

VU Research Portal

Towards a global system of trade preferences among developing countries

van Dijck, P.

1987

document version

Publisher's PDF, also known as Version of record

[Link to publication in VU Research Portal](#)

citation for published version (APA)

van Dijck, P. (1987). *Towards a global system of trade preferences among developing countries*. (Serie Research Memoranda; No. 1987-55). Faculty of Economics and Business Administration, Vrije Universiteit Amsterdam.

General rights

Copyright and moral rights for the publications made accessible in the public portal are retained by the authors and/or other copyright owners and it is a condition of accessing publications that users recognise and abide by the legal requirements associated with these rights.

- Users may download and print one copy of any publication from the public portal for the purpose of private study or research.
- You may not further distribute the material or use it for any profit-making activity or commercial gain
- You may freely distribute the URL identifying the publication in the public portal ?

Take down policy

If you believe that this document breaches copyright please contact us providing details, and we will remove access to the work immediately and investigate your claim.

E-mail address:

vuresearchportal.ub@vu.nl

ET 55

05348

1987

SERIE RESEARCH MEMORANDA

TOWARDS A GLOBAL SYSTEM OF TRADE PREFERENCES
AMONG DEVELOPING COUNTRIES

P. van Dijck

Researchmemorandum 1987-55

december



**VRIJE UNIVERSITEIT
FACULTEIT DER ECONOMISCHE WETENSCHAPPEN
EN ECONOMETRIE
AMSTERDAM**

TOWARDS A GLOBAL SYSTEM
OF TRADE PREFERENCES
AMONG DEVELOPING COUNTRIES

Pitou van Dijck
Economic and Social Institute
Free University, Amsterdam
IDPAD, The Hague



CONTENTS	page
1. GENERAL CONSIDERATIONS	1
2. THE GATT PROTOCOL RELATING TO TRADE NEGOTIATIONS AMONG DEVELOPING COUNTRIES	4
3. CHANGING THE FRAMEWORK FOR NEGOTIATIONS	8
4. PROPOSALS FOR A GSTP	9
4.1 Introductory remarks	9
4.2 The reduction of barriers to trade	9
4.3 Rules of origin	13
4.4 Safeguard measures	17
5. CONCLUDING REMARKS	19
NOTES	21
BIBLIOGRAPHY	22

ABSTRACT

This paper studies two attempts that have been made to stimulate trade among developing countries by means of a trade-preferential system under the auspices of GATT and UNCTAD. It will be shown that these attempts have not been successful when measured in terms of the number of countries that have offered so-called "concessions" and the number of products for which substantial tariff cuts have been proposed.

As shown, the lack of success is due to abrupt changes in the framework in which the negotiations take place and to the insufficient economic and political contributions by the larger developing countries.

TOWARDS A GLOBAL SYSTEM OF TRADE PREFERENCES AMONG DEVELOPING COUNTRIES

1. GENERAL CONSIDERATIONS

Economic policies in many developing countries have resulted in complex trade and industrialization regimes that have had a profound impact on the structure and market orientation of production. A wide range of tariff and non-tariff barriers have protected the manufacturing sector from international competition and have stimulated an inward-oriented pattern of industrial development. Production has become inefficient in many industries and comparative advantages have been exploited only to a limited extent. However, it would be a fallacy to characterize industrial policies of developing countries as a continuous move towards more protection against international competition and a further seclusion from world markets. Many countries have made attempts to liberalize their economy so as to create a structure of production which makes a more efficient use of available factors of production and is more capable to reap advantages of international specialization. Such attempts have been undertaken by individual countries as well as by (regional) groups of countries that have been cooperating to establish trade preferential areas. The most ambitious attempt to co-ordinate liberalization efforts of developing countries has been the proposed Global System of Trade Preferences among Developing Countries (henceforth GSTP) that will be discussed in this paper. By way of introduction to a review of an earlier attempt to create a preferential trading system among developing countries under the auspices of GATT, and the more recent attempt under the auspices of UNCTAD to create a GSTP, we shall make some general observations on implementing rule systems in the area of international trade.

Gains of trade and liberalization do not depend on reciprocity. Nevertheless, co-ordination of liberalization attempts may be advantageous to all countries engaged in such attempts provided that a number of conditions are met.

To be successfully implemented, the rule system must, first of all, be acceptable to all partners in the negotiations. Negotiating countries may differ widely in economic structure, conduct and performance, and consequently have different power positions from which they enter negotiations. The size of the domestic market and the competitiveness of domestic suppliers are

major sources of power when it comes to negotiations on the liberalization of trade regimes. Countries that do possess an import-capacity-based bargaining power or a bargaining power based on industrial competitiveness may dominate negotiations by compelling concessions via reciprocity. In the real negotiations, therefore, concessions are spelled out by the inner group of principal suppliers to ensure broad reciprocity. According to W. Cline "(s)ome argue that in economic terms MFN (most favoured nation), has in practice been conditional because the products submitted for tariff liberalization have systematically been selected such that they came primarily from countries that offered tariff concessions in return, and tariff cuts might have been more limited had this not been the case."¹ Beneath the most-favoured nation approach, there appears to be a kind of sector-wise negotiation approach based on reciprocity. At the other extreme are countries with a small domestic market and a weak and little diversified domestic economy. Such countries lack import-capacity-based negotiating power and their industry lacks competitiveness required to gain from improved access to foreign markets that results from the negotiation process. Therefore, equal rules for unequal partners in the negotiations may be an insufficient offer to be acceptable for the countries least equipped to liberalize. However, once a set of rules is accepted and implemented, this set itself may become a liberalizing force: rules that are internationally agreed upon may function as a support system to governments for defending liberalization measures against domestic interest groups opposing such efforts.²

To contribute to welfare, the accepted rules should have a significant trade creating impact on the countries engaged in the negotiations. This depends on the depth and width of the negotiated reductions of trade barriers. The contribution to welfare ultimately results from the reduction in the domestic price distortion brought about by "unjustified" government intervention. Since tariff and non-tariff barriers are frequently applied in combination, trade creation effects can only be substantial if the total package of barriers is reduced at the same time. Negotiations on tariff reductions are likely the starting point of any negotiation on trade barrier reductions. In case other trade barriers are not adequately dealt with, however, such negotiations may ultimately result in a next-best intervention system and create welfare losses, due to the shift from tariff to non-tariff measures in the trade regimes. To have a significant impact on all participating countries negotiations on cuts in trade barriers should cover a wide range

of product groups since there are large differences in the structure of production and trade between developing countries.

In brief, the implementation of a GSTP is an extremely complicated affair. It involves a large number of countries that differ widely in level of economic development and in economic and political system. Additionally, in many of these countries both government and domestic producers are highly dependent on the existing system of trade barriers for their income which makes the liberalization issue all the more sensitive. Also, the system of trade barriers itself is partly unknown for a number of countries participating in the preparatory negotiations. Moreover, the economic impact of many trade barriers in use is hardly tracable. Consequently, the effects of changes in barriers - the so-called "concessions" to trading partners - are hard to quantify.

Notwithstanding these obstacles and some discouraging experiences with less ambitious regional preferential systems, preparatory negotiations for a GSTP have been taking place that aim at the implementation of such a system in a group as large as possible of developing countries.

2. THE GATT PROTOCOL RELATING TO TRADE NEGOTIATIONS AMONG DEVELOPING COUNTRIES

Notwithstanding the provision of Article I of GATT, a differential and more favourable treatment of developing countries through the creation of regional or global trade preferential arrangements is provided for in the so-called Enabling Clause. This clause, included in the Protocol of the Tokyo Round, thus constitutes the standing legal basis for preferential trading systems among developing countries. For many years, developing countries had pressed for such a legal right to exceptions from the two basic principles of GATT, non-discrimination and reciprocity. Until the Tokyo Round Protocol, exceptions from the non-discrimination rule could only be adopted by *ad hoc* waivers. Non-reciprocity was already included in Part IV 'Trade and Development' of the GATT (1965).

An initial effort to implement a preferential trading system among developing countries was undertaken under the auspices of GATT and supported and co-serviced by UNCTAD. A Protocol Relating to Trade Negotiations among Developing Countries was implemented and signed by 16 countries at November 26th, 1971 and entered into force at February 11th, 1973.³ Since the GSTP is an offspring of this Protocol, be it procreated under somewhat peculiar conditions, we shall first review this previous attempt to create a preferential trading system among developing countries.

Basic stimulus to engage in such a preferential system was the disenchantment of developing countries with the results of the Kennedy Round (1964-1967). The foundation of the negotiation process was laid in March 1965 with the establishment of the GATT Committee on Trade and Development. This committee established a Group on Expansion of Trade among Developing Countries that made an investigation of problems related to the stimulation of trade among developing countries. By the end of 1967 the Trade Negotiations Committee of Developing Countries in GATT held its first meeting. During the fact-finding stage, the negotiating countries had submitted lists of products that were exported or expected to be exported by them in the near future. At one stage or another, 37 countries took part in the negotiations that went on for almost four years before they were finalized in February 1973. By the end of 1968 it was agreed that the actual negotiations were to start, based on specific lists of requests for concessions by partners. By the end of 1969 only 13 countries had submitted such lists with requests. By the end of 1970, 18 countries were actively participating in the negotiations. While 19 countries requested concessions, only 12 countries offered conces-

sions. During the period March-August 1971 the essential negotiations took place. Finally, on October 15th, 1971, 48 bilateral agreements were reached among 16 countries and a draft text was adopted. On November 26th, 1971 a Protocol Relating to Trade Negotiations among Developing Countries was implemented and signed, and entered into force on February 11th, 1973.

As declared in the Protocol its aim is to foster a rational and outward-looking expansion of production that benefits from the advantages of specialization and economies of scale. This should be brought about by the reduction or elimination of both tariff and non-tariff barriers to be negotiated among the participating countries according to the principle of mutual benefits. It was agreed that a most-favoured-nation approach was to be pursued: concessions pursuant to the Protocol are applicable to all participating countries (par. 1). The effects of concessions should not be reduced by the imposition of new trade barriers. However, countries are allowed to impose such new barriers (1) when such a charge corresponds to a newly charge on the domestically produced product, (2) in the case of dumping by the foreign supplier and (3) as a countervailing duty (par. 3). Additionally, countries are allowed to implement new trade barriers in case of balance-of-payments problems or the threat thereof (par. 11) or in case of injury or the threat thereof (par. 12). In case such a safeguard measure is taken in case of emergency and a concession is suspended, the affected exporting country is allowed to suspend equivalent concessions, for instance by means of the imposition of countervailing duties. For three reasons the Protocol could have only a limited impact on trade and welfare in the participating countries. First, the number of signatories was limited. The Protocol entered into force in February 1973 for Brazil, India, Israel, Pakistan, Korea Republic, Spain, Turkey and Yugoslavia. Subsequently it entered into force for Tunisia (March 1973), Egypt (August 1973), Chile (May 1974), Mexico (August 1974), Greece (November 1974), Uruguay (September 1975) and Peru (May 1976). Accession to the Protocol was made by Paraguay (November 1975), Bangladesh (August 1976) and Romania (September 1978). At a later stage, Bangladesh and Romania signed the Protocol while Paraguay signed ad referendum. The Philippines signed but had not yet ratified the Protocol and Argentina had requested for accessation to the Protocol by 1984. At June, 28th, 1980, Greece withdrew from the Protocol because of its accessation to the EC.

Second, the number of concessions was limited. The 48 bilateral agreements among 16 participating countries included 740 tariff positions. These con-

cessions were ultimately "multilateralized" in the final stage of the negotiations and extended to all participating countries. About one third of these concessions relate to agricultural products and raw materials, products that play a relatively important role in total preferential trade among the participating countries.⁴ Concessions were mainly granted for products not produced domestically in the country offering the concession. Nine countries originally offered 15 tariff concessions or less, only four countries offered 50 to 100 tariff concessions. It is true that in the end all concessions applied to all signatories but many of these concessions related to very specific products that were produced and exported by only a few countries. All together, imports of concessional items from participating countries as a percentage share of total imports of these items in the participating countries was 9.3 in 1976, 8.9 in 1977 and 9.2 in 1978.

Third, the package of issues to be negotiated was rather limited. With respect to trade concessions, only tariffs were negotiated. Non-tariff barriers were not on the agenda. No additional policies were discussed to integrate the economies of the participating countries. Thus, this integration attempt is a typical example of negative integration, *i.e.* integration through the reduction of trade barriers. In brief, a fairly small number of countries were involved in the negotiations on a rather limited number of tariff reductions on products that were selected in a time-consuming negotiation process. The selection of products was in many cases apparently based on the criterion that trade liberalization were not to increase import competition in a significant way.

After five years of experience the Committee of Participating Countries undertook a review.⁵ It was concluded that "the operation of the Protocol has been encouraging and provides a basis for the expectation that the work presently being undertaken with a view to the further enlargement in terms of membership and coverage will make a substantial contribution to a further significant broadening of the area of trade co-operation among developing countries".⁶ It certainly did not follow from this review that the effort should be terminated. On the contrary, prolongation with a new round of negotiations was on the agenda of the committee from 1973 onwards. On its meeting of July 1979 it was suggested to convene a meeting within short to define the objective of new negotiations. Thus, the meeting that was convened on October 1979 and attended by representatives of 56 countries

was thought to be a preparatory step for new rounds of negotiations within GATT. However, at that very meeting some representatives emphasized that negotiations on trade liberalization were part of a broader programme of economic co-operation among developing countries that they considered their primary responsibility to negotiate and implement. Moreover, instead of describing the meeting as "Trade Negotiations among Developing Countries" its character was changed into *ad hoc* consultations among member countries of the Group of 77 and others.⁷ This intervention was inspired by the limited outcome of the negotiations within GATT so far but as well - and may be even above all - by political motives. Rather than prolonging and extending the existing preferential arrangement, a new system of preferences was to be created.

3. CHANGING THE FRAMEWORK FOR NEGOTIATIONS

An important step towards the preparation of a new round of negotiations on a preferential trade system among developing countries was taken at the Third Ministerial Meeting of the Group of 77 in Manila in January and February 1976. At this preparatory meeting for UNCTAD IV it was decided to propose the establishment of a Committee on Economic Co-operation among Developing Countries. The proposal was accepted by UNCTAD's board on October 1976 and the newly established committee decided in early 1977 to use the Mexico City Programme of Action, formulated in May 1976, as its guideline for future activities. One of the programme points for action was the creation of a global system of trade preferences among developing countries, and the committee agreed that this point should have priority status in UNCTAD. Priority status was also attached to the promotion of co-operation among state trading organizations and the establishment of multinational marketing enterprises in developing countries. The proposal to establish a preferential system among developing countries was presented at UNCTAD IV in Nairobi, 1976. Apart from the overall economic goal of stimulating economic development in the participating countries, the proposal emphasizes the possible contribution of such a system to the strengthening of collective self-reliance of developing countries. It was stressed that the modalities of the system should be so that it would ensure trade advantages for the least developed countries.

To facilitate the negotiation process the UNCTAD secretariat undertook a series of studies on issues to be negotiated such as rules of origin and special measures in favour of least developed countries.⁹ At UNCTAD V in Manila, 1979, the Group of 77 called for the establishment of an UNCTAD Trade Information System as a support mechanism for the negotiations. This was formally approved in May 1982 but the system started to operate already in September 1981. To further stimulate the preparations, the Committee on Economic Co-operation among Developing Countries was requested (by a meeting of governmental experts in April 1981) to establish a GSTP committee. This committee was set the task to prepare and undertake the negotiation process. This committee, to be serviced by UNCTAD, was formally established in a declaration of the Ministers of Foreign Affairs of the Group of 77 at New York, October 1982.

We shall now turn to a discussion of the proposals related to the main issues to be included in a GSTP.

4. PROPOSALS FOR A GSTP

4.1 Introductory remarks

As of now the process of negotiating trade preferences among developing countries within the framework of a GSTP is still in its preparatory stage - and it is not clear when the detailed negotiations on trade concessions are going to take place, if at all. Therefore, the proposals discussed here do not reflect outcomes of negotiations among participating developing countries but are merely suggestions and ideas that have been formulated in background papers and expert reports during the many years preparations are already taking place. Since October 1982, when the Committee on Economic Co-operation among Developing Countries was formally established, progress in some preparatory areas have been made, the most significant of which is the development of an information system on tariff and non-tariff barriers by UNCTAD.

4.2 The reduction of barriers to trade

The GSTP intends to reduce tariff and non-tariff barriers and aims at an even distribution of the overall benefits of such reductions among participating countries. It does not intend to supplement existing (regional) preferential systems but to complement these. Nevertheless it will affect existing systems in that it reduces the preferential margins enjoyed by countries participating in these systems *vis-à-vis* other developing countries. It has been proposed that all tariff and para-tariff concessions are given on a most-favoured-nation basis to all countries participating in the negotiations. An exception is made for all least developed countries that are entitled to enjoy (exclusive) preferences on a non-reciprocal basis.⁹ The most-favoured-nation approach, however, does not imply that existing (regional) preferential systems among countries participating in the GSTP cannot be extended once the GSTP comes into force: neither existing nor future preferences among regional groupings need be extended on a most-favoured-nation basis.¹⁰ It has been proposed that existing tariff and para-tariff preferences given by a participating developing country or other developing countries outside the framework of an existing grouping shall be tabled as negotiating offers. The concessions that follow from these negotiations will subsequently be extended on a most-favoured-nation basis. Preferences given by a participating developing country to a developed country shall be extended to all participating countries. There are several approaches to tariff reduction. The product-by-product approach is complicated and time consuming as follows from the

experience with the negotiations on the GATT protocol on trade preferences, discussed earlier. For that very reason, such an approach was not followed during some major previous rounds of tariff negotiations such as the Kennedy Round and the Tokyo Round. There is a high risk indeed that a product-wise approach will concentrate on tariff reductions in a number of product groups that are especially of interest to the most important countries involved, bypassing the interest of smaller countries that have less concessions to offer. Moreover, such an approach may tend to result in the lowest common denominator of achievement. A sectoral approach may also be envisaged in which, per sector, all tariff and non-tariff barriers are dealt with simultaneously in a comprehensive way. Here again is the risk that only a relatively limited number of countries may have great interest in the sectors selected for negotiations. As is born out by experience, an across-the-board approach to tariff cutting that includes the maximum number of trade items feasible, is by far the most preferable. Negotiations on trade items, not included, could be on an item-by-item approach, but here again, general and automatic application of rules might be preferable. Although a flexible approach in negotiating preferences is called for that enables (groups of) countries to choose from the three approaches mentioned here, there is a clear preference for an across-the-board approach, supplemented by both other approaches. This may especially be required to secure sufficient concessions for the least developed countries.¹¹

Several tariff-cutting formula may be applied, ranging from linear tariff cutting to a tariff harmonization formula. A linear across-the-board tariff cut has the major advantage of being relatively simple, but it may well result in an unequal distribution of benefits among participating countries. A major determinant of the effect of a tariff cut on the size of trade flows is the price effect of the tariff cut, which is dependent both on depth of the tariff cut and the initial tariff level. With T_1 the initial tariff rate and t the rate to cut tariffs the price effect p of t is

$$p = t \cdot T_1 / (1 + T_1).$$

Consequently, the application of a uniform tariff cut across countries may result in quite different price effects. This holds even if the negotiating partners have identical initial *average* levels of tariffs, because of the differences among countries in the dispersion of tariffs. Therefore, a simple linear tariff cut may lead to unequal "concessions". Given the depth of the uniform tariff cut it goes that the higher the initial tariff level,

the larger the price effect. However, in the case of excessive initial tariff levels this may not have a real economic meaning since even after the tariff cut tariff rates may be prohibitive. In such cases a tariff harmonization formula or *écrêtement* (cutting the peaks) might be applied in which the tariff cut is deeper the higher the initial tariff level. In such an approach tariff cuts and price effects differ, ultimately resulting in more equalized levels of tariffs among countries in the post-negotiations era. In case the original tariff level was *not* excessive it follows that the most sensitive sectors that are protected most will face the largest price effects in the case of a uniform tariff cut and even more so if a tariff harmonization formula were applied. If sensitive sectors with relatively high initial tariff rates were allowed reduced tariff reductions to avoid these large price effects (or to realize equality in price effects in all negotiating countries) this approach would result in non-uniform tariff cuts, harmonized price effects and increased tariff dispersions in the post-negotiations era. If, in case of large initial tariff dispersions among countries, the approach would be that countries with relatively low tariffs were allowed reduced tariff reductions as compared to countries with initial high tariff levels, so as to harmonize tariff levels, this would substantially reduce the overall trade liberalization effect of tariff reductions. Such an approach would be particularly harmful to "third countries" that are offered reduced tariff reductions and would not so much be harmful to countries that do have relatively high tariffs themselves as they are most likely no major exporters.

The hard core of the tariff negotiations proposals as formulated by a group of experts consists of an across-the-board linear tariff cut to which are added a number of provisions. The across-the-board linear tariff cut should be applied to agricultural products and other unprocessed commodities, semi-manufactures and industrial products so as to provide a substantial trade interest to the largest possible group of developing countries, including the least developed countries.^{1 2} Exports of many developing countries are concentrated in quite a limited range of products and are dominated by unprocessed products.

It has been suggested that the initial margin of preference should be limited to avoid disruptions. Therefore a linear tariff cut of 10 to 20 per cent has been suggested. This initial cut is envisaged to be proceeded by a new round of tariff cuts of a similar depth.^{1 3} To limit somewhat the number of exceptions to the general rule, it has been suggested to allow exception

lists for sensitive products with 100 to 200 CCCN positions per country. It is envisaged that this across-the-board rule might be adapted to ensure that minimum levels of effective concessions are effectuated by the formulation of maximum tariff rates and of minimum percentage tariff cuts.¹⁴

Elsewhere, a minimal margin of mutual preference of some percentage points among partners has been suggested.¹⁵ Hamza has suggested to apply the so-called Swiss formula that has been applied in the Tokyo Round. According to this tariff harmonization formula tariffs are cut according to

$$T_2 = t \cdot T_1 / (t + T_1).$$

If an across-the-board tariff cutting formula were applied, countries will claim the right to exclude products from tariff reduction. As it seems likely that products on the exclusion list will be highly protected by tariffs, it may well turn out that the economic meaning of the tariff cuts will be very limited.¹⁶ No proposals have been formulated on how to deal with the products on the exemption lists and it is not clear to what extent a sector-wise negotiation approach towards the products listed is envisaged, as has been done in other multilateral negotiations such as the Kennedy Round.¹⁷

Apart from the right to exclude products from tariff reductions, flexible safeguard measures, to be discussed later, have been suggested to reduce the risk of disruption. Tariff quotas and seasonal tariff reductions for agricultural products have been envisaged as well for the same purpose. The general rule of a uniform tariff cut is supplemented by specific rules for least developed countries.¹⁸ Because of the lack of international competitiveness of industry in these countries, it has been proposed that these countries implement a more limited tariff cut of 5 per cent (proposal of 1981) or 10 per cent (proposal of 1980).¹⁹ At the same time, these countries must be offered preferential treatment in importing developing countries (excluding the least developed) through a deeper than general tariff cut in their favour of 30 per cent instead of 20 per cent. The use of more flexible criteria for rules of origin in favour of developing countries have been proposed as well to strengthen the position of these countries in international trade.²⁰ This will be discussed in more detail below.

In many developing countries, non-tariff barriers are a much larger obstacle to trade than tariff barriers are. Due to the complex and opaque structure of non-tariff barriers, it seems likely that negotiations on the reduction of

such barriers will be more difficult and time consuming than the negotiations on tariff cuts. To avoid invalidation of negotiated tariff reductions, therefore, a standstill in the area of non-tariff barriers is required as long as negotiations on these barriers are going on.²¹ However, an exception is envisaged here for least developed countries that should be permitted to adopt quantitative restrictions to protect their domestic industries from the effects of trade liberalization.²² More in general it goes that such a standstill may be abrogated in the case countries take safeguard measures to protect domestic industry or the balance of payments.²³

4.3 Rules of origin

Trade preferences, by definition, deal with products originating from countries that do have preferential access. Rules of origin are required to define which of the products imported from countries with preferential access do originate from these countries and are, consequently, entitled to preferential treatment. Goods that are imported by a member country of the trade preferential area from a non-member country must have undergone a substantial transformation in the member country to be entitled to preferential treatment when traded among member countries. Two kinds of rules of origin are usually applied, referred to as the percentage criterion and the process criterion. When the percentage criterion is applied the product is entitled to enjoy preferential treatment when at least a specified share of its value is added in the country participating in the preferential system. When the process criterion is applied it is required that the imported inputs have undergone a specified transformation process or have been transformed to such an extent that the processed inputs are classified differently from the unprocessed inputs according to the CCCN nomenclature. This shift in classification is referred to as a "BTN-jump".

Both criteria have their advantages and drawbacks.²⁷ The major advantage of the percentage criterion is its uniformity; its major drawbacks are related to the "arbitrariness" of prices of inputs and outputs. Prices, in the real world, are subject to many factors that make them deviate from theoretical "equilibrium prices". Moreover, they are far from stable, especially in the case of primary products. The major advantages of the process criterion are that it gives a precise formulation of the minimal transformation required to entitle the product to enjoy preferential treatment and that it is

independent of prices. The major drawback of the criterion is that a "BTN-jump" does not necessarily coincide with a substantial addition of value to the imported inputs. For a product to get preferential access within the preferential area, it is not necessary that the transformation of imports from a non-member country has taken place in the one member country that exports the product to another member country. A cumulation provision may be applied that takes into account the value added creation or the process of transformation in all countries participating in the preferential system.

Preferential systems differ in their application of rules of origin as illustrated in table 1. Some systems apply the percentage criterion while others use the process criterion, *i.e.* the "BTN-jump". Some systems have a specific provision for assembly and most systems have a "full cumulation" provision. In some cases more relaxed rules of origin are applied in favour of least developed countries. Column 2 shows that with respect to the "percentage criterion" generally at least 40-50 per cent of the value of the product must be produced in member countries of the preferential area to entitle the product to preferential treatment. This may have quite a restrictive impact on preferential trade opportunities among member countries and may be to the advantage of the larger and/or more developed countries that have a more diversified industrial sector, allowing them to process to a sufficient extent imported inputs. In general, exported manufactures of developing countries have a high import content and consequently a low domestic value added component.

The UNCTAD consultative group of experts has proposed to apply across-the-board the "BTN-jump" as the criterion for rules of origin.²⁸ However, as mentioned earlier, this criterion has the shortcoming that a "BTN-jump" does not necessarily imply a "substantial transformation" and that a substantial transformation is not always reflected in a "BTN-jump". Therefore, a list of exceptions should be constructed with products for which a percentage criterion applies. More specifically the following proposals have been made. For agricultural products (CCCN chapters 1-24) that do not undergo industrial transformation the wholly produced criterion should be applied. For products in CCCN chapters 25-83 it goes that the "BTN-jump" is the basic criterion. For products on the exception list the *c.i.f.* value of inputs imported from outside the preferential area should be less than 50 to 60 per cent of the *f.o.b.* export value. Full cumulation has been suggested here. The area

Table 1. Rules of origin in regional preferential systems.

Country group	BTN-jump	Extraregional cif import value in fob export value or regional value added requirements	Full cumulation	Assembly provision for import value in export value	Provisions for least developed countries (members)
LAFTA	x		x	< extraregional import value	
ANDEAN group	x		x	< extraregional import value	some regulations for less stringent origin requirements
CACM		no stringent requirements	x (de facto)		
CARICOM (old rules) autumn 1978 (new rules)	x	< 50 % extraregional import value	x x?		< 60 %
CEAO		< 40 % of materials used (quantity), or > 40 % regional value added	x		
ECOWAS		< 50 % extraregional value in total materials used, or < 40 % extraregional quantity of materials, or > 35 % regional value added	x		

Table 1. (continued)

Country group	BTN-jump	Extraregional cif import value in fob export value or regional value added requirements	Full cumulation	Assembly provision for import value in export value	Provisions for least developed countries (members)
ASEAN		< 50 % extraregional import value	x		
ACM		< 60 % extraregional import value	x		
Tripartite Agreement Egypt, India, Yugoslavia		> 50 % materials produced and labour performed in region	no cumulative treatment		

Source: UNCTAD, Rules of Origin within a GSTP, with Special Reference to Provisions Assuring that Preferential Measures Benefit National Development, TD/B/C.7/33 (Part II), Geneva, 1979.

comprises not only developing countries participating in the negotiations but all least developed countries as well. For least developed countries this criterion could be relaxed to 60-70 per cent.

For products in CCCN chapters 84-99 the percentage criterion has been suggested.

4.4 Safeguard measures

Some proposals have been drafted concerning the application of safeguard measures. Rules of safeguards deal with undoing the results of trade liberalization rules that are agreed upon, in order to preserve such rules. If the safeguard rules are formulated too loosely they may create the risk of the GSTP to be eroded from within. If the rules are formulated too strictly they may create the risk of the whole rule system to be undermined by government actions outside the rule system to protect domestic interests. In both cases, the predictability of the rule system is undermined and protectionist measures may make headway.

Two major reasons for safeguard actions are distinguishable: balance-of-payments difficulties and (the threat of) serious injury to domestic producers which arises from a sudden increase of imports under the preferential system. Thus, the safeguard measures may be applied in the case of broadly defined problems and are not restricted to cases of proven unfair competition by specific exporters. The country that intends to apply safeguard measures is required to give prior notice to affected countries and a Permanent Mechanism and to consult with them the nature of the safeguard measures and the compensation for its effects to exporters. Agreement is, however, not a necessary precondition for implementation of measures. In case of disagreement the affected parties may retaliate by withdrawing compensatory concessions.²⁹ The application of safeguard measures has been restricted in a report of the Group of 77 to the extent that such measures may not affect negotiated concessions during the first year or first two years after these concessions have been put into effect.³⁰

It was agreed upon by the negotiating committee in its meeting on October 17th, 1984, that safeguard measures should be applied in a non-discriminatory fashion among the participants in the GSTP. In earlier proposals, however, it was suggested that imports from the least developed countries should be exempted from general balance-of-payments safeguard measures.³¹ In principle, non-selective application of safeguard measures is preferable over discrimina-

tion in application. A selective application would most likely affect above all new exporters, especially those in small countries that do not have much power to retaliate, while the interests of vested exporters in major trading partners will be respected. If products in a narrowly defined product category exported by different suppliers can be considered as substitutes there is no ground for a selective approach in the application of safeguard measures. This, indeed, is reflected in GATT Article XIV "Emergency Action on Imports of Particular Products" that deals with the escape clause. The GATT rule is based on the principle of non-discrimination. Nevertheless, the experience up to now is that countries prefer not to apply this rule but make bilateral arrangements outside the GATT system in case of (the threat of) injury. Such arrangements comprise voluntary export restraints (VERs), orderly market arrangements (OMAs) and other forms of quantitative restrictions.

Another problem related to the safeguard rule is that there is a lack of conditionality on the application of the rule. Without consent of the partner(s) a country is allowed to restrict imports and undo preferences. There is a need for specified rules related to the period of application and the efforts to be undertaken during this period to adjust to increased imports. In case the partner country has great retaliatory power because of its importance in bilateral trade flows, the threat of countermeasures may prevent a country to apply safeguard measures unduly and without consent. However, when the partner country does not have great retaliatory power, it may not be able to prevent the application of safeguard measures. Therefore, to prevent abuse of safeguard measures, strict rules for the application of such measures are needed. Moreover, surveillance on a strict application of non-discrimination is needed since the threat of multilateral retaliation is more preventive than a bilateral threat. The application of the rule should be surveyed by an independent body, a so-called Permanent Mechanism.

5. CONCLUDING REMARKS

As outlined earlier, the proposals and ideas related to a GSTP, presented here, do not result from negotiations among trading partners but are proposals without engagement. Nevertheless, some sobering remarks are in place regarding the impact a GSTP is likely to have on the trade performance of developing countries. First, in view of the relatively high tariff and non-tariff barriers in developing countries, the proposed cuts in tariff barriers will have a very limited effect on resource allocation and trade, even if such cuts were applied across-the-board. Erzan, Laird and Yeats calculated the effects of different tariff cuts on the value of South-South trade.³² Their calculations are based on trade values for all developing countries, tariff cuts are assumed to be applied across-the-board and non-tariff barriers are assumed away. In reality, of course, it will be unlikely that all developing countries participate in a GSTP. Besides, it is very likely that least developed countries will negotiate for a free riders position. Next, it is questionable that tariff cuts will be across-the-board, and even if they were, products will be excluded from preferential treatment and be put on an exception list. Also, tariff barriers are in many cases only one element of a complicated set of barriers to imports. The calculations show that limited cuts in tariffs yield fairly small results in terms of projected changes in trade flows. As shown in table 2, South-South trade would grow by 3.4 per cent in case of a 20 per cent tariff cut. For the reasons mentioned above it is likely that the direct impact will be more limited in reality.

Second, in view of the debt-servicing problems many developing countries face, policies have been implemented to contract domestic demand and import demand and stimulate exports. In a situation of large government deficits and trade imbalances it appears rational to substitute tariff barriers for quantitative restrictions so as to increase government revenue and control imports. Under such circumstances liberalization of the trade regime appears to be a risky strategy for many developing countries, particularly those with a weak export sector.

Third, the start of a new round of trade barrier reductions in GATT, the so-called Uruguay round, may well invalidate efforts to create a preferential trading system among developing countries. What developing countries want from developed countries is a reduction of tariff and non-tariff barriers against labour-intensive products. What developed countries want from developing

Table 2. Projected percentage changes in South-South trade.

GSTP tariff cut	<i>Developing countries' imports from</i>			trade balance
	developing countries	developed countries	all countries	
10 per cent	1.7	-0.2	0.3	0.4
20 per cent	3.4	-0.3	0.6	0.8
35 per cent	6.0	-0.6	1.1	1.4
50 per cent	8.5	-0.8	1.6	2.0
Full tariff margins	17.0	-1.6	3.1	4.0

Source: R. Erzan, S. Laird and A. Yeats, *On the Potential for Expanding South-South trade through the Extension of Mutual Preferences among Developing Countries*, UNCTAD Discussion Papers No. 16, Geneva, p. 6, table 1.

countries is that the latter give up their free-rider position in GATT negotiations and become full member. The graduation issue implies that particularly the middle-income countries should start liberalizing their economy and integrate more fully into the world trading system. The point has been pushed already during the Tokyo Round and will, undoubtedly, come back on the agenda of the next round. Therefore, developing countries will use concessions to liberalize their trade regime as a bargaining tool to obtain concessions from developed countries to reduce their tariff and non-tariff barriers to products of particular interest to developing countries. In the meantime they themselves will be extremely reluctant to do any trade concession at all outside GATT.

NOTES

- ¹ W.R. Cline, 1983, p. 133.
- ² C.F. Bergsten and W.R. Cline, 1983, p. 94.
- ³ GATT, 1972, pp. 11-18.
- ⁴ UNCTAD, 1981, TD/B/C.7/49, pp. 4, 10, 17.
- ⁵ The review was scheduled to take place after five years. It was delayed and took place in the period February 1978 - February 1979.
- ⁶ GATT, 1979, p. 173.
- ⁷ UNCTAD, 1981, TD/B/C.7/49, pp. 23, 24.
- ⁸ These proposals are discussed in paragraph 4 of this paper.
- ⁹ UNCTAD, 1984, TD/B/C.7/AC.2/CRP.1.
- ¹⁰ UNCTAD, 1981, TD/B/C.7/48, p. 5.
- ¹¹ UNCTAD, 1980, TD/B/C.7/42, p. 9.
- ¹² UNCTAD, 1980, TD/B/C.7/42, p. 3 and UNCTAD, 1981, TD/B/C.7/47, p. 3.
- ¹³ UNCTAD, 1980, TD/B/C.7/42, p. 10.
- ¹⁴ UNCTAD, 1981, TD/B/C.7/47, p. 4.
- ¹⁵ UNCTAD, 1980, TD/B/C.7/42, p. 12.
- ¹⁶ UNCTAD, 1981, TD/B/C.7/49, pp. 31, 41.
- ¹⁷ E.H. Preeg, 1971, pp. 89, 90.
- ¹⁸ UNCTAD, 1980, TD/B/C.7/42, p. 12.
- ¹⁹ UNCTAD, 1980, TD/B/C.7/42, p. 11. UNCTAD, 1981, TD/B/C.7/47, p. 3.
- ²⁰ UNCTAD, 1980, TD/B/C.7/42, p. 11.
- ²¹ UNCTAD, 1980, TD/B/C.7/42, p. 16.
- ²² UNCTAD, 1979, TD/B/C.7/35, p. 27.
- ²³ UNCTAD, 1984, TD/B/C.7/AC2/CRP.3, p. 2.
- ²⁴ See UNCTAD, 1984, TD/B/C.7/AC2/CRP.1, p. 2. In UNCTAD, 1980, TD/B/C.7/42, p. 13 it is suggested that concessions in the area of non-tariff barriers should be applicable on a most-favoured-nation basis.
- ²⁵ UNCTAD, 1981, TD/B/C.7/47, p. 6.
- ²⁶ UNCTAD, 1981, TD/B/C.7/47, p. 6.
- ²⁷ UNCTAD, 1979, TD/B/C.7/33, Part I, pp. 5, 6.
- ²⁸ UNCTAD, 1979, TD/B/C.7/33, Part I, pp. 18-20.
- ²⁹ UNCTAD, 1984, TD/B/C.7/AC2/CRP.3, p. 2.
- ³⁰ OSG, 1984, 77/Misc. 233/Rev.4.
- ³¹ UNCTAD, 1979, TD/B/C.7/35, p. 30.
- ³² R. Erzan, S. Laird and A. Yeats, p. 6.

BIBLIOGRAPHY

- Bergsten, C.F. and W.R. Cline, 'Trade Policy in the 1980s: An Overview', in: W.R. Cline (ed.), *Trade Policy in the 1980s*, Institute for International Economics, Washington DC, 1983.
- Cline, W.R. 'Reciprocity': A New Approach to World Trade Policy?', in: W.R. Cline (ed.), *Trade Policy in the 1980s*, Institute for International Economics, Washington DC, 1983.
- Erzan, R., S. Laird and A. Yeats, *On the Potential for Expanding South-South Trade Through the Extension of Mutual Preference among Developing Countries*, UNCTAD Discussion Paper No. 16, Geneva.
- GATT, *Basic Instruments and Selected Documents*, 18th Supplement, Geneva, 1972.
- OSG, *Rules of Safeguards for the GSTP*, OSG/77/Misc. 233/Rev. 4, 1984 (document not for publication).
- Preeg, E.H., *Traders and Diplomats: An Analysis of the Kennedy Round under the General Agreement on Tariffs and Trade*, Brookings Institution, Washington DC, 1971.
- UNCTAD, *A Global System of Trade Preferences among Developing Countries, Rules of Origin within a GSTP, with Special Reference to Provisions Assuring that Preferential Measures Benefit National Development*, TD/B/C.7/33 (Part I), Geneva, 1979.
- UNCTAD, *Global System of Trade Preferences among Developing Countries, Special, Differential and Non-Reciprocal Measures in Favour of Least Developed Countries within a Global System of Trade Preferences among Developing Countries*, TD/B/C.7/35, Geneva, 1979.
- UNCTAD, *A Global System of Trade Preferences among Developing Countries (GSTP), Issues for Consideration in Preparing for GSTP Negotiations*, TD/B/C.7/42, Geneva, 1980.
- UNCTAD, *A Global System of Trade Preferences among Developing Countries (GSTP), Outline of Possible Elements for the Initial Phase of the GSTP Negotiations*, TD/B/C.7/47, Geneva, 1981.
- UNCTAD, *A Global System of Trade Preferences among Developing Countries (GSTP)*, TD/B/C.7/48, Geneva, 1981.
- UNCTAD, *Review of the Preferential Arrangements Established under the GATT Protocol Relating to Trade Negotiations among Developing Countries*, TD/B/C.7/49, Geneva, 1981.
- UNCTAD, *Further Consideration of Issues Relating to the Negotiations on a Global System of Trade Preferences among Developing Countries, Draft Rules of Safeguards for the GSTP*, TD/B/C.7/AC.2/CRP.3, Geneva, 1984.
- UNCTAD, *Further Consideration of Issues Relating to the Negotiations on a Global System of Trade Preferences among Developing Countries*, TD/B/C.7/AC.2/CRP.1, Geneva, 1984.