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The EU's Generalized System of Preferences and its ASEAN beneficiaries: a success story?

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1. Introduction

The European Union (EU) is a party in many preferential trading agreements (PTAs) with non-member countries. Firstly, the EU forms a customs union with Turkey, Andorra and San Marino and forms a free trade area (FTA) with more than a dozen other countries. Secondly, the EU extends non-reciprocal trade preferences to developing countries: by unilaterally reducing tariffs on imports originating in eligible developing countries, the EU hopes to help increase beneficiaries' exports to the European market, thus stimulating economic growth and development in these countries. It should not come as a surprise then, that the EU's trade and development policies are closely intertwined.

It is important to distinguish between contractual and autonomous non-reciprocal trade preferences. The former are restricted to limited groups of countries with special historical and/or geographical ties to the EU. A first group includes a number of African, Caribbean and Pacific (ACP) countries, many of them being ex-colonies of EU member states. ACP countries – in the beginning just a few of them but their number has been growing ever since – have consecutively enjoyed contractual trade preferences under the Yaoundé Convention (1963), the Lomé Conventions (1975) and the Cotonou Agreement (2000). As the EU member states were worried about swelling immigration from the Maghreb and Mashreq countries in the first half of the 1970s, the EU also started offering extensive trade preferences to the wider Mediterranean region. It would lead us too far to discus these contractual agreements in detail here, as this paper focuses on autonomous trade preferences instead: autonomous non-reciprocal trade preferences are generally available to all developing countries under the EU's Generalized System of Preferences (GSP).

In 1968, the United Nations Conference on Trade and Development (UNCTAD) favorably advised for the creation of the Generalized System of Preferences (GSP). These preferences were to be generalized, i.e. available to all developing countries and no longer restricted to countries having privileged relationships with certain industrialized countries. The EU was the first developed region or country to answer the UNCTAD's call by introducing its GSP scheme in 1971.[3] Since then, around a dozen other industrialized nations have also introduced GSP schemes, all differing in the range of products that are covered and the depth of the preferences that are offered, depending on particular sensitivities to the preference-granting country. It is generally accepted that the EU GSP is by far the most generous system currently applied. (UNCTAD 1999, p 4)

The next section of this paper provides a brief outline of the current EU GSP scheme, and discusses its functioning with special reference to a specific group of beneficiary countries, being the ten member states of the Association of Southeast Asian Nations (ASEAN). This regional group was founded in 1967, when the five original members – Indonesia, Malaysia, the Philippines, Singapore and Thailand – signed the Bangkok Declaration. During the following decades membership grew to ten, as successively Brunei Darussalam (1984), Vietnam (1995), Laos (1997), Myanmar (1997) and Cambodia

[3] For simplicity, we will refer to the European Union (EU) throughout this paper, although the EU as such does not have a legal personality. Therefore it would be more appropriate to refer to the European Communities (or the European Economic Community prior to the adoption of the Treaty of Maastricht in 1993), technically still bearing the responsibility for the formation of the common external trade policy.

(1999) joined. At first, the ASEAN member countries saw the Association above all as a political vehicle, which was hoped to bring peace and security to Southeast Asia. From the late 1970s onwards, the idea of closer economic collaboration and integration slowly but steadily gained support, eventually leading to the gradual establishment of an ASEAN Free Trade Area (AFTA) from 1992 onwards. The AFTA is now virtually realized, as tariff duties on almost all intra-ASEAN imports have been brought down to a maximum of five percent. The ultimate goal of duty-free intra-ASEAN trade should be achieved by 2010 for the five original members plus Brunei and by 2015 for Vietnam, Laos, Myanmar and Cambodia. (Cuyvers et al. 2005, pp 2-4)

In a third section, statistical data are presented on the utilization of the EU GSP by developing countries in general and on the utilization rates of the ten ASEAN beneficiaries in particular. We evidently also look at ASEAN members' export performance over the same period 1992-2002, with special attention to the GSP-covered imports into the EU. There are good reasons to have a closer look at ASEAN members' utilization of the EU GSP scheme. For one, most ASEAN economies are among the top beneficiaries of the scheme and have indeed increased their exports and economic growth rate, in spite of the Asian financial crisis. Moreover, it would be interesting to see whether the EU GSP on the one hand and regional economic integration initiatives (such as e.g. the AFTA framework) on the other hand, interact in some way or another. A fourth section discusses future prospects of the EU GSP and draws some conclusions, considering the modifications to the EU GSP that will enter into force on 1 January 2006 and – in a broader sense – the quickly changing international environment.

2. Applicability and provisions of the EU GSP

Preferential trade acts counter to the principles laid down in the General Agreement on Tariffs and Trade (GATT) and administered by the World Trade Organization (WTO). The most favored nation (MFN) principle implies that tariff concessions granted to any other country should automatically be extended to all WTO member countries, resulting in multilateral tariff reductions. Moreover, tariff reductions from each member country have to be answered by tariff reductions from others as dictated by the principle of reciprocity. Therefore, a special waiver from article 1 of the GATT was needed to allow industrialized countries to start operating their GSP schemes. This waiver was first granted in 1971 and has been extended for an indefinite period of time in 1979 in the so called 'enabling clause'.[4]

Once the legal framework was established in 1971, the EU presented the first cycle of its GSP scheme soon afterwards. Since then, a new cycle has been launched every ten years, often introducing thorough reforms. The scheme currently in operation is therefore hardly comparable to the one introduced in 1971. Already in the first period after its inception, the EU GSP scheme offered duty-free access for most manufactured and semi-manufactured products coming from eligible beneficiary countries. Certain processed agricultural goods enjoyed full or partial tariff exemptions. Separate regula-

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[4] It should be noted that contractual non-reciprocal trade agreements, such as the agreements with the Mediterranean countries and the ACP countries, are incompatible with the enabling clause because of their restrictive and discriminatory nature. That is why the EU has recently endeavored to reform these agreements by transforming them into reciprocal trading agreements – the so called economic partnership agreements – which should gradually lead to the formation of a bilateral or regional FTA between the EU and the former contractual beneficiaries. In doing so, the EU is obviously seeking compatibility with Article XXIV of the WTO.

tions were in place for textiles and for products covered by the European Coal and Steel Community (ECSC) Treaty. The amount of preferential imports was also limited through quotas and ceilings, which differed depending on the origin of the imports and the product group. Beyond these specific thresholds, MFN duties could be levied again by the EU. Such quantitative restrictions, and other preconditions specific to certain countries and products, were prolonged or revised every year. The different product classifications, the complex quantitative restrictions and the yearly adaptations made the GSP scheme into a rather incomprehensible and instable policy instrument.

A drastic reform in 1995 removed all quantitative restrictions on preferential GSP imports. Moreover, the scheme was no longer to be revised every year, but only once every three years to enhance the predictability of preferential market access for traders. New graduation rules based on the interaction of the beneficiary countries' development index and their product specialization index were introduced and applied. Different GSPs were established for industrial and textile products on the one hand and for agricultural products on the other hand, and products were granted a preference margin which decreased with the degree of 'sensitivity' of the product groups involved. The introduction of a social clause in the 1995 GSP enabled the EU to grant additional preferences to countries that respect specified social minimum standards of the International Labor Organization. A similar incentive system was introduced for countries that respect the standards laid down by the International Tropical Timber Organization.[5]

This system was revised again in 1998, when one single regulation came in place for all products, and in the 2001 GSP the complicated categories of very sensitive, sensitive, semi-sensitive and non-sensitive products with distinctive tariff preferences, were reduced to two categories for sensitive and non-sensitive products on the European market. The 2001 reform also included the introduction of a distinctive GSP arrangement for least developed countries, aiming to reorient preferences on those developing countries that need it the most. In July 2004, the European Commission presented its plans for the functioning of the GSP scheme during the next ten-year cycle from 2006 to 2015. The new regulation, enacted in Council Regulation no. 980/2005, provides for three different GSP arrangements[6]:

- the general arrangement
- the special incentive arrangement for sustainable development and good governance
- the special arrangement for least developed countries

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[5] For an overview of the 1995 reform and its impact, see Cuyvers (1998), which also illustrates the specific graduation mechanisms introduced.

[6] Originally, the new cycle was scheduled to begin on 1 January 2005. However, its introduction was delayed with one year, as the European Commission hoped to gain better insight in the outcomes of the WTO Doha Round of multilateral trade negotiations, which was not progressing as smoothly as expected. Moreover, India had initiated an official complaint with the WTO in 2002, challenging the conformity of the EU GSP with WTO rules. As the WTO's Appellate Body eventually ruled against the EU early 2004, the European Commission clearly needed some time to reflect on this decision and to incorporate the Appellate Body's suggestions into the outline of the new GSP cycle. For a thorough technical discussion of India's case against the EU GSP we refer to Grossman & Sykes (2005).

We will first discuss these three arrangements in further detail, before turning to some important mechanisms for the functioning of the EU GSP in practice: the exclusion of beneficiary countries, the graduation of sectors and the rules of origin.

a. General Arrangement[7]

Tariff preferences under the general arrangement are available to all countries in the list of GSP beneficiary countries as published in annex to the new 2006 regulation and primarily includes members of the Group of 77, but also China and most transition economies. Beneficiary countries will be excluded from the list once they have reached a level of high income country as defined by the World Bank, while also being sufficiently diversified in their exports to the EU, as will be discussed below. In addition, if a country has concluded an agreement with the EU that offers at least the same preferences as the GSP (e.g. FTA), the 2006 GSP regulation also provides for the beneficiary country's exclusion.

In addition to the list of beneficiary countries, a list of GSP-covered products is available as an annex to the new GSP regulation. This list contains around 7 200 products (both sensitive and non-sensitive products) out of a total number of approximately 11 000 tariff lines of the Common Customs Tariff (CCT).[8] For some 2 100 tariff lines, the MFN rate applied is already zero, thus leaving no room for additional GSP preferences on these products. (CEC 2004b) As a result, more than 1 500 dutiable products remain uncovered by the 2006 GSP, although some 300 products – mostly agricultural and fishery products – were additionally transferred to the product list in comparison to the 2001 GSP of the EU.

Under the general arrangement of the 2006 regulation, GSP-covered imports of non-sensitive products are fully exempted from tariff duties, except for agricultural products. Duties on sensitive products are gradually being reduced. This method of 'tariff modulation' is supposed to help protecting the most sensitive sectors in the EU market, while avoiding complete preference erosion for beneficiary countries.[9] *Ad valorem duties* are reduced by a flat rate of 3.5 percentage points of the MFN rate, with an exception for duties on textiles and clothing products which will be proportionally reduced by 20%. If the previous GSP regulation offers more generous tariff reductions than the new three-yearly regulation 2006-2008, the rates of the former regulation will apply. *Specific duties* on all sensitive products are reduced by 30%, unless these products are affected by a combination of ad valorem and specific duties. In that case, only ad valorem duties are reduced.

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[7] In this paper we will only provide a general outline of the preferences enjoyed by eligible countries. For all specific details and exceptions, we refer to Council Regulation no. 980/2005 of 27 June 2005.

[8] The Common Customs Tariff (CCT) specifies the duty rates applicable to imports from non-privileged trading partners outside the customs union, for all individual products included in the Combined Nomenclature. The Combined Nomenclature (CN) is the products nomenclature used by the EU, which is based on the internationally widely used Harmonized System (HS) Nomenclature. HS product headings consist of 6-digit codes and these are further refined by CN subheadings defined up to the 8-digit level.

[9] As MFN tariffs have been brought down in successive rounds of multilateral trade liberalization, preferential tariff rates also have to decrease in order to maintain the same preference margin for beneficiary countries. If preference margins are eroded, the incentives to make use of the GSP scheme disappear, thus turning it into an inefficient policy instrument.

b. Special incentive arrangement for sustainable development and good governance

A new arrangement in the GSP cycle starting off on 1 January 2006, is the special arrangement for sustainable development and good governance, also designated as the 'GSP Plus' incentive scheme. This arrangement should considerably simplify the GSP regulation as it combines three different arrangements from the previous ten-year cycle 1995-2005. Under the new arrangement, *vulnerable countries* are granted additional preferences if they have ratified and implemented 16 selected international core human and labor rights conventions (United Nations/International Labor Organization Conventions) and at least 7 out of 11 selected conventions relating to the environment and to good governance principles (with the commitment to comply with the missing ones by 31 December 2008).[10] Candidate countries have to request inclusion in the list of countries eligible for preferences under the GSP Plus incentive scheme. Once accepted, their status will be monitored and regularly reviewed by the European Commission.

Three conditions have to be fulfilled for a beneficiary country to be considered as a vulnerable country: Firstly, the country should not have been classified as a high income country by the World Bank for three consecutive years. Secondly, the five largest sections of its GSP-covered imports to the EU should represent more than 75% of its total GSP-covered imports.[11] If this condition is met, the country is considered to be too dependent on the GSP with exports that are too specialized, indeed adding to its vulnerability. Finally, the GSP-covered imports from that country should represent less than 1% of total GSP-covered imports to the EU.

The arrangement for sustainable development and good governance removes ad valorem duties on all 7 200 GSP-covered products for imports coming from eligible vulnerable countries. Specific duties are also suspended, unless they are combined with ad valorem duties. For certain sugar products however (CN codes 1704 10 91 and 1704 10 99), specific duties are not completely removed but restricted to 16% of the customs value. In conclusion, preferences offered under the GSP Plus incentive scheme are more generous than under the general arrangement of the EU GSP indeed, as duties on all sensitive items are now fully abolished instead of just being reduced.

c. Special arrangement for least developed countries

The special arrangement for least developed countries (LDCs), better known as the 'Everything But Arms' (EBA) initiative, is available to all countries classified as LDCs by the United Nations. The EBA initiative was introduced in February 2001, and contrary to the two other arrangements reviewed above, it is laid down for an indefinite period of time and therefore not subject to the normal three-yearly revisions. This is an additional measure taken by the EU to enhance the stability and predictability of preferences for this group of countries that most need them.

Under the EBA, both ad valorem and specific duties are fully suspended on all dutiable products, except for arms and ammunition (chapter 93 of the Harmonized System). Duties on bananas, sugar and rice remain, but are gradually being phased out to completely disappear as from 1 January 2006,

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[10] An enumeration of all specific conventions can be found in annex III to Council Regulation no. 980/2005.

1 July 2009 and 1 September 2009 respectively. The EBA initiative is the most generous of all three arrangements as the product coverage is extended to all dutiable products, while the general arrangement and the GSP Plus incentive scheme are restricting preferential treatment to products explicitly included in the list of GSP covered tariff lines.

d. Exclusion and graduation

In order to allow the EU GSP to keep focusing on countries most in need of preferences, a mechanism of county exclusion has been built into the scheme. Beneficiary countries that have reached a level of development allowing them to compete internationally with developed exporting countries, will therefore be excluded from the EU GSP once two criteria are met as follows. Firstly, during three consecutive years the country has been classified by the World Bank as a high-income country, and secondly, the five largest sections of its GSP-covered imports to the EU represent less than 75% of its total GSP-covered imports. Therefore, a country will only disappear from the list of beneficiaries, when it has reached a satisfactory level of diversification in its exports to the EU.

It can be expected that a beneficiary country becomes internationally competitive for certain products at an intermediate stage in its development process, i.e. before meeting the criteria for complete exclusion from the GSP. Even if this country would no longer enjoy preferential market access for the products at issue, it can probably maintain its strong export position in the particular product sections. Therefore, the GSP scheme also provides for a mechanism of 'section graduation': if imports from a beneficiary country in a specific product section represent more than 15% of GSP-covered imports from all beneficiary countries in that section over three consecutive years, the country graduates for that particular section and all imported products of that section consequently lose their preferential treatment. For both the textiles and clothing sections, this market share threshold is somewhat stricter, i.e. 12.5%.

The European Commission has stressed that countries affected by graduation should not consider this as a punishment, but rather as a proof of their good export performance and most importantly, as an opportunity to further diversify their economies into sections still eligible for preferential treatment. (CEC 2004a, pp 8-9) It should also be noted that the new graduation rules strongly differ from these used in the previous GSP cycle (1995-2005). Firstly, the new cycle refers to the 21 sections of the Combined Nomenclature, which have a broader coverage than the 34 'sectors' in the previously used system of 'sector graduation'. Moreover, while the current system uses one criterion only (share in the EU's GSP-covered imports for a specific section), graduation in the previous system was based on a combination of criteria (the beneficiary country's development index, its export-specialization index and its share in the EU's GSP-covered imports for a specific sector). The new graduation rules should not only simplify things a great deal, but should also restrict graduation to the most successful export sections of the largest beneficiaries.

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[11] The term 'section' in this respect, refers to the 21 product sections of the EU's Combined Nomenclature.

The European Commission is expecting that under the new regulation less than 10 out of a total of 178 beneficiary countries will be affected by graduation. (CEC 2004a, p 9) Due to the broader definition of the product sections and the revised graduation criteria, it seems more difficult for beneficiary countries to graduate for a particular section. To illustrate this point, we consider the situation of Malaysia, the most important exporter to the EU of all ASEAN members. Under the new scheme, entering into force on 1 January 2006, Malaysia will only be affected by graduation for *section* III, i.e. animal or vegetable fats and oils and their cleavage products; prepared edible fats; animal or vegetable waxes. However, on 1 January 2002, towards the end of the previous cycle, Malaysia had been graduated for 6 s*ectors* in total, i.e. sector VII: cereals and malt and starches; sector X: fats, oils and waxes; sector XVI: plastics and rubber; sector XIX: wood; sector XXII: clothing, and finally sector XXIX: consumer electronics.

Table 1 shows the current beneficiary status of the ten ASEAN economies. Six members fall under the general GSP arrangement. The third column specifies the sections Indonesia, Malaysia and Thailand have graduated for, based on the new graduation rules. Brunei, the Philippines and Vietnam still enjoy preferences in all sections covered by the general arrangement. Cambodia and Laos qualify for the most generous arrangement, i.e. the EBA initiative. Myanmar is also considered as a LDC by the United Nations, but the EU has temporarily suspended all GSP preferences because of the harsh dictatorship of the military rulers and the violations of human rights in that country. Finally, Singapore no longer enjoys the EU's GSP preferences as the country has reached a level of development such that it is excluded from the scheme according to the above-mentioned criteria.

Table 1: ASEAN countries and their beneficiary status in the EU GSP

Country	GSP Arrangement	Graduated sections
Brunei Darussalam	General	/
Cambodia	EBA	/
Indonesia	General	S-III Animal or vegetable fats and oils and their cleavage products; prepared edible fats; animal or vegetable waxes. S-IX Wood and articles of wood; wood charcoal; cork and articles of cork; manufactures of straw, of esparto or of other plaiting materials; basketware and wickerwork.
Laos	EBA	/
Malaysia	General	S-III Animal or vegetable fats and oils and their cleavage products; prepared edible fats; animal or vegetable waxes.
Myanmar	Temporarily suspended	
Philippines	General	/
Singapore	Excluded	
Thailand	General	S-XIV Natural or cultured pearls, precious or semi-precious stones, precious metals, metals clad with precious metal, and articles thereof; imitation jewellery; coins. S-XVII Vehicles, aircraft, vessels and associated transport equipment.
Vietnam	General	/

Source: Selection from Annex 1, CEC Council Regulation no. 980/2005 of 27 June 2005

GSP preferences are not only discontinued because of exclusion or graduation, as both individual EU member states and the European Commission can appeal to a ‘safeguard clause’ in the GSP system, which states that when GSP-covered imports from a beneficiary country cause, or threaten to cause, serious problems to a producer in the EU, normal duties may be reinstalled at any time. This clause seems to open the door for an arbitrary withdrawal of unilateral preferences granted under the GSP. Its main disadvantage for beneficiary countries is therefore an adverse effect on the predictability of future preferences, which in turn might well discourage sustained investment in the supply capacity of beneficiary countries.

e. Rules of origin

In order to determine whether imports qualify for preferential access, it is essential to know their precise origin. If an imported GSP-covered product originated from a single production stage in a beneficiary country, it obviously enjoys preferential access. Most products, however, are produced in a multistage production process, with inputs procured in various countries. Therefore, specific requirements are laid down specifying when, where and how much processing has to be done to consider a product as having originated in a certain country. Various methods, such as a change of tariff heading, the percentage of value added and other economic and technical criteria, are currently used in this respect by the EU.

A possibility for cumulation of origin was introduced by the EU to support regional economic integration initiatives between developing countries, which is also one of the goals of the present Doha Development Round. When the cumulation rules are strictly respected, inputs from other countries of the regional grouping that are used during the production process can be regarded as having originated in the exporting beneficiary country. Three regional groups currently qualify for regional cumulation under the EU GSP: ASEAN, the South Asian Association for Regional Cooperation (SAARC), and a third group of countries encompassing all member countries of the Andean Community and the Central American Common Market (CACM). With respect to ASEAN, it is important to note that Myanmar is not allowed to participate in the cumulation of origin, contrary to Singapore in spite of its exclusion from the EU's GSP. As the ASEAN Free Trade Area (AFTA) has now been virtually realized, the provision of origin cumulation greatly adds to the GSP's attractiveness for the ASEAN beneficiaries.

The EU is currently preparing a revision of the rules of origin used in its PTAs, which should contribute to a smooth operation of the new GSP scheme. The new rules of origin should be simpler, contributing to more efficient procedures while not neglecting proper enforcement of the rules by the competent authorities. For further technical details, we refer to the Commission's proposal for future orientations of the rules of origin. (CEC 2005b)

3. Export performance under the EU GSP

Table 2 depicts the top 15 beneficiary countries of the EU GSP. Although 178 countries currently qualify for preferential treatment under the EU GSP, benefits seem to be going to a limited number of beneficiaries. Based on the most recent data available, China and India take a very prominent position in this list, ranking first and second respectively and together accounting for almost 45% of all GSP-covered imports into the EU in 2002. The top 10 beneficiaries together account for more than three quarters of total covered imports. The EU hopes that the revised graduation rules and the special incentive schemes of the new GSP cycle 2006-2015, will redirect the situation in favor of a larger group of less developed beneficiary countries.

Table 2: Top 15 beneficiaries of the EU GSP

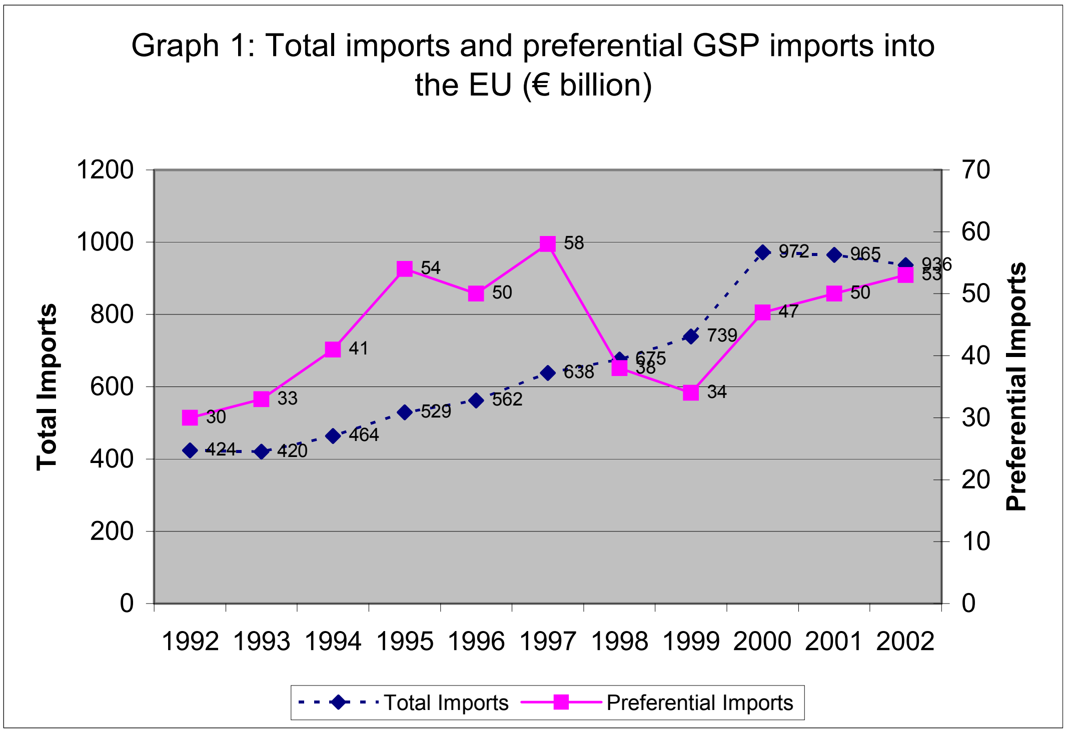
Rank	Country	2002 Share (%)
1	China	33.1
2	India	11.5
3	Indonesia	5.6
4	Vietnam	4.8
5	Brazil	4.8
6	Thailand	4.5
7	South Africa	4.2
8	Bangladesh	3.6
9	Pakistan	2.9
10	Argentina	2.5
11	Malaysia	2.3
12	Russia	2.0
13	Ukraine	1.6
14	Saudi Arabia	1.4
15	United Arab Emirates	1.3

Note: The percentages represent the country's share of total GSP-covered imports in 2002

Source: Data obtained from the European Commission

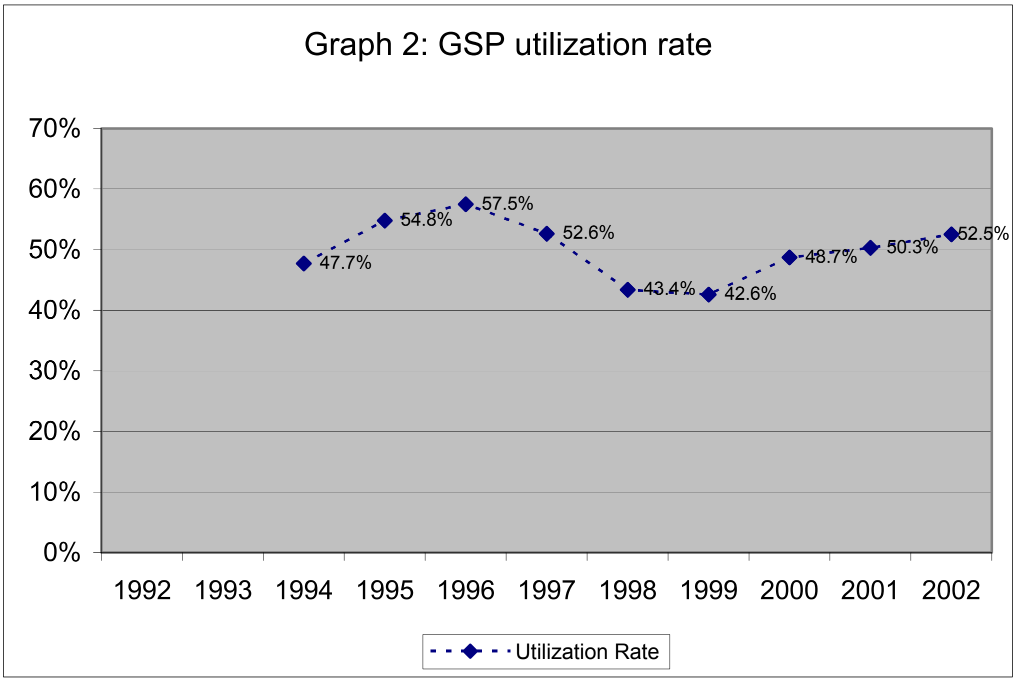
a. EU GSP and all beneficiaries

Graph 1 shows the gradually increasing value of total imports into the EU over the last decade, going up from € 424 billion in 1992 to € 936 billion in 2002. Preferential imports entering the EU under the GSP scheme, increased from € 30 billion to € 53 billion over the same period, but show a more erratic course, with a sharp fall-back for the years 1998-1999. (CEC 2004a, p 4) It is hazardous to assess the EU GSP scheme by simply looking at the ratio of preferential to total imports, as product coverage and preference margins of the GSP vary over time. The significant drop in the amount of preferential imports from 1997 onwards for instance, is to a large extent attributable to the successful completion of the Uruguay Round, which significantly brought down MFN duties in a number of sectors, while even completely abolishing import tariffs in others. Consequently, the scope for preferential imports considerably diminished.



Source: Commission of the European Communities, COM(2004) 461 final, p 5

One important indicator to assess the success of a preferential scheme is the utilization rate. The utilization rate is defined as the imports receiving preferential treatment as a share of imports eligible for receiving such preferences under the GSP in a certain year. Consequently, the utilization rate indicates how well the potential benefits of the GSP scheme are tapped by beneficiary countries. Graph 2 shows a fluctuating GSP utilization rate for the period 1994–2002.[12]



Source: Commission of the European Communities, COM(2004) 461 final, p 5

[12] Our analysis of the EU GSP system in this section covers the period 1994-2002, mainly because reliable data on GSP eligible imports are not available for the period prior to 1994.

A utilization rate of 50% indicates that traders request preferences for only half of the value of imports that qualify for preferential access to the European market, which is disappointingly low. What factors could explain the low utilization rates? It seems quite logical to assume that a direct relationship exists between preference margins and utilization rates of any preferential scheme: if the preferential benefits are not clearly exceeding the costs of requesting them, few traders will rationally bother to request preferential treatment. Apart from the administrative burden, these costs also involve technical matters for producers and traders in complying with the rules of origin. Therefore, the higher the preferences offered, the larger the probability that importers will eventually make the effort to request preferential access. Manchin (2004) finds evidence for this hypothesis in a study of EU preferences offered to ACP countries. She goes on to show that the preference margin needs to exceed a certain threshold value, if traders are to request preferences. These results are probably easy to generalize to other preferential schemes as well. The relatively low utilization rates of the EU GSP could therefore be due to preference margins that are too small and/or costs involved (directly or indirectly) that are too high.

Graph 2 clearly shows that the GSP utilization rate fell in the period after 1996 before going up again from 2000 onwards. As explained above, the lower MFN rates as agreed at the end of the Uruguay Round, will most likely have had a negative impact on the degree of utilization. However, the downturn after 1996 can probably also be explained by the introduction of a new ten-year GSP cycle in 1995, which drastically reformed the previous GSP scheme at that time. Too many products were classified as 'sensitive', undermining their preferential treatment even further. (FAO 2003, pp 37-39) Moreover, exporters in beneficiary countries and European importers needed some time to become familiar with the innovations of the new scheme, such as the special incentive arrangements offering additional preferences, which were gradually introduced after 1995. Luckily, the three-yearly revisions of the new cycle in 1998 and 2001 introduced some improvements to the scheme, so that the downward movement of the utilization rate was gradually reversed.

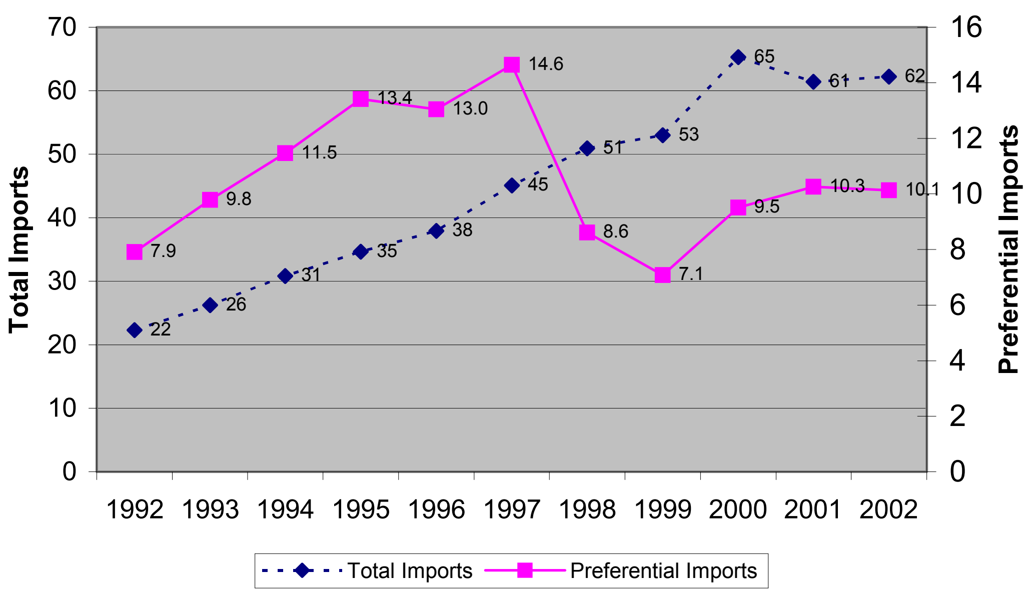
b. EU GSP and ASEAN

Restricting our analysis to the ten ASEAN member states[13], we can see in Graph 3 that ASEAN's total and preferential imports to the EU follow a similar pattern as total imports into the EU and preferential imports into the EU from all GSP beneficiary countries respectively, as depicted in Graph 1. While preferential imports from all beneficiary countries have regained their pre-1997 levels (Graph 1), preferential imports from ASEAN have not yet done so (Graph 3). Initially, the Asian financial crisis of 1997-1998 caused a general crisis of confidence in the region as well as in the rest of the world making international trade with ASEAN countries risky, which might have contributed to the additional decline in preferential imports from the ASEAN economies.

[13] Although Vietnam, Myanmar, Laos and Cambodia have not been a member of ASEAN during the whole period 1992-2002, they are included here in all figures that concern ASEAN as a group for the sake of comparability over time. As official membership of ASEAN is not a condition to qualify for preferential treatment under the EU GSP, this issue should not distort our analysis.

The persistent stagnation of preferential imports originating in the ASEAN region can further be explained by Singapore's exclusion from the GSP scheme in 1998, as Singapore was traditionally one of the main contributors to ASEAN's preferential exports to the EU. Only part of Singapore's excluded exports have been taken over by other ASEAN members still enjoying preferences for these products. The same conclusions can be drawn from Graph 4, which shows the evolution of the share of preferential in total imports from the ten ASEAN beneficiaries.[14] While this proportion still averaged around 35% in the early 1990s, it started to decline from 1996 onwards and stagnated around 15% ever since. In 2002, this ratio amounted to 16.29%.

Graph 3: Total imports and preferential GSP imports from ASEAN into the EU (€ billion)

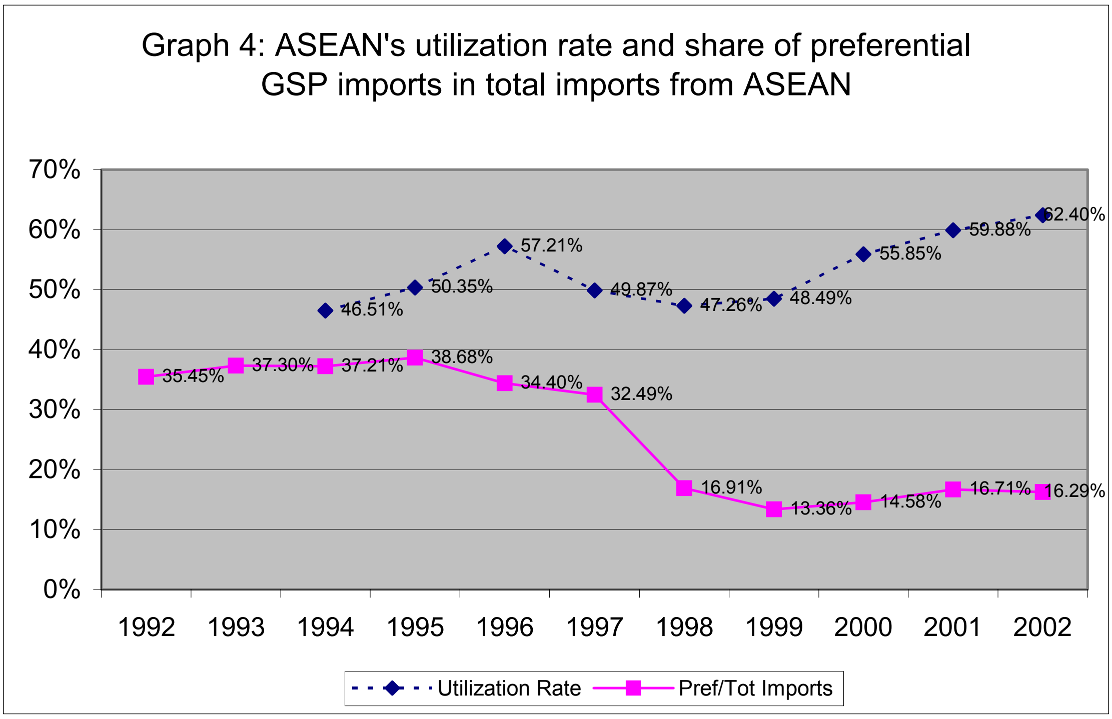


Source: Own graph, based on data obtained from the European Commission

Imports from ASEAN into the EU totaled € 62 billion in 2002, which represented 6.62% of total EU imports. ASEAN's preferential imports under the EU GSP were at € 10.1 billion in 2002, i.e. 19.1% of GSP preferential imports from all beneficiary countries. This large weight of ASEAN beneficiaries in total preferential imports should not come as a surprise, as Indonesia, Vietnam, Thailand and Malaysia figure among the top 15 beneficiaries of the EU GSP (Table 2). A closer look at the industry breakdown of ASEAN's GSP eligible imports in 2002 reveals a share of 4.7% for agricultural products, 71.1% for industrial products, and 24.2% for textile products. Looking at ASEAN's utilization rate of the EU GSP in 2002, we see that 62.4% of ASEAN's total exports eligible for receiving preferences effectively enjoyed preferential access to the European market. ASEAN's utilization rates by industry in turn, amounted to 73.3% for agricultural products, 66.9% for industrial products, and only 46.7% for textile products.[15] As mentioned above, restrictive rules of origin are an important reason for the far

[14] In order to avoid unnecessary confusion, we did not depict a comparable share in Graph 2. Total imports into the EU in Graph 1 reflect overall imports from the rest of the world (non-EU), while preferential imports originate in GSP beneficiary countries only. In Graph 4, however, total imports and preferential imports both originate in the same set of countries, i.e. the ten ASEAN members.
[15] All data obtained from the European Commission, DG Trade.

from full exploitation of the GSP preferences by beneficiary countries. Brenton and Manchin (2003) argue that the adverse effect of restrictive rules of origin is particularly present in the textiles and clothing sector, where many technical requirements currently replace the normal 'change of tariff heading' rule, making it even harder for developing countries' exports to qualify for preferential treatment. It remains to be seen whether the new rules of origin that are currently being prepared by the European Commission for use in its PTAs will finally reduce the gap between the theoretical value of the preferences offered and their value in practice.



Source: Own graph, based on data obtained from the European Commission

ASEAN's utilization rate (Graph 4) follows a similar pattern over time as the utilization rate of all beneficiary countries (Graph 2), although the ASEAN countries do have an increasingly higher utilization rate over other beneficiary countries from 1998 onwards. In 2002, ASEAN's utilization rate amounted to 62.4%, compared to an overall utilization rate of only 52.5% for all beneficiary countries. The relatively higher utilization rate of ASEAN over the last couple of years might be the result of the gradual realization of the AFTA, which makes it more beneficial to source certain inputs from the regional partner countries, thus not only contributing to the international competitiveness of the outputs, but also providing more scope for preferential access from less-developed ASEAN sources. As the EU wants to make an additional contribution to regional economic integration initiatives in developing countries, it has recently announced that it will further relax the conditions for cumulation of origin in the near future. This reform might further enhance ASEAN's utilization rates and strengthen ASEAN's relative position to other beneficiary countries.

c. EU GSP and individual ASEAN beneficiaries

Having looked at ASEAN as a group, we will now consider the individual ASEAN member states, as they inevitably each have some distinctive characteristics. A first column in Table 3 depicts the value of GSP-covered preferential imports from the ten ASEAN member states into the EU, both for 1994 and 2002. A second column shows total imports from these beneficiaries into the EU. For both years we also included the share of preferential imports in total imports, in order to allow a balanced judgment about the importance of the EU GSP for the individual beneficiary countries. Using data on the imports eligible for receiving GSP preferences (not shown in Table 3), we also calculated the utilization rate for each beneficiary country. In the last column of Table 3, the percentage change (increase or decrease) in total imports over the 8 year period 1994-2002 is shown for each ASEAN member.

Table 3 offers some interesting insights into the export performance of individual ASEAN member states. As can be inferred from the previous sections, the EU GSP scheme envisions a typical development process as a kind of life cycle, say the ‘GSP life cycle’. In a first stage, (least) developed countries need to get accustomed to the GSP scheme and its administrative requirements. After a while, these beneficiaries should manage to push up their preferential exports to the EU, gradually gaining a competitive edge in certain sectors. At this stage, the beneficiary is familiar with the scheme and consequently, utilization rates are expected to be high. Eventually, total exports should keep on rising, while the ratio of preferential to total exports might start falling because of possible sector graduation. In a last stage, the beneficiary country will be completely excluded from the GSP scheme when it has reached a comparatively high level of income, at the same time being sufficiently diversified in its exports.

Table 3: EU GSP trade statistics for imports from ASEAN beneficiary countries into the EU

Country	1994 Preferential Imports (€ 1000)	1994 Total Imports (€ 1000)	1994 Pref/Tot Imports (%)	1994 Utilization rate (%)	2002 Preferential Imports (€ 1000)	2002 Total Imports (€ 1000)	2002 Pref/Tot Imports (%)	2002 Utilization rate (%)	1994-2002 % change in Tot Imports
Malaysia	2,457,154.96	7,525,419.01	32.65	41.63	1,243,137.86	14,401,820.91	8.63	58.07	+ 91.38%
Singapore	2,350,488.08	7,751,282.27	30.32	33.46	0	13,099,701.60	-	-	+ 69.00%
Thailand	2,744,523.42	6,264,698.06	43.81	59.05	2,375,069.16	11,203,212.12	21.20	65.85	+ 78.83%
Indonesia	2,801,219.55	5,855,263.43	47.84	62.01	3,008,619.05	10,299,564.58	29.21	63.11	+ 75.90%
Philippines	719,601.65	2,096,805.68	34.32	45.01	599,931.22	7,581,546.61	7.91	43.02	+ 261.58%
Vietnam	324,813.34	857,852.25	37.86	57.75	2,540,832.94	4,428,734.79	57.37	69.16	+ 416.26%
Cambodia	13,155.92	23,394.92	56.23	59.50	270,112.77	509,100.14	53.06	53.72	+ 2076.11%
Myanmar	14,761.31	60,233.89	24.51	36.61	0	438,924.46	-	-	+ 628.70%
Laos	35,249.08	50,165.82	70.27	73.58	89,160.03	143,019.65	62.34	68.34	+ 185.09%
Brunei	500.27	313,916.93	0.16	0.18	66.18	78,500.19	0.08	0.48	- 74.99%
ASEAN	11,461,467.59	30,799,032.26	37.21	46.51	10,126,929.16	62,184,125.05	16.29	62.40	+ 101.90%

Note: Countries are ranked according to the amount of total imports from these countries into the EU in 2002

Source: Own calculations, based on data obtained from the European Commission

Singapore has already gone through the complete 'GSP life cycle', being excluded from the EU GSP in 1998. Singapore's low utilization rate in 1994 is not really abnormal as the country had already graduated for its most important export sectors. The remaining non-graduated sectors were therefore relatively less important, so that traders were often less motivated to request preferences for these GSP eligible exports. Also Malaysia, Thailand, Indonesia and the Philippines seem to have made good use of the EU GSP, judged by their relatively high utilization rates, and have steadily improved their level of development over the last decade. More importantly, these countries have managed to continuously push up their total exports to the European market, while at the same time becoming less dependant on the GSP scheme, as revealed by the decreasing ratio of preferential to total imports. It is interesting to note that Indonesia, Malaysia and Thailand benefited from Singapore's exclusion in 1998, as these three countries increased their export share to the EU market at Singapore's expense in the years after its exclusion. In absolute terms, Indonesia is still the most important beneficiary of all ASEAN members, with preferential imports into the EU of about € 3 billion in 2002. Malaysia in turn, has overtaken Singapore's position as the most important ASEAN exporter to the EU, with total exports of € 14.4 billion in 2002.

Vietnam, Cambodia and Laos are still at an earlier stage of development: the high ratio of preferential to total exports reveals that these economies still very much depend on the GSP preferences for their exports to the EU. In the case of Cambodia and Laos, this high share of preferential in total exports is not really surprising: being classified as least developed countries, they benefit from the extensive product coverage under the Everything But Arms arrangement. Moreover, the three countries seem to be experts in using the preferences of the GSP to their advantage, reaching utilization rates as high as 69.16% for Vietnam and 68.34% for Laos in 2002. Vietnam, Cambodia and Laos definitely still have some way to go, but they have nevertheless managed to spectacularly increase their total exports to the EU, although initial values evidently were relatively low in 1994. Vietnam's total exports to the EU are now catching up with the figures of the five strongest ASEAN economies, and the country has become the second most important ASEAN beneficiary in absolute terms, next to Indonesia.

Since 1997, Myanmar has been temporarily suspended from the GSP scheme, due to international accusations of systematic forced labor practices. Although Myanmar managed to increase its total exports to the EU over the last decade, it is questionable whether its tense relationship with the European Commission will contribute to any form of sustainable development in this least developed country. Brunei Darussalam at last, seems to be quite indifferent towards the EU GSP, with utilization rates barely different from zero. This shouldn't come too much as a surprise taking into account the largely oil-dominated exports of the country. Moreover, it is the only ASEAN member of which total exports to the EU actually dropped over the last decade.

4. Future prospects and conclusions

The descriptive statistics of the previous section are leading to an intuitive conclusion that the intense utilization of the EU GSP scheme by most ASEAN members has considerably contributed to the good general economic performance of this region during the period 1994-2002. A causal link between the EU GSP and the strengthened development of the ASEAN beneficiaries, however, cannot be demonstrated by such descriptive statistics. Many scholars have endeavored to assess the impact of preferential trade on beneficiary countries on the one hand and third countries (non-beneficiaries) on the other hand, originally relying on the concepts of trade creation and trade diversion due to Viner (1950). Even when restricting the analysis to these static concepts of international trade, it remains hard to say whether the EU GSP scheme is good or bad policy: a principal point of discussion is methodological in nature and amounts whether it is best to use ex-ante models (partial or general equilibrium models) or ex-post studies (often using some form of the gravity equation) to assess the impact of preferential trade agreements on trade flows and welfare. The accelerated regionalism since the beginning of the 1990s caused a renewed interest in the economic consequences of PTAs. However, the focus no longer was on the static effects of these agreements, but shifted to the question whether PTAs are a 'building' or a 'stumbling block' to multilateral trade liberalization (Bhagwati 1991). Karacaovali and Limão (2005) provide evidence that PTAs concluded by the EU have been a stumbling block to its multilateral liberalization efforts in the Uruguay Round: in order to maintain decent preference margins for its preferential trading partners, the EU reduced its multilateral tariffs on goods imported under PTAs by only half as much as on goods not imported under any of its PTAs. Moreover, Özden and Reinhardt (2005) demonstrate that GSP schemes hinder developing countries' own trade liberalization process, which might curtail overall external trade and economic growth of these countries.[16] An increasing number of free trade economists have therefore argued that it would be in developing countries' best interest to discontinue the unilateral GSP schemes, and to turn to WTO guided reciprocal trade instead.

With the introduction of the new ten-year GSP cycle 2006-2015, the European Commission gave a strong signal of its belief in this '*single most important trade tool for development'*, as EU Trade Commissioner Peter Mandelson put it. (CEC 2005a) Two factors, however, threaten to reduce the value of tariff preferences for GSP beneficiaries. Firstly, consecutive rounds of multilateral trade liberalization will inevitably erode preference margins, which might make it difficult to maintain proper utilization rates. Much will depend on the outcomes of the Doha Round negotiations, which are scheduled to be completed at the end of 2006. Secondly, the increasing number of economic partnership agreements and FTAs concluded by the EU during the last couple of years also tends to undermine the relevancy of the GSP.

The European Commission clearly realizes that continuous efforts are needed to keep its GSP scheme relevant in the future. The new cycle should ensure that generous tariff preferences will remain to be granted on all products contributing to sustainable development in the beneficiary countries. This can for instance be realized by further extending the product coverage of the general arrangement and by reclassifying sensitive products as non-sensitive ones. The Commission also believes the new system is simpler and fairer than the previous one. Simpler, mainly because the new GSP scheme only contains three different arrangements compared to the previous five and because the new graduation mechanism is supposed to be more transparent too. Fairer, because preferences will be granted to those countries that most need them, via the new GSP Plus incentive scheme, offe-

[16] In fact, Özden and Reinhardt only use data on the United States' GSP scheme. They point out, however, that the EU GSP probably has similar adverse effects on beneficiary countries' trade policies, as the different GSP schemes are highly correlated. (Özden & Reinhardt 2005, p 7)

ring additional preferences to vulnerable countries that have ratified and implemented certain international conventions relating to sustainable development and good governance, and via the Everything But Arms arrangement for the least developed countries. Taking into account the meager results of the social and environmental provisions in the previous GSP of the EU, there is reason to caution about the Commission's optimism. The new GSP Plus arrangement should also silence India’s complaints about the unfairness of the special incentive arrangements in the previous GSP cycle. All these reforms have to ensure that traders fully appreciate the benefits of the new system, in that way at least maintaining the current level of utilization rates.

After a discussion of the provisions of the new EU GSP, this paper provided some descriptive statistics on the EU GSP in general and on the utilization of the scheme by the ten ASEAN member states in particular. The most-striking observations were the sharp decrease in preferential imports and the simultaneously falling utilization rate after 1996, largely attributable to multilateral tariff reductions within the WTO framework and the introduction of a new GSP cycle for the period 1996-2005. An assessment of the export performance of individual ASEAN countries under the EU GSP scheme revealed that 4 ASEAN member states figure prominently among the top 15 beneficiaries of the scheme worldwide. Singapore is the economically most advanced ASEAN member and was excluded from receiving further GSP preferences in 1998, when its exports were deemed to be internationally competitive vis-à-vis other developed countries. Malaysia, Thailand, Indonesia and the Philippines have also successfully made use of the GSP, thus boosting their total exports to the EU over the last decade. These countries already graduated from the GSP for some of their most competitive exports, but continue to enjoy substantial preferences in other sections. Vietnam, Cambodia and Laos are swiftly expanding exports to the EU and largely depend on the GSP to do so. The export performance of these countries sharply contrasts with the limited progress that has been made by Myanmar and Brunei, two countries that are respectively not allowed and indifferent to the benefits of preferential access to the European market under the GSP. Export opportunities for these countries therefore appear to be far less rosy than for Vietnam, Cambodia and Laos in the near future.

As it will take some time before traders are completely accustomed to the provisions of the new GSP cycle starting on 1 January 2006, utilization rates might well slightly drop at first, but the simplified regulation and the more transparent rules of origin should ensure higher utilization rates soon afterwards, not to forget the impact of regional cumulation of origin. The ASEAN members will almost certainly keep their position in the leading group of most important GSP beneficiaries, as they strongly believe that trade is the key to their economic development. The EU in turn, seems inclined to promote regional economic integration initiatives such as AFTA even more in the future.

For some of the ASEAN countries, lasting export growth might well lead to their eventual exclusion from the EU GSP benefits. Especially for the least developed ASEAN members, GSP preferences will remain vital for their export growth, even in the longer term. However, the future success of the EU GSP also crucially depends on the European Commission's ability to keep its GSP both relevant and acceptable policy: not only will the Commission have to ensure that GSP utilization by developing countries remains high, but it will also need success stories in practice which can – at least temporarily – push free-trade economists’ theoretical concerns into the background.

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