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"A COMPARATIVE ANALYSIS OF GENERALISED SYSTEMS OF PREFERENCES: CHALLENGES, CONSTRAINTS AND OPPORTUNITIES FOR IMPROVEMENT"*

Memorandum to: The European Parliament, Committee on International Trade

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TABLE OF ABBREVIATIONS

AGOA	**African Growth and Opportunity Act**
ASEAN	**Association of Southeast Asian Nations**
ASTP	**Australian System of Tariffs and Preferences**
ATPA	**Andean Trade Preference Act**
BDC	**Beneficiary Developing Country**
CARICOM	**Caribbean Community**
CBI	**Caribbean Basin Initiative**
CNL	**Competitive Needs Limitations**
DSU	**Dispute Settlement Understanding**
EBA	**Everything But Arms**
FIC	**Forum Island Countries**
FTA	**Free Trade Agreement**
GATT	**General Agreement on Tariffs and Trade 1994**
GNP	**Gross National Product**
GPT	**General Preferential Tariff**
GSP	**Generalised System of Preferences**
HS	**Harmonized Commodity Description and Coding System**
ILO	**International Labour Organization**
IMF	**International Monetary Fund**
LDBDC	**Least Developed Beneficiary Developing Country**
LDC	**Least Developed Country**
LDCT	**Least Developed Country Tariff**
MFN	**Most Favoured Nation**
OECD	**Organisation for Economic Co-Operation and Development**
PTA	**Preferential Trade Area**
RTA	**Regional Trade Agreement**
SAARC	**South Asian Association for Regional Cooperation**
SADC	**Southern African Development Community**
SPS	**Agreement on Sanitary and Phytosanitary Measures**
TBT	**Agreement on Technical Barriers to Trade**
UNCTAD	**United Nations Conference on Trade and Development**
UNFCCC	**United Nations Framework Convention on Climate Change**
WAEMU	**West African Economic and Monetary Union**
WTO	**World Trade Organization**

I. EXECUTIVE SUMMARY

Since its inception in 1964, the Generalised System of Preferences (GSP) has served developed countries to foster trade with poorer countries. In both the design and implementation of GSP programs, the EU—like other major GSP donors—must **balance** the development needs of poorer countries with domestic political pressures. Further, donors must tailor their GSPs to address **diversity** among developing countries, which now include states with significantly different levels of economic development.

To address this challenge, donors first divide their GSP schemes into various beneficiary **categories**. The EU, like the other major donors studied (the United States, Canada, Australia and Japan), grants greater market access to Least Developed Countries (LDCs) through a separate category in its preferential system, Everything But Arms (EBA). However, the EU additionally administers an intermediate tariff preference category (GSP Plus) that ventures further than EBA into **conditionality**. Like the U.S., the EU uses conditionality to induce strategic improvements in developing states, though the EU uniquely ties elevated preferences to sustainable development.

The effectiveness of these mechanisms is currently under review because the EU GSP requires reauthorization every three years. Compared to the 10-year GSP **duration** of donors such as Canada, this marks a high frequency of legislative reaction. Canada also simplifies another aspect of domestic GSP review by maintaining no **graduation** mechanism for stripping newly developed countries of preferences, whereas the EU annually performs such review for each beneficiary, including unique calculations of product-based competitiveness.

However, such focus on individual articles is common to all donors that limit GSP product **coverage** for specific imported articles. The EU is thus not unique in reducing domestically sensitive products such as textiles from duty-free to MFN-reduced tariff preferences, and in fact restricts coverage less than donors such as Australia, which removes all preferences from a variety of products. Australia also differs notably on how otherwise qualifying products must originate from beneficiary countries. Whereas its rules of **origin** permit a certain degree of cumulation of

product components from other beneficiaries, the EU restricts such contributions to partner states in any of a few regional economic organizations.

Exporters in beneficiary countries may face onerous standards to demonstrate **compliance** with such rules, particularly in situations of "reasonable doubt" under the current EU model. However, Japan's scheme flips this presumption on its head, offering relatively laxed compliance standards when "origins are evident." Yet Japan's relaxed approach creates difficulties in other aspects of trade practice, such as its proliferation of non-GSP trade agreements. While such agreements offer donors legitimate discrimination and reciprocity, their proliferation—coupled with reductions in MFN rates—threaten the **erosion** of GSP's attractiveness for beneficiaries and effectiveness for donors.

From the **economic** perspective, GSP programs have contributed to the growth of developing countries. As trade flow has increased among GSP beneficiaries, it is unsurprising that FDI in these countries has undergone a corresponding and proportionately larger boom. It is noteworthy that GSP's positive outcomes have been greater for LDCs, which enjoy more preferential treatment (duty-free-quota-free for almost 100% of their exports).

Nevertheless, GSP programs have not met their potential. Indeed, economic assessments have found that they create additional drawbacks for developing countries. For example, GSP programs offer **no incentive for liberalization** in developing countries, because unilateral guaranteed preferences diminish export lobbies' interest in pressuring their governments to eliminate domestic trade barriers. Additionally, GSPs may contain highly **complex rules of origin**, which limit compliance among developing countries, thus reducing their market access to preferences. As these preferences cover specific goods, GSP may also encourage perverse specializations in such goods (which are entirely reliant on such preferences), **preventing export diversification** in developing countries. Furthermore, the uncertain length and unpredictable regulatory framework of GSP programs may create **extra risks for investment** in beneficiary sectors.

These beneficiaries are further **discouraged from becoming competitive**, insofar as their exports will be deprived of the preference when reaching an import share or

value in the donor country (i.e., graduation). GSP's weaknesses also **encourage the negotiation of RTAs** under a reciprocal basis. Finally, GSP **margins of preference are eroding**, as multilateral, bilateral and regional liberalization increase.

The **legal requirements** that the WTO regime imposes on GSP permit some degree of discrimination among beneficiary countries, in so far as preferential tariff treatment is offered to **improve a "development, financial and trade" need** shared by those countries. At the same time, the preferential tariff treatment must be made available to all countries that share the need the GSP program addresses. There are exceptions to the requirement of non-discrimination, namely the special category of LDCs to whom donors can offer additional preferential treatment and the product coverage carve-outs identified during the UNCTAD negotiations that established the GSP framework.

A number of **grey areas** surrounding the interpretation of these legal criteria make it difficult to define clear-cut parameters for the design and implementation of GSP programs. The main areas of uncertainty concern the extent to which preferential tariff treatment must be **'generalized'** and **'non-reciprocal'**, and the **criteria** according to which "development, financial and trade" needs of beneficiaries should be selected. A further grey area is the extent to which the **preferential tariff treatment must improve or alleviate** the identified "development, financial and trade" needs. The requirement is for a 'sufficient' link between the preferential tariff treatment and the improvement of the identified development needs; the WTO has provided no further guidance to illustrate what practical degree of improvement would meet this requirement.

The main challenge, as emphasized throughout this Memorandum, lies in striking a balance between achieving GSP objectives through unilateral concessions to developing countries and paying appropriate attention to domestic political pressures. This is illustrated by this Memorandum's **analysis of a hypothetical condition** granting preferential tariff treatment to countries that do not impose export restrictions, and in particular those restrictions relating to raw materials. As explained, this type of conditionality would be unlikely to meet the non-reciprocity and non-discrimination requirements for GSP, and may be best developed outside the context of GSP (for example, through a bilateral or plurilateral trade agreement).

This Memorandum also concludes that key to the effectiveness of GSP as a development tool is the **need to increase utilization** among those states that most benefit from preferential access and **simplify implementation procedures**. This may be achieved as follows:

- extending the EU's GSP to a **longer term than 3 years** would likely encourage broader participation among beneficiaries and increase predictability, as well as conserve EU legislative resources.

- **expanding product coverage** to a greater share of exports from all LDCs, including currently 'sensitive' textiles, if Parliament determines this to be politically feasible.

- encouraging LDC partnerships and compliance with rules of origin by **globalizing permissible cumulation**.

- making **standards of graduation transparent** through country-specific graduation based on overall competitiveness, and not complex product-specific graduation schemes.

- **avoiding** conditionality with **only tangential links to development**. Any increase in conditionality should take into account the compliance burdens imposed on beneficiaries. Consideration should be given to whether compliance with conditionality creates costs (especially for poorer countries) that outweigh the benefits of preferential treatment. A balance should be struck, so as not to dissuade participation.

II. INTRODUCTION

In 1964, UNCTAD proposed that developed countries grant unilateral tariff preferences to exports from developing countries. The objective was to increase industrialization in developing countries and encourage investment in their exports,[1] by reducing the hurdles that developing countries face when entering the international market.[2] Developed countries have since designed GSP programs with this common aim, but their efforts vary in scope, degree of regulation and popularity among developing countries.

In both design and implementation of GSP programs, the EU—like other major GSP donors—must balance the development needs of poorer countries with domestic political pressures. GSP donors must also respect the regulatory constraints that WTO rules impose on GSPs. However, following the first and only WTO decision concerning GSP, these remain to some extent untested or not clearly defined.[3]

An added dimension to the challenges that GSP donors face when formulating and implementing unilateral preferential treatment programs is diversity. Developing countries no longer form a homogeneous group, and now include states with significantly different levels of economic, social and cultural development. This was not the case thirty years ago, when GSP became an established part of the development toolbox. Today's challenge for preference-granting countries is to avoid unlawful discrimination among beneficiaries without compromising the effectiveness of unilateral preferential tariff treatment.

By comparing aspects of GSP that are common to major donors around the world, this Memorandum identifies those GSP features that most effectively reach donor objectives. It then explores these aspects from an economic perspective, providing a critique of both GSP systems in general and the EU's current policy. Thereafter, this Memorandum analyses the legal requirements for GSP programs under the WTO

[1] Donp. Clark and Simonetta Zarilli (1992), Non-tariff Measures and Industrial Nation Imports of GSP-Covered Products, Southern Economic Journal, 59 (2), October, 284-93 in Trade Preferences and Differential Treatment of Developing Countries edited by Bernard Hoekman and Caglar Ozden.Glos: EE, at 220 (2008).

[2] Constantine Michalopoulos, The role of special and differential treatment for developing countries in GATT and the World trade Organization, at 16 (2000). Available at http://www.acp-eu-trade.org/library/files/Michalopoulos%20-%20Role%20of%20Special%20and%20Differential%20Treatment%20for%20Deve.pdf .

[3] *EC –Tariff Preferences* (WT/DS246/AB/R adopted 20 April 2004).

legislative framework. With attention to the balance between GSP economic effectiveness and legality, this Memorandum concludes with practical recommendations for EU GSP revisions. As with any discussion of GSP improvement, these recommendations underline that the GSP is a political commitment with acknowledged value to both donor and developing country.

III. COMPARATIVE GSP ANALYSIS

Bearing in mind the European Commission's public consultation report, we have isolated key features common to major donors' GSPs. The GSPs that this section comparatively analyzes are those of the U.S., Canada, Australia and Japan.

COMMON GSP FEATURES
• Beneficiary Categories
• Duration and Implementation Schemes
• Scope of Product Coverage
• Rules of Origin
• Monitoring and Compliance Schemes
• Graduation
• Conditionality
• Potential Erosion of Preferential Margins

A. Common Features of Major GSP Systems

1. *GSP Beneficiary Categories*

Major GSP donors establish categories of beneficiary eligibility, generally based on development thresholds. The current EU GSP establishes three such categories: 'Standard' GSP, providing preferences for 176 developing countries and territories; GSP+, providing additional tariff reductions to support vulnerable developing states in the ratification and implementation of international conventions on sustainable development and good governance; and Everything But Arms (EBA), providing duty-free, quota-free access for all products originating in the 49 LDCs.[4]

Although the U.S. GSP lapsed at the end of 2010, any Congressional reauthorization would likely retain its long-established two-tier program. The first beneficiary category is the standard grouping of Beneficiary Developing Countries (BDCs),

[4] UNCTAD Generalized System of Preferences Handbook on the Scheme of the European Community, at vii-viii (2008).

which may export most goods to the U.S. on a reduced-tariff basis.[5] However, benefits to these 138 states and territories are capped by Competitive Needs Limitations, which place a waivable ceiling on GSP benefits for each product and BDC.[6] BDC eligibility is based on a series of mandatory and discretionary criteria that go well beyond the basic criterion of beneficiary gross national product; the resulting exclusion of China is discussed in detail in the section on 'Conditionality', *infra*. In *US-Steel Safeguards*, the WTO Panel declined to rule on whether such deviation from pure 'development' standards violated Article 9.1 of the Agreement on Safeguards.[7] The second category is Least Developed Beneficiary Developing Countries (LDBDC), a sub-group of 46 states taken from the current U.N. list of least developed countries.[8] LDBDCs may export specifically enumerated goods to the U.S. on a duty-free basis. Additionally, Critical Needs Limitations do not apply to LDBDCs.[9]

Canada also implements a two-tier GSP beneficiary program, with similar contours to the lapsed U.S. model. The first beneficiary category is the standard grouping of General Preferential Tariff (GPT) recipients, including over 180 developing countries.[10] This expansive list includes countries such as Singapore, which are notably absent from other major GSPs, including the U.S. and Japanese schemes (for further information, see section on 'Graduation', *infra*).[11] The second category is the Least-Developed Country Tariff (LDCT) sub-group, which provides greater preferential access to imports from the 49 least developed countries.[12]

Australia's long-established GSP program divides beneficiaries into similar categories. The first beneficiary category receives the general 'developing country

[5] Congressional Research Service Report for Congress, Generalized System of Preferences: Background and Renewal Debate, at 9 (January 25, 2008).
[6] UNCTAD Generalized System of Preferences Handbook on the Scheme of the United States, at 17 (2010).
[7] *United States—Definitive Safeguard Measures on Imports of Certain Steel Products*, AB-2003-3, Report of the Appellate Body, WT/DS258/AB/R, WT/DS259/AB/R
Page 170 (10 November 2003).
[8] U.S. Handbook, supra n. 6, at 17.
[9] U.S. Handbook, supra n. 6, at 18.
[10] UNCTAD Generalized System of Preferences Handbook on the Scheme of Canada, at vii (2001).
[11] Canada Handbook, supra n. 10, at 12.
[12] Canada Handbook, supra n. 10, at vii.

tariff,' which accounts for over 75% of preferential imports into Australia.[13] A separate category of 'LDC preferences' expands preferences along specific tariff lines for duty-free and quota-free access for least-developed economies.[14] Australia has concurrently administered preferential arrangements on a regional, non-GSP basis. It administered a program, now phased-out, consisting of 'special rates for selected economies', which applied to the Asian economies of Hong Kong, South Korea, Singapore and Taipei.[15] As Hong Kong is no longer a beneficiary under Australia's GSP, all Chinese imports via Hong Kong must satisfy non-manipulation requirements under Australia's rules of origin, as in the EU (see section on 'Rules of Origin', *infra*). Another regional program, the 'preference scheme targeting the Forum Island Countries,' still targets Pacific island economies.[16]

Japan offers wide GSP coverage to 151 developing countries and territories.[17] A standard GSP beneficiary must meet four formalistic criteria: it must be developing, be a country or a territory with its own tariff and trade system, request preferential tariff treatment, and receive the formality of a Cabinet Order granting benefits.[18] Special preferential treatment for LDCs is contingent upon the U.N. General Assembly labeling such states as LDCs.[19]

Beneficiary categories are listed for each studied GSP donor in the following chart. This chart includes category-based exclusions of 'gray area' states, such as Brazil, China, Korea, Russia and Singapore. Some notable inclusions or exclusions are discussed in subsequent pertinent sections. U.S. GSP exclusion of China is discussed in the section on 'Conditionality', *infra*. Continued Canada GSP inclusion of Singapore is discussed in the section on 'Graduation', *infra*.

[13] OECD Trade Directorate, The Australian Preferential Tariff Regime, at 5 (May 22, 2008).
[14] OECD Trade Directorate, supra n. 13, at 6.
[15] OECD Trade Directorate, supra n. 13, at 5.
[16] OECD Trade Directorate, supra n. 13, at 5-6.
[17] Ministry of Foreign Affairs in Japan, Explanatory Notes for Japan's Scheme, available at http://www.mofa.go.jp/policy/economy/gsp/explain.html
[18] Ministry of Foreign Affairs, supra n. 17.
[19] Ministry of Foreign Affairs, supra n. 17.

BREAKDOWN OF BENEFICIARY CATEGORIES SUBSUMED UNDER GSP

EU	GSP, GSP+, EBA	Excludes Korea, Singapore
US	BDC, LDBDC	Excludes Korea, Singapore. China: see 'Conditionality'
CAN	GPT, LDCT	No exclusions. Notable *inclusions*: see 'Graduation'
AUS	Developing Country Preferences, LDC Preferences	Excludes Brazil, Korea, Russia, Singapore
JAP	GSP, LDC Preferential Treatment	Excludes Korea, Russia, Singapore

2. *Duration and Implementation of GSP*

Major GSP donors employ different windows of legislative review for their GSP programs and sub-groups. These donors have also followed divergent paths in how they have avoided or handled lapses in statutory GSP authorization. The EU employs a three-year period for GSP renewal and revision, which currently runs from January 2009 through December 2011.[20] Concerns over time requirements in the new ordinary legislative procedure compelled a recent EU stopgap measure, extending a 'rollover' of the current GSP program in the event that GSP revisions are not approved by year's end.[21] Such trade measures begin as proposals of the Commission and are subsequently legislated through the post-Lisbon co-decision process.[22]

In the U.S., full Critical Needs Limitation review of each beneficiary country occurs annually.[23] From a U.S. GSP beneficiary's perspective, this may inject frequent uncertainty for those domestic businesses arranging U.S.-bound exports. The entire U.S. GSP program has undergone various periods of reauthorization. The current GSP lapse is the seventh since 1993.[24] All prior lapses ended with the retroactive

[20] EU Handbook, supra n. 4, at viii.
[21] EU Parliament web site, "Trade Regimes Applicable to Developing Countries", available at http://www.europarl.europa.eu/parliament/expert/displayFtu.do?id=74&ftuId=FTU_6.5.2.html&language=en (May 2010).
[22] EU Parliament web site, supra n. 27.
[23] U.S. Handbook, supra n. 6, at 17.
[24] Office of the United States Trade Representative, GSP Expiration: Frequently Asked Questions, available at http://www.ustr.gov/about-us/press-office/fact-sheets/2010/december/gsp-expiration-frequently-asked-questions (December 2010).

reauthorization of GSP benefits, which may help maintain confidence in the interim among U.S. trade partners in the developing world.[25] U.S. GSP lapses (including the present lapse) do not affect recipient benefits under RTAs and FTAs to which the U.S. is a contracting Party. States participating in AGOA, CBI or other U.S. extra-GSP trade schemes are not affected by the failure of the U.S. Congress to reauthorize the U.S. GSP.[26]

Canada's GSP is implemented and extended in 10 year windows, and is next subject to extension in 2014.[27] This applies to the entire GSP framework, including both GPT and LDCT.

Australian authorities have reauthorized the country's GSP framework every 10 years since it amended its Customs Tariff Act in 1995.[28] Since that time, Australia has made efforts to tailor its legislative review to the twin aims of simplification and more effective preferences for LDCs.

Japan's GSP program has also operated on 10-year review since its establishment, and is next subject to extension in 2021.[29]

COMPARISON OF DEADLINES FOR REAUTHORIZATION OF GSP

EU	2012 (Roll-Over Through 2013)
US	Lapsed
CAN	2014
AUS	2016
JAP	2021

[25] U.S. Trade web site, supra n. 14.
[26] U.S. Trade web site, supra n. 14.
[27] Canada Handbook, supra n. 10, at vii.
[28] OECD Trade Directorate, supra n. 13, at 4-5.
[29] UNCTAD Generalized System of Preferences Handbook on the Scheme of Japan, at 9 (2006).

3. *Product Coverage*

All major donors focus their GSP coverage on specifically enumerated products, in line with tariff classifications. However, it is common for these donors to remove entire industries from GSP coverage. The WTO Appellate Body in *EC-Tariffs* raised the question of whether such practice violates the requirement that GSPs be 'generalised', an issue discussed in greater detail in the legal analysis of Section V. The current EU program applies GSP benefits to approximately 6,350 products, and EBA benefits to about 7,200 products.[30] These include a number of agricultural and fish products listed in HS chapters 1-24, and almost all processed and semi-processed industrial products listed in HS chapters 25-97 (except chapter 93 arms and ammunition).[31] However, the standard EU GSP offers only limited benefits for 'sensitive products.' For example, duties on textiles and clothing are pegged at 20% below the MFN rate.[32] Nonetheless, GSP+ and EBA beneficiaries retain duty-free access on all 'sensitive products'.[33]

U.S. GSP coverage is broadly similar to the EU's current framework. Products eligible for duty-free treatment are defined based on placement in the Harmonized Tariff Schedule of the United States. Eligible products include most dutiable manufactures and semi-manufactures, as well as selected agricultural, fishery and primary industrial products.[34] Textiles are as a rule removed from coverage, except for a special subset bearing cultural value indigenous to the exporting country ("Certified Handicraft Textiles").[35]

As for the Canadian system, roughly 67 percent of GPT-eligible products are admitted duty-free.[36] The remaining quarter of eligible products receive a reduction in the MFN rate. Products such as textiles, plastics, specialty steels and chemical products are altogether excluded from coverage. LCDT countries receive duty-free access as a rule for all virtually all exports.[37] However, Canada does not extend this access to supply-

[30] EU Handbook, supra n. 4, at 1.
[31] EU Handbook, supra n. 4, at 1.
[32] EU Handbook, supra n. 4, at 3.
[33] EU Handbook, supra n. 4, at 3.
[34] U.S. Handbook, supra n. 6, at 12.
[35] U.S. Handbook, supra n. 6, at 12.
[36] WTO Trade Policy Review WT/TPR/S/179 of 2007.
[37] Center for Global Development, Summary of Major Trade Preference Programs, at 8 (April 2009).

managed poultry and dairy products that exceed established quotas.[38] Furthermore, Canada employs a safeguard based on the terms of GATT Article XIX, wherein it reserves the right to remove product benefits or impose quotas if the Canadian International Trade Tribunal determines that an import surge has cause potentially serious injury to domestic producers.[39]

In the Australian system, products originating from LDCs receive duty-free coverage on some products, though in terms of active import, these products have in the past amounted to only one tenth of the HS tariff lines of active imports receiving developing country preferences.[40] For developing countries, benefits are calculated based on a five percent (5%) reduction in tariff rates, when the MFN rate is 5% or higher.[41] GSP duties for developing countries are set at zero where MFN rates fall to 5% or less. For both groups of beneficiaries, agricultural and fishery products are covered only when specifically listed in Australia's GSP program. Australia draws another exception for industrial products, but this sector follows a negative list. Therefore, Australia extends benefits to all industrial products as a rule, but carves out non-coverage for specific ineligible products, such as leather textiles.

The scope of Japanese GSP product coverage is relatively narrow, with safeguards protecting broad sectors such as industry and mining.[42] 118 industrial products in HS chapters 25-97 are excluded from GSP treatment.[43] Fishery articles from HS chapters 1-24 have been removed from coverage, along with another exclusion addressing products concurrently covered by any FTA to which Japan is a Party.[44] Sensitive goods may also be subject to import ceilings affecting all non-LCD GSP beneficiaries.[45] Japan's GSP includes an escape clause whereby preferential treatment may be temporarily suspended for products when an import surge threatens like or directly competitive domestic products.[46] This flexible protectionism is broadly

[38] Center for Global Development, supra n. 37 , at 8.
[39] Canada Handbook, supra n. 10, at vii-viii.
[40] See, cf, OECD Trade Directorate, supra n. 13, at 7.
[41] UNCTAD Generalized System of Preferences Handbook on the Scheme of Australia, at 5 (June 2000).
[42] Japan Handbook, supra n. 29, at 9.
[43] Japan Handbook, supra n. 29, at 9.
[44] Japan Handbook, supra n. 29, at 9.
[45] Center for Global Development, supra n. 37, at 8.
[46] Ministry of Foreign Affairs, supra n. 17.

similar to the Canadian safeguards discussed above, and such provisions have appeared in GSPs since the 1970s.

BROAD EXCEPTIONS TO DUTY-FREE IMPORTS OF ALL PRODUCTS

EU	GSP (Sensitive products pegged at MFN-reduced rate)
US	BDC (Textiles removed from coverage)
CAN	GPT (Textiles removed from coverage); LCDT (Poultry/Dairy subject to quotas)
AUS	All Categories (Leather, some Industrial/Fishery products removed from coverage); Developing Countries (Pegged at MFN-reduced rate)
JAP	All Categories (Fishery products removed from coverage)

4. *Rules of Origin*

While the impetus for GSP is development, this aim is circumvented when products originate not from the workforce of a developing state, but from the workforce of an otherwise ineligible state. As a result, all GSP donors have established rules of origin to help ensure that GSP benefits are not plagued by fraud. In November 2010, the E.U. modified its rules of origin, requiring that eligible products receive at least 30 percent "sufficient processing" in the beneficiary state (but establishing a 70% threshold for LDCs under the EBA scheme, beginning in January 2011).[47] Moreover, beneficiary countries may rely on cumulation to combine their contributions to a product, for the purposes of reaching the 30 percent processing threshold. Cumulation permits imported inputs from third-party beneficiary countries to be regarded as 'local content', thus making it easier to comply with EU rules of origin. However, the EU limits cumulation to three regional groups of beneficiaries within ASEAN, SAARC, and the Andean Community--Central American Common Market.[48] Non-beneficiaries such as Singapore may nonetheless contribute to regional cumulation among ASEAN beneficiaries. North African countries are not included as a regional cumulation

[47] Commission Regulation (EU) No 1063/2010 of 18 November 2010, Official Journal of the European Union, 11.23.2010. Entry into force 1 January 2011.
[48] EU Handbook, supra n. 4, at 27.

block, as these countries have external, non-GSP trade agreements ('Euromed') with the EU.

The U.S. employs a more stringent threshold of 35 percent, which is explicitly tied to the cost of production. The sum of the cost or value of materials produced in the BDC must equal at least 35 percent of the appraised value of the article (at the time of entry into the U.S.).[49] The specific standard is that imported articles must be the "growth, product or manufacture" of a BDC.[50] Imported materials may be counted toward the 35 percent threshold only if they are "substantially transformed" into new and different constituent materials that are then used to produce the article.[51] Like the EU, the U.S. permits cumulation of contributions from multiple beneficiary countries. However, the U.S. permits cumulation from a wider array of regional economic integration organizations, including not only ASEAN, SAARC and the Andean Group, but also WAEMU, SADC and CARICOM.[52] Yet this broader access to cumulation raises questions about regional stratification. For example, Paraguay, a GSP beneficiary, cannot cumulate material inputs originating in Uruguay, even though such materials may enter the U.S. duty-free if exported directly from Uruguay.[53]

Within the Canadian GSP system, when an article is not wholly produced in the beneficiary state, that article must follow Canada's acumulative rule. This rule establishes a 40 percent threshold for the ex-factory price of the goods, as packed for shipment to Canada.[54] Furthermore, 60 percent of qualifying content may be contributed from various GPT beneficiary countries.[55] Materials sourced in Canada may also count toward this threshold, a caveat found in some other GSPs (see Japan, below).[56] As a firm rule, any goods, parts or materials that enter the commerce of a non-beneficiary lose GPT eligibility.[57] As for LCDTs, goods not wholly produced in a

[49] U.S. Handbook, supra n. 6, at 57.
[50] U.S. Handbook, supra n. 6, at 57.
[51] U.S. Handbook, supra n. 6, at 14.
[52] U.S. Handbook, supra n. 6, at 14-15.
[53] Inter-American Development Bank, IDB Working Paper Series #IDB WP-135, Rules of Origin for Development: From GSP to Global Free Trade, at 21-22 (November 2009).
[54] Canada Handbook, supra n. 10, at 26.
[55] Canada Handbook, supra n. 10, at 29.
[56] Canada Handbook, supra n. 10, at 29.
[57] Canada Handbook, supra n. 10, at 29.

beneficiary country are eligible for acumulation if the value of the materials constituting the article is no more than 60 percent of the ex-factory price of the goods, as packed for shipment to Canada.[58] Apparel products produced in an LDC can use textile inputs from any developing country or Canada, including China.[59]

Under the Australian model, eligible products must be either wholly obtained in a beneficiary country or must be substantially transformed in the beneficiary country before shipment to Australia.[60] 'Substantial transformation' requires that the last stage of manufacturing be performed in the country claiming origin, and that this results in a minimum level of added value (generally 50 percent of the total factory cost in terms of materials, labor and overhead).[61] Further, LDCs are additionally permitted to use materials from developing countries, FICs and Australia, so long as these do not combine to more than 25 percent of the total factory cost of the goods.[62]

In the Japanese system, eligible products must be recognized as originating in a beneficiary country and as having been transported to Japan under specific rules. With respect to origin, goods are considered as originating in a beneficiary country if they are wholly obtained there.[63] In the case of goods produced from materials imported from other countries, such materials must have undergone sufficient working or processing in the beneficiary country territory.[64] As a general rule, such operations are sufficient when the resulting goods are classified under an HS tariff heading other than that covering each of the non-originating materials.[65] With respect to transportation, eligible products must be transported directly to Japan without passing through any territory other than that of the beneficiary country.[66] An exception is permitted if such products have not undergone any operations in transit countries other than transshipment or temporary storage due to transport requirements.[67] Cumulation is permitted only for specific southeast Asian countries (Indonesia,

[58] Canada Handbook, supra n. 10, at 29.
[59] Center for Global Development, supra n. 37, at 8.
[60] OECD Trade Directorate, supra n. 13, at 8.
[61] OECD Trade Directorate, supra n. 13, at 8.
[62] OECD Trade Directorate, supra n. 13, at 8.
[63] Ministry of Foreign Affairs, supra n. 17.
[64] Ministry of Foreign Affairs, supra n. 17.
[65] Ministry of Foreign Affairs, supra n. 17.
[66] Ministry of Foreign Affairs, supra n. 17.
[67] Ministry of Foreign Affairs, supra n. 17.

Malaysia, the Philippines, Thailand and Vietnam), although any beneficiary may receive GSP treatment for products obtained from Japanese material sources.[68]

COMPARISON OF RULES OF ORIGIN AND CUMULATION

EU	30% Sufficient Processing; Regional Cumulation
US	35% Substantial Transformation; Regional Cumulation
CAN	40% Ex-Factory Price; 60% Max. Cumulation (Global)
AUS	50% Ex-Factory Price; 25% Max. Cumulation (Global)
JAP	Suff. Processing (Product & Components occupy distinct HS tariff headings)

5. ***Monitoring and Compliance***

As GSP is an exception to WTO MFN practices, the enforcement of GSP requirements is necessary to properly limit the application of this exception. However, those states for which GSPs encourage development are the same states that are unlikely to have the financial and organizational resources to endure onerous compliance requirements. The EU has long been acquainted with rigorous GSP monitoring, having imposed strict controls over preferential imports of sensitive products in the 1980s. The current EU compliance system imposes very specific requirements on export authorities in beneficiary states, involving the size and weight of certificates of origin, very limited circumstances permitting a single certificate for multiple exports, "exceptional circumstances" thresholds for the delayed dispatch of certificates, and lengthy verification phases in the event of "reasonable doubt" as to a certificate's legitimacy.[69]

Under the U.S. model, any interested party can monitor levels of imports of a specific product, through request to the U.S. Department of Commerce.[70] Red tape is most acutely felt by entities petitioning for full Critical Needs Limitation waiver. This can become very time-consuming and particularly costly for beneficiary developing countries.

[68] Ministry of Foreign Affairs, supra n. 17.
[69] EU Handbook, supra n. 4, at 37.
[70] U.S. Handbook, supra n. 6, at 114.

Canada requires that eligible goods be separately invoiced with its standard GSP Certificate of Origin form.[71] The importing party or agent must be identified in this form.[72] However, Canada does not impose bureaucratic requirements as to which exporting authorities are authorized to certify, and requires no importer identification for goods originating entirely in the beneficiary country in question.[73]

Australia's GSP monitoring mechanism is designed to directly combat problems of fraudulent origin certificates, but compliance costs for LDCs to meet the requirements of rules of origin can also become burdensome. Australia employs a system of self-assessment for entry clearance that places responsibility for correct clearance of goods through customs on the importer.[74] The importer is required to provide a certificate of origin from the manufacturer.[75] After clearance of the goods, Australian customs authorities monitor compliance with the requirements of the applicable preference scheme.[76]

Japan maintains a relatively streamlined system of compliance with its rules of origin and transport. For the former, a standard form may be submitted by any competent authority in the beneficiary country, and is not required for consignments of customs value not exceeding 200,000 yen—nor for goods "whose origins are evident."[77] For the latter, a standard bill of lading (or "any other substantiating document")[78] is sufficient to demonstrate transport conformity.[79]

[71] Canada Handbook, supra n. 10, at xi.
[72] Canada Handbook, supra n. 10, at xi.
[73] Canada Handbook, supra n. 10, at xi.
[74] Australian Customs Service (2000), *Factsheet: Rules of Origin*: http://www.customs.gov.au/webdata/resources/files/commer08.pdf , November 2000.
[75] Australian Customs Service, supra n. 92.
[76] Australian Customs Service, supra n. 92.
[77] Ministry of Foreign Affairs, supra n. 17.
[78] Ministry of Foreign Affairs, supra n. 17.
[79] Ministry of Foreign Affairs, supra n. 17.

COMPARATIVE ASSESSMENT OF COMPLIANCE MECHANISMS

EU	Stringent ("exceptional circumstances", "reasonable doubt")
US	Public Monitoring; Burdensome CNL Waiver Process
CAN	Exporter must identify Importer
AUS	Burden shifted to Importer
JAP	Flexible ("any competent authority", "origins are evident", "any other substantiating document")

6. *Graduation*

GSP donors may institute a system for removing beneficiary countries from GSP eligibility, known as 'graduation'. However, these systems vary in the frequency of review and criteria for removal. The European Commission views graduation as a vital mechanism toward ensuring that GSP benefits are targeted on those countries most in need of them, in order to expand their exports to the EU and thus support development.[80] The Commission has indicated that graduation will remain an important feature of the EU GSP, and will continue to be based on beneficiary countries' relative performance on the EU market for certain groups of products.[81] The current EU graduation framework implements graduation on both a country-specific and product basis, though the latter has been simplified to encompass broad categories of products. For example, products falling under section S-IX of the EU's Combined Nomenclature system ("Wood and articles of wood") are ineligible for GSP benefits when they originate from China or Brazil.[82] This form of graduation occurs when the value of GSP-covered products in the relevant Combined Nomenclature section imported from a country exceeds 15% of the total imports of the same products from all GSP beneficiary countries to the EU over three consecutive years.[83] This threshold is reduced to 12.5% for textiles.[84] Country-specific graduation is based on two

[80] EU Trade Commissioner Peter Mandelson said: "The continuation of GSP will ensure stability and predictability for beneficiaries and traders in the EU and developing countries. GSP is a vital tool of our pro-development EU trade policy." See European Union agrees to maintain trade preferences for developing countries, available at *eeas.europa.eu/delegations/india/.../eu.../022_06_tariff_preferences_en.pdf*

[81] Delegations, supra n. 69.

[82] EU Handbook, supra n. 4, at 7.

[83] EU Handbook, supra n. 4, at 8.

[84] EU Handbook, supra n. 4, at 8.

criteria. A country graduates if, during three consecutive years, it is classified by the World Bank as a 'high-income country' and imports to the EU from its five largest product sections constitute less than 75% of the value of its total GSP-covered imports to the EU.[85] Graduation currently applies only to GSP and GSP+ preferences. LDC access under the EBA program is not at all affected.[86]

Within the U.S. graduation framework, the President may withdraw or suspend duty-free treatment for any BDC at any time.[87] 'Mandatory' graduation occurs when the President determines that a beneficiary country is a 'high-income country' as defined by the domestic U.S. GSP statute.[88] This is based on World Bank statistics: per capita GNP, with a threshold at the lower end of the World Bank's standard for "high income" countries ($11,116 in 2006).[89] Mandatory graduation occurs January 1 of the second year after the year in which the President makes a determination of graduation. Discretionary graduation may occur after a review of a BDC's advances in economic development and trade competitiveness.[90] The relevant factors for discretionary graduation include a country's general level of development, trade competitiveness, labor rights violations, overall U.S. economic interests, and a catch-all denoted as "any other relevant information".[91]

Canada has no formal review mechanism in place to regularly determine country-specific graduation.[92] This lack of a frequent review mechanism—coupled with Canada's standard 10 year cycle for legislative GSP revision—explains Canada's continued inclusion of beneficiary countries such as Hong Kong and Singapore, which the other donors under review have eliminated from GSP coverage. Nevertheless, Canada has implemented a form of *ad hoc* graduation by removing states from eligibility after their accession to the EU. Moreover, while Canada provides duty-free access for all products from LDCs (including textile and apparel

[85] EU Handbook, supra n. 4, at 7.
[86] Trade Regimes Applicable to Developing Countries, available at *www.europarl.europa.**eu**/ftu/pdf/en//FTU_6.5.2.pdf*
[87] U.S. Handbook, supra n. 6, at 114.
[88] U.S. Handbook, supra n. 6, at 9.
[89] U.S. Handbook, supra n. 6, at 8.
[90] U.S. Handbook, supra n. 6, at 112.
[91] U.S. Handbook, supra n. 6, at 9.
[92] http://www.gazette.gc.ca/archives/p1/2007/2007-04-28/pdf/g1-14117.pdf; see also Anthony, Daniel. "Unilateral Preferential Trade Programs Offered by the United States, the European Union and Canada: A Comparison". The Trade Partnership, Dec. 2008, USA.

products), standard developing countries may experience indirect graduation on a product-specific basis (such as in the event of an import surge (see prior section on product coverage).

Australia may graduate beneficiaries on the basis of income and competitiveness.[93] Notably, in 1991, Australia effectively phased out its Asia-focused beneficiary group by graduating Singapore, Taipei, Hong Kong and South Korea on this basis.[94] Similarly, Australia has phased out benefits for China, to which the 1995 Customs Tariff Act originally allotted benefits under a sub-division of its 'developing countries' group.[95]

Graduation in the Japanese GSP program occurs once the World Bank officially classifies a beneficiary country's economy as "high income" for three consecutive years.[96] Japan also implements a partial graduation program, permitting revocation of preferences on a product-by-product basis.[97] Partial graduation begins when a beneficiary's exports of a product to Japan exceed 25% of the world's exports of the product to Japan and amount to more than 1 billion yen.[98]

NON-LDC BENEFICIARY GRADUATION STANDARDS

EU	Graduation if 3 Yrs. 'High Income' and hits Proportional Import Threshold
US	Mandatory Graduation if 'High Income'; Broad Discretionary Graduation
CAN	No Formal Mechanism
AUS	Graduation based on Income and Competitiveness
JAP	Graduation if 3 Years 'High Income'

7. *Conditionality*

[93] Center for Global Development, supra n.37 , at 11.
[94] Center for Global Development, supra n. 37, at 11.
[95] Customs Tariff Schedule 1/3, R.7 Section 12 (annex to 1995 Customs Tariff Act).
[96] Ministry of Foreign Affairs, supra n. 17.
[97] Ministry of Foreign Affairs, supra n. 17.
[98] Ministry of Foreign Affairs, supra n. 17.

Conditionality in this sense refers to non-graduation criteria by which the donor country may suspend GSP eligibility for countries that violate such standards. These conditions are categorized separately from the typical economic criteria that donors use to categorize beneficiaries; indeed, they generally do not have immediately recognizable connections to international trade. Not all donors employ these 'conditionality' factors. As such, Australia and Canada's purely economic criteria for GSP eligibility are discussed in the section on 'Beneficiary Categories', *supra*.

The EU GSP and GSP+ benefits can currently be suspended for "the serious and systematic violation of principles" laid down in 8 ILO core labour rights conventions and 8 U.N. core human rights conventions.[99] Temporary withdrawal is not automatic, but instead requires that the Commission follow a regulatory process of consultation, investigation, and published findings.[100] For example, the EU's 2010 suspension of Sri Lanka from GSP+ benefits arose from human rights violations, but provided Sri Lanka a six-month window to avoid suspension by taking positive actions.[101] It is worth noting that the EU Commission's recently proposed GSP revisions would clarify that reporting convention compliance for the purpose of GSP+ eligibility is a beneficiary state obligation, subject to the Commission's satisfaction upon biannual review.[102]

The U.S. has designed a complex conditionality system, wherein the President reviews GSP eligibility using two distinct lists of conditionality criteria: a "mandatory" list applicable to all BDCs, and a 'discretionary' list that grants flexibility in maintaining or removing beneficiary status. While *EC-Tariffs* does not directly bind U.S. practice, any challenge to these conditionality criteria would hinge on whether such criteria are reciprocal or discriminatory. Conditionality criteria on the 'mandatory' list include prohibitions against countries that: practice state communism, withhold supplies of vital commodity resources from international trade, grant preferential treatment that is likely to have a significantly adverse effect on U.S.

[99] EU Handbook, supra n. 4, at 16.
[100] EU Handbook, supra n. 4, at 17.
[101] EU Policy web page on Sri Lanka, available at http://eeas.europa.eu/sri_lanka/index_en.htm
[102] European Commission, COM(2011) 241 final 2011/0117 (COD), Proposal for a Regulation of the European Parliament and of the Council applying a scheme of generalised tariff preferences, SEC(2011) 536 final, SEC(2011) 537 final, 10.5.2011.

commerce, expropriate U.S. citizens' assets, fail to recognize or enforce arbitral awards favoring U.S. citizens, aid or abet international terrorism, refuse to recognize workers' rights, or practice the worst forms of child labor.[103] It is through these mandatory conditions—particularly the first factor concerning state communism—that the U.S. targets and excludes China from GSP benefits, without any facially discriminatory or subjective language. The prohibition on communism includes caveats that not only reinforces this condition's link to trade concerns but also deflects concerns over subjectivity, as its Cold War terminology ("international communism") implies a U.S. legislative intent far beyond China's borders:

> "A GSP beneficiary may not be a Communist country, unless such country receives Normal Trade Relations (NTR) treatment, is a WTO member and a member of the International Monetary Fund (IMF), and is not dominated by international communism."[104]

By contrast, conditionality criteria on the "discretionary" list include more directly trade-related factors, such as: a country's expression of its desire for GSP beneficiary designation, a country's level of economic development (including per capita GNP, living standards, or any other economic factors), whether a country receives GSP benefits from other major developed countries, the extent to which a country has assured the U.S. that it will provide equitable and reasonable access to its markets and basic commodity resources, the extent to which a country provides adequate and effective protection of intellectual property rights, the extent to which a country has taken action to reduce trade distorting investment practices and policies, and whether a country has taken (or is taking steps) to afford internationally recognized worker rights.[105]

As stated above, Canada and Australia's criteria for beneficiary eligibility are not forms of conditionality *per se*, and therefore are discussed more appropriately in the section on 'Beneficiary Categories', *supra*. Nevertheless, Canada has exercised a form of *ad hoc* conditionality by removing Belarus from eligibility (on human rights

[103] U.S. Handbook, supra n. 4.
[104] 19 U.S.C. § 2462(b)(2).
[105] U.S. Handbook, supra n. 4.

grounds) through Council Order, which is also how Canada has removed states from eligibility upon accession to the EU (see section on 'Graduation', *supra*).

By contrast, while Japan also imposes certain conditions on the application of its GSP, its conditions are generally 'inward-looking'. The fundamental objective of such conditions is to prevent GSP imports from harming Japan's domestic industry. It remains uncommon for Japan to take non-trade elements—or even labor standards—into account when crafting trade policy.[106] Instead, Japan's annual GSP review focuses on the domestic competitiveness of imported products. Japan excludes "highly competitive" products from GSP treatment for three years when—over the prior three years—such a product accounts for more than 50% of its import from the world to Japan, and amounts to over 1.5 billion yen.[107] LDCs, however, are immune from this product exclusion review.

GSP CONDITIONALITY SUMMARIES

EU	GSP & GSP+ may be suspended for 'serious and systematic violation of [UN/ILO] principles' >> Sri Lanka
US	Economic factors fall under 'Discretionary List'; Social factors fall under 'Mandatory List' >> China
CAN	Ad hoc >> Belarus. See also 'Beneficiary Categories'
AUS	See also 'Beneficiary Categories'
JAP	Focus on competitiveness of domestic products ('highly competitive' products excluded)

8. ***Erosion of Preferential GSP Margins***

Beneficiary countries that are also contracting Parties to PTAs, FTAs or RTAs with a GSP donor may receive comparable preferences under those arrangements. Thus, these countries may be less willing to endure the compliance burdens and periodic uncertainties of certain GSP programs. Furthermore, as countries have negotiated decreases in tariff ceilings over the last two decades, reduced tariff rates under GSP

[106] See, cf, Ministry of Foreign Affairs, supra n. 17.
[107] Ministry of Foreign Affairs, supra n. 17.

programs have in turn lost varying degrees of preference over the standard MFN tariff rate. These factors in preference erosion merit separate analyses.

a. *Erosion associated with the Proliferation of Trade Agreements*

As discussed earlier, the U.S. in particular has supported the proliferation of trade blocs through its regionally-focused GSP cumulation rules. Beyond its GSP, however, the U.S. has unilaterally enacted trade schemes focused on LDC regions, such as the African Growth and Opportunity Act (AGOA), Andean Trade Preference Act (ATPA), and Caribbean Basin Intiative (CBI). As such, U.S. GSP beneficiary countries in these regions may receive two competing beneficiary rates on many products exported to the U.S. This in turn reduces the value that the U.S. GSP holds for those double-beneficiaries.

Such U.S. trade schemes justify discrimination between AGOA and non-AGOA LDCs on the basis of a WTO waiver of MFN provisions.[108] For this reason, such programs are not dependent on the Enabling Clause, and thus are not a component of the U.S. GSP (as opposed to the EU's GSP+ scheme, which distinguishes between preference categories under the Enabling clause, as no such WTO waiver has been issued). Nonetheless, the parallel existence of the U.S. GSP and trade schemes such as AGOA demonstrates the fragmentation of trade policies--and resulting erosion of preferences--since the inception of GSP.

The U.S. is not alone subject to this concern. Canada currently maintains parallel customs treatment for Latin American countries under both its GSP and RTAs.[109] FTAs currently under consideration in Australia include countries that also benefit from non-reciprocal GSP preferential access to the Australian market.[110] The Japanese GSP framework particularly suffers a significant erosion of preferences, due to the conclusion of FTAs with GSP beneficiaries (including Latin American countries such as Mexico and Chile, as well as ASEAN countries). Yet Japan's GSP creates no bar against simultaneously partnering with Japan through a FTA or RTA. Instead, Japan

[108] GATT Article 1:1.
[109] See Pacific Economic Cooperation Council, Implications for the Multilateral Trading System of the New Preferential Trading Arrangements in the Asia Pacific Region (November 11-12, 2002).
[110] See OECD Trade Directorate, supra n. 13.

has lowered its MFN tariff rates and granted least-applicable tariffs to partners with whom it has a GSP and FTA relationship governing the same product. Japan's foray into regionalism is thus a prime example of the erosion of trade preferences.

b. *Erosion associated with the Reduction of MFN Tariff Rates*

While the proliferation of trade agreements between GSP donors and beneficiaries threatens erosion of GSP preferences from the bottom-up, the progressive reduction of MFN tariff rates among all WTO Members erodes preferences from the top-down. Unless GSP donors keep up pace with MFN reduction by frequently revising GSP legislation through product-based tariff reductions, comparative savings erode between export to such GSP donors and export to other markets. The U.S. GSP (due to conditionality requirements) and the EU GSP (due to compliance requirements) demonstrate how the various restrictions that GSP donors impose can appear increasingly burdensome to beneficiaries, once the comparative value of GSP participation erodes.

B. Conclusions

The preceding analysis highlights how the tension between development and domestic pressure shapes individual aspects of GSP policy and implementation. Due to its insistence on short-term renewals, the United States' GSP is currently lapsed. Australia has made strides to increase its low GSP utilization rate among LDCs, but has only gone so far as to shift some of the burdens of compliance, rather than remove them. Most critically, all GSP donors discussed above remove groups of products from coverage, due to the politically sensitive nature of those corresponding domestic industries. Therefore, given the constituencies and increased powers of the European Parliament, this particular tension may cast a long shadow over negotiated revisions to the EU's GSP.

GSP ELIGIBILITY CHECKLIST (4 = NOTABLE BENEFICIARY)

	BRAZIL	CHINA	HONG KONG	KOREA	RUSSIA	SINGAPORE
EU	4	4			4	
US	4				4	

CAN	4	4	4	4	4	4
AUS		4				
JAP	4	4				

IV. ECONOMIC ASSESSMENT OF GSP

Since it was first established over thirty years ago, the GSP has been subject to many economic assessments in order to measure its outcomes in comparison to its original purpose. This section seeks to convey the findings of these studies. Firstly, it will present the positive impacts of GSP programs in developing countries. Secondly, the economic critiques will be pointed out, stressing the difficulties and drawbacks for developing countries in benefiting from tariff preferences schemes. Finally, this section concludes that, in order to guarantee GSP´s effectiveness, unilateral preferences should be available for a sufficient length of time, regulated by transparent and predictable mechanisms, and covering products where developing countries are competitive.

A. Positive Effects of GSP

Undoubtedly, developing countries have benefited historically from GSP programs. During the 1980s, the EEC GSP resulted in a significant trade preference, particularly to labour-intensive products, according to a study of 20 beneficiary countries.[111] More updated studies suggest the following:

- Preferences do impact positively on trade flows in an average of 10% to 30% using a gravity model[112] applied over bilateral imports between 183 countries from 1996 to 2008;[113]

[111] André Sapir and Lars Lundberg (1981), Trade Benefits under the EEC Generalized System of Preferences, European Economic Review, 15, 339-55, in Trade Preferences and Differential Treatment of Developing Countries edited by Bernard Hoekman and Caglar Ozden. Glos: EE, 2008. at. 157

[112] It assumes that trade between countries will depend on their respective sizes and income levels, the distance between them, any common cultural/linguistic factors, and then on key policy variables (RTA or common currency). This method assesses the impact of either *differences* in policy or *changes* in policy on flows of goods, services, and investment between countries. Thus, it can assess the aggregate and sectoral impact on trade flows on a given country or country groupings as well as on the impact on trade creation and trade.

[113] Michael Gasiorek, Mid-term Evaluation of the EU's Generalised System of Preferences, CARIS, University of Sussex, 2010, available at http://trade.ec.europa.eu/doclib/docs/2010/may/tradoc_146196.pdf, at.97.

Percentage Change in Aggregate Trade

Scheme	% increase in export to EU
GSP	15.48%
EBA	25.86%
GSP PLUS	29.04%
COTONOU	10.62%

Source: CARIS, University of Sussex, 2010

- The impact of GSP in foreign direct investments (FDI) is positive. A recent study, carried out by the University of Sussex for OECD countries from 1997 to 2007, specifically measures if trade preferences from more developed countries made beneficiaries more suitable as hosts for foreign direct investments. The study found that non-EU countries´ FDI outward stocks have risen between 37% and 179% in EU GSP beneficiary countries.[114]

Moreover, it is noteworthy to mention that least developed countries (LDCs) have received special and broader advantages from GSP such as:

i) Pursuant to the Singapore Ministerial Declaration, on 13 December 1996, WTO Members agreed to undertake the Plan of Action of LDCs by which developed countries grant duty-free-quota-free market access to almost 100% of LDC exports.

ii) On 15 June 1999, the WTO General Council adopted the Decision on Waiver Regarding Preferential Tariff Treatment for LDCs. This general waiver allowed the U.S. and Canada to adopt preferential legislation toward the Caribbean Community (CARICOM), as well as the Canadian Tariff Treatment for Commonwealth Caribbean Countries (CARIBCAN), respectively.

[114] Michael Gasiorek, supra n. 113 at106.

As a matter of fact, the Canadian GSP reform (in 2003) offers the most compelling evidence of the greatest advantages received from the aforementioned extra benefits for LDCs. Canada made two important reforms:

i) it lowered the threshold for locally added value; and ii) allowed accumulation from all developing-country beneficiaries, not just other LDCs. As a consequence, the LDC share of non-oil Canadian imports nearly tripled over the course of a few years.[115]

B. Negative effects of GSP

Some economic studies in the field denounce that GSP programs have not accomplished effectively their original aim of enhancing the economic growth of developing countries. Indeed, these studies argue that GSP has provoked the opposite effects. The main arguments are the following:

1. GSP programs offer no incentive for liberalization in developing countries

Under reciprocal concessions, developing countries face the following scenario:

- They need to grant concessions in order to obtain market access in developed countries in return;
- Exports lobbies will exercise pressure for lower tariffs and the elimination of non-tariff barriers. They will also resist their introduction, because of fear of retaliation in their export markets; and
- Protectionist forces become weaker and export lobby gets stronger as trade policies are liberalized.

By contrast, unilateral concessions shift this dynamic in favour of protectionist policies.[116] As a result, tariffs are likely to be higher because:

[115] Kimberly Ann Elliot, Open Markets for the poorest countries, Center for Global Development, April 2010, available at http://www.cgdev.org/content/publications/details/1423918/, at. 12

[116] Caglar Ozden and Eric Reinhardt (2005), *The Perversity of Preferences: GSP and Developing*

- Developing countries do not gain additional market access by liberalizing their own trade policies;

- As there are no risks of retaliation, export lobby is dormant when it comes to domestic protectionist pressures. Then, export-led industries will be in favour of protectionist measures;[117] and

- For instance, if developing countries restrict imports, given that GSP is non-reciprocal, exporters have nothing to fear and will hence not object (unless they need imports for inputs).

Using a database of annual observations of 154 developing countries since the U.S. started its GSP program in 1976, an empirical study[118], assessing the effectiveness of GSP, found that:

- countries no longer benefiting from GSP subsequently adopted lower trade barriers. For instance, South Korea cut the average nominal tariff by 6 points, four years after being dropped from the U.S. GSP;

- as exports are graduated when becoming more competitive in the donor´s market, developing countries have a perverse incentive to implement more protectionist policies restricting their exports in order to avoid being deprived of the preferences.

- the withdrawal from GSP will stimulate developing countries to reduce these trade barriers.

Under the hypothesis that liberalization drives economic growth, developing countries would be better by dropping GSP programs and entering into a reciprocal bargain.

Country Trade Policies, 1976-2000, Journal of Development Economics, 78 (1), October, 1-21, in Trade Preferences and Differential Treatment of Developing Countries edited by Bernard Hoekman and Caglar Ozden.Glos: EE, 2008. at. 357-358

[117] Richard E. Baldwin nd Frederic Robert-Nicoud, A simple model of the juggernaut effect of trade liberalization, CEP Discussion Paper N 845, January 2008.

[118] Caglar Ozden and Eric Reinhardt, supra n. 116 supra, at 355-356

2. Complex Rules of Origin limit developing countries´ market access

According to the available evidence[119], eligible goods imported from developing countries often do not receive preferences. Indeed, non-LDC rates of utilization of GSP schemes is 50% over the last 15 years and the rate is steadily declining.[120] These studies share the common finding that rules of origin are the main reason for this under- utilization of unilateral tariff preferences[121], because:

- Developing countries´ industries have limited technical capacity to comply with complex rules of origin under GSP; thus it restrains full use of the preferences[122] and concentrates benefits in the most advanced developing countries.[123] For instance, only four beneficiaries (Brazil, Hong Kong, Korea and Taiwan) benefitted from more than 50% of all GSP benefits in 1987.[124] In addition, EBA´s preferences were used only 56% in 2002 (45% in 2001) due to strict rules of origin impeding the utilization of most competitive inputs and suppliers, in spite of the EBA´s broad coverage of products.[125]

- Rules of origin may be very strict giving rise to high compliance costs for developing countries and making it economically less onerous to pay the MFN tariff.[126] For example, exports of textiles and clothing totaling roughly US$ 1.6 billion were levied a 10 % MFN average instead of getting duty-free status. The AGOA faces a similar scenario.[127]

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[119] Gene M. Grossman and Alna O. Sykes, *A Preference for Development: the Law and Economics of GSP*, in WTO Law and Developing Countries edited by George A. Berman and Petros C. Mavroidis. at.274.
[120] UNCTAD, *Trade Preference for LDCs: an early assessment of benefits and possible improvements*, UNCTAD/ITCD/TSB/2003/8, Geneva, 2003 at 7.
[121] UNCTAD, supra n 120 at 106.
[122] Caglar Ozden and Eric Reinhardt supra n. 116 at 357.
[123] Michael Gasiorek, supra n 114 at 83.
[124] Constantine Michalopoulos, *The role of special and differential treatment for developing countries in GATT and the World trade Organization*, 2000, available at http://www.acp-eu-trade.org/library/files/Michalopoulos%20-%20Role%20of%20Special%20and%20Differential%20Treatment%20for%20Deve.pdf .at. 10.
[125] UNCTAD, supra n. 120 at 105
[126] Richard Baldwin and Patrick Low, *Multilateralizing Regionalism: Challenges for the Global Trading System*, New York: Cambridge University, 2009 at 686.
[127] UNCTAD, supra n. 120 at 105.

- Different rules of origin for each GSP program make it more difficult to reach economies of scale, since input requirements may vary according to destination markets.

- They also generate an incentive to import components and intermediate inputs from the preference-granting country, potentially creating economic inefficiency and trade diversion.[128]

Finally, the assessments shared conclusion that rules of origin need to be simplified taking into account the developing countries´ realities. Indeed, they emphasize that the success of GSP programs mainly depends on this amendment.

3. GSP coverage does not promote export diversification in developing states

Most GSP programs cover raw material exports while maintaining MFN duties for finished goods, such as textiles and apparel, preventing developing countries from diversifying their export offers in manufactured goods.[129] This factor may:

- significantly reduce the value and the impact of the unilateral preferences, insofar as a reduced fraction of their exports are eligible.[130]

- foster overinvestment in eligible sectors and encourage expansion of output at non-sustainable economical levels.[131]

- encourage a perverse specialization in industries that only survive because of these preferences.

4. GSP features may add extra risks to direct investment in developing states

The GSP´s aim was to encourage investment decisions in favor of developing countries. Nonetheless, these long-term benefits may be threatened by the unstable environment around these preferences.[132] The reasons are the following:

[128] Bernard Hoekman and Çaglar Özden, *Trade Preferences and Differential Treatment of Developing Countries: A Selective Survey*. World Bank, 2005 at http://www.iadb.org/intal/intalcdi/PE/2007/00313.pdf
[129] Caglar Ozden and Eric Reinhardt supra n. 116 at 357.
[130] UNCTAD,supra n. 120 at85.
[131] Gene M. Grossman and Alna O. Sykes, supra n. 119 at 276.

- donor countries may not renew or extend GSP programs for policy reasons, such as pressure from a donor´s import-competing producers that are jeopardized by a beneficiary´s exports.[133]

- the extension of GSP programs depends on legislative procedures of reauthorization which are never guaranteed.[134]

- GSP may impose arbitrary and nontransparent eligibility conditions.[135] For instance, the U.S. includes conditions relating to beneficiaries' protection of human rights or anti- corruption measures depending on the program, albeit the criteria for their application are often uncertain and unpredictable.

To sum up, these possible scenarios bring considerable commercial fears, diminishing the incentives to invest in eligible sectors. Therefore, unilateral preference programs with a permanent and transparent legal framework shall maximize effectiveness in promoting investment in developing countries.

5. Graduation restrains developing countries´ benefits from GSP

Donors GSP countries impose ceilings on developing countries´ exports when the latter exceed a certain value or import share. As a result, these eligible exports lose the preferential tariffs affecting developing countries[136] as follows:

- graduation has a negligible impact to reallocate the preferences to less developed countries. Indeed, domestic producers in donor countries are more

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[132] R.E. Baldwin and T. Murray (1977), MFN Tariff Reductions and Developing Country Trade Benefits under the GSP, Economic Journal, 87 (345) March 30-46, in Trade Preferences and Differential Treatment of Developing Countries edited by Bernard Hoekman and Caglar Ozden.Glos: EE, 2008. at 158

[133] Caglar Ozden and Eric Reinhardt supra n. 116 at 358.

[134] Jeffrey L Dunoff, *Diversion and the Debate over preferences (How) do Preferential Trade Policies Works?*, in Developed Countries in the WTO Legal System edited by Chantal Thomas and Joel P Trachtman. New York: Oxford University Press, 2009 at 52-53

[135] Kimberly Ann Elliot, *Open markets for the poorest countries, Center for Global Development,* April 2010. Available at http://www.cgdev.org/content/publications/detail/1423918/ at13

[136] James Devault (1996), *"Competitive Need Limits and the U.S. Generalized System of Preference"*, Comtemporary Economic Policy, XIV, October, 58-66 in Trade Preferences and Differential Treatment of Developing Countries edited by Bernard Hoekman and Caglar Ozden.Glos: EE, 2008 at 230-238

often the principal beneficiaries of these restrictions, especially when the import share of the affected product is high.[137]

- Graduation discourages competitiveness in developing countries insofar as they have exhibited competitive advantage.[138]

6. GSP encourages the proliferation of RTAs

As mentioned above, unilateral preferences are inherently unstable because donor countries enjoy full discretion in the establishment and variation of the GSP´s requirements. In addition, as developing countries´ imports become more competitive, they can be excluded from the preferences.

Therefore, in order to address these drawbacks, developing countries might seek to enter into RTA negotiations with developed countries in order to have reciprocal and stable preferences. Unlike unilateral preferences, RTAs are reciprocal agreements which cannot be unilaterally changed where both counterparts, developed and developing countries are supposed to open their markets.

However, in spite of its reciprocity, RTAs may replicate the same weaknesses of GSP, such as the impracticability to comply with complex rules of origin by developing countries.[139]

Furthermore, developed countries take RTAs as an opportunity to address issues not agreed yet at the multilateral level such as labour, environment, government procurement and competition. As a consequence, developed countries loss their willingness to reduce tariff and advance in deeper liberalization at the multilateral level.[140]

7. Erosion of the preferences

The value of the unilateral preferences has been further diminished by two following phenomena in the context of international trade:

[137] James Devault supra n. 136 at 230-238
[138] James Devault , supra n. 136 at 230-238
[139] Jeffrey L Dunoff, supra n. 134 at. 63-64.
[140] Jeffrey L Dunoff, supra n. 134 at 230-238.

a) Multilateral MFN reductions have eroded preference margins after the Uruguay Round. For instance, U.S. tariff rates, which averaged 5.4% on industrial products before the Uruguay Round, have been reduced to 3.5%. Moreover, many developing countries´ exports obtain duty-free or very low duty access under the general MFN tariffs. For example, even though Afghanistan is an EBA country, nearly 93 % of its exports to the EU enjoy of duty-free at MFN basis.[141]

b) RTAs between developed and developing countries provide deeper and more secure preferences, as explained above.[142] Therefore, it may create trade diversion because the donor country can substitute imports from the preferred sources for imports from the non-preferred.[143]

As a result, this erosion of preferential tariff margins represents the loss of the developing countries' margin benefits from GSP in comparison with the MFN applied to non-beneficiary country exports.[144] Therefore, developing countries would benefit more from MFN tariff cuts than the eroded GSP.[145]

C. Conclusions

GSP programs have been beneficial for the economic growth of developing countries. These programs have increased trade flows between developed and developing countries, as well as FDI in developing countries. Moreover, the benefits have been greater for LDCs countries which enjoy more preferential treatment. Nevertheless, GSP programs have not displayed their whole potential because of structural weaknesses related to length, coverage and legal framework, including rules of origin. By this token, these preferences should be available for a sufficient length of time, regulated by transparent and predictable mechanisms, and covering products where developing countries are competitive in order to guarantee GSP´s effectiveness. It is important to bear in mind that GSP is useful for the economic growth of developing

[141] UNCTAD, supra n. 120 at 190.
[142] Constantine Michalopoulos, supra n. at. 24.
[143] André Sapir and Lars Lundberg, supra n 11 at 146.
[144] R.E. Baldwin and T. Murray (1977), supra n. 132 at 40.
[145] R.E. Baldwin and T. Murray,supra n. 132 at 44.

countries when applied under appropriate conditions. Therefore, the aim of developed countries should be to improve their scheme, rather than withdraw them.

Positive Effects	Negative Effects
▪ Preferences do impact positively on trade flows in an average of 10% to 30%	▪ GSP programs offer no incentive for liberalization in developing countries
▪ The impact of GSP in foreign direct investments (FDI) is positive.	▪ Complex Rules of Origin limit developing countries´ market access
▪ Developed countries grant duty-free-quota-free market access to almost 100% of LDC´s exports pursuant to the Singapore Ministerial Declaration	▪ The GSP´s product coverage does not promote export diversification in developing countries
▪ The WTO Decision on Waiver Regarding Preferential Tariff Treatment for LDCs allows implementing programs (such as CARICOM and CARIBCAN)	▪ Some GSP´s features may add extra risks to direct investment in developing countries
▪ Example: After the Canadian GSP reform (2003), the LDC share of non-oil Canadian imports nearly tripled, over a few years.	▪ Graduation restrains developing countries´ benefits from GSP ▪ GSP encourages the proliferation of RTAs ▪ Erosion of the preferences

V. LEGAL GSP ANALYSIS

A. Introduction

Any GSP program entails tariff discrimination by the preference-granting country. Therefore a certain degree of derogation is required from the legal prohibition on discrimination amongst WTO members known as the most-favoured nation ("MFN") rule.[146] This section analyses the rules setting the parameters of such derogation under current WTO rules and cases with particular reference to the following questions:

- to what extent can preference-granting countries differentiate between GSP beneficiaries?

- are preference-granting countries under an obligation to accept as beneficiaries those countries that declare themselves to be 'developing countries'?

- in so far as differentiation between beneficiaries occurs on the basis of conditions to the grant of preferences, what degree and form of reciprocity is permissible under the WTO regime?

- to what extent can GSP programs carve out products or major industry sectors?

As will be discussed below, there are still some grey areas in the interpretation and application of the relevant WTO rules that call for caution in the formulation of GSP programs. These yet untested aspects of existing GSP programs may arguably challenge the parameters established under the WTO regime or at the very least raise further questions relevant to the reform and improvement of GSP programs.

To conclude our legal GSP analysis, this section goes on to apply the relevant WTO

[146] See Article I:1 of GATT.

rules to a hypothetical condition granting tariff preferences to developing countries that do not impose export restrictions on raw materials.

B. Legal Basis for GSP Programs

The WTO rules applicable to GSP are set out in the "Enabling Clause" provided by 1979 GATT decision[147] (now part of GATT 1994[148]) which legitimized GSP beyond its provisional term under the GATT 1971 waiver.

The Enabling Clause essentially provides that MFN Article 1 is not applicable to the grant of tariff preferences by developed countries to developing countries under GSP programs[149]. This allows a certain degree of discrimination amongst WTO members but is subject to a number of requirements as interpreted by the Appellate Body in the only WTO case regarding GSP [150], analyzed in section D below.

C. Legal status of Enabling Clause and burden of proof

The requirements of the Enabling Clause constitute a binding legal obligation upon WTO members [151]. Secondly, the Enabling Clause is an "exception" to Article 1 of GATT 1994 but "not a typical exception."[152]

This means that in case of a dispute regarding the application of the Enabling Clause to a GSP program, the complainant needs to identify those provisions of the Enabling Clause "with which the program is allegedly inconsistent, without bearing the burden of establishing the facts necessary to support such inconsistency".[153] That burden of proof relates only to issues of fact and not law and rests on the responding party relying on the Enabling Clause as a defence.[154] In such case, the responding party must provide sufficient evidence to demonstrate that the measure in question complies

[147] GATT Document, Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries ("Enabling Clause"), Decision of 28 November 1979, L/4903.
[148] Paragraph 1(b)(iv) of GATT 1994 incorporates "other decisions of the CONTRACTING PARTIES TO GATT 1947".
[149] Paragraph 1 and 2 (a) of the Enabling Clause read together.
[150] *EC –Tariff Preferences* (WT/DS246/AB/R adopted 20 April 2004).
[151] Report of the Appellate Body, paragraph 147.
[152] Report of the Appellate Body, paragraph 106.
[153] Report of the Appellate Body, paragraph 115.
[154] Report of the Appellate Body, paragraph 115

with the requirements of the Enabling Clause (rather than providing the legal interpretation to be given to a particular provision of the Enabling Clause).[155] For example, if the EU was challenged by China regarding preferential tariff treatment under its GSP, it would be for the EU to produce evidence that this treatment was in fact consistent with the provisions of the Enabling Clause that China alleges it violates.

D. Legal requirements for GSP programs under the Enabling Clause

The preferential tariff treatment accorded by developed countries to products originating in developing countries under the GSP must:

(i) be **generalized:** GSP preferences should "apply more generally; [or] become more extended in application"[156]. However in light of the historical background to the negotiation of GSP, 'generalized' also has a more specific meaning that is aimed at eliminating the special preferences that existed between developed countries and their former colonies[157]. "The term 'generalized' requires that GSP programs of preference-granting countries remain generally applicable";[158]

(ii) be **non-reciprocal:** preference-granting countries must not demand reciprocal concessions;

(iii) be **non-discriminatory:**[159] this does not mean that identical tariff preferences must be granted to all beneficiaries. Preference-granting countries may differentiate between developing countries based on different development contexts but subject to the following conditions:

(a) the differentiation between beneficiaries is made on the basis of their development, financial and trade needs and that tariff preferences under GSP

[155] Report of the Appellate Body, paragraph 104 and 105. This is significant for preference-granting countries in that proving compliance with the Enabling Clause even if only from a factual rather than legal perspective may prove a difficult burden to carry in light of the complexities surrounding the application of the Enabling Clause analyzed below.
[156] Report of the Appellate Body, paragraph 155.
[157] Report of the Appellate Body, paragraph 164.
[158] Report of the Appellate Body, paragraph 156.
[159] Footnote 3 to paragraph 2(a) of the Enabling Clause.

programs are made **available to all beneficiaries that share that need.** GSP programs whose procedures for beneficiary selection lack criteria or standards as a basis for distinguishing amongst beneficiaries will not satisfy paragraph 2(a) of the Enabling Clause. The fact that the EU granted additional preferences to a 'closed list' of beneficiaries, set without reference to clear criteria and incapable of being revised, was the fatal flaw that led the Appellate Body to determine its GSP program to be discriminatory;[160]

(b) the existence of a development, financial and trade need is to be assessed according to an **objective standard**. Broad-based recognition of a particular need, set out in the WTO Agreement or in multilateral instruments adopted by international organizations could serve as such a standard;[161]

(c) a **sufficient nexus** must exist between on the one hand, the preferential tariff treatment provided by the developed country and the likelihood of alleviating the relevant development, financial or trade need, meaning that the preferential treatment must designed to have a **positive effect on the improvement** of the development, financial or trade needs attributed to the group of beneficiaries that share those needs. It follows that "the particular need at issue must, by its nature, be such that it can be effectively addressed through tariff preferences";[162]

(iv) be **mutually acceptable** (i.e. capable or worthy of being accepted rather than mutually

[160] Report of the Appellate Body paragraph 165. GSP programs whose procedures for beneficiary selection lack criteria or standards as a basis for distinguishing amongst beneficiaries will not satisfy paragraph 2(a) of the Enabling Clause. The fact that the EU granted additional preferences to a 'closed list' of beneficiaries was the fatal flaw that led the Appellate Body to determine its GSP program to be discriminatory. As a result the EU offered a new preferential tariff program (GSP+) to those developing countries considered "vulnerable" in terms of its size or the limited diversification in its exports. Poor diversification and dependence is defined as meaning that the five largest sections of a country's GSP-covered imports to the EU must represent more than 75% of its total GSP-covered imports. GSP-covered imports from that country must also represent less than 1% of total EU imports under GSP. GSP+ beneficiaries must also have ratified and effectively implemented 27 specified international conventions in the fields of human rights, core labour standards, sustainable development and good governance. The list of countries that qualify for GSP+ preferences is reviewed bi-annually.

[161] Report of the Appellate Body paragraph 163.

[162] Report of the Appellate Body paragraph 164 and as required under paragraph 3(c) of the Enabling Clause.

accepted);[163]

(v) 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 **other WTO members**;[164] and

(vi) not be an obstacle to the **reduction or elimination of tariffs** or other t**rade restrictions under MFN**.[165]

E. Legal requirements under Article 23 of DSU

Pursuant to Article 23 of the DSU, any conditionality attached to the grant of preferential tariff treatment under a GSP program **should not seek to redress a WTO violation.** Article 23 of the DSU imposes an obligation on WTO members to have exclusive recourse and abide by the rules and procedures of the DSU, i.e. not to undertake any kind of unilateral retaliation against other WTO member. "Seeking redress of a violation" under Article 23 of DSU has been interpreted to render "any WTO suspension of concessions or other obligations without prior DSB authorization is explicitly prohibited"[166]. Therefore a GSP program that made the grant of preferential tariff treatment conditional upon the beneficiary's withdrawal of trade measures violating or perceived to be violating WTO rules could breach Article 23 of the DSU.[167]

[163] Footnote 3 refers to the Waiver Decision on the Generalized System of Preferences, June 25 1971 which describes preferences not only as "generalized, non-reciprocal and non-discriminatory" but also "mutually acceptable".
[164] Paragraph 3 (a) of the Enabling Clause.
[165] Paragraph 3 (b) of the Enabling Clause.
[166] *US-Certain EC Products,*WT/DS165/13, para 1146, Panel finding not reviewed by the Appellate Body.
[167] In *US-Certain EC Products,*WT/DS165/AB/R adopted on 10 January 2001, paragraph 781 the Appellate Body stated that the term 'redress' implies a reaction by a WTO members against another because of a perceived (or WTO determined) WTO violation with a view to remedying a situation.

CHECKLIST OF WTO LEGAL REQUIREMENTS FOR GSP PROGRAMS
Preferential tariff treatment must:
• be of general application (wider than the historic special preferences granted by developed countries to their former colonies);
• be capable or worthy of mutual acceptance (rather than be mutually accepted);
• be non-reciprocal;
• be non-discriminatory: any differentiation amongst developing countries as beneficiaries is made on the basis of individual development, financial and trade needs of beneficiaries;
• be made available to all beneficiaries who share the needs at issue (beware of any procedural conditions that may restrict access to all those beneficiaries);
• be designed to facilitate and promote trade and development of developing countries;
• not create undue difficulties nor raise barriers for other WTO members;
• not impede the reduction or elimination of tariffs and other restrictions on trade on a MFN basis;
• not seek to redress WTO violations (as determined by the WTO or perceived by the preference-granting country).
Development, financial and trade needs addressed by tariff preferences must be:
• assessed in accordance with objective standards (eg. a need identified in the WTO agreement or other multilateral instruments adopted by international organizations);
• capable of being positively/effectively addressed by tariff treatment.

SUMMARY OF *EC-TARIFF* RULINGS	
Panel's findings	• the Enabling Clause operates as an exception to Article I:1 of the GATT 1994 and it does not exclude the applicability of Article I:1 of the GATT 1994 • Legal interpretation of paragraph 2(a) of the Enabling Clause and footnote 3 thereto requires that, in granting differential tariff treatment, preference-granting countries are required, by virtue of the term "non-discriminatory", to ensure that identical treatment is available to all similarly-situated GSP beneficiaries, that is, to all GSP beneficiaries that have the same "development, financial and trade needs" to which the treatment in question is intended to respond.
AB ruling	• AB upheld Panel's finding that Enabling clause is an exception to Article I:1 of the GATT 1994 but reversed its finding on the relationship between the two provision holding that complaining party is obliged not only to claim inconsistency with Article I:1 of the GATT 1994, but also to raise the relevant provisions of the Enabling Clause that the complaining party argues are not satisfied by the challenged measure. • GSP donors may differentiate between beneficiaries (in addition to carve outs for LDCs) in so far that such differentiation is based on objective criteria: all developing countries fulfilling these criteria obtain the same benefits. • The criteria have to be related to the "development, financial or trade needs" of developing countries (reversing reasons for Panel's finding that the EU measure was discriminatory) • The objective standards cannot be any assertion about needs, but "Broad-based recognition of a particular need, set out in the WTO agreement or in multilateral instruments adopted by multilateral organizations, could serve as such a standard." • such discrimination should not impose unjustifiable burdens on other WTO members. • The fact that the EC drug regulation offered benefits only to a 'closed list' of beneficiaries, defined without reference to clear and transparent objectives and incapable of being reviewed, was discriminatory and in violation with the Enabling Clause.
Action taken by EU (in response to AB's ruling)	• EU adopted a new system called 'GSP+'. Under GSP+, additional tariff preferences were provided to countries representing less than one per cent of EC imports under the GSP that 'accept the main international conventions on social and human rights, environmental protection and governance, including the fight against drugs. • List of beneficiaries that fulfilled this condition to be reviewed on a bi-annual basis.

F. Grey areas surrounding the meaning and application of the Enabling Clause in the context of GSP

1. Exclusion of beneficiaries ab initio

It remains unanswered whether the requirement for tariff preferences to be 'generalized' requires GSP programs to cover all developing countries or whether carve outs, beyond that permitted for LDCs, are acceptable from the outset of a GSP scheme.

In its appellant submissions the EU argued that, given the history of the UNCTAD negotiations that led to the establishment of GSP, developed countries would need to recognize 'in general' as beneficiaries those countries that considered themselves as developing countries. However according to the EU, this did not preclude a developed country from deciding to exclude a country *ab initio* on grounds it considered compelling.[168] As the Panel had not made any finding on this point the Appellate Body was not required to and did not express its views. Instead, it based its decision on the requirement of 'non-discrimination' amongst beneficiaries.

Examples of preferential tariff schemes granting extended benefits to specific country groups beyond the LDCs are the EU's preferences for the ACP (Africa, Caribbean, Pacific) countries, USA's special preferences for Africa under the African Growth and Opportunity Act (AGOA), or Norway's special preferences for Botswana and Namibia. However these schemes have been subject to specific waivers in the WTO[169] and therefore the question remains whether, if challenged and in the absence of those waivers, they would meet the '**generalized**' criterion under the Enabling Clause.

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[168] EU's appellant's submissions paragraph 85 and 87 as referred to by the Report of Appellate Body paragraph 22.

[169] Waivers are commonly applied for by developed countries seeking to confine tariff preferences to a limited number of developing countries located in a certain geographical region. The US has a waiver for its *Caribbean Basin Economic Recovery Act 1984*, 19 USC §§ 2701–2 (2000): see *United States — Caribbean Basin Economic Recovery Act*, GATT BISD, 31st Supp, 20, GATT Doc L/5779 (1985) (Waiver Decision, adopted on 15 February 1985, renewed on 15 November 1995). The US also has a waiver for its *Andean Trade Preference Act 1991*, 19 USC §§ 3201–6 (2002): see *United States — Andean Trade Preference Act*, GATT BISD, 39th Supp, 385, GATT Doc L/6991 (1992) (Waiver Decision, adopted on 19 March 1992, renewed on 14 October 1996). The EC has a waiver for its *Partnership Agreement between the African, Caribbean and Pacific Group of States, of the One Part, and the European Community and Its Member States, of the Other Part*, opened for signature 23 June 2000, [2000] OJ L 317, 3 (entered into force 1 April 2003): see *European Communities — The ACP–EC Partnership Agreement*, WTO Doc WT/MIN(01)/15 (2001) (Waiver Decision, adopted on 14 November 2001).

2. Product coverage limitations

Product coverage could be and is used as a way to differentiate between beneficiaries. As discussed above, some GSP programs (for example the GSP programs of Japan and the US) make extensive exclusion of specific import-sensitive products. It is not clear to what extent these exclusions are consistent with the obligation to provide 'generalized' tariff preferences pursuant to the Enabling Clause.

The Appellate Body did not address this question but the Panel examined the drafting history in UNCTAD that led to the 'Agreed Conclusions', i.e. the mutually acceptable arrangements referred to in the 1971 Waiver Decision on GSP. The Panel concluded that GSP programs should provide product coverage [and tariff cuts] "at levels in general no less than those offered and accepted in the Agreed Conclusions"[170], subject to limited exceptions.

For the Panel, the practice of preference-granting countries in the implementation of GSP schemes illustrated that **the general level of product coverage and depth of tariff cuts should not be reduced**. Conversely the requirement of the Enabling Clause to respond positively to the development, financial and trade needs of developing countries did not exclude but rather "encouraged **further improvements in the levels of product coverage** and depth of tariff cuts commensurate with development needs of developing countries".[171]

The exceptions (safeguard mechanisms) to product coverage levels referred to in the Agreed Conclusions are:

(i) *a priori* limitations on imports from developing countries, such as import ceilings;[172] and

[170] I.e., all industrial semi-manufactured and manufactured products as described in chapters 25-99 of the Brussels Nomenclature; other products, including agricultural products in chapters 1-24 could be included on a case-by-case basis in the form of positive lists provided by donor countries; and donor countries could make limited exceptions.

[171] See Panel Report at paragraph 7.99.

[172] Example of *a priori* limitations is that of the 1970 EEC GSP scheme that provided an import ceiling on preferential imports of a given product from a single developing country of 50 percent of the ceiling fixed for that product. Import ceilings are measures to exclude certain imports originating in individual developing countries where the products concerned reached a certain competitive level in the market of

(ii) escape-clause measures for the purpose of retaining a certain degree of control over the trade which may be generated by new tariff advantages.[173]

The Agreed Conclusions also state that:

- preference giving countries have the right to make changes in the application as in the scope of their safeguard measures, limit or withdraw entirely or partly some of the tariff advantages granted;

- safeguard measures should remain exceptional and are decided on only after taking due account in so far as their legal provisions permit, of the aims of the generalized system and the general interests of developing countries.

The Panel's conclusion on the legality of *a priori* limitations and escape-clause type safeguard mechanisms[174] was that:

- *a priori* limitations are applicable to all beneficiaries without differentiation so have no bearing limitations on whether preferential tariff treatment is non-discriminatory[175];

- escape clause type safeguard mechanisms are relevant to a GSP program's compatibility with the Enabling Clause. Their compliance with the Enabling Clause 'is a matter that can only be decided in light of the particular factual setting of the measure'[176](which was not raised as an issue for Panel's consideration and was therefore not decided upon).

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the preference-giving country. See reference to TD/B/330 Section III in paragraphs 108 and 109 of the Panel Report WT/DS246/R)

[173] TD/B/330 Section III.

[174] In particular, with paragraph 3(c) of the Enabling Clause.

[175] As required under paragraph 3(c) of the Enabling Clause.

[176] See Panel Report at paragraph 7.114.

3. Definition of 'developing countries'

As mentioned above, there are no WTO definitions of "developed" and "developing" countries[177]. Members announce for themselves whether they are "developed" or "developing" countries. Beyond the general concept of developing countries, the only special category accepted is the LDCs, which benefit from various forms of extended preferential treatment. If developed countries grant tariff preferences to developing countries in general, they must accept a country's self-declared 'developing' status. This is not a written rule but practice, derived from the lack of definitions of development, developed and developing in the WTO.

4. Non-reciprocity

Neither the Panel nor the Appellate Body addressed the requirement that tariff preference must be 'non-reciprocal'. The terms 'reciprocity' and 'non-reciprocity' are not defined anywhere in GATT. However, it is arguable that the requirement entails an obligation on developed countries **not to demand developing countries** to make trade contributions. Further developing countries must not be expected to make contributions which are **inconsistent with their individual development, financial and trade needs**[178]. Moreover when dealing with LDCs, developed countries must "exercise the utmost restraint" in seeking any concessions and contributions for commitments made to them to reduce or eliminate tariffs and other barriers to trade; LDCs must not be expected to make concessions or contributions that are inconsistent with the recognition of their particular situation and problems. [179]

5. Meaning of "development, financial and trade needs"

The Appellate Body did not need to decide whether the EU measure at issue positively addressed the development, financial and trade needs of the selected group of developing countries. As the arrangement pursuant to the EU's measure was operated through a 'closed list' of beneficiaries, the regulation lacked any means of removing or

[177] Footnote 1 to paragraph 1 of the Enabling Clause states that 'developing countries' also include 'developing territories'.

[178] As required under paragraphs 5 and 6 of the Enabling Clause. Although these paragraphs deal with requests for reciprocity in the context of "trade negotiations", they may impact conditions of GSP programs in that these may be considered a process of 'negotiation' of sorts (despite dealing with unilateral concessions).

[179] Paragraph 6 of the Enabling Clause.

adding a country from the closed list of beneficiaries. In the view of the Appellate Body there must be a mechanism under which the list of beneficiaries receiving additional preferences can be modified (such that countries can be added to or removed from the list). With regard to the Drug Arrangements, the Appellate Body found that 'by their very terms' the additional preferences were limited to 12 developing countries. There was no mechanism under which additional beneficiaries could be added to the existing list. Moreover, removal from the list could occur for reasons 'not specific to the Drug Arrangements'.[180]Thus the measure was held to be discriminatory and in violation of the Enabling Clause. Therefore there are still some areas of uncertainty relating to this requirement of the Enabling Clause.

(i) *What constitutes a 'development need'?* The Appellate Body ruling as well as the Panel's decision provide no guidance as to the meaning of the term 'development need', other than its existence must be assessed according to an objective standard and the need must be broadly recognized. The concept of 'development' has evolved over time. As evidenced by references to its meaning in a number of international instruments[181] it is plausible to argue that development needs of developing countries go beyond economic progress, thus expanding the range of needs that GSP conditionality may address, subject to the other WTO requirements.

(ii) *What constitutes an 'objective standard'?* As mentioned above, the Appellate Body considered that 'broad based recognition as set out in the WTO Agreement or in multilateral instruments adopted by international organizations could constitute an objective standard to assess the existence of a development need'[182]. It is not clear whether this refers to multilateral instruments that have

[180] See paragraphs 181-184 of the Appellate Body report.
[181] Preamble to the WTO Agreement includes the acknowledgment of the objective of 'sustainable development'. The 1986 UN Declaration on the Right to Development stated the 'development is a comprehensive economic, social, cultural and political process, which aims at the constant improvement of the well-being of the entire population and of all individuals on the basis of their active, free and meaningful participation in development and in their fair distribution of benefits resulting therefrom". The 1987 Brundtland Report added an intergenerational dimension encapsulating the term 'sustainable development'. This was further defined by the 2002 UN Johannesburg Declaration as 'economic development, social development and environmental protection'. Furthermore the UN Development Programme Human Development Index defines human development as 'expanding the choices people have to lead the lives that they value'.
[182] See Appellate Body Report paragraph 165.

> been signed and ratified by beneficiaries of GSP schemes. Regardless of legal ratification, multilateral recognition of a certain goal will provide the basis for asserting the existence of that goal for the purposes of complying with the Enabling Clause. Where a beneficiary country has accepted the relevant international standards on which a GSP condition is based, for example by becoming a party to the relevant international convention or agreement, it would be difficult for a developing country to argue that compliance with the condition is inconsistent with its 'individual development, financial and trade needs'.[183]

Also, the Appellate Body did not give a full definition of what sort of multi-lateral instruments and what kind of international organizations would constitute broad-based recognition. Some multi-lateral instruments are legally binding and others are not: do non- legally binding instruments qualify under the objective standard requirement? Non-legally binding instruments may qualify as much as legally – binding ones insofar as they endorse a development financial or trade need of GSP beneficiaries. Institutions such as the UN, IMF or the World Bank are sufficiently international to qualify under the Appellate Body's test. Beyond those clear-cut examples it is uncertain what types of institutions may qualify. For example, holding developing countries to standards adopted by OECD may be more questionable than those adopted under the UN framework as most developing countries are not party to it. The requirement that GSP conditions must be 'mutually acceptable' (referred to in footnote 3 of paragraph 2(a) of the Enabling Clause mentioned above) would not be met in this instance. Therefore there should be a real correlation between the institution setting the relevant standards through which development needs are assessed and the beneficiary developing countries.

(iii) *How is the causal link between the likely alleviation of the need and preferential tariff treatment to be ascertained?* The requirement is for a 'sufficient nexus' between the likelihood of alleviation of the development, financial or trade need and the preferential tariff treatment. However the Appellate Body did not apply this test to the facts of the case nor did it provide any indication as to possible

[183] These points are raised in general by Lorand Bartels, *The WTO Enabling Clause and Positive conditionality in the European Community's GSP Program*, Journal of International Economic Law 6(2), 507-532, Oxford University Press 2003.

criteria for ascertaining such causal link. It is therefore not clear whether preference-granting countries are required to identify all relevant needs of all GSP beneficiaries and ensure that their trade preferences represent a positive response to those needs at all times. This would entail a duty to re-assess the effect of the preferential treatment upon the need addressed thereby at certain intervals in time. A GSP program could become ineffective over time as circumstances change: would it then become actionable on the basis of the *positive response* requirement? This remains unclear. It seems advisable nevertheless to equip GSP programs with appropriate review mechanisms to ensure they continue to positively respond to the development needs of their beneficiaries.

G. Legal compliance of a hypothetical GSP condition requiring beneficiary countries not to impose restrictions on exports of raw materials ("raw materials condition")

This section considers the legality under WTO rules of a hypothetical raw materials condition. This could be phrased as follows: the grant of additional preferential tariff treatment is offered to products originating from those developing countries that do not impose any restrictions on exportation permitted by WTO rules and protocols but which nevertheless have distortive effects on trade (Raw materials condition **"**Option A"). This condition would be 'non-discriminatory' insofar as it addresses a need shared by all developing countries, i.e. the need to liberalize their international trade. Export barriers distort international trade and therefore affect business opportunities, conditions of competition and investment decisions such as foreign inward investment, generating long-term obstacles to economic development. The need to liberalize exportation in recognized by the WTO Agreement albeit certain export restrictions (such as export taxes) are generally permitted. As mentioned, the Appellate Body specifically mentioned the WTO Agreement as a multilateral instrument that would provide the 'objective standard' basis for the existence of development, trade or financial needs of GSP beneficiaries.

The proposed draft raw materials conditions would only refer to the absence of export

restrictions that are permitted by WTO rules/protocols. This is to prevent the conditions from breaching Article 23 of the DSU. As mentioned above, Article 23 of the DSU precludes WTO members from seeking unilateral redress of WTO violations (interpreted by the Panel as WTO determined or perceived breaches). Moreover, given the ongoing dispute initiated by the US (joined, *inter alia*, by the EU and Mexico) against China in relation to 32 measures imposing restrictions on exports of raw materials allegedly violating WTO rules[184], careful attention should also be paid to ensure that the condition does not appear to be a response to the perceived violation of WTO rules by China in that particular dispute. For example, the raw materials condition should only address new restrictions on exports not part of the restrictions being considered by the WTO Panel under the ongoing proceedings, as in respect of the latter, the EU has already expressed its view that it considers them to be WTO violations.[185] It would also be advisable to conduct any political discussion on a proposed raw materials condition avoiding any statements that may be construed as evidence of the retaliatory purpose of such condition.

The main hurdle for the raw materials condition is that of satisfying the requirement that any preferential treatment granted under GSP be 'non-reciprocal'. As discussed there is no definition of this term in the GATT nor was the requirement fully clarified by the case of *EC-Tariff Preferences*. It can be concluded from that case that a certain degree of reciprocity is permissible in so far as it positively responds to development, trade or financial needs of beneficiaries.

However the compatibility of this condition with the requirement of non-reciprocity is weak. This is because the grant of preferential tariff treatment would be conditional on the absence or withdrawal of trade measures by developing countries, which could arguable constitute a requirement for a reciprocal trade concession. On the other hand, it could be argued that the condition is not an equal or reciprocal trade concession in that what is asked of beneficiaries (i.e. being limited to export restrictions only) is far below what the donor country is offering to them. In any event, even a lower level of

[185] This was the reason why the Panel decided that an EU Regulation was in breach of Article 23 (1) DSU as it was enacted to seek unilateral redress for rights under a WTO agreement, Panel Report, *EC–Measures Affecting Trade in Commercial Vessels*, WT/DS301/R adopted on 20 June 2005, paragraph 7.216.

reciprocity would need to be consistent with the improvement of the identified development financial or trade need (e.g, liberalization of export trade). An argument to support the compliance of the raw materials condition with this requirement would be that the grant of additional preferential tariff treatment under the condition acts as an incentive to eliminate trade barriers therefore aiding the beneficiary's economic development. However, it is possible that such an incentive will not be deemed to constitute to have sufficiently 'positive effect' on the improvement of the development trade or financial need, if the required nexus between the preferential tariff treatment and the improvement of the identified financial development or trade need cannot be established.

Another possible option would be to make the grant of additional preferential tariff treatment available to those developing countries that promote the liberalization of clean technology by eliminating export restrictions on clean technology inputs (i.e. to include those raw materials essential for the development of clean technology) ("Option B") that do not violate WTO rules. The dissemination of clean technology is part of the international initiatives undertaken under multilateral instruments such as the UN Framework Convention on Climate Change which developing countries are signatories of as well as the Doha Negotiation Round[186] aimed at promoting sustainable development. It could therefore be argued that eliminating export restrictions on these types of raw materials is necessary to sustainable development as such restrictions would hinder the development and dissemination of clean technology. However the same issue of reciprocity applies to this argument as the condition would still be requiring the absence or withdrawal of trade measures.

The requirements of Article 23 of the DSU are relevant to the proposed new draft GSP Regulation by the EU Commission ("EU GSP draft regulation")[187]. In particular Article 19 thereof sets out the reasons that justify the EU's temporary withdrawal of provisions common to all of the GSP schemes it operates. One of these reasons is the "serious and systematic unfair trading practices including those affecting the supply

[186] In particular the Doha Communique' states that "the aims of upholding and safeguarding an open and non-discriminatory multilateral trading system and acting for the protection of the environment and promotion of sustainable development can and must be mutually supportive".

[187] Proposal for a regulation of the European Parliament and of the Council applying a scheme of generalized tariff preferences, COM (2011) 241/5, 2011/0117 (COD), {SEC (2011)536} {SEC (2011)537}, published on 10 May 2011.

of raw materials which have a direct effect on the Union industry and which have not been addressed by the beneficiary country. For those unfair trading practices, which are prohibited or actionable under the WTO Agreements, the application of [Article 19] shall be based on a previous determination to that effect by the competent WTO body".[188] This is interpreted to mean that temporary withdrawals of preferential tariff treatment will only be carried out once the WTO Dispute Settlement Body has made its finding that the beneficiary has violated the WTO rules and the EU is entitled to request retaliation against the beneficiary in question. Should this situation arise, the EU should ensure that the level of retaliation it requests is commensurate with the preferential tariff treatment granted.

In conclusion, the raw materials condition would be unlikely to meet the requirements of the Enabling Clause. A step-by-step application of these requirements to raw materials condition Options A and B is set out below.

[188] Article 19.1(d).

APPLICATION OF WTO REQUIREMENTS TO RAW MATERIALS CONDITIONS		
Requirement	**Compatibility of Option A**	**Compatibility of Option B**
Preferential tariff treatment ("PTT") is generalized, i.e. of general application;	Probable if offered to all developing countries that comply with condition and in relation to same level of product coverage as in UNCTAD Agreed Conclusions.	See Option A.
PTT is capable or worthy of being mutually accepted	Arguably yes, developing countries would benefit from PTT and trade liberalization of raw materials	Arguably yes, developing countries would benefit from PTT, trade liberalization of raw materials used in clean technology and the improvements on the promotion of sustainable development that would derive therefrom.
PTT is non-discriminatory: 1. *Beneficiary differentiation is based on individual development, financial and trade needs of beneficiaries.*	1. The individual development financial and trade need addressed by the condition is the need for developing countries to eliminate export barriers and their negative impact on their economic development (i.e. to liberalize trade of raw materials). Export barriers distort international trade, affect business opportunities (such as foreign inward investment in the raw materials industry of the developing country) and cause a lose-lose situation for developing and developed countries.	1. The individual development financial and trade need addressed by the condition is environmental progress and sustainable development. Export restrictions on raw materials necessary for clean technology development.
2. *Existence of such need is assessed according to an objective standard.*	2. The objective to eliminate tariff barriers is widely referenced throughout the WTO Agreement (an objective standard according to the Appellate Body).	2. Many multilateral instruments recognize sustainable development as a global objective and need.[189] Doha Mandate identifies liberalization of environmental goods and services as WTO member international objective.

[189] For instance, the 1972 Rio Declaration on Sustainable Development, the Biodeversity Convention and UN Framework Convention on Climate Change.

3. *PTT positively affects the improvement of the identified need.*	3. Arguably preferential tariff treatment will incentivize beneficiaries to eliminate export barriers. In turn this will improve the competitiveness of beneficiaries' products favoring their economic progress. But this nexus could be deemed too weak if PTT not deemed a sufficient incentive.	3. Possible. Arguably preferential tariff treatment will incentivize liberalization of trade of raw materials used in clean technology. This in turn will improve the dissemination of clean technology (by increasing market access/lowering its price), thus contributing to sustainable development (for developing countries and on global scale).
PTT is non-reciprocal.	**Weak. Condition could be construed as a demand for reciprocal trade concessions of the type exchanged in trade agreements, therefore imposing a reciprocity requirement on beneficiaries.**	**Weak. Condition could be construed as a demand for reciprocal trade concessions of the type exchanged in trade agreements, therefore imposing a reciprocity requirement on beneficiaries .**
PTT is made available to all developing countries that share identified development need.	Probable if condition is not linked to closed list of beneficiaries (including *de facto* closed list), i.e. procedural requirements for developing countries' uptake of preferences needs to be flexible and transparent, such as time frame for compliance with condition, transparency of requirements, and offer under condition of providing technical assistance to poorer countries in their implementation of the condition.	See Option A.
PTT is designed to facilitate and promote trade and development of developing countries.	Probable. Tariff preferences are aimed at improving competitiveness of developing countries in raw materials sector.	See Option A.
PTT does not create undue difficulties nor raises barriers for other WTO members.	Probable.	See Option A.
PTT does not impede reduction or elimination of tariffs and other trade restrictions on MFN basis.	Probable. Condition seeks to promote elimination of trade barriers.	See Option A.

Other grounds for legitimizing conditionality. Developed countries may avail themselves to other instruments to justify conditions on GSP preferential treatment beyond the Enabling Clause. For example, preference-granting countries could apply for a **waiver** for conditions that would otherwise violate the MFN rule and the Enabling Clause[190]. Under "exceptional circumstances," members acting jointly can waive an obligation imposed upon another member by the GATT. It can therefore (and has been) invoked by members who, in breach of GATT Article I, want to enter into preferential trading arrangements. A waiver is typically requested if the parties to the preferential trading arrangement cannot comply with the terms of GATT Article XXIV (or the Enabling Clause). The decision to waive a GATT obligation of a member however shall be approved by a two-third majority of the votes cast and that such a majority shall comprise more than half of the WTO members. Under the terms of the WTO Agreement Article IX:3 and 4, members who want to obtain waivers have to go through a complicated process before being authorized to deviate from their obligations under GATT. The waiver could be granted by the WTO Ministerial Conference in "exceptional circumstances," provided that the decision is taken by three fourths of WTO members (about 111 members at present count of 148 WTO members). However some flexibility is provided in terms of decision-making:

• Article IX:3(a) provides for the possibility that, upon request, the Ministerial Conference's decision on the waiver could be taken by consensus. In this case the Ministerial Conference shall establish a time period not exceeding 90 days to consider the request. Failing the reaching of consensus cannot be reached during that period, the decision would be taken by three fourths of WTO members.

• Article IX:3(b) provides for a waiver request concerning the multilateral trade agreements relating to, inter alia, trade in goods to its relevant supervisory body, namely the Council for Trade in Goods, for consideration during a time period not exceeding 90 days. At the end of that period the relevant Council shall submit a report to the Ministerial Conference.

If a member (or group of them) should succeed in obtaining a waiver, it would have to

[190] Under Article XXV(5) of GATT 1994; enables WTO members may to waive the GATT obligations of members in “exceptional circumstances” by two-thirds majority vote.

abide by the stringent conditions that are likely to be set by the Ministerial Conference. Article IX:4 provides that the granting of the waiver shall clearly explain the exceptional circumstances justifying the decision, the terms and conditions governing the application of the waiver and the date of its expiry. If the waiver is extended over several years, it would be reviewed annually until its expiry. In each annual review the Ministerial Conference shall examine whether the exceptional circumstances continue to prevail and the relevant terms and conditions have been met, and on that basis extend, modify or terminate the waiver. This provision introduces an element of uncertainty over the sustainability of a waiver with adverse implications for economic operators wishing to take advantage of it.

The provisions of the Understanding on the waiver and the WTO Agreement Article IX indicate that unless a WTO member (or a group of them) requesting a waiver could mobilize widespread support from other WTO members to support their request, they will not be able to easily obtain the waiver. This gives the impression that further use of waivers by WTO members as a basis for preferential trading arrangements that are not consistent with the provisions of GATT Article XXIV or the Enabling Clause is likely to diminish. Nonetheless, it can be possible as evidenced by the securing of the waiver by the EU and ACP States for the Cotonou Partnership Agreement from the 4th WTO Ministerial Conference in 2001.[191] In the case of a raw materials condition it is questionable whether obtaining a waiver would be feasible given the political interests at stake.

Alternatively a condition violating WTO rules could be argued to fall within one of the **exceptions** to WTO violations [192]. The more relavant ground for exception would be that the condition is 'necessary to protect human, animal or plant life or health'[193]. As some raw materials (i.e. rare earths) are essential for the development of clean technology (crucial to many climate change mitigation initiatives), it could be argued that the export restrictions addressed by the raw materials condition have an adverse impact on human, animal or plant life and health as they impede the diffusion of clean technology. It could be argued that the raw materials condition is necessary to

[191] See UNCTAD Geneva, 2005 "Multilateralism and Regionalism: the new interface", Chapter IV: Issues Regarding Notification to the WTO of a Regional Trade Agreement
[192] Provided for under Article XX of the 1994 GATT 1994.
[193] Article XX (b) of GATT 1994.

discourage beneficiaries from imposing such export restrictions and therefore necessary to protect life and health. The condition need not be absolutely indispensible to qualify under this exception but whether it is deemed necessary would involve a weighing and balancing of facts (the contribution of the measure to the ends pursued, i.e. protection of health and life; the importance of the common interests or values protected, and the impact of the measure on imports), as confirmed by comparing the condition with its possible and reasonably available alternatives. However the above argument could be faulted by the fact that currently the mining of rare earths is in itself an extremely polluting activity which needs to be reduced or limited (hence the reason claimed by countries like China to impose these export restrictions).

Finally the condition would need to be applied or implemented in a way that does not constitute unjustifiable discrimination (e.g. it is applied indiscriminately to countries where similar situations prevail but also differential treatment is allowed when countries are in different situations) or arbitrary discrimination (eg the condition is applied rigidly and inflexibly, without providing transparent and predictable criteria) or a disguised restriction on trade.

H. Conclusions

The above legal analysis presents the constraints imposed by the WTO regime on the ability of developed countries to grant preferential treatment to developing countries. The rationale for these constraints stems for the fact that GSP derogates from the principle of non-discrimination enshrined under the MFN rule and at the core of the WTO Agreement. As discussed, the full extent of these legal requirements is at times undefined or unclear. Therefore achieving a balance between the need to ensure that the objectives of GSP are met and that domestic industries are not negatively affected whilst respecting the WTO regulatory framework represents a complex exercise for donor countries.

A GSP program that was in line with the following requirements would ensure, in so far as we understand, compliance with current WTO rules:

- Identify a concrete development trade or financial need that is common to all intended beneficiaries. It is plausible to identify development needs that go beyond economic progress (i.e. sustainable development).

- Demand for reciprocal concessions is not permitted.

- Ensure that from a substantive as well as procedural perspective the preferential treatment is offered to all beneficiaries who share that need; this means taking into account their specific levels of resources, infrastructure and ability to meet conditions.

- Research, establish and document the extent to which the preferential treatment is likely to alleviate the need identified.

- GSP programs should be implemented fairly with well-developed administrative, investigation and monitoring procedure.

- Any statements at political and legislative level that could suggest conditionality to preferential tariff treatment is seeking to redress unilaterally a breach of WTO-rules (whether that breach has been determined or is perceived) should be avoided.

VI. RECOMMENDATIONS

Bearing in mind the need to increase utilization among those states that most benefit from preferential access, and simplify implementation procedures, this Memorandum proposes the following recommendations for EU revisions to its GSP.

a. Beneficiary Categories

No major changes are recommended to the EU's current GSP beneficiary categories, as these are appropriate to ensure that the benefits of preferential tariff treatment reach a sufficiently large portion of the world's poor population. However, maximizing the effectiveness of EU beneficiary categories requires that every country that complies with conditionality receive the proper degree of benefits. This avoids discrimination and inconsistency with the WTO ruling in *EC-Tariffs*. Moreover, the EU must bear in mind the resources required to monitor beneficiary compliance with treaty obligations and other preferential conditions.

b. Duration and Implementation

Given the need for predictability of preferential tariff treatment, extending the EU's GSP to a longer term than 3 years would likely encourage broader participation among beneficiaries, as well as conserve EU legislative resources. However, the EU should continue to annually review for general suspension and GSP+ compliance. In this manner, the EU may guard against not only the legislative upheaval that comes with short reauthorization cycles (such as the current U.S. lapse), but also the anachronistic extension of benefits to countries with moderate per capita income (as is the case with Canada's lack of graduation mechanism).

c. Scope of Product Coverage

The EU should consider expanding product coverage to a greater share of exports from all LDCs, including textiles. Although this reform is likely to negatively impact some of the EBA countries, a progressive relaxation of product-specific limitations would encourage greater utilization among LDCs. Because many beneficiaries would stand to reap significant gains from reduced tariffs on these sensitive products, expanded GSP product coverage could result in high levels of utilization regardless of

additional burdens that the EU may choose to implement in its Conditionality, Rules of Origin or other GSP revisions.

d. Rules of Origin and Compliance

While the EU's 30% "sufficient processing" standard is comparatively low, it is hereby recommended that the EU relax the regional focus of its cumulation requirements. So long as a contributing country is a GSP beneficiary, regional limitations stifle what is otherwise the development of two countries. Such limited cumulation partners make it difficult for LDCs to comply with rules of origin, regardless of the EU's recently increased 70% threshold for LDC cumulation. While this risk of non-compliance may justify the EU's stringent verification procedures, the EU should more directly encourage LDC compliance by globalizing cumulation.

e. Graduation

Graduation is an appropriate tool for the EU to differentiate between GSP beneficiaries. Through graduation, the EU can maintain broad GSP coverage but exclude competitive countries whose economies no longer rely on preferential tariff treatment. However, the standards of graduation must be transparent, and not risk the appearance of discrimination. This is best acquired through country-specific graduation based on overall competitiveness, and not complex product-specific graduation schemes, such as the EU's current proportionate import thresholds.

f. Conditionality

An attractive GSP gives a donor country leverage to affect social and legal change in a beneficiary state. However, this Memorandum recommends two key points for effective conditionality. First, the EU should carefully deliberate any conditions with only tangential links to development. Second, the EU should ensure that any increase in conditionality correspond to a reduction in compliance burdens, so as not to dissuade participation.

With respect to the EU's interest in Chinese raw materials, the EU should approach conditionality cautiously. On one hand, the EU could apply U.S.-style conditionality to eliminate China from its pool of beneficiaries (for example, on grounds of state communism, or the U.S. condition against the withholding of vital commodities). Any

such objective standard is unlikely to be challenged at the WTO if phrased transparently and applied to all beneficiaries. On the other hand, eliminating China from GSP beneficiary status is unlikely to deter China from restricting access to raw materials, as the U.S. has proven.

Moreover, as highly populous developing countries such as China include large swaths of the world's poor, the EU must balance its attempt to apply targeted conditionality with its broader GSP goals for increased global development. In order to avoid conditionality being vulnerable to legal challenge, developed countries may implement GSP through waivers or a plurilateral agreement (providing a template of agreed terms and conditions for GSP schemes) under the WTO framework. In the latter case, developing countries should be ideally also be party to such plurilateral agreement. By this token, beneficiaries would agree with GSP regulation and conditionality which will decrease the possibilities of challenging these scheme at the WTO.

g. Erosion

Where the balance between addressing development needs and protecting domestic industry does not significantly favor developing countries, the EU should address its objectives through separate trade agreements, rather than through its GSP. This mitigates the potential for violation of the Enabling Clause. For instance, by pursuing the EU's interest in raw materials conditionality through reciprocal agreements outside the scope of GSP, the EU can focus its GSP revisions on maximizing its intended benefits. The EU should recall that its GSP is a politically supported tool for both Europe and poorer regions, and must continue to provide comparably favorable treatment to the broad range of developing countries that benefit from participation.

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