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**COMMUNICATION FROM THE COMMISSION
TO THE COUNCIL, THE EUROPEAN PARLIAMENT AND THE EUROPEAN
ECONOMIC AND SOCIAL COMMITTEE**

**Developing countries, international trade and sustainable development: the function of
the Community's generalised system of preferences (GSP)
for the ten-year period from 2006 to 2015**

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Executive summary

- The Generalised System of Preferences (GSP) is one of the key instruments to assist developing countries to reduce poverty by helping them to generate revenue through international trade. This communication sets out guidelines for achieving this objective under GSP schemes from 2006 to 2015.
- The GSP is part of a wider set of priorities for the Community's trade policies. In particular, among these policies are the priorities laid down by the "Doha Agenda" aimed at the developing countries.
- The GSP must be stable, predictable, objective and simple. The system must build on the experience gained from past schemes. It must be made more accessible to traders. The number of arrangements must be reduced from the current five.
- The GSP must be targeted on the countries that most need it and must encourage regional cooperation between developing countries by various means. The GSP should assist these countries to attain a level of competitiveness which could make them self-supporting economically and full partners in international trade.
- The goal of promoting sustainable development must be given greater prominence, by means of a single system of additional concessions for all developing countries' special development needs ("GSP+") that accept the main international conventions relating to social rights, environmental protection and governance, including the fight against drugs. The Community will withdraw entitlement to such additional preferences whenever the evaluation mechanisms of the relevant international organisations reveal serious systemic failings on the part of the beneficiary countries.

1. INTRODUCTION

There is agreement in the international community that trade is essential for development. Though not sufficient by itself, greater involvement in international trade by developing countries is nevertheless an important part of poverty reduction. The Declaration adopted by WTO Ministerial Conference on 14 November 2001 in Doha acknowledged that international trade could play a major role in promoting economic development and reducing poverty.

The very concept of development has been changing in recent years. The definition now goes far beyond just economic criteria. Development is now measured in terms of the environment, improved social conditions, anti-corruption measures, governance and so on.

The various GSP schemes granted to the developing countries by the developed countries, with the Community foremost amongst them, must be compatible with the Doha Development Agenda. A key priority is to help developing countries to benefit from globalisation, in particular by linking trade and sustainable development.

Lastly, development can also be promoted by South-South regional cooperation¹. The GSP must, wherever possible, contribute to the achievement of these objectives.

The purpose of this communication is to establish the main objectives of the GSP for the coming ten-year period (2006 to 2015) and the instruments to be used to achieve them in the shape of multi-annual implementing regulations, the first of which will enter into force on 1 January 2006.

2. DEVELOPMENT IN THE INTERNATIONAL ECONOMY

Efforts to promote development and eradicate poverty must be stepped up. The continuing expansion of international trade and the increasing openness of both developing and developed economies both enhance the effectiveness of external trade-policy instruments, such as the GSP.

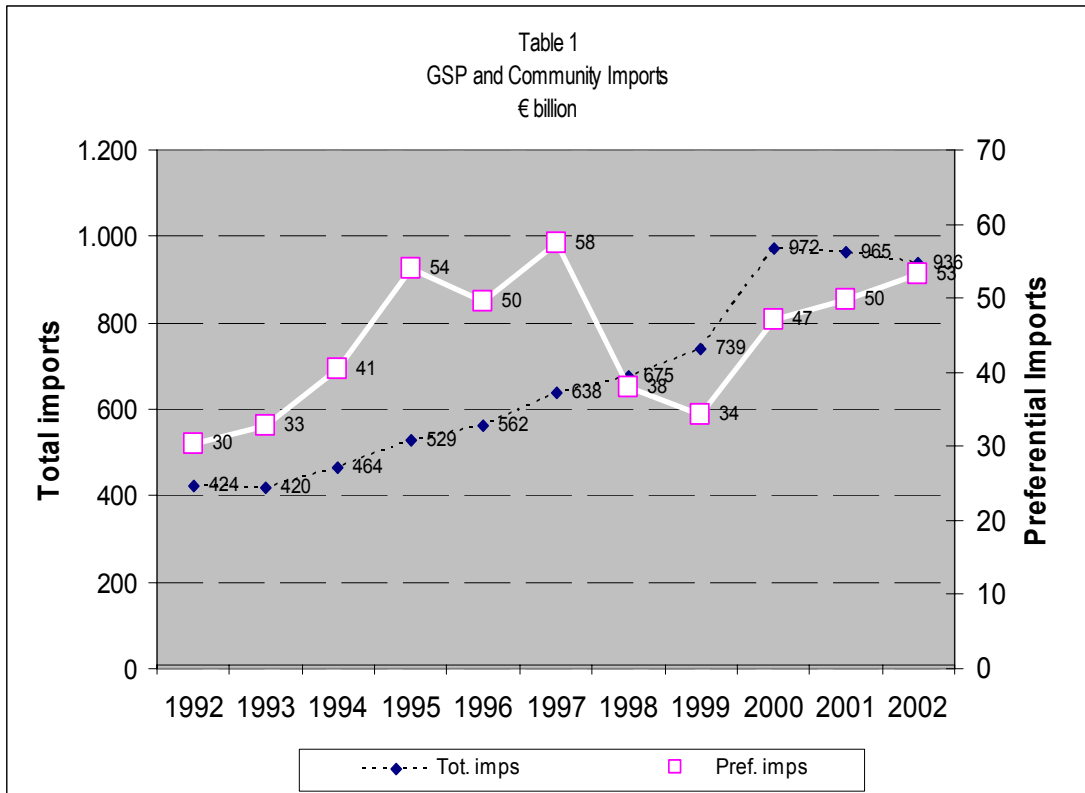
Furthermore, the right balance has to be struck between development through trade on the one hand and development through industrialisation on the other. The origin rules must reflect that balance. The big cotton debate at the WTO ministerial conference in *Cancun* in September 2003, revealed that certain African countries no longer wanted just to export cotton fibres with a low value-added, but wanted to start selling fabrics and clothes. This approach would tend to favour an industrial view of development, with origin rules requiring a high level of vertical integration. At the same time, certain Asian countries, specialising in labour-intensive industries, would like to be able to buy in semi-finished products so that they can make full use of the advantage that a generally lower level of wages gives them on international markets. Here, a trade-based approach to development, i.e. one that facilitates trade, would be more appropriate. For that, the rules of origin need to be less strict. Thus, origin rules should evolve in a balanced way that takes account of these different situations.

3. REVIEW OF THE GSP

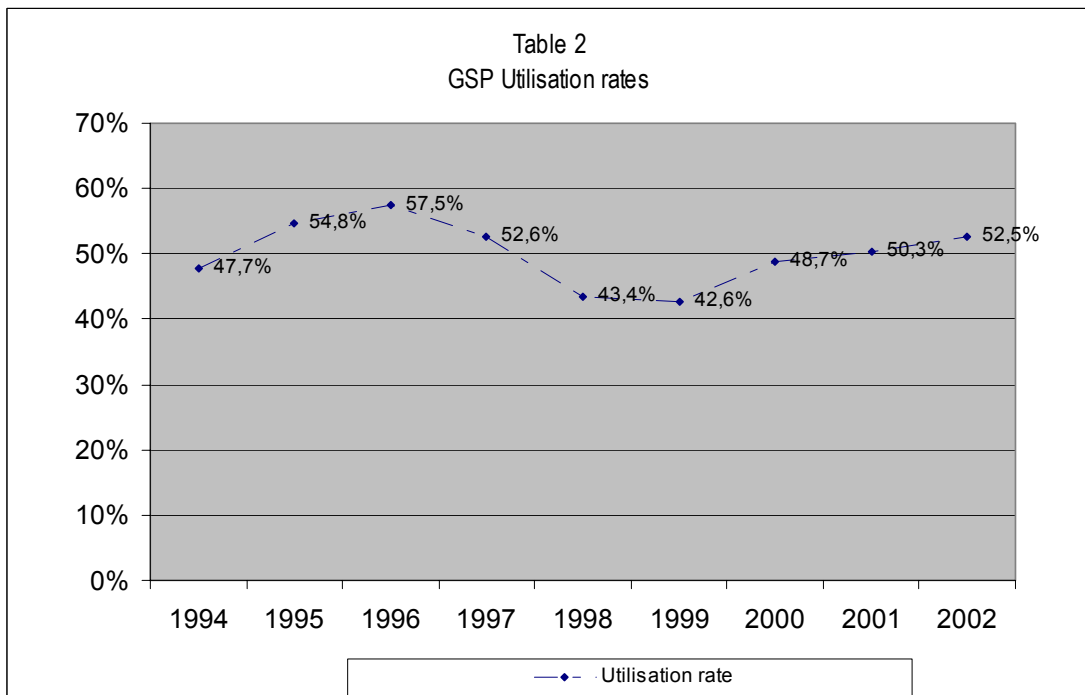
Two trends can be discerned from the most recent ten years for which full GSP statistics are available (up to 2002).

The first is that value of total imports into the Community doubled from €424 billion to €936 billion (*fig. 1*) while, over the same period, the volume of GSP imports rose from €30 billion to €53 billion. Furthermore the increase in GSP imports was uneven. This is because, in line with tariff agreements concluded at WTO level, customs duties were abolished for the output of entire industries. (For instance, the decision was taken in 1996 to abolish customs duties for electronic products and information technology, which accounts at least in part for the drop in preferential imports seen in Table 1 below for the years 1997-98.) So GSP coverage has varied over time, which creates difficulties for a quantitative assessment of the system.

¹ Within the framework of the GSP, regional cooperation can be encouraged through rules of origin. Rules of origin are the backbone of any preferential arrangements for products from a given country. They are relaxed in relation to GSP through regional cumulation, which makes it possible to reach the required degree of local integration with components from neighbouring countries.



Secondly, the GSP utilisation rate² has fluctuated (*fig. 2*), also in a rather unsteady way. However, the last four years have seen a mild increase in the utilisation rate to 52.5% in 2002.



² Utilisation rate: the volume of imports actually enjoying tariff preferences as a proportion of the volume of trade eligible under the GSP.

4. THE GSP FOR 2006-15

Although customs duties have steadily fallen to an all-time low, they are still an issue for some products. There are a number of industries where competition is becoming increasingly fierce and where a reduction in customs duties will provide an incentive for companies to buy from one country rather than another.

Tariff reductions should be agreed on in the course of the Doha Development Agenda but in any case, GSP will continue to be a useful tool in favour of developing countries, especially the Community scheme. Indeed, our GSP is by far the most generous and the broadest of any offered by the developed countries³. The Community's GSP scheme will moreover consolidate this leading position over the coming years with the accession of the new Member States on 1 May 2004⁴.

5. THE LEGAL FRAMEWORK FOR THE GSP

The GSP is an exception to the most-favoured nation principle under the GATT and it must, therefore, comply with the Enabling Clause as interpreted by the WTO Appellate Body in the recent case taken by India against the Community's existing GSP scheme (and in particular the special "drugs regime").

The Enabling Clause provides that a GSP scheme shall be "generalized, non-reciprocal and non-discriminatory". It needs to be designed to facilitate and promote trade of developing countries, and to respond positively to the development, financial and trade needs of developing countries.

The Appellate Body found that WTO Members are in principle allowed to grant different tariffs to products originating in different GSP beneficiaries under the condition that identical treatment is available to all similarly-situated GSP beneficiaries. A WTO Member which intends to grant additional tariff preferences under its GSP scheme would have to identify on an objective basis the special "development needs" of developing countries which can be effectively addressed through tariff preferences.

6. HOW TO IMPLEMENT THE GSP

In accordance with the above, the GSP scheme for the ten year period from 2006 to 2015 must pursue a number of objectives:

³ The Community GSP covers 178 independent countries and territories. Of the just over 10 000 products in the Combined Nomenclature, 7 000 processed products are eligible for the GSP, including the majority of industrial products and a great many agricultural and fish products. Half of all products are admitted at a zero rate while the other, more sensitive half, are granted a limited reduction of 3.5 percentage points (MFN tariff minus 20% for textile and clothing products). Under separate arrangements, the GSP grants a zero rate for all products (except arms) originating from the 49 LDCs (plus East Timor).

⁴ In 2002, the volume of trade from developing countries covered by the GSP amounted to €53 billion, accounting for 5.6% of Community imports, against €16.4 billion for the US's GSP, the second biggest, accounting for 1.4% of its imports.

6.1. Maintain generous tariff rates

Three factors tend to reduce the impact of the GSP offer⁵: (1) the reduction in MFN customs duties⁶, which automatically lowers the average preference margin⁷; (2) the international agreements concluded at WTO level aimed at abolishing customs duties on a certain number of products eligible for the GSP (see paragraph 3 above). The international agreement on coffee, dating from 2001, and the ITA (*Information Technology Agreement*) adopted in 1996 at the WTO Ministerial Conference in Singapore, both led to the abolition of customs duties on a great number of products and thus a corresponding reduction in nominal GSP coverage, whilst totally opening to them the Community market; and (3) the increasing number of bilateral and regional free trade agreements.

There are a number of ways of maintaining and improving the Community offer. First of all, the offer was improved substantially by the accession to the Community of ten new Member States on 1 May 2004. But we should also consider extending the GSP to cover new products. Almost one tenth of dutiable products in the Common Customs Tariff are not covered by the GSP. Certain products currently classed as sensitive could be transferred to the non-sensitive category, given the changing definition of sensitivity (see paragraph 2 above).

Preferential margins (currently 3.5 percentage points for sensitive products and 100% for non-sensitive products) will be at least maintained

The Commission will continue to take into account the impact of these measures on outermost regions.

6.2. Target the GSP on the countries that most need it

Given the wide geographic coverage of the Community's GSP scheme, it has a high Community budgetary cost. Accordingly, in the future, the GSP should focus on the countries most in need, such as the LDCs and the most vulnerable developing countries (small economies, land-locked countries, small island states, and low income countries) in order to help them play a greater role in international trade. These are the countries that the GSP must focus on as its first priority. One appropriate method to manage priorities is undoubtedly via graduation⁸. In particular, we have to graduate the most competitive groups of products from certain beneficiaries. Given this high level of competitiveness, there is no further justification for these products to continue to benefit from a preferential tariff treatment for these countries. However, special consideration should be given to the countries most in need in designing the graduation mechanism.

So on which countries should we try to focus the benefits in particular? Most obviously, on the LDCs to which preferences should be granted as widely as possible. Measures should also be adopted that provide some way of damping the

⁵ The GSP offer: tariff preferences for GSP beneficiaries. In 2002, the *effective* GSP offer was valued at €2.2 billion in terms of uncollected customs duties.

⁶ MFN duties: the duties which the Community applies to non-member countries, not counting tariff preferences such as the GSP.

⁷ Preference margin: the difference between the MFN rate of duty and the GSP preferential rate.

⁸ Graduation: withdrawal of the GSP for certain products (for one or several countries of origin only).

shock when the United Nations removes a country from the list of LDCs. At present, when this happens, the country in question automatically loses all the GSP advantages it enjoyed as an LDC. There ought to be a mechanism for gradual withdrawal of a country from the special GSP, the Everything-But-Arms arrangement⁹.

In addition, a further obvious group of countries are the land-locked and low income countries, countries that are unable to take advantage of economies of scale or are beset by logistical problems and those whose economies are not at all diversified. This goes in particular for the textiles and clothing industry. In October 2003, a Commission Communication¹⁰ stressed the need to target preferences on the countries that would need them most when the MFA textile-quota system came to an end in December 2004.

6.3. Propose a simpler GSP with easier access

There should be greater emphasis on simplification. The current GSP has already been greatly simplified. Simplification should also be achieved through a reduction in the number of arrangements, of which there are five at present¹¹ and in particular by the introduction of a single arrangement in place of the three separate types of special incentives: to encourage the protection of labour rights, to encourage protection of the environment and to combat illegal drug production and trafficking. Thus, in place of the current five, there would be three arrangements in total: the general arrangement, the special arrangement for the least developed countries and an arrangement to encourage sustainable development. Simplification should also involve removing from the list of beneficiaries, those countries that enjoy preferential access to the Community market under the terms of an agreement, usually a free-trade agreement. However, the Community would of course ensure that no country would lose as a result of this because GSP benefits for any particular product which formerly received GSP treatment should be consolidated into the FTA in question. A concerted effort must also be made with regard to rules of origin, in the light of the debate triggered by the Commission's Green Paper on the future of rules of origin in preferential trade agreements¹². Lastly, the GSP Regulation should enter into force as soon as possible to enable traders to plan ahead.

6.4. Make graduation more transparent and target it on the prime beneficiaries

Graduation must be applied to groups of products from countries that are competitive on the Community market and no longer need the GSP to boost their exports. Graduation is not a penalty, it is a sign that the GSP has successfully performed its

⁹ This is the most advantageous of all GSP arrangements. A zero rate is charged on the 10 000 or so products in the Combined Nomenclature (excluding arms), with no exceptions for sensitive products.

¹⁰ Communication from the Commission to the Council, Parliament and the Economic and Social Committee on the future of the textiles and clothing sector in the enlarged European Union, COM 2003 (649) final, 29 October 2003.

¹¹ The basic GSP (the 7000 sensitive and non-sensitive products), the EBA arrangement for the LDCs, the two special social and environmental arrangements that grant additional preference to sensitive products from eligible countries (Moldova and Sri Lanka under the current GSP) and the arrangement aimed at reducing illegal drug production and trafficking, which is comparable to the EBA arrangement, with twelve beneficiaries.

¹² COM (2003) 787 of 18 December 2003.

function, at least in relation to the countries and products in question. Thus graduation is very closely linked to the economic competitiveness of the beneficiary countries.

Graduation gives the countries to which it is applied an incentive to do more to diversify their economies. For the other beneficiary countries, it means a greater share of the benefits of GSP. Graduation should also play an important role in regulating trade flows for textile products and clothing, following the abolition of MFA quotas on 31 December 2004.

Essential changes will be made to the graduation arrangements to make them simpler. The current criteria (share of preferential imports, development index and export-specialisation index) will be replaced with a single straightforward criterion: share of the Community market, expressed as a share of preferential imports. Goods will no longer be broken down into “sectors”, as before for the purposes of graduation¹³. Groups of products will be defined by reference to the “sections” in the Combined Nomenclature¹⁴. As well as being simple, this system has the advantage that it would graduate only groups of products from the biggest beneficiaries¹⁵. Only the countries that were, on average, competitive for all the products in a section would be graduated for these groups of products. Small beneficiaries, competitive for just a few products, or group of products would under no circumstances be graduated solely on the basis of those few products.

6.5. Devise new incentives to encourage sustainable development and governance

As already made clear, a number of developing countries face particular problems in the globalised economy, such as the fight against drugs (to which the Community remains committed through a policy based on shared responsibility), or inadequate diversification of their economies. In accordance with the objective to concentrate the GSP on such countries that are most in need, the new GSP scheme should provide for special incentives that respond positively to special development needs in a manner consistent with the Enabling Clause. These additional preferences would be open to all developing countries which face the same development needs.

The two special arrangements to encourage protection of basic workers’ rights and protection of the environment (the “social” and “environmental” clauses) are little used in their current form. Some beneficiary countries have preferred not to have the content and implementation of their social legislation subjected to the rigours of scrutiny. The length and relative complexity of the evaluation procedures have probably made the arrangements even less attractive. The environmental arrangement takes an extremely limited approach to environmental protection; it applies only to tropical timber. And on the special arrangement to combat illegal drug production and trafficking, the Appellate Body criticized the lack of objective criteria for the inclusion or removal of beneficiary countries.

¹³ The 7 000 products covered by the GSP are grouped into 34 sectors.

¹⁴ The Combined Nomenclature is the Community’s subdivision of the Harmonised System, the international customs nomenclature adopted by the World Customs Organisation and used for 95% of international trade. Both nomenclatures are divided into 21 sections (for instance, section 11 covers fabrics and clothing).

¹⁵ Fewer than ten of the 178 countries and territories covered by the GSP.

Therefore it is appropriate to move to a broader concept of sustainable development and governance. Multiple international conventions and declarations have acknowledged the link between development and the respect of basic human and labour rights, of the environment, and of the principles of governance. The failure to honour these basic standards, which are specified in various international conventions, entails particular problems for developing countries. It is therefore appropriate to address these special development needs positively through granting additional GSP preferences to those developing countries which have taken on board the major international conventions in these areas.

The new sustainable-development incentive will replace prior evaluations, carried out under the current incentive arrangements, with a system that will encourage ratification and implementation of international conventions. The scheme will be granted to beneficiaries who have taken on board the relevant international standards relating to sustainable development, including basic human rights conventions (agreements designed to uphold political and economic and social rights, combat torture and discrimination on grounds of race and gender, and protect women's and children's rights), labour rights conventions and certain conventions relating to environmental protection (e.g. conventions designed to combat trafficking in endangered species and to protect the ozone layer), as well as the various conventions relating to the fight against illegal drugs production and trafficking, which is of course an important development policy (see above).

The relevant conventions are those with mechanisms that the relevant international organisations can use to regularly evaluate how effectively they have been implemented. The Commission will take account of these evaluations before deciding which of the applicant countries will be selected to benefit from the incentive schemes. To be considered, potential beneficiaries will have to submit an official application containing essential information in support of the application. Applications could be submitted from the first day the new GSP Regulation is adopted by the Council to enable those countries who will qualify under the new objective criteria in line with development needs to obtain those benefits as soon as possible. The incentive scheme will include a credible suspension clause that can be rapidly activated. In the event of a serious breach of international agreements, the decision to withdraw the regime could be invoked by the Commission, the Member States or the European Parliament. This would trigger an investigation by the Commission which could lead to suspension of the additional benefits if it is established that countries have not honoured their commitments.

6.6. Improving rules of origin

The rules of origin lay down the main criteria for access to preferences but they were drawn up at a time when the international economy was very different from that of today and when goods were produced in a very different way. In the light of recent consideration of this question (see the Green Paper referred to at point 6.3), the need for change is widely recognised: in form (simplification), in substance (amendment of the origin criteria and cumulation rules) and in procedures (formalities and controls).

A need has been identified for flexibility. However, this must be done in a way that promotes not just trade but also development. One of the objectives must be to

facilitate acquisition of origin to better benefit from preferences. The benefits of the system could be enhanced through regional cumulation, thus promoting the regional cooperation between the beneficiary countries. The Commission has stressed the importance of regional integration for southern countries as a route to greater involvement in international trade¹⁶. This cooperation element was introduced into the GSP two decades ago when it was decided that a more regionalised approach should be taken towards development with the creation of regional cumulation (ASEAN, Andean and Central America and SAARC). Further consideration needs to be given to the possibility of *cross*-regional cumulation, based on requests coming from the different regional groupings. In this respect facilitation of cumulation could be envisaged through a proper revision of the conditions required today.

6.7. Reinforce the temporary withdrawal instruments, safeguard measures and anti-fraud measures

The new GSP with a graduation mechanism targeted on the most competitive countries will mean that most beneficiaries will be granted preferences without any restrictions other than compliance with the relevant GSP rules. The GSP temporary withdrawal provisions and the safeguard clause will be redefined to take account of this new situation. Even though they will still be for use in exceptional circumstances only, those provisions must be made more credible, which will involve simplifying them and making the way they are used more flexible, in particular in case of unfair trading practices.

Generally speaking, the anti-fraud measures and measures to protect the Community's financial interests within the GSP framework already enjoy a high degree of credibility. The Commission wishes to maintain this but thinks that they can be truly effective only if the Commission (and the Member states who are responsible for administering the GSP), have enough political will and the determination to apply them systematically when the situation calls for it.

The beneficiary countries should also have responsibilities in managing the GSP, in everyone's interest, including their own. They must take the necessary control measures such as ensuring that the effective and appropriate administrative structures are available to ascertain the validity of the origin documents when they are established and released.

7. CONCLUSION

The Commission will put the draft multi-annual regulations designed to achieve the objectives set out in this communication to the Council. It will make every effort to present the proposals early so that the Council can adopt them in time to enable beneficiaries and traders time to organise trade flows. This measure will provide greater continuity (with the end of the annual graduation review) and stabilise the GSP, thereby making it more attractive.

¹⁶ Communication from the Commission to the Council and the European Parliament on Trade and Development Assisting Developing Countries to Benefit from Trade COM (2002) 513 final of 18.09.02.

The revised GSP is proposed to last for ten years until 2015. But on past experience, an evaluation of the detailed GSP rules should be carried out on a regular basis, preferably every three years as at present, and improvements considered as necessary – for example, in the light of the outcome of multilateral negotiations, such as the Doha Development Agenda.

Accordingly, a new GSP Regulation to apply for three years will be presented to the Council, European Parliament, and European Economic and Social Committee in autumn 2004 and should enter into force on 1 January 2006.