, there should be no discrimination between them, except for the benefit of Least Developed Countries (LDCs). Moreover, preferences cannot be negotiated, nor can they be granted in the framework of an agreement under which beneficiary countries make mutual concessions.

The European Community was the first to implement a GSP scheme in 1971. In order to update it on a regular basis and to adjust it to the changing environment of the multilateral trading system, the EU's GSP is implemented following a cycle of ten years (based, originally, on the period covered by the first GATT waiver). The present cycle began in 1995 and will expire in 2005. In practice, the GSP is implemented through Council regulations during the ten-year cycle. Originally regulations were adopted on an annual basis, and there were different regulations for industrialised products, textile products, agricultural products and those covered by the European Coal and Steel Community (ECSC) Treaty. Currently, there is only one GSP regulation that applies to all products and arrangements and is in effect for at least 3 years. The third scheme of the decade entered into force on 1 January 2002 and expires on 31 December 2005. It is contained in Council Regulation (EC) No 2501/2001 (GSP Regulation).

Under the early schemes, quotas and ceilings were imposed on individual countries and products, but in 1995 quantitative limitations were eliminated and tariff preferences, varied according to the sensitivity of products on the EU market, became the main feature of the GSP. Tariffs and other provisions allow the EC to target preferences on the countries that need them most. Under the current Regulation, each of the GSP arrangements covers different products, as listed in Annex IV of the Regulation, and different arrangements may grant different tariff preferences for the same products. The availability of tariff preferences as well as their extent therefore depend on the arrangement enjoyed by the individual beneficiary country in which the products originate. With the exception of products from Chapter 93

(arms and ammunition), the GSP covers all products that are 'dutiable' under the Common Customs Tariff - approximately 8200. No tariff preferences can be granted on the 2100 or so products, out of 10,300 product lines, that are zero-rated.

Over time, the concept of development has changed, and new arrangements have been put in place to promote sustainable economic and social development by fostering environmental protection and the respect of fundamental social rights. According to the recent Communication, the Commission intends to broaden the concept of development even further in the next decade, by combining the three existing special incentives into one arrangement for the encouragement of 'sustainable development'.

3. What Does The New GSP Purport To Do?

(a) Maintain generous tariff rates.

The Commission says that it intends to maintain levels of benefits that developing countries will receive under the GSP, even though several factors tend to reduce preferential margins. The tariff preferences available under the GSP are related to duty rates extended to WTO Members on an MFN basis, without any quantitative restrictions. Because preferences are linked to MFN rates, the average preferential duty margin tends to shrink as MFN rates are lowered. Once MFN duty rates reach zero, it is impossible to maintain a preference; the erosion of preferences caused by total liberalisation cannot be avoided. As long as the MFN rates remain above zero, the extent of the erosion depends on how the preferences are determined: where tariff preferences are calculated as a percentage of the MFN rate, they shrink in line with that rate. Present EU rules on GSP tariff modulation therefore apply a flat rate reduction of 3.5% under the general arrangements, which allows the preference to stay the same in absolute terms, as MFN rates drop. The textiles and clothing sector is an exception, benefiting from a preferential reduction of 20%, to counteract strong international competition.

In addition to increased liberalisation, abolition of duties on certain products may occur by international agreement, thus reducing GSP coverage while opening the Community market to them. The international agreement on coffee concluded in 2001 and the Information Technology Agreement (ITA) adopted at the WTO's Ministerial Conference in Singapore in 1996, for example, abolished customs duties on a number of products. The increasing number of bilateral and regional free trade agreements can have a similar effect.

Nevertheless, the Community says that its offer will be improved in a number of ways, one of which is the expansion of the GSP to include imports into ten new Member States that acceded to the Community on 1 May 2004. In addition, the Community will consider extending the GSP to new products, as 10% of dutiable products in the Common Customs Tariff are not covered by the GSP. It will also reclassify as 'non-sensitive' (thus giving them duty-free status) some products currently in the 'sensitive' category (subject only to a tariff reduction), as a result of changing levels of industrialisation and patterns of trade.

(b) Target countries that most need help.

Given the high cost of a GSP scheme, the number of developing countries, and the different levels of development that they represent, the Commission has decided to prioritise the most vulnerable beneficiary countries for receipt of the preferences available under the GSP. These countries include the least developed countries (LDCs), small economies, land-locked countries, small island states, and low income countries. To the LDCs, in particular, the EC will be as generous as possible. One of its suggestions is that when the United Nations removes an LDC from its list, there should be a means for its gradual withdrawal from the special GSP (EBA), instead of automatic retraction of all advantages previously enjoyed.

Countries that are reliant on specific industries or have largely non-diversified economies are also susceptible to economic shocks. The clothing and textiles industry is a prime example. In October 2003

the Commission stressed³ the need to target preferences on countries that will need them most when the MFA textile quota system comes to an end under the WTO Agreement on Textiles and Clothing in December 2004. Indonesia, for example, is currently reporting price adjustments of 10-15 per cent to enable producers to remain competitive in open competition with powerful rivals such as China, India and Vietnam.⁴ Producers have complained of marketing problems even in the domestic market, and banks are discouraged from extending new credit to textile companies already laden with debts. Others have dismissed the suggestion that the Indonesian textile industry is heading for total bankruptcy, saying that non-quota countries account for 68 per cent of the country's exports, and that although price cuts have caused a decline in export values, volumes have increased from 1.73 million tons in 2001 to 1.77 million tons in 2003.

There are two ways that the EC can target the GSP toward countries that need most assistance: either it can remove preferences from certain beneficiaries or improve the preferences for others. The GSP does a combination of both, and each in two different ways. Preferences can be removed by 'exclusion' of a country, or by 'graduation' of a sector, out of an arrangement. More preferential treatment can be provided by lowering duty rates, or by including products that are not otherwise included in the arrangement. Some of the other objectives of the Commission, such as the simplification of the graduation process, propose modifications for these aspects of the GSP.

(c) Make the GSP simpler and more accessible.

The GSP of the EU grants products imported from GSP beneficiary countries either duty-free access or a tariff reduction, depending on the sensitivity of the product and which of the five GSP arrangements the country enjoys. The Commission proposes to reduce the number of arrangements available to GSP beneficiaries from the current five, to three, being:

- the general arrangements;
- the special arrangement for LDCs ('Everything but Arms'); and,
- one arrangement to encourage sustainable development, in place of the three existing special incentive arrangements to protect labour rights and the environment, and to combat illegal drug production and trafficking.

The Commission also plans to withdraw the GSP from countries that already enjoy preferential access to the Community market under a free trade agreement, while ensuring that existing GSP benefits for particular products are incorporated into the terms of the FTA. It will also seek to implement the Commission's Green Paper on the future of rules of origin in preferential trade agreements⁵.

The General Arrangements

The general arrangements, which the Commission intends to maintain, are available to all beneficiary countries. These are listed in Annex I of the GSP Regulation, and include developing countries (historically by self-selection within the UN system, with the addition of China), ex-Soviet transition economies that have not concluded a trade agreement with the EU, and dependent territories. Annex I also indicates the sectors that are not included in the general arrangements for the beneficiary country concerned, and those in respect of which tariff preferences have been removed.

The general arrangements offer basic preferential treatment: suspension of duties on approximately 3300 'non-sensitive' products, and tariff reductions on the 3700 or so 'sensitive' products that require higher border protection in order to compete with developing country imports. Under the GSP, *ad valorem* duties on sensitive products are reduced by 3.5%, with the exception of textiles and clothing, which are to be reduced by 20%. Specific duties on sensitive products are subject to reduction by 30%, or in the case of ethyl alcohol, 15%.

³ Communication from the Commission to the Council, Parliament and the Economic and Social Committee on the future of the textiles and clothing sector in the enlarged European Union, COM 2003 (649) final, 29 October 2003.

⁴ Asia Pulse; July 29, 2004.

⁵ COM (2003) 787 of 18 December 2003.

Everything But Arms (LDCs)

The special arrangements for Least Developed Countries (LDCs), which will also persist under the new GSP, are available to the 49 countries recognised by the United Nations as belonging to that group. Also known as the 'Everything But Arms' (EBA) initiative, these provide the most favourable treatment of all of the GSP arrangements. Under Council Regulation (EC) 416/2001, adopted February 2001 (EBA Regulation), duty-free access was granted to imports of all products, except for arms and munitions, from least developed countries without any quantitative restrictions. Only imports of fresh bananas, rice and sugar were not fully liberalised immediately; duties are being reduced gradually, aiming for duty free access for bananas by January 2006, for sugar in July 2009, and for rice in September 2009.

The provisions of the EBA Regulation have since been incorporated into the GSP Regulation. The date of expiry of the GSP Regulation does not, however, apply to its EBA provisions, because the EBA Regulation had contemplated that the special arrangements for LDCs would be in place indefinitely, rather than be subject to periodic renewal.

Sustainable Development

The Commission has decided that the three existing special arrangements should be combined into one type of preference that moves toward a broader concept of sustainable development and governance. The three existing arrangements are:

- The special arrangements to combat drug production and trafficking are intended to assist beneficiary countries in their fight against drugs;
- The special incentive arrangements for the protection of labour rights are available on request to countries implementing certain labour standards; and,
- The special incentive arrangements for the protection of the environment are available on request to countries implementing certain standards for the sustainable management of tropical forests.

These incentive arrangements apply only to sensitive products, non-sensitive products being already exempt from import duties under the general arrangements. The additional incentives apply to all products covered by the general arrangements and provide a further tariff reduction. The additional reduction is generally of the same extent as that available under the general arrangements, thus doubling the applicable tariff reduction. For textiles, the total reduction is therefore 40% and for specific duties it is 60%, except for ethyl alcohol, which is 30%. Additional reductions for *ad valorem* duties are, however, greater than the basic: 5% instead of 3.5%. Where the product is subject to *ad valorem* and specific duties, only the *ad valorem* duties are reduced. If the special incentive arrangements for protection of both labour rights and environment apply, the two reductions are combined into one.

The special arrangements to combat *drug production and trafficking* are meant to assist beneficiary countries by providing them with export opportunities for substitution crops and by improving their economic and social development. Initially for the assistance of the Andean Community, duty-free access was granted to products originating in Bolivia, Colombia, Ecuador, Peru in 1990 and later in Venezuela. The special arrangements have since been extended to Costa Rica, Guatemala, Honduras, Nicaragua and El Salvador, Panama, and more recently to Pakistan. The arrangement is intended to foster not only industrialisation and diversification, but also sustainable development. To this end, the Commission not only monitors beneficiaries' efforts to combat drugs, but also evaluates their social development (primarily their promotion of labour standards) and environmental policy (in particular the sustainable management of tropical forests). The Commission establishes a dialogue with each beneficiary by inviting them to participate in the evaluation.

The special incentive programs for the *protection of the environment* and the *protection of labour rights* are available to all beneficiaries of the general arrangements, upon request. In regard to each of these arrangements, the requesting country must show that it has incorporated into its domestic legislation the substance of the relevant international conventions and standards - in particular those of the eight

ILO Conventions and, in relation to environment, the International Tropical Timber Convention. Incentives for protection of labour rights offer additional tariff preferences for imports of all sensitive products included in the general arrangements, unless the decision granting the special incentives excludes certain sectors where the conditions are not fulfilled. Where a sector included in a special incentive arrangement is 'graduated', imports will continue to benefit from the preferential treatment available under the general arrangements (but not the additional preferences offered by the special incentive arrangements).

(d) Provide new incentives to encourage sustainable development and governance.

The special incentives for the protection of labour rights and the protection of the environment have not been used extensively, perhaps because states prefer not to have their social legislation scrutinised through lengthy and complex evaluation procedures. The protection of the environment is very narrowly focused, applying solely to tropical timber. In regard to the combating of drugs, the WTO Appellate Body criticised the lack of objective criteria for inclusion or removal of beneficiaries. A new sustainable development incentive will therefore replace the other three, with the aim of encouraging ratification and implementation of international conventions.

The additional preferences will be granted to beneficiaries who can demonstrate that they have adopted the relevant international standards relating to sustainable development, including basic human rights conventions, labour rights conventions and certain conventions relating to environmental protection as well as the conventions relating to the fight against illegal drugs production and trafficking. The relevant conventions will be those with mechanisms that can be used by international organisations to evaluate how effectively they have been implemented. Prior to selection, potential beneficiaries will be subjected to evaluation by the Commission on the basis of objective criteria in line with development needs. The incentive scheme will include a suspension clause for rapid activation by the Commission and suspension of additional benefits if it is established that the countries have not honoured their commitments.

(e) Simplify the 'graduation' mechanism.

Currently, the GSP provides for both the exclusion of countries and the graduation of groups of products by sector, once levels of competitiveness have increased to the point that they no longer need support. *Exclusion* of a country from the application of the GSP is possible when it has reached a level of development similar to that of developed countries, and the rationale for trade preferences no longer exists. The sufficiency of development is assessed on the basis of classification by the World Bank and a development index that refers to industrial development and participation in international trade. It is calculated as a ratio between per capita income and the value of manufactured exports of the beneficiary country, as compared to EU data. If a country has for three consecutive years been classified by the World Bank as high-income and the development index is higher than -1, it is excluded from the GSP. It may be reincluded in the System if, over 3 consecutive years, it fails meet those criteria.

Even where a beneficiary country does not meet the criteria for exclusion, certain sectors may be competitive enough to ensure further growth without preferential access to the EU market. Groups of products from these sectors, originating in beneficiary countries, are '*graduated*' out of the GSP program and will no longer receive tariff preferences upon import into the EU. Each year, the Commission determines which sectors will be graduated and notifies the countries concerned. The current criteria for graduation is complex. Sectors, for the purposes of the GSP Regulation, are set out in Annex III, and do not correspond exactly to the chapters of the Common Customs Tariff. Graduation can occur either as a result of the '*lion's share clause*' or the '*graduation mechanism*'. The lion's share provision measures performance as a proportion of total EU imports from all beneficiary countries. When imports from a beneficiary in a particular sector reach 25% of imports of the same products from all beneficiary countries, the sector can be graduated. The graduation mechanism takes into account the degree of specialisation of a beneficiary country's economy in a given sector; it establishes thresholds that vary

with a country's development index: the lower the development index the higher the threshold for graduation. The formula for the 'export specialisation index' is a ratio between the beneficiary's share of all EU imports in the sector (from all countries, not just GSP beneficiaries), and its share of total EU imports of all products.

The Commission's Communication doesn't express an intention to change the basis for exclusion of countries, but it proposes to simplify the mechanism for graduation of product sectors by replacing the existing formulae with a single criterion: 'Community market share, expressed as a share of preferential imports'. In addition, goods will not be defined by reference to sectors, as currently defined in the Regulation, but by the relevant 'section' of the Community's Combined Nomenclature.⁶ The Commission says that the advantage of this simplified mechanism is that it will graduate groups of products from only the biggest beneficiaries, which are fewer than 10 of the 178 countries and territories covered by the GSP. It also says that these are the countries that will on average be competitive for all the products in a section, rather than just a few.

The Commission's reasoning on these points is not plain. It is not apparent that products receiving the most preferential treatment will necessarily be the strongest competitors in the absence of further support, even though they might have immediate market access and even constitute a large proportion of EU preferential imports. In fact, given the EC's intention to direct greater preferences toward the most vulnerable countries, the opposite might be the case. Under the current system, graduation does not apply to groups of products from LDCs, by reason of the development index criterion. If the Commission eliminates the development index and reduces the formula to what sounds very much like the 'lion's share clause', as it suggests it will, then the design of the graduation process should be carefully considered from the view of the countries most in need.

(f) Improve the applicable rules of origin.

GSP preferences apply to imports of specific products from individual countries. The products must originate in a beneficiary country, and that country has to benefit from GSP arrangements that include those products. The rules of origin for EU imports under the GSP are meant to ensure that the tariff preferences foster the development of beneficiary countries, so the criteria for determining origin are somewhat more stringent than those for non-preferential imports, but are also designed to allow beneficiaries to take advantage of the tariff preferences.

At present, rules of origin relating to the GSP are contained in Annex 15 to Regulation 2454/93, the EU legislation implementing the Community Customs Code. Obviously products wholly obtained in the exporting country are considered as originating there, while those manufactured with inputs from other countries have 'origin' only if they have undergone sufficient working or processing in the exporting country. There are various technical criteria (value added and other economic criteria) that apply to different products, by reference to the Common Customs Tariff. Products must be accompanied by a certificate of origin or an invoice declaration, and shipped directly to the EC. The Commission envisages simplifying these 'preferential' rules of origin both in terms of substance and procedure.

In addition, the Commission intends to facilitate more regional integration among developing countries by revising the conditions for *regional cumulation* of origin. 'Cumulation' of origin means that inputs from other countries are considered as originating in the export country, thus extending the possibilities for producers in the beneficiary countries to use such inputs. The rules of origin provide for cumulation of origin within certain regional groups: manufacturing inputs from two or more members of the group are treated as if they originate in the exporting beneficiary country. The regional inputs may come from countries that are beneficiaries of less favourable arrangements or which are not beneficiaries of the GSP at all. There are presently 3 regional groups that benefit from regional cumulation:

⁶ The Combined Nomenclature is the Community's subdivision of the Harmonised System, the international customs nomenclature adopted by the World Customs Organization and used for 95% of international trade. Both nomenclatures are divided into 21 sections.

- Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, the Philippines, Thailand, Vietnam, Singapore (though excluded from the GSP);
- Costa Rica, Honduras, Guatemala, Nicaragua, Panama, El Salvador, Bolivia, Colombia, Ecuador, Peru, Venezuela; and,
- Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, Sri Lanka.

Similarly, as a means of fostering economic co-operation between the EC and beneficiary countries, all imports under the GSP are entitled to bilateral cumulation of origin (referred to as ‘donor country content’).

The Commission continues to support regional cumulation, and recognises the need, based on requests from different regional groupings, to consider provision for *cross-regional* cumulation as a means of expanding economic co-operation further.

(g) Reinforce temporary withdrawal instruments, safeguard measures and anti-fraud measures.

Since preferential treatment under the GSP is granted without any quantitative limitations, the EC has anticipated that imports might increase in a way that causes serious difficulties for Community producers of like, or directly competitive, products. The GSP Regulation allows the EC to apply emergency safeguards, by reintroducing customs duties, in such circumstances. GSP arrangements may also, in circumstances involving clearly unacceptable practices on the part of the beneficiary, be temporarily withdrawn. In each instance, the EC must initiate an investigation, announce its intention in the Official Journal and consult with the Committee on Generalised Preferences. Although used only in exceptional circumstances, the Commission plans to revise the temporary withdrawal and safeguard provisions of the GSP in light of other amendments to the system to make them more ‘credible’: simpler and more flexible, particularly in their application to unfair trade practices.

The anti-fraud measures and measures for the protection of the Community’s financial interests within the GSP framework already enjoy a ‘high degree of credibility’, but will be made effective only through systematic application by the Commission and the Member States as necessary. The Commission states that it is in everyone’s interests, including their own, that beneficiary countries should take more responsibility for managing the GSP. This would include ensuring availability of appropriate administrative structures and ascertaining the validity of origin documents when they are established and released.

4. India v EC: Conditions for Granting Tariff Preferences

In *EC - Conditions for the Granting of Tariff Preferences to Developing Countries*,⁷ India asked the Panel to find that the special incentives for combating drug production and trafficking (‘drug arrangements’) set out in the GSP Regulation are inconsistent with Article I of the GATT 1994, and are not justified by the Enabling Clause that provides for the GSP. Although all beneficiary countries, including India, receive preferential treatment under the GSP general arrangements, the four additional arrangements for special incentives are restricted to countries predetermined by the EC. Under the drug arrangements, the EC provides preferences to a group of 12 specified countries, which does not include India.

The panel found in favour of the claimants. The drug arrangements were held to be inconsistent with Article I of the GATT (MFN), and were not justified by either paragraph 2(a) of the Enabling Clause, or by GATT Article XX(b) on grounds of necessity to protect human, animal or plant life or health. Although the Appellate Body reached the same conclusion as the panel, it did so for different reasons.

⁷ *European Communities - Conditions for the Granting of Tariff Preferences to Developing Countries*, Report of the Appellate Body, WT/DS246/AB/R, 7 April 2004.

Characterisation of the Enabling Clause

One of the main issues on appeal was whether the panel had erred in finding that the Enabling Clause is an ‘exception’ to the MFN rule. The panel held that the Clause constituted an ‘affirmative defence’, in relation to which the responding party bears the burden of proof if it should invoke the Clause in order to justify the challenged measure. The Appellate Body upheld that decision on appeal, finding that the characterisation of the Enabling Clause as an exception in no way limits the pursuit of the WTO objectives through it, nor undermines the critical role of the Enabling Clause in encouraging the granting of special and differential treatment to developing-country Members of the WTO. On the issue of burden of proof, the claim of inconsistency with Article I, it said, was inextricably linked to the argument that the drug arrangements do not meet the conditions for justification under the Enabling Clause. In addition to claiming inconsistency with MFN, therefore, India should have identified which obligations in the Enabling Clause the measures are alleged to have contravened, even though the ultimate burden of proof was on the EC to establish the consistency of the drug arrangements with the Enabling Clause.

‘Non-discriminatory’

In regard to compliance of the drug arrangements with paragraph 2(a) of the Enabling Clause, the AB reversed the finding of the panel - that the term ‘non-discriminatory’⁸ required that identical tariff preferences under GSP schemes be provided to *all* developing countries without differentiation, except for the implementation of *a priori* limitations. The AB held that ‘non-discriminatory’ does not prohibit developed-country Members from granting different tariffs to products originating in different GSP beneficiaries. It does, however, require that they ensure that identical treatment is available to all *similarly-situated* GSP beneficiaries that have the ‘development, financial and trade needs’ to which the treatment in question is intended to respond.⁹

The reasoning of the AB was that the term ‘discriminate’ has divergent ordinary meanings (*a neutral* distinction or a *negative* or prejudicial differentiation), and that therefore ‘non-discriminatory’ on its own could not be regarded as determinative of the permissibility of a preference-granting country according different tariff preferences to different beneficiaries of its GSP scheme. Assessing the meaning of the term in context, it noted that preferential tariff treatment under the GSP must also be ‘generalised’. Contrary to the view of the panel, that ‘generalisation’ refers to the eradication of ‘special’ preferences for certain designated developing countries, the AB found it to mean that the GSP schemes of preference-granting countries must ‘remain generally applicable’.¹⁰

The AB also looked at para 3(c) of the Enabling Clause, which requires that special and differential treatment be designed to respond positively to the ‘development, financial and trade needs’ of developing countries. It said that the particular need targeted by a GSP scheme must be capable of being effectively addressed through tariff preferences, but, because the needs of developing countries are varied and not homogeneous, a GSP scheme may be ‘non-discriminatory’ even if it doesn’t provide ‘identical’ tariff treatment to all GSP beneficiaries¹¹. Further, according to paragraph 3(a) of the Clause, the positive response of a preference-granting country to such varying needs must not raise barriers or impose unjustifiable burdens on other Members.¹²

On the basis of its findings that provisions of the Enabling Clause do not preclude the granting of differential tariffs to different sub-categories of GSP beneficiaries, the AB reversed the panel on a further point: it said that ‘developing countries’ in paragraph 2(a) of the Enabling Clause cannot be read to mean ‘all’ developing countries.

⁸ Footnote 3, paragraph 2(a) of the Enabling Clause.

⁹ AB Report, para 173.

¹⁰ AB Report, para 156.

¹¹ AB Report, para 165.

¹² AB Report, para 167.

Justification of the drug arrangements

Finally, looking at the drug arrangements themselves, the AB found that the EC had failed to prove that the arrangements are ‘non-discriminatory’, and therefore to demonstrate their justification, under the terms of the Enabling Clause. As the panel had not made any findings on their consistency with paragraphs 3(a) and (c) of the Enabling Clause, the AB limited its analysis to paragraph 2(a) of the Clause; noting that the other sub-paragraphs impose separate and distinct requirements, it declined to examine *per se* whether the drug arrangements ‘respond positively to the development, financial and trade needs of developing countries’, or whether they ‘raise barriers or create undue difficulties for the trade of other Members’. In relation to paragraph 2(a) it held that the drug arrangements could only be considered to be ‘non-discriminatory’ if the EC could prove at minimum that the preferences granted under the arrangements are available to all GSP beneficiaries that are similarly affected by the drug problem. In this the EC was unsuccessful.

In addition to being limited to 12 developing countries, the AB noted that the drug arrangements provide no mechanism for the *addition* of beneficiaries to the designated list, in contrast to the special incentive arrangements for the protection of labour rights or the environment. Other developing countries can therefore only be included in the drug arrangements by amendment to the Regulation. Further, even if a procedural mechanism were available, the drug arrangements do not set out any clear prerequisites or ‘*objective criteria*’ on the basis of which other countries might be selected by the EC for inclusion. The Commission’s own Explanatory Memorandum on the arrangements indicate that the benefits are given without any prerequisite. Similarly, the GSP Regulation provides no criteria for the *removal* of beneficiaries from the drug arrangements, and provides specifically that the evaluation of the effects of the drug arrangements would be without prejudice to their continuation until 2004 and possible extension thereafter. General provisions of the Regulation for the exclusion of beneficiaries altogether (Article 3) or for their graduation in respect of certain product sectors (Article 12), do so on grounds that a beneficiary has achieved a certain degree of development or competitiveness and are in no way related to the degree to which the country is suffering from the ‘drug problem’.¹³ Similarly, the temporary withdrawal and safeguard provisions are common to all the preferential arrangements under the GSP Regulation. Even though one of the criteria for their application is a breakdown in controls on drugs, the panel and AB agreed that this is not connected to the question as to whether a beneficiary is a seriously drug-affected country.¹⁴

The AB ultimately decided that the drug arrangements cannot be distinguished from other schemes described by the EC as ‘confined *ab initio* and permanently to a limited number of developing countries’. Although the EC sought to distinguish the drug arrangements from such discriminatory schemes, on grounds that they potentially included all developing countries, it expressly acknowledged the limitation on availability of the arrangements in its request for a WTO waiver to facilitate the new program in October 2001.¹⁵

5. Conclusion

Until the Commission produces a draft Regulation for the new GSP at the end of the year, we will not be in a position to provide a definitive analysis of the proposed changes and the effect that the amendments might have on specific countries or industry sectors. We do know, however, that should the expressed intentions of the Commission be realised, changes to the graduation mechanism, the special incentive arrangements and the rules of origin will have both positive and negative repercussions for developing country producers. Changes to the criteria for exclusion from the GSP and graduation of sectors, particularly the formulae for determination of sufficient competitiveness, may be of concern to,

¹³ AB Report, para 184.

¹⁴ Panel Report, para 7.216, AB Report, para 184.

¹⁵ Council for Trade in Goods, Request for a WTO Waiver, New EC Special Tariff Arrangements to Combat Drug Production and Trafficking, G/C/W/328, 24 October 2001, p 2.

and require particular scrutiny by, developing countries. The net effect of the consolidation of the three special incentive programs into one 'sustainable development incentive' will be a new configuration of GSP+ recipients that will benefit some producers but be adverse to the interests of others. GSP recipients should now be considering carefully how they might distinguish themselves from their competitors in the international market, and so position themselves advantageously under the new GSP.

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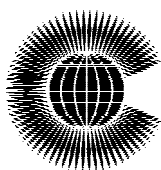
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