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## **Creating WTO Law by Stealth: GSP Conditionalities and the *EC – Tariff Preferences Case***

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The WTO is witnessing an increasing intrusion of its remit into areas that hitherto were the preserve of the state. This makes the legitimacy of its law creation process critical. The article engages in analyses of the conditionalities in developed countries' Generalized System of Preferences (GSP) schemes, notably those of the EU. It argues that the maintenance of conditionalities in developed countries' GSP schemes can result in extra regulatory burdens for developing countries and can have the effect of creating WTO law by stealth. The analyses centre on the Appellate Body decision in the *EC – Tariff Preferences* case.

Keywords: conditionalities, developing countries, trade preferences.

## The EC – Tariff Preferences Case: The Facts

The EC – *Tariff Preferences* case was brought against the European Communities (EC) by India due to Council Regulation (EC) No. 2501/2001, which India deemed to be discriminatory in the granting of preferences under the EC’s Generalized System of Preferences (GSP). The regulation at issue sought to apply “a scheme of generalized tariff preferences for the period from 1 January 2002 to 31 December 2004”.<sup>1</sup>

Five categories of tariff preferences were provided for under the regulation. These were the General Arrangements, special incentive arrangements for labour rights protection, special incentive arrangements for environmental protection, special arrangements relating to least-developed countries, and special arrangements aimed at combating drug production and trafficking (the Drug Arrangements).<sup>2</sup>

The General Arrangements were accessible to all the countries listed in Annex I of the regulation (i.e., developing countries) and accorded duty-free access to products that were deemed ‘non-sensitive’ and a preferential tariff scheme for products deemed to be ‘sensitive’.<sup>3</sup> The special incentive arrangements for labour rights protection and protection of the environment were only accessible to countries that, based on the EC’s determination, had met certain policy standards that protect labour rights and the environment. These special arrangements offered additional preferences to qualifying countries that were not available under the General Arrangements.<sup>4</sup> The special arrangements for least-developed countries offered additional preferences that were exclusively accessible to least-developed countries.<sup>5</sup>

The Drug Arrangements also exclusively offered additional preferences not available under the General Arrangements to 12 countries<sup>6</sup> determined by the EC to be facing a peculiar problem with production of illicit drugs. The Drug Arrangements thus served as an incentive for local farmers to engage in producing economically viable crops instead of drug-related plants.<sup>7</sup>

India, which was a beneficiary only of the General Arrangements, had argued to the panel at the first instance that “the Drug Arrangements ... are inconsistent with Article I:1 of GATT 1994 and are not justified by the Enabling Clause”.<sup>8</sup> India further argued that the Drug Arrangements had nullified or impaired benefits accruing to it under the GATT 1994. The crux of India’s objection to the Drug Arrangements lay in their supposed discriminatory nature, in that they offered preferential treatment to the 12 predetermined states. It thus viewed the Drug Arrangements as a violation of the most favoured nation (MFN) principle enshrined in Article I:1 of the GATT 1994. Based, *inter alia*, on the foregoing, it was necessary for the EC “to bring the measure

at issue into conformity with the GATT 1994”.<sup>9</sup> India had initially also challenged the consistency of the special arrangements relating to labour rights and the protection of the environment on the same basis as the Drug Arrangements but later relinquished this challenge.<sup>10</sup>

The EC, on its part, was of the view that the Enabling Clause was an autonomous right and not an affirmative defence. Consequently, the MFN provision of Article I:1 of the GATT 1994 did not apply to the Enabling Clause. Furthermore, being a measure maintained under the Enabling Clause, India’s assertion that the Drug Arrangement had breached Article I:1 of the GATT 1994 and nullified or impaired benefits accruing to it under the same was erroneous. The EC further argued that even “[i]f the Panel were to find that the Drug Arrangements fall within Article I:1 of GATT 1994, and that they were *prima facie* inconsistent with that provision, the European Communities requests the Panel to find that they are justified under Article XX(b) of GATT 1994 ....”<sup>11</sup>

### **Decision of the Panel**

**A**t the first instance, the panel found that the Enabling Clause was an exception to the GATT 1994 and also that the Drug Arrangements were not consistent with Article I:1 of the GATT 1994 and were justified neither by Article 2(a) of the Enabling Clause nor by Article XX(b) of the GATT 1994.<sup>12</sup> The panel also found that the Enabling Clause required the application of identical GSP tariff preferences to all developing countries in order to prevent discrimination amongst them. Based on the foregoing, the panel held that the EC had nullified or impaired benefits accruing to India under the GATT 1994.

### **Decision of the Appellate Body**

**O**n appeal, the Appellate Body *inter alia* upheld the findings of the panel on the application of Article I:1 of the GATT to the Enabling Clause and the inconsistency of the Drug Arrangements with the same, but with some significant variations. To the Appellate Body, the inconsistency of the Drug Arrangements with the Enabling Clause lay in the fact that the selection of the developing countries that qualified for this scheme was done arbitrarily by the EC and not based on objective criteria.<sup>13</sup> The Appellate Body however differed with the panel on the finding that the Enabling Clause required the application of identical GSP tariff preferences to all developing countries in order to prevent discrimination amongst them. It thus held that paragraph 3(c) of the Enabling Clause authorized “preference-granting countries to ‘respond positively’ to ‘needs’ that are *not* necessarily common or shared by all

developing countries. Responding to the ‘needs’ of developing countries may thus entail treating different developing country beneficiaries differently.”<sup>14</sup>

### **Analysis of the Appellate Body Decision**

**T**he key issues that formed the basis of the Appellate Body’s decision are analysed below.

One important question that the Appellate Body addressed was whether the Enabling Clause constituted a positive rule that set out obligations or, rather, it was an exception authorising derogation from one or more such positive rules.<sup>15</sup> In establishing whether the Enabling Clause was a derogation from the GATT 1994, the Appellate Body considered the meaning of ‘notwithstanding’ as used in paragraph 1 and came to the conclusion that “[t]he ordinary meaning of the term ‘notwithstanding’ is, as the panel noted, ‘[i]n spite of, without regard to or prevention by’.”<sup>16</sup> Based, *inter alia*, on this analysis, the Appellate Body upheld the finding of the panel that the Enabling Clause acted as an exception to the MFN provision in Article I:1 of the GATT 1994<sup>17</sup> and that “as an exception provision, the Enabling Clause applies concurrently with Article I:1”<sup>18</sup> and thus “takes precedence to the extent of the conflict between the two provisions.”<sup>19</sup>

The application of Article I:1 to the Enabling Clause also raised the issue of non-discrimination in the provision of preferences to developing countries. The panel’s view that the non-discrimination rule in paragraph 2(a) of the Enabling Clause required the provision of identical preferences to all developing countries had the potential effect of bringing to an end the adoption of GSP schemes by developed countries.<sup>20</sup> The panel had also held that, with the exception of *a priori* limitations, the term ‘developing countries’ in paragraph 2(a) means all developing countries.<sup>21</sup> The threat to the continuance of the GSP lay in the fact that the provision of GSP schemes has been thought of as a voluntary undertaking by developed countries to aid developing countries. Thus the institution of rules that oblige the provision of identical preferences to all developing countries would have taken away the voluntary nature of the GSP and negatively affected the willingness of developed countries to grant such preferences, as GSP schemes do not usually provide origin-neutral preferences.<sup>22</sup> The United States is, for instance, noted for using mandatory criteria to determine developing countries that qualify for GSP status. Some of the considerations that disqualify countries include communism, membership in an international cartel causing harm to the global economy (ostensibly aimed at members of the Organisation of the Petroleum Exporting Countries (OPEC)), expropriation, non-enforcement of arbitral awards, involvement in terrorism, non-observance of the rights

of workers, and violation of prohibitions against child labour.<sup>23</sup> Evidently, a disqualifying condition like communism or membership in an international cartel would result in *de facto* discrimination regarding origin of products, as communist and OPEC countries would be automatically disqualified.

Consequently, the less mandatory interpretation given by the Appellate Body – that preference-granting countries can treat developing countries differently, albeit with the proviso that such treatment must address differences of needs – had the effect of preserving the voluntary nature of the GSP. Thus, ‘similarly situated’ developing countries could be treated differently from other developing countries that do not share the same ‘situation’.<sup>24</sup> However, the objective criteria requirement set by the Appellate Body prevents arbitrary discrimination, as GSP-granting countries would not be able to institute a closed-ended list of countries that qualify for preferences, as was the case with the EC’s Drug Arrangements.

It is important to note that the use of objective criteria to ‘respond positively’ to the needs of developing countries in itself ‘sanctions’ the adoption of GSP conditionalities. The Appellate Body held that “[b]road-based recognition of a particular need, set out in the WTO Agreement or in multilateral instruments adopted by international organizations, could serve as such a standard.”<sup>25</sup> In its reformed GSP scheme after the Appellate Body’s decision in *EC – Tariff Preferences* for example, the EC instituted a GSP Plus, which grants greater preferences to countries that have ratified and are implementing a list of 27 international conventions.<sup>26</sup> Also, GSP-granting nations can still withdraw (i.e., negative conditionality) or vary their schemes at will. Lorand Bartels thus argues that

... the provisions on ‘negative’ conditionality in the EC and US GSP programs now present a problem. If differentiation between developing countries is only permissible on the basis of a ‘positive response’ to development needs, this means that differentiation is permitted only when tariff preferences are granted to achieve an objective, not when they are withdrawn to achieve an objective. It might be possible to argue that the relevant development needs are those of the countries that are continuing to benefit from the preferences. However, the difficulty with this argument is that the country from which preferences have been withdrawn will no doubt share these development needs. Any failure to grant the same preferences will therefore be discriminatory.<sup>27</sup>

The question must be asked whether the WTO or the trade regime is the right forum to address issues like human rights, good governance, labour rights, and environmental protection. If it is, then there should be a general application of these standards in the trade regime. Among others, the preamble to the WTO Agreement,

Article XX of the GATT 1994, and Article XIV of the GATS contain binding policy principles on issues like the protection of the environment and human, animal, and plant life and health. There is, however, no multilateral agreement that specifically deals with these policy issues in detail in the way disciplines on, for example, trade in goods and services, or intellectual property rights are addressed at the multilateral level.

Limiting some disciplines largely as conditionalities for accessing GSP schemes granted to developing countries brings to the fore the use of unequal leverages in trade relations between developing and developed countries. For instance, in 1997 preferences to Argentina were suspended by the United States due to a dispute over intellectual property protection.<sup>28</sup> The United States also suspended preferences to Pakistan for some time but later restored them in return for cooperation with the ‘fight’ against terrorism.<sup>29</sup>

If however GSP conditionalities were uniformly applied in the trade regime as multilateral agreements, they would have gone through a process of negotiations and developing countries would have made inputs into these negotiations that reflect their peculiar interests. Because the regulation of preferences under the GSP has been left, to a large extent, at the discretion of the providing nations, it gives them the leeway to institute some norms that otherwise do not normally pertain in the rules of the trade regime. Thus, because they are beneficiaries of preferences provided on a voluntary basis, developing countries have no say or leverage in the setting of standards for accessing the preferential treatments.

Evidently, the Enabling Clause, as the discussion above shows, contains rules that regulate the granting of GSP schemes to developing and least-developed countries. This however does not take away the fact that developed countries can institute, vary, or withdraw GSP schemes at will, and also establish requirements that place conditions on access to preferences. There is thus an increasing institutionalisation of a dual legal system, a bijuralism in the offing, with regard to the participation of developing countries in the international trade regime. Developing countries would have to meet the ‘normal’ multilateral rules and the ‘extra-normal’ GSP conditionalities.

Commenting on the exclusion of Iran, Cuba, North Korea, and Syria from the U.S. GSP scheme, Gene Grossman and Alan Sykes argue that

[i]t is assuredly possible that geopolitical considerations play a broader role *sub rosa* in many of the decisions regarding beneficiary status, and there is no mechanism to ensure that the various criteria are applied in careful and even-handed fashion.<sup>30</sup>

They argue further that the GSP systems run by the United States and the EC “exhibit a significant degree of ‘discrimination’ and ‘reciprocity’ in their design and their application that goes well beyond simply the more favourable treatment of least-developed nations that was envisioned by UNCTAD.”<sup>31</sup>

Special and differential treatment of developing countries in the WTO is aimed at addressing some of the asymmetries of economic power in the trade regime and, by so doing, promoting ‘effective’ equality in the participation of countries in international trade. Pascal Lamy, the immediate past Director-General of the WTO, argues that

... the WTO goes beyond formal equality and seeks to establish real equality. True equality can only exist between equals. When it comes to trade, some of the less developed countries require certain flexibilities if trade and development are to continue to exist side by side. So the developing countries can enjoy non-reciprocal benefits, in particular special and differential treatment.<sup>32</sup>

However, the actual practice of special and differential treatment presents some of the problems of inequality that it is supposed to address, one of the most significant being the use of conditionalities as prerequisites for accessing preferential treatment under various developed-country GSP schemes.<sup>33</sup> The example of the use of labour standards, among others, in the EU’s GSP Plus is a case in point. Of note is the fact that regulation of labour standards under the WTO was one of the most hotly debated issues, especially prior to the 1996 Singapore Ministerial Meeting.<sup>34</sup> Proposals to incorporate core labour standards as identified under the International Labour Organisation (ILO)<sup>35</sup> under the rubric of multilateral disciplines was described by the WTO Secretariat as being “among the most controversial currently before the WTO”.<sup>36</sup> Whereas developing countries were against such incorporation, support for it came from developed countries, notably the EU and the United States.<sup>37</sup> However, the 1996 Singapore Ministerial Conference effectively delineated the WTO’s competence regarding labour standards, noting that the ILO is the competent body to deal with this issue. The 1996 Singapore Ministerial Declaration states in relevant part the following:

We renew our commitment to the observance of internationally recognized core labour standards. The International Labour Organization (ILO) is the competent body to set and deal with these standards, and we affirm our support for its work in promoting them. We believe that economic growth and development fostered by increased trade and further trade liberalization contribute to the promotion of these standards. We reject the use of labour standards for protectionist purposes, and agree that the comparative advantage of countries, particularly low-wage developing countries, must in no way be put into question. In this regard, we note that the WTO and ILO Secretariats will continue their existing collaboration.<sup>38</sup>

Reasonably, the Singapore Declaration, made by the Ministerial Conference, the highest decision-making body of the WTO, should have been enough to clarify the position of the WTO on the matter of labour standards. Thus, to use labour standards, among others, as a condition for granting preferences under the GSP raises legitimate questions of leverage, arm twisting, and inequality in the WTO. Of greater significance is the fact that the very system that was meant to be used to achieve some measure of 'effective' equality can become the vehicle for driving a deeper chasm of inequality within the WTO, especially when it comes to influence on the policy direction of the WTO. Elisabeth De Vos thus argues that

... economic weakness gives the developing states little choice and power to influence the system in this interdependent world. 'Join the club and conform to the existing rules' is the present position. Does this leave them with the possibility of a meaningful exercise of their economic sovereignty, or is it a sovereignty without substance?<sup>39</sup>

## Conclusion

A pertinent question that must be asked is whether a sovereign state can be compelled to grant trade preferences even in a treaty organisation that the state has acceded to. Evidently, there is a moral case to be made for being good to others, but should goodness to others be obliged through binding rules? The voluntary nature of the GSP underlies the possible objection to a binding system of trade preferences.

Much as it may be objectionable to oblige goodness to others based on binding rules, the case can be made for prohibiting the use of one's goodness as a tool for manipulation or leverage. It should be possible, for instance, to institute multilateral rules that prevent the use of extra-WTO standards or norms as conditions for granting trade preferences, because contentious issues that have not been incorporated under multilateral rules could easily find their way by stealth into the trade regime under the guise of GSP conditionalities.

As things stand at the moment, it is evident that special and differential treatment provisions in general and GSP schemes in particular cannot assure the integration of developing countries into international trade, and neither can they be relied on as a development tool. Also, the current direction of special and differential treatment as evidenced in the post-Uruguay Round multilateral trade agreements points towards a more uniform application of multilateral rules. By dint of the application of the single-undertaking principle in the WTO Agreement, multilateral rules are binding on all members of the WTO.<sup>40</sup> The era of 'pick and choose' has come to an end. Developing and least-developed countries must thus be more assertive in the policy direction of the WTO so their trading needs can be represented under multilateral rules and not

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under the voluntary largesse of developed countries. For this to happen, developing countries must be more proactive in their participation in decision-making at the WTO.

## Endnotes

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1. Official Journal of the European Communities, L Series, No.346 (31 December 2001), p.1.
2. Appellate Body Report on European Communities – Conditions for the Granting of Tariff Preferences to Developing Countries, WT/DS246/AB/R, adopted on 7 April 2004, (hereinafter Appellate Body Report on EC – Tariff Preferences), para. 5.
3. Ibid.
4. Appellate Body Report on EC – Tariff Preferences, para. 5.
5. Ibid.
6. I.e., Bolivia, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Nicaragua, Pakistan, Panama, Peru, and Venezuela.
7. Appellate Body Report on EC – Tariff Preferences, para. 29.
8. Panel Report on European Communities – Conditions for the Granting of Tariff Preferences to Developing Countries, WT/DS246/R, 1 December 2003, (hereinafter Panel Report on EC – Tariff Preferences), para. 3.1.
9. Ibid., para. 3.3.
10. Appellate Body Report on EC – Tariff Preferences, para. 4.
11. Ibid., para. 3.7.
12. Ibid., para 8.1(f).
13. Appellate Body Report on EC – Tariff Preferences, para. 163.
14. Ibid., para. 162.
15. Ibid., para. 80.
16. Ibid., para. 90.
17. Ibid., para. 98.
18. Ibid., para. 102.
19. Ibid.
20. Michael J. Trebilcock and Robert Howse, *The Regulation of International Trade*, (3rd ed. London: Routledge, 2005), at 478.
21. Appellate Body Report on EC – Tariff Preferences, paras. 174-175.
22. Michael J. Trebilcock and Robert Howse, *op cit.*, note 20.
23. Lorand Bartels, ‘The Appellate Body Report in European Communities – Conditions for the Granting of Tariff Preferences to Developing Countries, WT/DS246/AB/R, and its Implications for Conditionality in GSP Programs,’ <http://www.worldtradelaw.net/articles/bartelsgsp.pdf>, at 4, (viewed on 30/04/13).
24. Peter Van den Bossche, *The Law and Policy of the World Trade Organisation*, (Cambridge: Cambridge University Press, 2005), at 683.

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25. Appellate Body Report on EC – Tariff Preferences, para. 163.
  26. The following are the 27 international conventions the implementation of which qualifies a developing country for GSP Plus: International Covenant on Civil and Political Rights; International Covenant on Economic Social and Cultural Rights; International Convention on the Elimination of All Forms of Racial Discrimination; Convention on the Elimination of All Forms of Discrimination against Women; Convention against Torture and Other Cruel, Inhuman or Degrading Treatment or Punishment; Convention on the Rights of the Child; Convention on the Prevention and Punishment of the Crime of Genocide; Minimum Age for Admission to Employment; Prohibition and Immediate Action for the Elimination of the Worst Forms of Child Labour; Abolition of Forced Labour Convention; Forced Compulsory Labour Convention; Equal Remuneration of Men and Women Workers for Work of Equal Value Convention; Discrimination in Respect of Employment and Occupation Convention; Freedom of Association and Protection of the Right to Organise Convention; Application of the Principles of the Right to Organise and to Bargain Collectively Convention; International Convention on the Suppression and Punishment of the Crime of Apartheid; Montreal Protocol on Substances that Deplete the Ozone Layer; Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and Their Disposal; Stockholm Convention on Persistent Organic Pollutants; Convention on International Trade in Endangered Species; Convention on Biological Diversity; Cartagena Protocol on Biosafety; Kyoto Protocol to the UN Framework Convention on Climate Change; UN Single Convention on Narcotic Drugs (1961); UN Convention on Psychotropic Substances (1971); UN Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (1988); Mexico UN Convention against Corruption. [http://trade.ec.europa.eu/doclib/docs/2013/september/tradoc\\_151705.%2013-07%20GSP%20InfoPack%20Update%20Final.pdf](http://trade.ec.europa.eu/doclib/docs/2013/september/tradoc_151705.%2013-07%20GSP%20InfoPack%20Update%20Final.pdf) (viewed on 20 September 2013).
  27. Lorand Bartels, at 19, *op cit.*, note 23.
  28. UNCTAD, *Generalized System of Preferences: Handbook on the Scheme of the United States of America*, (2003).
  29. *Ibid.*
  30. Gene M. Grossman and Alan O. Sykes, ‘European Communities – Conditions for the Granting of Tariff Preferences to Developing Countries’, *American Law Institute*, (2005), pp. 242-243
  31. *Ibid.*, at 245.
  32. Pascal Lamy, ‘The Place of the WTO and its Law in the International Legal Order’, *European Journal of International Law*, 17:5, (2007), pp. 969-984 at 973.
  33. See Gene M. Grossman and Alan O. Sykes, *op cit.*, note 30; Lorand Bartels, *op cit.*, note 23; Michael J. Trebilcock and Robert Howse, *op cit.*, note 20.

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34. WTO Secretariat, 'Trade and Labour Standards: Subject of Intense Debate' [http://www.wto.org/english/thewto\\_e/minist\\_e/min99\\_e/english/about\\_e/18lab\\_e.htm](http://www.wto.org/english/thewto_e/minist_e/min99_e/english/about_e/18lab_e.htm) (viewed on 20 February 2011).
  35. See Ernst-Ulrich Petersmann, 'The 'Human Rights Approach' Advocated by the UN High Commissioner for Human Rights and by the International Labour Organization: Is it Relevant for WTO Law and Policy?', *Journal of International Economic Law*, 7(3) (2004), pp. 605-627; Friederike Hoffmann, *Core Labor Standards and the WTO: Core Labor Standards on the U.S. International Trade Agenda – A Frame Analysis of the AFL-CIO's Support of the Labor-Trade Linkage in WTO Agreements*, VDM Publishing, (2008); Patrick Macklem, 'Labour Law beyond Borders', *Journal of International Economic Law*, 5(3), (2002), pp. 605-645; Chantal Thomas, 'Trade-Related Labor and Environment Agreements?', *Journal of International Economic Law*, 5(4) (2002), pp. 791-819; C. McCrudden and A. Davies, 'A Perspective on Trade and Labor Rights', *Journal of International Economic Law*, 3(1), (2000), pp. 43-62; J. M. Salazar-Xirinachs, 'The Trade-Labour Nexus: Developing Countries' Perspectives', *Journal of International Economic Law*, 3(2), (2000), pp. 377-385; Lorand Bartels, 'The WTO Enabling Clause and Positive Conditionality in the European Community's GSP Program', *Journal of International Economic Law*, 6(2), (2003), pp. 507-532.
  36. WTO Secretariat, *op cit.*, note 34.
  37. *Ibid.*
  38. Paragraph 4 of the Singapore Ministerial Declaration, 1996 [http://www.wto.org/english/news\\_e/pres96\\_e/wtodec.htm](http://www.wto.org/english/news_e/pres96_e/wtodec.htm) (viewed on 13 April 2013).
  39. Elisabeth De Vos, 'The Cotonou Agreement: A Case of Forced Regional Integration?' in Gerard Kreijen ed., *State, Sovereignty, and International Governance*, (Oxford: Oxford University Press, 2002), pp. 482-497 at 477-478.
  40. Article II:2 of the Agreement Establishing the World Trade Organisation.