

Critically assess the Generalised System of
Preferences as a response to the needs and
aspirations of developing states

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Abstract

This article will briefly explain the Description of the Generalised System of Preferences (GSP). Moreover, it will discuss the Economic Effects of the GSP. The question arises whether the GSP will successful or deficient instrument of development cooperation economic. Furthermore, the ambiguity of the Enabling Clause which is the heart of the GSP schemes, especially in the context ‘generalized, non-reciprocal and non-discriminatory will be analysed. Finally, this article will answer the question why GSP became a significant mechanism to serve the needs of developing countries.

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บทคัดย่อ

บทความนี้ได้อธิบายถึงลักษณะ และหลักการสำคัญของระบบสิทธิพิเศษทางภาษีศุลกากรเป็นการทั่วไป (GSP) และวิเคราะห์ถึง ผลกระทบทางเศรษฐกิจที่เกิดจากการได้สิทธิพิเศษทางภาษีศุลกากร (GSP) ประเด็นที่ถูกเลียงกันมีขึ้นว่า มาตรการนี้ถือว่ามีส่วนส่งเสริม อัตราการเจริญเติบโตทางเศรษฐกิจของประเทศโดยส่วนรวมหรือไม่ นอกจากนี้ บทความนี้ยังได้กล่าวถึงปัญหาความไม่ชัดเจนของบทบัญญัติว่าด้วยการอนุญาตให้ปฏิบัติ (Enabling Clause) สุดท้ายบทความนี้ได้ชี้ให้เห็นว่า เหตุใด สิทธิพิเศษทางภาษีศุลกากร จึงเป็นเครื่องมือสำคัญที่สร้างโอกาสให้ประเทศกำลังพัฒนา

คำสำคัญ: ระบบสิทธิพิเศษทางภาษีศุลกากรเป็นการทั่วไป องค์การการค้าโลก
เศรษฐศาสตร์

Keywords: GSP, WTO, Economic

1. Introduction

Cross border transactions are normal practice in doing business since long time ago. It can provide significant benefit to the development of economic through out the world. However, those transactions are sometime obstructed by trade barriers such as tariff or quantitative restriction. It is understandable that one country chose to protect domestic products by obstructing better or cheaper products from other countries. Nevertheless, those efforts may lead to an adverse effect. It can separate market into fragments. For example, if country A treated products from country B with an adversary manner, then country B is likely to react with the same method. As a result, there will be no cooperation between countries. This will ruin the whole process of international trade around the world.

“The World Trade Organization” (WTO), as well as its predecessor “the General Agreement on Tariffs and Trade” (GATT), is trying to facilitate, supervise, and liberalize international trade. WTO deals with regulation of trade among member countries. It provides a framework for negotiating and formalizing trade agreements, including a dispute resolution process¹. It is proper to say that WTO is the largest and most successful trade organization in the last decade, as having 153 members around the world and representing more than 97% of total world trade². It encouraged a lot of cooperation between countries and promoted the growth of international economy.

One of the most important frameworks of WTO concerns with trade barriers, either tariff or non-tariff. It does not directly interfere with the discretion of each participating country to raise or decrease its barrier, but rather focus on non-discrimination manner in those policies. In other words, a

¹Wikipedia, the free encyclopedia, **World Trade Organization** [Online], available URL: http://en.wikipedia.org/wiki/World_Trade_Organization, 2015 (March, 19).

²Ibid.

WTO member must apply the same conditions on all trade with other WTO members³. For example, if country A granted country B a special favour, it has to do the same for all other WTO members as well. This is so-called the most favoured nation (MFN) rule which can be referred as the heart of the WTO based on a concept of free trade.

However, there are criticisms about the compatibility of WTO's framework toward the nature of developing countries. The small scale of industry and low level of development make it difficult for developed nations to compete under the same rule with the developed world⁴. There were some analysis pointed out that the developing nations were suffering from trade deficits and were losing under the GATT⁵. Whether free trade is the best way to achieve internal growth and development within developing countries was in doubt, since many of their industries still far from effectiveness and their fragile economies may need some protection against fierceful competition from the giant transnational companies⁶. Many people even perceive GATT or WTO as the rich man's club designed to serve the interests of the industrialized nations, which developing countries have no choice but to participate in order to get as a good deal as they can⁷.

That is why the trade preferences have been introduced in response to the issue that MFN basis ignored unequal economic realities between developing and developed nations⁸. Its concept is to allow developed nations

³ Wikipedia, the free encyclopedia, Ibid.

⁴ Paulette Vander Schueren and Michal Cieplinski, "EC generalized system of tariff preferences in the making: Improved market access for developing countries," **International Trade Law and Regulation** 11, 4 (2005): 118-125.

⁵ Ibid., p.579.

⁶ Ibid., p.582.

⁷ Ibid.

⁸ Bonapas Francis Onguglo, DEVELOPING COUNTRIES AND UNILATERAL TRADE PREFERENCES IN THE NEW INTERNATIONAL TRADING SYSTEM, in **Trade Rules in the Making: Challenges in Regional and Multilateral Negotiations**, eds. Miguel Rodriguez

to grant special and differential treatments for developing countries, without doing the same to other developed members, in order to increase their export earnings, promote their industrialization, and accelerate their rates of economic growth⁹. There are a number of preferential trade schemes such as the Caribbean Basin Initiative (CBI), the Andean Trade Preference Act (ATPA), the Canadian Trade, Investment and Industrial Cooperation programme (CARIBCAN), and Lomé Conventions¹⁰. However, the most significant scheme is the Generalised System of Preferences or the GSP. This essay will briefly explain the description of GSP, its effects toward international economy, and its deficiencies that need to be further developed, in order to analyse whether it responds to the needs and aspirations of developing countries.

2. Description of the Generalised System of Preferences (GSP)

The Generalised System of Preferences (GSP) is an exemption from the general rule of WTO, which is the Most Favoured Nation (MFN) principle that obligates WTO member countries to treat the imports of all WTO member countries equally, for example, to impose equal tariffs on them¹¹. In other words, the GSP allows WTO member countries to lower tariffs for developing countries, or even more favorable treatment to the least developed countries, without doing so for developed nations. The objectives of the GSP are (a) to increase the export earnings of developing countries, (b) to promote their industrialization, and (c) to accelerate their rates of economic growth. Note that GSP schemes are determined unilaterally by the

Mendoza, Patrick Low and Barbara Kotschwar, (Washington, D.C.: The Brookings Institution Press/Organization of American States, 1999), pp. 109-133.

⁹Ibid.

¹⁰Ibid., pp. 1-2.

¹¹Wikipedia, the free encyclopedia, **Generalized System of Preferences** [Online], available URL: http://en.wikipedia.org/wiki/Generalized_System_of_Preferences, 2015 (March, 23).

preference-giving countries, regarding to extent of preferences, product coverage, and beneficiary countries. The preference-receiving countries does not involve with the determination or modification of the schemes.

The idea of tariff preferences for developing countries was established by United Nations Conference on Trade and Development (UNCTAD) in the 1960s. Afterward, the legal framework for the operation of GSP was laid out by the GATT in form of a 10 year waiver to the MFN principle in 1971. In 1979, the GATT finally established a permanent exemption to the MFN obligation by way of the Enabling Clause, which has been using until the present time, to replace with the soon to expire 1971 waiver.

The most important condition when granting the GSP is that such preferential tariff treatment must be in accordance with the ‘generalized, non-reciprocal and non-discriminatory’ requirement. This requirement is intended to ensure that GSP will facilitate and promote the trade of developing countries without raising any barriers to or create undue difficulties for the trade of other contracting parties. The ‘non-discriminatory’ requirement is breached when there is differentiation among similarly situated beneficiaries. However, since economic development needs among developing countries may vary, mere differences in treatment would not necessarily result in discrimination. In other words, the context “non-discriminatory” does not mean that a donor country has to grant identical tariff preferences to all developing countries if such differences are justified by the Enabling Clause. This issue is quite problematic and subject to many criticisms, which will be discussed later in this essay.

Even though the GSP is a permanent exemption from the MFN rule by the existence of the Enabling Clause as already mentioned above, it does not mean that preferences receiving countries will continue to receive special treatment forever. The benefit of the GSP may be withdrawn from specified sectors when such sectors meet certain levels of value of imports and development. This process is commonly referred to as “graduation.”

Moreover, a beneficiary country may graduate as a whole out of the GSP schemes when reaching a certain level of development.

3. Economic Effects of the GSP

3.1 Success of the GSP

The GSP has been in operation for many last decades and proved itself to be a significant instrument of development cooperation. The preferential margins, product coverage and related features have been improved, from time to time, by the preference-giving countries. The reduction or elimination of MFN tariffs actually makes the exports of beneficiaries more competitive with other similar products entering under MFN duties. Prior study showed that the system of preferences have created more favourable market access conditions and gradually promoted the growth of economy in some preference-receiving countries. For example, “*in 1996, the aggregated dutiable imports of the United States from its GSP beneficiaries amounted to US\$ 69.5 billion in current value terms (UNCTAD, 1998). About 24 per cent of that amount (US\$ 16.8 billion) received GSP preferences. In the EU, total dutiable imports from its GSP beneficiaries in 1996 amounted to US\$ 169.6 billion. About 37 per cent of that amount (US\$ 62.5 billion) received GSP preferences.*”

3.2 Deficiencies of the GSP

Even though the GSP does encourage greater export output of the qualified products in beneficiary countries than would be in its absence, it is still far from archiving its full potential. Only few and not the majority of the preference-receiving countries benefit from the schemes. For example, “*neither the OPEC countries nor the Mediterranean countries of Greece, Spain and Portugal benefit from the United States GSP, the European Community (EEC) does not grant preferences to Taiwan or the Mediterranean countries, Japan's beneficiary list is quite broad but Hong Kong comes under special*

*restrictive treatment*¹²”. Some commentator thinks that the GSP schemes, as functioning at the moment, provided a limited benefit to more advanced developing countries and no benefit to the others. Thus, if one really concerns about all developing countries, it would be better to focus on archiving a successful round of MFN tariff reductions than maintaining the existing GSP tariff margins, so that these more advanced countries do not have to sacrifice in favour of the poorer.

Moreover, it is hardly clear about to what extent that the expansion of the industries in beneficiary countries, which will play a significant part in promoting economic growth over the long run, is a result of the GSP arrangements¹³. Since the export activities that the GSP schemes seek to support are usually infant industries which subject to learning experiences, its growth, therefore, can be a result of other external factors rather than the effect of preferences system, especially under many products exclusions and limitations in the GSP schemes (which will be discussed further in the following paragraph.)

Product exclusions in the GSP schemes can be another obstruction that prevents the GSP from serving the needs of developing countries. Not all manufactured products are eligible for GSP tariff treatment. The most important exclusions are agricultural products, fishery items, footwear, and textiles. More precisely, those that classified as sensitive products, which are of export interest to many developing countries, always be excluded from the schemes. However, there is no explicit or uniform standard to identify which products are sensitive. Therefore, the process of identification is very subjective and might be non-transparent.

The limited scope of product coverage may also distort investment decision in beneficiary countries. For example, it may lead to over-investment

¹²Baldwin and Murray, “MFN Tariff Reductions and Developing Country Trade Benefits Under the GSP,” *The Economic Journal* 87, 345 (March 1977): 34.

¹³Grossman and Sykes, “A preference for development: the law and economics of GSP,” *World Trade Review* 4, 1 (March 2005): 41-67.

in the sectors that are eligible for preferential treatment. This is a very undesirable and risky outcome since trade preferences are temporary in its nature. Besides, even though the products are qualified for GSP tariff treatment, there usually be limits on the value of imports that can receive such preferences. Thus, imports in excess of the ceiling limits will be charged normal MFN duties. Products coverage or other conditions can also change overtime. Moreover, there is a possibility that such sectors or the whole country may graduate from the GSP schemes some day. If this happened, the objective of the GSP to encourage investments in the long terms growth would be collapse.

Another issue is that preferential tariff treatment may restrain trade liberalization in beneficiary countries because GSP preferences can reduce the effort of developing countries to lobby for trade liberalization at home to gain market access abroad. In other words, the trade preferences may put developing countries to a form of dependency, not try to pursue for better MFN treatment on their export. This issue lay down a further doubt toward the effectiveness of the GSP, since some study point out that developing countries with more liberal trade policies achieve higher rates of growth and development.

Difficulties to comply with many complicated requirement of the GSP schemes can be defined as another deficiency. For example, many goods imported from developing countries, though qualify for preferences, do not receive them because the complex rules of origins. Such rules define that only products originated in a GSP beneficiary country will benefit from the GSP tariff. It would not be a problem if one product is wholly obtained in the exporting country. Unfortunately, tons of products in business reality these days are manufactured with materials from all over the world. Therefore, it is not easy to determine the origin of any product only in the first glance. There are three measures in the rules of origin which are specific process rules, value-added rules, and change of tariff heading rules. Nevertheless, none of these rules are easy to archive common understanding.

The most important and controversial problem is the ambiguity of the Enabling Clause which is the heart of the GSP schemes, especially in the context ‘generalized, non-reciprocal and non-discriminatory.’ Contrary interpretations of such contexts lead to the problems of how far a donor country can define conditions for developing nations to qualify as preferences receiving countries and to what extent that tariff preferences shall be provided for each of them. It could be seen that the willingness of nations to grant preferences are usually affected by political reasons. For example, some developing countries are not accepted as a recipient of preferences because of different ideology. The use of GSP schemes as a political mechanism may come in the form of additional limitations as to product coverage and beneficiaries or safeguards. Some preferences granting countries try to persuade beneficiary nation to cooperate on various policy by using greater preferences as a reward, or even threaten them with the withdrawal of the GSP. If we take a look at trade preference policies of the U.S. and EU, it could be seen that both systems contain measures that show a significant degree of discrimination and reciprocity, which also far from simply economic issue. For example, the U.S. does foreclose countries that fail to aid in efforts to combat terrorism. With these circumstances, the GSP schemes might be seen as a tool to serve the rich rather than respond to the needs of developing countries.

To clearly understand the problem, it is necessary to study the most controversial WTO case brought by India in 2002 against the EC preference scheme, regarding to impermissible discrimination among developing countries. The key question raised by India is that what type of discrimination is permissible, i.e. must donor nations treat all developing countries identically, or some degree of discrimination is allowed based on differences among recipients?

The European system afforded more generous preferences to the least developed countries, developing nations having adequate measures to protect the environment and labor rights, and 12 nations involved in efforts to combat drug-trafficking. At first, India challenged all above aspects, except

only the least developed countries preferences, before narrowed its complaint to only drug-related issue.

By refer to the Enabling Clause, India alleged that a donor nation must extend its preferences to all developing countries, except only the least developed nation that may receive more favourable treatment. Since drug-related preferences are inconsistency with the provision above, the preferences, therefore, failed to comply with the non-discriminatory requirement under the Enabling Clause and violated GATT Article I (the MFN rule.) Europe preliminarily argued that the Enabling Clause is a separate legal basis from Article I of GATT. The panel, however, held in favour of India on this point by concluded that the Enabling Clause is an exception to the MFN obligation. Beside of that, Europe had three main arguments.

First, it refer to paragraph 3(c) of the Enabling Clause, which states that “*3. Any differential and more favourable treatment provided under this clause...(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'.*” Therefore, it is authorized, or even required, by the provision to adjust its preferences so that they can suitably respond to different needs.

Second, Europe argued that the word ‘discrimination’ means arbitrary discrimination among similarly situated entities. In other words, no ‘discrimination’ should be found as long as differences treatments are justified by legitimate objective.

Third, Europe argued that the context ‘developing countries’ in paragraph 2(a) of the Enabling Clause, which states that “*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 Generalized System of Preferences...*” does not refer to all developing countries, since the drafters should add the word ‘all’ into the context if they intended to do it that way.

The panel realized that the texts of the Enabling Clause were ambiguous and turns to the context of the treaty text, its object and purpose, and other aids to interpretation. It found that nothing in the negotiating history support discrimination among developing countries and, therefore, the phrase ‘developing countries’ does refer to all developing countries. It also determined that different preferences are not allowed, except only for the least developed countries. The Europe’s suggestion that the differences can be justified by legitimate purpose is not supported by any text or negotiating history at all.

However, the panel findings were reversed by the Appellate Body (AB) in almost every aspect, except only the proposition that the Enabling Clause is an exception to GATT Article I. The AB accepted the European argument that the absence of the word ‘all’ before ‘developing countries’ implies that all developing countries may not be treated identically. Moreover, since developments and needs of developing countries can be varied, donor countries are allowed to treat beneficiary countries differently as long as such differences positively respond to varying development, financial, and trade needs.

Unfortunately, there was no specific finding whether drug-related preferences are qualified as a positive response to ‘development, financial, and trade needs’, since the panel ended it finding to the point that differences are not allowed and the AB held that the preferences failed the non-discrimination test only because the European Community failed to proof that the preferences granted under the Drug Arrangements are available to all beneficiaries that encounter similar drug problem.

It is difficult to say whether the panel or the AB was right since both decisions can be supported by a number of economic and legal reasons. One might afraid that the main purpose of the UNCTAD negotiation may collapse if developed nation are allowed to freely discriminate among developing countries. The requirement that such differences must ‘positively respond to development, financial, and trade needs’ is not very useful since it is also

ambiguous in its context. Developed nations may, nevertheless, use such authority to justify their discrimination policy. This aspect seems to agree with the panel decision to forbid such different treatments. On the other hand, too tight restriction may discourage developed nations from granting any preferences, since, after all, the GSP benefits are unilateral in its nature that such nations are free to grant or withdraw at any time.

The ambiguity of the Enabling Clause is the root of the problem. It plainly allows nations to grant more favourable tariff treatment to goods from developing countries, without exact definition of elastic words such as 'discrimination' or 'developing countries.' Is wide range of products exclusions contrary to the 'generalise' requirement? To what extent the different treatments among developing countries will amount to 'discrimination'? What kind of attaching conditions to benefit from the schemes are acceptable as 'non-reciprocity'? These questions were left without a clear answer.

Furthermore, the AB decision also raised a question of what counts as 'a development, financial, and trade needs. Many criteria for beneficiary status in modern GSP schemes seem to far from the needs of beneficiary countries. For example, the drug-related preferences in this case seem to exist for the benefit of Europe, which is to reduce the drug problem in their territory, rather than respond to the needs of preferences receiving countries. Moreover, if trade preferences must be adjusted to address various needs of developing countries, it might be appeared that the amount required for each beneficiary country would hardly be the same. If this is the case, what will be the criteria to define such amount? In addition, there are numerous factors that can be qualified as the 'needs' of developing countries. What kinds of need that each donor country may choose as a criteria to settle the degree of preferences? If one country can choose whatever need they want while ignore others, it would be very easy to justify their discrimination purpose. One might suggest that it would be better for developing nations to only take what they can get than challenging the GSP schemes which may distort developed nations' willingness to grant trade preferences. However, if

developing countries have no choice but to comply with the donor nations' policies, would this be qualified as some kind of economic colonialism? Moreover, it is understood that the purpose of WTO is to limit negative externalities resulted from fragmentation of trade policies among countries. That is why the MFN principle has been introduced to limit discriminations to the considerable degree. If the GSP can be used as a tool to make such discriminations become legitimate, would this ruin the whole process? Therefore, the ambiguity of the Enabling Clause needs to be clarified. Otherwise, the gorgeous ambition to constitute the GSP as a 'generalized, non-reciprocal and non-discriminatory' system would barely come true.

4. Conclusion

Even though there are a number of deficiencies in the present GSP schemes, it is clear that the idea of GSP constituted for the great intention to reduce the gap between developing countries and developed world. It is proved that merely MFN provision cannot perfectly respond to the needs of developing nations. Low development of economy does actually make it hard for them to compete in the world market under the same condition. Therefore, the system of preferences became a significant mechanism to solve the problem. Its purpose not only aims to serve the needs of developing countries, but also seeks to archive the growth of world market which will benefit all WTO members. However, because of a number of deficiencies mentioned above, the GSP is still far from its full function. The most important problem is the ambiguity of the Enabling Clause that in urgent need to be clarified. The AB's decision in the mentioned case that donor nations are authorized to grant different treatment to address each developing nations' needs is quite reasonable. However, there should be definite scope of what qualified as 'development, financial, and trade's needs' to prevent any arbitrary measures in one's GSP schemes. It might be true that the GSP is more like a 'gift' since there is no strict obligation for

developed nations to grant any preference, and tight restriction toward the issues of ‘non-reciprocity’ and ‘non-discriminatory’ can prevent them from providing such special treatments. Moreover, one might think that there is no point to give out such a ‘gift’ if they cannot expect any reciprocity at all. However, the key question is whether developed nations think that it worth to give a fewer donation, which is the GSP schemes, to archive a greater goal such as eliminating the negative externalities. After all, there is no perfect rule in the world, especially in the large stage such as WTO which contains members from different culture, religious, ideology, and etc. What more important is the sincerely between member countries to coordinate and help each other, in order to bring the world market to the splendid destination. Therefore, it is proper to conclude that the GSP, as functioning at the moment, does show some degree of response to the needs and aspirations of developing countries. However, its function is limited by a number of deficiencies mentioned in this essay and need to be further developed.

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