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The Significance of the EEC's Generalized System of Preferences

by Axel Borrmann, Hamburg*

In 1986 the EEC's Generalized System of Preferences will be entering its 15th year. In line with the Community's decision for the granting of generalized tariff preferences for the period 1981-90 the time has come for an interim appraisal of the scheme with the aim of evaluating experiences gathered since the system was reformed at the end of 1980 and discussing modifications which may now seem expedient.

During the 14 years of its existence the EEC's Generalized System of Preferences (GSP) has undergone frequent changes. Since the substantial reforms of the scheme in 1981 it has undoubtedly become much more liberal and there has been a lasting increase in the Community's GSP-imports (cf. Table 1). The enlargement of the circle of beneficiaries was not the major precondition for a more widespread impact of the system. The extension of the product coverage by approximately 1,000 tariff items since 1971, together with a reduction of tariffs in the agricultural sector, were of much greater significance in this respect. The Community can quite rightly claim that of all the GSPs operated by industrialised countries its preferences to developing countries cover the widest range of industrial products.

Although trade in sensitive and semi-sensitive products accounted for over 50 % of total preferential trade on the average of past years, the change from quantitative controls to supplier-specific guaranteed minimum import levels led to a relaxation of the strict surveillance of imports. Individual tariff quotas and ceilings give the system a greater, albeit not sufficient, degree of predictability.

These measures have concomitantly provided the weaker supplying countries with better opportunities for conducting trade on preferential terms. Other reform measures, such as the determination of quotas

according to "needs" in the field of the MFA textiles or the special measures benefitting the least developed of the developing countries (LLDCs), underline the GSP's definite distributional policy orientation. With regard to the nine LLDCs actually covered by the GSP, the almost complete elimination of quantitative restrictions, the extensive range of preferential agricultural products, the complete tariff exemption, the decision by the Community not to apply the safeguard clause in the field of non-sensitive products, and the relaxed rules of origin have created a clearly improved preferential framework which can be utilised by LLDCs providing they have the corresponding production and exporting capacities. The well above-average utilisation of preferential export opportunities by the LLDCs and their slightly increased share in GSP trade indicate the success of the aforementioned measures. In addition, this reveals just how effective non-restrictive preferences can be (cf. Table 2).

Trade Liberalisation via Preferences

The Community's system of generalized preferences plays an important part in the trade policy considerations of the beneficiary developing countries. The GSP of the EEC, the world's most important export market, provides – in its present form – the Third World with the best exporting opportunities under preferential conditions. It can claim the greatest amount of actual preferential trade among all preference-giving industrialised countries and economic groupings. This leading position is strengthened even more if the EEC's special preferential agreements with the developing countries of the Mediterranean region and the ACP states are also taken into account.

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The GSP is part of the Community's wide-ranging preferential policy framework. In connection with the latter and the multilateral liberalisation of trade, it has contributed towards the dismantling of the Community's tariff barriers in its trade with third countries.

From the point of view of the GSP-dependent developing countries, the GSP represents a substantial yet limited instrument of trade liberalisation. However, a substantial non-preferential and dutiable volume of imports still remains which is by and large covered by the product list of the GSP (cf. Table 3).

The analysis uncovers a number of shortcomings within the GSP system. Firstly, the scheme bypasses a considerable proportion of the dutiable imports from

beneficiary developing countries; most of them are agricultural products (Chapters 1-24), for which the GSP only makes a limited offer to developing countries right from the start. Secondly, it has not yet been even possible to utilise half of the GSP's preferential potential (cf. Table 3).

Nevertheless, the GSP's rate of utilisation is higher than hitherto assumed and reached 47.1 % in 1982 (cf. Table 2). Furthermore, in contrast to the tenable opinion held so far there has also been an increase in the utilisation of preferences which was 41.3 % in 1976. Success in this respect, however, still leaves a great deal to be desired. Despite various reform measures the GSP still lacks the effectiveness it requires. This fact is confirmed by numerous empirical studies on the statistical and causal links between the granting of preferences and the export successes of beneficiary developing countries.

NICs the Main Beneficiaries

Only a few analyses provide evidence of truly extensive and significant preferential effects of the EEC's GSP. Methodologically, however, they are not convincing enough to serve as a reliable evaluation yardstick. This applies both to methods based on elasticity as well as to those which work on the basis of (market) share concepts.

Accepting the imperfection of virtually all methodological approaches, gravity models are probably among the most suitable measurement concepts. If the findings of studies based on the gravity model conducted so far are combined with those established in our particular, much more extensively designed study,¹ a positive, albeit limited link can be established between the development of imports and the granting of preferences. There is significant proof that the introduction of the GSP has brought about a sustained and continuous reduction in the former degree of discrimination against developing countries in their trade with the EEC. It is important, on the other hand, to note that the main beneficiaries of the increase in trade have been the newly industrialising countries (NICs), whose export product structure would appear to be much more strongly aligned to the GSP's product structure than is the case for middle-income developing countries and LLDCs. A further striking finding is that the improvement was less pronounced in the case of the non-sensitive products, i.e. fully preferential products with no quantitative restrictions, than in the case of the

Table 1
Development of EEC's^a Dutiable GSP and
Total Trade, 1976 and 1982
(in billion ECU and %)

	1976 (bn ECU)	1982 (bn ECU)	Growth 1976-1982 (in %)
EEC's total imports (intra and extra)	219.5	354.8	+ 8.3
From third countries	85.4	138.2	+ 8.4
From developing countries	21.1	34.9	+ 8.8
From GSP-dependent beneficiaries ^b			
– total	15.2	25.7 ^b	+ 9.2
– GSP-products ^c	6.8	18.8 ^d	+18.5
– GSP-trade	2.9	8.9	+20.5

^a EEC-9.

^b Including Yugoslavia.

^c GSP-potential taking into account exclusions of beneficiaries on specific product levels.

^d Including Yugoslavia's remaining GSP-potential.

Source: Own calculations based on SOEC data.

Table 2
GSP and Dutiable Trade in Preferential Products
by Developing Country Groups^a, 1976 and 1982
(in %)

Country Groups	GSP imports		Total imports of dutiable GSP products		Rate of utilization	
	1976	1982	1976	1982	1976	1982
NICs ^b	62.7	55.7	71.8	64.1	43.8	76.7
Middle-income countries	35.3	40.7	27.3	33.7	53.4	55.8
LLDCs ^c	1.0	3.6	0.9	2.2	36.0	41.6
All countries	100.0	100.0	100.0	100.0	41.3	47.1

^a GSP-dependent developing countries.

^b Mexico, Columbia, Venezuela, Brazil, Argentina, Thailand, Malaysia, Singapore, Philippines, South Korea, Hong Kong.

^c Haiti, North Yemen, South Yemen, Afghanistan, Bangladesh, Maldives, Nepal, Bhutan, Laos.

Source: Own calculations based on SOEC data.

¹ Cf. A. Borrmann et al., op. cit., pp. 141 ff.

more sensitive GSP products. The somewhat lower preferential margin for non-sensitive products could provide an explanation here.

Limits to Preferential Effects

This result is connected with the fact that the supplying strength of beneficiaries is a major determinant of the development of imports from these countries and not the granting of preferences alone. This factor is clearly at its strongest in the field of sensitive products.

Preferences and the prices they influence are only one determinant factor of competitiveness and, on the whole, certainly not the most decisive one. In some fields, in particular the afore-mentioned field of sensitive products, developing countries, and above all the NICs, are in many cases competitive not *because of* but *in spite of* tariff preferences.² Although this does not question the effects of preferences altogether it does put them into the proper perspective. Even in the sensitive product field, preference-induced trade effects, albeit of a less substantial nature, cannot be ruled out.³

The supply strength of the NICs compares with the marked supply weakness of smaller and middle-income developing countries. In fact, even the more advanced countries often lack the necessary production and exporting capacities to take full advantage of the complete range of the GSP's offer. The beneficiary developing countries lack the necessary supply power for about 900 of the approximately 6,000⁴ GSP products. This factor must also be taken into account when trying to arrive at a balanced evaluation of the benefit of the GSP.

Table 3
Liberalisation of EEC Imports from
Developing Countries, 1982
(in billion ECU)

	Total developing countries ^a	GSP-dependent developing countries	Other develop- ing countries enjoying EEC preferences
1. Total EEC imports	131.3	92.9	38.4
2. Mfn duty-free	94.7	69.1	25.6
3. Mfn dutiable	36.7	23.8	12.9
4. Imports of Mfn dutiable preferential products	30.4	18.7 ^b	11.7
5. Preferential trade	18.9	8.9	10.8 ^c

^a All nominal and actual GSP beneficiaries.

^b Preferential potential taking into account specific country exclusions at product level.

^c Estimated at 85 % of preferential potential.

Source: Own calculations based on SOEC and ZSD data.

Preferential tariffs represent a stimulus which, given the corresponding market conditions, by no means results in a once-only thrust for the expansion of trade.⁵ The low supply elasticities of developing countries, together with the particularly limited absorptive capacities for external resource inflows, means that the GSP has a long-term significance as an incentive for developing countries to set up and gradually extend their production network.

The marked orientation of most foreign direct investments towards domestic markets is one of the reasons why the generalized preferences are hardly able to develop their dynamic effects. Furthermore, the system does not provide a guarantee for reliable and long-term preferential market access upon which enterprises can base their investment decisions. In addition, the preferential margin will generally be too low as to be of decisive importance for the cost and locational considerations of business enterprises.

Erosion of Preferential Margin

The success of multilateral efforts to liberalise trade has made the preferential margin aspect less and less appealing and clearly lessened preferential effects. The unweighted preferential margin, for example, fell between 1973 and 1982 from 9.6 % to 7 %. Weighted by GSP trade the figure dropped from 8.5 % to 6.7 %.⁶ Although this preferential margin is still appreciable, it only applies to actual preferential trade. This could be much greater if it were not faced by the following problems: quantitative restrictions, complex rules of origin, unfavourable administrative procedures, and the only limited tariff concessions in the agricultural sector. The restrictive effect of these barriers is reflected in the clearly lower preferential margin for *total* trade in GSP products, which also takes into account the non-preferred part of trade in GSP-products. This preferential margin amounted to 2.6 % in 1982 and led to an overall reduction in tariff protection for GSP products of about 27 % (cf. Table 4). Again, it becomes clear that the GSP only makes a limited contribution

² Cf. R. J. Langhammer: Die Allgemeinen Zollpräferenzen der Europäischen Gemeinschaft für Entwicklungsländer, Fehlschlag oder Erfolg? Kieler Diskussionsbeiträge No. 95, Kiel 1983, p. 10.

³ Cf. A. Weston, K. Cable, A. Hewitt: The EEC's Generalized System of Preferences, London 1980, p. 88.

⁴ Calculated on the basis of 6-digit NIMEXE items.

⁵ Cf. on this point and on the following, A. Borrmann, C. Borrmann, M. Stegger: The EEC's Generalized System of Preferences, The Hague, Boston, London 1981, p. 199.

⁶ The Community's tariff revenues foregone in 1982 amounted to approx. 590 million ECU, 8.7 % of the EEC's tariff revenues in 1982, to 6.5 % of the EEC's total customs charges and to 2.8 % of its total budgetary revenues.

Table 4
Weighted Preferential Margin Averages for
GSP and Total Trade in all Preferential Products
by Sensitivity Categories^a, 1982
 (in %)

	Preferential margin ^b for GSP trade	Mfn rate of tariff for GSP-trade	Preferential margin for total trade ^c	Mfn rate of tariff for total trade
Sensitive GSP products	6.7	7.2	2.3	10.6
Semi-sensitive GSP products	16.2	16.2	0.0	15.7
Sensitive and semi-sensitive GSP products	7.2	7.8	2.5	11.0
Non-sensitive GSP products	6.1	8.3	2.8	7.6
All GSP products	6.7	8.0	2.6	9.6

^a Product-, not country-specific grouping.

^b Difference between preferential and mfn rate of tariff weighted by GSP trade.

^c Preferential margin for GSP trade divided by total trade (defined as the sum of preferential GSP trade and non-preferential mfn trade for GSP products).

Source: Own calculations based on SOEC and ZSD data.

towards liberalisation. In many product fields, the preferential tariff reduction is now probably hardly noticeable for the more powerful supplying countries. The erosion of the average preferential benefit has continued, a trend which will be speeded up by the advanced tariff reduction within the framework of GATT negotiations. Admittedly, low preferential margins do not rule out positive effects for products characterised by lively price competition (e.g. mass-produced textile products); nonetheless, the area in which they are at all relevant is being increasingly reduced to high-tariff

items. This may not make preferences superfluous but it does further restrict the scope of their possible effects.

There is no alternative between multilateral tariff-cutting and the maintenance of preferential margins. Such an alternative is not only out of the question in terms of its practical implementability, but cannot – as shown by the previous analysis – be convincingly justified economically under the present circumstances. Even if it were possible to turn all trade into preferential trade – which would involve an in itself desirable, but at present illusory removal of all system restrictions – the GSP would still have to be viewed as a temporary development policy measure, preceding a comprehensive and, in welfare terms, superior dismantling of tariffs. The erosion of the preferential margin is inevitable and economically rational.

Non-tariff Barriers

The gradual reduction of tariff protection means that the non-tariff barriers (NTBs) are increasingly becoming the focus of attention for GSP-dependent countries too. One negative aspect, for example, is the practice of tying GSP preferences to the conclusion of bilateral voluntary export restraint agreements. It is clear that the envisaged GSP effects on trade cannot materialise given the simultaneous existence of the Multi-Fibre Arrangement (MFA). The GSP quotas for the more competitive suppliers are quite simply ridiculously low, whereas the MFA quotas are extensively utilised. Even higher GSP quotas would make no sense if the exports of the supercompetitive suppliers are actually limited by absolute import limitations. In such a situation, a preference-induced promotion of exports and

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development is out of the question right from the start. There are also signs of a similarly non-peaceful co-existence between NTBs and the GSP, for example, in the voluntary export restraints for steel and quartz watches.

The GSP can only cater for the interests of its beneficiaries in the field of NTBs in so far as it reduces those NTBs inherent in the system which considerably limit the effectiveness of preferential tariffs. This just as much includes the quantitative limits for preferential imports as it does the rules of origin. This leads on to the general question as to the ways and means of increasing the efficiency of the GSP.

Towards a More Rational GSP

The GSP must be understood as a part of the Community's general trade policy. Furthermore, the GSP is positioned in a web of extremely varying, indeed often opposing, interests. For this reason, approaching GSP reforms from an angle of "pure economic reason" or flatly demanding an immediate total consolidation of the GSP in line with the principles of free trade is of little use. Reforms of the GSP presuppose a will to accept policy changes on the part of those groups which have up to now emphatically insisted on retaining tariff quotas and ceilings together with the scheme's other trade barriers.

A patent remedy for increasing the general willingness to accept the GSP does not exist. Efforts concentrate, therefore, on making the structures and effects of the GSP as transparent as possible and obliging those intent on retaining the scheme's restrictive elements or incorporating additional restrictions to permanently justify such moves. A sufficiently structured and reliable statistical base, which is not given at present, is absolutely essential if protectionist arguments are to be countered and the liberal nature of the GSP reinforced. This should be linked with the fixing of generally verifiable objective criteria for both the introduction of new tariff quotas and ceilings as well as for their elimination, which could be phased in the framework of a "degressivity clause".

Differentiation

A calculable "phasing-out" approach should not only set out to introduce a more rational basis for the reduction of the system's protectionist elements, but also be considered for the already initiated graduation of developing countries. The continuation of differentiated preferential treatment definitely complies with both the GSP's basic principles and a liberal system of trade, even if developing countries often dismiss the idea as

protectionist manipulation. In analogy to the "infant-industry" argument, it would grant developing countries a transitional period to set up competitive export industries and gather experience on donor country markets via their tariff-related competitive lead. Once this has been achieved, preferential treatment is no longer necessary. It could then be phased out, for example, in certain sectors and over a certain period of time. This does not, however, mean that constant efforts to achieve an overall reduction of tariff levels are superfluous!

On the basis of a general graduation of developing countries according to per capita income, the degree of industrialisation, the export ratio, and/or the balance on current account, product-specific reference could be made to market share, on the one hand, and the relationship between GSP trade and total trade on the other. These criteria can be quite easily derived statistically. An important market share of 20 % or 30 % ("market-share" criterion) and an overshooting of trade beyond preferential trade quota or ceiling level of, for example, 100-200 % ("excess" criterion) could serve as a basis for discussion. The latter criterion would provide a clear indication of both the pronounced competitive strength of the country in question, and also of the ineffectiveness and thus dispensability of preferential treatment in that particular sector. Any such extension of the graduation principle should be accompanied by a more liberal approach to the granting of preferences in the case of the remaining supplying countries (reclassification of previously semi-sensitive products as non-sensitive products or at least a raising of tariff ceilings).

Product Coverage

The analysis of the dutiable products not covered by the GSP shows that a substantial liberalisation and preferential potential still exists (1982: 1.8 billion ECU). The agricultural sector (Chapters 1-24) accounts for 79.2 % of this figure and the industrial sector (Chapters 25-98) for 20.8 %.

The inclusion of dutiable raw materials, however, should not be taboo and should be taken into account. Raw materials are still the most important foreign exchange earners for many developing countries and thus an essential source of finance for development projects, including those in the industrial sector. Confining preferences to industrial products is not convincing. On the one hand, other preference-giving countries, such as Japan, include dutiable raw materials in their GSP; on the other hand, the EEC itself grants Mediterranean and ACP states, and even GSP-

dependent developing countries, "raw materials preferences". The principle has already been broken in the GSP in the case of some unprocessed agricultural products (e.g. fish, vegetables, nuts, tobacco), as well as a few unprocessed or only slightly processed industrial raw materials (e.g. crude light oil, petroleum, gases, fluorspar).

More can be achieved in the field of tropical agricultural products, which at most indirectly compete against products produced in the EEC. The LLDCs could at least expect to attain a status equal to that of the ACP states, particularly considering that the latter no longer seem to oppose such a move. The agricultural export interests of the ACP states would only be marginally affected by such a step.

The GSP's agricultural tariffs also provide a useful point of reference for reform. Instead of improving the agricultural preferences in marginal steps year after year it would make more sense to substantially raise the preferential margin. One way of doing this would be to eliminate all marginal residual tariffs which are lower than or equal to 3 %; another means of effecting such an increase would be to consider the application of a minimum preferential margin of, for example, 50 % of the most favoured nation (mfn) rate. Applying the first criterion, market access would be eased for 5 % of potential GSP trade and for 32 % using the latter.

As regards quantitative restrictions, the proposal has been repeatedly made to abandon quotas and ceilings and at the same time lower the preferential margin so that the inflow of imports can be "kept in check".⁷

The proposal does have a considerable appeal, as it would help increase the badly needed predictability of preference-granting in the case of the sensitive GSP products as well as simplify administrative procedure. However, it should only be supported under the following conditions:

(1) obligatory application procedure for the fixing of *additional* quotas and ceilings, characterised by

- ☐ a clear justification of the need for such a move,
- ☐ compliance with minimum requirements,⁸
- ☐ limitation of the period of application, and
- ☐ "phasing-out" approach,

⁷ This proposal was discussed inter alia by Weston et al. and recently introduced to the discussion on GSP reforms for the operational period 1986-90 by the Foreign Trade Association and the Belgian government. Cf. A. Weston et al., op. cit., pp. 98ff. and Foreign Trade Association: Memorandum, Generalized Tariff Preferences as from 1 January 1986, Brussels, 1984 (unpublished).

⁸ E.g. significant domestic or import market share in the applicant EEC member state.

(2) guaranteed longer-term classification of GSP products in the three product sensitivity categories,

(3) elimination of quantitative restrictions in cases where there are parallel voluntary export restraint quotas (in analogy to the bilateral jute and coir agreements),

(4) abandonment of the sharing out of tariff quotas among member states,

(5) exclusion of LLDCs from the quota ruling in the case of sensitive agricultural products.

Efforts towards greater international harmonisation should be intensified emphatically with regard to the rules of origin. In addition, the Community should at long last accept cumulative origin and Community content for all beneficiaries, a step which has already been taken in the case of the ACP states. At least the GSP-dependent LLDCs should be granted the same treatment as the ACP states in this respect.

Some of the suggestions made for removing obvious defects in the System have been taken up by the Commission and a draft for the adjustment of the GSP during the period 1986-1990 was presented in May 1985.⁹ The Commission itself is now considering, among other things, the above-mentioned introduction of a "market-share" and/or "excess" criterion, a return to the adjustment of tariff quotas according to a formula, tighter conditions for the reintroduction of Community tariffs for non-sensitive products and the admission of the selling country's share in the rules of origin. The Commission is also demanding greater powers for itself in the day-to-day administration of the system to enable it to react more flexibly and effectively regarding, for instance, the application of the rules of preference, in particular in the case of the reintroduction of tariffs.

Although the Commission can be sure of the support of the EC-Parliament for most of its reform suggestions,¹⁰ there is nevertheless no great hope that the Council will see its way to carrying out extensive reforms at the present point in time; such reforms will probably have to wait until the end of the GSP's second decade.

⁹ Cf. Commission of the European Communities: Review of the European Communities' Generalized Tariff Preferences Scheme COM (85) 203 final, Brussels 1985, p. 10.

¹⁰ European Parliament: Report drawn up on behalf of the Committee on Development and Cooperation on I. the communication from the Commission to the Council on the review of the European Community's generalized tariff preferences scheme (COM (85) 203 final – Dec. C 2-41/85) and II. the proposal from the Commission to the Council fixing the Community's generalized tariff preferences scheme for 1986 (COM (85) 425 final – Dec. C 2-85/85), rapporteur: Brigitte Heinrich, PE Dec. A2-125/85 of 21 October 1985.