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**INTEGRATION OF DEVELOPING COUNTRIES
IN THE INTERNATIONAL TRADING SYSTEM**

Role of the GSP
1995-2004

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INTRODUCTION

It is no longer disputed that trade has a vital role to play in development. The developing countries themselves are more aware of this than anyone. A number of Asian developing countries, in particular, have followed a strategy of export-led growth; the majority, notably the Latin American countries, as part of the reforms undertaken in connection with the restructuring of their debt, were actively involved in the successful outcome of the Uruguay Round and will become full members of the WTO.

Nevertheless, problems remain. Genuine integration into the international trading system entails the prospect of generous market access at an early stage, but the Uruguay Round results will be implemented only gradually, and a number of tariff barriers will remain. Also, much trade today is carried out via joint enterprises or big multinationals and in any case demands sophisticated marketing, finance, telecommunications and transport back-up. Some developing countries - if such they can still be called - have succeeded in plugging their economies into the global trade and production networks, but the majority are not at that stage and even in the more advanced of these countries export diversification is still a necessity, given the existence of barely-developed sectors and regions of great poverty.

The Community aims, in GATT and in its own development activities, to integrate the developing and transitional countries into the international trading system.

One pillar of its strategy is the GSP, backed by special cooperation arrangements.

The GSP offers developing countries tariff reductions or in some cases duty-free access for their manufactured exports and certain agricultural exports as well. It is

1°) a tariff instrument it operates purely at the level of tariffs which, with a few sectoral exceptions, are now very far from being the main barrier to trade.

2°) autonomous : preferences are granted by the Community under a special GATT enabling clause designed to ensure the system is non-discriminatory.

3°) And the GSP is complementary to GATT. While in the past it may have been perceived as an alternative to GATT, it is now a back-up rather than a substitute for the multilateral liberalization of trade.

The Commission drew attention to these three factors in its July 1990 Communication to the Council. Since that time, in addition to the conclusion of the Uruguay Round, other major changes have taken place which put the global economy and development issues as a whole in a different perspective.

- . In the first place, much of the additional development aid is currently being channelled towards the former Communist countries to help them make the transition to the market economy.
- . Second, the Treaty on European Union has given a fresh impetus to the Community's development policy in the context of the Union's foreign policy. Article 130u includes among the prime objectives of that policy "sustainable economic and social development" and "the smooth and gradual integration of the developing countries into the world economy".

There are therefore two priorities for the GSP for the decade 1995-2004. First, although it has traditionally come under Article 113, the GSP is a tool of development and must thus be directed chiefly at the neediest - i.e. the poorest - countries. The GSP must be placed at the service of development in the broader sense, embracing social and environmental concerns and based on a coherent economic strategy, including the IMF/World Bank-sponsored adjustment programmes. And the GSP must complement GATT, i.e. foster the integration of the developing countries into the international economy and the WTO.

What this means is that the GSP, like any other cooperation instrument, has a transitional function: preferences, like aid, are granted commensurate to need and should be phased out when the need is judged no longer to exist.

THE CURRENT GSP: REPORT

Many of the trends in GSP use noted in the Commission's July 1990 Communication on the ten-year guidelines (COM(90) 329 final) have been confirmed into the 1990s. The inclusion of new countries (the central and eastern European countries, Baltic states and CIS countries) and the introduction of special preferential arrangements for four Andean

countries (from 1990) and the Central American countries (from 1991) considerably increased the level of imports under GSP, which totalled ECU 30.1 billion in 1991 and ECU 27.5 billion in 1992, as the following table shows:

Community imports from
GSP beneficiary countries

million ECU

	Total Imports	Imports subject to duty	Eligible for GSP	Admitted under GSP
1981	99 675.0	27 575.5	21 470.8	8 063.1
1986	80 917.2	46 108.9	31 574.5	11 289.1
1990	112 494.2	69 064.0	49 147.2	21 403.9
1991	127 856.9	83 847.8	63 485.4	30 081.3
1992	115 130.2	77 057.7	60 488.5	27 485.1

The apparent drop in imports under the GSP in 1992 is explained by the entry into force of the Europe Agreements between the Community and the central and eastern European countries, which thereby lost their GSP entitlement (though South Korea reappeared on the list of beneficiaries that year, having earlier been suspended because of its discriminatory practices in the field of intellectual property rights).

On the whole the product coverage and utilization rate of the Community scheme was again relatively high in 1992, with 78.5% of dutiable imports from beneficiary countries covered by the scheme, and 35.6% of dutiable imports actually admitted under the preferential arrangements (the utilization rate) - figures which easily sustain a comparison with those of the United States and Japan. Overall, take-up of GSP has improved considerably from the levels recorded in the early 1980s. Even after 1990, at a time of weak domestic demand in the Community and intensified external competition, GSP access continued to grow briskly, though not so much in sensitive sectors, reflecting implementation of the product/country differentiation policy. The percentage of dutiable imports admitted on preferential terms increased from 29.2% in 1981 to 35.6% in 1992. However, the policy of product differentiation adopted in the 1980s and the growing competitiveness of the developing countries was reflected by a sharp rise in the number of tariff quotas and ceilings. The number of duties reintroduced

on products subject to ceilings was 172 in 1992, compared with 76 in 1986. There were 189 individual quotas for industrial products in 1993, as against 116 in 1988 and 91 in 1981.

Despite the practical problems, the product/country differentiation policy has had an effect: countries such as China, Thailand, Indonesia and Malaysia have seen a marked growth in their GSP exports to the Community in recent years in parallel with a relative decline for the most highly-competitive countries like Hong Kong and South Korea, and have in turn become extremely competitive in certain sectors.

Asia is far and away the major GSP beneficiary, accounting for almost 70% of the preferential advantage in 1992. Within the region the lion's share goes to China, which takes nearly 25% of total GSP benefits, more or less in line with its share of dutiable imports (20%). The large proportion of GSP preferences taken up by Asia is a reflection not only of its high population but of its swift industrialization and the improvement in the terms of trade for manufactured products. According to UNIDO statistics manufacturing output in Asian developing countries (excluding China, Vietnam and North Korea) grew at an annual rate of 8.5% throughout the 1980s, compared with a growth rate of just 3.6% for Latin American countries. The rise in manufactured output in Asia in the 1980s represents a doubling of production in nine years. The Community's GSP scheme, as a buttress for industrial development in accordance with its stated aims, has surely played a significant part in this achievement, particularly in the early stages.

The position of the least-developed countries (as classified by the UN, without reference to the Lomé Convention), has continued poor; in 1992, they accounted for 1.2% of imports from beneficiaries and 1.7% of GSP benefits. Even more worrying is the fact that GSP take-up by least-developed countries, at 51.6%, was only slightly higher than the figure for GSP beneficiaries as a whole (45.4%), despite their freedom from quotas or ceilings. This highlights the need for further effort to improve the take-up of GSP preferences by LLDCs, though the scope for extending the actual coverage is virtually nil, as 98% of their zero-duty imports already come under the scheme in any case. Improvements for the LLDCs would have to be sought in the first instance via changes to the origin rules and more efficient administration and management of the scheme. Naturally, the most crucial factor in ensuring more effective GSP utilization by these countries is expansion of the offer.

Giving effect to the Community's Uruguay Round market-access offer reduces both the need and the scope for significant preferential treatment on several product categories. On aggregate the weighted average Community tariff on industrial products will ultimately be cut from 6.8% to 4.1%, a reduction of 37%. In some sectors (construction, equipment, medical and pharmaceutical equipment, furniture, steel, agricultural equipment, paper, toys, beer and spirits) duties will disappear entirely; in others, they will be aligned with other countries' tariffs or cut. In the textile and clothing sector quantitative restrictions are to be phased out, even though the tariff concessions offered by some of the supplier countries are far from adequate and talks on this issue are therefore continuing. These changes will be phased in only gradually, however; for most sectors there will be a transition period of five years, though in some a ten-year transition period has been agreed.

GENERAL GUIDELINES

Introduction

(a) The new ten-year scheme assumes that the level of liberalization will be neutral overall compared with the existing scheme as regards the impact of the preferential margin on the potential volume of preferential trade.¹ In other words, it will not offer additional liberalization over and above that achieved under the Uruguay Round combined with the existing GSP, but nor will it attempt to claw back the Uruguay Round element.

Starting out from this assumption of neutrality the offer will then be modified by the application of special incentive arrangements providing supplementary preferences consistent with the Community's development aims. Thus, incentive arrangements constitute an additional offer in relation to the initial overall neutrality.

Surveillance will be used to ensure that these neutrality criteria are observed.

(b) The new ten-year scheme will take account of certain sectors or products which are sensitive for Community industry and agriculture. Because of the extreme sensitivity of fisheries and the development of second-generation fishery agreements, the scope of tariff reductions in this sector will have to be examined very carefully. Sensitive sectors will be protected against import surges not by differentiation, as they are at present, but by a dual mechanism involving a precautionary modulation of preferential tariff margins structured to reflect product sensitivity and by an emergency safeguard clause. This two-tier system would replace the machinery of quotas and ceilings which is currently used to effect country/product differentiation.

¹ In technical terms this means that the financial statement drawn up to cover the operational scheme for 1995 will incorporate an aggregate GSP offer reflecting forecasts for the effects of graduation (based on the past preferential performance of the countries concerned) plus the potential preferential trade of countries unaffected by graduation. This should give the current level of preferential trade.

Both tariff modulation and the safeguard clause must fit within the framework of overall neutrality defined above. Overall, therefore, there will be no increase in the proportion of sensitive products in the scheme.

(c) The priority for the new ten-year scheme is to increase export opportunities on the Community market and boost actual take-up of preferences for the "ordinary" or least-developed developing countries. The way to do this, within the overall framework of neutrality, is by graduation, which amounts to transferring preferential margins from advanced to less-developed LDCs.

Such graduation no longer has anything to do with product sensitivity; that is dealt with by tariff modulation and the safeguard clause. It is purely development-oriented and is thus radically different from the country/product differentiation machinery in use at the moment.

(d) The new graduation mechanism will be phased in gradually to allow traders in the countries concerned and in the Community time to adjust to the new GSP offer and thus keep within the framework of overall neutrality.

1. Simplification, stabilization, transparency

The principles set out by the Commission in its July 1990 Communication remain applicable to the normal GSP, viz.:

(a) Simplification (tariffication)

Volume restrictions in the form of fixed amounts, tariff quotas or tariff ceilings should be replaced by tariff modulation reflecting the sensitivity of different sectors (products or groups of products), to be decided when the proposal for the operational scheme is drawn up in the light of the final outcome of the Uruguay Round. Modulation represents the EC's main line of defence against the likelihood of a surge of preferential imports in certain sensitive sectors.

Wherever possible the degree of sensitivity should, for ease of administration, be determined by sector, but it could be fine-tuned (down to product level) if necessary. It should be assessed on the basis of objective data relating to the Community market for that sector (import penetration rate, productivity, job losses, prices) irrespective of the source of the imports. This would then enable us,

for the purposes of the operational scheme, to draw up lists of sensitive and non-sensitive sectors (products) subject to different rates of preferential duty (e.g. 75% of the MFN rate for sensitive products and 0% for non-sensitive products).

(b) Stability

Each operational scheme within the ten-year period 1995-2004 should run for three years.

(c) Transparency

A special product/country safeguard clause is needed to cope with significant unexpected import penetration in sensitive lines, as a back-up to the modulation system. It should be based on the test of serious damage or threat of serious damage. The management rules should be modified accordingly.

2. GSP graduation

Graduation amounts to recognition by the European Union that some third countries are no longer in need of GSP benefits.

It should represent a solution to the problem of a few highly-competitive beneficiaries hogging the lion's share of total GSP, partly at the expense of LLDCs.

Because of its political implications the graduation machinery would have to be absolutely objective and acceptable to our developing-country partners.

The existing system is based on product/country differentiation, i.e. the phasing out of specific product/country combinations on the grounds of sensitivity of the product for Community industry and the competitiveness of the exporting countries. It allows precise targeting but this makes it difficult for traders and customs to manage and raises intractable statistical problems. To keep this much-criticized system in being would therefore be inept. What is more, it is of necessity essentially trade based and has little latitude for development considerations.

Broadly speaking there are three ways of achieving graduation: by excluding certain highly-developed countries, by excluding certain highly-sensitive sectors, or by excluding certain sectors (or product groups) in the case of the highest-performing countries.

Exclusion of the highly-developed countries does benefit the less-developed but raises economic and political problems:

- the countries concerned might feel strongly about exclusion, which would distance them from the other developing countries (in the G 77 and regionally);
- country graduation could disrupt regional integration processes.

Nevertheless, some current GSP beneficiaries are highly-developed.

Exclusion of sectors impacts purely at a trade level, depriving both more- and less-developed countries of preferential access to the Community market, and it also has other drawbacks:

- the sectors likeliest to be affected (textiles and footwear) provide the industrial base for countries in the early stages of industrialization - and some beneficiary countries are still at a very early stage indeed. Sector/country graduation offers a way round this problem;
- it runs counter to the general approach adhered to in the Uruguay Round, which aimed to cover all sectors.

The Commission, subject to a detailed assessment of the actual results emerging from the 1995 operational scheme, therefore favours the third option, sector/country graduation as being the most balanced at this stage. However, it would not oppose a system of country graduation removing GSP entitlement from certain countries on the grounds of their advanced development. This would follow an objective, non-discriminatory analysis of their situation in terms of the level of development.

Should the Council opt purely for the sector/country approach, the Commission does not feel this should rule out full graduation of certain beneficiary countries after three years of application of the new scheme, depending on how the level of those countries' overall development progresses, and if it appears that the more highly-developed LDCs are failing to allow the less-developed adequate access to their markets.

What would graduation by sector/country consist of?

The sole purpose of sector/country graduation is to increase export opportunities for the least-developed countries by withdrawing GSP entitlement from countries which are both more advanced in their development and stronger in certain export sectors (including agriculture and agri-food), and thus objectively no longer require GSP for those sectors, thereby giving a boost to less highly-performing countries. It is therefore development-oriented, not trade-oriented, and this supports the distinction made for graduation purposes between advanced developing countries, ordinary developing countries and LLDCs. The advanced LDCs are better able either to export without GSP concessions, once they have attained a certain level of industrialization, or to diversify into other sectors in which they would retain GSP entitlement; ordinary LDCs are more dependent on GSP, and it is

therefore right to treat them with greater flexibility; while LLDCs depend too heavily on GSP to be excluded at all. Nevertheless, this focus on the different needs of the LDCs in development terms should not blind us to the fact that advanced and ordinary developing countries seeing their access to GSP restricted will argue that they need GSP to offset the trade preferences granted by the Community to the ACP, Mediterranean countries, and Central and Eastern European countries.

These considerations dictate that country/sector graduation should be applied sensibly and gradually.

In addition, the cumulative origin rules should be used to ensure that sector/country graduation is applied in such a way as to minimize the impact on regional integration when one member of a regional group is affected.

Even when a country loses GSP entitlement, the regional cumulation rules would, in principle, still apply to inputs sourced there which are used in other countries of the group. In other words, components sourced in a "graduated" country incorporated in manufactured products in another member of the group would continue to be treated in the same way as now; similarly, products eligible for GSP originating in countries of a regional group which transit via a graduated country and are then re-exported after minimal working would remain eligible for GSP.

(a) Criteria

These are based on relative specialization, coupled with a development weighting.

- . The development weighting of beneficiary countries is determined by a development index combining a country's per capita income and the level of its exports as compared with those of the Community.
- . Relative specialization is determined by a specialization index based on the ratio of a beneficiary country's share of total Community imports in general to its share of total Community imports in a given sector. The larger the sectoral proportion compared with the general proportion, the greater the specialization.

By combining both criteria it is possible to adjust the crude results of the specialization index in terms of the sectors to be excluded in line with the level of development.

(b) Solidarity mechanism

We have noted that certain beneficiary countries - including some in the earlier stages of development - hog the lion's share of GSP benefits in some sectors. The sector/country graduation system should therefore be supplemented by a "solidarity mechanism" applicable in exceptional circumstances, when beneficiary countries whose exports of products covered by the GSP in a given sector exceeded a certain percentage (15-25%) of all beneficiaries' exports of those products in that sector would be excluded from GSP entitlement for that sector irrespective of their level of development.

3. Suspension of GSP

The withdrawal of proportional (total or partial) preferences, commensurate with the scale of the phenomenon, might be justified in the case of certain actions or omissions on the part of beneficiary countries, such as:

- fraud or failure to provide administrative cooperation;
- unfair trading practices, including discrimination against the Community;
- practice of any form of slavery;
- export of goods made by prison labour;
- inadequate controls on export or transit of drugs (illicit substances or precursors), or money laundering;
- failure to comply with obligations entered into in the Uruguay Round to meet agreed market-access objectives.

Withdrawal would not be automatic but would follow "hearings", and could be applied piecemeal or across the board. In any case GSP would be suspended for a limited period only (a year) and the "sentence" would have to be explicitly extended if the country persisted with the "offence".

4. Special incentives

The Commission is proposing that the general GSP regime should be supplemented by special incentive arrangements, with the emphasis on social and environment schemes.

The special incentives should be positive inducements and logical components of development policy in that they reflect the idea of social progress and protection of the environment as aspects of, rather than preconditions for, sustainable development. The Community could also contemplate enhancing "basic" GSP benefits so that they provide more of a return in social and environmental terms and help businesses meet the extra cost of progressive social and environmental practices.

A similar system could be used to encourage developing countries to speed up the introduction of proper protection for intellectual property rights, a crucial stimulus to investment and trade.

As the GSP is an autonomous instrument the Community also has some margin of manoeuvre in linking additional benefits to compliance with certain standards, though this is restricted by the terms of the GATT enabling clause. The Commission is therefore planning to start informal exploratory talks with the countries concerned to ensure that the parameters of this issue are clarified before the Council finalizes its scrutiny of the draft 1995 regulation.

So that beneficiaries can gradually gear their own development policies up to the requirements of social progress and protection of the environment and will thus be ready to derive the full benefit of the incentives, the arrangements would really come into force only once the new scheme had been operating for two years, unless international agreement is reached in the meantime to have them come into force before the end of the two years.

The special incentives will operate as follows:

1. A basic preferential margin (expressed in this case as a percentage of the MFN tariff) will be granted to all beneficiary countries under the normal GSP;
2. Under the special incentive arrangements, i.e. the social and environmental clauses, an additional margin would be offered to all countries submitting a reasoned request and stating that they comply with certain internationally-recognized standards.

The incentives would operate entirely on the basis of a product-certification system. Preferences would in practice be granted only for products certified by the exporting country to have been manufactured in accordance with production methods and in conditions conforming to certain internationally-recognized standards or criteria. The veracity of the certificates would be checked by means of administrative cooperation with the exporting countries (certificates to be returned for verification of their authenticity and the accuracy of the particulars they contain, with on-the-spot verification if necessary in important cases). Such a fair and objective verification procedure would tend to resolve any disputes by actually changing the offending practices rather than by applying a penalty, which would happen only some time later. A strengthening of the investigative machinery should be considered, as part of the overall evaluation of Commission and Member State resources for combating fraud.

A. The social clause

This would refer to internationally-recognized labour standards, i.e. ILO conventions.

Among standards protected by ILO conventions, those relating to the right to organize and the right of collective bargaining are likeliest to bring about improvements in social conditions (better wages and working conditions) and thus help raise living standards. That being the case, the additional incentives available under the social clause would be made conditional on genuine implementation of the principles enshrined in these conventions, irrespective of whether they have been formally ratified.

The incentive social clause could be used not only to promote the right to organize but also against practices directly linked to under-development, notably child labour.

B. The environment clause

This incentive clause would be used to promote products or production methods internationally approved as consistent with the objectives set out in international conventions on the environment (e.g. on the ozone layer, climate and biodiversity) and in Agenda 21.

The additional preferential margin would be granted to offset the extra costs of bringing the industries concerned into line with these standards or criteria.

The environment clause would initially be confined to tropical wood products, one sector in which international criteria have already been developed, and would refer to the criteria laid down by the ITTO for sustainable forest management. It would apply to other product categories as and when international standards or criteria were introduced pursuant to international conventions on the environment or Agenda 21.

C. Intellectual property rights

New rules have just been adopted as part of the Uruguay Round package but the developing countries have been granted a breathing space of four to nine years, depending on subject matter, before they need to transpose them into domestic law. The incentive system could be used to encourage countries willing to implement the new international disciplines far enough in

advance, and might help overcome local political resistance to faster implementation which is, in any case, in these own countries' economic development interests.

D. Other incentives

Other incentives could be introduced, particularly for structural adjustment and commercial policy towards other developing countries: further special concessions (applying to all GSP beneficiaries) could be granted to countries tackling reforms in order to meet IMF criteria or opening up their markets to other developing countries.

5. Drugs

The Commission considers the special arrangements aimed at the fight against drugs should be continued, provided the countries concerned for their part continue their efforts to combat drugs and some results are achieved. Progress should be monitored by evaluation and dialogue, via a suitable procedure to be established between the countries concerned and the Commission.

Pursuant to a European Council recommendation, the special arrangements currently applying to the Andean Pact and Central American countries are to be renewed in order to secure the full benefits, and the Commission also advocates a limited extension of the scheme to other countries in a similar situation.

6. List of beneficiaries

Save for possible application of the graduation machinery, the Commission is not otherwise proposing to make any changes to the list of current beneficiaries for at least three years, including, as an interim arrangement, the countries of the former USSR until any free-trade agreement with them comes into force, and provided they undertake to open their markets to developing-country exports.

South Africa is to be included in the list on terms to be worked out.

7. The GSP's compatibility with the GATT enabling clause

Since there is legal uncertainty about the compatibility of the new features of the GSP (graduation, suspensions and special incentives) - and indeed some of the old ones (differentiation, provisions on drugs) - with the informal soundings should begin GATT enabling clause, within the OECD, Unctad and the GATT with a view to examining the consistency of enabling clause and the principles governing the Unctad GSP system with the realities of world development and trade today. It might be found necessary ultimately to adapt the enabling clause, which would require our partners' agreement.

Development

A. GSP-related technical assistance and trade promotion

To make sure that the graduation provision works properly and tilts the GSP to the advantage of the non-graduated countries, above all the least-developed among them, technical assistance to these countries should be stepped up.

This could be done by organizing more information seminars in these countries and enlarging the scope of such seminars to cover the conditions of access to the Community market, by increasing the Community contribution to Unctad programmes on the subject and by making special assistance available for the implementation of the Uruguay Round conclusions.

This should be backed up by more intensive trade promotion directly linked to GSP use (fairs, market research) and investment promotion (information on the European Community Investment Partners (ECIP), for example).

Further backing would take the form of aid for the setting-up of producer groups able to establish direct links with Community importers, and also aimed at improving social and environmental conditions.

A suitable amount for this purpose should be entered in the budget from 1995.

B. Accompanying measures linked to special arrangements

Funds from financial and technical cooperation are already allocated to development operations that may be considered as accompanying measures for the special incentive schemes.

Such measures could be stepped up, especially in the following fields:

- child education
- the setting-up of structures for social dialogue and training of trade unionists
- implementation of strategies to combat drugs
- implementation of environmental protection measures

CONCLUSIONS

1. Now that the Uruguay Round has been concluded, the Community needs to update the GSP by: incorporating performance differentiation for exporting developing countries; taking account of the new international situation and institutional changes within the European Union itself; and promoting a modern concept of development that embraces social progress, environmental protection and an open international economy.
2. Leaving aside the additional incentives, the future scheme should be neither more nor less liberal overall than the present arrangements, but graduation should serve to target its benefits on the less competitive countries, the least-developed in particular. Technical assistance has an important back-up role to play in ensuring that the poorer countries use the preferential margins accorded by the Community to the full and that they also diversify their export markets (i.e. regional markets or markets of other industrialized parts of the world). Lastly, the "donor country" element in the rules of origin will promote a process of industrial integration between these countries and the Community.
3. Adjustments in the ten-year GSP have to be discussed with preference-giving countries and beneficiaries within GATT and Unctad in Geneva. Even though our GSP is an independent scheme, the Community still needs to hold talks on these changes to ensure that they are understood and accepted.