



ICRIER

Policy series

No. 6 | November 2011

Is the GSP Scheme of the EU benefiting India's exports?

**Anwarul Hoda
Shravani Prakash**

Abstract

A review of the implementation of the European Union scheme of preferential tariffs for developing countries under the Generalised System of Preferences during the past forty years shows that the scheme has made at best a modest contribution towards increasing the export earnings of India and other beneficiary countries covered by the standard GSP. The benefits for these countries have been constrained by the shallow cuts in tariffs for important products and the practice of product/sector graduation. The policy of differentiation among beneficiaries, which is a central pillar of the EU scheme, has resulted in deeper and wider preferences for GSP + countries and LDCs and limited the benefits for other developing countries.

The reduction of MFN tariffs after successive rounds of multilateral trade negotiations has diminished the value of the GSP concessions. If there is accord in the current trade talks in the WTO, the general level of MFN tariffs will be in the range of 3-4 per cent, rendering preferential tariffs even less consequential. It is unfortunate that at present, the prospect for conclusion of the Doha Round appears to be dim. In light of this, perhaps a better bet is forging ahead with the bilateral trade and investment agreement that India and the EU have been negotiating since 2007. A deal on this front might bring home advantage on the tariff front vis-à-vis the EU that is bigger than what the Doha Round can offer.

JEL Classification: F13, F14, F15

Key Words: Generalised System of Preferences (GSP), preferential tariffs, European Union, India's exports

Authors' Email Address: anwarhoda@yahoo.com; sprakash@icrier.res.in

Executive Summary

It is now forty years since the EU introduced its scheme of preferential tariffs for developing countries under the Generalised System of Preferences (GSP). The GSP was recommended at the Second Session of United Nations Conference on Trade and Development held in 1968 as a generalized, non-reciprocal, and non-discriminatory system of preferences in favour of developing countries to increase their export earnings, promote their industrialization and accelerate their rates of economic growth. The paper undertakes an evaluation of the operation of the EU scheme from India's perspective.

Expanding FTAs diminish significance of EU GSP

From the outset the significance of the EU GSP scheme was considerably reduced by the unilateral and non-reciprocal preferential arrangements such as those for the African-Caribbean-Pacific (ACP) countries, which generally envisaged deeper and wider preferences for a subset of GSP beneficiaries, which were either erstwhile colonies of the member states or developing countries in the neighbourhood of Europe. These preferences have been or are being phased out but they are being substituted with Free Trade Area (FTA) agreements. The EU is also entering into FTA agreements with a number of other developing countries, which did not benefit from any pre-existing preferential arrangements. The fast expanding territorial coverage of FTAs beyond the ACP and Mediterranean countries will diminish the significance of the EU GSP scheme even further.

Policy of differentiation among beneficiaries

Differentiation among beneficiaries is a central feature of the EU scheme as it has evolved. This has resulted in three separate arrangements under the GSP viz., the standard GSP for developing countries generally, GSP Plus for selected beneficiary countries and Everything But Arms (EBA) initiative for the least developed countries. The differentiation between the standard GSP scheme on the one hand and the GSP + and EBA initiative is both in terms of product coverage and the depth of tariff cut. The product coverage of the standard EU GSP scheme is nevertheless quite extensive: its main limitation from the perspective of India is the shallow preferential advantage in the case of labour intensive products, which in most cases are listed as sensitive products, with a tariff advantage of 3.5 percentage points below the MFN rate. In respect of textiles and clothing, the admissible margin is even less at 20 per cent of the MFN tariffs.

An unfavourable aspect of the policy of differentiation among beneficiaries is that the GSP + benefits are linked to the attainment of non-trade related objectives. GSP + benefits are available to beneficiaries who have ratified 16 core human and labour rights UN/ILO conventions and at least seven of the 11 conventions related to the

environment and governance principles listed in the Council Regulations. The paper argues that multilevel preferences, which the EU introduces to reward those beneficiaries that accept the conditionality, are bad for the trading system: they may cause trade diversion and welfare loss to importing donor countries and loss of trade opportunity for exporting countries not covered by the additional benefits. In this context, the paper recalls the criticism made by another scholar on legal, economic, political and systemic grounds and calls for fresh scrutiny by WTO members of the Appellate Body of the 2004 ruling in a dispute, permitting GSP granting countries to differentiate among the beneficiary countries based on their development, trade and financial needs.

Policy of product/sector graduation

Another important aspect of the EU GSP scheme is the policy of product/sector graduation, whereby a beneficiary is excluded from the GSP benefit in case imports from that beneficiary exceeds 15 per cent (or 12.5 for textiles) of the GSP imports in a section of EC customs tariff from all beneficiaries in three consecutive years. If, in subsequent years, imports from the beneficiary concerned fall below the designated levels, the benefit is restored. The study finds a fundamental flaw in this practice. Preferences cannot be expected to spur investment in beneficiary developing countries if they are switched off just when they begin to show results and switched on again when they fall below the threshold. By creating uncertainty in the continuation of the preference, it eviscerates it of the long-term benefit of promoting industrialisation in the preference receiving country.

Trends in preferential imports into the EU under the GSP

Analysis of the trends of imports from beneficiary countries other than China (which was affected greatly by product/sector graduation) during the five years before the Great Recession of 2008 shows that preferential imports grew by 91 per cent as compared to 61 per cent for MFN dutiable imports. A preliminary conclusion from this is that, on the whole, the standard GSP is having a mild incremental effect on imports from the covered developing countries.

India has to its credit the highest level of imports benefiting from the GSP. India's GSP exports of products in which the preferential duty was more than zero grew by 72 per cent whereas those of products that entered duty free grew by 180 per cent. Another indicator of the value of GSP is the fact that the GSP utilisation rate during the decade was 81-90 per cent, which would not have been the case if the exporters had not attached value to the duty preference and not cared to submit the certificates of origin.

India experienced product/sector graduation in three groups of products, and the trends show that graduation had an adverse effect and de-graduation a favourable effect.

Way forward

The analysis of the EU scheme shows that it has made a modest contribution to the original objectives of the GSP in respect of developing countries covered by the standard GSP, including India. The benefits have, however, been constrained by the shallow cuts in tariffs for important products, product/sector graduation and the deeper and wider preference for GSP + countries and LDCs.

The reduction of MFN tariffs after successive rounds of multilateral trade negotiations has diminished the value of the GSP concessions. If the current trade talks are eventually successful, the general level of MFN tariffs will be in the range of 3-4 per cent, rendering preferential tariffs even less consequential. At the same time, with more FTAs being negotiated by the EU, the territorial coverage of its trading partners with duty free status is expanding. In light of these developments, it would be unwise to waste political capital in seeking improvements in order to rid the EU scheme of the shortcomings noted above. It is unfortunate that, at present, the prospect for the successful conclusion of the Doha Round appears to be dim. Perhaps a better bet is forging ahead with the bilateral trade and investment agreement that India and the EU have been negotiating since 2007. A deal on this front might bring home advantage on the tariff front vis-à-vis the EU that is bigger than what the Doha Round can offer.

Contents

Abstract	i
Executive Summary	ii
1. Introduction	1
2. Evolution and Structure of the EU GSP Scheme	2
3. The EU GSP Schemes in Operation	13
4. Conclusions and Recommendations	18
References	22
Annexes	24

List of Tables

Table 1: Total Imports into EU from GSP Beneficiaries (General Program).....	14
Table 2: Total Imports into EU from GSP Beneficiaries (Excluding China)	14
Table 3: Total Imports from the Top GSP Beneficiaries (Billion Euros)	15
Table 4: Imports into EU from India.....	16
Table 5: MFN Dutiable Imports from India of Graduated Tariff Lines	17
Table 6: Textile and Clothing Imports from Pakistan into EU (Million Euros)*	18

Is the GSP Scheme of the EU benefiting India's exports?

Anwarul Hoda and Shravani Prakash

1. Introduction

In 1968, the Second United Nations Conference on Trade and Development adopted Resolution 21 (II) (UNCTAD 1968), recommending the establishment by the developed countries of a “generalized, non-reciprocal, non-discriminatory system of preferences in favour of the developing countries, including special measures in favour of the least advanced among the developing countries”. The objectives were to increase their export earnings, promote their industrialization and to accelerate their rates of economic growth. Conformity with the General Agreement on Tariffs and Trade was ensured by obtaining a waiver (GATT 1971) from the obligations of Article I of the agreement for 10 years. Later the Contracting Parties adopted the decision “Differential and More Favourable Treatment, and Fuller Participation of Developing Countries” (GATT 1979), which gave a more permanent legal basis to preferential tariff treatment under the Generalized System of Preferences (GSP) to developing countries.

The EU was one of the first developed economies to introduce the preferential scheme for developing countries in 1971. In the four decades since it was introduced, the scheme has evolved and from time to time, the European Commission has announced changes in product coverage, tariff treatment and differentiation among beneficiary countries. During the three rounds of multilateral trade negotiations held since 1971, the EC has reduced its MFN tariffs and this has narrowed the margin of preference under the GSP. This margin is likely to be reduced further if the ongoing Doha Round negotiations conclude successfully. There has also been a sea change in the external economic policies of India after economic reforms were introduced in 1991-92 and the country decided to progressively integrate itself with the world economy. Now the economic environment and trade policies in the major economies of the world have a greater impact on the economic activities in the country. In the past, the EU has been one of the most important markets for India's exports and it remains important, even though the shares of many developing countries in India's trade have risen rapidly.

In this context, this paper undertakes an evaluation of the GSP scheme of the EU from India's perspective. How has this scheme evolved and what has been the trend in its operation and implementation? What does the future hold in respect of preferential tariff treatment under the GSP in the EU for countries like India? Section 2 takes up the evolution and structure of the scheme and Section 3, its operation and implementation. In Section 4, we offer our conclusions and recommendations.

2. Evolution and Structure of the EU GSP Scheme

Periodic renewal of GSP scheme of the EU

The current EU GSP scheme is embodied in the EU Regulation of 2008 (EU 2008) which is valid for the period 2009-11. The Proposal for a Regulation of the European Parliament and of the Council (EU. 2011a) envisages that new rules will apply from January 1, 2014. In the meantime the existing provisions have been rolled over until December 2013 (EU. 2011b).

One feature of the EU GSP scheme from the outset has been that it has been renewed for three years at a time. While this periodicity is better than a yearly review, it must be noted that even this three years life period does not invest the trade regime with the desired level of stability and predictability. A longer period is needed if the improved access given under the GSP is to result in increased investment. The good news is that in its latest report (EU.2011a), the Commission has recommended that the extension of the scheme beyond 2013 should be on an open-ended basis.

Beneficiaries and country graduation

When the EC GSP scheme was first introduced in 1971, its benefits were extended to all developing countries that were members of the Group of 77 in UNCTAD. Subsequently, China and the 'economies in transition' that emerged from the dissolution of the Soviet Union were also made eligible.

Country graduation was introduced in 1998 (EC.1998) for the scheme for the years 1999-2001, which provided that countries/territories would be excluded from the list if the per capita income exceeded US\$8210 for 1995, and the development index calculated according to the methodology indicated in the Regulation exceeded a certain level. Accordingly, three beneficiary countries/territories – Hong Kong China, Singapore and South Korea – were excluded from the list. Subsequent regulations have provided that a beneficiary country would be removed from the scheme if it was classified by the World Bank as a high-income country for three consecutive years and the imports from the beneficiary are regarded as sufficiently diversified. The latest Proposal (EU.2011a) envisages graduation of the upper-middle income countries as well in the schemes after December 31, 2013, but eliminates the requirement of diversification.

Clearly, the trend in the EU is to increasingly limit the benefits of GSP to the poorer developing countries and to edge out the richer or more competitive developing countries. In a press release (EU. 2011c), it has been observed that 'many poorer countries are lagging behind' and 'are affected by competition from more advanced emerging countries' and goes on to suggest that there is 'need to concentrate preferences on those that most need them: low and lower middle income countries'.

Phase out of non-reciprocal preferential arrangements and establishment of free trade area agreements

For many decades, non-reciprocal preferential arrangements with African-Caribbean-Pacific (ACP) countries were a key feature of the European Communities' trade policy. These preferences were a legacy of the preferences of colonial times, which were initially embodied in the first Yaounde Convention (1963) and the second Yaounde Convention (1969) between the EC(6) and 18 African states. Subsequent years saw the perpetuation of the non-reciprocal preference through a succession of conventions, the last of which (Lome IV *bis*) was signed in 1995 between the EU (15) and 70 ACP states.

The Lome Convention envisaged non-reciprocal preferences between the EC on the one hand and the ACP states on the other. The signatories sought to justify these agreements as GATT/WTO compatible by arguing that while Article XXIV envisaged elimination of trade barriers by all participating countries in a free trade area, Article XXXVI permitted developing countries not to make reciprocal concessions in trade negotiations with developed countries. This argument was not accepted by other contracting parties to GATT and the mechanism of waiver had to be resorted to.

Following the entry into force of the WTO Agreement, the rules relating to waivers became tougher. Further, a succession of disputes raised by the Latin American producers of bananas and the USA resulted in adverse findings by the WTO panels and Appellate Body on the EU's preferential regime for ACP countries relating to bananas. Consequently, the EC (15) and 79 ACP countries signed the ACP-EC Partnership Agreement (2000) or the Cotonou Agreement, bringing the curtain down on non-reciprocal preferences. The Cotonou Convention envisages that new agreements would be concluded, which would be WTO compatible trading arrangement. The non-reciprocal approach in preferences for the ACP countries was abandoned and the parties decided to go in for Economic Partnership Agreements (EPAs), which are essentially free trade area agreements with certain agreed flexibilities for the ACP countries in question to take into account the asymmetric economic relationship. For negotiating EPAs, the 77 ACP countries were grouped into six negotiation regions (West Africa, Central Africa, Eastern and Southern Africa, the Southern African Development Community, the Caribbean and the Pacific), based on existing regional integration institutions. The non-reciprocal preferences under the erstwhile Lome Conventions were phased out in 2007. The EU has offered interim EPA agreements to the ACP countries and extended EBA type concessions to those who have initialled the interim agreements. As of June 10, 2011, the EU had entered into a definitive EPA with the 17 countries of the Caribbean region and with Papua New Guinea from among the ACP countries.

Another important group of developing countries, which earlier benefited from essentially non-reciprocal preferences under co-operation agreements signed with the EC in the 1970s, was those in the Southern Mediterranean region. Following a ministerial conference at Barcelona held on November 27-28, 1995, Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, Syria¹ and Tunisia have entered into a new generation of association agreements, which replace the earlier co-operation agreements and envisage, inter alia, the establishment of a free trade area after a transitional period of 12 years. The Palestinian Authority has also signed an interim Euro-Mediterranean Agreement.

The EU has also signed free trade area agreements with a number of other developing countries, which did not benefit from any pre-existing preferential arrangements. These are Mexico, Chile, Colombia, Peru, Korea and six Central American countries – Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama. Apart from the remaining ACP countries, the EU is pursuing FTA negotiations with several other important developing countries including India, Singapore, Malaysia, Brazil, Argentina, Uruguay and Paraguay.

In the past, the significance of the EC GSP scheme was considerably reduced by the unilateral non-reciprocal preferential arrangements such as those for the ACP and Mediterranean countries. The replacement of these preferences by FTAs and the fast expanding territorial coverage of FTAs even beyond the ACP and Mediterranean countries will diminish the significance of the EU GSP scheme even further.

In a recent decision to narrow down the country coverage under its GSP, the EU has also decided that beneficiary countries that have entered into an FTA agreement or signed the proposed Economic Partnership Agreement (EPA) offered to all ACP countries would be excluded from the list of GSP beneficiaries. As a result, the list of beneficiaries is likely to shrink from 176 to 85 countries and further to 81 by the time the new regulations enter into force in 2014. The dwindling number of GSP beneficiaries reflects the decline in the economic importance of the programme.

Tariff treatment

In the original GSP scheme introduced in 1971, agricultural and non-agricultural products received different tariff treatment. Agricultural products received preferential treatment selectively but all industrial products were, in principle, eligible for tariff free treatment. However, ceilings or tariff quotas applied for each country and product. In 1980, the selective treatment of agriculture was continued but a change was made in the system of tariff quotas/ceilings for industrial products. All the beneficiary countries were no longer treated on an identical basis. Instead, limitations were placed through

¹ The agreement with Syria signed in 2008 has not entered into force. On May 23, 2011, the EU decided to put the Association Agreement on hold. .

the rigorous application of tariff quotas fixed by a country for individual products only in respect of highly competitive suppliers. The access for other beneficiary countries was regulated more flexibly through target ceilings for each country. This system of tariff ceilings/ quotas created uncertainty as the exporters did not know at the time of shipping the consignment whether there would be balance remaining in the ceiling/quota when the consignment reached the destination and the GSP concession would be available. If the concessional tariff was applied eventually, it came as a windfall profit for the importer and the exporter got no benefit.

The tariff treatment regime under the GSP scheme was radically altered in 1995. All tariff quotas were abolished and tariff reductions were modulated according to the sensitivity of the product. For very sensitive products, the preferential tariff was 85 per cent of the MFN rate, for sensitive products 70 per cent, and for semi-sensitive products 35 per cent. Non-sensitive products entered duty free into the EC market.

The structure of preferential tariffs evolved further subsequently. In Regulation (EC) 2501/2001, products were divided into just two groups, sensitive and non-sensitive, for the purposes of tariff treatment. All products listed as non-sensitive were duty free under the GSP scheme, except where the MFN tariff had an agricultural component.² For sensitive products with ad valorem duties, the duty was reduced by 3.5 percentage points, except for textile products (Chapter 50 to 63), in which the reduction was by 20 per cent. If in the 1998 scheme, the duty reduction in any sensitive product was more than 3.5 percentage points, the deeper reduction was maintained. The general rule for sensitive products with specific duties was for 30 per cent reduction (except for maxima and minima), but for sensitive products with mixed tariffs, the specific duty component was not reduced. A protectionist feature of the EU GSP scheme that was embodied in the 2001 scheme was that where the duties specified a maximum duty, that maximum was not to be reduced.

The current EU GSP scheme has retained to the present day the basic features of the 2001 scheme with regard to tariff treatment. There are two categories of products, sensitive and non-sensitive, and the same pattern of reduction applies in respect of ad valorem and specific duties.

One more complexity must be recognised here. As we shall see later in the section below under the caption 'Differentiation among beneficiaries', the EU policy of differentiation among beneficiaries has resulted in three separate arrangements under the GSP viz., the standard GSP for developing countries generally, GSP Plus for selected beneficiary countries and Everything But Arms (EBA) initiative for the least

² For many processed agricultural products, the EU tariffs have an agricultural component, the import duties under which are linked to the import duties on the basic agricultural products that go into the manufacture of the processed product. They are calculated on the basis of quantities of notional basic products (skimmed milk powder, sugar, common wheat etc.) in the standard recipe composition for the product.

developed countries. In 2011, the standard GSP envisaged tariff concessions for 6209 out of 9443 tariff lines. Since as many as 2338 tariff lines were duty free on an MFN basis, this meant that only 896 tariff lines were excluded and paid MFN duties. The position regarding GSP tariff treatment under the standard GSP is as follows:

- non-sensitive products are granted duty free treatment, except for the agricultural component
- ad valorem MFN duties for sensitive products are cut by 3.5 percentage points
- specific MFN duties for sensitive products are reduced by 30 per cent
- for textiles and apparel products, the MFN duties are reduced by 20 per cent
- for agricultural products with mixed duties, the reduction applies only to ad valorem component
- Where the MFN rate envisages a maximum, the maximum is not reduced. Where there is a minimum, the minimum does not apply

The differentiation between the standard GSP scheme on the one hand and the GSP + and EBA initiative is both in terms of product coverage and the depth of tariff cut. Against 896 MFN dutiable tariff lines excluded from the standard GSP, 831 are excluded for GSP+ countries and only 22 (covering arms and ammunition) for EBA countries. Further, the EBA countries receive duty free treatment for all products under the GSP. For the GSP+ countries, the MFN duties are suspended in all cases in which only ad valorem or specific duties apply. Where mixed tariffs apply, only the ad valorem component is suspended. A limited exception has been made in respect of chewing gum and the specific duty is reduced to no more than 16 per cent.

While the product coverage of the EU GSP scheme is quite extensive, its main limitation from the perspective of India is the shallow preferential advantage in sensitive products in the standard GSP scheme. As we shall see in Table EU-5 below, the three HS chapters 61(clothing, knitted), 62 (clothing, not knitted) and 82 (motor vehicles and parts), which account for the largest exports from India to the EU, are all listed fully or substantially as sensitive products and consequently, the tariff cuts under the GSP are limited. In men's shirts, for instance, the MFN duty of 12 per cent is reduced by 20 per cent to 9.6 per cent ad valorem under the GSP.

Product/sector graduation

The notion of product graduation of beneficiary countries existed in the EC scheme from the outset and quantitative limits were applied to preferential treatment on imports from more competitive suppliers (OECD, 1983, 30-31). However, in 1994 (EC 1994), the EC took a more decisive step by introducing product/sector graduation. The idea was to ensure that the benefit was directed increasingly towards moderately developed and the least developed countries. The identification of product/sector/country for graduation depended upon the application of a complex formula with two variables, the

development index and the sectoral specialization index of the beneficiary country. The development index was calculated on the basis of the ratios of the per capita GDP and its manufactured exports to the per capita income and manufactured exports of the EC. The specialization index was calculated on the basis of the proportion of a country's imports in a sector of the total imports into the EC in that sector, on the one hand, and the proportion of that country's share of the total EC imports, on the other. For the sectors/countries identified for graduation, the preferential margins were eliminated in phases. The 1994 Regulation further provided that the graduation mechanism would also apply to country/sector if a beneficiary country appropriated more than 25 per cent share of GSP imports in that sector from all beneficiaries. On the other hand, the graduation mechanism did not apply if the exports in a sector did not exceed 2 per cent of the total exports into the EC from all beneficiary countries in that sector.

The product/sector graduation mechanism remained largely unchanged in the scheme for the period 1998-2001 and an annex in the Council Regulation (EC 1998) listed out the country/sector that had been graduated out. In the next scheme for the period 2002-2004 (EC 2001)), the same elements of product/sector graduation were retained but some changes were made in their application. It was provided that the product/country graduation would be applied if the criteria regarding either the development or the specialization index were met for three consecutive years. Equally importantly, it was provided that if the criteria were not met in the three consecutive years, the preference would be re-established.

In the scheme for the period 2006-2008 (EU 2005), the sector/country graduation provision was simplified and based entirely on the share of a beneficiary in the GSP imports from all beneficiaries. The general rule put in place was that the graduation would take place if the share of a beneficiary in the GSP imports in a section of EC customs tariff from all beneficiaries exceeded 15 per cent in three consecutive years. In respect of textiles and clothing, the percentage share was put at 12.5. It was further provided that graduation would not be applied in case the exports of a beneficiary were concentrated in any section and represented more than 50 per cent of imports from the beneficiary in question. This provision has been maintained in the scheme for the period 2009-2011 (EU 2008).

The indication given by the European Commission in the latest proposal (EU 2011a) is that in future, the sector/country graduation provision would be maintained but the number of sections would be expanded and the thresholds will be changed from 15 to 17.5 per cent generally and from 12.5 to 14.5 per cent for textiles and clothing. The number of product sections would be expanded from 21 to 32 in order to ensure that individual product groups are not too wide in coverage and competitive products are not bunched together with non-competitive products.

The application of sector/country graduation mechanism since 1998 shows that, with the increasing dominance of China in the exports of manufactures, that country has

been progressively graduated out for more and more sectors. In 2008, China had been graduated in 12 out of 21 sections, including wood articles, leather and leather goods, footwear, textiles and clothing, jewellery, electronic equipment, automobiles and parts, and miscellaneous manufactured goods. Although other emerging developing countries such as Brazil and Thailand have been graduated for a wider range of products in the past, in the 2008 scheme they have been graduated only for one or two product groups. Brazil has been graduated only for section 4, prepared foodstuffs and section 9, wood and articles of wood and Thailand for section 14, jewellery items. India has been graduated off and on for leather and jewellery but has been excluded for section 11 (a) textiles throughout.

While country graduation on the basis of objective criterion of characterisation as a higher income or upper middle-income country has a certain inherent rationale, there is a fundamental flaw in the practice in the EU of product/sector graduation. By creating uncertainty in the continuation of the preference, it eviscerates it of the long-term benefit of promoting industrialisation in the preference receiving country. As observed by Hudec (1987, 151-152): ‘Just as in the case where trade barriers are reduced on an MFN basis, of course, the trade benefits of a preferential tariff reduction depend in part on the stability of that tariff reduction over time. If the preferential benefit were subsequently withdrawn, investments made by the developing countries in the new trade opportunity could turn out to be wasteful.’

Differentiation among beneficiaries

Special benefits for the least developed countries had been mentioned in the UNCTAD II resolution in recognition of their widely accepted economic backwardness. But a feature of the evolution of the EC scheme has been the introduction of new benefits for other groups of countries in pursuit of non-trade related goals. The first step was taken by them in the 1980s to give more favourable treatment to a number of Latin American countries that had undertaken effective programmes to combat drug production and trafficking. In the policy announced in December 1994 (Council Regulation No 3281/94), non-trade related objectives made a bigger inroad into the EC’s GSP scheme. The EC announced its intention to introduce special features “aimed at supporting the introduction of forward-looking social or environmental policies in certain moderately advanced developing countries”. In 1998, special incentive arrangements and additional preferences were announced for beneficiary countries that voluntarily implemented labour standards laid down in specified ILO conventions or those laid down by ITTO for sustainable management of forests.

Differentiation among beneficiaries on the basis of non-trade related objectives became more entrenched in the EC GSP Scheme in 2001. The scheme (Council Regulation No 2501/2001) for the three-year period 2002-2004 had five components out of which three were related to non-trade related objectives as shown below:

- general arrangements
- special incentive arrangements for the protection of labour rights
- special incentive arrangements for the protection of the environment
- special arrangements for least-developed countries
- special arrangements to combat drug production and trafficking

The pre-existing benefits for the Andean and Central American countries and Pakistan (12 beneficiaries in all) were continued. Additional benefits were also granted for beneficiaries, who implemented the rules embodied in certain listed ILO conventions. Similarly, special benefits were envisaged for beneficiaries, which incorporated in their national legislation, standards and guidelines of the International Tropical Timber Organisation on sustainable management of forests.

The next step in the evolution of the EC scheme was that the three schemes were merged into one, so that instead of five arrangements, there were only three:

- general arrangements
- special arrangements for least developed countries
- special arrangements for sustainable development and good governance

The changes in the EC scheme were to a large extent influenced by the WTO Appellate Body ruling in the WTO dispute raised by India against the EC (WTO 2004). In a far-reaching finding, the Appellate Body ruled that the Enabling Clause allowed GSP granting countries to differentiate among the beneficiary countries based on their development, trade and financial needs.

The Council Regulation of 2005 (EU 2005) consolidated the programmes related to non-trade related objectives into one special incentive arrangement for sustainable development and good governance, known as “GSP plus”. GSP plus benefits are available to beneficiaries who have ratified 16 core human and labour rights UN/ILO conventions and at least seven of the 11 conventions related to environment and governance principles listed in the Council Regulations. In addition, the beneficiaries have to fulfil the vulnerability criteria related to the diversification of its GSP imports to the EC (five largest sections represent more than 75 per cent of GSP import into the EC) and small share of total GSP imports (not more than one per cent of EC total GSP imports). In 2011, 15 beneficiaries (predominantly Latin American countries, a few East European ones and Sri Lanka) are eligible for GSP Plus benefits.

The elements related to non-trade related objectives have remained unchanged during the period 2009-2011. In the scheme beyond December 31, 2013, the current proposal is that GSP Plus arrangement would be strengthened and the incentives would be deepened. There would be minor changes in the vulnerability criteria and the import share limit would be raised from one to two per cent of the total EC GSP imports. At

the same time, the number of sections under which the imports should be more than 75 per cent of the GSP import into the EU has been raised from five to seven. Modulation of GSP benefits among beneficiaries in pursuit of non-trade related benefits has become a permanent feature of the EU GSP scheme. What is more, although the criteria for differential treatment are couched in transparent terms, there is arbitrariness in the selection of criteria and they are designed clearly to make particular countries eligible. It has been acknowledged by the Commission that the changes in the criteria of vulnerability are being made with a view to making larger countries such as Pakistan and the Philippines eligible for GSP Plus benefits. As far as Pakistan is concerned, the initial attempt by the EU was to seek a WTO waiver to enable special preferential benefits to be given to alleviate the economic problems that had resulted from severe floods in 2010.

From India's point of view, the development of a hierarchy of preferential treatment among GSP beneficiaries is an adverse development and it hurts the country's trade interest to be in the least preferred category. Discrimination among developing countries for preferential treatment as practised in the EU also raises wider legal, economic and political/systemic questions. Tomazos (2007, 322-323) has encapsulated the arguments succinctly:

'The Appellate Body's Ruling in *EC-Tariff Preferences* is difficult to justify on legal grounds as tariff preferences that discriminate among "similarly situated" developing countries are not supported either by a reasonable interpretation of the Enabling Clause nor are they tenable in light of its negotiating history. The decision is also difficult to defend on economic grounds as it disregards the potential harm that is caused by trade diversion and the negative externalities that are produced for those developing countries excluded from the special arrangement. Essentially, the Appellate Body's Ruling on the facts of the case can be viewed as a political compromise of sorts: on the one hand, it did not prevent the EC and other donor countries from granting different tariff rates on products from different developing countries, provided such differential treatment is available to all similarly situated country beneficiaries; on the other hand, it found the EC's Drug Arrangements to be inconsistent with the Enabling Clause because they were not made available to all similarly situated developing countries. Ultimately, however, the Appellate Body ruling also fails on political/systemic grounds. Even if the practical effect of this decision might make it harder for preference-granting countries to justify their GSP schemes that treat developing countries differently, the Appellate Body's ruling nevertheless has done relatively little to provide predictability to the GSP system or, more important, provide the much-needed impetus for the WTO Members and, in particular, developing countries to question whether today the Enabling Clause still fulfils its original mandate.'

Temporary withdrawal of benefits

The EC has provisions in its legislation for temporary withdrawal of the GSP benefit from a beneficiary for deficiencies in important aspects of public policy and their implementation. The 1994 EC Regulation provided that the decision for such withdrawal could be taken if, after investigation, it was established that the country concerned practised any form of forced labour or it exported goods made by prison labour. Manifest shortcomings in customs control on export of drugs, fraud or failure to provide administrative co-operation in the administrative verification of the origin of goods and cases of unfair trading practices on the part of the beneficiary country could also lead to such withdrawal. In 1998, it was added that cases of infringement of the objectives of certain international conventions concerning the conservation and management of fishery resources could also result in temporary withdrawal. In 2001, another element was added to the list of reasons for which temporary withdrawal could take place. Flouting of core international labour standards relating to freedom of association, the right of collective bargaining, non-discrimination in employment, or use of child labour could also lead to temporary withdrawal. In the 2005 scheme, the reference to forced labour and core labour standards was replaced by a list of international conventions on human and labour rights in respect of which, serious and systematic violations could lead to temporary withdrawal of benefits. To date, the GSP benefit has been withdrawn from two beneficiaries: from Myanmar in 1997 for systematic use of forced labour and from 2007 from Belarus for widespread violation of trade union rights. In 2009, the GSP plus benefits were withdrawn from Sri Lanka for violations related to three human rights conventions listed in the EC GSP Regulations: the Covenant on Civil and Political Rights, the Convention against torture and the Convention on the Rights of the Child.

There is also a safeguard provision in the EC scheme, enabling withdrawal of the GSP benefit if a product originating in a beneficiary country 'is imported in terms which cause, or threaten to cause, serious difficulties to a Community producer of like or directly competitive products'. This language follows closely the language of Article XIX of GATT 1994, except that the term 'serious injury' has been replaced by 'serious difficulties'. The EC regulations also contain the list of factors that need to be taken into account while deciding on whether serious difficulties are being caused. This provision has not evolved over the years and no safeguard action has been taken. In the latest review of the existing policy, it has been proposed that rules would be elaborated to facilitate invocation of this provision.

Rules of Origin

Rules of origin are necessary to ensure that the beneficiary countries and not others benefit from the preference. Generally, the preference giving countries stipulate rules on when a product is deemed to be fully produced within a country, such as when vegetable crops are harvested or animals are raised there. As regards non-originating

components, rules also list out the processes that do not confer originating status, such as simple operations consisting of sorting, washing, painting and cutting up. More complex are the rules on manufacturing processes that are deemed to confer originating status on the products. The basic requirement is that imported materials should have undergone substantial transformation. Preference giving countries have generally followed two types of rules for determining substantial transformation. The first is a simple requirement regarding a certain percentage of value addition over the imported components and the second is the principle of shift in tariff nomenclature from the imported component to the finished product. Even when this principle is used, the preference giving countries attach specific conditions in some cases.

When the EC GSP scheme was introduced, the rules of origin in cases where imported products were used were intricate and restrictive, based on the principle of shift in tariff nomenclature, with exceptions covered in Lists A and B (OECD, 1983, 25). Recently, the EU rules of origin for GSP have been overhauled (EU 2010) to make them friendly for users in the developing countries. There is significant relaxation of the rules, particularly for the LDCs, but they retain considerable complexity and restrictiveness for other developing countries. In a globalising world, simple rules should govern the originating status of a product that contains material and components imported from third countries. The EU rules stipulate three types of criteria for this purpose – change of HS tariff heading, value percentage and specific process. In some cases, a choice is given between the alternative criteria of change in tariff heading or value percentage, e.g. for motorcycles, it can be manufacture using material other than from HS 8711 or value addition involving third country components valued at not more than 50 per cent. The EU rules of origin become more complex and indeed more restrictive when a specific process is prescribed, as in the case of textiles and clothing products. For men's shirts, for instance, the general rule is that the fabric, which is used, should also have been woven in the beneficiary country concerned in order to be eligible for the preference, the yarn forward rule as it has come to be known. This restrictiveness is extraordinary considering that apparel products are eligible for a preference of 20 per cent, that is, mere 2.4 percentage points on the MFN rate of 12 per cent ad valorem.

The new rules of origin envisage a marked differentiation in favour of LDCs. For instance, in the example of motorcycles given above, the LDC exporter may use imported components up to 70 per cent instead of just 50 per cent allowed to others. Similarly, in the example of men's shirts, the LDC exporter is allowed to use fabric imported from third countries.

One aspect of the EC rules is regional cumulation, whereby the components and materials imported from other beneficiary countries in a regional grouping are treated as domestic products for applying the rules of origin. The four regional groupings eligible for regional cumulation are the ASEAN, Andean and Central American countries, the SAARC and the MERCOSUR.

In addition, the EC rules allow donor country cumulation as well as cumulation in respect of imports of materials from Norway, Switzerland and Turkey. As a country with a relatively diversified economy, India is not affected much by either the restrictiveness of the rules of origin or by the regional cumulation. However, with increasing globalization, the donor country cumulation could be of interest to India in future. Also, as our neighbours industrialise, exports of components from India could be facilitated.

3. The EU GSP Schemes in Operation

Impact of EU GSP on imports from beneficiary countries

Several studies were made during the first two decades of operation of the EC GSP scheme to assess its impact on trade flows. The first by Baldwin and Murray (1977) using pre-GSP 1971 trade flows and an ex ante technique finds the gross trade expansion from the beneficiaries resulting from the EC GSP to be \$217.3 million or 25 per cent of the actual trade flows. Of this increase, only \$18.1 million, or 8.3 per cent, is the result of trade diversion. Sapir (1981), using ex post method concludes that in EC's imports under the GSP from 10 semi-industrialised countries, the gross trade creation grew from 24 per cent (\$153 out of \$627 million) in 1971 to 44 per cent (\$2139 out of \$4807) in 1978. Brown (1989) arrives at a much lower estimate of \$129.6 million for gross trade creation from the GSP schemes of both the EC and EFTA, based on 1976 trade, against trade diversion of \$56.8 million.

Since these studies were made the structure of EU GSP scheme has evolved considerably. After reviewing the results of several studies on the increase in trade volumes and export earnings in preference receiving countries, Grossman and Sykes (2008, 274) reach the conclusion that 'a consensus view might be that the revenue gains have been modest but not trivial.' In the analysis that follows of the trends of imports into the European Union from the GSP beneficiary countries in general and from India in particular, we examine how far this conclusion is borne out by the trade flows in recent years. Is there any evidence of increase in imports benefiting from preferential treatment and of an adverse effect when such treatment ceases to apply as a result of changes in beneficiary status or product/sector graduation? For our purposes, it is not relevant whether there is trade creation or trade diversion because increased exports have a positive effect on export earnings, industrialisation and economic growth. As Hudec(1987) points out:

'From the developing country's perspective, any trade induced by a preference will necessarily represent a higher return than is otherwise available from the resources being employed. In addition, preferences in this final trade-diversion situation may also have positive long-term effects of the infant-industry sort, helping a potentially efficient industry get on its feet.' (Hudec, 1987, 151)

Trends in preferential imports into the EU under the GSP

For assessing the impact of the preferential advantage, we compare the growth rate of total imports with those of preferential imports under the GSP (Table 1). Our starting point is 2004, when the EU expanded with the accession of 10 new member states. While data is available for 2009, it needs to be recognized that in that year, world trade had contracted under the influence of the Great Recession that followed the 2008 financial crisis.

Table 1: Total Imports into EU from GSP Beneficiaries (General Program)

	Value (Billion Euros)						Growth (%)	
	2004	2005	2006	2007	2008	2009	04-08	08-09
Total imports	407	520	629	699	790	597	94%	-24%
<i>MFN=0</i>	251	336	403	428	511	359	103%	-30%
<i>MFN Dutiable</i>	156	184	226	271	279	238	79%	-15%
Eligible imports	75	72	89	104	110	91	47%	-17%
Preferential imports	35	39	43	51	60	48	71%	-20%
Utilization rate (%)	47%	54%	48%	49%	55%	53%	17%	-3%

Source: Commission Report pursuant to Article 28(3) of Council Regulation (EC) No 980/2005 of 27 June 2005 applying a scheme of generalized tariff preferences (2008/C 66/01); GSP Statistical Report from the Commission to the European Parliament and the Council (2011); Eurostat External Trade

It is seen that preferential imports grew only 71 per cent against the rate of growth of 79 per cent in MFN dutiable imports. However, the above data include imports from China, which accounts for a large proportion of developed country imports. Since China has been subjected to product specific graduation in 14 out of 21 sections, the preferential import data of the developing countries as a group has got distorted by the inclusion of China. Imports into the EU from China covered by product/section graduation rose from 31 billion to 112 billion Euros during the period 2004-2008. In Table 2, we consider the data of imports from the beneficiaries of standard GSP without China.

Table 2: Total Imports into EU from GSP Beneficiaries (Excluding China)

	Imports (Billion Euros)						Growth (%)	
	2004	2005	2006	2007	2008	2009	04-08	08-09
Total imports	292	367	441	473	548	388	87%	-29%
<i>MFN=0</i>	201	272	319	326	401	266	99%	-34%
<i>Dutiable</i>	91	95	122	147	147	122	61%	-17%
Covered	80	80	96	113	121	95	51%	-21%
Eligible imports	67	66	86	101	107	88	59%	-17%
Preferential imports	30	34	41	49	58	47	91%	-20%
Utilization rate	45%	52%	48%	49%	54%	53%	20%	-3%

Source: Eurostat External Trade Database

It is seen that preferential imports rose by 91 per cent during this period as compared to 61 per cent for MFN dutiable imports. A preliminary conclusion from this is that, on the whole, the standard GSP is having a mild incremental effect on imports from the covered developing countries. One other aspect that comes out from that table is that the percentage utilisation of GSP has hovered around 50 per cent in recent years. Low utilisation was widely experienced in the early days of the GSP because of the lack of knowledge about the availability of the preference. However, after four decades of GSP, if the utilisation is still low, the causes might be deeper. Where the MFN tariffs are low or where the depth of cut is very shallow, the exporter/importer may not care to ensure that the preferential tariff is actually utilised.

Table 3 gives details about imports from the top 10 countries who are also beneficiaries of EU GSP. It is seen that the proportion of MFN dutiable imports is higher in the case of China, India, Thailand, Indonesia and Bangladesh; and consequently, the GSP matters more to them. On the other hand, MFN duty free imports are predominant in the case of Russia, Brazil and Malaysia. Out of the beneficiaries with high proportion of MFN dutiable imports, China is hit by the product/sector graduation with the result that the preferential imports from it are very small. It is to be noted, however, that imports from China have continued to surge in the period 2004-2008 even without the preferential benefit. This reflects their high level of competitiveness over a broad area of goods, particularly manufactures. India has to its credit the highest level of imports benefiting from the GSP. However, Bangladesh, which benefits from the wider and deeper preference available to EBA countries, utilises the concession over a larger proportion of MFN dutiable imports.

Table 3: Total Imports from the Top GSP Beneficiaries (Billion Euros)

	Total Imports			MFN Duty-free Imports			MFN Dutiable Imports			Eligible Imports			Preferential Imports		
	2004	2008	2009	2004	2008	2009	2004	2008	2009	2004	2008	2009	2004	2008	2009
China	115	242	209	51	111	93	64	132	116	8	3	3	5	2	1
Russia	62	144	96	58	137	91	4	7	5	2	4	5	1	2	3
India	15	28	24	5	9	7	10	19	17	8	18	16	7	15	13
Brazil	19	33	23	12	23	16	7	10	7	3	6	4	3	5	3
Malaysia	14	16	14	10	11	9	4	6	4	2	5	4	2	3	3
Thailand	12	16	13	5	6	5	7	10	8	4	7	7	3	5	4
Indonesia	9	12	10	4	6	4	5	6	6	4	5	5	3	4	3
Argentina	6	10	8	3	6	5	2	4	3	1	3	2	1	2	2
Bangladesh	4	5	6	0	0	0	4	5	6	4	5	6	3	4	5
UAE	4	5	3	3	2	1	2	3	2	1	3	2	1	2	1

Source: Eurostat External Trade Database

Table 4 gives the data of India's exports benefiting from the EC GSP scheme during the period 2004-2009. We consider the data for the period 2000 to 2008 because of the effects of recession in 2009. During this period, exports of dutiable products have risen by 91 per cent while the exports of products benefiting from the preference have grown at a slightly higher rate of 113 per cent.

Table 4: Imports into EU from India

	Value (Billion Euros)						Growth (%)	
	2004	2005	2006	2007	2008	2009	04-08	08-09
Total imports	15	17	21	24	28	24	90%	-14%
<i>MFN=0</i>	5	5	7	8	9	7	87%	-23%
<i>Dutiable</i>	10	12	14	17	19	17	91%	-10%
Eligible imports	8	10	12	14	18	16	116%	-7%
Preferential imports	6.9	8.6	10.2	12.3	14.7	13.1	113%	-11%
<i>imports at GSP=0</i>	2.6	3.2	4.0	5.5	7.3	5.4	181%	-26%
<i>imports at GSP>0</i>	4.3	5.4	6.2	6.7	7.4	7.7	72%	4%
Utilization rate	88%	90%	83%	86%	83%	81%	-5%	-3%

Source: Eurostat External Trade Database

Since the figures of preferential imports are influenced by exclusion/inclusion as a result of graduation/de-graduation and there were changes in this during the period 2004-08, the calculations of increase in preferential exports could have got biased to some extent. Within the GSP, the exports of products in which the preferential duty was more than zero grew by 72 per cent whereas those of products that entered duty free grew by 180 per cent. Another indicator of the value of GSP is the fact that the GSP utilisation rate during the decade was 81-90 per cent, which would not have been the case if the exporters had not attached value to the duty preference and not cared to submit the certificates of origin.

Annex Table 1 shows the trend in preferential imports in the 16 HS Chapters that constitute the major preferential imports from India. Out of these, the trend in preferential imports got affected by graduation in Chapter 42 (Articles of leather), Chapter 57 (Woollen carpets) and Chapter 71 (Jewellery). It is seen that exports from India of non-traditional items such as machinery, electrical machinery and vehicles and vehicle parts have been more buoyant than those of traditional items such as textiles and apparel, leather articles and jewellery. One of the reasons for the lower growth in apparel is competition from Bangladesh, which benefits from duty free treatment as an LDC against the shallow cut of 20 per cent in the MFN duty that India gets. Bangladesh is particularly strong in knitted garments (HS Chapter 61), accounting for preferential imports in 2009 of about 3.3 billion Euros (market share 16 per cent) against 1.8 billion Euros (market share 9 per cent) from India. In this area, the deeper GSP concessions for LDCs have clearly had an adverse impact on India. In fact, while the effect of GSP on

India's exports as a whole is beneficial, the same cannot be said about its effect on exports of textiles and clothing. Here, due to deeper benefits given to Bangladesh, the overall effect of GSP on India's exports is negative.

Effect of graduation on imports from beneficiary countries

We have noted earlier that one of the features of the EU scheme for many years has been the practice of product/sector graduation of beneficiary countries, imports from which cross the stipulated threshold of share of global GSP exports in particular years. What effect does graduation have on the trend in imports? This is an important aspect to look at, because the value of a GSP concession is likely to be more apparent in cases in which the availability of the concession is not continuous.

India has experienced graduation in three product groups in certain years during the last decade and Table 5 shows the export performance in those groups from 2002.

Table 5: MFN Dutiable Imports from India of Graduated Tariff Lines
(Million Euros)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Textiles (Chapters 50-60)	1,227	1,265	1,097	1,019	1,137	1,191	1,319	1,433	1,313	1,044
Leather and Articles of Leather (Chapters 41-43)	863	972	892	799	775	840	878	967	1,075	946
Pearls, Gems and Jewellery (Chapter 71)	249	253	282	286	294	343	392	395	363	359

Source: Eurostat External Trade Database

* Shaded area shows the years in which the products were graduated

In Chapter 42 Articles of leather (luggage, handbags, leather apparel etc.), exports from India showed a marked upward trend after 2006 when the preference was restored after four years of graduation. In textiles (chapters 50-60 including woollen carpets etc.) too, exports dipped immediately after graduation in 2001 although the levels improved over a longer period. In jewellery, imports did not register a fall immediately after graduation but the growth rate did tend to become flat after a period of sustained rise.

Other emerging countries have also been subjected to product/country graduation and Annex Table 2 shows the value of exports of these countries during the years of graduation as well as the years in which they were eligible for the benefit. Brazil's exports of meat under Chapters 1 and 2 and of coffee under chapter 9 seem to have been affected adversely by the withdrawal of GSP during the years 2002-2005. On the other hand, the effect is not so perceptible in the case of footwear. In Thailand's case, some effect is seen on fishery products and in leather products but very little effect is

apparent in jewellery and edible beverages. In both Malaysia and Indonesia, graduation affected exports of wood and wood products. On the other hand, it did not affect exports of fats and oils from these countries, reflecting the high degree of their competitiveness in this product. The effect on Malaysia's exports of plastic and rubber articles is not very pronounced but in Indonesia, graduation seems to have affected exports of footwear. As noted earlier, graduation does not seem to have affected China's exports of a wide range of goods because of its high level of competitiveness. In some chapters (5 and 12), graduation has caused a blip for one or two years before resuming growth while in others, (39-40 and 47-49) no brake is perceptible at all in the onward march of China's exports despite graduation.

Pakistan's case also merits analysis on account of the fact that during the years 2002-05, it benefited temporarily from deeper preference under the Drugs Arrangement and enjoyed full suspension of ad valorem tariffs. We examine the data for the years (2002-05), in which Pakistan enjoyed the benefit, and later years, when it did not remain eligible for the benefit under the Drugs Arrangement. Pakistan is a major exporter of textiles and clothing and the data in Table EU-8 shows the effect that the deeper preference under the Drugs Arrangement had on its exports to the EC. We find that during the years 2002-05, the benefit of the Drugs Arrangement gave a perceptible push to Pakistan's exports of textiles and even more to Pakistan's exports of clothing.

Table 6: Textile and Clothing Imports from Pakistan into EU (Million Euros)*

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Textiles (50-60)	620	635	572	552	645	631	657	701	702	569
Clothing (61-63)	1,044	1,124	1,324	1,444	1,520	1,375	1,450	1,538	1,600	1,655

Source: Eurostat External Trade Database

* Shaded area shows the impact of Drugs Arrangement (2002-05)

4. Conclusions and Recommendations

Has GSP scheme of EU stimulated imports from India?

The GSP scheme of the EU countries has served to stimulate mildly India's exports of manufactured products in the long-term and, despite limitations, it seems to have had more than borderline utility for India. As export flows are affected by myriad factors, the most important of which is the supplying country's competitiveness in a particular product, it is not always possible to connect buoyancy in exports with the availability of preferential concession. However, the weight of evidence points towards a positive correlation. The EU preferential imports from India grew at a rate somewhat higher than MFN dutiable imports, and the preferential imports that received duty free treatment under the GSP were more buoyant than preferential imports on which duties were paid. Graduation/degradation of specific products had some effect on the level of

imports but such effect was not always pronounced. The rate of utilisation (preferential imports/eligible imports) was uniformly high (80-90 per cent) for India, indicating that importers/exporters attached value to the preferential rate of import duty.

Limitations affecting GSP benefits for India

In the EU, the limiting factor is shallow reduction of tariff in sensitive categories, particularly textiles and apparel on which only a 20 per cent concession is available. Sector/country exclusion in the EU scheme is another feature that affects India adversely.

Graduation of countries from the benefit of the GSP programme was a major issue in the early days of the programme when there was no settled practice in this regard among the preference granting countries. However, since then, the EU has decided that the principal criterion for graduation of a country as a whole from the GSP programme will be its designation as a high-income country by the World Bank and there is wide acceptability of the criterion. The EU has stirred the pot again by proposing that in addition to the high-income countries, the upper middle-income countries would also be excluded from beneficiary status after December 31, 2013, when the existing framework would change. The exclusion of upper-middle income countries will impinge only on a few beneficiaries like Namibia and Gabon, who have the alternative of signing Comprehensive Economic Partnership Agreements proposed by the EU in lieu of the unilateral preferences for ACP countries that have been withdrawn. Although the EU policy papers show that there is a clear move for the exclusion of more competitive developing countries, the danger of India being excluded does not appear to be imminent. From the perspective of India, the main issue now is the practice of product or sector specific exclusion/graduation, under which exports from beneficiaries lose the benefit when imports from them under particular groups of products, tariff lines or sections cross a stipulated threshold. This practice defeats the main purpose for which the GSP was introduced, which is to promote the industrialisation of the developing countries. Preferences cannot be expected to spur investment in beneficiary developing countries if they are switched off just when they begin to show results and switched on again when they fall below the threshold. The concept is flawed for one other reason. By stipulating the same threshold of share of imports for graduation/exclusion for all countries, the EU ignores the difference in size of the economy of the beneficiary countries.

Differentiation among beneficiaries

Another feature of the EU scheme is the availability of deeper benefits to various categories of beneficiaries. When the concept of preferential tariffs under the GSP was agreed to in the UNCTAD, an important requirement was for it to be non-discriminatory. During the debates in the early 1960s, the main objection raised against introducing preferential tariffs was that it would lead to trade diversion (from efficient

developed country to inefficient developing country suppliers) and cause welfare loss in preference granting countries. By accepting to introduce preferential tariffs, developed countries tacitly accepted the sacrifice on their part with a view to promoting development in developing countries. When the preference granting countries start differentiating among the preference receiving countries, they harm the interest of those who are not favoured with special benefits. Thus, they compel the preference receiving countries to share the cost of granting special benefits to a sub-set of developing countries. It was agreed at the outset that additional benefits would be granted to the least developed countries but by requiring non-discrimination, the UNCTAD recommendations and the Enabling Clause would seem to have ruled out further differentiation among developing countries.

Discriminatory distribution of trade benefits among developing countries by giving some of them better access to markets than others hurts the interests of those who get the lower level of access. For this reason, the argument is unacceptable that the GSP is a gift and therefore, some amount of freedom should be given to the preference granting countries to modulate the benefits among the beneficiary countries inter se.

In this context, the Appellate Body ruling in the WTO dispute (WTO 2004)), permitting GSP granting countries to differentiate among the beneficiary countries based on their development, trade and financial needs, would seem to need fresh scrutiny by the WTO Members. If this ruling is carried to its logical conclusion, it could result in each developing country being given a different treatment on account of its unique development, trade and financial needs. We already have various groupings among developing countries in the UN and in the WTO such as the landlocked countries, island developing countries, net food importing countries, small vulnerable economies; the numbers of categories could keep growing. It is also possible to break up the least developed countries into separate groups on the basis of the availability of natural resources, dependence on agriculture etc. A preferential tariff regime envisaging differentiation among dozens of groupings of developing countries through different levels of tariffs as well as diverse rules of origin would be a nightmare for customs officials and the antithesis of trade facilitation that the WTO Members are seeking to promote.

Policy conditionality

The EU offers deeper benefits if the beneficiary adopts and implements the international conventions and instruments on good governance and sustainable development. The main point of objection against this practice is that the policy conditionality imposes costs on the beneficiary countries that may not be justified from the perspectives of the countries concerned. Multilevel preferences, which the EU introduces to reward those beneficiaries that accept the conditionality, are bad for the trading system: they may cause trade diversion and welfare loss to the importing donor countries and loss of trade opportunity for the exporting countries not covered by the

additional benefits. In addition, it is questionable if the economic benefits derived from the preferences are significant enough for the beneficiary countries to compensate for the effort necessary to implement the policy in question. As an internal paper prepared in the European Commission recognises, while the GSP+ scheme might have persuaded the beneficiary countries to sign and ratify international conventions, actual progress in implementing them has not been demonstrable as that depends on ‘domestic political dynamics’.

Way forward

It would appear from the foregoing analysis that the EU scheme has made some contribution to the original objectives of the GSP in respect of developing countries covered by the standard GSP, including India. However, these benefits are somewhat modest, constrained as they are by the shallow cuts in tariffs for important products, product/sector graduation, deeper and wider preference for GATT + countries and LDCs. The reduction of MFN tariffs after successive rounds of multilateral trade negotiations has diminished the value of the GSP concessions. If there is accord on the Swiss formula and the coefficient of 8 proposed by the Chairman of the Negotiating Group (WTO 2011), the highest bound level of MFN duty on industrial products will come down from 26 to 6.1 per cent in the EU and the general level of tariffs will be in the range of 3-4 per cent, rendering preferential tariffs even less consequential. At the same time with more FTAs being negotiated by the EU, the territorial coverage of its GSP scheme is contracting. In light of these developments, it would be unwise to waste political capital in seeking improvements in order to rid the EU scheme of the shortcomings noted above. It is unfortunate that at present, the prospect for conclusion of the Doha Round appears to be dim. In light of this, perhaps a better bet is forging ahead with the bilateral trade and investment agreement that India and the EU have been negotiating since 2007. A deal on this front might bring home advantage on the tariff front vis-à-vis the EU that is even bigger than what the Doha Round can offer. At one stroke, it would get us much deeper access into EU markets in goods and deliver us from the inequities and discriminatory treatment in the EU GSP scheme, which is slated to increase in 2014.

References

- Baldwin, R.E. and T. Murray. 1977. 'MFN Tariff Reduction and Developing Country Benefits under the GSP', *Economic Journal* 87 (March):30-46.
- Brown, Drusilla K. 1989. 'Trade and Welfare Effects of the European Schemes of the Generalised System of Preferences', *Economic Development and Cultural Change*, 37: 757-776.
- European Communities (EC) 1994. Council Regulation (EC) No 3281/94 of 19 December 1994. Official Journal L 348.
- European Communities (EC). 1996. Council Regulation (EC) No. 1256/96 of 30 June 1996. Official Journal L 160.
- European Communities (EC). 1998. Council Regulation (EC) No 2820/98 of 21 December 1998. Official Journal L 357.
- European Communities (EC). 2001. Council Regulation (EC) No 2501/ 2001 of 10 December 2001. Official Journal L 346.
- European Union (EU). 2005. Council Regulation (EC) No. 980/2005 of 27 June 2005. Official Journal 2005 L 169.
- European Union (EU). 2008. Council Regulation (EC) No 732/ 2008 of 22 July 2008. Official Journal 2008 L 211.
- European Union (EU).2011a. Proposal for a Regulation of the European Parliament and of the Council Applying a Scheme of Generalised Tariff Preferences, Brussels, 10.5.2011 COM (2011) 241 final, 2011/0117 (COD)
- European Union (EU). 2011b. Regulation (EU) No 512/2011 of the European Parliament and of the Council of 11 May 2011. Official Journal L/145/28
- European Union (EU). 2011c. More Benefits from Preferential Trade Tariffs for Countries Most in Need: Reform of the EU Generalised System of Preferences Europa Press Releases, MEMO/11/284
- European Union (EU). 2011 d. European Commission, Commission Staff Working Paper, Impact Assessment, Volume I, Accompanying the document, Proposal for a Regulation of the European Parliament and of the Council, Brussels, 10.5.2011

- General Agreement on Tariffs and Trade (GATT). 1971. Basic Instruments and selected documents (BISD), Supplement 18, 24, Geneva. Contracting Parties to the GATT
- General Agreement on Tariffs and Trade (GATT). 1979. Basic Instruments and selected documents (BISD), Supplement 26, 203. Geneva. Contracting Parties to the GATT
- Grossman, Gene M and Alan O. Sykes. 2007. 'A Preference for Development: The Law and Economics of GSP', in George A. Bermann and Petros C. Mavroidis (eds.), *WTO Law and Developing Countries*, Columbia Studies in WTO Law and Policy, 2007
- Hudec, Robert E. 1987. *Developing Countries in the GATT Legal System*. Cambridge, England: Cambridge University Press.
- Organisation for Economic Cooperation and Development (OECD). 1983. The Generalised System of Preferences: Review of the First Decade, Report by the Secretary General, Paris: OECD.
- Sapir, A. 1981. 'Trade Benefits under the EEC Generalized System of Preferences', *European Economic Review* 15 (February 1981): 339-55.
- Tomazos, Anastasios. 2007. 'The GSP Fallacy: A critique of the Appellate Body's Ruling in the GSP Case on Legal, Economic, and Political/ Systemic Grounds', in George A. Bermann and Petros C. Mavroidis (eds.), *WTO Law and Developing Countries*, Columbia Studies in WTO Law and Policy, 2007
- United Nations Conference on Trade and Development (UNCTAD). Proceedings of the United Nations Conference on Trade and Development, Second Session, vol. I [and Corr.1 and 3 and Add.1 and 2], Report and Annexes (United Nations publication, Sales No. E.68.II.D.14), p. 38.
- World Trade Organisation (WTO) 2004. European Communities – Conditions for the Granting of Tariff Preferences to Developing Countries- Report of the Appellate Body. Document WT/DS246/AB/R
- World Trade Organisation (WTO). 2011. Textual Report by the Chairman, Ambassador Luzius Wasescha, on the State of Play of the NAMA Negotiations.
- WTO Document TN/MA/W/103/Rev.3/Add.1 of 21-04-2011

Annex Table 1 – Major Imported Commodities from India into EU

HS Chapter	Imports (Million Euros)									% Growth	
	Total			GSP Eligible			Preferential			Total Imports	Preferential Imports
	2004	2008	2009	2004	2008	2009	2004	2008	2009	2004-08	2004-08
27 Mineral Fuels & Oils	286	2,005	1,557	141	1,664	855	133	1,085	372	600%	718%
29 Organic Chemicals	764	1,593	1,492	608	1,190	1,183	405	731	707	108%	80%
39 Plastics	152	420	305	145	391	288	130	337	251	177%	159%
40 Rubber and articles	155	384	294	118	307	244	108	291	234	147%	170%
42 Articles of leather	645	893	839	0	893	839	0	800	759	39%	De-graduated in 2006
57 Carpets	349	430	354	0	0	0	0	0	0	23%	Graduated in 2001
61 Clothing, knitted/crocheted	1,126	1,859	1,901	1,126	1,859	1,901	1,044	1,772	1,820	65%	70%
62 Clothing, not knitted/crocheted	1,143	1,910	2,113	1,143	1,910	2,113	1,001	1,720	1,957	67%	72%
63 Other made up textile articles	610	766	704	609	763	703	577	720	669	25%	25%
64 Footwear	638	957	921	638	957	921	593	901	867	50%	52%
71 Pearls, Gems and Jewellery	1,641	2,061	1,612	294	0	359	272	0	293	26%	Graduated from 2006-2008
72 Iron and Steel	669	2,044	695	49	512	100	48	502	96	206%	945%
73 Articles of Iron and steel	350	839	594	263	620	486	231	558	443	140%	142%
84 Machinery	565	1,664	1,284	472	1,338	1,058	358	1,021	826	195%	185%
85 electronics	703	1,906	1,618	295	873	541	183	678	373	171%	270%
87 Vehicles and parts	545	1,161	1,892	542	1,134	1,870	460	946	1,192	113%	106%
Total Imports	14,667	27,938	24,020	8,078	17,539	16,173	6,930	14,697	13,116	90%	112%

Source: Eurostat External Trade Database

Annex Table 2 – Total Imports into EU in Graduated Tariff Lines (Million Euros)

Country	Chapters	Year										
		2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Brazil	Live animals and Meat (1-2)	493	713	632	632	666	797	958	1,319	843	755	794
	Coffee, Tea (9)	982	844	728	696	735	1,094	1,194	1,287	1,470	1,470	1,923
	Paper (47-49)	801	609	670	743	831	1,051	1,302	1,511	1,422	1,120	1,803
	Footwear (64-67)	90	88	100	115	161	216	251	287	324	265	296
	Iron and steel (72)	648	472	450	691	727	974	1,160	1,612	1,433	580	827
	Aircrafts and space crafts (88)	1,202	903	383	335	284	362	252	382	196	734	806
Thailand	Pearls, Gems and Jewellery (71)	654	633	629	565	634	669	717	739	702	627	758
	Fishery products (03)	170	169	137	134	144	158	205	238	268	273	293
	Edible Preparations and Beverages (16-23)	449	445	435	483	477	572	654	730	877	891	928
	Leather and Fur Articles (42-43)	66	63	57	42	45	45	46	51	60	55	59
	Clothing (61-63)	659	579	559	559	608	545	633	579	583	562	586
Malaysia	cereals and malt (10-11)	1	2	2	2	1	0	-	-	0	-	0
	wood (44-46)	466	339	303	303	300	294	398	391	358	266	292
	Fats oils and waxes (15)	309	392	439	502	529	584	650	797	1,044	708	925
	Plastic and rubber (39-40)	584	547	546	556	616	628	842	977	1,064	717	1,194
	clothing (61-63)	240	203	201	167	149	158	212	156	136	103	105

Country	Chapters	Year										
		2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Indonesia	Fats, oils, waxes (15)	617	506	695	621	766	801	833	1,125	1,801	1,773	1,921
	Wood (44-46)	713	577	521	502	513	573	605	523	460	359	409
	Footwear (64-67)	507	531	468	421	390	383	469	506	541	619	688
China	Products of animal origin (5)	253	227	172	148	170	249	278	280	357	367	397
	Grains, seeds, fruits (12)	187	196	180	219	218	257	205	253	334	280	322
	Plastics an rubber (39-40)	1,974	2,017	2,074	2,241	2,455	3,062	3,481	4,308	4,619	4,053	5,506
	Paper (47-49)	305	329	316	385	503	669	796	1,156	1,267	1,237	1,449

Source: Eurostat External Trade Database

* Shaded area shows the years in which the products were graduated



**INDIAN COUNCIL FOR RESEARCH ON
INTERNATIONAL ECONOMIC RELATIONS**

Core - 6A, 4th Floor, India Habitat Centre,
Lodi Road, New Delhi - 110003
INDIA