

The India-EC GSP Dispute: The Issues and the Process

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The WTO dispute settlement system and developing countries

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International Centre for Trade
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Abstract

Since the inception of the WTO in 1995, India has initiated cases against other countries 16 times and has been complained against 17 times in the WTO Dispute Settlement Body (DSB). India can therefore be considered as one of the most frequent developing country users of the WTO dispute settlement system. This paper looks at the case where India contested the tariff concessions granted by the members of the European Communities (EC) to twelve developing countries under its Generalised System of Preferences (GSP) scheme (EC GSP case) to highlight some critical dimensions relating to India's use of the WTO dispute settlement mechanism.¹ Some of the highlighted issues relate to the economic and political factors behind India's decision to challenge the EC, the participation of the industry and private sector stakeholders in India in the case, and measures that the Indian government can take to increase and make stakeholders' participation more effective. The EC GSP case is chosen to demonstrate these issues as it has significant long-term implications for the trading interests of developing countries, including India's.

Introduction

On 10 December 2001, the EC launched its new GSP scheme through Council Regulation (EC) No. 2501/2001.² The Regulation had five different preferential tariff preferences, however, India was especially concerned with three: tariff preferences granted under the special arrangements as reward for some countries efforts to combat drug production and trafficking (the Drug Arrangements);³ the special incentive arrangements for the protection of labour rights (the Labour Arrangements) and for the protection of the environment (the Environment Arrangements). The preferences under these three schemes were accorded only to specified countries selected by the EC. The other two tariff preferences

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¹EC – *Conditions for the Granting of Tariff Preferences to Developing Countries* (WT/DS246), available at <http://docsonline.wto.org>.

²Official Journal of the European Communities, L Series, No. 346 (31 December 2001).

³Bolivia, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Nicaragua, Pakistan, Panama, Peru and Venezuela (collectively referred to as the 'Preferred Members').

under the GSP were the General Arrangements, under which India was a beneficiary, and the Special Arrangements for least developed countries (LDCs).⁴

The effect of the Drug Arrangements was that 12 beneficiary countries received greater tariff reductions than that received by countries such as India under the General Arrangements.⁵ When it requested consultation with the EC⁶ as well as when it requested that a Panel be established to settle the case, India argued that the tariff preferences accorded under the three arrangements created undue difficulties for its exports to the EC and nullified or impaired the benefits accruing under the most favoured nation (MFN) provisions of Article I:1 of the GATT 1994 and paragraphs 2(a), 3(a) and 3(c) of the Enabling Clause.⁷ However, on February 2003, at the meeting with the WTO Director General to compose the Panel, India indicated that it was limiting its challenge to only one aspect - the Drug Arrangements.

At the time, India reserved its rights to bring separate new complaints on the other measures, as the EC had not accorded any preferences under the environment arrangement and only Moldova had benefited from the labour arrangement. However, the economic rationale for India's case against the EC, as well as India's decision to challenge only the Drug Arrangements can be better understood from the discussion in the four sections to follow.

The first section analyses the detrimental impact of the Drug Arrangements on India's trade, especially in textile and clothing. This section reflects on the social context of the case, India's justification for initiating the case and the importance of clothing and textile to the Indian economy generally. The second section examines the participation of the stakeholders in India in the case. The third section focuses on the ruling in the EC-GSP case – its context and the findings of the Panel and Appellate body. Such an exercise is essential, in our view, as the available literature has largely analysed the issues from a western perspective. The fourth section highlights some important lessons from India's participation in the WTO dispute settlement system, and makes suggestions for the way forward.

⁴Described in Article 7 of Council Regulation (EC) No. 2501/2001 of 10 December 2001, above, note 2.

⁵For products included in the Drug Arrangements but not in the General Arrangements, the 12 beneficiary countries were granted duty free access to the ECs' market, while all other developing countries had to pay the full duties applicable under the Common Customs Tariff. For products included in both the Drug and the General Arrangements and that were deemed "sensitive" under column G of Annex IV to the Regulation with a few exceptions, the 12 beneficiary countries were also granted duty free access to the ECs' market, while all other developing countries were only given reductions in the duties applicable - see the Panel Report, paragraph 2.8.

⁶WTO, EC– Conditions for the Granting of Tariff Preferences to Developing Countries: Request for Consultations by India (WT/DS246/1), March 2002.

⁷GATT, Differential and More Favourable Treatment Reciprocity and Fuller Participation of Developing Countries, Decision of 28 November 1979 (L/4903).

1. Impact of the EC Drug Arrangements

GSP preferences are conferred pursuant to the 1968 recommendation of the United Nations Conference on Trade and Development (UNCTAD) authorising developed countries to establish individual GSP schemes to grant trade preferences to all developing countries. The first scheme was implemented by the EC in 1971. The importance of the EC's GSP scheme to India's exports can be seen from EC figures, which shows that between 1990 and 2001, imports from India under the EC's GSP increased to €5.336 from €2.011 million and that India's share of all imports under the EC's GSP scheme increased to 12 percent, up from 9.1 percent.⁸

The Drug Arrangements, which came into effect on 1 January 2002, had an immediate impact on India's exports to the EC. It affected more than 60 percent of the total EC imports from India in value and nearly one-half of the eight-digit tariff lines. The impact was felt mainly by three broad product categories, *viz*: textiles and clothing, leather and footwear and marine products. These categories of products accounted for almost 50 per cent of the value of India's exports to the EC in 2001. The textiles and clothing sector which constituted more than one-third of India's exports to the EC in 2001, was the worst affected, as it was wholly included in the Drug Arrangements.

Between 2001 and 2003, that is, before and after the implementation of the preferential schemes under Drugs Arrangements, Pakistan's exports to the EC under the GSP scheme increased by more than 37 percent, while, Indian exports of similar products grew at a substantially lower 22 percent. Hence, exports of products other than textiles and clothing seem also to have been affected by the preferences implemented under the Drugs Arrangements. Nonetheless, the EC-GSP case focused essentially on India's textiles and clothing interest.

The negative impact of the Drug arrangement can be seen from a comparison of exports and competitive conditions between countries, such as China, Pakistan and Turkey. For textiles and clothing, India is traditionally a significant player in the market, however, from the second half of the 1990s, India faced considerable competition from Pakistan and China. During the early 1990s, India's share in global exports of textiles increased quite rapidly but by the late-1990s, the industry lost growth momentum, and by 2003 India's share in global exports of textiles declined. In sharp contrast, Pakistan, which emerged as a major player in the textiles industry only in the 1990's, had an impressive share before the end of the 1990s.

Although India's share in the global clothing exports doubled between 1980 and 2001, it pales significantly when compared to China's. From 1995-2002, India featured in the list of top 10 suppliers to the global textile and clothing markets, but China was the world's largest exporter of both textiles and clothing.⁹ China's share of global clothing exports increased to almost 19 percent in 2001, as compared to four percent in 1980, and by 2002 it was 30 percent. Similarly, China dominated in the global textile market accounting for 22 percent in 2002.¹⁰ In contrast, Pakistan's share in the global market for clothing was not very significant at the time India brought the EC-GSP case. Despite this, the impact of the Drug

⁸EC, First Written Submission to the Panel, paragraph 4.

⁹Nordas 2004.

¹⁰Ibid.

Arrangements on Pakistani exports was important to India. Pakistan had a major share in the EC market and was a competitor (see the discussion in heading (i) below).

A comparison of the data on EC imports from China and Turkey during 2001-2003 shows that China's share increased by more than 3 percent in quantity (representing in excess of 10 percent in value), and Turkey's increased by 11 percent in quantity (15 per cent increase in value). However, there are two noteworthy remarks to be made on China and Turkey. Turkey exports duty-free to the EC due to its customs union with EC, and its share had already increased dramatically following the formation of the custom union in 1996. Hence, the Drug Arrangement did not affect India's export in relation to Turkey's. For China, it is an isolated case as China already accounted for a large share of EC imports (almost 22 percent of extra-EC imports) and the increase from 2001-2003 was only marginal in quantity terms considering that China's import grew nearly 63 percent in 2001 over 2000, prior to the Drug Arrangements.

On the other hand, there was a general decline in overall EC imports of textiles and clothing. There was a 24 percent quantity decline of imports from non-EC sources. Even so, at the time of general contraction in demand, EC imports from Pakistan rose by 26 percent, hence, Pakistan's import share increased at a substantial rate, even more than experienced by China and Turkey. It is in this context that the trade diversion from and among clothing supplies in India and Pakistan becomes important.

(i) Textile and Clothing, and the Social Dynamics in India

The textiles and clothing sector is, by a long way, the most significant among the manufacturing sectors in the Indian economy on account of its contribution to the industrial output, employment generation and foreign exchange earnings. The sector contributes more than 4 per cent to the country's GDP, which is equivalent to a fifth of the total contribution of the manufacturing sector¹¹. Till about the second half of the 1990s, the share of the sector in India's total merchandise trade had remained close to on-third, but from the beginning of the decade, there has been significant erosion in its share. In 2004-05, the latest year for which detailed data are available, the share of the textiles and clothing sector was down to around 17 per cent¹².

Textile and clothing is labour intensive, and unskilled labour can easily find entry-level job in the sector.¹³ The industry is important in creating jobs for the semi-skilled and unskilled and is a major employer of women. Since 1995, there has been significant employment growth in the clothing sector in India.¹⁴ In 2001, the total employment in the textiles and clothing sector was nearly 34 million and is projected to increase by nearly 17 per cent, or nearly 6 million people, during the period 2002 to 2007. Textile and clothing is often cited as one of the sectors where developing countries have the most to gain from trade

¹¹Ministry of Textiles, Govt. of India, sources

¹²In fact, textiles and clothing has lost its top slot to the gems and jewellery sector as the largest exporting sector overall since 2002-03.

¹³Nordas, Hidlegunn Kyvik: "A note on the impact of Trade Liberalization on Women's job opportunities and earnings in developing countries," *Trade Policy Review* 2:2,221-231, see Nordas 2004 footnote 2.

¹⁴Ibid.

liberalization.¹⁵

The textile industry includes spinning, weaving and finishing, and provides jobs in all these areas. In addition, there are jobs in related sectors such as in distribution, the supply chain, and in assembly. But most importantly, the industry supports a sizeable population in agriculture as well¹⁶. Moreover, India, along with China and Hong Kong, relies mainly on locally produced inputs for textiles and clothing, and this has spin-off effects for many other areas of the economy.¹⁷ It is therefore no surprise that India has tried to defend its interests in the textile and clothing sector through the dispute settlement mechanism of the WTO.

Almost half, namely 14, of the 33 cases that India has been involved in the WTO disputes – eight out of the 16 cases where India was the complaining party and six out of the 17 cases to which India was a respondent.¹⁸ Four of those eight cases that concern textiles were between India and the EC, and these include the case at hand, the EC GSP case. It is interesting to note that although the erosion of preferences suffered by India, as a result of the EC Drug Arrangements, covered a number of sectors, the large share of textiles and clothing in the sectors affected by preference erosion made this dispute one that addressed issues pertaining to the textiles and clothing sector alone. As a result, in its dispute with the EC, India did not address the interests of more than 44 per cent of its exports to the EC (in 2001) that were covered by the Drug Arrangements. Quite clearly, India's interests in textiles and clothing were given disproportionately large attention by the policy makers, and as pointed out above, this attention was to the detriment of the interests of several other key sectors.

The tariff advantage that the Drug Arrangements conferred on Pakistan adversely affected the competitiveness of the suppliers of clothing between India and Pakistan. This is demonstrated by the fact that while EC imports of clothing from Pakistan for items covered by chapters 61-63 of the EC's Tariff schedule increased by nearly 20 percent in value (27 percent in quantity) from 2001-2002, India's increased by less than two percent in value and declined by six percent in quantity. This trend is not reflected in textile where both India and Pakistan were graduated, and Pakistan did not have tariff advantages.¹⁹

¹⁵Reinert, K.A., 2000 "Give use virtue, but no yet: Safeguard actions under the Agreement on Textiles and clothing," *The World Economy* 1 23, 1:22-55 quoted in Nordas 2004 page 1.

¹⁶Available data show that this indirect employment was as much as 34 million in 2001.

¹⁷See Nordas 2004, page 7.

¹⁸Of the 33 cases India has been involved in at the WTO, 14 have been with the EC (5 where India complained against the EC 9 where the EC complained against India). This is not surprising as the EU is India's largest trading partner. The US, another one of India's large trading partners is the only other country that India has faced in more than one case. India has been sued 9 times by the EC, 3 times by the US and 1 time each by Australia, Bangladesh, Canada, Switzerland and Taiwan. The US was the respondent in 6 cases; the others were against Argentina, Brazil, Poland, South Africa and Turkey. For a complete list of all the cases India has been involved in see http://www.wto.org/english/tratop_e/dispu_e/dispu_by_country_e.htm.

¹⁹A cumulative analysis of import items covered by Chapters 61-63 of the EC's Tariff schedule shows that Pakistan increased its T-Shirts, Trousers, Gents Shirts Ladies Blouses, and Bed Linen exports to the EC by 26.8 percent in quantity and 19.54 percent in value. On the other hand, imports from India declined by over 6 percent in quantity and marginally increased by less than 2 percent in value for these items.

This is even more obvious if one examines the figures for 1997-2001. In this period, India's clothing exports grew appreciably compared to Pakistan's in some categories.²⁰ However, after the Drug Arrangement, India's clothing exports to the EC increased at a much slower rate. This was manifest in the sharply falling share of textiles and clothing in India's overall exports to the EC, which fell from nearly one-third in 2001 to less than 26 per cent in 2004-05.

At least three factors contributed to this phenomenon. One, India and Pakistan have stark similarities in their product ranges. Two, they cater to the same market segment, and three, the countries have common buyers. The similarity between Pakistan and India clothing products is borne out by the fact that the EC even initiated trade defence measures for cotton bed linen simultaneously for both countries.²¹

The duty free regime under the Drug Arrangements affected the unit value realisation for comparable products in both countries.²² For example, a Pakistani producer supplying to the UK was able to realise a better price than his Indian counterpart. He was able to, for example, supply a standard quality, bleached cotton bed sheet (of dimensions 20/20 60/60 "70x108") cheaper than one in India. For T-shirts and pullovers, where both India and Pakistan had comparable levels of quota, the average unit price increased from US\$2.52 in 2001 to US\$2.55 in 2002 for India and from US\$1.78 in 2001 to US\$1.89 for Pakistan. In 2002, the unit value for pullovers went down from US\$3.59 to US\$3.54 in India, and in Pakistan it increased from US\$3.73 to US\$4.08. Pakistan was thus able to increase its unit price and at the same times to sell products cheaper owing primarily to the approximately 9.6 percent duty advantage (see Table A in Annex 1).

The information that Indian exporters received from their buyers in the EC markets regarding their decision to source from Pakistan instead of from India supported the shifting dynamics of the market, and this was further corroborated by the feedback from Indian exporters participating in overseas market exhibitions. For example, at the HEIMTEXTIL fair held in Germany 2002, Pakistani exporters displayed banners proclaiming their price advantage on account of duty free access for articles originating in Pakistan. Consequently, Pakistani stalls received overwhelming response from the buyers, while the

²⁰The increase was particularly marked for knitted or crocheted apparel and clothing accessories and non-knitted or non-crocheted apparel and clothing accessories (Chapter 61).

²¹At the time of imposing provisional anti-dumping duties on imports of cotton type bed linen originating in India, Pakistan and Egypt, the EC stated that:

"In accordance with the terms of Article 3 (4) (b), the conditions of competition between imported products, and between imported products and the like Community products, were analysed. It was found that the imports compete directly with each other with the like Community product, and that in particular a number of large purchasers of bed linen buy both from the Community industry and from the countries concerned. While there are variations in the proportions by type and destination of exports from each of the countries concerned, it was found that products from each exporting country were substitutable and competed with each other with the products of Community producers on the Community market."

Hence the EU was able to justify the cumulative assessment of the effects of dumped imports on injury suffered by their industry.

²²A probable explanation increased imports of Pakistani clothing into the EU was that the EC increased the quota levels for Pakistani exports. However, as shown below, the data did not support the view that this was the only factor. In petitioning the Government to act the Indian clothing and textile industry argued that, as well as increases in exports from Pakistan, the duty free regime under the Drug Arrangements also affected Indian exporters in terms of unit value realisation.

Indian participants reported lower than normal business turnout. It seems that EC importers acted in view of the duty concessions.

The above discussion reinforces the point that India had a firm basis for initiating the case against the EC. From an Indian point of view, the EC Drug Arrangements disturbed the delicate balance between the trade interests of India and Pakistan. Almost one-half of the EC's imports from Pakistan under the Drug Arrangements were in the clothing sector, and this was where the arrangements distorted the competitive conditions between the countries. Another pertinent issue concerns the process launched by the Government as the initiator of the case to gather all the relevant stakeholders. The following discussion deals with this issue.

(ii) Stakeholder Participation

The stakeholder participation dimension remains the weakest link in India's trade policy making and this reflects on the country's participation in the dispute settlement mechanism as well. Trade policy making in India is complex and involves many stakeholders; it ranges from the sub-federal government, the private sector, industrial and service sectors to farmers groups and civil society organisations. But, in India, the central government is vested with the responsibility of making trade policy; the others make, at the very best, marginal contributions.²³

At least three factors have contributed to this scenario. First, the factor that has played an important role in guiding India's participation in the multilateral trading system is that the Indian constitution vested the powers to engage in international negotiations and to assume obligations arising from trade negotiation in the central government. But while the central government has these powers, there are no established processes of internal consultations. Thus, the constitution provided for a decision-making structure that includes the central government and the States, however, on matters that involve engagement with the global community, for example, the country's engagement in the multilateral trading system, there are no clear guidelines.

It may be argued that the country never previously felt the need for such a consultation given that for more than four decades, India's economic policies was focused essentially on the domestic market and was driven by "import-substitution" sentiments. Such a policy orientation did not attach much prominence to the external sector. However, it is intriguing that a decade and a half after the government took steps to change the previous policy orientation by effecting greater integration of the country's economy with the rest of the world, the decision-making process remains a hostage of the past. But possibly more important an issue here is that there have hardly been any demands by the stakeholders for a re-orientation of the decision-making process to take account of the present realities.

This brings into focus the third critical factor that has contributed to the almost uni-dimensional process of trade policy-making; the preservation of a statist model of development pursued by India. The variant of this model that has been adopted by India is a "state-guided" structure, where the central government has had the determining role in the making of policies.

²³This aspect has been elaborated in Dhar, Biswajit and Murali Kallummal, "Getting Trade Policy off the Hook.

Given this structure of policy-making in India, it is not surprising that the most obvious deficit in terms of participation of the stakeholders is felt in the processes involving the WTO. In this context, most stakeholders do not have any strategies, which would allow them to assume a proactive role. Their responses are limited to only to *ex post facto* moves, the significance of which do not become immediately obvious.

An example of the latter can be given in the context of the EC-GSP case. The dispute was initiated at the instance of the Ministry of Textiles, Govt. of India, which is the administrative ministry for the textiles and clothing sector. The Ministry of Textiles perceived threats to the country's export interest in the sector which, in the beginning of the present decade, had the largest share among India's industrial sectors. Besides the export interests, the threat to the livelihoods of those dependent directly or indirectly on this sector²⁴ as a result of the preference erosion arising from the EC Drug Arrangements made it a fit case to be brought up before the WTO dispute settlement mechanism.

The Ministry of Textiles, having made the case of the perceived threat to the domestic textiles and clothing sector, the Ministry of Commerce, which is the administrative ministry for trade-related issues, took the necessary steps to initiate the dispute. Stakeholders from the industry were conspicuous by their absence. In the absence of industry participation, the consultations in respect of the dispute remained confined to the Ministry of Textiles and the Ministry of Commerce. This scenario continued till well after the panel was constituted by the dispute settlement mechanism.

The only recorded instance of a stakeholder petitioning the government to act in the EC-GSP case was the Cotton Textiles Export Promotion Council of India (TEXPROCIL). TEXPROCIL submitted a memorandum to the government towards the end of July 2002, which sought to draw the attention of the government to the problems that the clothing sector was experiencing as a result of the Drug Arrangements. The organisation made a comparison of the performance of India and Pakistan during the first half of 2002, the period immediately following the implementation of the Drug Arrangement, which showed that while exports from Pakistan in select product categories increased quite considerably, in quantity and volume, India's exports had declined. These trends, according to TEXPROCIL, were "highly disturbing as in the coming years, Pakistan will establish itself as a strong supplier of clothing and made-up articles at the expense of India." Furthermore, TEXPROCIL reported that joint ventures between European buyers and Pakistan based exporters were being established to take advantage of the tariff concessions under the Drug Arrangements. TEXPROCIL expressed the opinion that as a result of the benefits accruing to countries like Pakistan, India was faced with the prospect of being completely wiped out from the EC market, especially after the quota-restrictions on textiles and clothing were abolished in favour of tariff concessions.

TEXPROCIL argued that, in view of the above-mentioned disquieting trends in the clothing sector, the government should take strong initiatives "at the highest levels to correct this distortion in international trade." The organisation recommended that the Government of India: strive to get similar duty concession for Indian exports of clothing/made-ups; block the consensus on the EC's proposal to grant zero duty concession to Pakistan; and/or take up the matter regarding the zero-duty concession to Pakistan at the WTO as the concession is detrimental to the trade interests of countries like India.

²⁴It was indicated earlier that the direct and indirect employment was as high as 68 million.

The TEXPROCIL memorandum is interesting for two reasons. Firstly, this stakeholder petitioned the government more than four months after India consulted with the EC on the Drug Arrangements in the dispute settlement body. The data provided by TEXPROCIL regarding the losses suffered by the Indian clothing sector, were therefore not the trigger for initiating the case against the Drug Arrangements. Instead these details proved useful for the government to justify its action in the case. The importance of this dimension is not insignificant as TEXPROCIL provided much of the factual evidence that helped in successfully arguing the case. The second dimension of the TEXPROCIL memorandum sums up the stakeholder consultation process that precedes the initiation of WTO cases by India. There was no indication in the memorandum that it was aware that India had moved the dispute settlement body to rule that the Drug Arrangements was WTO inconsistent. In fact, the memorandum urged the government to “take up the matter regarding the zero-duty concession to Pakistan at WTO ...” – 4 months after India had requested for the initiation of the consultations with the EC.

While the industry provided some of the evidence that was used in the substantive arguments, legal support for the dispute was provided by the Advisory Centre on WTO Law in Geneva along with the standing legal team of the Govt. of India. It has been a standard practice for India to seek the opinion of legal counsels well acquainted with WTO jurisprudence in the disputes that it has been involved in, and the EC-GSP case is no exception.

2. Analyses of the Issues in the GSP Dispute

India’s main contentions with the EC Drug Arrangements were that it was discriminatory, as it benefited only 12 countries, did not account for the relative development needs of developing countries, and had no objective criterion for identifying beneficiaries.²⁵ Before the Panel, India argued that the Drug Arrangements were inconsistent with Article I:1 of GATT 1994 and could not be justified by the Enabling Clause nor by Article XX (b) of the GATT 1994, and that the EC had the burden of proving that the Drug Arrangement were WTO consistent.

India’s strategy in the EC-GSP case was twofold: to oppose the Drug Arrangements, specifically its adverse and unfair consequences, which threatened its economic interests, and at the same time; to ensure that the objective behind GSP schemes, which is giving preference to developing countries, was not undermined (since India is a developing country and a GSP beneficiary). These objectives were reflected in the two suggestions that India made to the Panel for bringing the Drug Arrangements into conformity with EC’s WTO obligations; suggestions to either extend the tariff preferences granted under the Drug Arrangements to all other developing country Members consistently with the Enabling Clause; or to obtain a waiver under Article I:1 of GATT 1994 on satisfactory terms and conditions.

²⁵The Arrangement relied on only the efforts countries made to combat drugs production and trafficking Panel Report, (second written submission) para. 4.201 and 4.202.

The Panel found in favour of India on most issues but left a grey area in suggesting steps that the EC should take to bring the Drug Arrangement in conformity with its WTO obligations.²⁶ As shown below, the Panel in its findings dwelt on the circumstances for the grant of GSP preferences, in particular the consistency of the EC Drug Arrangements with Article I.1 and the Enabling Clause; and whether it can be justified under Article XX (b). In January 2004, the EC appealed the Panel's findings. Soon after, India filed its appellee submissions. The appeal was heard on 19 February 2004. The Appellate Body Report wrought substantial modifications to the Panel's findings, which marked a radical departure from established WTO practice, bringing them much closer to conventional interpretations.²⁷ For that reason, as well as for the logic it espoused it makes interesting reading. Moreover, as shown below, in several instances, the Appellate Body upheld the Panel's findings for altogether different reasons.

(i) Relation between Article I:1 and the Enabling Clause

At the outset, India pointed out that the EC Drug Arrangements granted the 12 beneficiary countries an advantage which was in violation of the MFN principles enshrined in Article I:1 of GATT 1994. India argued that Article I:1 does not permit the EC to confer the advantages under the Drug Arrangements conditional upon the situation of conduct of the exporting countries.²⁸ Moreover, India was of the view that the EC implemented the Arrangement knowing that it was inconsistent with Article I:1 and it should have obtained a waiver before doing so.²⁹ Having failed to obtain the required waiver, the EC was in effect upsetting the balance of rights and obligations resulting from the market access negotiations. This, in view of India, could have far reaching consequences since it was depriving all other Members, particularly the developing countries excluded from these arrangements, of their right to compensation for the trade diversion to which they were subjected. In view of the above, India stated that the EC had the burden of demonstrating that the Drug Arrangements were consistent with the Enabling Clause, which allows for countries to derogate from their obligations under Article I:1 of GATT 1994. In other words, India alleged that the Enabling Clause was in the nature of an "affirmative defence".³⁰

²⁶The Panel contended that "[i]n light of the fact that there is more than one way that the EC could bring its measure into conformity with its obligations under GATT 1994 ... the Panel does not consider it appropriate to make any particular suggestions to the EC as to how the EC should bring its inconsistent measure into conformity with its obligations under GATT 1994."

²⁷Howse 2004 b, p. 5. This was in a way only expected.

²⁸Panel Report, *European Communities – Conditions for the Granting of Tariff Preferences to Developing Countries*, WT/DS246/R, para. 4.14

²⁹Panel Report, para. 4.16. India emphasised that the EC, by requesting a waiver (on 24 October 2001), acknowledged that a waiver was required before it could apply the tariff preferences under the Arrangements. According to the EC's waiver request "The revised special arrangements to combat drug production and trafficking that should apply from 1 January 2002 will be open to eligible products listed in Annex I originating in Bolivia, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Nicaragua, Pakistan, Panama, Peru and Venezuela. Because the special arrangements are only available to imports originating in those Members, a waiver from the provisions of paragraph 1 of Article I of GATT 1994 appears necessary before they can effectively enter into force for reasons of legal certainty."

³⁰India argued that paragraph 2(a) of the Enabling Clause, permits or "enables" developed country Members to take certain measures which Article I:1 otherwise prohibits, subject to certain conditions. They said paragraph 2(a) was adopted to benefit developing countries by permitting developed countries to grant preferential tariff treatment to developing countries under GSP schemes and not to confer a privilege to developed countries.

The EC disagreed. They argued that the Enabling Clause was neither an ‘affirmative defence,’ nor an ‘exception’ to Article I:1. The Clause, according to the EC, conferred an “autonomous and permanent right” to grant certain types of “differential and more favourable treatment” to developing countries, “notwithstanding Article I:1 of the GATT”. The EC said that as the Drug Arrangements were intended to benefit developing countries, Article I:1 did not apply.³¹ To support this argument, the EC referred to the *Brazil – Aircraft* case where the Appellate Body held that Article 27 of the Agreement on Security and Countervailing Measures (SCM), which also sanctioned differential treatment to developing countries, was not an ‘affirmative defence,’ as it excluded the application of Article 3.1(a) of that Agreement.³²

Differing considerably with EC’s position, India held that the Enabling Clause does not exclude the application of Article I:1 in all circumstances and that the scope of the exception under the Clause must be examined carefully. India’s contention was that paragraph 2(a) of the Enabling Clause does not give any indication of an agreement between developing countries to forego their rights under Article I:1, and any derogation from the MFN rights of developing countries under Article I:1 cannot be authorised under the Enabling Clause.

In deciding whether the Drug Arrangements were consistent with Article I:1, the Panel noted that Article I:1 imposes MFN principles ‘unconditionally,’ that is, ‘not limited by or subject to any conditions.’³³ They said that the Enabling Clause and Article I:1 apply concurrently, with the Enabling Clause prevailing in cases of irreconcilable conflicts.³⁴ The Panel ruled that the Enabling Clause was only an exception to Article I:1 and that preferences under the Enabling Clause had to be conferred amongst developing countries on an MFN basis. Hence the EC could not discriminate among the beneficiaries as it sought to do with India and Pakistan in the Drug Arrangements.³⁵

These arguments about Article I:1 and the Enabling Clause applying concurrently surprised experts more than anything else; some even found it confusing.³⁶ Hitherto, once the Enabling Clause was invoked, it was commonly understood to constitute the sole validating provision for GSP schemes. The contention that MFN obligations apply even in respect of schemes authorised by the Enabling Clause was radical in its outlook. Even more surprising, however, was that the Panel accepted the argument. Scholars not only found it astonishing, but also pointed out that the Panel in *Canada-Autos* had held that MFN obligations were not meant to prevent origin-neutral distinctions between products.

The EC argued on appeal that the Panel erred in: characterising the Enabling Clause as an ‘exception’ to Article I:1, rather than an autonomous right; and in holding that the Drug Arrangements were inconsistent with Article I:1.³⁷ In contrast, India alleged that the Panel had correctly characterised the Enabling Clause

³¹Panel Report, para. 4.42. As the Enabling Clause excluded the operation of Article 1.1 in respect of tariff preference to developing countries.

³²Panel Report, para. 4.43.

³³Panel Report, para. 7.59.

³⁴Panel Report, para. 7.46. The panel said that if the Enabling Clause did precluded the applicability of Article I:1, different countries would be subject to different levels of taxation - something the drafters had not contemplated.

³⁵Panel Report, para. 7.37-7.39. They said Article I:1 was a positive rule establishing obligations, while the Enabling Clause established no positive obligation on its own, but authorised limited derogation from Article I:1

³⁶See e.g. Howse 2004 a, p. 6.

³⁷Appellate Body Report, para. 9 *et. seq.*

as an exception and that the Enabling Clause is not *lex specialis* (special law). India argued that Article I:1 and the Enabling Clause applied concurrently, and that as there was no conflict there was no need to apply the maxim *lex specialis derogat legi generali* (the special rule prevails over the general) as the EC suggested.³⁸

The Appellate Body upheld the Panel's finding on whether the Enabling Clause excludes the applicability of Article I:1, but with an important qualification. They held that Article I:1's applicability is not excluded in that any challenged measure must first be tested against it, and only if found inconsistent will it be examined in the light of the Enabling Clause.³⁹ While the Appellate Body agreed with the EC that the Enabling Clause aims to facilitate developing countries' growth, they held that it was irrelevant whether the Clause was an exception to Article I:1 or an autonomous right. They also held that WTO objectives could be achieved just as well through measures characterised as exceptions, hence, the Appellate Body upheld the Panel's characterisation of the Enabling Clause as an exception to Article I:1.⁴⁰

There is little doubt that the Enabling Clause constitutes an exception. The words 'Notwithstanding the provisions of Article I of the General Agreement' in paragraph 1 imply that the Clause's applicability is determined with reference to Article I:1. Thus the Enabling Clause cannot be considered 'autonomous.' Though the terms 'exception' and 'defence' are at times used interchangeably and even synonymously, they are not jurisprudentially identical. Exceptions characteristically justify the circumstances they contemplate. That is to say, a conduct considered wrong under normal circumstances no longer remains wrong if it shown to fall within the scope and extent of the exception.⁴¹

In its oral arguments, the EC claimed that defences justify violation of provisions.⁴² That is not true. Exceptions are what justify deviation from provisions. Defences merely excuse violations. When a person deviates from a norm and invokes an exception that permits the deviation, his deviance is not *wrongful*. This is because the exception justifies the action. There can be no doubt that the Enabling Clause is in the nature of an exception and not a defence. Its application justifies and not merely excuses derogation from Article I:1. Surely, once a GSP scheme is justified under the Enabling Clause, it can no longer be considered *wrong* or *unjustified*. Had the Enabling Clause been merely a defence, the scheme would have been considered wrong but not censurable due to extraneous circumstances.

³⁸Appellate Body Report, para. 35 and 39.

³⁹Appellate Body Report, para. 102 and 103.

⁴⁰See *e.g.* preamble to the WTO Agreement and the Appellate Body Report, para. 92, 94, 97, and 99.

⁴¹For example, Clause (1)(a) to Article 19 of the Constitution of India guarantees to its citizens the right to free speech and expression. To this, Clause (2) of the same Article, which provides that Clause (1)(a) shall not apply to reasonable restrictions on grounds of State security, public order, decency etc., constitutes an exception. If the State curbs freedom of speech, under normal circumstances such an action amounts to a violation of Clause (1)(a). But if the State shows that the restrictions in consonance with Clause (2), then its act of curbing is no longer considered wrong notwithstanding its inconsistency with Clause (1)(a). On the other hand, defences only excuse and not justify the acts they contemplate. The act continues to be considered wrong, but its legal consequences do not devolve upon the perpetrator. Section 84 of the Indian Penal Code, 1860 recognises insanity as a defence in criminal law. Suppose a man kills another while in a state of insanity. Surely it cannot be said that his act becomes justified merely because he was insane. The homicide remains as wrong and illegal as it did. However, given that he was not in his senses at the time, the penal consequences the act would normally attract are not imposed on him.

⁴²Panel Report, para. 4.291.

(ii) Burden of Proof

The Panel's ruling on the burden of proof issue was in India's favour. The Panel found that Article I:1 was binding on all Members, except where they had recourse to one or more of several exceptions to Article I:1. They reasoned that the country seeking to derogate from Article I:1 must both invoke the exception(s), and justify their derogation, as it was not always possible for a complainant to know which exception that Member has adopted. The Panel then ruled that as the EC invoked two exceptions, the Enabling Clause and Article XX (b), the EC had the burden of proof.⁴³

The Appellate Body's ruling on the *onus probandi* was markedly different from the Panel's. It ruled that India, at the time of requesting the establishment of a panel, was required to identify the obligations of the Enabling Clause that the Drug Arrangements violated, and to make written submissions explaining why. Subsequently, the EC had to *prove* that the Drug Arrangements were consistent with the Clause.⁴⁴ It would seem from a perusal of the relevant passages in the report that India should at least establish a *prima facie* case, as it is suggested in for example Paragraph 118 of the Appellate Body Report, that the submissions that should have been made by India lie somewhere between mere allegations and conclusive proof.

The characterisation of the Enabling Clause as an exception or a defence played a significant role in the determination of the burden of proof. Contrary to the Panel's conclusion, a party taking recourse to an exception is not required to justify its action under that exception. In its third party submissions, Mauritius referred to the Appellate Body's rulings in *US –Wool Shirts and Blouses* and *EC – Hormones* to the effect that the respondent is presumed to have acted in accordance with covered agreements, and that the burden of proving otherwise lies with the complainant. It is merely in accordance with accepted jurisprudential principles, that a person is always presumed to have acted legally. Such presumption is relevant for exceptions also. That is to say, the party invoking an exception is *presumed* to be justified, and the burden of proving otherwise lies with the other party. In practical terms, the former party merely has to demonstrate that he has complied with the requirements of the exception.

Hence, if a country's GSP scheme derogates from Article I:1 and the country invokes the Enabling Clause to justify the scheme, it is only required to demonstrate *prima facie* that the scheme is generalised, non-reciprocal, non discriminatory and otherwise consistent with the requirements of the Clause. The onus then lies on the complainant to prove that the Enabling Clause criteria have not been satisfied. Therefore, in characterising the Enabling Clause as an 'affirmative defence' and shifting the onus on the EC, the Panel acted contrary to the most fundamental of all principles regarding burden of proof; that of presumption of legality.

The Appellate Body ruling further complicates the situation. The ruling required India, at the time of making its claim under Article I:1, to identify the obligations of the Enabling Clause which the Drug Arrangements violated, and to make out what seems to be a *prima facie* case. Subsequently, the burden lay on EC to prove compliance with the Enabling Clause. Does this mean that India had to make out a

⁴³Panel Report, para. 7.40, 7.49.

⁴⁴Appellate Body Report, para. 118 and para. 125. Paragraph 123 is similar to para 118, except for requiring that the violated provisions be identified at the time of claiming inconsistency with Article I:1.

prima facie case in respect of the Enabling Clause *before* EC invoked it? What would have happened if India had neglected to do so? Would its action have failed altogether?

Paragraph 113 of the Appellate Body Report states that if the complaining party, at the time of the complaint, fails to mention the specific provisions of the Enabling Clause that, in its opinion, is violated by the respondent, this will place undue strain on the responding party. Paragraph 118 goes on to add that merely alleging that the EC Drug Arrangements are inconsistent with the provisions of Article I:1 of GATT 1994 is not enough. The complainant was required to identify, in its request for the establishment of a panel, which obligations in the Enabling Clause the Drug Arrangements are allegedly to have contravened, and also make written submissions in support of this allegation. From this, we may conclude that India had to make out a *prima facie* case in respect of the Enabling Clause at the time of complaining, and before EC invoked it. The Appellate Body is, however, silent about the consequences of failure of the complainant to fulfil what it considers are essential requirements. Hence, any conjecture on the matter must amount to speculation.

In any case, as a general rule, placing the burden of proof on the respondent is inconsistent with accepted principles of natural justice and bears serious consequences. If every time a Member takes advantage of an exception, it has to invoke the relevant provision and also justify its own conduct in terms of the provision, then it is vulnerable to vexatious litigation, and may have to spend considerable time, money and effort to vindicate its actions while the complaining party merely sits back and watches. For economically weak Members seeking to take advantage of exceptions granted to developing countries, such litigation could prove financially ruinous. At the very least, it may take up valuable resources. Money spent defending frivolous actions might hinder developing countries from instituting actions of their own. This would weaken developing countries' legal presence, and cannot augur well for the WTO regime.

(iii) Drug Arrangement's Consistency with the Enabling Clause

India contended that paragraph 2(a) of the Enabling Clause covers only preferences that are "beneficial to the developing countries" and are designed to respond positively to their needs.⁴⁵ In support of this view, India pointed out that the use of the definite article "the" with reference to "developing countries" makes clear that GSP schemes must benefit all developing countries. The Enabling Clause thus justifies only preferences that do not discriminate between developing countries.⁴⁶

In contrast, the EC submitted that differential and favourable treatment granted to *some* developing countries would satisfy the Article I:1 non-discriminatory criterion.⁴⁷ The EC postulated that the phrase 'non discriminatory' in footnote 3 did not imply the granting of preferences to *all* developing countries

⁴⁵Panel Report, para. 4.31

⁴⁶Panel Report, para. 4.31. India argued that the Clause permitted limited derogation, but did not absolve developed countries from the obligation not to discriminate between their trading partners.

⁴⁷Panel Report, para. 4.45. As regards India's contention that paragraph 2(a) of the Enabling Clause used the phrase 'the developing countries,' the EC pointed out that paragraph 1 used the phrase 'developing countries' without prefacing it with the article 'the.'

equally and that different countries could be treated differently, if they, based on objective criteria, were found to have different development needs.⁴⁸ The EC submitted that special and differential treatment was necessary to ensure the economic growth of developing countries.⁴⁹ The EC also maintained that the Drug Arrangements were not discriminatory as it used a system of objective assessment to designate beneficiaries, *viz.* the criterion of the gravity of the drug problem in every country.⁵⁰ Based on these arguments, it can be seen that the EC's interpretation of 'non discriminatory' entail connotations of non-arbitrariness, that is, differential treatment in accordance with prevailing realities and the objective to be achieved. We may refer to this as *substantive* non-discrimination.

The Panel's finding on the consistency of the Drug Arrangement with the Enabling Clause rested on its interpretation of the phrase 'non discriminatory' in footnote 3 of paragraph 2(a) of the Enabling Clause. The Panel held that the phrase 'developing countries' in paragraph 2(a) refers to all developing countries collectively, and not selected countries.⁵¹ The panel traced the origins of footnote 3 to Resolution 21(II) of the Second Session of UNCTAD and the Agreed Conclusions and said that these clearly suggest that 'non-discrimination' was used in the sense of absolute non-differentiation rather than differentiation according to objective criteria, as suggested by EC

Furthermore, the Panel said that it could not be gleaned from the provision whether paragraph 3(c) of the Enabling Clause refers to *all* developing countries or individual ones, and therefore permits preferences to be conferred accordingly.⁵² Having regard to those findings, the panel held that the MFN principle applies to preferences given under the Enabling Clause.⁵³ Its analysis of the GSP schemes and their permissibility, led the Panel to conclude that paragraph 3(c) permits derogation from MFN principles in two circumstances only: (a) *a priori* limitation in respect of specific products originating in selected developing countries where these products reach a certain competitive level in the market of the preference-giving countries, and (b) special treatment of LDCs in accordance with paragraph 2(d).

The Panel therefore found that the Drug Arrangements, as a GSP scheme, did not provide identical tariff preferences to all developing countries and that the differentiation was neither for the purpose of special treatment to LDCs, nor to implement *priori* measures, so the differentiation was inconsistent with paragraph 2(a) (particularly the term "non-discriminatory" in footnote 3), and was not justified by paragraph 3(c) of the Enabling Clause.⁵⁴

On appeal, as a 'subsidiary' argument, the EC argued that the Panel had incorrectly found that the Drug Arrangements were not justified under paragraph 2(a) of the Enabling Clause.⁵⁵ It said that Panel incorrectly construed the words 'non discriminatory' in footnote 3 to paragraph 2(a) of the Enabling

⁴⁸Panel Report, para. 4.47, 4.51, 4.57, and 4.61 respectively.

⁴⁹Appellate Body Report, para. 15.

⁵⁰Panel Report, para. 4.75.

⁵¹Panel Report, para. 7.116, 7.144, and 7.174.

⁵²Panel Report, para. 7.65.

⁵³Panel Report, para. 7.150.

⁵⁴Panel Report, para. 7.177.

⁵⁵The argument was 'subsidiary' in that it was intended to apply only in case Appellate Body concluded that the Enabling Clause as an exception to Article I:1, or if India made a valid claim under the Enabling Clause. Appellate Body Report, para. 18.

Clause as non-discrimination in the absolute sense, whereas the term merely describes preferences in the 1971 Waiver⁵⁶ and does not impose an obligation on Members. Moreover, even if it did, the term only obliges Members to accord preferences on the basis of objective criteria.⁵⁷ The EC argued that this construction of ‘non discriminatory’ was consistent with paragraph 3(c), which stipulates designing and modifying GSP schemes according to the needs of developing countries.⁵⁸ It also said that the Panel’s interpretation of the term ‘developing countries’ in paragraph 2(a) to mean ‘*all* developing countries’ was incorrect. It argued that since footnote 3 permits discrimination on the basis of objective criteria, paragraph 2(a) could not require the conferment of preferences to *all* developing countries.⁵⁹

The EC’s contention that the term ‘non discriminatory’ in footnote 3, is only to describe the GSP in the 1971 Waiver Decision, and is not binding in character was rejected by the Appellate Body.⁶⁰ Instead, the Appellate Body noted that paragraph 2(a) applies to preferences ‘... in *accordance* with the Generalized System of Preferences.’⁶¹ It said that the obligations in paragraph 3(c) lend credence to the fact that ‘non discriminatory’ does not have to be interpreted as ‘identical.’⁶² The Appellate Body reasoned that as the needs of developing countries vary across nations and over time, responding to them might require treating different developing countries differently, subject to the other criteria imposed by the Enabling Clause. For the Appellate Body, the context required that due emphasis be placed on paragraph 3(a), which requires that preferences facilitate and promote the trade of developing countries and not raise trade barriers or create undue difficulties for other countries.⁶³

Hence, the Appellate Body rejected the Panel’s finding that ‘developing countries’ in paragraph 2(a) is a reference to *all* developing countries. The Appellate Body said that some flexibility must be allowed in the conferment of preferences and such an interpretation of paragraph 2(a) prevents this flexibility.⁶⁴ They also ruled that sub-paragraph 2(d) permit developed nations to freely discriminate between developing and LDCs, and to give special preferences to LDCs.⁶⁵

Finally, the Appellate Body upheld the Panel’s findings on the inconsistency of Drug Arrangements with Enabling Clause “albeit for different reasons.”⁶⁶ The Appellate Body said that the Drug Arrangements were inconsistent with paragraph 2(a) and that footnote 3 requires that the preferences be granted to all

⁵⁶Decision of the CONTRACTING PARTIES of 25 June 1971

⁵⁷Appellate Body Report, para. 20.

⁵⁸Appellate Body Report, para. 26.

⁵⁹Appellate Body Report, para. 33 and para. 45.

⁶⁰Appellate Body Report, para. 146.

⁶¹The word ‘accordance’ is defined in dictionaries as ‘conformity’.(Appellate Body Report, para. 145) The terms ‘*conformément*’ and ‘*conformidad*’ in the French and Spanish versions respectively lend credence to the obligatory nature of the phrase ‘in accordance with.’Moreover, the French and Spanish texts employ in footnote 3 the words ‘*défini*’ and ‘*define*’ respectively, which translate as ‘defined.’ This is in contrast to the English version, which uses the phrase ‘as described in.’ The Appellate Body felt that the stronger, more obligatory language in the French and Spanish versions emphasise the mandatory nature of the phrasing used in paragraph 2(a). (Appellate Body Report, para. 147.)

⁶²Appellate Body Report, para. 155-157.

⁶³Appellate Body Report, paragraphs 160, 162 and 167.

⁶⁴Appellate Body Report, para. 175.

⁶⁵Appellate Body Report, para. 172.

⁶⁶Appellate Body Report, para. 189.

beneficiaries similarly affected by the drug problem, but ruled that the Panel erred in effectively confining itself to whether the Drug Arrangements conformed to paragraph 2(a) and footnote 3.⁶⁷ According to the Appellate Body, discrimination was evidenced by the fact that the Arrangements were limited to only 12 countries; and the implementing Regulation (EC) No 2501/2001 did not set clear prerequisites or 'objective criteria' to add or even to remove existing beneficiary countries.⁶⁸

The Appellate Body's interpretative commentary on the application of the Enabling Clause, the use of the term "non-discriminatory" (footnote 3 of paragraph 2(a)), and on the meaning of "developing countries" in paragraph 2(a) are the most significant aspects of its findings. The Appellate Body reversed the Panel and ruled that footnote 3 of paragraph 2(a) did not prohibit developed-country Members from granting different tariffs to products originating in different GSP beneficiaries, provided that such differential tariff treatment meets the remaining conditions in the Enabling Clause.

While interpreting the term "non-discriminatory" in the Enabling Clause, the Panel had observed that the term meant that "identical tariff preferences under GSP schemes be provided to all developing countries without differentiation, except for the implementation of a priori limitations." The Appellate Body, on the other hand, recognized that differentiation between developing countries was allowable, provided that "objective" criteria were adopted.⁶⁹ The Appellate Body clarified, however, that "in granting such differential tariff treatment preference-granting countries are required, by virtue of the term "non-discriminatory," to ensure that identical treatment is available to all GSP beneficiaries that have the "development, financial and trade needs" to which the treatment in question is intended to respond."

Similarly, commenting on the meaning of the term "developing countries" in paragraph 2(a) of the Enabling Clause, the Panel had ruled that the term should be interpreted to mean "all developing countries." Giving a completely different interpretation, the Appellate Body opined that the term "should not be read to mean "all" developing countries and, accordingly, that paragraph 2(a) does not prohibit preference-granting countries from according different tariff preferences to different sub-categories of GSP beneficiaries."⁷⁰ It may, however, be pointed out that the Appellate Body, by adopting an "exclusive", as opposed to an "inclusive", interpretation of the term "developing countries" that the Panel had adopted, had made a serious error in the textual reading of the Enabling Clause. Footnote 1 of the Enabling Clause states the following explanation: "The words "developing countries" as used in this text are to be understood to refer *also to developing territories*" (emphasis added). This definition of the term "developing countries" would suggest *a priori* exclusions of the kind suggested by the Appellate Body would be in violation of the spirit of the Enabling Clause.

The interpretations of the Appellate Body alluded to above could have far reaching implications for developing countries in the multilateral trading system on two accounts. In the first place, the interpretations leave the door ajar for the use of differentiated policies by the developed countries in the

⁶⁷Appellate Body Report, para. 178.

⁶⁸Appellate Body Report, para. 180, 183, 184, and 188. To explicate, although the Regulation provided for removal of beneficiaries, such provisions were not specific to the Drug Arrangements -Articles 3 and 12 contemplated removal only if certain levels of development were met. In addition, the Regulation had no criteria to distinguish the beneficiaries of the Drug Arrangements from other GSP schemes.

⁶⁹Appellate Body Report, para. 173.

⁷⁰Appellate Body Report, para. 177.

grant of preferences, which has the potential of becoming a determining factor in deciding the future of trade negotiations.⁷¹ Perhaps more problematic is the second interpretation of the Appellate Body which provides an interpretation of the term “developing countries”. The Appellate Body has stated that since the term “... needs of developing countries”, as appearing in paragraph 3(c) of the Enabling Clause, does not explicitly require a response “to the needs of “all” developing countries or to the needs of “each and every” developing country, the provision imposes no such obligation”⁷². This interpretation, which leaves the meaning of the term “developing countries” open-ended, could lead to a drafting nightmare in all future decisions that are adopted not merely in the WTO, but in other multilateral institutions as well.

The MFN principle can be read into the GSP schemes in two ways. The first is by contending that Article I:1 and the Enabling Clause apply concurrently. As we saw, the Appellate Body ultimately rejected this contention. The second is by suitably interpreting the term ‘non discriminatory’ in footnote 3. Hence, a lot depends on the interpretation of the phrase, as well as of the Enabling Clause generally. Developing countries’ interests are significantly tied to the Enabling Clause, and only a correct construction of it can further their interests. Certainly, developed countries cannot be permitted to freely discriminate between beneficiary developing countries. At the same time one has to question whether strict, formal non-discrimination is really the answer. Will it not do more good than harm?

Finally, the Appellate Body upheld the Panel’s finding that the Drug Arrangements could not be justified under Article XX (b) of GATT 1994.⁷³ The EC had argued before the Panel that the Drugs Arrangements could be justified, as necessary for the protection of human life and health.⁷⁴ They said that narcotic drugs pose a serious threat to human life and health in the EC countries, wherefore the Drug Arrangements were justifiable as it contributed positively to the eradication of the drugs menace. In contrast, India contended that the Arrangements were neither designed, nor necessary to protect human life or health.⁷⁵ India said that the granting of trade preferences for the eradication of drug problems in developing countries was too remote to fulfil that causal link between human life and health in EC countries. In arriving at its decision, the panel noted that neither the EC Council Regulation 2501/2001, nor the Commission’s Explanatory Memorandum made reference to life or health requirements and that there was no evidence to indicate that the Drug Arrangements were intended to protect life and health in drug importing countries.⁷⁶ The panel also agreed that it had not been proved that the improving of market access was a *necessary* criterion to protect life and health, even if improving market access was an important aspect in the fight against drugs.⁷⁷

⁷¹EU’s then Trade Commissioner Pascal Lamy observed that: “Today’s decision makes it clear that we can continue, to give trade preferences to developing countries according to their particular situation and needs, provided this is done in an objective, non-discriminatory and transparent manner. This is certainly good news for many developing countries whose preferential access to the EU was being put at risk by India’s WTO challenge.”

⁷²Appellate Body Report, para. 159.

⁷³Panel Report, para. 7.236.

⁷⁴Panel Report, para. 4.91.

⁷⁵Panel Report, para. 4.204 to 4.205 (second written submission).

⁷⁶Panel Report, para. 7.201.

⁷⁷Panel Report, para. Panel Report, para. 7.207 and 7.223.

(a) Objective of Enabling Clause

What is the purpose of the Enabling Clause? There are several ways of answering this question, including conducting statutory interpretation, semantic analysis, and examining the background and context of the Clause. However, perhaps a simple common-sense appraisal will best satisfy our present purpose.

In an earlier discussion, it was stated that the Enabling Clause is intended to establish “generalized, non-reciprocal and non discriminatory preferences beneficial to the developing countries”⁷⁸. The Clause provided in paragraph 2(a), that one of the ways in which preferences could be granted, was through preferential tariff treatment accorded by developed contracting parties to products originating in developing countries in accordance with the Generalized System of Preferences⁷⁹. The express objectives of the Enabling Clause are elaborated in paragraph 3(a) and 3(b). Hence, paragraph 3(a) stipulates that the differential and more favourable treatment provided under the Clause “shall be designed to facilitate and promote trade of developing countries and not to raise trade barriers to or create undue difficulties for the trade of any other contracting parties.” Furthermore, paragraph 3(b) provides “that such treatment accorded by developed contracting parties to developing countries [can] be designed and, if necessary, modified, to respond positively to the development, financial and trade needs of developing countries”. Surely, if the EC had tried to find justification for its Drugs Arrangements under the Enabling Clause, this measure should include first the requirements of both paragraph 3(a) and 3(b). The EC did not, but more importantly, the Appellate Body also ignored the fact that its interpretations of the Enabling Clause were ignoring the key requirements of paragraph 3(a).

The Drug Arrangements were based on the assumption that increased trading opportunities offered to preference recipient countries will reduce law-and-order problems, specifically drug production and trafficking. If this assumption holds, it stands to reason that a corresponding quantum of job losses is likely to actually exacerbate the law-and-order situation. Hence, the argument can be made that if A’s drug problem lessens as a result of increased market access, then B’s reduced market access will surely enhance its own law-and-order situation.

Surely the objective of the Enabling Clause is not to ‘enable’ one developing country to transplant its law-and-order problems onto another developing country. And yet, according to the rationale of the Drug Arrangements, that was exactly what would have happened. The root of this problem is not difficult to spot. Even if we assume that the Drug Arrangements had contributed to eradicating drug-related problems in developing countries and in the EC, the question still remains who actually pays for this process. Not the beneficiary developing countries, for their economies stand to benefit. Nor even EC itself, except to the extent of its reduced revenue earnings.

Clearly, the biggest sufferers are other trade partners of the EC, especially other developing countries, for whom the Arrangements translated into reduced market access. This means the EC solves its problems *at the expense of other developing countries*. To conclude, there can be no doubt that the Drug Arrangements were irreconcilably inconsistent with the philosophy behind the WTO framework and,

⁷⁸GATT, Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries”, Decision of 28 November 1979 (L/4903), footnote 3.

⁷⁹ As introduced through the Decision of the CONTRACTING PARTIES of 25 June 1971

indeed, any rational legal regime. To be fair, India had raised this issue.⁸⁰ However, India chose not to elaborate on it, and instead continue to rely on its formalist arguments. Why it did so remains unclear.

(iv) Is the ‘Non discriminatory’ Criterion Obligatory in Character?

Before we examine what ‘non discriminatory’ denotes, we must determine whether it is an obligatory requirement. In 2003, Robert Howse characterised the Enabling Clause as merely aspirational and not *per se* determinate enough to create enforceable conditions.⁸¹

If we look at the history of the GSP, the relevant legal texts, and subsequent state practice, it becomes clear that the idea of non-discrimination in the description of the GSP has a largely, though not entirely, aspirational legal effect.⁸² For instance, from the inception of the GSP, very few schemes actually applied to ‘all countries and all products.’⁸³ Moreover, the Doha Decision on Implementation in 2001 reaffirms that preferences *should* be *inter alia* non discriminatory, but does not provide any clear guidelines in this regard.⁸⁴

Subsequently, as we saw, the Appellate Body ruled that non-discrimination was indeed obligatory. It reached this conclusion on the basis of the stronger language used in the French and Spanish texts. Howse termed this ‘legally incorrect.’ According to Article 33(4) of the Vienna Convention on the Law of Treaties, one may have recourse to texts in other languages only when Articles 31 and 32 do not resolve the ambiguity. Article 31 includes, *inter alia*, subsequent practices in the application of the treaty.

The flaws in this reasoning are obvious. The phrase ‘all countries and all products’ indicates that Howse’s understanding of subsequent practice is based on an unduly formal interpretation of the term ‘non discriminatory.’ Moreover, the mere fact that the Doha Decision did not provide guidelines does not necessarily imply aspirational and non-obligatory character. At the very least, it leaves the issue open, thereby necessitating recourse to other texts in accordance with Article 33(4) of the Vienna Convention. But more significant to WTO jurisprudence are the potential consequences of Howse’s understanding. One can scarcely imagine how much havoc can be caused if non-discrimination is interpreted to be non-obligatory in character. It will effectively give developed countries unfettered discretion to grant preferences according to their whims and fancies in the name of helping developing countries. Surely this scenario is contrary to the very ethos of the WTO.

⁸⁰ *E.g.* Panel Report, para. 4.38 (first written submission).

⁸¹ Howse 2003, p. 398-99.

⁸² *Ibid.* p. 393.

⁸³ *Ibid.*

⁸⁴ *Ibid.* p. 394, referring to: World Trade Organization, Ministerial Conference, 4th Session, *Implementation-Related Issues and Concerns*, WTO Doc No WT/MIN(01)/17 (Nov 20, 2001), [*sic* para 12.2], available online at: <http://docsonline.wto.org/DDFDocuments/t/WT/min01/17.doc> (visited Oct 6, 2003) [*sic* http://www.wto.org/english/thewto_e/minist_e/min01_e/mindecl_implementation_e.doc (accessed 25 November 2005)].

(v) Interpretation of ‘Development’

It is surprising to note that while the interpretation of ‘non-discriminatory’ has attracted much attention, the seemingly innocuous term ‘development’ in paragraph 3(c) seems to have almost gone unnoticed. Examined in itself, ‘development’ is a catch-all term applying equally to economic growth, social reform, a stable law-and-order situation, environmental protection, and innumerable other factors. The breadth of the term effectively gives developed countries unduly wide discretion in designing GSP schemes.⁸⁵

Panagariya points out that such discretion even effectively undermines the non-reciprocal and unilateral characteristics stipulated by the Enabling Clause.⁸⁶ Howse even terms the Drug Arrangements a ‘sham,’ since its primary intention is not third-world development but the need to protect the EC’s citizens from drugs. He also points out that the Arrangements actually give countries with drug-enforcement problems *better* treatment than other developing nations.⁸⁷ This means that the latter are in effect penalised for their good governance and law-and-order situation.

Evidently, the term ‘development’ needs to be interpreted in a significantly restricted manner. To this ends, insights may be gained from the fact that the Enabling Clause itself uses terms like ‘developing countries’ and ‘least developed among the developing countries’ as guidelines for determining beneficiaries. These terms are based on economic parameters to the exclusion of all others. We may infer from this that the Enabling Clause was designed to augment *economic* development.

If we take recourse to statutory interpretation, we may draw further credence from the fact that paragraphs 3(c) and 5 of the Enabling Clause both mention ‘development, financial and trade needs’ of developing countries. The specific terms ‘financial’ and ‘trade’ constitute a class of requirements, namely economic needs. Consequently the general term ‘development’ should be construed as *ejusdem generis*, while the other two specific terms, viz. “financial” and “trade needs” would represent *economic* development needs.

After all, had the drafters of the Enabling Clause intended social and other needs to be taken into account, they could have incorporated terms like ‘socially disadvantaged countries.’ That they did not and instead referred to ‘developing countries’ and ‘least developed among the developing countries’ indicates that they intended economic needs to be the most significant considerations. This is only inevitable. The multilateral trading regime was set up to enhance economic development in the ultimate analysis, and therefore any reference to development in the treaty provisions must be interpreted in that context. Hence, the Drug Arrangements were unfair and undesirable not because they address non-economic issues, *i.e.* problems relating to law-and-order and governance, but because they do not give adequate weight to economic aspects.

⁸⁵‘In calling for transparent classification schemes based on an “objective standard,” the AB has in fact extended the ability of the developed countries to import into the trading system, non-trade concerns whether environment standards, ILO standards, or for that matter human rights standards, if the standards or norms are in an international agreement.’ Raghavan 2004.

⁸⁶‘Finally, despite the original conception of GSP as unilateral, autonomous preferences, they have been effectively turned into reciprocal, contractual preferences through side conditions. Thus, with all the special agendas relating to labour, environment and drug production and trafficking attached to the grant of any significant preferences under GSP, it is difficult to see regard these preferences as non-reciprocal or even non contractual.’ Panagariya 2002, p.23.

⁸⁷ Howse 2003, p. 401.

One of the features of this dispute is that the issues therein had ramifications not only for several sectors of the Indian economy but also the future of the country as a preference recipient. This stems from the observation by the Appellate Body that the preference granting countries can differentiate between developing countries while applying preferential scheme. Given the importance of the issues that was dealt with in the dispute, it is useful to look at the processes that lay behind India's participation in the dispute. The following section addresses this issue.

3. Lessons Learnt and the Way Forward

The following discussion tries to reflect on each dimension with a view to understanding the imperatives for improving the quality of India's engagement in what is a crucial element of the multilateral trading system.

India's engagement with the WTO processes has brought into sharp focus the absence of any meaningful participation by the stakeholders. While in the more recent years, civil society has improved its level of participation; business interests have not taken the necessary steps to prepare itself for the multilateral trading system. The EC-India GSP case stands out as a case where effective involvement of business interests was lacking.

In this context it needs to be pointed out that the Government of India should take substantive measures to address the deficit in stakeholder consultations. This need for the government to address problems of stakeholder consultations arises from the fact that in India, stakeholders have generally not taken the initiative to define the scope and the content of the engagement with the WTO process. The government remains the prime mover on issues that have broad policy relevance and no worthwhile attempt has been made by the major stakeholders to change the dynamics of the process. The government therefore needs to include the stakeholders in these processes to make the process more meaningful.

Yet another issue that needs close consideration is that of transparency in the processes involving the WTO. While it may be argued that the participation of a larger number of stakeholders in the policy-making processes relevant to the WTO would in itself improve the degree of transparency, it needs to be pointed out that a better sharing of information could have the cascading effect of bringing more stakeholders into the process.⁸⁸

Finally, the outcome of the case and the choice to settle this dispute in the WTO is another issue worth exploring. Specifically, the GSP dispute examined key issues about how clauses conferring benefits to developing countries are to be interpreted. It also brings the effectiveness of the WTO dispute settlement mechanism into the discussion, especially in relation to developing countries. But most importantly, it forces us to think about how efficacious the WTO framework is in addressing issues relating to the GSP, which has long been recognised as an essential pre-requisite for facilitating development in developing countries. The dispute and its resolution raise more questions than they answer. No one is sure if the consequences will actually benefit developing countries. To some it represents a 'serious setback' to the

⁸⁸The Parliament has recently enacted the Right to Information Act, which among other things seeks "to promote transparency and accountability in the working of every public authority ..."

rights of developing countries,⁸⁹ while others label it as a ‘brilliant compromise ... navigating carefully between different constituencies.’⁹⁰

India won the case, but it has taken an inordinately long period of time to get the EC to effect changes to its GSP scheme, particularly since the EC-GSP case went to arbitration. On the 10 September 2004, two years and five months to the date when India requested consultation, the arbitrator gave the EC until 1 July 2005 to make its GSP scheme WTO consistent. The EC eventually repealed the Drug Arrangements on 27 June 2005 when it implemented a new GSP scheme. It took three years and 3 months from India requested consultation for the offending measure to be removed. Meanwhile, the EC member countries’ imports of textiles and clothing from India grew annually by only 3.5 per cent as compared to a nearly 8 per cent growth in the overall imports. And consequently, the share of textiles and clothing sector in the total imports from India fell by sever percentage points.

The EC’s new scheme was adopted through Council Regulation (EC) No 980/2005, and will apply from 1 January 2006 to 31 December 2008, but there are provisions concerning the special incentive scheme for sustainable development and good governance ("GSP Plus") which apply already from 1 July 2005. The new scheme has a period for review of preferences - by end of 2008, the EC will review the system.

As was the case previously, Indian textiles will not benefit from the GSP preferential access in this regime. However, India’s clothing will continue to be exported under the GSP scheme. The new GSP scheme includes a rule that countries who hold more than 15 percent of the EC market share of any goods will lose their preferential tariffs - the so-called “graduation rule”. Tighter restrictions are found on textiles as it faces a ceiling of a 12.5 percent market share. The effect of these rules on India has to be seen in light of the elimination of quotas for international textile trade at the WTO. On 1 January, 2005, the textile and clothing sector became subject to WTO rules after more than 40 years of import quotas. Should India’s share of clothing exports increase substantially above the 10-11 due to the new WTO rules it may lose its benefit under the scheme.⁹¹

4. Conclusion

As was shown, the Government of India initiated the GSP case for three reasons. The first was the fact that the denial of preferences to India under the Drug Arrangements caused a substantial loss in its share of total exports to the EC. The second reason was that the Drug Arrangements affected one of the most significant sectors in India’s export to the EC, viz. textiles and clothing. The third, and possibly most significant of the reasons, one that is closely related to the second, is that the Drug Arrangements extended concessions to Pakistan, India’s close competitor in the global market for textiles and clothing.

Hence, it was the effect on the exports of textiles and clothing to its largest trading partner that was the focus of India’s submissions to the Panel and Appellate Body. Exports of products other than textiles and clothing seem also to have been affected as a result of the preferences implemented under the Drugs

⁸⁹ Raghavan 2004.

⁹⁰ Howse 2004 b, p. 6.

⁹¹ See New EU GSP scheme explained, available online at <http://www.tralac.org/scripts/content.php?id=3008>, last visited December 19,2005.

Arrangements. However, there is no evidence to suggest that the implications of the Drug Arrangements on the fortunes of other sectors were taken into consideration in the dispute settlement process.

The case focused essentially on India's interests in the textiles and clothing sector because of the relatively high stakes in this sector. India and Pakistan are close competitors with similar product range. They both have a strong raw material base in cottons, low conversion costs, vertical production units, comparable unit values and bilateral quotas in the same products range. The trend showed a large-scale shift in orders in favour of Pakistan with respect to those textile items in which India has traditionally enjoyed higher market share and growth. Textiles and clothing comprise nearly a third of India's exports to the EC. Moreover, it was inevitable that any tariff preferences granted Pakistan would change the balance between the countries. While the EC's imports of textiles and clothing from India was significantly affected following the introduction of the Drug Arrangements, India as the complainant in the dispute was unable in the ultimate analysis to secure advantages for what has been, by a long way, the most critical amongst its industrial sectors.

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Annex 1

Table A below shows the example of a standard quality, bleached cotton bed sheet (of dimensions 20/20 60/60 "70x108") supplied to UK from India & Pakistan. The table illustrates that a producer in Pakistan was able to realise a better price than the corresponding Indian supplier, and to supply the product cheaper to the customer in the EC primarily on account of the tariff preferences.

Table A

Components	India (£)	Pakistan (£)
CIF value/price	£ 1.62	£1.70
Duty rate	9.6 per cent	Nil
Duty charged	£0.16	Nil
Total CIF + duty amount	£1.78	£ 1.70

Table B below gives the differential tariff treatment for some of the main India and Pakistani products that compete in the EC market.

Table B

EU Tariffs on Selected Products Covered under Chapters 61 to 63

CN Code	Product	MFN Rate	Applicable To India (At 20 % GSP Concession)	Applicable To Pakistan (At 100 %GSP Concession)
6109 10 00	T-Shirts	12	9.6	0
6203 42	Trousers	12.4	9.92	0
6205 20 00	Gents Shirts	12	9.6	0
6206 30 00	Ladies Blouses	12.4	9.92	0
6302 10 10	Bed Linen	12	9.6	0

Source: Official Journal of the EU dated 23rd October 2001 – Commission Regulation (EC) No. 2031/2001 of 6th August 2001

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Annex II

CASES CONCERNING TEXTILE AT THE WTO

Cases Brought by India

1. United States — Measures Affecting Imports of Women's and Girls' Wool Coats (**Dispute DS32**)
2. United States — Measures Affecting Imports of Woven Wool Shirts and Blouses from India (**Dispute DS33**)
3. Turkey — Restrictions on Imports of Textile and Clothing Products (**Dispute DS34**)
4. European Communities — Anti-Dumping Investigations Regarding Unbleached Cotton Fabrics from India (**Dispute DS140**)
5. European Communities — Anti-Dumping Duties on Imports of Cotton-type Bed Linen from India (**Dispute DS141**)
6. Brazil — Anti-Dumping Duties on Jute Bags from India (**Dispute DS229**)
7. United States — Rules of Origin for Textiles and Apparel Products (**Dispute DS243**)
8. European Communities — Conditions for the Granting of Tariff Preferences to Developing Countries (**Dispute DS246**)

Cases Brought Against India

1. India — Quantitative Restrictions On Imports Of Agricultural, Textile And Industrial Products- (**Dispute DS90 brought by the US**).
2. India — Quantitative Restrictions On Imports Of Agricultural, Textile And Industrial Products- (**Dispute DS91 brought by Australia**).
3. India — Quantitative Restrictions On Imports Of Agricultural, Textile And Industrial Products- (**Dispute DS92 brought by Canada**).
4. India — Quantitative Restrictions On Imports Of Agricultural, Textile And Industrial Products - (**Dispute DS93 brought by New Zealand**).
5. India — Quantitative Restrictions On Imports Of Agricultural, Textile And Industrial Products - (**Dispute DS94 brought by Switzerland**).
6. India — Quantitative Restrictions On Imports Of Agricultural, Textile And Industrial Products - (**Dispute DS96 brought by the EC**).