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# The Impact of the Generalized System of Preferences on Imports

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**Although the EC's Generalized System of Preferences has been in force since July 1, 1971, vagueness still prevails with regard to the question to what extent the system has contributed to the lowering of tariff barriers and of what service it has thus been as a tool for the promotion of exports from the developing countries. Now that EC statistics on preferential imports in 1973-1976 are available, it is for the first time possible to undertake a detailed evaluation of the GSP in the light of more germane and comprehensive evidence than the general foreign trade statistics and a few incidental figures at hand previously<sup>1</sup>.**

Being the largest trading unit in the world, the European Community has often come under attack. The USA and Japan are not alone in finding fault with its increasingly protectionist policies. For years past the developing countries have felt aggrieved by the obstruction of their access to the EC, which is their most important market, by a large number of restrictions. The Generalized System of Preferences (GSP) was introduced by the European Community in order to parry these charges.

Preferential tariff systems have been established in most western industrialized countries<sup>2</sup>, and in several socialist states as well, with the object of

- increasing export earnings,
- promoting industrialization and
- hastening economic growth

in the developing countries. As divergent economic and political interests have hitherto prevented the elaboration of a uniform system for all the states which grant trade preferences to developing countries, each system is trying to achieve these objectives in its own way.

The design of the EC system shows a very clear intention to allow only a *controlled* preferential trade. This is manifest in the choice of beneficiaries, the product coverage, the depth of the tariff cuts, the

methods of surveillance and, above all, in the quantitative and formal limitations with a bearing on the import potential.

In 1978 the GSP operated to the benefit of altogether 115 independent and 27 dependent countries and territories. The system thus covered almost all developing countries except four in Europe (Portugal, Spain, Greece and Turkey). The preferences for the semi-finished and finished industrial products of chapters 25-99 of the EC's common customs tariff (CCT) were applied with a measure of differentiation, especially in regard to Romania, Yugoslavia and the group of dependent territories.

In 1976 the GSP covered 241 selected processed agricultural items (chapters 1-24 CCT) and almost all semi-finished and finished industrial products (chapters 25-99). The principal exceptions in the agricultural sector were goods subject to market regulation and agricultural raw materials; in the industrial sector raw materials and non-precious metals processed no further than into bars which can in any case be imported duty-free or at very low tariff rates are the principal items left outside the GSP.

The GSP preference for imports of agricultural products takes mostly the form of reduced tariff rates. Of altogether 241 agricultural products falling under the GSP 61 only were free of duty. Since 1979 the poorest developing countries have as a general rule been exempt from duties on agricultural products covered by the GSP. The industrial GSP products of

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<sup>1</sup> For the following cf. A. Borrmann, C. Borrmann, M. Stegger: Das allgemeine Zollpräferenzsystem der EG und seine Auswirkungen auf die Einfuhren aus Entwicklungsländern; Eine Untersuchung im Auftrage des Bundesministeriums für Wirtschaft (The EC's Generalized System of Tariff Preferences and its effects on the imports from developing countries; an investigation on behalf of the Federal Ministry of Economic Affairs), Hamburg 1979.

<sup>2</sup> The preference systems of various western industrialized countries have been in force since the following dates: EC – July 1, 1971; Japan – August 1, 1971; Norway – October 1, 1971; Finland, Sweden, New Zealand – January 1, 1972; Switzerland – March 1, 1972; Austria – April 1, 1972; Australia – July 1, 1966 and January 1, 1974 respectively; Canada – July 1, 1974; USA – January 1, 1976.

chapters 25-99 CCT may all be imported into the EC free of duty but are subject to quantitative limitations; in the agricultural sector these are applied to five product groups only. The limits are based on general maximum import amounts for the whole of the EC (Community quotas, ceilings). Calculated anew every year for each kind of goods, they are made up of a basic amount equal to the total of imports from beneficiary developing countries in the base year and a supplementary amount equal to 5 % of the EC's imports from other non-EC countries. The base year is usually an annual period three or four years before the year to which the maximum amounts apply.

### Quantitative Limitations

Within the general limits as calculated in this manner there are other upper limits in the form of "butoirs" and member state shares. The butoirs (maximum country amounts) serve the purpose of regulating the competition between the developing countries; they set a limit of 50 % to the imports from any single supplier country but actually restrict them mostly to an even smaller proportion of the overall ceilings and EC quotas. The member state shares on the other hand have the purpose of dividing the general maximum amounts for imports among the individual EC member countries prorated so as to "share the burden". In the course of time these basic components have become more and more interlocked, with the result that the system is by now very complex indeed<sup>3</sup>.

The intensity of the application and supervision of these limitations depends upon the degree of sensitivity of the imported goods (sensitive, hybrid<sup>4</sup>, quasi-sensitive, non-sensitive) and the competitive conditions in the individual markets.

The external tariff of the EC is re-introduced automatically for sensitive goods when the upper limits are reached; quasi-sensitive goods are only under surveillance and may be re-subjected to the most-favoured-nation rate on application; the imports of non-sensitive goods are in general neither supervised nor limited. Since 1979 the imports of industrial products (other than textiles) from the least developed countries have been free from quantitative regulation. These countries are therefore now enjoying what amounts almost to free-trade conditions in their

<sup>3</sup> The arrangements in the textile sector had a large share in this, but the "fine-tuning" of maximum country amounts by special butoirs and consideration of such criteria as import market shares, export quotas, per-capita incomes and intra-EC apportionment and the introduction of the Community reserve operated in the same direction.

<sup>4</sup> These are products which depending on the supplying country are regarded as either sensitive or quasi-sensitive.

commerce with the EC but this is at present of relatively moderate benefit to them because of their low development level.

The EC has reserved for itself a general right to invoke an escape clause: the preferences may be rescinded in the event of severe disruption of the internal market of the EC or significant impairment of the export interests of associated or other countries to which special preferences have been granted (ACP, Maghreb, Mashrek, etc.).

### Rules of Origin

The GSP stipulates certification of the origin of GSP goods so as to prevent misuse of the preferences by other countries. It has to be stated that an appropriate amount of the working or processing has been carried out in the beneficiary developing country and that the goods in question were sent directly to the EC area. This rule probably militates against the efforts of the developing countries for increased economic cooperation. Exempted from it are only the ASEAN, Andean Group and Central American Common Market (MCCA) as integration areas which may certify what is known as "cumulative origin", which means that goods may be worked or processed in several member states of these groups without impairment of their preferential status.

A comparison of the GSP with similar systems of other industrial countries shows no scheme to be beyond question superior to the others. From the point of view of the developing countries the EC scheme has probably advantages in this product range, especially because it includes textiles, shoes and mineral oil products. The depth of the tariff cuts seems also to be fairly generous, particularly if the continual growth of the preference margins in the agricultural sector is taken into account. There is on the other hand no other preference system with comparable quantitative limitations. Of importance is also the proviso concerning preference and association treaties, e. g. for the Maghreb and Mashrek countries, Spain and Greece, and the ACP states which have been given a higher preferential rank; agreements of this kind do not play such a large role in other industrial countries.

### GSP Imports

The development of the EC's preferential trade from 1971 till 1976 is shown in a tabulated form. There have been many special events in this period which make it difficult to interpret the data: the preferential trade statistics begin with a half-year figure for 1971; the

accession of Great Britain, Denmark and Ireland to the EC in 1974 and the partial inclusion of Romania in the GSP distorted the picture in the following years; the continuous increase of the number of GSP goods, especially in the agricultural sector, was a factor in all years; and the modification of EC association and preferential trade policy towards Mediterranean and ACP countries also affected the GSP results. The decline in 1975 was probably largely due to cyclical influences.

### GSP Imports into the EC according to Degree of Sensitivity in 1971-1976

(EUA '000)<sup>a</sup>

Year	Sensitive	Quasi-sensitive	Non-sensitive	Total <sup>b</sup>
1971 <sup>d</sup>	—	—	—	220,000
1972	—	—	—	450,000
1973	183,060	86,731	342,327	612,118
1974	496,257	451,785	805,170	1 753,211
1975	274,488	608,139 <sup>c</sup>	847,319	1 729,945
1976	441,451	1 110,720 <sup>c</sup>	1 483,681	3 085,852

<sup>a</sup>European Unit of Account on a gold basis at fixed parities: EUA 1 = DM 3.66.

<sup>b</sup>Deviations due to rounding. <sup>c</sup>Incl. hybrid goods. <sup>d</sup>Second half of the year.

S o u r c e: Own calculations based on data of the Statistical Offices of the European Communities and the Federal Ministry of Economic Affairs.

The distribution of the preferential trade over the various categories of goods shows a marked concentration on sensitive and quasi-sensitive goods, accounting for nearly 50 % of the total, and on relatively few classes of goods: minerals, foodstuffs and tobacco, textiles etc., and machines and electrotechnical articles. A striking feature is the predominance of a few individual products: ten major items accounted in 1976 for 45 % of all GSP imports, compared with 28.6 % in 1973; 700 others shared the remaining 55 %. Oil derivatives alone contributed 18.6 % (in 1976).

The feature of the regional pattern of the GSP trade is the outstanding importance of the Federal Republic of Germany as a market for GSP goods (1976: 40.2 %). France, Italy and Ireland have a poor GSP record: their GSP imports grew at a signally low rate; it is also significant that they conduct a much smaller part of their total trade with developing countries through the GSP.

A polarization of trade patterns is also evident among the supplying countries: predominant as sources of supply in 1976 were Brazil (11.8 %), Yugoslavia (11.1 %) and Hongkong (8.2 %). They and

the other more advanced developing countries<sup>5</sup> account for almost half of all preferential imports. The ten largest suppliers among the developing countries provided 71.3 % of all GSP imports in 1976, and the top twenty supplied 88 %. Such a trade concentration is however also to be noted in regard to the total trade in goods falling under the GSP; it is not a specific feature of the GSP trade. Less than one-fifth of all GSP imports originate in the poorer countries<sup>6</sup>. This also is in line with the non-GSP trade in these goods.

### GSP Potential

By supplying 51 % (in 1976) of all non-EC imports into EC countries the developing countries are making a substantial contribution to the EC's total supplies. Quite obviously however the importance of the developing countries does *not* derive from the goods covered by the GSP and the countries supplying them, for GSP products account for no more than 16 % (1976) of all EC imports from developing countries; 84 % of all EC imports from developing countries, with a value of EUA 72.1 bn, are outside the GSP's product range. Energy and raw materials not covered by the GSP alone account for 70 %; they enter in general duty-free and for this reason cannot be the subject of preferential arrangements.

The EC imports from developing countries for which the GSP can provide effective preferences (the GSP potential) are limited by a number of factors including the limitation of preferential rights to special countries and goods and the duplication of preferences for many developing countries, e. g. the Maghreb, Mashrek and ACP states which are assured of at least equivalent if not more advantageous tariff preferences by cooperation agreements with the EC and do not need the GSP insofar as this is the case. Bearing these factors in mind, the GSP potential works out at 8 % (on the basis of 1976 figures) of all EC imports from developing countries. The system-induced quantitative limitations of the GSP have been left *out of account* in this calculation.

In 1976 the actual GSP imports into the EC amounted to about EUA 3 bn. A comparison of these actual GSP imports with the GSP potential indicates a rate of no more than 40 %.

### Maximum Import Amounts

This discrepancy is essentially due to the quantitative and formal limitations. The Community's

<sup>5</sup> With per-capita incomes in excess of US\$ 1,075 (in 1975).

<sup>6</sup> With per-capita incomes below US\$ 520 (in 1975).

quotas and ceilings alone lopped about 30 % off the GSP potential (in 1976), and their impact is mounting. Responsible for this fact are the modalities for the computation of the general maximum import amounts which typically involve a three- to five-year lag and the numerous deviations from the basic formula for reasons of cyclical or structural policy. The result is that the total amount of actually granted preferences<sup>7</sup> does *not* keep in step with the growth of the EC imports from beneficiary developing countries.

### Utilization of the Scheme

The intensity of the utilization of the GSP by developing countries and importers is usually measured by the ratio of actual GSP imports to the total amount of GSP preferences granted. This indicator has been fluctuating around 50 % since 1973 but it is misleading. There seems little point in going on using the average utilization rate as an indicator for on the one hand it is computed on the basis of import quotas and ceilings which the developing countries are at present unable to utilize in full or at all because they lack the supply capabilities or competitive strength and on the other actual deliveries even of quasi-sensitive goods over and above the maximum import amounts have been recorded<sup>8</sup>.

The absolute or relative *non-utilization* level could be considered as a possible alternative indicator. It can be computed from the sum total of all positive differences between GSP ceilings and effective GSP imports. When imports reach or exceed the general maximum amounts, they are disregarded in this calculation. Computed in this way, the non-utilization total works out at EUA 3.1 bn, i. e. 80 % of the ceilings and Community quotas for 1976. To this considerable extent at least the GSP would offer further preferential sales opportunities to the beneficiary countries.

Lack of supplying capability and competitive strength can be shown to be the cause of 63 % of the non-utilization. The quantitative limits of the GSP on imports account for 10 % of the non-utilization and are thus of far less importance than might have been expected. Their effect should not however be underrated. As far as the more sensitive categories of goods are concerned<sup>9</sup>, the non-utilization is due almost entirely to these limitations. They apply today to 43 % of the GSP trade in more sensitive goods, and the trend is upward. In 1971-1976 EC imports from

<sup>7</sup> Expressed by the sum of all maximum import amounts plus the imports of agricultural products in the preceding year.

<sup>8</sup> In 1976 this happened in as many as 246 of altogether 1,031 preference items.

<sup>9</sup> Sensitive, hybrid and quasi-sensitive GSP goods.

developing countries were curtailed in 1,350 cases by application of the various quantitative limits.

The butoirs are the most important instrument of control for the GSP. Apart from their undisputed restrictive effect they *also* provide, according to corroborative evidence, protection for weaker suppliers among the developing countries. The butoir-induced non-utilization constitutes future GSP potential which these weaker supplying countries may take up under the protection of the butoirs. The stimulatory effect of the butoirs is however in danger of being dissipated with increasing allotment of small and minute import quotas and growing complexity of the butoir arrangements for the more sensitive goods.

### Effects on Trade

Any figures for the trade-creating and -diverting effects of the GSP on the basis of the data for four past years are bound to be approximations. Whether the margin of preference, which in 1976 averaged 8.8 percentage points<sup>10</sup>, sufficed to improve the trading position of the beneficiary developing countries can be ascertained after adjustments for "disruptive influences" such as the EC enlargement in 1974 and the modification of the preferences for individual countries and commodities. A necessary condition for such an improvement is above-average growth of GSP imports and, in consequence of this, a distinctly higher share of the EC's imports from non-EC countries. An analysis of the imports of semi-finished and finished industrial products shows indeed that the pattern of trade is changing in favour of the developing countries: adjusted for the above-mentioned factors, the GSP trade expanded at an annual rate of 33.2 %, i. e. by 12 percentage points more than the total imports of GSP products from non-EC countries. There is thus clear evidence of a stimulatory effect of the GSP on trade.

### Delayed GSP Impact

The incremental growth due to the stimulatory effect of the GSP is no abrupt or non-recurring phenomenon. Growth impulses due to the preferences tend to work through gradually because the design of the GSP, which is in parts highly complex and also subject to constant alterations, and the gradual transformation of traditional trade relations and changes in consumer preferences make it difficult for interested parties to keep fully informed. The relatively low supply elasticity of the developing countries has in many cases even

<sup>10</sup> The GSP-induced customs revenue shortfall of the EC amounted in 1976 to EUA 267 mn, i. e. 2.6 % of all EC customs revenues.

ruled out a major success of the GSP in the short term. It often takes a long time to set up new production capacities and solve the problems of capital and technology involved. One result of this is that economies of scale which are in some circumstances far more important for gaining new markets and extending market shares than the preferential tariffs themselves begin to show up belatedly.

It follows from this that a system of generalized tariff preferences can achieve the desired objectives of growth, diversification and export promotion only gradually.

There is no doubt whatsoever that the maximum import amounts and the other limitations – including the rules of origin in particular – have held the expansion of preferential imports from developing countries in check. This is especially true of the more sensitive categories of goods. That the quotas and ceilings for import goods which compete more or less strongly with domestic products in the EC market were stepped up less than proportionately had a decisive effect in this respect.

The complete removal of the value and quantity limitations must be the long-term objective of development policy. This problem should not however detract attention from the as yet unexploited opportunities opened up by the GSP. The extensive non-utilization of Community quotas and ceilings is only in small measure due to the limitations which, it may be noted in passing, are being interpreted fairly liberally in practice. As much as 90 % of the non-utilization of the sales potential must be attributed to other factors.

The non-utilization of GSP opportunities is, as has been shown, probably for the most part to be ascribed to lack of supply capabilities and competitive strength on the part of the developing countries although the rules of origin and countless other non-tariff trade obstacles have had a restrictive effect.

It must also be borne in mind, besides, that import duties are only one among many other determinants of competition in foreign trade which can easily neutralize and overcompensate for tariff preferences.

Nevertheless it is a fact that the GSP is capable and in need of improvement. Its main weakness is the lack of clarity which greatly lessens its efficiency. It has by now become so complex that the existing system can in its end effect no longer be puzzled out and understood by anybody but a few experts<sup>11</sup>. This is something to be observed also in other industrial

countries which provide preferences, and the question has therefore been raised repeatedly whether the Generalized System of Preferences can really be regarded as either "general" or a "system"<sup>12</sup>. By its increasing complexity the GSP is itself creating non-tariff barriers to trade. Examples can be found in the large number of individual EC regulations which are made even less accessible by linguistic difficulties, in the many, sometimes involuted quantitative limitations and in the special stipulations for the textile sector in particular which probably match those of the agricultural market regulations. The rules of origin which are, incidentally, of a discriminatory nature should be mentioned in this context. An extensive simplification and international harmonization of the rules of origin is therefore as necessary as recognition of the concept of cumulative origin in the GSP system.

A simplification of the GSP would certainly be helped by abolition of the member state shares. The division of the Community quotas between the EC member countries runs counter to the principle of treating the EC as a uniform customs zone because preferential duty rates and normal external EC tariff rates may be chargeable at the same time when individual member state shares have been exhausted. Moreover, the division is arbitrary and detrimental to efficiency because the apportionment of member state shares according to a rigid formula usually does not tally with the actual pattern of GSP imports.

Finally it must be stated that the attempt to limit the GSP imports from developing countries in a strong trading position, extend the opportunities for weaker exporting countries and delimit the competition hitting producers inside the EC by increasingly complex regulations is also problematic. The highly complex regulations for the imports of sensitive textiles point hardly in the right direction. The question whether all developing countries, and the threshold countries in particular, need the preferences will have to be re-appraised when the EC's Generalized System of Preferences comes up for revision in the near future. The question of the inclusion of more countries in the scheme calls likewise for careful examination.

<sup>11</sup> Bericht im Namen des Ausschusses für Entwicklung und Zusammenarbeit über die Vorschläge der Kommission der Europäischen Gemeinschaften an den Rat (Dok. 245/77) für Verordnungen über die Anwendung der allgemeinen Zollpräferenzen der Europäischen Gemeinschaften im Jahre 1978 (Report on behalf of the Committee for Development and Cooperation concerning the proposals of the Commission of the European Communities to the Council (Doc. 245/77) for regulations on the application of the Generalized Tariff Preferences in 1978), in: Europäische Gemeinschaften: Europäisches Parlament, Sitzungsdokumente, 1977/78, Dok. 302/77, October 10, 1977, p. 20.

<sup>12</sup> Ibid., p. 8.