

GSP Dispute

Winning the battle, losing the war

The Generalised System of Preferences (GSP)¹ in international trade is a mutually acceptable system of generalised, non-reciprocal and non-discriminatory preferences beneficial to developing countries extended by developed countries. The primary aim of such a programme is to accelerate the rates of economic growth of developing countries.

This programme was recently scrutinised by the Appellate Body (AB) of the World Trade Organisation (WTO) in the matter of India's dispute against the European Commission (EC). India claims victory in terms of being successful in demonstrating that EC's drug arrangements under which it provided additional concessions to Pakistan was inconsistent with the GSP programme. EC feels that the AB has not invalidated its GSP programme *per se*. This trade law brief critically examines some of the aspects of this important case.

What is the dispute?

The EC under its drug arrangements scheme of GSP granted an extra textiles quota in 2002 to Pakistan. This was a reward to Pakistan for allegedly distancing itself from the Taliban regime. India found the additional concessions granted to Pakistan to be discriminatory and complained that her own exports to the extent of US\$250mn have been adversely affected.

EC offered this concession to Pakistan under the WTO's 'enabling clause' which authorises WTO members to operate the GSP notwithstanding the Most Favoured Nation (MFN) obligation given in Article I.1 of General Agreement on Tariffs & Trade (GATT) 1994.

In other words, under the enabling clause a country can grant preferential treatment to goods of a particular country or a group of countries without extending it to other WTO members.

In pursuing the complaint, India argued that the enabling clause does not permit discrimination among the countries, which can be given GSP privileges. The Panel vindicated India's position. It said that under the enabling clause and in particular the "non-discrimination" principle, identical tariff preferences under GSP schemes be provided to all developing countries without any differentiation, except for the implementation of *a priori* limitations.²

In other words, under a GSP programme, better tariff treatment has to be extended to developing countries as a whole and different developing countries cannot be treated differently.

Following the adverse panel decision, the EC filed an appeal before the appellate body on January 8, 2004.

Appellate Body's verdict

The AB overturned the Panel decision, and held that the panel's interpretation of the principle of 'non-discrimination' defined under the enabling clause was incorrect.

The AB held that the term 'non-discriminatory' should not be interpreted to require that GSP donor countries provide 'identical' tariff preferences to 'all' developing countries. Hence, GSP donor countries can discriminate between developing countries, which are at different levels of development.

This is subject to the condition that such discrimination has a development objective and other conditions are met. GSP-donor countries are under no obligation to extend identical tariff preferences to 'all' developing countries.

The other important condition laid down by the AB was that tariff preferences must be an effective means to address the development objectives. The AB also held that conditionality (conditions on basis of which preferential treatment is extended) under the GSP programme should be transparent, objective and non-discriminatory for countries similarly situated.

A GSP scheme can be said to have an objective and transparent basis if there exists enough detailed substantive and procedural criteria to back them.

Apart from the preferential tariff treatment accorded by developed countries to the products of developing countries under GSP programme being non-discriminatory also has to be generalised and non-reciprocal.³

Who won & who lost?

Both the sides *i.e.* India and the EC, based on their own respective interpretation of the AB report are claiming victory. India is claiming that the AB has upheld the finding of the Panel that the tariff preferences to 12 countries given by the EC under its drug arrangements programme of the GSP scheme is inconsistent with the enabling clause.

On the other hand, EC is arguing that the AB has reversed the finding of the Panel and rejected India's claim.

Box 1: Origins of the GSP

The origins of the GSP lie in the first conference of the United Nations Conference on Trade and Development (UNCTAD), held in 1964. In this conference, it was resolved that developed countries should grant concessions to all developing countries and extend to developing countries all concessions they grant to one another and should not, in granting these or other concessions, require any concessions in return from developing countries.

At the second session of UNCTAD in New Delhi in 1968, a unanimous agreement in favour of the early establishment of a mutually acceptable system of generalized, non-reciprocal, non-discriminatory preferences, which would be beneficial to developing countries, was recognised. In 1970, a specialised UNCTAD - Trade and Development Board was established, which adopted the decision on the GSP.

Source: Lorand Bartels (2003): "The WTO Enabling Clause and Positive Conditionality in the European Community's GSP Programme", *Journal of International Economic Law* 6(2).

This case reminds us of the Shrimp-Turtle case⁴, which was procedurally decided in favour of developing countries, but a closer scrutiny revealed that on substantive grounds it favoured the US. In that case the US adopted an import measure, which prohibited the importation of shrimp from any country that did not have a turtle conservation programme. According to US this adopted measure was based on Article XX (g) of General Agreement on Tariffs and Trade (GATT).

According to this Article countries may impose import measures for the conservation of exhaustible natural resources provided the principal conditions given in Article XX are satisfied. Article XX allows imposition of measures restricting imports for non-trade concerns provided the following principal conditions are satisfied.

Firstly, import measures should not be imposed if they lead to unjustifiable discrimination between countries where same conditions prevail. Secondly, the import measures should not act as disguised restriction to international trade.

In this case AB found the US import measure satisfying Article XX (g). However, according to the AB, the import measure adopted by US violated the principal conditions given in Article XX. The US import measure treated some Asian countries differently than its trading partners in western hemisphere.

Therefore, the import measure that was imposed by US was arbitrary and led to unjustifiable discrimination between countries where same conditions prevailed. In other words, the import measure, which restricted importation of shrimp for conservation of exhaustible natural resources, was not illegal *per se*. It became illegal because the import measure discriminated amongst countries, which were similarly situated.

This reasoning is similar to the reasoning given by the AB in the GSP case. The discrimination amongst developing countries by GSP donor country is legal *per se*. However, this discrimination becomes illegal if it is not based on an objective and transparent criteria. The AB found that the EC failed to demonstrate that its drug arrangements are based on transparent and objective

criteria, as they do not allow all developing countries, which are similarly situated to qualify for the preferences under the arrangement.

Thus, there is discrimination amongst countries, which are at a similar footing in terms of development, financial and trade needs.

Hence, just as a country can impose import restrictive measures under Article XX provided there is no discrimination between similarly situated countries, a GSP donor (here EC) country can provide tariff preferences under its drug arrangements scheme provided it does not discriminate between similarly situated countries. Other conditions of GSP programme also need to be fulfilled.

Thus, India won the case, but EC won the law just like in Shrimp turtle where developing countries won the case, but US the law.

Non trade concerns & GSP

One significant element of this case, which has perhaps gone unnoticed, is related to non-trade concerns. To put it squarely, "has the GSP dispute contributed to the jurisprudence related to linking non-trade concerns with trade issues?". The textual support to link non-trade concerns with trade measures is to be found in Article XX of GATT, as discussed above.

Non-trade concerns like labour; environment, human rights etc have often occupied considerable space in trade negotiations. A concerted effort is on by developed countries to bring these issues into the WTO. Developing countries, as a principle and without downsizing the significance of these issues, have opposed the linking of these issues with trade arguing that WTO is a trade body and thus not the right forum to discuss non-trade imperatives.

It is in this context that schemes like GSP assume great importance. Under, a GSP scheme country extends tariff preferences on many grounds or conditionalities. Many of the conditionalities mentioned in the GSP schemes are non-trade in nature. GSP preferences can be extended on non-trade grounds provided these preferences are beneficial to developing countries and are extended on a generalised, non-reciprocal and non-discriminatory basis.

Conditional preferences

Simply stated, conditional preferences mean that extension of preferences (in the form of tariff or other forms) by developed countries to developing countries will be contingent to the fulfilling of certain conditions.

These conditional preferences can be broken into positive and negative conditionalities. In EC's GSP, positive conditionality refers to the possibility of developing countries to apply for additional tariff preferences on all products if they comply with specified labour and environmental measures.

In fact, in EC's GSP programme this positive conditionality has been given a special name called "special incentive arrangement". As the name suggests, under this arrangement countries are granted additional tariff preferences as an incentive or reward for complying with certain labour and environmental conditions.

Negative conditionality refers to the right to withdraw GSP preferences from beneficiary countries for reasons like involvement in slavery, money laundering, etc.

Simply because a conditionality is a positive conditionality, it will not automatically become GATT compliant. The chances of positive conditionality being successful are that most of them are structured in a manner that satisfies the conditions laid down by the AB.

After having explained the basic landscape of EC's GSP, it will be relevant to view this system through the prism of the AB ruling. AB, in its ruling issued on 7th April 2004, stated that developed countries are entitled to apply differential treatment to GSP beneficiaries based on their development, trade and financial needs. It also said that this need should be based on an objective and transparent criteria.

According to the AB, EC's drug arrangement, which was challenged in this case, was not based on an objective and transparent criteria and thus was inconsistent with the "enabling clause".

However, the AB took a contrary position on the conditionality for the protection of labour rights and environment, though this issue was not before it. AB stated that these arrangements are premised on detailed substantive and procedural criteria. Hence there is an objective and transparent basis for them to exist.⁵

Objective and transparent criteria implies that GSP donor countries can base their tariff preferences on those standards or norms, which are, say, part of international agreements. Thus, a GSP donor country can make granting of additional tariff preferences contingent on a country complying with core labour standards or other ILO conventions, or multilateral environment treaties.

Significance of AB's ruling: conditionality & non-trade issues

AB's ruling in the GSP case is significant for three reasons. First, it gives a judicial approval to the existing positive conditionality of EC's GSP. Secondly, it has amplified the scope of adding more conditions to the existing list of positive conditionalities. For instance, tomorrow EC may add human rights to its list of "special incentive arrangement". EC can say that it will extend additional preferences to all those countries that comply with the international UN treaties on human rights.

According to the AB ruling EC is well under its right to have such a positive conditionality. Thirdly, and most importantly, it has imparted momentum to the possibility of bringing in non-trade issues into the WTO.

But, this is not the first time that the AB has done this. In the Shrimp-Turtle case (discussed above) the frontiers of the interface between trade and environment were put to test.

Three years later, in 2001, when AB ruled on Malaysia's challenge to US implementation of its original ruling⁶ it substantiated its position further. It stated that the position it took in shrimp turtle was not just an observation but had a legal significance. The intention was that this ruling should act as a guide for future panels on this issue.

What is interesting to see is that the GSP ruling has moved this issue forward. This ruling is a signal of a greater assertion by the DSB regarding the openness with which it is ready to view non-trade issues. This ruling along with the other two shrimp turtle cases also exhibit a more significant and visible departure from the jurisprudence that evolved in the tuna-dolphin disputes⁷

(which had taken place before the WTO came into being). In these disputes, the approach was that any conflict between environment and trade rules should be resolved in favour of the latter.

One can argue that the DSB reports or rulings are binding only on the parties to the dispute and do not have a precedential value. But, the fact of the matter is that they do have an impact on the existing multilateralism. They influence the negotiations and enable countries to take position on different issues. It won't be imprudent to say that the jurisprudence that evolved in the shrimp turtle case had a role in officially bringing environment onto the trade negotiating agenda. The significance of the GSP ruling should be understood in this context.

Political outfall

The ruling has crucial political outcomes. In the context of the Special & Differential Treatment debate in the Doha Round, rich countries are arguing that there should be differential approach to developing countries, i.e. India, Brazil et al will need to be treated less favourably than say Bangladesh and Benin (see Box: two) It has been vehemently argued that this would only divide the world, and that even otherwise it defies logic.

Developed countries have been using the GSP programme for political purposes and thus there is no guaranteed market access for developing and least developed countries (See Box: three). Even after this ruling the use of GSP programmes for political and foreign policy purposes will continue.

There can be a situation where two developing countries, which are competitors in international trade, are given different tariff preferences, say, by US because one of the two countries serves the political and foreign policy needs of US in a better way. Although, in light of the AB ruling this will not be easy, but at the same time, it will also not be difficult.

Burden of proof

One very important dimension of this case pertains to the issue of burden of proof. One of the questions before the AB was that who bears the burden of invoking the enabling clause.

In order to understand the issue of burden of proof the important fact to be borne in mind is that the enabling

Box 2: GSP and S&DT
Historically schemes like the GSP have been used to operationalise the special & differential treatment (S&DT). In recent years the focus of GSP Programmes has been more on deepening trade preferences for least developed countries and sub-Saharan Africa.
Examples are the EC Everything But Arms initiative, which grants duty- and quota-free access for all goods exported by least developed countries (with delayed implementation for three important products: sugar, rice and bananas) and the US Africa Growth and Opportunities Act, which does similar for a large number of African countries.
Source: Hoekman B, Michalopoulos C, Winters AL (2003), Draft: Special & Differential Treatment for developing countries: Towards a new approach to WTO

clause is an exception to the general principle of MFN. Both the Panel and the AB took this position. As a general rule the burden of proof of an 'exception' falls on the respondent i.e. on the party asserting a particular defence. Applying this rule to the present case the burden of invoking the enabling clause must lie on the EC.

However, in this case the AB came out with a new jurisprudence on the issue of burden of proof for those rules, which are an exception to the general rule.

AB stated that the enabling clause has a special nature. It helps in the Economic development of developing and least developed countries by providing them preferential treatment in the markets of the donor country. This special nature of the enabling clause mandates a change in the general rule on burden of proof for 'exceptions'.

The AB held that the complaining party (in this case India) is required to invoke the enabling clause in making its claim of inconsistency with MFN.

Once the complaining party has identified the relevant obligations of the enabling clause, which have not been met, only then, the respondent is required to show that it has met the obligations of the enabling clause.

It is submitted that the ruling of the AB on the issue of burden of proof is a shift from its own jurisprudence that it has evolved on the issue. This shift in the burden of proof will only complicate the matters further. Imagine a situation where a complainant (developing country) does not invoke a particular provision of the enabling clause in making its claim of inconsistency with MFN.

In such a scenario will the defendant (developed country) be debarred from using the provision not invoked by the complainant (developing country) in its defence?

Box 3: Politics of GSP

The GSP programme does not provide assured or guaranteed market access, as WTO Agreements do to developing and least developed countries. There is no predictable market access because of the ever-changing eligibility criteria in the GSP programme. US keeps changing the eligibility criteria for its GSP schemes. The US Trade Act of 2002 has brought in new conditions like labour, environment and democracy. The Trade Act of 2002 allows the US President to designate any good as GSP eligible from a country provided the good is not import sensitive. Thus, accessibility to American markets under GSP schemes depends on the whims and fancies of the US polity.

Similarly, in the past, changes have been made in country's eligibility by lowering the qualifying per capita Gross National Product (GNP) from \$11,800 to \$8,600. Due to frequent changes in the GSP programmes countries like Pakistan and Malaysia lost their eligibility in 1996 and 1997 respectively. EU has launched a new GSP scheme which will be effective from 1st January 2006. The new GSP scheme is meant to benefit the smaller economies and as a result bigger economies like India, Brazil and China will miss out. For the smaller economies duty free access to 7200 products will be provided. However, the beneficiaries are expected to meet a number of criteria including ratification and effective application of 27 key international conventions on sustainable development and good governance. In theory, this may be a good incentive but in reality many small countries will find it difficult to ratify these conventions. Moreover, whether a smaller country is implementing a convention or not will be based on "interpretative" notions of the EU.

Conclusion

India's victory in this case is restricted to the AB declaring the Drugs regime of the EC being inconsistent with GATT and the enabling clause. But, if viewed from substantive point of view the ruling is in favour of GSP donor-countries differentiating amongst developing countries provided other conditions are satisfied.

This ruling is also an assertive jurisprudence on non-trade issues. Further, it allows developed countries to continue using GSP programmes for political and foreign policy objectives.

On the basis of the arguments given above it can be safely said that this ruling overrides many of the concerns of developing countries.

References

1. Lorand Bartels (2003), The WTO Enabling clause and positive conditionality in the European Community's GSP program, *Journal of International Economic Law* 6(2), 507-532.
2. Robert Howse (2003), India's WTO challenge to drug enforcement conditions in the European community GSP: A little known case with major repercussions for "Political" conditionality in US trade policy, *Chicago Journal of International Law*, Vol.4 No.2.

Endnotes

- 1 It gives developing countries a margin of preference in the tariff rates their goods face in the markets of developed countries.
- 2 Para 7.161 of the Panel report on the GSP case (WT/DS246/R).
- 3 See footnote 3 to paragraph 2(a) of the Decision of 28 November 1979.
- 4 Report of the AB on US – import prohibition of certain shrimp and shrimp products, WT/DS58/AB/R.
- 5 Para 182 of the AB report on the GSP case (WT/DS246/AB/R).
- 6 The AB report on US – Import prohibition of certain shrimp and shrimp products, WT/DS58/AB/RW
- 7 GATT dispute Panel Report on US Restrictions on Imports of Tuna, Sept. 3, 1991, GATT B.I.S.D. (39th Supp.) at 155 (1993), GATT Dispute Panel Report on US – Restrictions on Import of Tuna, June 16, 1994, 33 I.L.M 839 (1994).

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