

CASE NOTE

EUROPEAN COMMUNITIES — CONDITIONS FOR THE GRANTING OF TARIFF PREFERENCES TO DEVELOPING COUNTRIES*

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I INTRODUCTION

The integration of developing countries into the multilateral trading system has been one of the major challenges faced by the GATT/WTO.¹ One mechanism used to increase the role played by developing countries in international trade is the Generalised System of Preferences (‘GSP’). The GSP, authorised by the 1979 *Enabling Clause*,² allows developed countries to grant preferential tariff treatment to products originating in developing countries. Without authorisation, developed countries adopting such a policy would be in breach of the most favoured nation (‘MFN’) obligation contained in art I of the 1994 *General Agreement on Tariffs and Trade*.³

* WTO Doc WT/DS246/AB/R, AB-2004-1 (2004) (Report of the Appellate Body). Throughout the case note this dispute shall be referred to as *EC — Tariff Preferences*.

¹ The World Trade Organization (‘WTO’) came into being in 1995 pursuant to the *Marrakesh Agreement Establishing the World Trade Organization*, opened for signature 15 April 1994, 1867 UNTS 3 (entered into force 1 January 1995) (‘*Marrakesh Agreement*’). The WTO replaced the entity known as ‘GATT’, which did not have a distinct institutional framework and merely comprised Contracting Parties to the 1947 *General Agreement on Tariffs and Trade*, opened for signature 30 October 1947, 55 UNTS 187 (entered into force 1 January 1948) (‘*GATT 1947*’).

² *Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries*, GATT BISD, 26th Supp, 203, GATT Doc L/4903 (1979) (Multilateral Trade Negotiations Decision, adopted on 28 November 1979) (‘*Enabling Clause*’).

³ *Marrakesh Agreement*, opened for signature 15 April 1994, 1867 UNTS 3 (entered into force 1 January 1995), annex 1A (*General Agreement on Tariffs and Trade*) 1867 UNTS 190, art I (‘*GATT 1994*’). The *GATT 1994* incorporates by reference the provisions of *GATT 1947*, above n 1.

Over the years, certain developed countries have included various conditions in their GSP schemes that developing countries must meet to be granted preferential tariff treatment. These conditions range from compliance with labour standards to the promotion of the fight against terrorism. Traditionally, 'negative conditionality' has been the common practice, whereby failure to comply with a particular condition results in the withdrawal of trade preferences. However, since 1994, the European Communities ('EC') have also operated a rewards-based system of 'positive conditionality'.⁴ Under the EC's GSP scheme,⁵ developing countries are provided with additional tariff preferences (beyond those accorded to all developing countries) if they adhere to specified environmental and labour standards.⁶ Reduced tariffs are also available to developing countries that have instituted measures to combat illegal drug production and trafficking (the 'Drug Arrangements').⁷

The legality of positive conditionality has recently been the subject of a WTO Appellate Body decision in *European Communities — Conditions for the Granting of Tariff Preferences to Developing Countries*.⁸ The case concerned a dispute between India and the EC regarding the consistency of the EC's Drug Arrangements with WTO law. The EC appealed against the Panel's finding at first instance that developed countries must provide *identical* tariff preferences to *all* developing countries under their GSP schemes (except when implementing a narrow range of a priori limitations).⁹ The Panel's finding was based on its interpretation of a non-discrimination requirement in the *Enabling Clause*.

Contrary to the Panel, the Appellate Body held that the non-discrimination requirement did not preclude developed countries from granting different tariffs to products originating in different GSP beneficiaries.¹⁰ Instead, it found that developed countries can differentiate between beneficiaries of their GSP schemes based on their different 'development, financial and trade needs', provided that identical treatment is available to all 'similarly-situated' GSP beneficiaries.¹¹ Ultimately, the EC's Drug Arrangements still failed to meet this new test.

This case note has two primary objectives. The first is to determine what implications the Appellate Body's decision has for the practice of conditionality in the GSP. The second is to critique the decision on the basis that it provides an

⁴ The distinction between negative and positive conditionality is made in Lorand Bartels, 'The WTO Enabling Clause and Positive Conditionality in the European Community's GSP Program' (2003) 6 *Journal of International Economic Law* 507, 508.

⁵ Council of the European Union, *Council Regulation No 2501/2001* [2001] OJ L 346/1 ('*GSP Regulation*').

⁶ *Ibid* arts 14–24.

⁷ *Ibid* art 10.

⁸ WTO Doc WT/DS246/AB/R, AB–2004–1 (2004) (Report of the Appellate Body) ('*Tariff Preferences Appellate Body Report*').

⁹ *European Communities — Conditions for the Granting of Tariff Preferences to Developing Countries*, WTO Doc WT/DS246/R (2003) [7.161] (Report of the Panel) ('*Tariff Preferences Panel Report*').

¹⁰ *Tariff Preferences Appellate Body Report*, WTO Doc WT/DS246/AB/R, AB–2004–1 (2004) [173].

¹¹ *Ibid*.

ill-founded justification for developed countries to differentiate between developing countries in their GSP schemes.

The case note begins with a short history of the GSP in Part II, and a background to the decisions in *EC — Tariff Preferences* in Part III. An analysis of the decision is then provided in Part IV, focusing on the Appellate Body's interpretation of the term 'non-discriminatory' in the *Enabling Clause*. In addition to identifying the requirements for positive conditionality, this section includes a brief discussion of whether the decision has any ramifications for the practice of negative conditionality. In Part V, a number of problems with the Appellate Body's finding that the *Enabling Clause* authorises needs-based differentiation are discussed. The case note concludes in Part VI with an assessment of the GSP's future in light of the Appellate Body decision.

II A SHORT HISTORY OF THE GSP

The origins of the GSP can be traced back to the first United Nations Conference on Trade and Development ('UNCTAD') in 1964. As part of a strategy to stimulate developing country trade, it was proposed that all developing countries should be granted preferential tariff treatment from developed countries.¹² At the second session of UNCTAD in 1968, a resolution was unanimously adopted in favour of adopting 'a mutually acceptable system of generalized, non-reciprocal and non-discriminatory trade preferences which would be beneficial to the developing countries'.¹³ A Special Committee on Preferences was established, which in 1970 adopted the *Agreed Conclusions* setting out the details of the GSP arrangement.¹⁴

A system of tariff preferences specific to developing countries would ordinarily have been in breach of the MFN obligation in art I of the *GATT 1947*.¹⁵ Consequently, in accordance with the *Agreed Conclusions*, a number of developed countries seeking to institute GSP schemes sought a waiver of the provisions of art I from the GATT Council.¹⁶ In 1971, a 10 year waiver was granted.¹⁷ Before the expiry of the waiver, the *GATT 1947* Contracting Parties decided to adopt the GSP on a more permanent basis. It was this 1979 decision, entitled *Differential and More Favourable Treatment, Reciprocity and Fuller*

¹² UNCTAD, *Final Act and Report of the Conference*, 1st sess, 35th plen mtg, annex A, UN Doc E/CONF.46/139 (1964) General Principle 8.

¹³ UNCTAD, *Expansion and Diversification of Exports of Manufactures and Semi-Manufactures of Developing Countries*, UNCTAD Res 21 (II) (1968), as reproduced in *Tariff Preferences Panel Report*, WTO Doc WT/DS246/R (2003) annex D-3.

¹⁴ UNCTAD, *Agreed Conclusions of the UNCTAD Special Committee on Preferences* (1970), as reproduced in *Tariff Preferences Panel Report*, WTO Doc WT/DS246/R (2003) annex D-4 ('*Agreed Conclusions*'). See also UNCTAD, *Terms of Reference for the Special Committee on Preferences*, in UNCTAD, *Basic Documents*, 78-9, UN Doc UNCTAD/LEG/1 (October 1995).

¹⁵ Above n 1.

¹⁶ The waiver was requested by Austria, Canada, Denmark, Finland, Ireland, Japan, New Zealand, Norway, Sweden, Switzerland, the UK, the US, and the EC and its Member States: see GATT Council, *Minutes of Meeting Held on 25 May 1971*, GATT Doc C/M/69 (28 May 1971).

¹⁷ *Generalized System of Preferences*, GATT BISD, 18th Supp, 24, GATT Doc L/3545 (1971) (Waiver Decision, adopted on 25 June 1971) ('*1971 Waiver Decision*').

Participation of Developing Countries, that became known as the *Enabling Clause*.¹⁸

Paragraph 1 of the *Enabling Clause* provides that Contracting Parties may accord differential and more favourable treatment to developing countries 'notwithstanding' art I of the *GATT 1947*. In paragraph 2(a), this exemption is taken to apply to 'preferential tariff treatment accorded by developed contracting parties to products originating in developing countries in accordance with the Generalized System of Preferences'. Footnote 3 to para 2(a), referencing the *1971 Waiver Decision*, describes the GSP as a system of 'generalized, non-reciprocal and non-discriminatory preferences beneficial to developing countries'. It is this description of the GSP as 'non-discriminatory' that is the focus of the Appellate Body's decision in *EC — Tariff Preferences*.

III BACKGROUND TO *EC — TARIFF PREFERENCES*

The EC has had a GSP scheme in place since 1971. Under its current GSP scheme, all beneficiaries are eligible to receive duty-free treatment on 'non-sensitive' products, and a reduction of the normal duty rate on 'sensitive' products.¹⁹ Additional preferences apply to countries which are determined by the EC to comply with certain labour and environmental standards.²⁰ Under the Drug Arrangements, 12 pre-determined countries also receive additional preferences to help them combat illegal drugs.²¹ Finally, as provided for under the *Enabling Clause*,²² the EC extends duty-free access to all products, except for arms and ammunition, originating in least-developed countries.²³

On 25 March 2002, India held consultations with the EC to discuss its concerns with the EC's system of positive conditionality.²⁴ After the two parties failed to resolve the matter, India requested the establishment of a WTO panel.²⁵ Originally, India sought to challenge the Drug Arrangements as well as the special incentive arrangements for the protection of labour rights and the environment. However, the complaint was subsequently limited to the Drug

¹⁸ Above n 2.

¹⁹ *GSP Regulation* [2001] OJ L 346/1, art 7.

²⁰ The special incentive arrangements for the protection of labour rights and the environment are provided for in *GSP Regulation* [2001] OJ L 346/1, arts 14–24. The special preferences concerning labour rights apply to all products. The special preferences regarding the environment apply only to tropical forest products. To date, special preferences concerning labour rights have been granted to Moldova and Sri Lanka. No developing countries currently receive special preferences regarding the environment.

²¹ *GSP Regulation* [2001] OJ L 346/1, art 10. The Drug Arrangements apply to Bolivia, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Nicaragua, Pakistan, Panama, Peru and Venezuela.

²² The *Enabling Clause*, above n 2, [2(d)], provides for the '[s]pecial treatment of the least developed among the developing countries in the context of any general or specific measures in favour of developing countries'.

²³ *GSP Regulation* [2001] OJ L 346/1, art 9.

²⁴ *European Communities — Conditions for the Granting of Tariff Preferences to Developing Countries*, WTO Doc WT/DS246/1, G/L/521 (2002) (Request for Consultations by India).

²⁵ *European Communities — Conditions for the Granting of Tariff Preferences to Developing Countries*, WTO Doc WT/DS246/4 (2002) (Request for the Establishment of a Panel by India).

Arrangements only.²⁶ India claimed that the Drug Arrangements were inconsistent with art I:1 of the *GATT 1994* and were not justified by the *Enabling Clause*.²⁷

In a 2:1 decision, the Panel ruled in India's favour. Having found that the *Enabling Clause* was an exception to art I:1,²⁸ and that the two provisions apply concurrently,²⁹ the Panel considered it appropriate to examine India's art I:1 claim. Unsurprisingly, the Panel held that the Drug Arrangements were inconsistent with art I:1 as the tariff preferences granted to the 12 beneficiaries had not been accorded to like products originating from all other WTO Members.³⁰ Turning to the *Enabling Clause*, the Panel held that the term 'non-discriminatory' in fn 3 to para 2(a) 'requires that identical tariff preferences under GSP schemes be provided to all developing countries without differentiation, except for the implementation of a priori limitations'.³¹ Clearly, the Drug Arrangements, which provided additional preferences to their 12 beneficiaries, failed to meet this test.³² Lastly, the Panel found that the Drug Arrangements could not be justified as a measure to protect human life or health under art XX(b) of the *GATT 1994*.³³

As a result of the Panel's interpretation of the term 'non-discriminatory', developed countries could no longer justify *any* of the conditions in their GSP schemes under the *Enabling Clause*. Conditions are introduced for many different reasons, including domestic pressure from sectors impacted by the tariff preferences, concerns raised by non-government organisations about issues such as labour and environmental standards, political differences (or alliances) with certain developing countries, and general opposition to the GSP.³⁴ Given the numerous conditions in the most important GSP schemes, namely those of the EC and the United States, the decision was considered a threat to the future of the GSP.³⁵ On 8 January 2004, the EC gave notice that it intended to appeal the Panel ruling.³⁶

²⁶ *Tariff Preferences Panel Report*, WTO Doc WT/DS246/R (2003) [1.5].

²⁷ *Ibid* [3.1].

²⁸ *Ibid* [7.36]–[7.37].

²⁹ *Ibid* [7.44]–[7.45].

³⁰ *Ibid* [7.58], [7.60].

³¹ *Ibid* [7.161]. The a priori limitations are measures that set import ceilings so as to exclude certain imports originating in individual developing countries where the products concerned reach a certain competitive level in the market of the preference-giving country: see Juan Sánchez Arnau, *The Generalised System of Preferences and the World Trade Organisation* (2002) 212.

³² *Tariff Preferences Panel Report*, WTO Doc WT/DS246/R (2003) [7.177].

³³ *Ibid* [7.178]–[7.236].

³⁴ See generally Sánchez Arnau, above n 31, 205–25.

³⁵ See, eg, Robert Howse, 'The Death of GSP? The Panel Ruling in the India–EC Dispute over Preferences for Drug Enforcement' (2004) 8(1) *Bridges Monthly Review* 7 <<http://www.ictsd.org/monthly/bridges/BRIDGES8-1.pdf>> at 1 May 2005.

³⁶ *European Communities — Conditions for the Granting of Tariff Preferences to Developing Countries*, WTO Doc WT/DS246/7 (2004) (Notification of an Appeal by the EC).

IV THE APPELLATE BODY DECISION

The EC appealed the Panel decision on a number of grounds.³⁷ The EC's principal ground of appeal involved an extended argument about the manner in which the Panel allocated the burden of proof in the dispute.³⁸ This part of the Appellate Body decision will not be discussed in this case note. In short, the EC believed that India had incorrectly brought its claim under art I:1 of the *GATT 1994* rather than under the *Enabling Clause*. The Appellate Body agreed with the Panel that, as the *Enabling Clause* was an 'exception' to art I:1, it was appropriate for India to claim that the Drug Arrangements were inconsistent with art I:1.³⁹ However, it also found that India was required to identify which elements of the *Enabling Clause* the Drug Arrangements were alleged to have contravened.⁴⁰ The EC then bore the burden of proving that the Drug Arrangements satisfied those elements of the *Enabling Clause*.⁴¹ This novel approach to allocating the burden of proof was adopted by the Appellate Body to account for the 'special status' of the *Enabling Clause* in the WTO system.⁴²

The Appellate Body was satisfied that India had sufficiently raised para 2(a) of the *Enabling Clause* in making its claim of inconsistency with the *GATT 1994* art I:1 before the Panel.⁴³ Thus, it proceeded to examine the EC's appeal 'subsidiarily'⁴⁴ that the Panel erred in finding that the Drug Arrangements were not justified under para 2(a) of the *Enabling Clause*.⁴⁵ The Appellate Body's

³⁷ States reserving their right to participate as third parties to the dispute were Bolivia, Brazil, Colombia, Costa Rica, Cuba, Ecuador, El Salvador, Guatemala, Honduras, Mauritius, Nicaragua, Pakistan, Panama, Paraguay, Peru, Sri Lanka, the US, and Venezuela: *Tariff Preferences Panel Report*, WTO Doc WT/DS246/R (2003) [1.7], [1.9].

³⁸ *Tariff Preferences Panel Report*, WTO Doc WT/DS246/R (2003) [7.40]–[7.51], [8.1(b)]–[8.1(c)].

³⁹ *Tariff Preferences Appellate Body Report*, WTO Doc WT/DS246/AB/R, AB–2004–1 (2004) [79]–[130]. The Appellate Body also agreed with the Panel that the two provisions apply concurrently (with the *Enabling Clause* prevailing to the extent of any conflict).

⁴⁰ *Ibid* [113]–[118], [190(c)].

⁴¹ *Ibid*.

⁴² *Ibid* [110]. Firstly, the Appellate Body noted that every measure that is authorised by the *Enabling Clause* is necessarily inconsistent with art I:1 of the *GATT 1994*. Therefore, for a complainant to allege mere inconsistency with art I:1 would not convey 'the legal basis of the complaint sufficient to present the problem clearly' required in a request for the establishment of a panel: *Marrakesh Agreement*, opened for signature 15 April 1994, 1867 UNTS 3 (entered into force 1 January 1995), annex 2 (*Understanding on Rules and Procedures Governing the Settlement of Disputes*) 1869 UNTS 401 ('*Dispute Settlement Understanding*'). Secondly, in light of the extensive requirements set out in the *Enabling Clause*, the Appellate Body considered that a complainant must identify the specific provision of the *Enabling Clause* of which the disputed measure allegedly falls foul. In the view of the Appellate Body, exposing preference schemes to open-ended challenges would be inconsistent with the intention of the Members to 'encourage' the adoption of preferential treatment for developing countries: *Tariff Preferences Appellate Body Report*, WTO Doc WT/DS246/AB/R, AB–2004–1 (2004) [112]–[114].

⁴³ *Tariff Preferences Appellate Body Report*, WTO Doc WT/DS246/AB/R, AB–2004–1 (2004) [119]–[125].

⁴⁴ *European Communities — Conditions for the Granting of Tariff Preferences to Developing Countries*, WTO Doc WT/DS246/7 (2004) 1 (Notification of an Appeal by the European Communities).

⁴⁵ *Tariff Preferences Panel Report*, WTO Doc WT/DS246/R (2003) [7.61]–[7.177], [8.1(d)].

treatment of this issue, and the attendant implications for the practice of conditionality in GSP schemes, will be the focus of this section.

A *The Non-Discrimination Requirement*

Before addressing the issues raised by the second part of the EC's appeal, the Appellate Body carefully defined the precise scope of the appeal. Concerns had been raised by both parties that, in addressing para 2(a) of the *Enabling Clause*, the Panel had implicitly made findings on matters that were not before it.⁴⁶ Given the fragility of the GSP, the parties were adamant that the Appellate Body should only address issues that were directly relevant to the resolution of the dispute.

The Appellate Body considered India's claim before the Panel to have been limited to the consistency of the Drug Arrangements with the term 'non-discriminatory' in fn 3 to para 2(a) of the *Enabling Clause*. In particular, India's challenge was taken to be

based on its submission that the term 'non-discriminatory' prevents preference-granting countries from according preferential tariff treatment to any beneficiary of their GSP schemes without granting identical preferential tariff treatment to all other beneficiaries.⁴⁷

1 *Legal Status of the Non-Discrimination Requirement*

As identified in Part II of this case note, the *Enabling Clause* does not directly provide that GSP schemes must be non-discriminatory. Instead, the term 'non-discriminatory' makes a more inconspicuous appearance in fn 3 to para 2(a). Paragraph 2(a) provides for:

Preferential tariff treatment accorded by developed contracting parties to products originating in developing countries in accordance with the Generalized System of Preferences.⁴⁸

The footnote corresponding to this provision of the *Enabling Clause* reads:

As described in the Decision of the Contracting Parties of 25 June 1971, relating to the establishment of 'generalized, non-reciprocal and non-discriminatory preferences beneficial to the developing countries'.⁴⁹

Prior to determining the meaning of this reference to the GSP as 'non-discriminatory', the Appellate Body first had to establish the legal status of the requirement of non-discrimination.

In the lead-up to the dispute in *EC — Tariff Preferences*, commentators were divided on whether non-discrimination should be regarded as an aspiration of the GSP or a binding legal condition. In a comprehensive analysis of the history of the GSP, the relevant legal texts, and subsequent state practice, Robert Howse

⁴⁶ *Tariff Preferences Appellate Body Report*, WTO Doc WT/DS246/AB/R, AB-2004-1 (2004) [128].

⁴⁷ *Ibid* [129].

⁴⁸ *Enabling Clause*, above n 2, [2(a)].

⁴⁹ *Ibid* fn 3.

contended that the idea of non-discrimination in the description of the GSP should be regarded as having a largely aspirational legal effect.⁵⁰ Howse noted that as recently as the *Doha Decision on Implementation* in 2001,⁵¹ the WTO membership had reaffirmed that preferences granted to developing countries ‘should’ be non-discriminatory.⁵² Elsewhere, however, it was argued that developed countries must provide non-discriminatory treatment in order to benefit from the *Enabling Clause*.⁵³ Lorand Bartels suggested that while non-discrimination was merely an aspiration in the *1971 Waiver Decision*, the *Enabling Clause* converted it into a binding condition.⁵⁴

Surprisingly, the EC never argued in *EC — Trade Preferences* that non-discrimination should be regarded as a mere aspiration of the GSP.⁵⁵ Before the Appellate Body, the EC’s strongest argument was that fn 3 referred to the description of the GSP in the *1971 Waiver Decision* and, of itself, did not impose any legal obligation on preference-granting countries.⁵⁶ For the most part, the third party submissions also skirted the issue. Reflecting the limited arguments of the parties, the Appellate Body gave short shrift to the question of the legal status of the term ‘non-discriminatory’.

Conflating para 2(a) and fn 3, the Appellate Body stated that preferential tariff treatment must be ‘in accordance’ with the GSP ‘as described’ in the preamble to the *1971 Waiver Decision*.⁵⁷ Noting that ‘accordance’ is defined in the dictionary as ‘conformity’, it went on to suggest that ‘only preferential tariff treatment that is in conformity with the description “generalized, non-reciprocal and non-discriminatory” can be justified under paragraph 2(a)’.⁵⁸ Hence, non-discrimination is a binding condition. The Appellate Body found support for this view in the more obligatory language used in both the French and Spanish texts of the *Enabling Clause* (both coming closer to ‘as defined in’ rather than ‘as described in’).⁵⁹

While the Appellate Body’s textual analysis is sound, it is not conclusive. It would have been appropriate to also consider subsequent state practice and the

⁵⁰ Robert Howse, ‘India’s WTO Challenge to Drug Enforcement Conditions in the European Community Generalized System of Preferences: A Little Known Case with Major Repercussions for “Political” Conditionality in US Trade Policy’ (2003) 4 *Chicago Journal of International Law* 385, 388–99.

⁵¹ *Implementation-Related Issues and Concerns*, WTO Doc WT/MIN(01)/17 (2001) (Ministerial Conference — Decision of 14 November 2001) (*‘Doha Decision on Implementation’*).

⁵² *Ibid* [12.2]. See Howse, ‘India’s WTO Challenge’, above n 50, 394.

⁵³ See, eg, Bartels, above n 4, 519–21; James Harrison, ‘GSP Conditionality and Non-Discrimination’ (2003) 9 *International Trade Law and Regulation* 159, 161.

⁵⁴ Bartels, above n 4, 520.

⁵⁵ Howse has suggested that perhaps the European Commission thought it could save its Drug Arrangements through an art XX exception on public health, if need be, and wanted to make it more difficult for the US to attach different kinds of political conditions to its own GSP (eg conditions relating to communist countries and the war on terrorism): see Howse, ‘India’s WTO Challenge’, above n 50, 401.

⁵⁶ *Tariff Preferences Appellate Body Report*, WTO Doc WT/DS246/AB/R, AB–2004–1 (2004) [20].

⁵⁷ *Ibid* [145].

⁵⁸ *Ibid*.

⁵⁹ *Ibid* [147].

object and purpose of the *Enabling Clause* in accordance with art 31 of the *Vienna Convention on the Law of Treaties*.⁶⁰ State practice, in particular, throws doubt on the conclusion of the Appellate Body, as evidenced by the aforementioned 2001 *Doha Decision on Implementation*.⁶¹ Yet, given the lack of arguments to this effect on behalf of the EC and its third party allies, the Appellate Body can hardly be criticised for providing a superficial treatment of this issue. More importantly, as Howse has suggested, the finding is politically correct even if the Appellate Body's legal analysis is lacking.⁶² Non-discrimination has been an informing principle of the GSP since its inception, and developing countries are entitled to its protection. If the Appellate Body had found that the term 'non-discriminatory' was merely descriptive or aspirational, developing countries would have been exposed to the arbitrary application of GSP schemes by developed countries. A binding condition of non-discrimination provides predictability and security to the GSP, and helps ensure that it does not become a mechanism through which developed countries pursue their foreign policy objectives.

2 *The Meaning of 'Non-Discriminatory'*

Having found that the term 'non-discriminatory' was a binding legal condition, the Appellate Body was faced with the difficult task of interpreting its legal meaning. The concept of non-discrimination has no uniform application in the GATT/WTO system, but is variously interpreted depending on the context of its use.⁶³ In this instance, the *Enabling Clause* and the other relevant legal texts provided little guidance as to how the term 'non-discriminatory' should be interpreted. It was inevitable, therefore, that some creative adjudication would be required to settle its meaning. Unfortunately, there are a number of weaknesses in the approach taken by the Appellate Body.

The Appellate Body began by examining the ordinary meaning of 'non-discriminatory'. Before the Panel, the parties had offered competing definitions of 'discrimination'. India's definition conveyed a '*neutral* meaning of making a distinction', whereas the EC's definition conveyed a '*negative* meaning carrying the connotation of a distinction that is unjust or prejudicial'.⁶⁴ Given these divergent meanings, the Appellate Body held that the term 'non-discriminatory'

⁶⁰ Opened for signature 23 May 1969, 1155 UNTS 331 (entered into force 27 January 1980).

⁶¹ Above n 51. See Howse, 'India's WTO Challenge', above n 50, 388–99; cf Bartels, above n 4, 521–2.

⁶² Robert Howse, 'Appellate Body Ruling Saves the GSP, at Least for Now' (2004) 8(4) *Bridges Monthly Review* 5 <<http://www.ictsd.org/monthly/bridges/BRIDGES8-4.pdf>> at 1 May 2005. Howse submits that 'to deny obligatory force to the notion of non-discrimination in the *Enabling Clause* in an explicit judicial ruling would be a provocation to developing countries at a very difficult time in the history of their relationship to the multilateral trading system': at 5.

⁶³ Some of the different applications concern art I of the *GATT 1994* (which involves a comparison of the treatment of like products), the *chapeau* of art XX (which entails a comparison of the treatment of countries where the same conditions prevail) and art III (which is informed by the objective of avoiding protection of domestic production): see *GATT 1994*, above n 3.

⁶⁴ *Tariff Preferences Panel Report*, WTO Doc WT/DS246/R (2003) [7.126] (emphases in original).

was not, on its own, determinative of the permissibility of a developed country according different tariff preferences to different beneficiaries of its GSP scheme.⁶⁵ It did, however, conclude that the two definitions converged in one respect as ‘they both suggest that distinguishing among similarly-situated beneficiaries is discriminatory’.⁶⁶ On this basis, the Appellate Body held that it was ‘clear from the ordinary meanings of “non-discriminatory” ... that preference-granting countries must make available identical tariff preferences to all similarly-situated beneficiaries’.⁶⁷

This analysis of the ordinary meanings of ‘non-discrimination’ is problematic. The Appellate Body claimed that both the ordinary meanings put forward by the parties suggested that distinguishing among ‘similarly-situated’ beneficiaries is discriminatory.⁶⁸ This was followed by the weaker claim that the parties ‘effectively appear to agree’ that this is the case.⁶⁹ However, neither of these claims is clearly substantiated. India’s definition of ‘discriminate’ comes closer to suggesting that distinguishing among GSP beneficiaries (regardless of their situation) is discriminatory.⁷⁰ This accords with India’s submission to the Panel that the term ‘non-discriminatory’ does not permit the making of distinctions between different categories of developing countries.⁷¹ By introducing the notion of ‘similarly-situated’ beneficiaries, the Appellate Body served its own interpretative purposes. The term ‘similarly-situated’ carries with it the possibility of *difference* between developing countries. As shall become evident, this facilitated the Appellate Body’s later finding that differential treatment of different developing countries by GSP donors is possible.

The Appellate Body continued its analysis by examining the context of the term ‘non-discriminatory’. Firstly, it found that the term ‘generalized’ in fn 3 ‘requires that the GSP schemes of preference-granting countries remain generally applicable’.⁷² The Appellate Body’s primary intention here was to reveal the error in the Panel’s exaggerated claim that allowing tariff preferences such as the Drug Arrangements would necessarily result in ‘the collapse of the whole GSP system and a return back to special preferences favouring selected developing countries’.⁷³ The Appellate Body also submitted that provisions such as paras 3(a) and 3(c) provide further protection against such an occurrence.⁷⁴

⁶⁵ *Tariff Preferences Appellate Body Report*, WTO Doc WT/DS246/AB/R, AB-2004-1 (2004) [152].

⁶⁶ *Ibid* [153].

⁶⁷ *Ibid* [154].

⁶⁸ *Ibid* [153].

⁶⁹ *Ibid*.

⁷⁰ India stated that the ordinary meaning of ‘discriminate’ is ‘to make or constitute difference in or between; distinguish’ and ‘to make a distinction in the treatment of different categories of peoples or things’: *Tariff Preferences Panel Report*, WTO Doc WT/DS246/R (2003) [7.117].

⁷¹ *Ibid*.

⁷² *Tariff Preferences Appellate Body Report*, WTO Doc WT/DS246/AB/R, AB-2004-1 (2004) [156]. Interestingly, Bartels has suggested that the term ‘generalized’ is a ‘type of primitive non-discrimination norm’ that may now be considered legally redundant: Bartels, above n 4, 523.

⁷³ *Tariff Preferences Panel Report*, WTO Doc WT/DS246/R (2003) [7.102].

⁷⁴ *Tariff Preferences Appellate Body Report*, WTO Doc WT/DS246/AB/R, AB-2004-1 (2004) [156], [173].

Next, the Appellate Body turned to para 3(c), which specifies that ‘differential and more favourable treatment’ provided under the *Enabling Clause*

shall in the case of such treatment accorded by developed contracting parties to developing countries be designed and, if necessary, modified, to respond positively to the development, financial and trade needs of developing countries.⁷⁵

Paragraph 3(c) became the key provision in this dispute because the EC argued that it permits developed countries to design their GSP schemes so as to take into account the development needs of certain categories of developing countries.⁷⁶ In other words, the EC believed that para 3(c) authorises GSP donors to treat developing countries differently based on their differing needs.

The EC’s contention is by no means clear on the wording of para 3(c) or the other provisions of the *Enabling Clause*. The Panel went so far as to suggest that it could find

nothing in the text of the *Enabling Clause* or in its drafting history to support the European Communities’ argument that paragraph 3(c) permits developed countries to respond to similar development needs of *selected* developing countries.⁷⁷

Moreover, it claimed that there was no discernable criteria (or reasonable explanation) for justifying the selective inclusion of only certain development needs, to the exclusion of others.⁷⁸ The Panel concluded that

the appropriate way of responding to the development needs of developing countries is to take into account *each and every* developing countries’ development needs by including, in the GSP schemes, a breadth of products of export interest to developing countries and by providing sufficient margins of preferences for such products.⁷⁹

The Appellate Body, however, was far more receptive to the EC’s position. It hastily dismissed the Panel’s analysis by suggesting that ‘the Panel appears to have placed a great deal of significance on the fact that paragraph 3(c) does not refer to needs of “individual” developing countries’.⁸⁰ In actual fact, the Panel merely made this point in passing by noting that the word ‘individual’ does appear in para 5.⁸¹ The Appellate Body then made its own inconclusive textual analysis by proposing that the absence of an explicit requirement to respond to the needs of ‘all’ developing countries suggests that para 3(c) imposes no such

⁷⁵ *Enabling Clause*, above n 2, [3(c)].

⁷⁶ *Tariff Preferences Appellate Body Report*, WTO Doc WT/DS246/AB/R, AB-2004-1 (2004) [26].

⁷⁷ *Tariff Preferences Panel Report*, WTO Doc WT/DS246/R (2003) [7.100] (emphasis in original).

⁷⁸ *Ibid* [7.100]–[7.106].

⁷⁹ *Ibid* [7.105] (emphasis in original).

⁸⁰ *Tariff Preferences Appellate Body Report*, WTO Doc WT/DS246/AB/R, AB-2004-1 (2004) [159] (emphasis omitted).

⁸¹ *Tariff Preferences Panel Report*, WTO Doc WT/DS246/R (2003) [7.78].

obligations.⁸² Even if this argument holds, it conveys little about whether para 3(c) actually authorises differential treatment of developing countries.

The Appellate Body continued by stating that

the participants in this case agree that developing countries may have ‘development, financial and trade needs’ that are subject to change and that certain development needs may be common to only a certain number of developing countries.⁸³

It then proceeded to find support for this view in both the *Enabling Clause* and the preamble to the *Marrakesh Agreement*.⁸⁴

It is certainly true that developing countries have different development needs. What is troubling is the conclusion that the Appellate Body drew from this understanding. The Appellate Body declared:

In sum, we read paragraph 3(c) as authorizing 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.⁸⁵

The problem with this interpretation is that it equates the fact that developing countries have different needs with the conclusion that GSP donors are authorised to treat developing countries differently based on these differing needs. As the Panel observed, there is insufficient evidence in the *Enabling Clause* (or its drafting history) to support this conclusion.⁸⁶ The Appellate Body falls short in its attempt to impose such a reading on para 3(c). As the Panel also appreciated, inequalities arise if needs-based differentiation is permitted.⁸⁷ This issue is addressed in Part V of this case note.

Returning to the non-discrimination requirement, the Appellate Body held that para 3(c) suggests that tariff preferences under GSP schemes ‘may be “non-discriminatory” when [they] are addressed to a particular “development, financial [or] trade need” and are made available to all beneficiaries that share

⁸² *Tariff Preferences Appellate Body Report*, WTO Doc WT/DS246/AB/R, AB-2004-1 (2004) [159].

⁸³ *Ibid* [160].

⁸⁴ *Ibid* [160]–[161]. The Appellate Body cited paras 3(c) and 7 of the *Enabling Clause* (neither of which clearly support this proposition). It also noted that the purpose of the special and differential treatment permitted under the *Enabling Clause* is to foster the economic development of developing countries. It then suggested that it would be ‘unrealistic to assume that such development will be in lockstep for all developing countries’: at [160]. In addition, it cited the preamble to the *Marrakesh Agreement*, above n 1, which recognises the ‘need for positive efforts designed to ensure that developing countries, and especially the least developed among them, secure a share in the growth in international trade commensurate with the needs of their economic development’: at [161]. The Appellate Body also observed (more convincingly) that the preamble recognises that Members’ “‘respective needs and concerns at different levels of economic development” may vary according to the different stages of development of different Members’: at [161].

⁸⁵ *Tariff Preferences Appellate Body Report*, WTO Doc WT/DS246/AB/R, AB-2004-1 (2004) [162] (emphasis in original).

⁸⁶ *Tariff Preferences Panel Report*, WTO Doc WT/DS246/R (2003) [7.148].

⁸⁷ *Ibid* [7.116].

that need'.⁸⁸ It went on to assert that this interpretation was consistent with the objective and purpose of the *Marrakesh Agreement* and the *Enabling Clause*.⁸⁹ As could be expected, the Appellate Body focused on the objective of promoting the trade of developing countries.⁹⁰ Notably, the Panel considered the function of the term 'non-discriminatory' to be the prevention of abuse of the GSP and consequently gave greater weight to the objective of 'elimination of discriminatory treatment' found in the preamble to the *GATT 1994*.⁹¹

Lastly, the Appellate Body rejected the Panel's claim that para 2(d) (providing for special treatment of least-developed countries) would be redundant if para 2(a) permitted differentiation between developing countries.⁹² The Appellate Body correctly held that para 2(d) has an effect that is 'different and independent' from para 2(a).⁹³ However, this does not strengthen the Appellate Body's own reading of para 2(a).

By drawing together a number of tenuous interpretations of the applicable legal sources and criticisms of the Panel decision, the Appellate Body ultimately reached its conclusion on the meaning of the term 'non-discriminatory'. It submitted that

the term 'non-discriminatory' in footnote 3 does not prohibit developed-country Members from granting different tariffs to products originating in different GSP beneficiaries, provided that such differential tariff treatment meets the remaining conditions in the *Enabling Clause*. In granting such differential tariff treatment, however, preference-granting countries are required, by virtue of the term 'non-discriminatory', to ensure that identical treatment is available to all similarly-situated GSP beneficiaries, that is, to all GSP beneficiaries that have the

⁸⁸ *Tariff Preferences Appellate Body Report*, WTO Doc WT/DS246/AB/R, AB-2004-1 (2004) [165].

⁸⁹ *Ibid* [168]–[169]. The Appellate Body cited the preamble to the *Marrakesh Agreement*, above n 1, and the preamble to the *1971 Waiver Decision*, above n 17, which provides that 'a principal aim of the Contracting Parties is promotion of the trade and export earnings of developing countries for the furtherance of their economic development'. The Appellate Body also noted that these objectives were 'reflected' in para 3(c) of the *Enabling Clause*, above n 2.

⁹⁰ The Appellate Body's analysis is based on the view that the objective of improving the trade of developing countries can be achieved by responding both to the collective needs of developing countries and also to the particular needs of subcategories of developing countries: *Tariff Preferences Appellate Body Report*, WTO Doc WT/DS246/AB/R, AB-2004-1 (2004) [169].

⁹¹ *Tariff Preferences Panel Report*, WTO Doc WT/DS246/R (2003) [7.157]–[7.158]. For its part, the Appellate Body suggested that it failed to see the basis on which the Panel gave more weight to this objective: *Tariff Preferences Appellate Body Report*, WTO Doc WT/DS246/AB/R, AB-2004-1 (2004) [170].

⁹² *Tariff Preferences Appellate Body Report*, WTO Doc WT/DS246/AB/R, AB-2004-1 (2004) [172]. See also *Tariff Preferences Panel Report*, WTO Doc WT/DS246/R (2003) [7.145]–[7.147].

⁹³ *Tariff Preferences Appellate Body Report*, WTO Doc WT/DS246/AB/R, AB-2004-1 (2004) [172].

‘development, financial and trade needs’ to which the treatment in question is intended to respond.⁹⁴

Admittedly, the Appellate Body was charged with an unenviable task in interpreting the meaning of the term ‘non-discriminatory’. Nonetheless, it chose a problematic interpretive path, and its conclusion fails to accurately reflect the text of the *Enabling Clause*.

3 Applying the Non-Discrimination Requirement

On the Appellate Body’s interpretation of ‘non-discriminatory’, tariff preferences granted in response to particular ‘development, financial [or] trade need[s]’ of developing countries must be made available to all GSP beneficiaries that have those needs. In the case of the Drug Arrangements, this required that, ‘at a minimum’, the additional preferences had to be made available to all GSP beneficiaries that were similarly affected by drug problems.⁹⁵

The Appellate Body established two related tests that a particular measure must meet to satisfy the non-discrimination requirement. Firstly, there must be a mechanism under which the list of beneficiaries receiving additional preferences can be modified (such that countries can be added to or removed from the list).⁹⁶ With regard to the Drug Arrangements, the Appellate Body found that ‘by their very terms’ the additional preferences were limited to 12 developing countries.⁹⁷ There was no mechanism under which additional beneficiaries could be added to the existing list.⁹⁸ Moreover, removal from the list could occur for reasons ‘not specific to the Drug Arrangements’.⁹⁹

Secondly, the GSP scheme must contain ‘criteria or standards’ to provide a basis for determining whether a developing country qualifies for preferences.¹⁰⁰ It can be assumed, on the basis of the Appellate Body’s analysis, that these criteria would need to be objective, transparent and non-discriminatory.¹⁰¹ In the

⁹⁴ Ibid [173]. On the basis of this finding, the Appellate Body reversed the Panel’s finding that the term ‘non-discriminatory’ requires that identical tariff preferences under GSP schemes be provided to all developing countries without differentiation: at [174]. Consistent with its own finding, the Appellate Body also reversed the Panel’s finding that ‘developing countries’ in para 2(a) should be interpreted to mean *all* developing countries: at [175]–[176].

⁹⁵ Ibid [180].

⁹⁶ Ibid [187].

⁹⁷ Ibid [181].

⁹⁸ Ibid [182]–[183].

⁹⁹ Ibid [184].

¹⁰⁰ Ibid [188].

¹⁰¹ Ibid [177]–[189]. The Appellate Body referred to ‘clear prerequisites’ and ‘objective criteria’: at [183]. The Appellate Body stated that, as the EC’s regulation ‘does not define the criteria or standards that a developing country must meet to qualify for preferences under the Drug Arrangements, there is no basis to determine whether those criteria or standards are *discriminatory* or not’: at [188] (emphasis added). This view was also reached by EC Trade Commissioner Pascal Lamy, who suggested that ‘today’s decision makes it clear that we can continue to give trade preferences to developing countries according to their particular situation and needs, provided that this is done in an objective, non-discriminatory and transparent manner’: ‘WTO Appellate Body: Differentiation Possible under Preference Schemes’ (2004) 8(14) *Bridges Weekly Trade News Digest* 5, 6 <<http://www.ictsd.org/weekly/04-04-22/BRIDGESWeekly8-14.pdf>> at 1 May 2005.

case of the Drug Arrangements, the Appellate Body noted that the EC's own Explanatory Memorandum stated that 'the benefits of the drug regime ... are given without *any* prerequisite'.¹⁰² The EC's *GSP Regulation* contained no criteria,¹⁰³ and it could not furnish any despite the Panel's request that it do so.¹⁰⁴

Having failed to satisfy the two tests, the Drug Arrangements did not meet the Appellate Body's minimum requirements for non-discrimination. Therefore, it upheld (for different reasons) the Panel's conclusion that the EC had 'failed to demonstrate that the Drug Arrangements are justified under paragraph 2(a) of the *Enabling Clause*'.¹⁰⁵ Interestingly, the Appellate Body hinted that the EC's special incentive arrangements for the protection of labour rights and the environment would meet the non-discrimination requirement. It noted that, in contrast to the Drug Arrangements, the *GSP Regulation* 'includes detailed provisions setting out the procedure and substantive criteria' that apply to a request to become a beneficiary under either of the special incentive arrangements.¹⁰⁶ This may also have been intended by the Appellate Body as a caution to India against pursuing its original challenge of these other arrangements.

It is worth reiterating that the Appellate Body only established the *minimum* requirement for complying with the term 'non-discriminatory'. Consequently, it would be open to future dispute panels to impose further requirements. One additional requirement alluded to by the Appellate Body was that the additional preferences must be an 'adequate and proportionate response' to the need in question.¹⁰⁷ It observed that

[i]n addition ... the Regulation does not, for instance, provide any indication as to how the European Communities would assess whether the Drug Arrangements provide an 'adequate and proportionate response' to the needs of developing countries suffering from the drug problem.¹⁰⁸

The 'adequate and proportionate' requirement, however, had its origins in the EC's submissions, and was not necessarily a requirement specifically endorsed by the Appellate Body.¹⁰⁹

B Responding to the Needs of Developing Countries

In examining para 3(c) of the *Enabling Clause* as context for the term 'non-discriminatory', the Appellate Body made some important remarks about the requirements of that provision. While the comments are dicta, the Appellate Body's interpretation of para 3(c) underpinned its findings on the non-discrimination requirement. It would be surprising, therefore, if a future dispute

¹⁰² *Tariff Preferences Appellate Body Report*, WTO Doc WT/DS246/AB/R, AB-2004-1 (2004) [183] (emphasis in original).

¹⁰³ *Ibid* [188].

¹⁰⁴ *Ibid*.

¹⁰⁵ *Ibid* [189].

¹⁰⁶ *Ibid* [182].

¹⁰⁷ *Ibid* [183].

¹⁰⁸ *Ibid*.

¹⁰⁹ *Ibid*.

panel did not follow this interpretation, unless it also sought to overturn the Appellate Body's finding on the meaning of 'non-discriminatory'.

As previously discussed, the Appellate Body argued that para 3(c) authorises GSP donors to treat developing countries differently in accordance with their differing needs. However, it went on to contend that it 'does not authorize *any* kind of response to *any* claimed needs of developing countries'.¹¹⁰

The Appellate Body articulated two conditions that GSP donors must meet in order to comply with para 3(c). Firstly, the Appellate Body noted that 'the types of needs to which a response is envisaged [under para 3(c)] are limited to "development, financial and trade needs"'.¹¹¹ In order to establish whether a particular need is one of these specified needs, the Appellate Body considered it necessary to have reference to an '*objective* standard'.¹¹² It suggested that the '[b]road-based recognition of a particular need, set out in the [*Marrakesh Agreement*] or in multilateral instruments adopted by international organizations, could serve as such a standard'.¹¹³ Notably, this indicates that developed countries are not confined to development needs recognised by the WTO membership.

Secondly, the Appellate Body observed that 'paragraph 3(c) mandates that the response provided to the needs of developing countries be "positive"'.¹¹⁴ It proposed that this required that the response of a donor country must be 'taken with a view to *improving* the development, financial or trade situation of a beneficiary country, based on the particular need at issue'.¹¹⁵ Accordingly, it suggested that a 'sufficient nexus' should exist between the preferential treatment provided under the *Enabling Clause*, and the 'likelihood of alleviating the relevant "development, financial [or] trade need"'. ... In the context of a GSP scheme, the particular need at issue must, by its nature, be such that it can be effectively addressed through tariff preferences'.¹¹⁶ As Howse has suggested, this would presumably require a rational connection, rather than any empirical proof of effectiveness.¹¹⁷

One particularly significant consequence follows from the Appellate Body's interpretation of para 3(c). If a GSP scheme must respond positively to the needs of developing countries, this rules out the possibility that donors can offer additional preferences for meeting conditions that reflect their own interests (other than incidentally). In other words, any system of positive conditionality

¹¹⁰ Ibid [163] (emphases in original).

¹¹¹ Ibid.

¹¹² Ibid (emphasis in original).

¹¹³ Ibid. In fn 335, the Appellate Body gave as an example the EC's claim that the drug problem was recognised in the *Marrakesh Agreement*, opened for signature 15 April 1994, 1867 UNTS 3 (entered into force 1 January 1995), annex 1A (*Agreement on Agriculture*) 1867 UNTS 410, and the *United States–Andean Trade Preference Act*, GATT BISD, 39th Supp, 385, GATT Doc L/6991 (1992) (Waiver Decision, adopted on 19 March 1992, renewed on 14 October 1996).

¹¹⁴ *Tariff Preferences Appellate Body Report*, WTO Doc WT/DS246/AB/R, AB–2004–1 (2004) [164].

¹¹⁵ Ibid (emphasis in original).

¹¹⁶ Ibid.

¹¹⁷ Howse, 'Appellate Body Ruling Saves the GSP, at Least for Now', above n 62, 6.

that is geared towards advancing the trade or foreign policy interests of the GSP donor will be inconsistent with para 3(c).

The EC's system of positive conditionality probably satisfies the requirements of para 3(c) as set out by the Appellate Body. The special incentives for the protection of labour and environmental standards, and the Drug Arrangements, are all ostensibly directed at internationally recognised developing country needs that could be effectively addressed by tariff preferences.¹¹⁸ The fact that they also reflect the interests of the EC is incidental.¹¹⁹

A positive condition would be inconsistent with para 3(c) if, for example, it was aimed at eliminating barriers to the donor's market access (eg protection of intellectual property rights). Similarly, an inconsistency would arise where a positive condition promoted the donor's foreign policy objectives (eg supporting efforts to combat terrorism). A GSP donor can only offer preferential tariff treatment that specifically targets the 'development, financial and trade needs' of developing countries.¹²⁰

C *The Unresolved Issue: The Legality of Negative Conditionality*

In addition to the EC's practice of positive conditionality, there is a more common practice of negative conditionality (whereby preferences are withheld or withdrawn for failure to comply with a condition). The US imposes numerous conditions of this kind in its GSP scheme.¹²¹ These include taking steps to afford core labour rights, providing for adequate protection of intellectual property rights and supporting US efforts to combat terrorism.¹²² The EC's scheme also

¹¹⁸ See European Commission, *Generalised System of Preferences: User's Guide to the European Union's Scheme of Generalised Tariff Preferences* (2003) <<http://europa.eu.int/comm/trade/issues/global/gsp/gspguide.htm>> at 1 May 2005.

¹¹⁹ See Sánchez Arnau, above n 31, 222–5. Sánchez Arnau notes that the special incentive arrangements were an attempt to incorporate domestic concerns (and pressures) relating to labour and environment standards. He claims that the Drug Arrangements were 'closely connected with a desire by the EU to give special treatment to a specific group of countries with which it shares a common ambition to construct its own regional scheme of integration', namely the Andean Group (Bolivia, Colombia, Ecuador, Peru and Venezuela): at 224. As the EC argued before the Panel in invoking the art XX exception on public health, the Drug Arrangements were also motivated by a desire to decrease the flow of illicit drugs into the EU: *Tariff Preferences Panel Report*, WTO Doc WT/DS246/R (2003) [4.91]–[4.99].

¹²⁰ *Tariff Preferences Appellate Body Report*, WTO Doc WT/DS246/AB/R, AB–2004–1 (2004) [168]. The Appellate Body also briefly discussed the requirements of para 3(a). Paragraph 3(a) states that any differential and more favourable treatment provided under the *Enabling Clause* 'shall be designed to facilitate and promote the trade of developing countries and not to raise barriers to or create undue difficulties for the trade of any other contracting parties'. The Appellate Body suggested that this 'requires that any positive response of a preference-granting country to the varying needs of developing countries not impose unjustifiable burdens on other [WTO] Members': at [167].

¹²¹ The current US GSP Scheme is authorised by the *Trade Act of 1974*, 19 USC § 2461 (1996). For a list of conditions imposed by the US scheme: see Office of the US Trade Representative, Executive Office of the President, *US Generalized System of Preferences Guidebook* (1999) <http://www.ustr.gov/assets/Trade_Development/Preference_Programs/GSP/asset_upload_file333_5430.pdf> at 1 May 2005. For an analysis of the use of conditions in the US scheme see Sánchez Arnau, above n 31, 205–9, 220–2.

¹²² The anti-terrorism criteria (which had previously only required that countries not provide aid or sanctuary to terrorists) were extended in 2002, following the attacks of 11 September 2001: *Trade Act of 2002*, 19 USC § 2462(b)(2)(F) (2002).

provides, to a more limited extent, that tariff preferences can be withdrawn under certain circumstances.¹²³

Following the Panel ruling, all conditions in GSP schemes were inconsistent with the *Enabling Clause* (as all conditions envision that identical tariff preferences will not be provided to all developing countries). However, in pursuing a different interpretation of the *Enabling Clause*, the Appellate Body indicated that the legality of negative conditionality would not be addressed in its ruling. Thus, it declared that

we do not rule on whether the *Enabling Clause* permits *ab initio* exclusions from GSP schemes of countries claiming developing country status, or the partial or total withdrawal of GSP benefits from certain developing countries under certain conditions.¹²⁴

The question remains whether the Appellate Body decision has any ramifications for the practice of negative conditionality. Developed countries would probably contend that they have always been entitled to impose negative conditions in their GSP schemes. The basis of this claim is expounded by Juan Sánchez Arnau in his detailed study of the GSP and the WTO. Sánchez Arnau claims that from the beginning of the GSP

it was tacitly agreed that any donor country would have the powers to extend the preferential treatment to any other country or to withdraw this treatment if there should be any valid reason for this in the opinion of the preference-giving country.¹²⁵

It is arguable that negative conditions satisfy the non-discrimination requirement because they are imposed on all developing countries alike (ie all developing countries are entitled to the same tariff preferences provided they meet the conditions). Of course, the nature and application of a condition would have to be such that all developing countries were equally capable of meeting it. In 1988, the US made this argument in response to a claim by Chile that it had been wrongly removed from the US GSP program for labour rights violations. The US asserted that '[c]ontrary to Chile's claim, the US action was non-discriminatory; the same criterion applies to all countries and was implemented on a non-discriminatory basis'.¹²⁶

The requirements of para 3(c), as understood by the Appellate Body, would be more difficult for developed countries to negotiate. In particular, where a negative condition reflects the interests of the donor (as many of the US

¹²³ *GSP Regulation* [2001] OJ L 346/1, art 26. For example, GSP treatment may be withdrawn where there have been serious violations of labour rights or manifest cases of unfair trading practices.

¹²⁴ *Tariff Preferences Appellate Body Report*, WTO Doc WT/DS246/AB/R, AB-2004-1 (2004) [129]. In addition to negative conditionality, the Appellate Body was also referring to mechanisms of graduation. The EC and the US both graduate (ie permanently remove) a product/sector of a certain country from their GSP schemes once the product/sector reaches a certain level of competitiveness. In addition, both schemes graduate countries from the GSP once they have achieved a sufficiently high level of income and development: see Sánchez Arnau, above n 31, 212-14.

¹²⁵ Sánchez Arnau, above n 31, 205.

¹²⁶ GATT Council, *Minutes of Meeting Held on February 1988*, GATT Doc C/M/217 (8 March 1988).

conditions do), it would be very hard to argue that it is part of a positive response to the needs of developing countries. However, developed countries might claim that para 3(c) only pertains to the provision of preferential tariff treatment and is not applicable to the separate practice of withholding or withdrawing tariff preferences under certain conditions.

This is a complex issue, and will not be discussed further in this case note. It is sufficient to appreciate that negative conditionality raises slightly different issues to positive conditionality that are not resolved by the Appellate Body decision. However, it is worth keeping in mind that negative conditions are a form of trade sanction and should be recognised as such. The WTO must be careful to ensure that the GSP is not exploited by developed countries for this purpose.

V THE PROBLEM WITH NEEDS-BASED DIFFERENTIATION

In Part IV(A)(2) of this case note, it was suggested that the Appellate Body did not have sufficient grounds for holding that the *Enabling Clause* permits developed countries to differentiate between beneficiaries of their GSP schemes on the basis of their different needs. In light of the Appellate Body's questionable legal analysis, it is interesting to inquire into the normative and pragmatic aspects of the decision.

The Appellate Body reasoned that needs-based differentiation between developing countries was appropriate because developing countries have different needs.¹²⁷ It maintained that the objective of fostering the economic development of developing countries 'can be fulfilled by promoting preferential policies aimed at those interests that developing countries have in common, *as well as* at those interests shared by sub-categories of developing countries based on their particular needs'.¹²⁸

On first glance this is an attractive argument. However, its logic is flawed. India succinctly articulated an objection to the Appellate Body's approach in its testimony before the Panel:

India recognizes the need for special financial assistance to developing countries to meet their individual development needs. However, it does not believe that tariff preferences discriminating between developing countries are the appropriate policy instrument to address the specific development needs of individual countries. Such preferences tend to help some poor countries at the expense of others, equally poor. The GSP was not created to shift market access opportunities between poor countries with different development needs, but to respond to the development needs of all of them.¹²⁹

Essentially, there is no justification for providing additional preferences to developing countries with a particular development need to the exclusion (and detriment) of developing countries with other needs.

¹²⁷ *Tariff Preferences Appellate Body Report*, WTO Doc WT/DS246/AB/R, AB-2004-1 (2004) [160].

¹²⁸ *Ibid* [169] (emphasis in original).

¹²⁹ *Tariff Preferences Panel Report*, WTO Doc WT/DS246/R (2003) [4.110].

Putting this point another way, the Panel observed that there could be ‘no reasonable explanation’ why certain causes of the problem of development should be addressed through the GSP, while other causes of the same problem are not.¹³⁰ The EC argued that the purpose of the Drug Arrangements was to ‘afford equal development opportunities’ to those countries ‘handicapped’ by illegal drug problems.¹³¹ Yet how can those development needs caused by drug production and trafficking be distinguished from other pressing needs caused by poverty, natural disasters, poor education, political unrest, the spread of epidemics, and countless other problems? The Drug Arrangements provide superior development opportunities to their beneficiaries, rather than equal opportunities. In effect, they discriminate against all developing countries that do not have drug problems but are burdened by other serious development needs. Market access opportunities are diverted away from these countries for the benefit of the beneficiaries of the Drug Arrangements.

The Appellate Body’s ruling also has undesirable systemic implications. The MFN obligation in art I, frequently called the ‘cornerstone’ of the GATT/WTO system,¹³² enjoins each *GATT 1994* Contracting Party to treat all countries in the same way. An exception to this rule is created in the *Enabling Clause* to allow developed countries to provide special and differential treatment to developing countries. One further division is also drawn between the treatment of developing countries and least-developed countries. These distinctions (between developed, developing and least-developed countries) undermine the art I MFN obligation, but are explicitly authorised by the WTO membership to help stimulate the economies of less developed countries. The Appellate Body has further eroded this ‘cornerstone’ of the GATT/WTO system by reading into the *Enabling Clause* an implicit authorisation for additional distinctions between developing countries (based on their individual needs rather than their level of development). This can only serve to weaken the stability and integrity of the multilateral trading system.¹³³

One further explanation for the Appellate Body’s decision is a purely pragmatic one. Given that the GSP is voluntary, its viability relies on the willingness of developed countries to participate. Before the Panel, the EC claimed that India’s interpretation of the *Enabling Clause* would not only result in fewer preferences for developing countries but that ‘turning the *Enabling Clause* into the kind of strait-jacket devised by India could dissuade some donor

¹³⁰ Ibid [7.103].

¹³¹ Ibid [4.155].

¹³² See, eg, *Tariff Preferences Appellate Body Report*, WTO Doc WT/DS246/AB/R, AB–2004–1 (2004) [101], citing *Canada — Certain Measures Affecting the Automotive Industry*, WTO Doc WT/DS139/AB/R, WT/DS142/AB/R, AB–2000–2 (2000) [69] (Report of the Appellate Body); *United States — Section 211 Omnibus Appropriations Act of 1998*, WTO Doc WT/DS176/AB/R, AB–2001–7 (2001) [297] (Report of the Appellate Body).

¹³³ India made a related argument before the Panel concerning the ability of developing countries to participate in multilateral tariff negotiations. It claimed that if the EC’s interpretation of the *Enabling Clause* was endorsed, developing countries (who mainly compete amongst themselves for access to the markets of GSP donors) would never have any assurance that the tariffs they had negotiated with developed countries would be applied on an MFN basis as between developing countries: see *Tariff Preferences Panel Report*, WTO Doc WT/DS246/R (2003) [4.197]–[4.198].

countries from providing any preferences *at all*.¹³⁴ It is probable that the Appellate Body recognised that an inflexible reading of the *Enabling Clause* could prejudice the EC and US GSP schemes.

While this consideration should not have been disregarded (and perhaps the Panel was guilty of this), it is not an excuse for bad law. There are other ways this dispute could have been decided so that some flexibility was retained in the *Enabling Clause*.¹³⁵ It is also worth noting that certain conditions would potentially be justifiable under the general exceptions in art XX or the security exceptions in art XXI of the *GATT 1994*.¹³⁶ As provided for in fn 2 of the *Enabling Clause*,¹³⁷ another option available to developed countries seeking to provide special preferences to only a subset of developing countries is to apply for a waiver from their art I:1 obligations.¹³⁸ The EC originally sought a waiver for the Drug Arrangements,¹³⁹ but did not proceed with this request.¹⁴⁰

¹³⁴ Ibid [4.145] (emphasis in original).

¹³⁵ It would take another article to discuss the merits of other possible interpretative approaches. A number of different approaches were proposed in the lead-up to this dispute: see, eg, Bartels, above n 4; Howse, 'India's WTO Challenge', above n 50; Harrison, above n 53; Jennifer Stamberger, 'The Legality of Conditional Preferences to Developing Countries under the *GATT Enabling Clause*' (2003) 4 *Chicago Journal of International Law* 607; Anthony Cole, 'Labor Standards and the Generalized System of Preferences: The European Labor Incentives' (2003) 25 *Michigan Journal of International Law* 179.

¹³⁶ Before the Panel, the EC unsuccessfully attempted to justify the Drug Arrangements under *GATT 1994* art XX(b) as a measure necessary to protect the life and health of European citizens: see *Tariff Preferences Panel Report*, WTO Doc WT/DS246/R (2003) [7.178]–[7.180]. For an analysis of whether the EC's special incentive arrangements for the protection of labour rights and the environment could be justified under art XX see Robert Howse, 'Back to Court after *Shrimp/Turtle*? Almost but Not Quite Yet: India's Short Lived Challenge to Labor and Environmental Exceptions in the European Union's Generalized System of Preferences' (2003) 18 *American University International Law Review* 1333, 1367–79.

¹³⁷ 'It would remain open for the Contracting Parties to consider on an *ad hoc* basis under the *GATT* provisions for joint action any proposals for differential and more favourable treatment not falling within the scope of this paragraph': *Enabling Clause*, above n 2, [2] (fn 2).

¹³⁸ Waivers are commonly applied for by developed countries seeking to confine tariff preferences to a limited number of developing countries located in a certain geographical region. The US has a waiver for its *Caribbean Basin Economic Recovery Act 1984*, 19 USC §§ 2701–2 (2000): see *United States — Caribbean Basin Economic Recovery Act*, GATT BISD, 31st Supp, 20, GATT Doc L/5779 (1985) (Waiver Decision, adopted on 15 February 1985, renewed on 15 November 1995). The US also has a waiver for its *Andean Trade Preference Act 1991*, 19 USC §§ 3201–6 (2002): see *United States — Andean Trade Preference Act*, GATT BISD, 39th Supp, 385, GATT Doc L/6991 (1992) (Waiver Decision, adopted on 19 March 1992, renewed on 14 October 1996). The EC has a waiver for its *Partnership Agreement between the African, Caribbean and Pacific Group of States, of the One Part, and the European Community and Its Member States, of the Other Part*, opened for signature 23 June 2000, [2000] OJ L 317, 3 (entered into force 1 April 2003): see *European Communities — The ACP–EC Partnership Agreement*, WTO Doc WT/MIN(01)/15 (2001) (Waiver Decision, adopted on 14 November 2001). Somewhat contentiously, the US does not have a waiver for its *African Growth and Opportunity Act 2002*, 19 USC § 3701 (2002), but provides it as an extension of its GSP program.

¹³⁹ Council for Trade in Goods, *New EC Special Tariff Arrangements to Combat Drug Production and Trafficking*, WTO Doc G/C/W/328 (2001) (Request for a WTO Waiver).

¹⁴⁰ Interestingly, the US holds a waiver to provide its own drug eradication incentives to the Andean countries under the *Andean Trade Preference Act*, 19 USC §§ 3201–6 (2002): see *United States — Andean Trade Preference Act*, GATT BISD, 39th Supp, 385, GATT Doc L/6991 (1992) (Waiver Decision, adopted on 19 March 1992, renewed on 14 October 1996).

VI CONCLUSION

In *EC — Tariff Preferences* the Appellate Body has created a troubling new basis for differential treatment of developing countries in GSP schemes. GSP donors can provide additional tariff preferences to developing countries with a specific development need, to the detriment of developing countries with other disabling needs. There is no clear basis for such differentiation in the text of the *Enabling Clause*, nor is there any evidence that the GSP was intended to permit such differentiation. Indeed, creating distinctions between developing countries in this way further undermines the ‘cornerstone’ MFN principle in art I:1.

More generally, the Appellate Body has missed an opportunity to rein in abuses of the GSP by donor countries. The authors of a recent report to the WTO Director-General Supachai Panitchpakdi were clearly cognisant of this point. They observed that, although the GSP was designed to be granted unilaterally by donors and for developmental purposes, ‘recipient countries have been burdened with obligations unrelated to trade’.¹⁴¹ They went on to suggest that the Appellate Body’s decision in *EC — Tariff Preferences*

seems to establish that there is at least some limitation on what developed countries can demand as conditions to receiving preferences. Nevertheless, by enabling discriminating conditions among GSP-eligible countries, non-trade conditions introduce clout for advancing what are principally developed country lobbying agendas.¹⁴²

Partly due to its limited scope, the short-term impact of the Appellate Body’s decision will be minimal. As the parties were unable to decide on a ‘reasonable period of time’¹⁴³ for implementation of the decision, a completion date of 1 July 2005 was set in a binding arbitration.¹⁴⁴ The EC informed the WTO in a recent status report regarding the implementation that, on 20 October 2004, the European Commission proposed to the Council of the EU a new GSP regulation that would, inter alia, repeal the Drug Arrangements.¹⁴⁵

¹⁴¹ Peter Sutherland et al, *The Future of the WTO: Addressing the Institutional Challenge in the New Millennium — Report of the Consultative Board to the Director-General Supachai Panitchpakdi* (2005) 24.

¹⁴² *Ibid* 24–5.

¹⁴³ *Dispute Settlement Understanding*, above n 42, art 21.3.

¹⁴⁴ *European Communities — Conditions for the Granting of Tariff Preferences to Developing Countries*, WTO Doc WT/DS246/14, ARB–2004–1/17 (2004) [1]–[3] (Award of the Arbitrator).

¹⁴⁵ *European Communities — Conditions for the Granting of Tariff Preferences to Developing Countries*, WTO Doc WT/DS246/16 (2005) (Status Report by the EC). The European Commission’s proposal sets out the details of a new GSP scheme for the period 2006–08. In place of the EC’s current system of positive conditionality, the European Commission has proposed a new system called ‘GSP+’. Under GSP+, tariff preferences will be provided to countries representing less than one per cent of EC imports under the GSP that ‘accept the main international conventions on social [and] human rights, environmental protection and governance, including the fight against drugs’. The European Commission claimed that ‘[t]he proposed GSP+ system, based on clear, transparent and non-discriminatory criteria, fully complies with the WTO Appellate Body ruling in the case brought forward by India against the EU’s GSP drugs regime’: see ‘Developing Countries: The Commission Proposes System of Trade Preferences for 2006–2008’ (Press Release, 20 October 2004) available at <<http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/04/1264&format=HTML&aged=0&language=en&guiLanguage=en>> at 1 May 2005.

It is questionable whether the GSP can hold up in its current form. The Appellate Body's decision does little to restrict developed countries from continuing to introduce new conditions into their GSP schemes. If the practice abates, and a large majority of developing countries continue to derive benefits from the GSP, it may yet survive as a 'mutually acceptable'¹⁴⁶ system of preferences. There are, however, other hurdles to overcome. The system itself is not without detractors,¹⁴⁷ and there are deficiencies in the way many GSP schemes are implemented, such as poor product coverage and tariff margins.¹⁴⁸ In the near future the WTO membership would be well advised to reassess the operation of the GSP if it is to remain an effective tool for promoting the trade and development of developing countries.

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¹⁴⁶ 1971 Waiver Decision, above n 17, preamble.

¹⁴⁷ See, eg, Caglar Ozden and Eric Reinhardt, *The Perversity of Preferences: GSP and Developing Country Trade Policies, 1976–2000* (2002) <<http://www.agtradepolicy.org/output/resource/GSPD.pdf>> at 1 May 2005. Ozden and Reinhardt argue that developing countries would be better served by full integration into the reciprocity-based world trade regime: at 20.

¹⁴⁸ For an analysis of the main limitations of certain schemes see Sánchez Arnau, above n 31, 202–26.

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