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## THE EUROPEAN UNION'S NEW GENERALIZED SYSTEM OF PREFERENCES (GSP) SCHEME

### Background

The Community GSP scheme was introduced on 1 July 1971, applying the principles laid down in the UNCTAD generalized system of preferences, which differ from the standard GATT rules and the most-favoured-nation clause, and were authorized by GATT by means of a formal derogation decision, commonly known as the "enabling clause", which was first adopted on 25 June 1971 and renewed on 28 November 1979.

The Community GSP scheme has, since its introduction, been regularly renewed, with a comprehensive review taking place every 10 years.

The first such revision was implemented on 1 January 1981, and was followed by a more limited mid-term exercise on 1 January 1986.

The 10-year revision scheduled for 1 January 1991 was postponed each year until 1 January 1995, when a new scheme entered into force, based on guidelines proposed by the Commission in June 1994 and unanimously approved by the Council on 19 December 1994.

### Main features of the GSP scheme

The GSP scheme has traditionally been an autonomous trade policy instrument aimed at promoting development,<sup>(1)</sup> making use of one of the most classic of trade policy tools, namely tariffs. Its purpose is to offer developing countries lower customs tariffs than those applied to the developed nations, giving their exports preferential access to the Community market.

Today it remains more than ever the accepted view that boosting these countries' exports is one of the best ways of promoting the general growth of their economies. The GSP's specific role is to help the developing countries to industrialize, diversify their exports, and thus increase their export earnings.

In the first years of its existence, the GSP was the only instrument offering the countries concerned this possibility. Being relatively undeveloped, they were not in a position to contribute to the trade

liberalization mechanisms (GATT), and consequently were unable to benefit fully from those mechanisms, which are based on reciprocal concessions.

The GSP was therefore conceived as an alternative to the GATT mechanisms for the countries concerned; hence its importance.

The situation has since changed somewhat. The developing countries have themselves come to realize that it is in their interests to join the multilateral trading system, and that they have the capacity to contribute to that system. Joining GATT, and now the WTO, has therefore become their main objective, and the alternative instrument, the GSP, has come to be seen as merely complementing multilateral mechanisms. This trend has been confirmed by the erosion of the preferential margin on offer to the developing countries as multilateral tariff barriers have been progressively lowered with each new round of GATT liberalization.

The Maastricht Treaty gave fresh impetus to the European Union's external policy in general and Community development policy in particular by identifying the sustainable economic and social development of the countries concerned, and their gradual integration into the world economy, as priority objectives.

The new scheme adopted by the Council of the European Union on 19 December 1994 reflects these developments. It consolidates the GSP's role as a development instrument, by simplifying its administrative procedures, improving the distribution of its benefits and assigning it new goals in the social and environmental fields.

How the new GSP scheme works

In the past, a number of regulations would be adopted each year by the Council establishing the preferential arrangements applicable from 1 January to 31 December for products covered by the scheme and originating in the beneficiary countries.

Henceforth, however, with a view to creating a more stable trade environment, the scheme will be multiannual. Thus, the arrangements entering into force on 1 January 1995 will remain valid for four years (until 1998).

Initially, the multiannual scheme will concern only industrial products (including textiles). For agricultural products, the provisions currently in force will be provisionally extended for one year in 1995 (see below), and a new three-year agricultural scheme will be introduced the year after.

The new scheme for industrial products will incorporate general arrangements and special incentive arrangements. The scheme, which will be run on a day-to-day basis by a Management Committee, will include provisions allowing for its temporary suspension.

## I. General arrangements for the industrial scheme

The general arrangements will be based on two complementary mechanisms, tariff modulation and graduation.

### A. Tariff modulation

Unlike the previous scheme, the new one will impose no preferential limits (quotas, fixed zero-duty amounts, ceilings), which is a major simplification. In other words, the preferential duty is applicable for as long as the scheme remains in force, with no limits on quantity. However, to allow for product sensitivity (previously done using quotas and ceilings), the preferential duty is no longer automatically zero, but will be modulated in line with the category of sensitivity established for each product (Article 2 of the Regulation).

#### 1. Criteria and scope of the modulation mechanism

There are four types of product:

- very sensitive products, basically textiles and ferro-alloys, for which the modulated preferential duty will be 85% of the CCT duty normally applied (Annex I, part 1);
- sensitive products, incorporating a wide range of products from chemicals to shoes, electronics, cars and brushes, for which the modulated preferential duty will be 70% of the CCT duty (Annex I, part 2);
- semi-sensitive products, also very diverse, for which the modulated preferential duty will be 35% of the CCT duty (Annex I, part 3);
- non-sensitive products, which will be completely exempt from customs duty (Annex I, part 4).

As the tariff modulation mechanism is based on product sensitivity rather than the competitiveness of the countries concerned, the modulated preferential duties will be applied to all the beneficiary countries without distinction, with the exception of the least developed countries (Article 3) and those benefiting from the special "drugs" arrangements (see below).

The modulated preferential duties and sensitivity lists will be valid throughout the period the scheme is in force, and will not be reviewed before 1 January 1999.

## 2. Safeguard clause

The only factor that might alter a product's status during this period is the application of the safeguard clause (Article 14), which can be brought into play in exceptional cases, where Community producers are caused, or are threatened by, serious difficulties. This is close to the GATT safeguard clause, and its application will be subject to a procedure that will combine the need for in-depth investigation (by the new Management Committee), and rapid reaction. Provision is even made (Article 14(6)) for an expedited procedure to be invoked under extreme circumstances.

## B. Graduation

Under the previous scheme, allowance could be made for the beneficiaries' varying degrees of competitiveness for specific products by applying individual quotas or even excluding certain countries (differentiation). The graduation mechanism involves an entirely different approach. Rather than assessing the competitiveness of a given country for a given product, the new system will be to evaluate the industrial capacity achieved by each beneficiary in each major production sector, to determine which countries, in view of their degree of development, still need the GSP to maintain satisfactory export levels. Where a country has developed to the extent that that is no longer the case, its GSP benefits will be gradually withdrawn in the sector concerned, giving the less developed countries a preferential advantage over the more advanced countries.

This is a major innovation that will re-emphasize the GSP's main role as an instrument targeting development needs.

### 1. Application criteria

In the interests of transparency and objectivity, details of the criteria are given in Annex II, part 2. The sectors affected by the graduation mechanism in each country are listed in Annex II, part 1. They are identified by applying a specialization index specific to each country in each sector, combined with a development index that measures each country's general level of industrial development in terms of annual per capital income and total manufacturing exports.

### 2. Gradual introduction of the mechanism

To enable the operators concerned to adapt to the new situation, the mechanism will be introduced very gradually.

Barring exceptions (see point 3 below), the graduation mechanism will be introduced in two phases. In the first phase, the preferential margin for a given country in the sector concerned will be halved. For example the preferential duty of 70% of the normal CCT duty applied to sensitive products will be amended to 85%, i.e. the preferential margin will be reduced from 30% to 15%. The margin will be entirely eliminated only in the second phase.

The dates on which the two phases are introduced will vary according to the per capita income of the countries concerned:

(Symbol) countries with a per capita income of over USD 6 000 in 1991 (South Korea, Hong Kong, Singapore and some oil-producing countries): 1 April 1995 for the first phase, and 1 January 1996 for the second phase (exclusion);

(Symbol) countries with per capita income of less than USD 6 000: 1 January 1997 for the first phase, and 1 January 1998 for the second phase (exclusion).

### 3. Exceptions

There will be three types of exception to the graduation mechanism, consisting of two complementary measures and a third exempting certain countries.

(a) eventual exclusion of the most advanced countries (Article 6)

The most advanced countries are due to be excluded from the scheme altogether by 1 January 1998, including in the sectors not initially affected by the basic mechanism, in accordance with criteria that will be defined in a proposal the Commission will submit to the Council in 1997.

(b) "lion's share" clause (Article 5 (1))

The graduation mechanism will also be applied to countries whose share of exports of eligible products in a given sector is greater than 25%, even if the criteria of the basic mechanism are not met.

Unlike the basic mechanism, this measure will bring about exclusion in a single phase, on 1 January 1996.

(c) "minimal share" clause (Article 5 (2))

The graduation mechanism will not be applied to countries whose share of exports of eligible products in graduation sectors is no more than 2%.

4. Transitional measures (Article 5 (3))

The staggered entry into force of the graduation mechanism could conceivably create abnormal situations in which some products would, during the transitional phase, benefit from conditions considerably more favourable than those available under the previous scheme, even though they are due to be completely excluded eventually. It is for this reason that products which were already excluded under the previous scheme, or for which the preferential treatment covered less than 1% by volume of the total exports of the country concerned (0.5% for textiles), will be excluded from 1 January 1995 (see Annex VI). The Commission will also be able to invoke the safeguard clause in a limited number of cases (e.g. cars originating in Korea) if it becomes apparent that preferential imports of these products exceed 1993 levels during the transitional period.

C. Special cases

1. Products covered by the ECSC Treaty (Article 4(4))

ECSC products will be included in the industrial scheme for the first time, but they will continue to be excluded in the case of countries that did not receive preferential treatment under the previous scheme (South Africa, former Soviet republics and Albania).

2. Korean textiles (Article 5 (4))

Textiles products originating in Korea, which were excluded from the scheme in 1994 in response to the increase in customs duties applied to Korean imports of European products, will remain so for one year under the new scheme.

II. Special incentives arrangements (Title II of the Regulation)

This is the most striking innovation of the new GSP scheme, which in this way has acquired new development policy objectives. The main reason for this is the need to bring all the available means - including trade - to bear on helping the beneficiary countries to improve the quality of their development by adopting more advanced social and environmental policies. The additional preferential advantages offered by the GSP scheme in this

connection are designed to offset the extra cost incurred by the countries concerned in introducing such policies.

The principle of awarding additional preferential margins on request to countries that adhere to the ILO conventions (in the social sphere) and those of the ITTO (tropical timber) is enshrined as a formal legal rule (Articles 7 and 8), although it will not be implemented until 1998, to allow the countries concerned to adjust their policies accordingly.

#### A. Application criteria

The social incentive clause (Article 7) will be offered to countries genuinely observing ILO conventions Nos 87 and 98 on trade union freedom and the right of collective bargaining, and convention No 138 on child labour.

The environmental incentive clause (Article 8) will focus only on tropical wood, and will be offered to countries genuinely observing ITTO standards with regard to sustainable tropical forest management.

#### B. Extent of the additional preferential margin

The exact extent of the additional margin offered under these clauses (anything up to a probable maximum of 25%) will be set by the end of 1997, on the basis of assessments carried out by international bodies such as the ILO, WTO and OECD. The intervening period will be used by the Commission to work with these bodies to establish the most effective margin.

#### C. Implementation procedures

The procedures for implementing the incentives clauses will also be established on the basis of a proposal to be submitted by the Commission reflecting the same assessments by the end of 1997. The aim will be to base the procedures for monitoring the application of these clauses on genuine cooperation, to be worked out in detail with the countries concerned, while setting out the procedures for cooperating with the international organizations concerned. Implementation is in any case set for 1 January 1998.

### III. Withdrawal of the GSP scheme (Articles 9 et seq.)

The concept of withdrawing GSP benefits from a country in response to certain practices is not new. It is an inherent feature of the autonomous character of the GSP, and has already been employed in the past in

response to discriminatory or fraudulent trading practices. However, the new provisions are more precise and refer to other degrading and clearly unacceptable practices, such as slave and forced labour, exports of prison-manufactured products, and manifestly inadequate controls on drug trafficking and money laundering.

What is new is the guarantees offered by the proposed procedure, akin to American-style "hearings", which will enable all the parties concerned to put their case on completion of the investigation conducted by the Management Committee.

Decisions to withdraw GSP benefits will be made by the Council acting on Commission proposals.

Unlike the graduation mechanism and the special incentives arrangements, the withdrawal procedure will be applicable from 1 January 1995, after which date complaints pursuant to Article 10 can be submitted to the Commission, which will forward them to the Management Committee.

#### IV. Suspending preferences for products subject to anti-dumping measures (Article 13)

Not all products subject to anti-dumping measures will be automatically suspended from the GSP. The sole purpose of this provision is to ensure that products for which the preferential margin is not taken into account when calculating the extent of the injury (owing to the fact that the GSP scheme is not applicable during the investigation period) do not receive the double benefit of the GSP scheme plus an anti-dumping duty that is lower than it would have been had the preferential margin been taken into account in calculating the extent of the injury.

The products concerned are artificial corundum, silicon carbide and urea originating in the CIS, Russian isobutanol, and South Korean glutamate, microdisks, car radios and D-RAMs.

#### V. Interim arrangement (Article 20)

Because of the extent of the changes the introduction of the new industrial scheme on 1 January 1995 will entail for traders, an interim arrangement will allow goods shipped from their countries of origin before 1 January to benefit from the preferences in force in 1994 up to 15 March, on condition that these goods are covered by fixed, zero-duty amounts that have not been exhausted. As soon as the fixed amounts set for 1994 have been exhausted, the new arrangements will apply. For goods subject to a ceiling in 1994, relief may be granted until 15 March, except under



extraordinary circumstances which would justify curtailing the 1994 arrangements and the application of the new scheme. However, there are no plans to use such measures before 15 March.

## VI. Agricultural scheme

As in the past, the preference scheme for agricultural products, which is to be extended for one year, is far more limited in scope than the industrial scheme. This is primarily because the priority GSP objective has always been to foster the industrialization of the developing countries rather than encourage exports of primary products. In the second place, the constraints of the common agricultural policy have always made it extremely difficult to offer concessions in sectors subject to common market organization. This will continue to be the case in 1995, in spite of a few improvements, notably in the field of cigars (30% rather than 35%).

The main innovation in 1995 is the inclusion of South Africa among the beneficiary countries, although that country will be subject to a fairly long list of exceptions (honey, tobacco, chapters 6-8 & 20 of the CCT) pending a review of its situation in July 1995.

## VII. Least developed countries

Since 1977, and in line with its Tokyo Round commitments, the Community has consistently afforded special treatment to the countries considered by the UN as the "least advanced" of the developing countries. Although most of them are parties to the Lome Convention, and therefore not greatly concerned with the GSP, Bangladesh, Afghanistan, Yemen, Maldives, Nepal, Bhutan, Myanmar, Laos and - a recent addition - Cambodia all benefit from the special GSP arrangements for the least developed countries.

These special arrangements consist of complete exemption from duty for industrial products and admission of a wide range of agricultural products under zero-duty rates. Although the safeguard clause also applies to these countries, they can also benefit from derogations from the rules of origin (see below).

## VIII. Special measures for countries combating drug trafficking

Traditionally, the only countries entitled to arrangements more favourable than the standard GSP benefits have been the least developed countries (see above). However, in 1990 a similar system was provisionally introduced for most of the Andean Group (Bolivia, Colombia, Ecuador and Peru) in view of the problems with which these countries were confronted

in their efforts to combat drug production and trafficking, and the serious social, political and economic destabilization they entailed. The aim is to give the countries concerned export opportunities that will encourage the cultivation of crops other than coca. In 1991, this system was extended to cover agricultural products from Central America (Costa Rica, Guatemala, Honduras, Nicaragua, Panama and El Salvador).

In 1995 these arrangements will be extended for a further four years for industrial products and for one year for agricultural products, and will include Venezuela for the first time.

However, shrimps will be excluded from the system for all the countries concerned, and carnations and tinned and fresh tuna will be closely monitored in 1995, in case it should prove necessary to invoke the safeguard clause against one or more countries, on the basis of reference quantities set in line with past performance or, in the case of the tuna, at 20 000 tonnes.

## IX. Rules of origin

The GSP as a whole is subject to compliance with strict conditions governing the origin of products eligible for preferential treatment.

The rules of origin are covered by detailed regulations of their own, which are laid down by the Commission with the endorsement of the Customs Code Committee, and which not only define product origin but also specify the requisite monitoring procedures.

### A. Definition of origin

The definition of product origin is particularly important where two or more countries are involved in the manufacture of a given product. In such cases, the country from which the goods in question are exported to the Community is only eligible for GSP treatment if the processing that has taken place in that country is sufficient to confer origin. In general, such processing is taken to be sufficient if it entails a change of heading in the nomenclature of the Harmonized System between the imported material and the finished product. However, there are many exceptions to this rule, adding or substituting other processing conditions by describing the type of process that must be carried out to confer origin, or by setting a maximum percentage of imported material.

### B. Regional cumulation of origin

These are special provisions allowing derogations from the above rules in

cases in which a series of processing operations is carried out within the same regional grouping of beneficiary countries. The regional cumulation of origin provisions are designed to encourage the regional integration of developing countries, and are currently applied to ASEAN and the Andean Group. They may also be applied to Central America Common Market countries and other interested regional groupings when the requisite administrative conditions have been met.

#### C. Donor country content

New provisions introduced in 1995 will allow materials or components originating in the European Union to be considered as originating in the beneficiary country in which they are processed. The "donor country content" rule is a major innovation for the GSP scheme, one that will encourage industrial cooperation between EU companies and their counterparts in the beneficiary countries, notably through the creation of joint ventures supplied by imports from the EU.

#### D. Checking procedures

The procedures for checking origin rely entirely on administrative cooperation between customs authorities in the Community and in the beneficiary countries, and require a considerable degree of mutual trust, particularly as the initial responsibility for checking origin lies with the exporting country. Form A certificates of origin issued by an exporting country for its goods are considered by the importing Community authorities to be a kind of "cheque" to be drawn against the Community budget, since the goods such a certificate accompanies are wholly or partially exempt from customs duties, which would otherwise generate own resources for the Community. This highlights the importance of this cooperation, and the acute problems that can be caused by any failure on the part of the beneficiary countries to fulfil their commitments when issuing certificates. There is also a "post-clearance" inspection procedure for certificates of origin, which enables the Community authorities to ask the beneficiary countries to confirm or invalidate their initial decision. Article 9 provides for the possibility of withdrawing GSP benefits in cases of fraud.

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- (1) As distinct from contractual instruments with the same purpose, such as the Lome Convention and the Mediterranean Agreements.

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