

# CRS Report for Congress

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## Trade Preferences for Developing Countries and the WTO

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### Summary

World Trade Organization (WTO) Members must grant immediate and unconditional most-favored-nation (MFN) treatment to the products of other Members with respect to tariffs and other trade-related measures. Programs such as the Generalized System of Preferences (GSP), under which developed countries grant preferential tariff rates to developing country products, are facially inconsistent with this obligation since they accord goods of some countries more favorable tariff treatment than that accorded goods of other WTO Members. Because such programs have been viewed as trade-expanding, however, Contracting Parties to the General Agreement on Tariffs and Trade (GATT) provided a legal basis for one-way tariff preferences and certain other preferential arrangements in a 1979 decision known as the Enabling Clause. WTO Members have received GATT waivers for preferences that exceed what this GATT exception allows. In 2004, the WTO Appellate Body ruled that the Enabling Clause allows developed countries to offer different treatment to developing countries, but only if identical treatment is available to all similarly-situated GSP beneficiaries. Two 109<sup>th</sup> Congress bills (S. 191 and H.R. 886) would grant preferential market access to products of the least-developed countries. H.R. 3175 would expand textile-related trade preferences to sub-Saharan African countries. This report will be updated.

### Trade Preferences and GATT MFN Requirements

As parties to the General Agreement on Tariffs and Trade (GATT) 1994, World Trade Organization (WTO) Members must under Article I:1 of the GATT grant immediate and unconditional most-favored-nation (MFN) treatment to the products of other Members with respect to customs duties and import charges, internal taxes and regulations, and other trade-related matters. Thus, whenever a WTO Member accords a benefit to a product of one country, whether it is a WTO Member or not, the Member

must accord the same treatment to the like product of all other WTO Members.<sup>1</sup> Tariff preference programs for developing countries are facially inconsistent with this obligation because the favorable treatment provided by the granting country to the goods of a specific group of countries is not extended to all WTO Members. Since preference programs have been viewed as vehicles of trade liberalization and economic development for developing countries, however, GATT Parties have accommodated them in a series of joint actions.

In 1965, the GATT Parties added Part IV to the General Agreement, an amendment that recognizes the special economic needs of developing countries and asserts the principle of non-reciprocity. Under this principle, developed countries forego the receipt of reciprocal benefits for their negotiated commitments to reduce or eliminate tariffs and restrictions on the trade of less developed contracting parties.<sup>2</sup> Because of the underlying MFN issue, GATT Parties in 1971 adopted a waiver of Article I for the Generalized System of Preferences (GSP), which allowed developed contracting parties to accord more favorable tariff treatment to the products of developing countries for ten years.<sup>3</sup> The GSP was described in the decision as a “system of generalized, non-reciprocal and non-discriminatory preferences beneficial to the developing countries.”

At the end of the Tokyo Round of Multilateral Trade Negotiations in 1979, developing countries secured adoption of the Enabling Clause, a permanent deviation from MFN by joint decision of the GATT Contracting Parties. The Clause states that notwithstanding GATT Article I, “contracting parties may accord differential and more favourable treatment to developing countries, without according such treatment to other contracting parties” and applies this exception to: (1) preferential tariff treatment in accordance with the GSP; (2) multilateral non-tariff preferences negotiated under GATT auspices; (3) multilateral arrangements among less developed countries; and (4) special treatment of the least developed countries in preference programs.<sup>4</sup> To describe the GSP, the Clause refers to the above-quoted description in the 1971 waiver. The Enabling Clause has since been incorporated into the GATT 1994.<sup>5</sup>

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<sup>1</sup> While the WTO uses the term “most-favored-nation” to describe nondiscriminatory trade treatment, U.S. law has since 1998 referred to this treatment as “normal trade relations” (NTR) status. *See* P.L. 105-206, § 5003. This report uses the WTO terminology.

<sup>2</sup> E. McGovern, *International Trade Regulation* § 9.212 (updated 1999)[hereinafter cited as McGovern]. Part IV is generally viewed as non-binding, though some have argued otherwise with regard to certain of its provisions. *Id.*; J. Jackson, W. Davey & A. Sykes, *Legal Problems of International Economic Relations* 1171 (4<sup>th</sup> ed. 2002).

<sup>3</sup> Generalized System of Preferences; Decision of 25 June 1971 (L/3545)(June 28, 1971), available at [<http://gatt.stanford.edu/page/home>].

<sup>4</sup> Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries; Decision of 28 November 1979 (L/4903)(December 3, 1979). This document and subsequently-cited WTO documents are available at [<http://docsonline.wto.org>].

<sup>5</sup> Agreement Establishing the World Trade Organization, Annex 1A, General Agreement on Tariffs and Trade 1994, ¶ 1(b)(iv); *see* European Communities – Conditions for the Granting of Tariff Preferences to Developing Countries; Report of the Appellate Body (WT/DS246/AB/R) (April 7, 2004), at ¶ 90.3

## WTO Waivers for Preferential Trade Agreements

The European Union had argued in the GATT that it could further deviate from Article I:1 MFN requirements for non-reciprocal free trade with developing countries pursuant to GATT Part IV, discussed above, as well as GATT Article XXIV, which provides an MFN exception for customs unions and free trade areas meeting specified conditions. At issue was the Lomé IV Convention, a preferential, non-reciprocal trade arrangement between the EEC and African, Caribbean and Pacific (ACP) countries. The Convention extended beneficial tariff and quota treatment to ACP imports as well as development assistance to ACP countries. GATT panels concluded in two unadopted panel reports, one issued in 1993 and the other in 1994, that such a deviation was not justified under either provision.<sup>6</sup> With regard to the Article XXIV claim, the 1994 report concluded that because the Lomé Convention involved non-GATT Parties, it was not an agreement covered by the Article and thus it could not be used to justify the inconsistency with Article I of trade preferences for bananas imported from ACP countries.<sup>7</sup> Shortly thereafter the European Communities (EC) obtained a temporary waiver of GATT Article I:1 for the Lomé agreement; it later received a waiver for the successor ACP-EC Partnership Agreement (Cotonou Agreement) until December 31, 2007.<sup>8</sup>

## WTO Waivers for U.S. Preference Programs<sup>9</sup>

The United States holds a temporary GATT waiver for the preferential tariff program established in the Caribbean Basin Economic Recovery Act (CBERA);<sup>10</sup> the waiver expires on December 31, 2005, however, and pertains solely to U.S. obligations under GATT Article I:1. The United States also holds a waiver of Article I:1 obligations with regard to tariff preferences accorded the former Trust Territories of the Pacific Island (TTPI); the waiver expires on December 31, 2006.<sup>11</sup> Although the United States acquired a GATT waiver from Article I:1 obligations for the Andean Trade Preference Act (ATPA),

<sup>6</sup> McGovern, *supra* note 2, at ¶ 9.212.

<sup>7</sup> EEC – Import Regime for Bananas; Report of the Panel, DS38/R, ¶¶ 156-164 (1994), *as reprinted in 34 Int'l Legal Mat.* 180 (1995).

<sup>8</sup> GATT, Document L/7604 (December 19, 1994); WTO, WT/L/436 (December 7, 2001). The current waiver may be nullified as of January 1, 2006, as it applies to bananas if the EC, in converting to a tariff-only system for banana imports as of that date, does not provide adequate market access for WTO Members exporting bananas to the European Union on an MFN basis.

<sup>9</sup> For further information on current U.S. trade preference programs, *see* CRS Report 97-389, *Generalized System of Preferences*, by William H. Cooper; CRS Report RL32895, *Textile Reports to Trade Preference Regions*, by Bernard A. Gelb; CRS Report RS21772, *AGOA III: Amendment to the African Growth and Opportunity Act*, by Danielle Langton; and CRS Report IB95050 *Caribbean Basin Interim Trade Program: CBI/NAFTA Parity*, by Vladimir N. Pregelj.

<sup>10</sup> *See* WTO Council for Trade in Goods, Caribbean Basin Economic Recovery Act; Draft Decision (G/C/W/21/Rev.1)(October 23, 1995), and World Trade Organization, *Guide to GATT Law and Practice; Analytical Index* 903 (updated 6<sup>th</sup> ed. 1995).

<sup>11</sup> United States – Former Trust Territory of the Pacific Islands; Decision of 14 October 1996 (WT/L/183)(October 18, 1996). The waiver covers the Republic of the Marshall Islands, the Federated States of Micronesia, the Commonwealth of the Northern Mariana Islands, and the Republic of Palau.

the waiver expired on December 4, 2001.<sup>12</sup> The United States does not hold a waiver for preferences authorized in the African Growth and Opportunity Act (AGOA), which are available to sub-Saharan African countries through September 30, 2015.<sup>13</sup>

In February 2005, the United States submitted requests for new GATT waivers for the following preferential tariff programs through their current expiration dates: (1) CBERA, as amended by the United States-Caribbean Trade Partnership Act (through September 30, 2008); (2) ATPA, as amended by the Andean Trade Promotion and Drug Eradication Act (through December 31, 2006); and (3) AGOA (through September 30, 2015).<sup>14</sup> These programs extend duty-free treatment that in some cases is subject to quantitative restrictions (QRs) and, consequently, the requests seek waivers not only of GATT Article I:1 but also of GATT Article XIII, paragraphs 1 and 2, which require non-discrimination in administering QRs. Answering a question from India about the exclusion of some sub-Saharan countries from AGOA, the United States outlined criteria used annually to determine a country's eligibility for preferences, among which were the establishment of a market-based economy and the rule of law.<sup>15</sup> The United States also faced questions about whether requirements that apparel imported under the preference programs be assembled from U.S. yarn and fabric constituted an export advantage to U.S. producers. The United States responded that the objective of the legislation is to "boost production, employment, and investment in the beneficiary countries."<sup>16</sup> The waivers are still pending.

## WTO-Legality of Non-trade Conditions in Preference Programs

In *European Communities - Conditions for the Granting of Tariff Preferences to Developing Countries*, the WTO Appellate Body (AB) explained how developed country WTO members may design preferential-tariff programs within the requirements of the Enabling Clause.<sup>17</sup> The dispute between India and the European Communities (EC) stemmed from an EC Regulation which awarded tariff preferences to a closed group of 12 beneficiary countries on the condition that they combat illicit drug production (the Drug

<sup>12</sup> See WTO Council for Trade in Goods, Andean Trade Preference Act; Draft Decision (G/C/W/54)(September 4, 1996).

<sup>13</sup> African Growth and Opportunity Act, P.L. 106-200, Title I, 19 U.S.C. §§ 3701 *et seq.* as amended by § 3108 of the Trade Act of 2002 (P.L. 107-210), the AGOA Acceleration Act of 2004 (P.L. 108-274), and the Miscellaneous Trade and Technical Corrections Act of 2004 (P.L. 108-429).

<sup>14</sup> See Request for a Waiver; Caribbean Basin Economic Recovery Act (G/C/W/508)(January 3, 2005); Request for a Waiver; Andean Trade Preferences Act (G/C/W/510)(January 3, 2005) and ((G/C/W/510/Add.1)(March 15, 2005); and Request for a Waiver; African Growth and Opportunity Act (AGOA)(G/C/W/509)(January 3, 2005).

<sup>15</sup> United States – Requests for Waivers; Replies of the United States to comments and questions from China, India and Pakistan (G/C/W/518)(May 13, 2005), at 3.

<sup>16</sup> *Id.* at 2-3. See also *id.* at 5-7. For subsequent discussions on U.S. waiver requests, see Replies of the United States to comments and questions from China and Pakistan (G/C/W/526)(July 15, 2005) and Comments and questions from Brazil (G/C/W/527)(July 20, 2005).

<sup>17</sup> European Communities – Conditions for the Granting of Tariff Preferences to Developing Countries; Report of the Appellate Body (WT/DS246/AB/R)(April 7, 2004).

Arrangements). India brought the claim alleging that the Drug Arrangements were inconsistent with GATT Article I:1 and unjustified by the Enabling Clause.

The initial dispute panel, in a report issued on December 1, 2003, concluded that the EC was in violation of its WTO obligations, with one panelist dissenting on procedural grounds.<sup>18</sup> Addressing the nature of the Enabling Clause and its procedural implications, a two member majority first concluded that the Enabling Clause functions as an exception to the GATT Article I:1 MFN obligation and that, consequently, the burden of proof rests on the party that invokes the Enabling Clause as a defense (¶ 7.53). The lone dissenter argued that the MFN obligation does not apply to the Enabling Clause and that India did not properly bring the claim under the Clause (¶¶ 9.15, 9.21). Employing a broad reading of the term “non-discriminatory” in the Clause’s description of the GSP, the panel concluded that developed countries were required to provide “identical tariff preferences” under GSP schemes to “all developing countries” (¶ 7.161). Applying this standard, the panel then ruled that the Drug Arrangements were inconsistent with GATT Article I:1 and could not be justified under the Clause (¶ 7.177). The European Communities appealed.

The Appellate Body report, issued on April 7, 2004, first addressed the relationship between GATT Article I:1 and the Enabling Clause. The AB upheld the panel’s findings that the Enabling Clause is an exception to GATT Article I:1 and that the Clause does not exclude the applicability of Article I:1 (¶¶ 99-103). The AB explained that the Enabling Clause is to be read together with Article I:1 in the procedural sense, since a challenged measure, such as the Drug Arrangements, is “submitted successively to the test of compatibility with the two provisions.” In other words, when the Enabling Clause is implicated, the dispute panel first examines whether a measure is consistent with Article I:1, “as the general rule,” and, if it is found not to be so, the panel then examines whether the measure may be justified under the Clause (¶¶ 101-102).

Noting the “vital role” played by the Enabling Clause “in promoting trade as a means of stimulating economic growth and development” and the intent of WTO Members through the Clause to encourage the adoption of preference schemes, the AB found that the Clause was not a typical GATT exception or defense (¶ 106, 114). Thus, the AB modified the panel’s finding and held that, unlike the ordinary practice with respect to GATT exceptions, under which exceptions are invoked only by the responding party, “it was incumbent upon [complainant] India to *raise* the Enabling Clause in making its claim of inconsistency with Article I:1 of the GATT 1994” and to identify specific provisions of the Clause which it believed were violated by the respondent’s measure (¶¶ 115, 123)(emphasis in original). At the same time, the burden of justifying GSP schemes under the cited Enabling Clause provisions still rests on a respondent (¶ 125). In application, the AB found that India sufficiently raised the issue, thereby placing the burden on the EC to justify the Drug Arrangements under the Clause.

Most importantly, the AB reversed the panel’s substantive decision regarding the breadth of acceptable preference programs under the Enabling Clause. The AB found instead that developed countries can grant preferences beyond those provided in their GSP to developing countries with particular needs, but only if identical treatment is available

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<sup>18</sup> European Communities – Conditions for the Granting of Tariff Preferences to Developing Countries; Report of the Panel (WT/DS246/R)(December 1, 2003).

to all similarly-situated GSP beneficiaries (¶ 173). The AB elaborated that similarly-situated GSP beneficiaries are all GSP beneficiaries that have the “development, financial, and trade needs” to which the treatment is intended to respond (¶ 173). In reaching this conclusion, the AB reversed the panel’s reading of the term “non-discriminatory” as used to define the GSP in the Enabling Clause. Even under the more expansive view of the Enabling Clause, however, the AB upheld the Panel’s ruling that the EC failed to prove the Drug Arrangements were in fact “non-discriminatory” (¶ 189). Two factors led the AB to its conclusion: (1) the closed list of beneficiary countries in the Drug Arrangements could not ensure that the preferences would be available to all GSP beneficiaries suffering from illicit drug production and trafficking, and (2) the Drug Arrangements did not set out objective criteria that distinguished beneficiaries under the Drug Arrangements from other GSP beneficiaries (¶¶ 187, 188).

Before the ruling was adopted by the WTO Dispute Settlement Body, the U.S. WTO representative stated, according to meeting minutes, that the United States was pleased that the Appellate Body had “reversed the Panel’s finding that the Enabling Clause required developed countries under their GSP programs to provide *identical* preferences to *all* developing countries” and that the AB’s decision “would help maintain the viability of GSP programs.”<sup>19</sup> However, the United States raised concerns about the AB’s finding that complainant India needed to raise the Enabling Clause, but that the EC bore the burden of proving that the Drug Arrangements were consistent with it, questioning the legal basis for this “hybrid approach” and suggesting that possible future difficulties may ensue in allowing the complaining party to set the burden of proof for the respondent.

## Trade Preference Legislation in the 109<sup>th</sup> Congress

Currently pending in the 109<sup>th</sup> Congress are two bills that would offer preferential market access for goods produced in certain least-developed countries (S. 191 (Smith)/H.R. 886 (Kolbe)).<sup>20</sup> The eligible duty-free goods would include textiles, even though these are excluded from the GSP. The pending bills also incorporate the criteria for eligibility outlined in AGOA. In addition, H.R. 3175 (McDermott) would extend through September 30, 2015, a provision in AGOA that authorizes the extension of duty-free treatment to apparel assembled in lesser developed AGOA beneficiaries regardless of the origin of the fabric. The existing provision is set to expire September 30, 2007.<sup>21</sup> Among other provisions, the bill would also authorize duty-free treatment of over-quota agricultural products from AGOA beneficiary countries, but with a formula for the possible imposition of a safeguard tariff in the event the unit import price of a good is lower than an annual trigger price.

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<sup>19</sup> Dispute Settlement Body; Minutes of Meeting, April 20, 2004 (WT/DSB/M/167)(May 27, 2004), at ¶¶ 58-59 (emphasis in original).

<sup>20</sup> Countries that may be designated as beneficiaries include Afghanistan, Bangladesh, Bhutan, Cambodia, Kiribati, Lao People’s Democratic Republic, Maldives, Nepal, Samoa, Solomon Islands, Timor-Leste (East Timor), Tuvalu, Vanuatu, Yemen, and Sri Lanka.

<sup>21</sup> The current third-country fabric expiration date was enacted in the AGOA Acceleration Act of 2004, P.L. 108-274, which extended the provision for three years from September 30, 2004.