Generalized preferences for the Third World

European File

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For more than 15 years now, the developing countries have been able to export the vast majority of their manufactured and semi-manufactured goods to numerous industrialized countries, including those of the European Community, with the aid of tariff preferences, that is a partial or total reduction of customs duties. These are known as 'generalized preferences'. 'Preferences' because the products enjoy an advantage over those exported by industrialized countries. 'Generalized' because they are granted to developing countries by most industrialized countries and because they involve all industrial goods, manufactured or semi-manufactured, as well as many processed agricultural products.[1]

The basis of the system

The generalized preferences are based on an exception to the usual rules of the GATT, the General Agreement on Tariffs and Trade. The GATT lays down that participating nations must extend to each other in general the most favourable terms negotiated with any singlè trading partner, except where such terms are result of an agreement to set up a free-trade area or a customs union.

The reasons for making an exception were to increase the export earnings of the developing countries, to facilitate their industrialization and to speed up their economic growth.

☐ The development of the Third World requires large financial resources — resources that are depleted by the debt burden and by fluctuations in the price of oil and other imports — combined with simultaneous progress on two fronts: agriculture, so as to wipe out malnutrition, and industry, so as to create a more balanced economy.

☐ The industrialization of Third-World countries is often tricky, however. Their limited internal market often prevents them from creating and intensifying industrial production on the scale required nowadays.

☐ Industrialists in developing countries must therefore be given opportunities to penetrate markets in richer countries, where the capacity to absorb imports remains considerable, despite the recession. To that end Third World products are given a preference, a customs advantage that puts them on an equal footing with those of national industries and gives them an advantage over products from other industrialized countries.

Since the economic crisis began there has been increased reluctance in the developed countries to increase imports from the Third World. Many Europeans imagine that industrialization of the developing countries primarily means moving factories to the south of the planet and seeing developed countries' markets invaded by low-price goods which compete unfairly with their own products. Statistics show that this

[1] This file replaces our No 9/81.

picture is false. Of course in certain specific cases competition from developing countries does pose difficult problems, but apart from those cases the industrialization of the Third World makes for a better balance in international trade, which is in the interest of all participants. Any improvement in the export performance of the Third World helps in return to develop profitable markets there which offer the industrialized countries one of the most effective ways of resolving their economic problems and checking unemployment. It has been calculated that if the developing countries attained the objective they set themselves in the Lima action plan and accounted for a quarter of world industrialization by the year 2000, trade between north and south would increase so that the rich countries' exports to the Third World would be 10 times greater than in 1972.

The origin of the system of generalized preferences goes back to 1963. That year, within the framework of the GATT, ministers of the European Community governments suggested preferential treatment for the manufactured and semi-manufactured products of Third-World countries. It was not until 1968 and the second session of Unctad (the United Nations Conference on Trade and Development) in New Delhi, that agreement was reached on the creation of a system of generalized preferences. It then took another two years to work out the main elements of the system. From 1970 onwards the industrialized countries gradually completed their implementation schemes. The European Community was the first to implement its scheme, on 1 July 1971. Japan followed a month later, then the other western industrialized countries and finally the United States in 1976. In all cases the scheme was for a period of 10 years (the initial duration of the exception allowed by the GATT), but this period was extended unconditionally in the international trade negotiations of the Tokyo Round in 1979: by then the generalized preferences system had become a normal part of international trade.

There were various reasons for the European Community to take a lead on the issue of generalized preferences:

- ☐ Historically, Europe has a tradition of privileged links with developing countries. After decolonization, the process of cooperation was strengthened and extended on a new basis.

- ☐ Politically, one of the purposes of the Community, stated in the preamble of its founding Treaties, is to promote peace in the world. A more harmonious share-out of prosperity is needed to secure this. The Community has therefore undertaken to implement gradually a development cooperation policy that is open to all Third World States, whether or not they have had special relations with any European country in the past.

- ☐ Economically, the Third World is Europe's principal trading partner. In 1985, 34% of the Community's exports went to developing countries. They in turn supplied 38% of the Community's imports.

The Community's system of generalized preferences lies at the intersection of its external trade and development aid[1] policies:

- ☐ On the one hand, when they signed the Treaty of Rome, the Member States of the Community decided to abolish the customs barriers that divided them and to apply uniform protection *vis-à-vis* the outside world by means of a Common Customs Tariff. Any measure that affects this Tariff falls therefore within the competence of the Community.

- ☐ On the other hand, generalized preferences are part of a very wide range of Community development aid measures. They go hand-in-hand with the tariff advantages that the Community has given to Mediterranean countries and to the African, Caribbean and Pacific States that have signed the Lomé Convention. The preferential agreements negotiated with those countries go further than the generalized preferences, as they allow the exportation to Europe, free of customs duty or volume limits, of practically all those countries' industrial goods and a good proportion of their agricultural produce.

The development of the Community's generalized preferences scheme

The European Community offered generalized preferences to all the member countries of the 'Group of 77': all those designated as developing countries by the United Nations, as well as certain territories or countries dependent on Community countries, such as Hong Kong, Macao and French Polynesia. The Community also left the system open, on a case-by-case basis, to other countries that might ask to avail of it: Romania has done so since 1974 and China since 1980, with exceptions for certain products. In all, the Community scheme applies to 128 independent countries and more than 20 dependent territories.

These preferences are non-discriminatory and unilateral. Non-discriminatory because they are granted to all developing countries. Unilateral because they are not the result of negotiation with the beneficiary countries. Nor are they reciprocal, since beneficiary countries do not grant tariff exemptions to the Community in return.

The Community's generalized preferences are governed by rules which vary depending on whether industrial goods, textiles or agricultural products are involved. The first category looms largest by far in the Community's scheme.

- ☐ *Industrial products.* Generalized preferences apply to all finished and semi-finished industrial products. The preference consists of a total suspension of customs duties, but subject to quota limits or ceilings which are reviewed each year taking account of the growth of international trade. The economic situation

[1] See *European File* No 16/86: 'The European Community in the world' and No 15/87: 'The European Community and the Third World'.

has however forced the Community to limit, even to 'freeze', the rate of increase in certain quotas or ceilings. Nevertheless since 1978 the least-developed countries – the poorest ones – listed by the United Nations have been exempted from the reimposition of customs duties, regardless of the size of their exports.

Until 1980 the system had four categories of industrial product, governed by regimes of varying strictness according to the seriousness of the problems their importation posed for the Community. This regime consisted of quotas (divided among the Community member countries, with a strict obligation to reintroduce customs duties when the national share of the quota was reached), and ceilings (not divided among the member countries, but administered on a Community basis). These amounts were global,open to all the beneficiaries. So that the weaker countries might have easier access, maximum quantities per beneficiary country were allocated, expressed as a percentage of the quota or ceiling. Customs duties could be reimposed on a country whose preferential exports had reached this cut-off point (or *butoir*).

In 1980 the Community decided to prolong its generalized preferences scheme until 1990. Following the lessons learned in the first 10 years, the 1981 version of the scheme introduced substantial changes in regard to industrial products. The changes were based on the principles of simplification, individualization and differentiation.

The categories of more or less sensitive products were reduced to two in number.

- For some 130 'sensitive' products the quantities enjoying preferential access are now fixed individually for each exporting country, generally at the level of the *butoir* previously applied. In this way every developing country is assured of being able to take advantage of the preference offered. There is no longer the risk that more capable countries will use up all the preferential advantage on offer, leading the Community to reintroduce tariffs even though the weaker country has had little or no benefit from the preference.

  – Imports from the most competitive beneficiary countries are subject to quotas, which are divided into maximum amounts for each Member State according to a fixed formula, with a Community reserve as an element of flexibility. Each Member State is obliged to reintroduce customs duty when its maximum amount of imports is exhausted and nothing remains to be drawn from the Community reserve. This method, which takes special account of the more developed beneficiary countries, enables their preferential exports to be sustained within the overall limit of the permitted quantity. It is important to note that the competitiveness of Third-World countries is assessed case by case according to the different products, and not determined in a general way by their degree of industrialization or the volume of their exports.

  – The other beneficiary countries, or all the countries if none of them is particularly competitive in the product in question, are allocated ceilings, which are managed by the European Commission for the Community as a whole (without individual Member State quotas). In practice this means that preferential imports are liable to exceed the set quantity – sometimes by a very wide margin – whenever the Community judges that it is not being harmed and that it can continue offering a special advantage to Third-World exporters.

– For petro-chemicals the Community in 1987 introduced zero-tariff amounts, which are like ceilings in that they are fixed for the Community as a whole, but which are strictly administered, like quotas, so that they are never exceeded. The European Commission is fully responsible for management of these amounts; Member States must go the Commission to find out what zero-tariff imports are possible and obtain authorization for them.

- For non-sensitive products, customs duty may be reintroduced against a beneficiary country when its preferential exports reach a certain reference index: in 1987 this index corresponded to 5% of all 1985 imports of the product in question from outside the Community. At the same time the Member State seeking to reintroduce the duty must supply economic justification for its request. Following consultations at Community level, the reintroduction of the duty can be allowed, postponed or refused.

When the scheme was prolonged, the Community made provision to evaluate its effects after five years. This concerned particularly the industrial aspect, which was the only one to undergo structural adjustment. The review highlighted a marked degree of development by certain beneficiary countries and led to increased emphasis on differentiation. In 1986 the Community reduced by half the quotas open to those competitive beneficiary countries who supplied more than 20% of imports to the Community of the products in question, or whose total exports of those products represented at least 10 times the preferential imports allowed. This line was pursued further in 1987 and two beneficiary countries, South Korea and Hong Kong, were excluded from the preferences for a total of 11 products for which the first criterion was fulfilled.

☐ *Textiles*

- In 1980, in the context of measures negotiated by the Community with the developing countries in order to cope with the crisis in the textile industry, a new regime was introduced for products covered by the Multifibre Arrangement (MFA). The benefit of duty-free imports was reserved for two groups of countries. Firstly, there were the 20 countries – including Brazil, China, South Korea, Hong Kong and India – that had concluded voluntary restraint agreements with the Community for their exports of cotton, wool and chemical fibres: they were granted duty-free exports within individual volume limits based on deliveries to the Community in 1977 and inversely proportionate to their degree of development and their competitiveness in textiles. Secondly, smaller suppliers were given the same preferential treatment by means of commitments according to a very flexible formula, similar to the terms of the voluntary restraint agreements. Six countries availed of this second formula between December 1983 and December 1986: Bolivia, Chile, Costa Rica, Ecuador, Honduras and Nicaragua.

- For the coir products of India and Sri Lanka, and for jute products exported by India, Bangladesh and Thailand, duty-free imports were allowed without quantitative limits.

- For other products, not covered by the MFA, preferences were granted within global limits. *Butoirs* were applied until 1982; from 1983 the system was individualized along the lines of the scheme for industrial products.

At the moment the Community is examining the results of the scheme in the textile sector, with a view to correcting its less satisfactory elements and making it more effective where less competitive beneficiary countries are concerned. It is intended to implement a revised scheme in 1988.

☐ *Agricultural products*

- For most Third-World countries the Community's scheme covers nearly 400 processed agricultural products. The regime applied to them consists of remission of customs duties; the remission may be total, as is the case at the moment for nearly 100 products. Quantitative limits are set for only six products: two kinds of tinned pineapple, soluble coffee and two kinds of tobacco, which are subject to global quotas as in the old scheme for industrial products. In this case the formula for dividing the quotas among Community Member States is based on traditional trade flows and therefore varies according to the product.

  For all the other products – the vast majority – which are not subject to limits, a safeguard clause provides for the reintroduction of duty if preferential imports cause damage to European producers or handicap the exports of African, Caribbean and Pacific countries that have signed the Lomé Convention. In such cases duty is reintroduced on imports from the beneficiary country whose preferential exports are causing the problem. Up to now this clause has been implemented only once (in 1986).

- The least-developed countries are allowed duty-free exports to the Community of some 700 agricultural products (including those subject to quotas) and are not liable to have the duty reintroduced except for tobacco.

An outline assessment

Since it was first introduced in 1971, the Community's generalized preferences scheme has been considerably improved. Firstly, its impact has increased with the enlargement of the Community: Denmark, Ireland and the United Kingdom applied the system from 1974, Greece from 1981, Spain and Portugal from 1 March 1986. Secondly, over the years the volume of trade eligible for preferential treatment has increased for most products.

- ☐ For textiles the preferences offered by the Community grew from 68 200 tonnes in 1974 to some 115 000 tonnes in 1980. They went on to increase even more: preferential imports for 1985 reached 215 000 tonnes, or 12% of all textile imports.

- ☐ The greatest improvements have been for agricultural products. The number of products benefiting from the scheme has increased from 147 in 1971 to nearly 400 in 1987. The preferences offered by the Community have more than tripled in value since 1974 – admittedly from a very low base.

- ☐ For industrial products also there has been a sizeable increase, with the preferences offered growing from 2 800 million ECU in 1974 to 6 800 million in 1980 and more than 19 000 million in 1987.[1]

If the use of preferential advantages remains confined to a limited number of products and is concentrated above all on sectors where the competitive position of beneficiary countries is already relatively favourable, that still does not mean that there is a real danger for the European economy. For sensitive products, preferential imports have represented only 4% of all Community imports. With a few rare exceptions, imports benefiting from preferences are not by themselves in a position to put European industry at risk.

There are, however, two problems to be noted:

- ☐ Despite the Community's efforts to get a better balance of the preferences offered and to improve the dissemination of information about them (organizing seminars for interested countries, publishing a practical guide to the use of the scheme, consulting with the beneficiary countries in the Unctad special committee on preferences etc.), the ratio of total imports to imports actually benefiting from preferences remains fairly average. The volume of products entering the Community duty-free represents about half of the Community's imports of products to which the scheme applies. However, the rate of use of the scheme varies considerably among the beneficiaries. It is markedly higher for India and China, for example, and is practically nil for other countries, particularly those that have no industrial infrastructure.

- ☐ The preferences are used by a limited number of beneficiaries: 10 countries supply nearly 70% of preferential imports. Some of these countries, such as South Korea, Brazil and Romania, are already relatively well-developed. The same phenomenon occurs with the schemes of other industrialized countries: as generalized preferences usually apply to manufactured or semi-manufactured industrial products, they tend to be availed of by countries that have already reached a certain level of development and are, in some cases, already quite competitive in normal trading conditions. Nevertheless, some poorer countries have achieved

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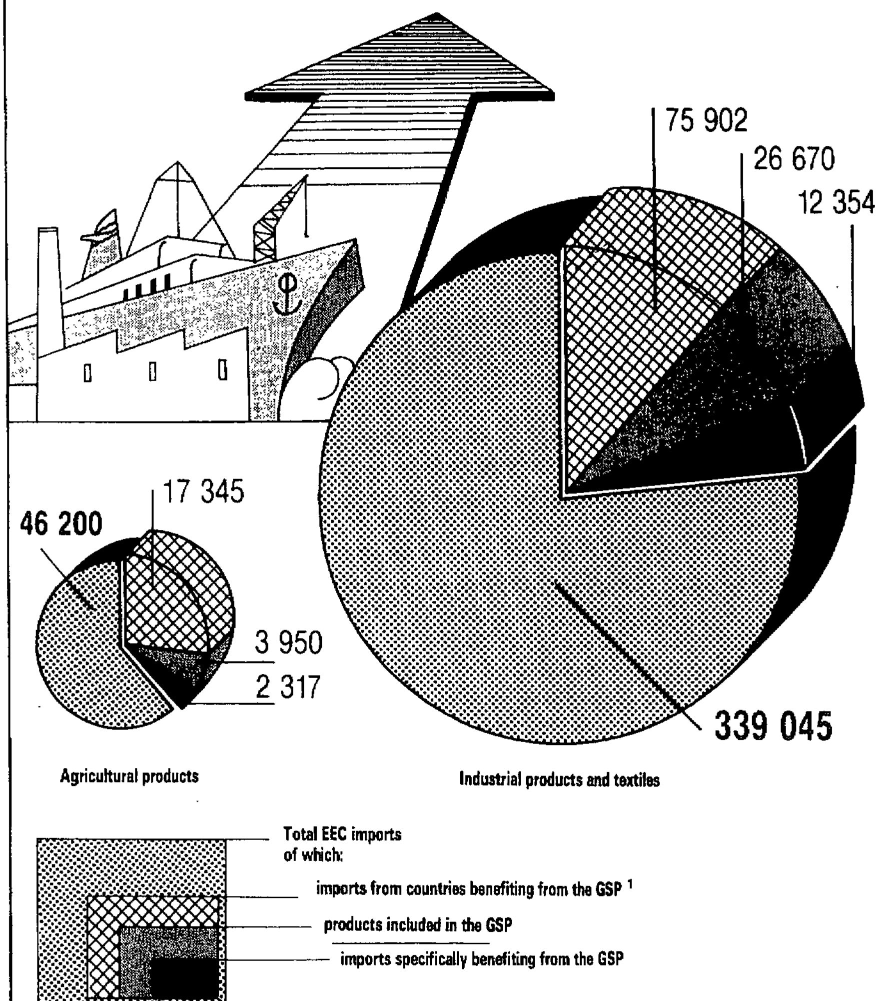
[1] 1 ECU (European currency unit) = about £ 0.7, Irf 0.8 or US$ 1.1 (at exchange rates current on 2 September 1987).

Share of imports benefiting from generalized preferences in total European Community imports
(1985, million ECU)



[1] The Community's generalized system of preferences. The African, Caribbean and Pacific countries and the Mediterranean countries, which have other preferential arrangements with the EEC, are not included.

Source: Eurostat.

good results. India, Pakistan, Peru, Indonesia, the Philippines and Malaysia have been able to take advantage of traditional trade relations and of their sometimes very heavy specialization in particular products.

It is because of such situations that the Community has a policy of differentiating among the beneficiaries. By diminishing or increasing the preferential advantage for beneficiary countries that have lesser or greater need of it, the Community can intensify its efforts to open up its markets to the countries that really need access to them ■

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